

The *GSE* REPORT™

Contents of GSE Report™

“The GSEs portray themselves as private institutions when it suits their needs while implying that they are government-backed to investors. They cannot have it both ways.” (*HomeEc Letter to Senator Gramm and Senator Sarbanes, 1/26/01 – HomeEc includes Citizens Against Government Waste, Citizens for a Sound Economy, Competitive Enterprise Institute, and Center for Freedom and Prosperity*)

“Private financial institutions routinely bundle, package and securitize huge blocks of mortgages, reselling them to insurance companies, pension funds and other investors. As a consequence, Freddie and Fannie are losing their basic justification for existence. Yet, at the very time that the need for them is falling, Fannie Mae and Freddie Mac are growing out of control.” (*Nationally syndicated columnist Bruce Bartlett, Op-Ed, Washington Times, 2/5/01*)

Major Events

- Congressional Budget Office (CBO) identifies the following as options for increasing federal revenues: [\(p. 5\)](#)
 - (1) Imposing an annual fee on the non-mission investment portfolios of the GSEs (to address GSE arbitrage concerns); and
 - (2) Repealing the GSEs' SEC registration exemption (to help level the playing field with private sector financial institutions and to ensure consumer protection)
 - CBO notes that the proposals do not appear to increase the cost of housing
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 - The Committee will also examine the Farm Credit Administration's controversial national charter initiative
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 - Commercial bankers testify that the proposal would create unfair competition and drive them out of business
 - House Agricultural Committee to hold March 7 hearing on the proposal
 - House Financial Services Committee plans to review the proposal
 - ICBA urges President Bush to delay the proposal

- Supreme Court rules against CoBank and some other farm credit lenders (specifically, production credit associations), saying that they must continue to pay state income taxes ([p. 13](#))
 - Banking industry officials cheer the ruling
 - Banking industry officials says the implications of the ruling were far reaching because any tax credits earned by CoBank and the production credit associations represent an unfair advantage over commercial banks
 - “If you don’t pay state taxes, you are starting a 100-yard race 50 yards ahead before the gun is even fired,” said ICBA’s Director of Agricultural Finance Mark Scanlan. “This decision helps to level the playing field a little bit.”
 - [Editorial Note: Fannie & Freddie are exempt from paying state and local income taxes representing an unfair competitive advantage over private-sector commercial financial institutions.]

All GSEs

- Taxpayer groups – Citizens Against Government Waste, Citizens for a Sound Economy, Competitive Enterprise Institute, and Center for Freedom and Prosperity – encourage Congressional oversight of the activities of the GSEs ([p. 15](#))
 - Taxpayer groups claim the GSEs’ exploding debt issuance is a “serious concern” and the GSEs are increasingly engaging in risky financial activities outside of their charters
 - “All of this puts American taxpayers at what may prove to be enormous risk”
- *Washington Times* op-ed by Bruce Bartlett states that while the national debt is declining, the GSEs are issuing “exploding” amounts of debt and “growing out of control” ([p. 15](#))

Fannie Mae and Freddie Mac

- Capital Markets Subcommittee Chairman Richard Baker is “frustrated” that the Congressional Budget Office (CBO) has not released its report on the federal subsidies that Fannie & Freddie receive due to their GSE status ([p. 17](#))
- *National Mortgage News* editorial by Brian Collins claims “HUD has always been known as a mouse when it comes to regulating Fannie Mae and Freddie Mac” ([p. 17](#))
 - HUD has still not completed its preliminary fair lending review of Fannie & Freddie’s automated underwriting systems and “like HUD’s other efforts to get tough with Fannie and Freddie, was just another feint - based more on public posturing than clarity of purpose or determination”
 - HUD’s fair lending review of Fannie & Freddie’s automated underwriting systems “illustrates that HUD isn’t suited to be a regulator”
- As the national debt shrinks, GSE debt skyrockets ([p. 18](#))
 - 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:

 - (1) Federal Reserve Chairman Alan Greenspan says as the supply of Treasuries dwindles, the Fed is looking at alternatives to Treasuries for its monetary policy, including bonds issued by US states and foreign governments
 - (2) *Dow Jones Newswire* reports that the Fed regards GSE debt as a substitute for Treasuries, but the Fed appears wary of the GSEs’ growth and its highly political sensitivity
 - (3) Former Treasury Department official says the status of GSE debt needs to be more clearly defined because foreign central banks may not understand the status of GSE debt [whether GSE debt enjoys an implied government guarantee]; urges an aggressive educational campaign to inform foreign central banks of the risks involved in investing in GSE debt
 - (4) Foreign investors dumped a large amount of Treasuries last year and offset those sales with purchases of GSE agency debt securities; Foreign central banks continue to increase their purchasing of agency debt securities
 - (5) Freddie’s debt issuance in Europe is costing more than anticipated
 - (6) Freddie’s long-term debt attracts an unusual number of foreign buyers
 - (7) Freddie offers multi-family borrowers the option of benchmarking their interest rate to Freddie’s Reference bill debt, using Freddie’s debt as an index instead of the London interbank offered rate (LIBOR)
 - (8) Freddie expands its Internet debt auctions
 - (9) Freddie ties its biggest-ever debt sale in a single day
 - (10) Chicago Board of Trade to launch newest GSE futures on March 23
 - (11) New bond service, Agency PX, will provide up-to-the-minute pricing of GSE agency securities
- Fannie & Freddie expand their technology to brokers, realtors, and consumers ([p. 24](#))

[Editorial Note: Such expansion conflicts with the Mortgage Bankers Association’s (MBA) policy statement on the GSEs – “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)]

