

The **GSE** REPORT™

Contents of GSE Report™

“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.” (*Bruce Marks, Neighborhood Assistance Corporation of America, GSE Roundtable, 9/12/00*)

“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. Yet almost no one is paying attention.” (*Steve Moore, CATO Institute, GSE Roundtable, 9/12/00*)

Major Events

- Opponents of the FHLBanks’ successful Mortgage Partnership Finance (MPF) program are seeking an amendment to cap the program (*p. 4*)
 - 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) has been lobbied heavily by Fannie to impose a cap on the MPF program
 - Senator Gramm plans to hold hearings next year on the issue
 - 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 on to 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.
 - In related news, despite political pressure from Fannie & Freddie, Pedestal creates the first Internet link that allows lenders to easily funnel loans to the MPF program
 - *American Banker* runs special report on the competitiveness of the MPF program: “*Home Loan Banks Invade Fannie’s, Freddie’s Turf*”
 - “The more competition there is in this market, the better it is for the consumer,” said John von Seggern, President of the Council of FHLBanks
- Cong. Richard Baker (R-LA) holds “GSE Roundtable” on September 12 (*p. 8*)
 - 27 groups (including the GSEs, their regulators, consumer groups, trade groups testify)
 - Consensus is that increased regulation is needed
 - Cong. Baker suggests the GSEs need more “bank-like” regulation – asks CRS and GAO to study differences in regulatory authority between OFHEO and bank regulators
 - Cong. Baker is committed to continuing work on strengthening the regulation of the GSEs and willing to work on an incremental approach – says he will pursue the issue next Congress
 - Cong. Baker says nothing at the Roundtable changed his mind and, if anything, more needs to be done on the mission creep concerns about the GSEs in addition to safety and soundness concerns
 - Consumer groups attack the GSEs for their affordable housing record; GSEs accused of exploiting the subprime market and being a major cause of predatory lending

- Industry groups, criticizing the GSEs for mission creep, say there is no clear separation between the primary and secondary market – GSEs disagree and say “origination” is the separation point
- GSEs criticized for the increased risk of repurchasing their MBS for their own portfolios and their increased issuance of debt
- FHFB extends comment period on its proposed risk-based capital rule until Nov. 20, despite a statutory deadline that the rule be finalized by Nov. 12 (*p. 23*)
 - Industry groups, including the America’s Community Bankers, had been seeking an even-longer extension
- Fannie & Freddie’s safety and soundness regulator, OFHEO, has its FY 2001 budget request cut by the Senate VA-HUD Appropriations Committee (*p. 24*)
 - The panel cut nearly \$5 million from OFHEO’s budget at a time when lawmakers and others are expressing concern about the GSEs’ safety and soundness
 - “To cut the budget of an agency [OFHEO] trying to cope with these mammoth financial institutions is an outrage - a slap at the taxpayers who, unfortunately, bear the ultimate risk.” (*Ralph Nader, Testimony before House Banking Capital Markets Subcommittee, 6/15/00*)
 - Cong. LaFalce, Cong. Baker, and Cong. Kanjorski support OFHEO’s budget request
 - OFHEO Director Armando Falcon vows to continue to fight for the full \$26.77 million funding request
 - OFHEO estimates that if Fannie & Freddie were regulated like national banks, the GSEs would have to pay \$70.9 million in assessments
 - Although OFHEO is subject to the appropriations process, it is not funded by taxpayers. Its funding comes from assessments on Fannie & Freddie. Other federal financial regulators are able to directly access the entities they regulate, without being subject to the appropriations process
 - Although Fannie testifies that it supports strong regulation of the GSEs, it has opposed removing OFHEO from the appropriations process, leaving OFHEO under-funded
- Wall Street analyst urges Fannie & Freddie to negotiate a deal with Cong. Baker over his bill to strengthen regulation of the GSEs (*p. 26*)
 - Fannie Chairman Franklin Raines says there is no hope for passage of Cong. Baker’s GSE bill
- News not yet reported: Fannie & Freddie would obtain an exemption from District of Columbia City Council predatory lending bill (*p. 26*)

All GSEs

- House Banking Committee Chairman Jim Leach (R-IA) calls Cong. Baker’s GSE bill (HR 3703) a “balanced” approach (*p. 27*)
 - Senate Banking Committee Chairman Phil Gramm (R-TX) says he doesn’t yet have an opinion on the bill and thinks the issue will be examined next year
 - Cong. LaFalce (D-NY) says he would move slowly on any attempt to strengthen regulation of GSEs [Cong. LaFalce is next in line to Chair the House Banking Committee in the next Congress should the Democrats regain control of the House.]

Fannie Mae and Freddie Mac

- OFHEO to examine the GSEs’ “mission creep” – OFHEO says it can help define Fannie & Freddie’s charters (*p. 28*)
 - [Concerns have been expressed that the GSEs engage in activities, such as consumer finance, that are beyond their charters (“mission creep”) and are using their GSE advantages to unfairly compete against private-sector competitors]
 - OFHEO will conduct a study on the “systemic risks” associated with Fannie & Freddie
 - “We must understand not just the risks faced by the enterprises, but also the risks they pose to the financial system,” said OFHEO Director Armando Falcon
 - “The rapid growth” of Fannie & Freddie’s outstanding debt and mortgage securities “has increased concerns about the systemic risk that Fannie Mae and Freddie Mac may pose to the financial system,” said Falcon
- Mortgage Bankers Association (MBA) is 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 (*p. 29*)
 - MBA believes that many of the concerns about the GSEs’ mission creep could be solved with a stronger definition of the primary and secondary market
 - The panel plans to share its work with Fannie & Freddie - the two GSEs have committed themselves to participating in the panel’s discussion
 - During a September 12 GSE Roundtable, Freddie’s Mitch Delk disagreed with the MBA and said there is no ambiguity between the primary and secondary market and that the GSEs’ charters are clearly defined – Delk does not believe the issue of “mission creep” exists

- Analysts and investors claim that a victory by Presidential candidate Al Gore would benefit the stocks of the GSEs by decreasing their political risks (*p. 29*)
 - However, many analysts say that Fannie & Freddie's political risks will continue regardless of the Administration
- As the national debt shrinks, GSE debt skyrockets (*p. 30*)
 - With the fading supply of Treasuries, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasuries as the new benchmark in the bond market

GSE debt news:

Credit Unions "have been fattening up on GSE debt for the past decade"

 - More than half of the total of credit union investments is in agency securities
 - At mid-year credit unions held \$52 billion worth of agency securities (most of it debt issued by Fannie, Freddie, and the FHLBanks)

Freddie euro-denominated debt issuances in Europe raises concerns about GSE expansion

 - More than half of Freddie's first euro-denominated debt issuance attracted new investors
 - US investment accounted for only 6% of the orders, more than 90% came from European accounts; foreign central banks bought 13% of the new deal
- Competition to create the leading web portals linking originators to the secondary market will be fierce (*p. 32*)
 - Pioneer in financial e-commerce, Scott Cooley of Contour Software, says the biggest strength of Fannie & Freddie's portal is that "everyone is using their automated underwriting systems," however, the GSEs lack the support of the industry, which fears they will eventually go directly to consumers

Fannie Mae

- Fannie Chairman Franklin Raines tells bankers the company has no interest in invading banks' business such as originating mortgages, issuing credit cards, or selling insurance (*p. 32*)
 - Bankers remain suspicious
 - Raines' latest comments "continue to show either a lack of understanding of the reality of the marketplace or a denial as to what they're really doing," said Steve Bartlett, President of the Financial Services Roundtable
 - In related news, Fannie promises bankers it will purchase more CRA loans
- Fannie Chairman Franklin Raines says Fannie would like to purchase more mortgages from credit unions and urges credit unions to use Fannie's technology (*p. 33*)

Freddie Mac

- Freddie provides its technology to mortgage brokers (bypassing their lending customers) (*p. 34*)
 - Freddie to provide its automated underwriting system directly to mortgage brokers who are members of the National Association of Hispanic Real Estate Professionals (NAHREP)
 - ["The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers or vendors of those partners, including but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals." (*MBA GSE Policy Statement, 8/10/99*)]

Farm Credit Administration/Farm Credit Banks

- American Bankers Association and Independent Community Bankers of America blast the Farm Credit Administration's (FCA) controversial plan to grant national charters to Farm Credit System banks (*p. 34*)
 - The groups argue the plan would cause unfair competition and destabilize the system – suggest Congress should hold hearings on the issue
 - House Banking Committee Chairman Leach has called the plan a "reflection" of all GSEs to "use their governmentally privileged positions" to expand their activities "in ways that distort the American market system."
- American Bankers Association urges US Supreme Court to find that states can impose sales and income taxes on federally chartered farm credit lenders (*p. 35*)

Ginnie Mae

- Ginnie Mae hires a contractor to help the agency develop a new program to securitize conventional loans backed by private mortgage insurance (e.g., "Ginnie Mae Choice") (*p. 36*)
 - Ginnie currently only guarantees FHA and VA loans

Major Events

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Senator Gramm plans to hold hearings next year on the issue

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***American Banker* runs special report on the competitiveness of the MPF program: "Home Loan Banks Invade Fannie's, Freddie's Turf"**

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Opponents of the MPF program are seeking an amendment to cap the program

- According to Lew Sichelman and Brian Collins with *National Mortgage News*, opponents of the MPF program are seeking an amendment that would place a \$15 billion cap on the FHLBanks' MPF program. An amendment to the VA-HUD Appropriations bill (HR 4635) was never offered during a September 14 mark-up of the bill, however opponents are expected to try again. The amendment was expected to be offered by Senator Christopher Bond (R-MO) who chairs the VA-HUD Appropriations Subcommittee. Senate Banking Committee Chairman Phil Gramm (R-TX) was reportedly disappointed that Senator Bond did not attach the cap amendment to HR 4635, and according to Sichelman and Collins, Senator Gramm is looking for another legislative vehicle. (*National Mortgage News*, Lew Sichelman and Brian Collins, 9/25/00; *National Mortgage News Daily*, 9/21/00)
- Speaking to reporters after an address to the ABA on September 19, Senator Gramm said he wants to get some authorizing language off the VA-HUD Appropriations bill, and it may take priority

over getting a MPF program cap attached to the same bill. “There are a lot of things I want to keep off the bill,” said Senator Gramm. It is “difficult to say ‘put my fix on but don’t put on any other authorizing language,’” he explained. (*National Mortgage News*, Lew Sichelman and Brian Collins, 9/25/00)

Fannie lobbies against its competitor – the MPF program

- FHLBank of Atlanta President Raymond Christian said that Senator Bond was ready to offer the cap amendment during the VA-HUD mark-up on behalf of “a GSE.” Christian would not identify which GSE because he could not prove whether it was Fannie or Freddie. Other sources indicated that it was Fannie. (*National Mortgage News*, Lew Sichelman and Brian Collins, 9/25/00)
- **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 their position in the secondary mortgage market. “We’re not trying to keep competition out of the marketplace,” said David Jeffers with Fannie Mae. “We just think they should play by the same rules that we do.” **However, according to Jerry Guidera with *Dow Jones Newswire*, 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)

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 that “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

- **According to Sichelman and Collins with *National Mortgage News*, Senator Bond did not offer his amendment to cap the program because nine national trade associations sent a joint**

letter urging Appropriations Members to reject an amendment that would place a cap on the MPF program. The letter was sent on September 12, one day prior to the mark-up of the bill in the VA-HUD Subcommittee and the Senate Appropriations Committee. 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. The Committee approved the bill and the amendment to cap the MPF program never surfaced. **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 Leadership and full House Appropriations Committee, 9/22/00; National Mortgage News, Lew Sichelman and Brian Collins, 9/25/00*)

Senator Gramm would like to cap the program – may hold hearings next year on issue

- According to news reports, Senator Gramm is committed to putting limits on the MPF program. Gramm Spokeswoman, Christi Harlan said that Senator Gramm “is not convinced that the FHLB is authorized by its charter” to conduct a program like MPF, with the potential financial risks it may pose to taxpayers. Harlan said rather than dismantling the program, Senator Gramm decided to cap it. “Abolishing it would be too disruptive to the market,” she said. “A cap would put a limit on it.” Harlan said that the Senator feels the FHLBanks have entered territory where they do not belong. She stated, “This fits into his [Senator Gramm’s] philosophy of limiting government-sponsored enterprises because of the risks to taxpayers.” Harlan stated, “Senator Gramm has never made any secret of his desire to see any government-sponsored enterprise less dependent on their government guarantees and therefore less dependent on taxpayers.” He wants to cap the program to make sure its growth doesn’t explode before he holds hearings next year on the issue. (*National Mortgage News Daily, 9/21/00; Reuters, Richard Leong, 9/21/00; American Banker, Erick Bergquist and Rob Blackwell, 9/18/00; Bloomberg, 9/22/00; Dow Jones Newswire, Jerry Guidera, 9/25/00*)

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 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.