- (1) Fannie, Univision, and Countrywide launch Web channel for consumers
 - (2) HomeStore.com [of which Fannie is an investor] has acquired substantially all the assets of Homebid.com which allows real estate professionals to manage offers and negotiate home sales
 - (3) Finet.com, which was the first Web site to allow consumers to use Fannie’s automated underwriting technology directly, announces reverse stock-split to boost its stock
 - (4) Fannie announces new enhanced “lender- and consumer-friendly” version of its automated underwriting system
 - (5) Fannie enhances its “true-cost calculator” for consumers
 - (6) ByOwner.com will approve customers using Fannie’s automated underwriting technology
 - (7) Microsoft is selling HomeAdvisor Technologies – Will Freddie, which is already an investor, purchase HomeAdvisor?
 - (8) Freddie claims more than 10 million loans have now been processed through its automated underwriting system
 - (9) Freddie offers awards to brokers, including trips to Hawaii and a new car, when they use Freddie’s technology
- OFHEO announces it intends to routinely disclose Fannie & Freddie’s critical capital levels ([p. 27](#))
 - OFHEO also announces a clarification of FAS 133 (new accounting rule for derivatives)
 - In related news, FAS 133 will decrease Freddie’s stockholders’ equity by \$2.5 billion, or about 16.8%
 - Some market pros note that the “volatility stemming from the accounting change underscores the antiquated nature of the regulatory rules” governing Fannie & Freddie
 - ACB survey shows that thrifts sold a lower percentage of loans to Fannie & Freddie in 2000 as compared to 1999 ([p. 28](#))

Fannie Mae

- Did Fannie pull its “FM Watch-bashing” Web site, FM Watch-Observer? ([p. 29](#))
- Fannie continues to try to exempt itself from predatory lending laws ([p. 29](#))
- The Mortgage Industry Standards Maintenance Organization (Mismo) – a coalition set up by the MBA – is working to create universal data exchange standards so that all mortgage participants can send electronic data in a common language and format ([p. 29](#))
 - Fannie is objecting to Mismo’s automated underwriting standards
 - It is not clear if Fannie will develop its own standard and then require the rest of the industry to comply or will compromise with Mismo
- *American Banker* runs profile piece on Fannie Mae CEO Franklin Raines ([p. 30](#))
 - Raines says his critics may have raised some legitimate issues, but despite criticisms, Raines says Fannie has no plans to change its ways. *American Banker* article says that “Raines is riding a growth machine...and he has no intention of reining it in.”
 - Raines states, “Our view is that we should do more.”
- Fannie expands its lobbying team ([p. 32](#))
- Fannie claims it exceeded its affordable housing goals ([p. 32](#))
- Fannie will no longer require individual property appraisals for single-family new home construction ([p. 32](#))

Freddie Mac

- Citizens Funds, a socially conscious money management firm, adds Freddie to its list of “sin stocks” because of charges of racial discrimination at the company ([p. 33](#))
- Freddie was one of the top 10 corporate campaign contributors to the 1999-2000 election cycle ([p. 33](#))
- Freddie names new Vice Presidents for Government Relations and Legislative and Regulatory Affairs ([p. 33](#))
- Freddie’s former Assistant General Counsel joins Goodwin, Procter law firm ([p. 33](#))

Federal Home Loan Banks

- Federal Housing Finance Board (FHFB) is “proceeding cautiously” on WaMu’s request to join the Dallas FHLBank while retaining membership in the Seattle FHLBank ([p. 34](#))
 - FHLBank of Dallas says it will face “real challenges” if WaMu is not allowed to join the FHLBank of Dallas
 - FHLBank of San Francisco and World Savings objects to WaMu’s request for dual membership
- America’s Community Bankers and 16 state trade groups urge changes in the final capital regulation for the FHLBanks ([p. 35](#))
 - Groups would like FHFB to publish for a 30-day comment period the capital plans of each of the 12 FHLBanks as they are submitted to the FHFB for approval and to wait until all 12 plans are submitted before approving

any plan

- Groups urge FHFB to require FHLBank members to purchase activity based stock for activities and programs, like the mortgage partnership programs
- *Wall Street Journal* reports that Fannie & Freddie are increasingly facing competition in the secondary mortgage market from the FHLBank System's Mortgage Partnership Finance (MPF) program ([p. 36](#))
 - However, Fannie & Freddie still dominate 90% of the secondary market for conventional home mortgages
 - Many banks, especially smaller regional ones say in certain situations they would rather sell mortgages to the FHLBanks than to Fannie & Freddie
- Lenders say a securitization program and servicing-release option would benefit the MPF program ([p. 37](#))
- FHFB cancels its open board meeting to discuss capital rule and WaMu's request for dual FHLBank membership ([p. 38](#))

Farm Credit Administration/Farm Credit Banks

- FCA approves risk-based capital rules for Farmer Mac ([p. 38](#))

Ginnie Mae

- Ginnie Mae hopes to have a rural rental housing program in place by year end ([p. 38](#))
- Ginnie Mae proposes regulation governing payments on Ginnie Mae I Modified Pass-Through Securities ([p. 39](#))

Major Events

Congressional Budget Office (CBO) identifies the following as options for increasing federal revenues:

- (1) Imposing an annual fee on the non-mission investment portfolios of the GSEs (to address GSE arbitrage concerns); and**
- (2) Repealing the GSEs' SEC registration exemption (to help level the playing field with private sector financial institutions and to ensure consumer protection)**

CBO notes that the proposals do not appear to increase the cost of housing

CBO has recommended these options for the past three years

- The Congressional Budget Office (CBO) in its annual report to Congress lists the following as revenue raising options:
 - (1) Imposing an annual fee on the non-mission investments of GSEs (raises \$13.4 billion over a 10-year period); and
 - (2) Requiring the GSEs to register their securities with the SEC (raises \$2 billion over a 10-year period) (*Budget Options*, Congressional Budget Office, February 2001)
- The CBO made these same proposals in its 1999 and 2000 annual reports to Congress. (*Budget Options*, Congressional Budget Office, March 2000; “*Maintaining Budgetary Discipline: Spending and Revenue Options*,” Congressional Budget Office, April 1999)