Despite political pressure from Fannie & Freddie, Pedestal creates Internet link to MPF

- ***Real Estate Finance Today* reported that “despite what a source described as political pressure from Fannie Mae and Freddie Mae,” Pedestal has created a service that will broaden lender access to the FHLBanks’ MPF program.** Cenlar, a member of the FHLBank of New York, is the first bank to use the Ineternet-based system. “We saw some room there to bring technology into the program,” said John Lewis, a spokesman for Pedestal. “Unlike Fannie Mae and Freddie Mac, which have a lot of technology in place and are connected to customers through the platforms on the Internet, the Federal Home Loan Banks have nothing.” The Pedestal product allows Cenlar to access a new business channel without the need to made additional investments in technology or personnel, said Michael Young, President and CEO of Cenlar. Pedestal is also in discussions with at least two other lenders and many potential correspondents, said a Pedestal spokesman.
- The MPF Internet link, which can be accessed over the company’s website, is an Internet-based portal that links correspondent lenders with FHLBank-member institutions participating in the MPF program. The link also provides secondary market support services, including marketing and sales, trading services, data transfer, loan delivery management, quality control and document management.
- “By creating the first Internet link that allows lenders to easily participate in the MPF program, we are enabling our customers to efficiently expand their trading relationships and product offerings while also improving their secondary market execution and profitability,” said Stuart McFarland, President and CEO of Pedestal. (*Real Estate Finance Today*, Chris De Reza, 9/18/00; *American Banker*, Erick Bergquist, 9/6/00)

American Banker special report on the competitiveness of the MPF program

- Alan Kline with the *American Banker* wrote a special report on the MPF program and its competition with Fannie and Freddie. In the three years since its existence, nearly 200 banks have sold roughly \$12 billion worth of loans to the FHLBank System. **Although that number is small in comparison to the \$5 trillion worth of mortgage debt industrywide, Kline reported that “the program is clearly making a dent in a market that for years has been dominated by Freddie Mac and Fannie Mae. Just its presence, observers say, has allowed banks to negotiate better deals with Fannie and Freddie.”** John von Seggern, President of the Council of FHLBanks states that “the more competition there is in this market, the better it is for consumers.”
- **FHLBank of Chicago President Alex Pollock says “We tell our member institutions that they are going to win three ways if they sign up with MPF. Number one, you get a better deal than you do selling to Fannie or Freddie. Number two...you will get a better deal from them because they’ll cut their rates to compete. Number three, the Home Loan Bank will make more money, and who owns the Home Loan Bank? The member banks.”**
- **Pollock noted that when he first started researching the creation of the MPF program, he asked member institutions how much they lost each year on home mortgages – to which, their answer was typically 0 to 1 basis points a year. When asked how much they were paying to Fannie and Freddie for taking on the entire risk of a mortgage – the response was 18 to 25 basis points a year. “What they told me is that they were paying 25 basis points a year to solve a 1-basis-point-a-year problem...Now why would you do that?” Under the MPF program, the FHLBank pays the member institution a fee when it buys the loan. Fannie and**

Freddie, on the other hand, charge the bank for buying mortgages. “When we heard about this [MPF], we said, ‘This is too good to be true,’” said Daniel Behrend, a Vice President at Community National. “I tell any bank that calls me for a reference that they’d be doing themselves a disservice if they didn’t look into this.” (*American Banker*, Alan Kline, 9/18/00)

Cong. Richard Baker (R-LA) holds” GSE Roundtable” on September 12

27 groups (including the GSEs, their regulators, consumer groups, trade groups testify)

Consensus that increased regulation is needed

Cong. Baker suggests that GSEs need more “bank-like” regulation – asks CRS and GAO to study the differences in regulatory authority between OFHEO and bank regulators

Cong. Baker is committed to continuing work on strengthening the regulation of the GSEs and willing to work on an incremental approach – says he will pursue the issue next Congress

Cong. Baker says nothing at the Roundtable changed his mind and, if anything, more needs to be done on the mission creep concerns about the GSEs in addition to safety and soundness concerns

Consumer groups attack the GSEs for their affordable housing record; GSEs accused of exploiting the subprime market and being a major cause of predatory lending

Industry groups, criticizing the GSEs for mission creep, say there is no clear separation between the primary and secondary market – GSEs disagree and say “origination” is the separation point

GSEs criticized for the increased risk of repurchasing their MBS for their own portfolios and their increased issuance of debt

- The House Banking Capital Markets, GSE Subcommittee held a “GSE Roundtable” on September 12, with 27 groups participating (including the GSEs, their regulators, consumer groups, academics, industry representatives and trade groups). Cong. Richard Baker (R-LA) and Ranking Subcommittee Member Paul Kanjorski (D-PA) presided over the nearly five hour-long session. The Roundtable format was held at the suggestion of Cong. Kanjorski who felt that the format would be less formal than a hearing and would provide the opportunity for interested parties to more openly debate the complexity of the GSE issue.
- Neither the Fed nor Treasury was represented at the hearing. However, both parties submitted letters to Cong. Baker. In his August 25 letter to Cong. Baker, Chairman Greenspan said it was “appropriate” for GSE government subsidies to be under Congress’ oversight. The Treasury Department said they had nothing new to add to Undersecretary Gary Gensler’s previous testimony before the Subcommittee.
- Fannie and Freddie’s current regulators, OFHEO and HUD, both testified. OFHEO argued for increasing its authority, removing its funding from the annual appropriations process, giving OFHEO independent litigation authority, providing the agency with express removal and prohibition authority, and removing OFHEO from the coverage of the Federal Advisory Committee Act. HUD said it hoped that its proposed affordable housing rule would help the GSEs serve low to moderate-income homebuyers since the GSEs do not currently lead the market in serving those communities. In terms of a new GSE bill, HUD said they would like more

clarification on HUD's new program authority over the GSEs and they would like to be able to assess the GSEs to pay for costs incurred in its regulation of the GSEs (as does the OCC and all other financial regulators). When asked by Cong. Baker whether it was appropriate for OFHEO to be removed from the appropriations process (which has left the regulator under-funded), Tom Donilon from Fannie Mae testified that OFHEO should be properly funded but that it would not be appropriate for Fannie to comment on the issue.

Consensus that increased regulation is needed – Cong. Baker suggests that GSEs need more bank-like regulation

- **There was a consensus at the Roundtable for stronger regulation for the GSEs. When asked by Cong. Baker for a show of hands of those in favor of strengthening oversight of the GSEs, a clear majority of the participants [including the GSEs] raised their hands.** (*BNA Daily Report for Executives*, Adam Wasch, 9/14/00)
- **Cong. Baker stressed that increased oversight and regulation of the GSEs was needed, given the changing nature of the GSEs' risk profiles since the early 1990s (when the last GSE regulatory bill was passed).** Cong. Baker used comments from Fannie and Freddie's CEOs in 1991 to point out that a lot has changed in terms of the GSEs' investment strategies, their capital regulation, their expansion into new programs (such as home equity), and their risk profiles (debt to capital ratios, increased purchasing of MBS for their own portfolios, etc.). **Cong. Baker would like to ensure that there is an independent third party with which Congress can consult to ensure that the GSEs are properly regulated for their risk profiles and mission, rather than relying on the word of the GSEs.** For the past eight years, Cong. Baker said there was not a regulator who could determine if the capital adequacy for the GSEs was sufficient for their increased business risk. And on top of that, HUD has determined that the GSEs may not have met their missions appropriately. Fannie and Freddie argue that they are stronger today than in 1991 yet Cong. Baker stated, "You may be 100% correct and Fannie and Freddie are stronger than they were in 1991, but don't you think there should be someone else to ask other than you." He added, "I don't doubt that you're [Fannie and Freddie] state-of-the-art," he said. "What I want is someone independent to come in and say you're state-of-the art." (*Real Estate Finance Today*, Chris De Reza, 9/18/00)
- **Cong. Baker suggested that one way to increase regulatory oversight would be to provide the GSEs' regulators with powers similar to those available to bank regulators. "One of several possibilities is to institute a bank-like regulatory structure," he said. "I don't think the GSEs should be excused from the kind of scrutiny other financial institutions are subject to."** Cong. Baker noted that Fannie Chairman Franklin Raines told him that it would be good for Fannie to have a strong regulator and that they needed bank-like regulation. (*BNA Daily Report for Executives*, Adam Wasch, 9/14/00)
- According to *Market News International*, Cong. Baker noted that banking statutes from the 1980s and 1990s established a mechanism called "prompt corrective action" that gives regulators the right to take certain actions "very early on" in a credit quality crisis "to avoid taxpayer loss." He noted that a GSE prompt and corrective action statute might be appropriate to allow a regulator to withhold the credit line until the GSE "does certain things." He explained, "There's a long history of regulatory response (at large financial institutions) that we ought to take a look at." (*Market News International*, 9/8/00)
- Mitch Delk from Freddie testified that the company supports a strong regulatory structure for the GSEs and if Congress examines the 1992 legislation for the GSEs, they will find that it is "bank-like in nature." Congress should consider looking at the new capital adequacy framework by the

Basle Committee. Delk noted that Freddie wants to improve the regulatory structure of the GSEs “to the point it makes sense.” Delk testified that the GSEs receive a number of benefits to enable them to fulfill their mission, however, he argues that federally insured depository institutions, such as banks and thrifts, also enjoy government benefits of their own. Further, he argues that banks and thrifts, unlike the GSEs, have the luxury of getting out of the mortgage business if it becomes less profitable.