Imposing an annual fee on the non-mission investments of GSEs – would address concerns about the arbitrage activities of the GSEs

- The CBO claims that imposing an annual fee on the GSEs' non-mission investments could address concerns about the arbitrage activities of the GSEs. The CBO notes that the implied government guarantee allows the GSEs to borrow at lower rates and then use the borrowed money to invest in higher yielding obligations. The CBO further noted that before the 1990s, the GSEs generally used the money they borrowed to make loans or buy loans made by other lenders. “More recently, four GSEs – Fannie Mae, Freddie Mac, Farmer Mac and the Federal Home Loan Bank System – have used borrowed funds to acquire large portfolios of debt securities.” The report noted that at the end of 2000, the investment portfolios of those four GSEs totaled \$773 billion, or 45 percent of their combined assets.
- The CBO estimates that imposing a 10 basis point fee (10 cents per \$1000 of investments) on non-mission related assets of the GSEs could raise \$936 million in 2002, \$5.6 billion over five years, and \$13.4 billion through 2011.
- The CBO noted that the proposal does not appear to increase the cost of housing. “Fannie Mae and Freddie Mac conceivably could compensate for the fee by increasing interest rates on new mortgages they bought, but competition from wholly private firms and between those two GSEs would limit their ability to do so.” (*Budget Options*, Congressional Budget Office, February 2001; *Dow Jones Newswire*, John Connor, 2/28/01)

Repealing the GSEs' securities exemption – require all GSEs to register with the SEC

- Another revenue raising option identified by CBO, would require that all GSEs register their securities with the SEC. The CBO notes that currently the federal government explicitly subsidizes four GSEs – Fannie, Freddie, the FHLBank System, and the Farm Credit System – by exempting them from the registration requirements of the Securities Act of 1933. (A fifth GSE, Farmer Mac, is not exempt from SEC registration.) In 1992, the Department of Treasury, the Federal Reserve, and the SEC advocated requiring the four GSEs to register their securities with the SEC. (*Budget Options*, Congressional Budget Office, February 2001)
- The CBO notes that originally the GSEs were exempted from registering their securities with the SEC in part to relieve them of the cost of registering until they became accepted names in the market. “That rationale no longer applies: the four exempt GSEs are well known in financial markets.” Repealing the exemption would not impose significant regulatory burdens on the GSEs because registration can be done electronically. **CBO also said that requiring the GSEs to register their securities “would reduce the competitive advantage that the enterprises have over other firms that finance loans by issuing debt or mortgage-backed securities.” The report stated that “a more level playing field would probably lead to a more efficient allocation of credit.” Further, the CBO notes that requiring issuers to register their securities with the SEC protects investors “by ensuring full disclosure of uniform financial information.”**
- The CBO estimated that requiring the GSEs to register their securities with the SEC would raise \$287 million in 2002, \$1.4 billion over five years, and \$2 billion by 2011. According to CBO, “To register with the SEC, each of the four GSEs would pay about 2.5 cents for every \$1,000 (about 2.5 basis points) in securities it issued in 2002.
- The CBO noted that the proposal does not appear to increase the cost of housing. “Competition from wholly private firms and between the enterprises would limit the GSEs’ ability to recoup the cost of paying registration fees by raising the interest rates on the loans they finance. Fully absorbing the costs of registration would have little effect on either the enterprises’ profits or the interest rates paid by the borrowers they serve.” (*Budget Options*, Congressional Budget Office, February 2001; *Dow Jones Newswire*, John Connor, 2/28/01)

House Financial Services Committee’s agenda to include a comprehensive review of the housing GSEs (Fannie, Freddie and the FHLBanks)

The Committee will examine Fannie & Freddie’s October 2000 voluntary risk management agreement; the regulatory structure of the GSEs for both safety and soundness and mission; and new risk-based capital rules

The Committee will also examine the Farm Credit Administration’s controversial national charter initiative

- On February 14, the House Financial Services Committee adopted an oversight plan for the 107th Congress that includes among other items, a comprehensive review of the housing GSEs (Fannie, Freddie, and the FHLBanks). According to the adopted agenda, the Committee will cover the following areas: “(1) review of implementation by Fannie Mae and Freddie Mac of their October 2000 voluntary agreement to enhance market discipline and transparency; (2) the governmental structure and authorities for conducting safety and soundness and mission regulation; and (3) new

leverage and risk-based capital rules. In addition, the Committee plans to examine the Farm Credit Administration's national charter initiative. (*Oversight Plan for the House Financial Services Committee for the 107th Congress*, adopted 2/14/01)

Capital Markets Subcommittee Chairman Richard Baker plans to hold a hearing in the near future on Fannie & Freddie's October 2000 voluntary risk management agreement; introduce GSE legislation by the end of March; and review CBO's upcoming study on the GSEs' subsidies

Cong. Baker plans to review a GAO study on the capital of the FHLBank System, including a comparison of the FHFBS and OFHEO's risk-based capital rules for the GSEs

Members of the Capital Markets Subcommittee are named (25 Republicans and 22 Democrats)