- Tom Donilon from Fannie stated the company “would not oppose” improved regulation of the GSEs and testified that “we’ve said all along that we’re always open to discussions that would make our regulatory oversight strong,” but Cong. Baker’s current GSE bill is not the appropriate framework. “We don’t oppose legislation for sport,” he stated. (*BNA Daily Report for Executives*, Adam Wasch, 9/14/00; *Dow Jones Newswire*, Jerry Guidera, 9/12/00)

Next Steps

- **Cong. Baker requested that the Congressional Research Service (CRS) and the Government Accounting Office (GAO) [which were participants at the Roundtable] conduct studies about the differences in regulatory authority between OFHEO and bank regulators.**
- **Cong. Baker committed to continuing work on strengthening the regulation of the GSEs and was willing to work on an incremental approach. “If there is an ability to seek out regulatory enhancements, I will pursue that goal in this session,” he said. Cong. Baker said he heard nothing at the Roundtable to change his mind and, if anything, more needs to be done on addressing the mission side and mission creep concerns about the GSEs in addition to safety and soundness concerns.** Cong. Baker said he would continue to push for passage of his bill. “The air is not out of the tires yet,” he said. “I believe we have taken an incremental approach to this issue, weeding hundreds of issues down to the eight main points where HR 3703 is now. I renew my request. I am going to pursue the goal in this session if it is at all possible.” He added, however, that should he not have time to pursue the goal this year, “I have a strong inclination to see this to a conclusion” and noted that he intends to pursue this issue in the next Congress. (*Bloomberg News*, 9/13/00; *Real Estate Finance Today*, Chris De Reza, 9/18/00)
- Cong. Kanjorski was skeptical about any action on a GSE bill this year. “We cannot formulate or resolve this issue in the next three to four weeks,” he said. He believes that Congress needs to know the unintended consequences of any GSE bill and that the Subcommittee should choose a path of caution and not enact any legislation this year.
- Steve Moore from CATO suggested a regulation that says the GSEs cannot insure loans to borrowers over a median income. Cong. Kanjorski argued that this was “institutionalizing poverty” by institutionalizing high housing prices and would have unintended consequences. Moore offered to assist Cong. Kanjorski’s office in determining proper targets for the GSEs.

The following organizations participated in the roundtable:

- American Association of Retired Persons - Marty Corry
- American Enterprise Institute - Peter Wallison
- America's Community Bankers - Weller Meyer (Acacia Federal Savings Bank)
- Bear Stearns - Frederick Khedouri
- CATO Institute - Stephen Moore
- CRS, Government and Finance Division - Barbara Miles
- Consumers Union - Frank Torres
- Council of Federal Home Loan Banks - Curt Hage, Mike Jessee (FHLBank of Boston)
- William Cunningham - Registered Investment Analyst
- Department of Housing and Urban Development - Bill Apgar
- Enterprise Foundation – Kristin Siglin
- Fannie Mae - Tom Donilon, Tim Howard
- Federal Housing Finance Board - Bill Apgar
- Financial Services Roundtable - Steve Bartlett
- Freddie Mac - Mitch Delk, Ed Golding
- GAO, Financial Institutions and Markets Issues - Tom McCool
- Homeowners Education Coalition - Tom Schatz
- Household Bank – Loren J. Morris
- Independent Community Bankers of America - C.R. "Rusty" Cloutier (MidSouth National Bank)
- Mortgage Bankers Association - Howard Glaser
- National Association of Home Builders - Tommy Thompson
- National Association of Federal Credit Unions - John Milazzo
- National Association of Realtors - Martin Edwards, Jr.
- National Community Reinvestment Coalition - John Taylor
- National Home Equity Mortgage Association - Wright Andrews
- Neighborhood Assistance Corporation of America - Bruce Marks
- Office of Federal Housing Enterprise Oversight - Armando Falcon

Consumer groups attack the GSEs

- Consumer groups, particularly Bruce Marks from NACA, were critical of the GSEs.
- When asked by Cong. Kanjorski which of the groups participating at the Roundtable considered themselves the most aggressive or antagonistic toward the GSEs, Bruce Marks raised his hand and proceeded to launch into the GSEs. **“GSEs, which are subsidized by the American taxpayer, are the major cause of predatory lending.”** He argued that since the GSEs were taxpayer subsidized they should be more flexible in their underwriting standards so that low-income homebuyers would more easily qualify for conventional mortgages. He argued that the GSEs set the homeownership standards in the country and that the GSEs determine what is a conventional loan and what is considered a subprime loan. **By setting the standards, the GSEs are setting these subprime borrowers up to potentially become victims of predatory lending.**
- 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. Tom Donilon from Fannie argued that predatory lending was primarily a primary market phenomenon. 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 that Fannie and Freddie should be privatized and compete on the same level as other non-government entities. **“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.”**
- Marks argued that the GSEs need more accountability. A single independent regulator would provide meaningful oversight of the GSEs. The regulator should require disclosure of the salaries of each GSEs’ directors and officers, the amount of money spent on public relations, lobbying and campaign contributions, involvement with subprime lenders and specifics on their record to low-and moderate-income homebuyers. **“It appears that Fannie Mae and the GSEs have much to hide which explains why these GSEs, even though they were created with government funding and have continually relied on government subsidies, have opposed having to reveal information about what they do with their money.”** Requiring the regulator’s prior approval of new programs and activities is significant and something that advocates of fair housing should support.
- William Cunningham, a registered investment adviser, testified that Fannie would not allow Seaway National Bank (a black-owned bank on the South side of Chicago) to provide Fannie products to its borrowers because the underwriting guidelines used by Seaway did not conform to Fannie’s guidelines. He argued that the GSEs need to increase transparency and suggests that the GSEs be subject to a “Social Audit.” Fannie claims that they sent a letter to Seaway National Bank and have not received a response.

[Notwithstanding their statements that they are in favor of stronger regulation, Fannie & Freddie state that no legislation is needed because they are already subject to strong regulatory oversight.]

- Fannie and Freddie argued that new legislation to strengthen their regulation was not necessary because they are currently subject to vigorous enforcement by their regulators (OFHEO and HUD).
- “I don’t know of any other company that goes through the level of accountability that we do,” said Tom Donilon from Fannie Mae. (*Real Estate Finance Today*, Chris De Reza, 9/18/00)
- Mitch Delk from Freddie stated that Freddie is among the strongest financial institutions and that S&P rated Freddie AA- on a stand-alone basis in 1996, a record he claims that only six bank holding companies enjoy. He stated that the “Three Pillars” framework proposed by the Basle Committee on Bank Supervision provides an excellent framework for considering enhancements to capital standards, market discipline and transparency. [Unlike other financial institutions, Fannie and Freddie are not subject to the Basle Accord.]

Separation between primary market/secondary market is becoming blurred

- Howard Glaser from the MBA testified that the lines between the primary market and secondary market were blurring. **Glaser stated that many of the concerns expressed about the GSEs' mission creep could be solved with a stronger definition of the primary and secondary market. The MBA supports a strong independent regulator with sufficient definitions of the primary and secondary markets to work with.**
- Mitch Delk from Freddie disagreed and said “there is a bright line between the primary and secondary markets. We cannot originate mortgages – that is quite clear. So, when Mr. Glaser says there is an ambiguity between them in the charter, I don't know what he is talking about.” He stated that there was a tremendous amount of oversight by HUD on the GSEs' new programs. [HUD has never denied a new program request by the GSEs.] Glaser asked Delk whether he was saying that the issue of mission creep did not exist to which Delk replied “yes.”
- **Steve Bartlett from Financial Services Roundtable disagreed with Freddie and said that “our members would disagree” that there is a bright line between the primary and secondary market. “Not only is there an ambiguous line, but there is no enforcement as well.”** (*Real Estate Finance Today*, Chris De Reza, 9/18/00)
- Tommy Thompson from the National Association of Home Builders testified that an unintended consequence of a strong regulator would be an interruption in the flow of GSE products for the housing market. He agreed that the regulation of the GSEs could be improved and enhanced, but this could be accomplished within the current regulatory structure.
- **Cong. Paul Ryan (R-WI) said that he hopes a GSE bill will define a bright line between the primary and secondary market. It is a legitimate concern that the GSEs, which have access to capital at cheaper rates than competitors, are moving into their competitors' markets.**

GSE expansion into home equity lending

- **Wright Andrews from the National Home Equity Mortgage Association stated that a new GSE regulator should review the GSEs' activities into the subprime and home equity markets for which the current regulators have not done a good job examining. Andrews testified that 70% of all home equity loans are not used for home acquisitions but rather for consumer credit (such as debt consolidation). Congress should consider if Fannie and Freddie should be in the consumer credit business or the homeownership business. It is important for Congress to consider what the GSEs' mission should be and redefine their charters, given how the markets have changed since the GSEs were first chartered. Maybe the current GSEs are not the best for the market, maybe Congress may decide more GSEs might be best, but whatever Congress decides the GSEs should do, it needs to ensure that most of the subsidies are going to homeowners and not shareholders.**
- **Steve Bartlett from the Financial Services Roundtable testified that the GSEs are virtually unregulated today and that other institutions are regulated in the subprime and home equity business. This is a long overdue area for the regulators to examine and why a single regulator would be beneficial.**
- In response, Freddie testified that Americans should be able use their assets in their home for medical use, etc. and if they choose to use their assets in this way then their loan should be priced fairly. Freddie testified that they are currently under vigorous and aggressive oversight by their regulators on a daily basis.

- Tom Donilon from Fannie testified that it is expressly authorized in the GSEs' charters to finance home equity loans.
- Cong. Spencer Bachus (R-AL) [who is not on the Subcommittee] stated that the GSEs should not be blamed for entering the home equity market because their charters give them authorization to engage in these markets. The GSEs should not be blamed for something Congress authorized them to do. He would not put the blame on the GSEs when their charters are wide enough for them to enter into new markets. "You would have to be blind" to say that the GSEs are not growing but in terms of safety and soundness, the GSEs look pretty strong. In terms of the GSEs receiving subsidies, he notes that banks also have subsidies and if there is a GSE subsidy, there's a lot of evidence that homebuyers are benefiting.

GSEs' increased purchasing of own MBS

- Frederick Khedouri of Bear Stearns testified that it is not riskier for the GSEs to purchase and hold securities than to purchase and hold whole loans. He argued that Fannie and Freddie have the same interest rate and prepayment risk when they own whole loans as they do when they own their own MBS. [Cong. Baker noted for the record that Bear Stearns is a significant co-sponsorship of issuances of Fannie and Freddie securities.]
- **Cong. Ryan stated that the GSEs are purchasing their own MBS on a magnitude that goes way beyond the need for stabilizing the market and are instead using these MBS purchases as an arbitrage activity for profits that poses new risks and does nothing for homeownership.** Tom Donilon from Fannie testified that Fannie is prudently managing the risk of holding its own MBS in its portfolio and spending billions of dollars in hedging interest rate risk. Cong. Ryan noted that there is no third-party regulator to consult on this increased risk, and that right now Congress can only rely on the word of the GSEs because there is no strong regulator.
- **Barbara Miles from Congressional Research Service stated that the GSEs' repurchasing of their own MBS does not appear to have a housing rationale behind it. There is nothing that the GSEs do in purchasing their own MBS that would result in the form of lower mortgage rates to homebuyers, she noted.**

GSEs' increased issuance of debt

- In terms of debt issuance, Cong. Ryan stated that it would be beneficial to have a third party for Congress to ensure that the GSEs' issuance of massive amounts of debt is not needlessly putting taxpayers at risk.
- **In his written statement, Steve Moore from CATO noted that the "unrestrained growth of the GSEs is one of the most economically dangerous development in our financial markets. Yet almost no one is paying attention." Moore noted that "very few policymakers realize that for virtually every dollar of debt that has been retired over the past three years in Treasury securities, the GSEs have taken on an additional dollar of debt." Moore suggested imposing a Congressional annual cap on GSE borrowing.** "GSE debt has skyrocketed in recent years virtually unbeknownst to Congress. The accountability has been virtually nonexistent. Congress should be required each year to approve a debt ceiling for the GSEs, just as the federal debt is capped. For Fannie and Freddie to exceed this annual borrowing cap should require a formal vote of Congress. The federal government's policy of debt retirement is being thwarted by the GSEs." (*Dow Jones Newswire*, John Connor, 9/14/00)
- **Peter Wallison from AEI said absent full privatization of the GSEs, "debt issuance by the GSEs should be treated as a budget item, so that every year their growth through the**

issuance of debt will be weighed against the use of the government's resources for other purposes.” (*Dow Jones Newswire*, John Connor, 9/14/00)

Privatization

- **Peter Wallison of AEI asked whether Congress wanted taxpayers to stand behind the GSEs' risk when the private sector can do it well now. The GSEs are matured and should be privatized. Why have a subsidized entity that doesn't meet the needs of the people for which it is chartered to serve?**
- Cong. Kanjorski wondered if the GSEs were privatized, whether it would be impossible to hold the GSEs under their mission of serving the low- to moderate-income homebuyers.
- Peter Wallison agreed but noted that the subsidies provided to the GSEs could instead be given as a down-payment relief to those homebuyers most in need of a subsidy.
- Consumer group activist Bruce Marks from NACA argued that Fannie and Freddie should be privatized and compete on the same level as other non-government entities. Cong. Kanjorksi asked Marks whether he was in favor of banks not being subject to CRA. Marks argued that if banks do not take deposit insurance then they should not be subject to CRA.
- “Rusty” Cloutier from the Independent Community Bankers was opposed to privatizing the GSEs. He believes there is a risk to taxpayers from the GSEs, but no more so than other large financial institutions.
- John Taylor from the National Community Reinvestment Coalition was against privatization. He supports a strong regulator that would require the GSEs to disclose the interest rates and terms and conditions of the loans they purchase.

Summary of written comments:

America Association of Retired Persons (AARP)

- More could be done in the GSEs' purchasing of low and moderate mortgages and multifamily mortgages
- More could be done in engaging Fannie and Freddie in efforts to reduce predatory lending and increasing disclosure of credit scores to borrowers
- Concerned that HR 3703 will limit the GSEs' innovation, could destabilize financial markets, could result in possible reductions in GSE commitments to affordable housing, and could delay OFHEO's plans to finalize its risk-based capital rule for the GSEs
- Concerned that a transition to a new regulatory structure could “destabilize the value of existing GSE financial instruments” including those held by private pension funds, mutual funds, and private and public investors.

America's Community Bankers (ACB)

- No official position on HR 3703
- Supports creating a single GSE regulator for Fannie and Freddie that would regulate both mission and safety and soundness, but opposes consolidating oversight of the FHLBanks with that of Fannie and Freddie because the FHLBank System is a cooperative system and Fannie and Freddie are publicly traded companies

- Supports the review and approval of new GSE activities to ensure that these activities meet the GSEs' mission and do not discourage competition with the private-sector (but not the "complicated" version in HR 3703)
- Supports a clearer definition of Fannie and Freddie's missions, risk-based capital standards based on the specific characteristics of the GSEs, and adoption of regulations providing private label AAA-rated MBS the same capital treatment as similar securities issued by GSEs
- Opposes repealing the Treasury credit line and eliminating the FHLBanks' super lien authority.
- Supports removing the GSE regulator from the appropriations process, supports review of the non-mission investments of the GSEs and possible limits
- Supports a prohibition on Fannie and Freddie's expansion into the home equity line of credit, which is not consistent with the GSEs' mission
- Supports requiring a study on the effects of GSE failure on depository institutions

American Enterprise Institute (AEI)

- H.R. 3703 is a "modest proposal"
- Fannie and Freddie are "out of control"
- Repealing the Treasury credit line is not enough to sever the GSEs' ties to the government because there are many other links between the government and the GSEs that the market relies upon to support its view that the GSEs are government backed.
- Supports review of new GSE activities, annual credit ratings by independent agencies, and a single independent regulator that is removed from the appropriations process. Should consider moving the single regulator under Treasury Department
- Assuming that full privatization of the GSEs cannot be achieved, the GSEs should be charged a guarantee fee to compensate the government for the implicit risk it assumes; debt issuance by the GSEs should be considered a budget item, and the GSEs should be treated like other government agencies covered by the Anti-Lobbying Act

Bear Stearns.

- Concerned that the structural changes to the GSEs in HR 3703 may permanently reduce the liquidity and efficiency of the U.S. debt markets
- Concerned that a new law may create a period of prolonged uncertainty as opposed to attempting to use existing law to address concerns. An extended period of uncertainty would impose substantial costs on investors and homeowners
- GSEs' purchases of mortgage-backed securities is a major source of liquidity, which in turn lowers rates for borrowers, and is therefore consistent with the GSEs' mission

CATO Institute

- CATO does not endorse or oppose legislation but supports many of the proposals in HR 3703
- Supports removing the GSEs' line of credit to the Treasury
- Ultimately the GSEs should be privatized
- The "unrestrained growth of the GSEs is one of the most economically dangerous developments in our financial markets. Yet almost no one is paying attention."
- GSEs no longer serve a public purpose; GSEs are a ticking time bomb that could suddenly explode in taxpayers' laps; Fannie and Freddie are forms of corporate welfare for the rich; GSEs are eroding competitive markets in housing finance; Fannie and Freddie constitute major threats to the health of the American capital markets
- A series of small steps would de facto privatize the GSEs including: peeling away their federal benefits; imposing a user fee of 10 to 20 basis points on GSE debt to level the playing field

between Fannie and its competitors; shut down Fannie's political activities; lower the ceiling on Fannie and Freddie's mortgages from \$252,000 to the median home price; impose a Congressional annual cap on GSE borrowing; increase the equity requirements of the GSEs; and abolish the subsidies to the GSEs and use the savings to create a first-time homebuyer income tax credit

- Congressional Research Service (CRS)
- CRS submitted its July 25 testimony to the Housing Task Force of the House Budget Committee hearing
- The GSEs create risks to the economy by displacing private sector competition and increasing economic inefficiency.
- The volume of GSE debt outstanding will surpass Treasury debt by 2004.
- The GSEs have corrected the market failures for which they were first chartered.
- Fannie and Freddie have much weaker market discipline compared to other institutions. GSEs have incentives not only to dominate the assigned market but also to seek ways to continue to grow even after the market to which the GSEs are constrained by charter is saturated. This, in turn, gives rise to new risks for the government.
- The GSEs' operations pose (1) normal business risks and (2) larger risks to the financial system and the economy (systemic and systematic risk)
- The GSEs' repurchasing of their own MBS provides profit and risk for the GSEs and does little for the mortgage market. "While it is clear that this increases shareholder value, it is difficult to understand what, if anything, it does for mortgage markets."
- GSEs may expand to fulfill benchmark role - There are drawbacks to using GSE debt as a benchmark security. For a benchmark to function properly, it should reflect only risks in the economy overall, whereas GSE securities reflect risks specific to the housing sector. "Thus, the problem arises again that the GSEs may have cause to expand their missions to fill the benchmark role...But the risk to the economy from introducing what is effectively a subsidized entity into a new market is that current competition will be displaced and economic inefficiency increased."

Consumers Union/Consumer Federation of America

- Appropriate to examine the operations of the GSEs
- GSEs have been responsive to concerns about predatory lending, while many private mortgage lenders have been slow to respond to the problems of predatory lending
- A greater effort should be made by the GSEs to serving the less affluent
- Question whether the existing regulators have adequate resources to fully evaluate the GSEs for safety and soundness
- The GSEs' ability to introduce new products "should not be unnecessarily hindered"
- Other financial institutions also receive direct or implicit subsidies from the federal government which "means that a bailout of larger banks...is just as likely as of GSEs"

Council of Federal Home Loan Banks

- Opposes elimination of "superlien" for FHLBanks and the removal of the GSEs' line of credit to the Treasury
- Legislation should respect the need for flexibility, allowing the investment in mortgage-backed securities as a mission consistent tool
- Expressed concerns about the need to fully implement the reforms outlined in last year's financial modernization law (e.g., implementation of a new capital rule) before proposing additional changes to the FHLBank System.
- Opposes limitation on FHLBanks' ability to invest in non-mission assets

Cunningham, William (registered investment adviser)

- HR 3703 would strengthen government regulation, encourage market discipline, insure that taxpayers will not face a bail-out, and make it easier for people to buy homes
- Supports all the current provisions of HR 3703, including removing the GSEs' line of credit to the Treasury, and increasing the transparency of the GSEs
- Suggests making the Federal Reserve Board the primary GSE regulator, requiring the GSEs to report on efforts they have undertaken to reduce homelessness, especially within the Washington, DC area
- Suggests the GSEs be subject to a "Social Audit"

Enterprise Foundation

- Concerned that OFHEO's proposed risk-based capital rule for Fannie and Freddie could curtail the GSEs' affordable housing activities at the same time HUD is proposing to increase the GSEs' affordable housing goals – encourages OFHEO and HUD to work together
- HR 3703 could impede the GSEs from meeting their goals of expanding affordable housing
- Repealing the GSEs' line of credit would raise the cost of homeownership
- New program review provisions would be slow and cumbersome and would stifle the GSEs' innovativeness

Fannie Mae

- Opposes HR 3703 because it limits innovation, would delay implementation of the risk-based capital test, creates an inferior regulator, and does not benefit homeownership.
- Repeal of the line of credit will increase the cost of homeownership
- Fannie claims that its debt issuance attracts investors to the mortgage market and reduces mortgage rates by increasing funds available for mortgages. Fannie suggests that when a GSE purchases its mortgage-backed securities to hold in portfolio, that action helps create demand, lowers mortgage rates and provides liquidity to the housing market.
- Fannie's securities are an important investment option for smaller investors and they do not pose a systemic risk because there is no unsafe concentration at large financial institutions
- Fannie argues that its recent expansion efforts (including Fannie's partnership with Home Depot) are consistent with its charter.
- Fannie competes with banks and thrifts which also receive government benefits
- Fannie suggests Congress should look at modifying the capital requirements of the FHLBanks.

Federal Housing Finance Board (FHFB)

- Did not submit written comments

Financial Services Roundtable

- Supports HR 3703
- Supports single regulator, immediate removal of OFHEO from the appropriations process, a requirement that a clear bright-line statutory statement on the mission of the GSEs against which new activities can be measured (specifically mentioned Fannie's Home Depot program and Freddie's Home Steps programs as clear examples of the GSEs creating their own definition of the mission)
- Supports limitation on GSEs' non-mission investments, annual review of the GSEs by rating agency, removing the GSEs' line of credit to the Treasury, and making any final capital standards for the GSEs consistent with those of other major financial institutions

- Supports the ability to adjust the conforming loans limits downward for the GSEs in the event that Housing Price Index exhibits lower average home prices
- Supports a study on the impact of GSEs on insured depository institutions

Freddie Mac

- The “Three Pillars” framework proposed by the Basel Committee provides an excellent framework of discussion on the GSEs – Freddie believes that measured against the Basel “Three Pillars,” the company’s current capital, supervisory, and disclosure standards “stand up extremely well”
- Freddie fulfills its mission without government funding. Congress conferred a number of benefits that enable Freddie to access the capital markets to fulfill its mission. Federally insured depository institutions, such as banks and thrifts, enjoy government benefits of their own.
- Freddie is among the strongest financial institutions which stems from its world class credit risk management, interest-rate risk management and capital management practices
- Former Office of Management and Budget Director James Miller found that eliminating Freddie Mac’s congressionally-granted statutory benefits while maintaining the benefits afforded to other government-chartered financial institutions would not result in a more efficient allocation of capital in the housing finance marketplace.