- On February 15, the Chairman of the House Financial Services Subcommittee on Capital Markets, Congressman Richard Baker (R-LA), outlined the next ninety days of the Subcommittee's oversight and legislative agenda for the 107th Congress. In the area of GSE regulatory reform, Cong. Baker said he plans to conduct a hearing in the near future to evaluate the implementation of the October 2000 voluntary risk management measures by Fannie and Freddie. By the end of March, Cong. Baker plans to introduce legislation reforming the regulatory oversight of the safety and soundness and mission compliance of the housing GSEs. He also plans to review an anticipated Congressional Budget Office (CBO) study on the GSEs' annual federal subsidy and its costs and benefits. (*Cong. Baker press release, 2/15/01*)
- On the issue of FHLBanks, Cong. Baker said he plans to review a GAO study of capital of the FHLBank System, including a comparison of OFHEO's risk-based capital rule for Fannie and Freddie and the FHFBS's risk-based capital rule for the FHLBank System. He also plans to examine the capital and risks posed by the traditional and new FHLBank advances programs, as well as the acquisition of mortgages, with the goal of exploring the future makeup of the FHLBank System. In addition, he intends to evaluate the progress of the FHFBS's implementation of FHLBank "modernization" measures contained in Title VI of the Gramm-Leach-Bliley Act. (*Cong. Baker press release, 2/15/01*)
- **"I am determined as ever to work towards the passage of strong regulatory reform of the housing GSEs," Cong. Baker told a news conference.** He stated, "Let me be crystal clear, so as to avoid any future confusion or misinterpretation about my intentions. I plan to introduce legislation before the end of next month. We will hold hearings. And I believe we could see a law enacted by year's end, although I could tolerate a timeframe that contemplates passage early next year." Speaking to reporters after a briefing on the House Financial Services Committee agenda, he stated, "My preference is for this year but if we can't, we can't...but certainly within this (congressional) term" of 2001-2002. "We will be, although pressing ahead, very methodical," he said. "We will telegraph every move we make well in advance so there should not be adverse reaction by markets." Cong Baker said he plans to meet with congressional leaders, Fed Chairman Alan Greenspan, Treasury Secretary Paul O'Neill, Senate Banking Committee Chairman Phil Gramm, and Fannie and Freddie representatives to discuss the GSE issue. "I do not have a proposal prepared yet. We're in the stages of drafting it," he said. "We are working as fast as we can within the organizational constraints we have." (*Cong. Baker press release, 2/15/01; Reuters, 12/14/01; American Banker, Michele Heller, 2/16/01*)

Members of Capital Markets Subcommittee named

- During the House Financial Services Committee organizational meeting on February 14, the Committee agreed by voice vote to Resolutions assigning Republican and Democratic Members to the Committee's six Subcommittees, including the GSE Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee Subcommittee. The Capital Markets Subcommittee will have jurisdiction over the nation's financial markets, plus oversight of the SEC and the exchanges, insurance (except for health insurance) and oversight of the GSEs (Fannie, Freddie, and the FHLBanks). Cong. Oxley will serve as an ex officio member of all subcommittees.
- There will be 25 Republicans and 22 Democrats on the Capital Markets Subcommittee. The Capital Markets Subcommittee will include the following Republican Members: Chairman Richard Baker (LA), Vice Chairman Robert Ney (OH), Christopher Shays (CT), Christopher Cox (CA), Paul Gillmor (OH), Ron Paul (TX), Spencer Bachus (AL), Michael Castle (DE), Edward Royce (CA), Frank Lucas (OK), Bob Barr (GA), Walter Jones (NC), Steven LaTourette (OH), John Shadegg (AZ), David Weldon (FL), Jim Ryun (KS), Bob Riley (AL), Vito Fossella (NY), Judy Biggert (IL), Gary Miller (CA), Doug Ose (CA), Pat Toomey (PA), Michael Ferguson (NJ), Melissa Hart (PA) and Mike Rogers (MI).
- The Democratic Members of the Subcommittee are the following: Ranking Member Paul Kanjorski (PA), Nydia Velazquez (NY), Gary Ackerman (NY), Ken Bentsen (TX), James Maloney (CT), Darlene Hooley (OR), Max Sandlin (TX), Frank Mascara (PA), Stephanie Tubbs Jones (OH), Michael Capuano (MA), Brad Sherman (CA), Gregory Meeks (NY), Jay Inslee (WA), Dennis Moore (KS), Charlie Gonzalez (TX), Harold E. Ford, Jr. (TN), Ruben Hinojosa (TX), Ken Lucas (KY), Ronnie Shows (MS), Joseph Crowley (NY), Steve Israel (NY), and Mike Ross (AR). (*Financial Services Committee press release, 2/8/01; CQ Daily Monitor, 2/14/01; Baker Resolution Electing Majority Members to the Subcommittees, LaFalce Resolution Electing Minority Members to the Subcommittees, Financial Services Committee Meeting, 2/14/01*)

Treasury Secretary Paul O'Neill says he has not taken a position on any legislation to reform the GSEs

Capital Markets Subcommittee Chairman Richard Baker hopes to meet with Secretary O'Neill soon to discuss the GSE issue

- In an interview with *Bloomberg News* on February 7, Treasury Secretary Paul O'Neill stated that he had not taken a position on any legislation to reform the GSEs and that he didn't believe Fannie and Freddie receive a government subsidy. Secretary O'Neill acknowledged that the GSEs could borrow in financial markets at lower rates because investors believe that the federal government would bail out Fannie and Freddie if they were ever in financial trouble. Secretary O'Neill said he sat down with Fannie Chairman Franklin Raines and discussed the company's business and recent criticisms directed at Fannie and Freddie. "I consider Frank Raines to be a close personal friend of mine," said O'Neill, adding that the two had served 10 years ago on the board of a nonprofit organization - Manpower Demonstration Research Corp. (*Dow Jones Newswire, Nicholas Kulish, 2/9/01; Dow Jones Newswire, Jennifer Corbett Dooren, 2/14/01*)
- *Dow Jones Newswire* notes Fannie and Freddie came under fire last year from Congress and from the Administration. Comments by Gary Gensler, then Treasury Under Secretary for Domestic Finance questioned the GSEs' line of credit to the Treasury. "Repeal of the line of credit would be

consistent with the congressional requirement that all GSE securities carry a disclaimer that they are not obligations of the US government,” Gensler testified. And, in a letter last year, Fed Chairman Alan Greenspan wrote that entities such as Fannie, Freddie, and the FHLBanks “collectively dominate the United States residential housing markets” and “clearly benefit from government sponsorship.” [Editorial Note: A Congressional Budget Office 1996 report found that Fannie and Freddie receive \$6.5 billion in annual federal subsidies but passed through only \$4.4 billion to homeowners.] (*Dow Jones Newswire*, Nicholas Kulish, 2/9/01; *Real Estate Finance Today*, Mike Sorohan, 2/19/01)