General Accounting Office (GAO)

- Supports a single GSE regulator that is independent and objective, prominent in government, able to achieve economy and efficiency, and to provide consistency in regulation
- Raised concerns in the past about HUD, OFHEO, and the FHFB’s regulation of the GSEs; some of these concerns have been met, others have not

Homeowners Education Coalition (HomeEC) (Citizens Against Government Waste, Small Business Survival Committee, American Association of Small Property Owners, CapitolWatch, Competitive Enterprise Institute, Citizens for a Sound Economy, National Taxpayers Union, and 60 Plus)

- Any reform work must be balanced
- Supports eliminating the GSEs’ line of credit to the Treasury, the practice of Presidential appointments to the GSEs’ Board of Directors, and the GSEs’ exemption from SEC disclosure requirements and fees
- Until the GSEs achieve full privatization, management and employees’ salaries should be linked to those of their federal government counterparts
- Until they are fully privatized, Congress should require the GSEs to disclose all expenditures on image advertising, lobbying, political campaign contributions, and any other grants made through their foundations
- Until they are fully privatized, Congress must exercise greater oversight of the GSEs
- Suggests moving a single GSE regulator to the Treasury Department, an annual review by OFHEO to Congress on the size of the GSEs’ debt including the amount of repurchased MBS, a review by the OMB of the GSEs’ activities and debt management to assess financial risk as part of its annual budget analysis, and a study by the OMB on how to proceed towards full privatization of the GSEs
- GSEs must not be allowed to stray further from their charters
- Congress should limit the amount of GSE debt commercial banks may hold
- GSEs’ debt should be capped

Household International

- Fannie and Freddie’s sheer size, dominance of the secondary marketplace, and the growth of their non-mission related activities warrant legislative scrutiny

- Current regulatory structure provides no effective control over the GSEs
- Supports single GSE regulator as an independent agency of the US Treasury Department
- Supports provision in the bill requiring public disclosure of information
- Supports subjecting the GSEs to an appropriate review of their new ventures
- GSEs have been pushing their charters to the breaking point and have shown little concern for their statutory mission in many of their new programs. An example is Fannie and Freddie's purchasing of home equity and subprime loans, which while possibly within their charters, do nothing to promote homeownership.
- The most troublesome recent ventures are Fannie and Freddie's new programs that replace the bona fide third party mortgage insurance mandated in the GSEs' charters with risky self-insurance. These loans undermine the GSEs' charters, put consumers into loans that are not subject to the mortgage insurance cancellation rights, and often cost consumers more over the life of the loan than comparable products in the marketplace.
- Supports removing the GSEs' line of credit to the Treasury
- GSEs operate at far higher debt to capital leverage ratios than permitted either by rule or in the marketplace for insured and uninsured financial institutions. Fannie and Freddie are now leveraged almost three times higher than the nation's largest banks.
- The GSEs' repurchasing of their own MBS contributes little to the creation of new homeownership opportunities and appears to be no more than an arbitrage operation to increase the profits of the GSEs.
- Supports the Budget Committee's ongoing review of GSE debt operations

Independent Community Bankers of America (ICBA)

- Supports a separate regulator for the FHLBanks because the "purpose of the FHLBanks has expanded beyond the narrow housing mission of Fannie Mae and Freddie Mac."
- Opposes repealing the line of credit and the review of new GSE activities proposed in H.R. 3703.
- Opposes placing limits on the amount of GSE debt held by banks
- Opposes removing the FHLBanks' super lien authority

Mortgage Bankers Association (MBA)

- Supports an independent and well-funded single regulator for the GSEs. The costs of this regulation should be fully funded by the GSEs themselves.
- Simply creating a single regulator will not adequately further overall oversight of the GSEs unless a clearer statutory definition of the primary and secondary market is created to help a regulator determine what is in a GSEs' charter or mission
- Suggests excluding from the new activity review process actions that are clearly within the scope of the GSEs' missions.

National Association of Federal Credit Unions (NAFCU)

- Opposes a single GSE regulator; should preserve the existing regulatory and oversight framework
- Concerned about new program review provisions in HR 3703
- HR 3703 could have a detrimental impact on the housing finance market by bureaucratizing the process by which lenders deal with GSEs

National Association of HomeBuilders (NAHB)

- Opposes removing the GSEs' line of credit and the "withdrawal of any of the federal privileges and legal exemptions" that might dilute the GSE status of Fannie, Freddie, and the FHLBanks
- Opposes eliminating the super-lien authority for the FHLBanks

- Opposes changes to the current regulatory structure; should encourage current GSE regulators to ensure the GSEs are safe and sound and within their missions
- Transition to a new regulatory structure could impede the implementation of the risk-based capital rule for Fannie and Freddie and the FHLBanks' capital implementation.
- Congress should consider the adverse impact that any changes to the regulatory structure could raise the cost of homeownership and rental housing

National Association of Realtors (NAR)

- Status quo should prevail regarding the regulation and federal ties of the GSEs
- Open to dialogue about strengthening the regulation of the GSEs but has reservations about changing the regulatory structure for the GSEs as proposed in HR 3703
- Opposes removing the GSEs' line of credit, the FHLBank super-lien authority, or any "diminution" of the GSEs' federal ties
- Opposes new program approval provisions in the bill, claims the provisions would expose the GSEs to cumbersome review
- There are significant charter and corporate differences between Fannie and Freddie and the FHLBanks that must be resolved

National Community Reinvestment Coalition (NCRC)

- Supports HUD as a single regulator for the GSEs. Regulation of the GSEs should be funded by the GSEs themselves instead of through the appropriations process.
- GSE regulator should regulate the financing of predatory lending and GSE involvement in subprime
- Supports requiring the GSEs to publicly disclose on an annual basis financial, business, and other information that is in the public interest
- Congress should consider enhancements to HMDA, the Public Use Database, and other databases on GSE activities that would provide more information on loan terms and conditions being offered to borrowers; GSE and lender data should be expanded to include the APR and loan terms and conditions
- Supports competitive automated underwriting systems. Supports transparency of credit scores and asks Fannie and Freddie to agree to let lending institutions use their own credit scoring systems without also having to use Fannie and Freddie's credit scoring systems. HR 3703 should require the GSEs to disclose their credit scores and the factors behind the scores to consumers.
- GSEs may ask their regulators to review lenders' credit scoring systems if they want a second opinion on safety and soundness and fair lending compliance
- Supports prior program approval and public comment periods for GSEs' new programs.
- GSEs should continue to have access to the line of credit to the Treasury Department, however, if the GSEs' do not meet their affordable housing goals, they should lose access to line of credit

National Home Equity Mortgage Association (NHEMA)

- Congress should re-evaluate the GSEs' missions to determine "what these GSEs' missions should be in the changed circumstances of the 21st Century"
- Fannie and Freddie have been aggressively moving into new program activities, including home equity that does not involve home purchases or home improvement. HUD's oversight of the GSEs' expansion into new programs has been virtually "non-existent"
- Fannie and Freddie's activities and HUD's timid regulatory approach raise troubling public policy questions that cry out for Congressional examination.

- Encourages Congress to examine carefully the tension between the GSEs' public mission and corporate obligations.

Neighborhood Assistance Corporation of America (NACA)

- GSEs, which are subsidized by the American taxpayer, have been a big part of creation and continuation of predatory lending
- GSEs should be more flexible in their underwriting standards so that low-income homebuyers would more easily qualify for conventional mortgages. The GSEs set the homeownership standards in the country and determine what is considered a conventional loan and subprime loan. By setting the standards, the GSEs are setting these subprime borrowers up to potentially become victims of predatory lending.
- GSEs argue 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, NACA says that 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." NACA 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."
- Fannie and Freddie should be privatized and compete on the same level as other non-government entities.
- GSEs need more accountability. A single independent regulator would provide meaningful oversight of the GSEs. The regulator should require disclosure of the salaries of each GSEs' directors and officers, the amount of money spent on public relations, lobbying and campaign contributions, involvement with subprime lenders and specifics on their record to low-and moderate-income homebuyers.
- Requiring the regulator's prior approval of new programs and activities is significant and something that advocates of fair housing should support.

Office of Federal Housing Enterprise Oversight (OFHEO)

- Offered an interim proposal should Congress defer action on H.R. 3703 that would clarify OFHEO's regulatory enforcement authority, remove OFHEO from the appropriations process, grant OFHEO independent litigation authority, provide OFHEO with express authority to remove "bad actors" from working at the GSEs, and remove OFHEO from the Federal Advisory Committee Act.

U.S. Department of Housing and Urban Development (HUD)

- Did not submit written comments. However, during its previous Subcommittee testimony, HUD pointed out that it believes that the current regulatory system is working well, that HUD and OFHEO have a good working relationship, and that HUD has open communication with the FHFB. HUD also highlighted three components of the bill that would strengthen oversight. They include the authority to assess GSEs for the cost of mission regulation, stronger authority to review new GSE activities, and additional legislative direction to limit non-mortgage investments.

(GSE Roundtable Oral and Written testimony, 9/12/00)

FM Watch submits comment letter to Roundtable

FM Watch

- Fannie/Freddie watchdog group, FM Watch, did not testify at the GSE Roundtable but did submit a written statement.
- “By virtue of their government-sponsored status, Fannie Mae and Freddie Mac are not governed by many of the market disciplines that apply to other privately held companies,” thus, FM Watch supports a strong single regulator for the GSEs and recommends placement under Treasury or the Federal Reserve
- Supports an annual review by a rating agency to determine a true “risk to the government” rating of each GSE
- Supports more disclosure by the GSEs to the market, including those governing insider-trading activity, applicable to all other publicly traded companies, and subject the agencies to the market disclosure standards being developed by the Federal Reserve for large, complex banking organizations
- Supports an end to “mission creep” by the GSEs, which causes higher costs to consumers and greater risks to the GSEs (concerned about the GSEs’ expansion into mortgage insurance, the mortgage origination process, and expansion into other private-sector markets (including Fannie’s Home Depot partnership and Freddie’s Home Steps venture))
- Supports new program review
- Supports mandatory acceptance of competitive automated underwriting systems. Suggests the GSEs be required to accept mortgage loans originated through any system or standard that meets criteria determined by a GSE regulator. Further, such acceptance should be on the same terms and conditions as loans evaluated through the GSEs’ automated underwriting systems
- Supports careful review of GSE debt operations in the financial markets to ensure that systemic risk is not increased as a result of the GSEs’ extensive debt issuances.
- Important to act “on all of these issues in a balanced legislative package...Separating individual components of a comprehensive reform package would result in a piecemeal approach with adverse consequences for consumer mortgage options, for the solvency of the GSEs and for competitiveness in consumer financial markets.”
- Supports “competition and consumer choice”
- **“Our position...would actually reduce consumer home financing costs. By limiting Fannie Mae and Freddie Mac’s business to the role of providing a liquid stable secondary mortgage market, while preventing them from using their government benefits to severely inhibit private market competition in the primary market, consumer choice is broadened and taxpayer risk is limited.”** (*Reuters*, Joanne Morrison, 9/1/00; *BridgeNews*, Simon Kennedy, 8/28/00; *Dow Jones Newswire*, Jerry Guidera, 8/29/00; *FM Watch Letter to Cong. Baker*, 8/25/00)

FHFB extends comment period on its proposed risk-based capital rule until Nov. 20, despite a statutory deadline that the rule be finalized by Nov. 12

Industry groups, including the America’s Community Bankers, had been seeking an even-longer extension

- The FHFB voted to extend the comment period on its proposed risk-based capital rule for the FHLBank System. The comment period was extended 40 days, until November 20. A proposal by FHFB Member Timothy O’Neill to extend the comment period six-months, was defeated by the FHFB by a vote of 2-1. The FHFB said it received numerous complaints from banking

associations, the FHLBanks, and members of the FHLBank System that they could not adequately comment on the complex rule by the original October 11 comment deadline. Although, the Gramm-Leach-Bliley Act signed into law last year requires the FHFB to issue the capital regulations no later than November 12, 2000, it appears that House and Senate Banking Committee leaders were briefed about the extension and will not object. However, a Senate Banking Committee Spokeswoman said that an amendment to Gramm-Leach-Bliley might be required to postpone the release. (*National Mortgage News Daily*, 9/20/00; *American Banker*, Lisa Daigle, 9/21/00)

- As reported in previous *GSE Reports*, industry groups urged the FHFB to extend the comment period 180-days and requested that the FHFB delay issuing its final regulations up to one year to November 12, 2001. In a July 17 letter to Capitol Hill, the America's Community Bankers, the American League of Financial Institutions and 21 state trade groups asked Congress for the extension. (*Dow Jones Newswire*, John Connor, 7/17/00; *BNA Daily Report for Executives*, Eileen Canning, 7/19/00)
- **“While ACB had originally asked for a longer extension than that granted by the FHFB, we are encouraged by the Finance Board’s decision to extend the comment period and to continue to seek input as it digests the comments that are received,” said Robert Davis, ACB’s Managing Director of Government Relations.** (*BNA Daily Report for Executives*, Adam Wasch, 9/21/00)

Fannie & Freddie’s safety and soundness regulator, OFHEO, has its FY 2001 budget request cut by the Senate VA-HUD Appropriations Committee

The panel cut nearly \$5 million from OFHEO’s budget at a time when lawmakers and others are expressing concern about the GSEs’ safety and soundness

“To cut the budget of an agency [OFHEO] trying to cope with these mammoth financial institutions is an outrage – a slap at the taxpayers who, unfortunately, bear the ultimate risk.”
(Ralph Nader, Testimony before House Banking Capital Markets Subcommittee, 6/15/00)

Cong. LaFalce, Cong. Baker, and Cong. Kanjorski support OFHEO’s budget request

OFHEO Director Armando Falcon vows to continue to fight for the full \$26.77 million funding request

OFHEO estimates that if Fannie & Freddie were regulated like national banks, the GSEs would have to pay \$70.9 million in assessments

Although OFHEO is subject to the appropriations process, it is not funded by taxpayers. Its funding comes from assessments on Fannie & Freddie. Other federal financial regulators are able to directly assess the entities they regulate, without being subject to the appropriations process

Although Fannie testifies that it supports strong regulation of the GSEs, it has opposed removing OFHEO from the appropriations process, leaving OFHEO under-funded

- On September 13, the Senate Appropriations Committee approved a VA-HUD Appropriations bill, which included only \$22 million in funding for OFHEO, even though OFHEO and a number of Congressional Members had requested \$26.77 million for fiscal year 2001. [The \$22 million in funding for OFHEO is identical to the amount included in the VA-HUD Appropriations bill passed by the House on June 21. An amendment to the HUD-VA Appropriations bill proposed by Congressman Maurice Hinchey (D-NY) that would have given OFHEO its full funding request of \$26.77 million failed by a vote of 207-211 on June 21, although the amendment was scored "budget neutral." Even though the OFHEO FY 2001 budget request was cut nearly \$5 million, OFHEO's budget would still be above the current level of \$19.48 million.]
- **[Although OFHEO is subject to the appropriations process, it is not funded by taxpayers. Its funding comes from assessments on Fannie and Freddie. Other federal financial regulators are able to directly assess the entities they regulate, without being subject to the appropriations process. OFHEO has been urging Congress to remove it from the appropriations process. Despite its regulator being under-funded, Fannie has been opposed to removing OFHEO from the appropriations process. A *Dow Jones Newswire* article reported that OFHEO Director Armando Falcon said that Fannie opposed an amendment circulated during last year's conference on the Gramm-Leach-Bliley Act, which would have removed OFHEO from the appropriations process. A Fannie spokeswoman said the company has always maintained that OFHEO should be part of the Congressional appropriations process, but added that it never has taken a position on any specific funding levels within that process. (*Dow Jones Newswire*, John Connor, 5/25/00) When asked by Cong. Baker at a September 12 GSE Roundtable whether it was appropriate for OFHEO to be removed from the appropriations process, Tom Donilon from Fannie testified that OFHEO should be properly funded but that it would not be appropriate for Fannie to comment on the issue.]**
- **Despite these setbacks, OFHEO Director Armando Falcon says he will continue to work for full funding (\$26.77 million) for OFHEO for FY 2001 and is "optimistic" that OFHEO will receive more money in late session spending negotiations between Congress and the Administration. Falcon said he is "very concerned" he will not be able to do his job properly unless he receives his FY 2001 full funding. Falcon said OFHEO needs more funds to keep up with the inexorable growth of Fannie and Freddie, warning that OFHEO may need to cut back on planned regulation if its FY 2001 funding is not met. Falcon noted that at the recent "GSE Roundtable" on September 12 [see earlier story in this *GSE Report*], there seemed to be consensus that Fannie and Freddie need a strong regulator. Falcon stated, "We have a strong regulator...but we need the resources to do the job." (*Dow Jones Newswire*, John Connor, 9/13/00, 9/15/00)**
- **OFHEO estimates that if Fannie and Freddie were regulated like national banks, the GSEs would have to pay \$70.9 million in assessments to the Office of the Comptroller of the Currency. (*National Mortgage News*, 9/25/00)**

Cong. LaFalce, Cong. Baker, and Cong. Kanjorski support OFHEO's budget request

- Cong. John LaFalce (D-NY), Cong. Richard Baker (R-LA) and Cong. Paul Kanjorski (D-PA) sent letters to the House VA-HUD Appropriations Subcommittee leadership the week of May 22 in support of OFHEO's budget request. **"OFHEO needs its full request to ensure that the ongoing growth and complexity of the Enterprises' operations are closely monitored," Baker and Kanjorski wrote.** "The Enterprises continue to grow at a rapid pace and their operations are only

increasing in complexity,” they wrote. “According to OFHEO, Fannie Mae and Freddie Mac presently are exposed to credit risk on more than \$2 trillion of mortgages, and their portfolio of mortgage assets exceeds \$850 billion, 350% larger than they were when OFHEO began operations in mid-1993. This amount is larger than the combined mortgage assets of the entire thrift industry,” they wrote. In a separate letter, **Cong. LaFalce wrote “As Congress debates the mission of GSEs and their regulation, the most important thing we can do this year is to give OFHEO the resources it needs to carry out its responsibilities to provide effective regulation of these GSEs.”** (*Dow Jones Newswire*, John Connor, 5/24/00; 5/25/00; *BNA Daily Report for Executives*, Eileen Canning, 5/25/00; *Bloomberg News*, 6/1/00)

Wall Street analyst urges Fannie & Freddie to negotiate a deal with Cong. Baker over his bill to strengthen regulation of the GSEs

Fannie Chairman Franklin Raines says there is no hope for passage of Cong. Baker’s GSE bill

- According to Rob Garver with the *American Banker*, Goldman Sachs & Co. analyst Howard Shapiro recommended that the GSEs give in and pursue a deal with Cong. Baker on his GSE bill. **“We believe today’s political risk is...serious because it could threaten the operating structure and charter benefits of the GSEs and ultimately their ability to grow,”** he wrote in a report released on September 21.
- The Goldman Sachs report does not take a position on the bill but notes that a deal with Cong. Baker now would be better for Fannie and Freddie if it were negotiated from a position of strength. **“We believe that investors would be best served if the GSEs were to negotiate on a voluntary basis...the parameters of any change in business structure. This would allow them to manage the process, thereby preventing disruption to the markets or to their business. It would also allow them to more actively shape the outcome,”** Shapiro wrote. (*American Banker*, Rob Garver, 9/22/00)
- Speaking to reporters after a September 11 speech before the National Association of Federal Credit Unions, Fannie Chairman Franklin Raines stated that Cong. Baker’s GSE bill had no chance of passage. Raines said “the bill is not going anywhere...I do not think that Congress is going to pass any bill related to us,” he said. (*American Banker*, Lisa Dingle, 9/12/00; *BNA Daily Report for Executives*, 9/12/00)

News not yet reported: Fannie & Freddie would obtain an exemption from District of Columbia City Council predatory lending bill.

- News not yet reported: On July 12, 2000, the District of Columbia Council introduced a bill, entitled "Predatory Lending Protections and Mortgage Foreclosure Improvements Act of 2000," that rewrites the laws relating to deeds of trust and mortgages, revamps the foreclosure process and addresses predatory lending practices. The bill (Bill 13-800) is the result of the District's Foreclosure Task Force, which has been meeting for the past two years. The District of Columbia's predatory lending bill is scheduled for a public hearing on October 2, 2000. The current version of the bill mirrors many of the provisions seen in the various model predatory lending bills, but excludes from the definition of home loans that are for purchase money or refinance that carry interest and fees consistent with loans graded prime or "A" by Fannie Mae or Freddie Mac in the secondary mortgage market. The bill also codifies the foreclosure process in the District and includes a process whereby a borrower facing foreclosure may petition the court for determination

of whether the loan was a "predatory loan" when originated. If so, the lender may be precluded from foreclosing. The bill would prohibit various "predatory" practices.

All GSEs

House Banking Committee Chairman Jim Leach (R-IA) calls Cong. Baker's GSE bill (HR 3703) a "balanced" approach

Senate Banking Committee Chairman Phil Gramm (R-TX) says he doesn't yet have an opinion on the bill and thinks the issue will be examined next year

Cong. John LaFalce (D-NY) says he would move slowly on any attempt to strengthen regulation of GSEs [Cong. LaFalce is next in line to Chair the House Banking Committee in the next Congress should the Democrats regain control of the House]

- Speaking to reporters after an appearance before the National Association of Federal Credit Unions, House Banking Committee Chairman Leach said he thinks Cong. Baker's bill to strengthen regulation of the GSEs is a "balanced approach." Chairman Leach was an early co-sponsor of Cong. Baker's bill. He said he "would stress the GSEs have served the public in general quite nicely. On the other hand, they've upended some of the competitive equality issues." *Dow Jones Newswire* reported that the Chairman was supportive of combining the regulation of the GSEs into a single regulator but was less supportive of the proposal to remove the GSEs' line of credit to the Treasury. "These will be issues I think for the committees themselves to work out and over time I think we'll see that's an issue that gets a decent review," he said. (*Dow Jones Newswire*, Jonathan Nicholson, 9/12/00)
- Speaking prior to the September 12 GSE Roundtable, Senate Banking Committee Chairman Gramm said it is too soon for the Senate to take up a similar bill. "I don't have an opinion yet," he said, referring to Cong. Baker's GSE bill. "I think that's something that we'll have to probably look at next year." (*Dow Jones Newswire*, Henry Pulizzi, 9/12/00)
- According to *National Mortgage News*, Cong. LaFalce says he would move slowly in any attempt to strengthen regulation of the GSEs. "While the GSEs are deserving of rigorous oversight, I don't want to destroy something that works," he told the Eastern Secondary Mortgage Market Conference on September 18. "And I certainly don't want to do anything that would increase mortgage costs by even a tenth of a percent if it's uncalled for." He said he sees "no reason" to repeal the GSEs' line of credit to the Treasury. He claims there is "no federal guarantee," stating that the GSEs' prospectuses contain that disclaimer. However, he could not say that Uncle Sam would not bail out the GSEs should they encounter financial difficulties. (*National Mortgage News Daily*, 9/18/00)

Fannie Mae and Freddie Mac

OFHEO to examine the GSEs' "mission creep" – OFHEO says it can help define Fannie & Freddie's charters