- Financial consultant Bert Ely said that too much shouldn't be made over Secretary O'Neill's comments. “I don't think we've heard the final word on the administration's position on Fannie Mae and Freddie Mac. Particularly since what he said has gone against traditional views in government toward the GSEs.” (*Real Estate Finance Today*, Mike Sorohan, 2/19/01) Ely said, “One can conclude that Fannie and Freddie have really scored some political victories here, but I think it is still too early to see where everything will be when the dust settles.” (*American Banker*, Rob Blackwell, 2/9/01)
- Capital Markets Subcommittee Chairman Richard Baker seemed largely unconcerned about Secretary O'Neill's comments, saying the Treasury Secretary was “new to the issue” and might “very well find there is merit in our cause” after consulting with the Treasury's professional staff. He added that he hoped to meet with Secretary O'Neill soon. (*Wall Street Journal*, Nicholas Kulish, 2/16/01)
- When Secretary Paul O'Neill was asked by *Bloomberg News* during his February 7 interview what the GSEs' share of the US mortgage market was, a *Bloomberg* reporter said: “I think they say it is around 10%.” (*Bloomberg News*, *Bloomberg Interview with Secretary O'Neill*, 2/7/01)

GSE Market Share Numbers: Well Beyond “10%”

- **In 1998, Fannie and Freddie together purchased 46% of the total \$.15 trillion of US mortgage originations.** (*Bernstein Research, The GSEs: Hegemony in the Mortgage Market*, January 2000, p. 28). At the end of 1999, Fannie Mae and Freddie Mac owned or had securitized 47% of all outstanding conventional single-family mortgages, i.e. excluding mortgages that are government insured or guaranteed (*OFHEO Annual Report 2000*, p.1). The two GSEs have an especially large share of the market for fixed-rate mortgages. **Conforming fixed rate mortgages, i.e., fixed rate mortgages of a size and type that the GSEs by law are allowed to purchase, amount to 60-80% of the annual dollar volume of conventional single-family originations in 1999. In 1998 and 1999, the two GSEs purchased \$1.1 trillion in conforming fixed-rate loans, which amounted to over two-thirds of the volume of such mortgages originated in those two years** (*OFHEO Annual Report 2000*, p. 10).
- **In the year 2000, both Fannie and Freddie moved aggressively to expand their market share. While OFHEO has not yet released its Year 2001 Annual Report, it is reasonable to assume that, once reported, OFHEO's market share statistics will show that both GSEs expanded their reach.**

Former House Banking Committee Chairman Jim Leach (R-IA) criticizes the Farm Credit Administration's (FCA) controversial national charter proposal

Senate Agricultural Committee holds February 26 hearing on the proposal

Cong. Leach testifies that the proposal would “expand to 34 the number of government sponsored enterprises operating in the American economy and each of these new GSEs will have power greater than that of Fannie Mae or Freddie Mac”

Commercial bankers testify that the proposal would create unfair competition and drive them out of business

House Agricultural Committee to hold March 7 hearing on the proposal

House Financial Services Committee plans to review the proposal

ICBA urges President Bush to delay the proposal

- The Senate Agricultural Committee held a February 26 hearing on the FCA's controversial national charter proposal. Traditionally, institutions in the Farm Credit System have been limited to certain geographical regions. Under the controversial proposal, individual farm credit lending institutions would be able to apply for a national charter, which would let them lend beyond their current regional geographic boundaries. The FCA adopted the proposed rule at a January 11, 2000 meeting. In May 2000, the FCA issued a booklet to all system institutions provided guidance on applying for national charters. Several parties, including former House Banking Committee Chairman Jim Leach and the GAO raised procedural concerns that the FCA bypassed the formal rule-making process when issuing the rule. Responding to criticisms, in July 2000, the FCA published the booklet in the *Federal Register* for public comment. On January 11, 2001 the FCA adopted the proposed rule and sent it to the House and Senate agriculture committees for a 30-day review. The proposed rule was published in the *Federal Register* on February 16, 2001 for a 30-day comment period.
- As noted previously in this *GSE Report*, on February 14, the House Financial Services Committee adopted an oversight plan for the 107th Congress that includes among other items, an examination of the Farm Credit Administration's national charter initiative. (*Oversight Plan for the House Financial Services Committee for the 107th Congress*, adopted 2/14/01)

Cong. Leach blasts the proposal

- **Cong. Leach testified about his concerns with the proposal, stating that “there are very few issues that I feel more strongly about.” If adopted, Cong. Leach warned that the proposal would “expand to 34 the number of government-sponsored enterprises operating in the American economy and each of these new GSEs will have greater power than that of Fannie Mae or Freddie Mac.” He called the proposal “the single greatest act of administrative arrogance I have ever seen” and believed that the proposal “should be absolutely rejected.”**
- **Cong. Leach and commercial bankers argued that the proposal would lead to unfair competition with the private sector, jeopardize the system's safety and soundness, and give**

farmers no benefit. Because of their unique GSE status, the proposal would raise unfair competition because the farm credit lenders can raise capital more cheaply.