[Concerns have been expressed that the GSEs engage in activities, such as consumer finance, that are beyond their charters ("mission creep") and are using their GSE advantages to unfairly compete against private-sector competitors]

OFHEO will conduct a study on the "systemic risks" associated with Fannie & Freddie

"We must understand not just the risks faced by the enterprises, but also the risks they pose to the financial system," said OFHEO Director Armando Falcon

"The rapid growth" of Fannie & Freddie's outstanding debt and mortgage securities "has increased concerns about the systemic risk that Fannie Mae and Freddie Mac may pose to the financial system," said Falcon

Mission creep

- According to *Reuters*, OFHEO says it can help define the types of businesses in which Fannie and Freddie can engage under their federal charters. Speaking at the Eastern Secondary Mortgage Conference on September 19, OFHEO Director Armando Falcon said there is no clear consensus on what kinds of business activities are permissible for the GSEs under their charters. "Unfortunately, there is little agreement on where that line should be," he said. "OFHEO is in a position to help define that line through the exercise of its broad statutory authorities to enforce the Enterprises' compliance with all laws, including their charters." He added, "While OFHEO has not committed to review every activity that the Enterprises engage in, we will act when we believe greater clarity is needed." (*Reuters*, 9/19/00)

Systemic risk

- At the same conference, Falcon stated that OFHEO "has initiated a comprehensive study of the systemic risk" posed by Fannie and Freddie. **"We must understand not just the risks faced by the enterprises, but also the risks they pose to the financial system," said Falcon.** OFHEO will also issue a notice, possibly in October, requesting public comments on the questions its study hopes to address. An OFHEO Spokeswoman said the study might take six months to a year to complete. "The topics we will examine include the nature of the systemic risks posed by Fannie Mae and Freddie Mac, the ways in which financial difficulties experienced by either enterprise could cause other financial market participants to incur losses, and the likelihood that such losses could cause those firms to default or lead to disruptions in financial markets," stated Falcon.
- Falcon said the "rapid growth" of the GSEs' debt and mortgage securities "has increased concerns about the systemic risk that Fannie Mae and Freddie Mac may pose to the financial system." Falcon noted that many financial institutions hold GSE debt and securities in amounts that are large relative to their capital. "If either Fannie Mae or Freddie Mac got into financial trouble, their securities become illiquid, or they defaulted on their obligations, the consequences for a significant number of investors might impair the functioning of financial markets." (*Dow Jones Newswire*, John Connor, 9/19/00; *National Mortgage News Daily*, 9/19/00)

Mortgage Bankers Association (MBA) is 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

MBA believes that many of the concerns expressed about the GSEs' mission creep could be solved with a stronger definition of the primary and secondary market

The panel plans to share its work with Fannie & Freddie - the two GSEs have committed themselves to participating in the panel's discussion

During a September 12 GSE Roundtable, Freddie's Mitch Delk disagreed with the MBA and said there is no ambiguity between the primary and secondary market and that the GSEs' charters are clearly defined – Delk does not believe the issue of “mission creep” exists

- According to the *American Banker*, the MBA is convening a blue-ribbon panel of industry experts to create a definition of the secondary market for residential mortgages. The article noted that the panel plans to share its work with Fannie and Freddie and that the two GSEs have committed themselves to participating in the panel's discussion of the issue. (*American Banker*, Erick Bergquist, 9/12/00)
- During the September 12 GSE Roundtable, MBA's Howard Glaser testified that the lines between the primary market and secondary market were blurring. **Glaser stated that many of the concerns expressed about the GSEs' mission creep could be solved with a stronger definition of the primary and secondary market. The MBA supports a strong independent regulator with sufficient definitions of the primary and secondary markets to work with.** (*Oral testimony of GSE Roundtable*, 9/12/00)
- Mitch Delk from Freddie disagreed and said “there is a bright line between the primary and secondary markets. We cannot originate mortgages – that is quite clear. So, when Mr. Glaser says there is an ambiguity between them in the charter, I don't know what he is talking about.” Glaser asked Delk whether he was saying that the issue of mission creep did not exist to which Delk replied “yes.” (*Oral testimony of GSE Roundtable*, 9/12/00)

Analysts and investors claim that a victory by Presidential candidate Al Gore would benefit the stocks of the GSEs by decreasing their political risks

However, many analysts say that Fannie & Freddie's political risks will continue regardless of the Administration

- **Gore is perceived as “must less likely to push for any change to the agencies” than Bush, said Brian Allen, who helps manage \$1.8 billion in bonds, including agency bonds at C.S. McKee. Still, “I'd be very surprised if it didn't come up again.”** (*Bloomberg*, 9/20/00)
- If Gore wins the Presidency, it would give Fannie and Freddie's flagging stocks an immediate 10% to 20% boost, said Morgan Stanley Dean Witter analyst Ken Posner. If Bush wins, it would take longer for the stocks to rebound, he noted. Posner argues that because Democrats are considered “pro consumer,” Republican legislators would not waste time fighting for a politically unpopular bill that would lack support from a Gore administration. Further, whoever Gore chose as Treasury Secretary, he claims would not make waves for the GSEs. Regardless of who is elected President,

however, Posner believes that legislative reform of the GSEs has little chance of passing. (*American Banker*, Erick Bergquist, 9/13/00)

- Sanford C. Bernstein & Co. analyst Jonathan Gray said a victory by Al Gore will likely work in the GSEs' favor as many of the critics have come from the Republican benches. (*Dow Jones Newswire*, Janet Morrisey, 9/14/00)
- **Salomon Smith Barney analyst Tom O'Donnell believes the political risk for Fannie and Freddie will continue for the next 12 months. "Now that Fannie and Freddie appear on Washington radar screens and now that it has become politically correct to bash them, political risks will wax and wane, but not completely go away," he said. "In our view, the shares have become trading vehicles rather than the core holdings they used to be."** (*National Mortgage News Daily*, 9/18/00)
- **After once being convinced Cong. Baker's GSE bill was not a threat, Sanford C. Bernstein analyst Jonathan Gray, has changed his mind. He now believes that there is a 30% chance that during the next five years, new legislation will be enacted to stunt Fannie and Freddie's growth.** (*Dow Jones Newswire*, David Stires, 9/19/00)

As the national debt shrinks, GSE debt skyrockets

With the fading supply of Treasurys, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasurys as the new benchmark in the bond market

GSE debt news:

Credit unions "have been fattening up on GSE debt for the past decade"

- **More than half of the total of credit union investments is in agency securities**
- **At mid-year credit unions held \$52 billion worth of agency securities (most of it debt issued by Fannie, Freddie or the FHLBanks)**

Freddie euro-denominated debt issuances in Europe raises concerns about GSE expansion

- **More than half of Freddie's first euro-denominated debt issuance attracted new investors**
- **US investment accounted for only 6% of the orders, more than 90% came from European accounts; foreign central banks bought 13% of the new deal**

- As reported in previous *GSE Reports*, as the national debt shrinks, GSE debt has been skyrocketing. As the national debt is paid down, the supply of Treasury securities shrinks. Investors, traders, borrowers, and even the US Federal Reserve are being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark are the debt securities of Fannie and Freddie. Investors view them as "almost" as good as US Treasurys because of the implicit government guarantee on Fannie and Freddie's securities. Fannie and Freddie would like to replace Treasurys as a benchmark security and the agencies both have bond issuance programs (Fannie – Benchmark bond program; Freddie-Reference bond program) that mirror traditional Treasury operations in size and regularity.

- Criticisms of the GSEs' skyrocketing debt have increased. "Efforts by Fannie Mae and Freddie Mac to become bigger players...raise concerns among some policy makers. The two firms are privately owned. Their securities are considered safe largely because the markets assume that the government, which created both agencies, will stand behind them. If this is true, it means taxpayers are assuming an ever larger risk as Fannie Mae and Freddie Mac expand, while the companies' shareholders enjoy profits at taxpayers' expense." (*Wall Street Journal*, 2/3/00) Says Jim Murphy with *Dow Jones Newswire*, "Combined Fannie, Freddie, and the FHLBanks have \$2.6 trillion – T as in trillion – of outstanding debt...I can't explain why the amount of outstanding debt is so huge. I would think that \$2.6 trillion would be enough to provide every man, woman and child in the US who doesn't own a home with the equivalent of a custom-designed palace on two acres in the Hamptons." (*Dow Jones Newswire*, Jim Murphy, 4/12/00)

Credit Unions investing heavily into agency securities

- According to Ed Roberts with the *Credit Union Journal*, credit unions "have been fattening up on GSE debt for the past decade." Agency securities have been the most favored investments for credit unions. At mid-year credit unions held \$52 billion worth of agency securities (most of it debt issued by Fannie, Freddie, and the FHLBanks) – this is more than half of total credit union investments. NCUA investment rules do not currently require a credit analysis for agency securities. (*Credit Union Journal*, Ed Roberts, 9/11/00)

Freddie's plan to issue euro-denominated debt in Europe raises concerns about GSE expansion

- In addition to its regular debt issuances in the United States, Freddie has begun selling 20 billion in euro-denominated debt (\$18 billion) a year. According to Freddie, the program will be one of the largest bond programs in Europe. The program was inaugurated recently with Fannie's first five billion euro 10-year offering in mid-September.
- Freddie was only finding muted investor support for its mid-September issuance despite pricing the deal at a discount to where it borrows in dollars. They said European investors' skeptical stance meant Freddie might have to rely on arbitrage buying from US accounts if the five billion euro 10-year bond was to perform. (*Reuters*, Catherine Evans, 9/13/00) Freddie's deal was priced to yield 55.5 basis points over bonds. The yield Freddie offered to investors was wider than it had hoped. The initial price talk at the start of the week was "the low to mid 50s," according to the bookrunners. But after consulting investors, Freddie increased the yield. (*Financial Times (London)*, Rebecca Bream, 9/15/00)
- Adam Tempkin with *Mortgage-Backed Securities Letter* noted that "market participants wondered whether the hoopla this year over the Baker bill in Congress and the criticism of the GSEs' continuing growth would affect how the new [euro] program is perceived abroad, and whether, in fact, it points to unbridled growth which the critics speak of." According to Lynn Adler with *Reuters*, "In marching overseas with an innovative annual 20 billion euro borrowing program...is Freddie sticking its neck out only to get its head chopped off?...Instead of taking a low profile while facing public scrutiny, Freddie Mac's new ambitious euro program, which is above and beyond its dollar-denominated funding, brightens the spotlight on the agencies' expansion plans. And it raises the question of whether the agencies are more than just savvy borrowers, but corporations growing rapidly enough for the government to cut its ties." (*Reuters*, Lynn Adler, 8/17/00; *Mortgage-Backed Securities Letter*, Adam Tempkin, 8/22/00)
- According to Lynn Adler and Catherine Evans with *Reuters*, Freddie's five billion euro offering "lured a huge pool of new overseas investors despite buyer concerns about that currency's weakness and some resistance to a first-time deal from a non-sovereign issuer." Jonathan Prince,

Freddie's Debt Marketing Manager said "(Freddie Mac) placed more than half (of the new deal) to investors who have never bought the Freddie Mac name on a primary issue before." US investment accounted for only 6% of the orders, 90% came from European accounts, with the rest going to Asia and the Middle East, he said. More than two-thirds of buyers for dollar-denominated Freddie offerings usually come from the United States. Foreign central banks bought 13% of the new deal, just behind their average of purchases in Freddie's dollar denominated reference notes. (*Reuters*, Lynn Adler and Catherine Evans, 9/14/00)

Competition to create the leading web portals linking originators to the secondary market will be fierce

Pioneer in financial e-commerce, Scott Cooley of Contour Software, says the biggest strength of Fannie & Freddie's portal is that "everyone is using their automated underwriting systems," however, the GSEs lack the support of the industry, which fears they will eventually go directly to consumers

- In a speech at the Eastern Secondary Mortgage Market Conference, Scott Cooley of Contour Software said there is "going to be bloodbath six months from now" to create web portals to become the main link to whatever lenders need to originate mortgages and sell them into the secondary market. Cooley predicts that most of the 20 or more web portals existing won't survive because "there are already too many e-commerce lending engines, but there's only room for three or four." The biggest strength of the portals from Fannie and Freddie is that "everyone is using their automated underwriting systems, which are a key driver of traffic." However, Cooley notes that the GSEs lack the support of the industry, which fears that they will eventually go directly to consumers. (*National Mortgage News Daily*, 9/19/00)

Fannie Mae

Fannie Chairman Franklin Raines tells bankers the company has no interest in invading banks' business such as originating mortgages, issuing credit cards, or selling insurance

Bankers remain suspicious

Raines' latest comments "continue to show either a lack of understanding of the reality of the marketplace or a denial as to what they're really doing," said Steve Bartlett, President of the Financial Services Roundtable

In related news, Fannie promises bankers it will purchase more CRA loans

- In a speech to the American Bankers Association on September 18, Fannie CEO Franklin Raines tried to assure bankers that Fannie was not interested in going outside its charter and competing in the banks' businesses. "There are those who say that Fannie Mae cannot achieve its financial goals without breaking out of our charter, getting into new lines of business, and competing with you. Some say we want to get into credit cards, insurance and other consumer services. Some say we want to originate mortgages. I'm here to tell you they're wrong." Raines said that Fannie is, and will continue to be, a monoline business. "We've put all our eggs in one basket, and it's a good basket," he said. "We net less than 4% of the revenue in the US mortgage business," he said. "But

our share is good enough to meet our financial goals and satisfy our shareholders. We don't need to compete with you or your mortgage business."

Bankers remain suspicious

- **Despite frequent assurances by Raines and the former Chairman James Johnson, bankers continue to be suspicious of Fannie. Raines' latest comments "continue to show either a lack of understanding of the reality of the marketplace or a denial as to what they're really doing," said Steve Bartlett, a former Congressman and Banking Committee Member who is now President of the Financial Services Roundtable.**
- **Outgoing ABA President Hjalma Johnson said that bankers' concerns about Fannie's expansion into their territory is natural, given Fannie's need to satisfy stockholders with higher earnings. Rob Garver with the *American Banker* reported that "Raines' promises were cold comfort to some of the bankers in attendance." "I think he believes what he is saying, but of course there is no assurance about what the next director will say," said C. Kendric Ferguson, Chairman of National Bank of Commerce. "His intentions are right, but I just don't know what the future holds." (*American Banker*, Rob Garver, 9/19/00; *Reuters*, Lynn Adler, 9/20/00; *Fannie Chairman Frank Raines speech to the American Bankers Association*, 9/18/00)**

Fannie tells ABA it will purchase more CRA loans

- During his speech to the ABA, Raines also announced that Fannie and the ABA had reached a deal on purchasing CRA loans. Under the agreement, which is similar to a partnership with Citicorp, the company will purchase CRA-qualifying loans from ABA-member banks. Fannie also claims it will purchase CRA loans at the point of origination, so banks will not have to hold these loans at all. For banks that need assistance meeting the CRA's investment requirements, Fannie will create customized mortgage-backed securities based on loans Fannie has purchased in the institution's service area. For banks that need assistance locating CRA loans, for a cost, Fannie's market research group will provide demographic and economic analysis to determine a bank's lending area. (*American Banker*, Rob Garver, 9/19/00; *Fannie Chairman Frank Raines speech to the American Bankers Association*, 9/18/00) [Editorial Note: Raines did not mention if the GSEs would purchase CRA loans at a competitive price. The GSEs' high prices have made it uneconomical for CRA institutions to sell CRA loans to the GSEs.]

Fannie Chairman Frank Raines says Fannie would like to purchase more mortgages from credit unions and urges credit unions to use Fannie's technology

- In a September 11 speech before the National Association of Federal Credit Unions (NAFCU), Fannie Chairman Frank Raines said that Fannie wants to purchase more mortgages from credit unions. Fannie purchased \$6 billion of loans from the credit unions in the last two years -- one third of the mortgages credit unions made. Raines says he wants that figure to increase "dramatically" but needs the credit unions to better tap the demand for home loans among their members. Raines claims that only 2% of credit union members get their mortgages from the credit union and he feels "there is no reason why at least half, if not the majority, of your members should not be able to buy a home through their credit union." Raines also urged NAFCU members to take advantage of Fannie's technological tools to create quick loan approval systems using Fannie's automated underwriting system, Desktop Underwriter. "We can build you a technology package customized for your needs," he said. (*American Banker*, Lisa Dingle, 9/12/00; *BNA Daily Report for Executives*, 9/12/00)

Freddie Mac

Freddie provides its technology to mortgage brokers (bypassing their lender customers)

Freddie to provide its automated underwriting system directly to mortgage brokers who are members of the National Association of Hispanic Real Estate Professionals (NAHREP)

[“The GSEs should not develop, distribute, or use technology in a way that bypasses their seller/servicers by going direct to the customers or vendors of those partners, including but not limited to consumers, owners/developers of housing, mortgage brokers, and other real estate professionals.” (MBA GSE Policy Statement, 8/10/99)]

- Freddie announced an agreement with the National Association of Hispanic Real Estate Professionals (NAHREP) to make Freddie’s automated underwriting system, Loan Prospector on the Internet, available to NAHREP members who are mortgage brokers. The service can be accessed via RealEstateEspanol.com, a wholly owned subsidiary of quepasa.com. The technology will allow the mortgage brokers to offer “near instant” loan decisions and to “dramatically reduce” documentation requirements at the point of sale, according to Freddie. (*National Mortgage News Daily*, 9/8/00; *Freddie press release*, 9/7/00)

Farm Credit System/Farm Credit Banks

American Bankers Association and Independent Community Bankers of America blast the Farm Credit Administration’s (FCA) controversial plan to grant national charters to Farm Credit System banks

The groups argue the plan would cause unfair competition and destabilize the system – suggest Congress should hold hearings on the issue

House Banking Committee Chairman Leach has called the plan a “reflection” of all GSEs to “use their governmentally privileged positions” to expand their activities “in ways that distort the American market system”

- According to Rob Garver with the *American Banker*, the American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA) blasted the FCA’s plan to grant national charters to Farm Credit System banks and remove geographical restrictions on the Farm Credit System lenders. The groups argue that the proposal threatens locally based lenders and should be the subject of Congressional hearings.
- In letters to the FCA, the ABA and ICBA accused the FCA of trying to sidestep the public comment process and warned that the proposal would create unfair competition and destabilize the system it was supposed to protect.
- ICBA President Tom Sheehan said the proposal would let the largest of the Farm Credit System lenders “cherry pick” the most eligible borrowers in areas already served by commercial banks and other Farm Credit System lenders.

- The FCA said it had received at least 600 comments on the proposal, more than half of which supported the proposals. Most of the letters criticizing the proposal were from commercial banks and their trade associations. (*American Banker*, Rob Garver, 9/5/00)

Background on the proposal

- In May, the FCA first announced its National Chartering proposal in a booklet. The proposal would allow Farm Credit banks to apply for a national charter to make loans anywhere in the country as soon as January 1, 2001, assuming the banks receive approval for a national charter from the FCA. Currently, the Farm Credit banks divide the country into exclusive territories in which they compete with commercial banks for farm loans. Regulators seldom allow the Farm Credit banks to move into one another's territories to compete. Historically, Farm Credit banks have been barred from making loans outside their geographic districts unless they were sharing a loan with another Farm Credit bank. They also could not participate in loans with commercial banks or other lenders unless they received approval from the FCA. Under the new plan, Farm Credit banks may share loans with commercial banks – no matter where they are based – without specific approval.
- With most rule changes, the FCA makes a formal proposal, takes public comment, and then votes. However, in this case, the FCA argued that it already had the right to allow Farm Credit banks to operate wherever they want and therefore only needed to clarify existing laws. The FCA amended its lending rules without comment from Farm Credit lenders, which angered Chairman Leach, Farm Credit banks, and commercial banks. In a June 23 letter to FCA Chairman Michael Reyna, Chairman Leach urged the FCA to “suspend this initiative, described in a FCA booklet, until proper processes involving formal rule making procedures are put in place and until there is adequate opportunity for Congressional scrutiny and oversight.” Chairman Leach **says the plan is “a reflection of the continual self-generated urge of all government-sponsored enterprises to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort the American market system.”** Leach wrote, **“The irony is that this country has the largest, most vibrantly competitive private sector financial system in the world, but without governmental oversight and restraint, GSEs – whether they be in housing or agriculture – have a natural tendency to push into new market-skewing areas and activities. The question is whether this benefits or distorts our financial system.”**
- Responding to the criticism, the FCA then agreed to publish its booklet in the *Federal Register* July 20 for comments, with comments due August 31, 2000. However, **FCA Chairman and Chief Executive Officer Michael Reyna noted, “although we are publishing the Booklet in the *Federal Register*, we are not conducting an actual rule-making.”** (*American Banker*, Alan Kline, 7/12/00, Craig Woker, 7/10/00; *House Banking Committee press release*, 7/14/00; *BNA Daily Report for Executives*, Eileen Canning, 7/18/00; *Chairman Jim Leach letter to FCA Chairman Michael Reyna*, 6/23/00)

American Bankers Association urges US Supreme Court to find that states can impose sales and income taxes on federally chartered farm credit lenders

- In an amicus brief filed in the US Supreme Court on August 29, the American Bankers Association argued that production credit associations (PCAs), which compete with community banks for agricultural loans, should have to pay state and local taxes. The case, *Missouri Director of Revenue v. CoBank ACB*, US, No. 99-1792, is an appeal from a January ruling by the Missouri

Supreme Court, which held that certain institutions in the Farm Credit System (including PCAs), are exempt from state and local taxes.

- The ABA argued that changes to the Farm Credit Act in 1985 inadvertently created a loophole for some lenders, Congress' actual intention was to subject PCAs to state and local taxes. "Congress never intended to create broad tax immunity to these private lenders," said ABA's brief. "PCAs and CoBank are direct retail lenders, no longer owned by the US government, and serve no government role or function warranting an exemption from state and local taxation," said the ABA's brief.
- In June, the Supreme Court decided to hear the case (124 DTR G-5, 6/27/00). The court is scheduled to open its new term October 3. (*BNA Daily Report for Executives*, R. Christian Bruce, 8/30/00; *Dow Jones Newswire*, Fowler Martin, 8/29/00)

Ginnie Mae

Ginnie Mae hires a contractor to help the agency develop a new program to securitize conventional loans backed by private mortgage insurance (e.g., "Ginnie Mae Choice")

Ginnie currently only guarantees FHA and VA loans

- According to *National Mortgage News*, Ginnie Mae is hiring a contractor to help the agency develop a new program to securitize conventional loans backed by private mortgage insurance. Some private mortgage insurance industry executives have been pushing for Ginnie to develop a plan, referred to as "Ginnie Mae Choice," that would allow Ginnie to securitize high LTV loans that Fannie and Freddie won't securitize. Currently, Ginnie Mae only guarantees securitizations involving FHA and VA loans. Ginnie Mae Executive Vice President George Anderson told *MortgageWire*, that the contractor "would assist us in considering that option among others." The contractor will also help to develop other programs. (*National Mortgage News Daily*, 8/31/00)

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