- **Cong. Leach claimed throughout the hearing that the national charter proposal would “socialize credit” and let farm credit lenders expand into auto, business, and “any other kind of loan you can visualize.” Cong. Leach stated, “You don’t know where the limit will be because each of them will have individual charters.” Cong. Leach further stated, “The history of GSEs is the demand for expanded power. All GSEs try to spread their wings.”** (*BNA Daily Report for Executives*, Adam Wasch, 2/27/01; *American Banker*, Michele Heller, 2/27/01; *Congress Daily*, 2/27/01; *Dow Jones Newswire*, Mark Anderson, 2/26/01)

Cong. Leach urges Treasury Department to reject the proposal

- In a February letter to Treasury Secretary Paul O’Neill, Cong. Leach criticized the FCA’s controversial national charter proposal and urged “immediate attention” by the Treasury Department. **Cong. Leach called the proposal “a manifestation of the continual self-generated urge of all GSEs to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort our market system.”** Besides procedural problems with the proposal, Cong. Leach said the issue has “major philosophical and market implications.” The proposal “raises the prospect of predatory financing, cherry picking of customers, the question of whether individual FCS entities could become captive to one or another commercial interest and...safety and soundness concerns for the Farm Credit System itself.”
- **Cong. Leach claimed the proposal could lead to “community banks, S&Ls, credit unions, and other tax-paying private sector financial institutions in rural areas, such as insurance and mortgage finance companies, find[ing] themselves competing on everything from car and home loans to business lending with new government subsidized credit.”**
- **“The national chartering of over one hundred new GSE entities implies the prospect that each may look to new financial activities for which there has been no case presented that private market credit is unavailable. The irony will not be lost that at the same time we are urging other countries to adopt market reforms, a US government agency is proposing that government subsidized credit should be expanded in the most sophisticated financial markets in the world,”** wrote Cong. Leach. (*BNA Daily Report for Executives*, Adam Wasch, 2/22/0; *Cong. Leach letter to Treasury Secretary O’Neill*, 2/16/01)

No response yet from Treasury Department

- The Treasury Department under the new Bush Administration has not yet responded to concerns raised about the FCA proposal. However, a representative from the Treasury Department under the Clinton Administration testified last year that the department did not recommend national charters and that “such a policy raises serious questions about the proper mission of the system.” (*BNA Daily Report for Executives*, Adam Wasch, 2/22/01)

Commercial banks claim proposal would cause unfair competition and drive them out business

- **Commercial bankers testified that the proposal would drive them out of business. “The proposal is driven by the large institutions within the Farm Credit System who will have the financial leverage and resources to drive smaller FCS associations out of business while driving some commercial banks either out of agriculture lending or out of business,”** testified Dale Leighty, President of the First National Bank of Las Animas (CO), who testified on behalf of the Independent Community Bankers of America. Leighty said the proposal was

unnecessary and should be “thrown on the scrap piles of bad policy ideas.” He warned that the proposal could allow farm credit lenders to shift to non-agricultural lending and alliances with large national businesses for a broad variety of consumer and business lending for activities targeting vaguely defined “rural areas.”

- **Commercial banks also argued that the proposal creates new risks to the system. “We believe that national charters will translate into new safety and soundness risks,” said Philip Burns, a Nebraska banker speaking on behalf of the American Bankers Association. Regarding the claim that the farm credit lenders have an unfair competitive advantage, Burns noted that “system institutions will consistently underprice credit on large deals in order to get business. We have many documented cases of this practice.” He added that there is no need for an expanded farm credit system. “The FCS was created when there were limited choices to secure credit for American agriculture...Today, seed companies, equipment manufacturers, fertilizer producers, life insurance companies, and foreign banks are all aggressive providers of agricultural credit.”** (*American Banker*, Michele Heller, 2/27/01; *BNA Daily Report for Executives*, Adam Wasch, 2/27/01; *ICBA press release*, 2/26/01)

FCA argues the proposal would reduce risk and modernize the system

- FCA Chairman Michael Reyna disagreed with the claims that the farm credit lenders would expand into new products, stating that the proposal “has no effect on new products or services.” He argued that the proposal was essential to the Farm Credit System’s health. He testified that limiting lenders to specific geographic regions makes them vulnerable to local economic downturns. “Improving geographic diversity and reducing industry concentration in system loan portfolios is essential for mitigating safety and soundness risks,” he stated. Reyna claims that unlike farm credit lenders, commercial banks “can abandon agriculture during recessions and lend instead to other sectors of the economy where the profit is greater and the credit problems are fewer.” He stated, “If the Farm Credit System is to remain a viable source of credit...it must be able to respond to changes in the market it serves.” (*American Banker*, Michele Heller, 2/27/01; *Dow Jones Newswire*, Mark Anderson, 2/26/01; *BNA Daily Report for Executives*, Adam Wasch, 2/27/01)

ICBA urges President Bush to delay the proposal

- In related news, the Independent Community Bankers of America urged President Bush to delay the FCA’s controversial national charter proposal. (*American Banker*, Lisa Daigle, 2/7/01)

Supreme Court rules against CoBank and some other farm credit lenders (specifically, production credit associations), saying that they must continue to pay state income taxes

Banking industry officials cheer the ruling

Banking industry officials say the implications of the ruling were far reaching because any tax credits earned by CoBank and the production credit associations represent an unfair advantage over commercial banks

“If you don’t pay state taxes, you are starting a 100-yard race 50 yards ahead before the gun is even fired,” said ICBA’s Director of Agricultural Finance Mark Scanlan. “This decision helps to level the playing field a little bit.”

[Editorial Note: Fannie & Freddie are exempt from paying state and local income taxes representing an unfair competitive advantage over private-sector commercial financial institutions.]

- The Supreme Court unanimously ruled that agricultural CoBank and some other farm credit lenders must continue to pay state income taxes (*Missouri v. CoBank*). According to the *American Banker*, the ruling does not apply to all 147 Farm Credit lenders – only CoBank and the approximately 50 so-called production credit associations. These associations, the most common members of the Farm Credit System, specialize in short-term loans to farms and agricultural businesses.
- The Supreme Court decision overruled a Missouri Supreme Court decision, which ruled that these entities were exempt from state income-tax laws. The Supreme Court ruled that such entities may have implied immunity if the law is silent, but in this case Congress specifically stated that such banks are subject to state taxes.
- The dispute over tax exemption arose in 1996 when CoBank sought refunds of approximately \$490,000 in Missouri income taxes paid in 1991, 1992, and 1993. CoBank argued that as a federal instrumentality, it was exempt from state taxes unless Congress specifically consented to the tax. The case centered on Congress’ intent when it amended the Farm Credit Act in 1985. When amending the Act, Congress removed a tax exemption that had been granted to most Farm Credit lenders, but retained an exemption for “instrumentalities of the United States.” CoBank argued that it met that description and should be exempt. The Missouri Supreme Court ruled in favor of CoBank and said Congress’ position was “unclear, at best.”
- Reversing the Missouri Supreme Court’s decision, Supreme Court Justice Clarence Thomas, writing for the Supreme Court, said banks and cooperatives were subject to state taxes. “We find Congress’ silence insufficient to disrupt the 50-year history of state taxation of banks for cooperatives,” The Supreme Court said that had “Congress intended to confer upon banks for cooperatives the more comprehensive exemption from taxation that it provided to Farm Credit banks and Federal Land Bank associations, it would have done so expressly as it had done elsewhere in the Farm Credit Act.” (*American Banker*, Rob Blackwell, 2/22/01; *Dow Jones Newswire*, John Ritter, 2/20/01; *Wall Street Journal*, Robert Greenberger, 2/21/01)

Bankers applaud the Supreme Court decision

- **“The Farm Credit System had a major blow dealt to it by this decision,”** said John Blanchfield, Director of the American Bankers Association’s center for agricultural and rural banking. “Because the Supreme Court, in their unanimous decision, found that Congress never intended to eliminate state and local taxation” when the law was updated in 1985. **Banking industry representatives believe that the implications of the Supreme Court ruling were far reaching because any tax credits earned by CoBank and other entities, would have constituted an unfair advantage over commercial banks. These tax benefits could then be used to underprice loans to agricultural cooperatives and squeeze commercial banks out of the business.**
- **“If you don’t pay state taxes, you are starting a 100-yard race 50 yards ahead before the gun is even fired,”** said Mark Scanlan, Director of Agricultural Finance with the Independent Community Bankers of America. **“This decision helps to level the playing field a bit.”** The American Bankers Association also praised the Supreme Court decision. **This helps level the playing field between rural community banks and Farm Credit System institutions, says ABA Senior Tax Counsel Mark Baran.** (*American Banker*, Rob Blackwell, 2/22/01; *Dow Jones Newswire*, Fowler Martin, 2/21/01)

All GSEs

Taxpayer groups – Citizens Against Government Waste, Citizens for a Sound Economy, Competitive Enterprise Institute, and Center for Freedom and Prosperity – encourage Congressional oversight of the activities of the GSEs

Taxpayer groups claim the GSEs’ exploding debt issuance is a “serious concern” and the GSEs are increasingly engaging in risky financial activities outside of their charters

“All of this puts American taxpayers at what may prove to be enormous risk”

- The Homeowners Education Coalition (HomeEc) sent letters to Senate Banking Committee Chairman Phil Gramm (R-TX) and Ranking Member Paul Sarbanes (D-MD) thanking them for their statements regarding the possible review of the GSEs’ activities. HomeEc consists of the following groups: Citizens Against Government Waste, Citizens for a Sound Economy, Competitive Enterprise Institute, and Center for Freedom and Prosperity.
- HomeEc argues that the private mortgage market is more mature and thriving than it was when Fannie and Freddie were first created. However, Fannie and Freddie “continue to operate as quasi-government agencies with billions in implicit taxpayer subsidies and, most importantly, the implied guarantee of the taxpayers behind them.” **HomeEc further notes that the GSEs’ “exploding debt burden is a serious cause of concern, especially since investors believe that taxpayers will bail them out in a financial crisis.” Further, the GSEs are “engaging in increasingly risky financial activities outside their charters in an effort to maximize profits.” All of which, HomeEc notes, “puts American taxpayers at what may prove to be enormous risk.”**
- HomeEc continues, “**The GSEs portray themselves as private institutions when it suits their needs while implying that they are government-backed to investors. They cannot have it both ways.**” HomeEc encourages Congressional oversight over the GSEs’ activities. HomeEc wrote, “**Congress has a fiduciary responsibility to safeguard the financial interests of taxpayers” and encourages Congress “to exercise prudent oversight over the activities of the GSEs.”** (*HomeEc Letter to Senator Gramm and Senator Sarbanes, 1/26/01*)

***Washington Times* op-ed by Bruce Bartlett states that while the national debt is declining, the GSEs are issuing “exploding” amounts of debt and “growing out of control”**

- Nationally syndicated columnist Bruce Bartlett wrote an op-ed for the *Washington Times* entitled “*Where Debt Still Rises.*” Bartlett notes that while the national debt is declining, this is “only one part of the federal government’s indebtedness.” Bartlett explains that the federal government has many other forms of debt in addition to the Treasury bonds, bills and notes that constitute the national debt. While the Treasury bonds, bills and notes are declining, other forms of the national debt are “exploding.” **Bartlett cites the GSEs, particularly Fannie and Freddie, “as one of the most rapidly growing elements of the federal government’s debt.”**
- When the GSEs were first created, financial markets were not as integrated as today, but now financial markets are vastly larger and more sophisticated and there is no longer a need for GSEs to make markets for mortgages. **He writes, “Private financial institutions routinely bundle, package and securitize huge blocks of mortgages, reselling them to insurance companies,**

pension funds and other investors. As a consequence, Freddie and Fannie are losing their basic justification for existence.” Bartlett adds, “Yet, at the very time that the need for them is falling, Fannie Mae and Freddie Mac are growing out of control. Lending by these agencies has exploded at the very time the national debt is declining. As a consequence, the federal government’s total debt continues to rise.”

- Bartlett claims that the total indebtedness of Fannie and Freddie and other GSEs has risen from \$2.8 trillion in 1997 to \$4.2 trillion at the end of September while new issues of Treasury securities have fallen dramatically over the same period. Bartlett adds that “between 1997 and 2000, while the total amount of Treasury securities declined by \$396 billion, adding this amount to capital markets, federal agencies such as Freddie Mac and Fannie Mae were increasing their indebtedness by \$1.3 trillion, taking that much back out the markets.” He explains, “In short, Uncle Sam is giving with the one hand, while he takes with the other. It is as if a private individual took out a home equity loan to pay down his credit cards.”
- 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. However, as Bartlett notes, “we may not know the full implications of this substitution for many years.”
- **Bartlett concludes, “those who think that paying down the national debt should be the first priority...ought to be looking much more closely at what Fannie Mae and Freddie Mac are doing. They will see that the federal government’s total indebtedness is declining much less than they think.** If it turns out there is a strong market demand for Treasury securities that will simply be satisfied by other forms of federal debt, then it greatly weakens the argument for paying down the national debt.” (*Washington Times op-ed* by Bruce Bartlett, 2/5/01)

Fannie Mae and Freddie Mac

Capital Markets Subcommittee Chairman Richard Baker is “frustrated” that the Congressional Budget Office (CBO) has not released its report on the federal subsidies that Fannie & Freddie receive due to their GSE status

- According to *National Mortgage News Daily*, Cong. Baker told reporters that he was “frustrated” that the CBO still has not released its report on the federal subsidies Fannie and Freddie receive due to their GSE status. Cong. Baker said he expected the CBO report to be out by now, but indicated that it would not prevent him from moving forward on introducing a GSE bill to strengthen regulation of the housing GSEs. The CBO is expected to release the study sometime this spring. The CBO study is an update of its 1996 study, which found that Fannie and Freddie receive \$6.5 billion in annual federal subsidies but passed through only \$4.4 billion to homeowners. The updated subsidy number is expected to be greater, since the GSEs are larger than they were in 1996. (*National Mortgage News Daily*, 2/15/01)
- A spokesman for Cong. Baker stated that he had not heard anything new on the release of the CBO report, other than it could appear in the next month. “We were told in December that it would be forthcoming,” said the spokesman. Financial consultant Bert Ely said sources told him that the report was undergoing an “intense review” and suggested that the delay in the report was not such a bad thing. “If the report had come out in January, it would have dropped out of sight,” said Ely. “Better to have it come out later, when it will have a higher profile in Congress.” (*Real Estate Finance Today*, Mike Sorohan, 2/26/01)

***National Mortgage News* editorial by Brian Collins claims “HUD has always been known as a mouse when it comes to regulating Fannie Mae and Freddie Mac”**

HUD has still not completed its preliminary fair lending review of Fannie & Freddie’s automated underwriting systems and “like HUD’s other efforts to get tough with Fannie and Freddie, was just another feint – based more on public posturing than clarity of purpose or determination”

HUD’s fair lending review of Fannie & Freddie’s automated underwriting systems “illustrates that HUD isn’t suited to be a regulator”

- Brian Collins with *National Mortgage News* wrote an editorial entitled “The Mouse that Didn’t Roar” describing HUD’s regulation of Fannie and Freddie, in particular the progress of HUD’s review of Fannie and Freddie’s automated underwriting systems to determine whether these systems discriminate against minorities. Collins notes that rumors were circulating at the end of the Clinton Administration that HUD would be releasing a “preliminary” review of Fannie and Freddie’s automated underwriting systems but “with each passing day, it appears the automated underwriting report, like HUD’s other efforts to get tough with Fannie and Freddie, was just another feint – based more on public posturing than clarity of purpose or determination.”
- Fannie initially resisted HUD’s examination of its automated underwriting system but HUD held its ground and threatened Fannie and its officer with fines if the information was not delivered. It was over a year ago that Fannie and Freddie provided information to HUD. Collins writes, “HUD has always been known as a mouse when it comes to regulating Fannie Mae and Freddie Mac.” Thus, the industry was “shocked” when HUD opened up another regulatory front – and requested

information on Fannie and Freddie's new business activities, which it felt, may be beyond the GSEs' charter mission. Collins adds, "It sounded like a mouse had roared." However, the fair lending review of Fannie and Freddie's systems has not materialized and the activity reviews "seem to be forgotten."

- Collins notes that then-HUD Secretary Andrew Cuomo issued press releases and made announcements about HUD's fair lending and activity reviews, which allowed him to claim that HUD was an "effective regulator." However, as Collins notes, "this whole episode illustrates that HUD isn't suited to be a regulator."
- Collins recommends that HUD Secretary Mel Martinez "would do himself a real favor if he could get this regulatory monkey off HUD's back." First, Collins recommends that HUD give all the Fannie and Freddie automated underwriting data and codes to the GAO or OFHEO to review. Second, Collins recommends that HUD should insist on setting Fannie and Freddie's affordable housing goals but give up HUD's responsibility for reviewing the GSEs' activities and mission compliance. "After all," Collins says, "HUD just doesn't have the capacity or the will to the job." As one HUD Assistant Secretary told Collins: "We basically find out about new products after they are on the market, and there is no requirement to notify us prior to that." (*National Mortgage News Editorial*, Brian Collins, 2/14/01)

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:

- (1) Federal Reserve Chairman Alan Greenspan says as the supply of Treasurys dwindles, the Fed is looking at alternatives to Treasurys for its monetary policy, including bonds issued by US states and foreign governments**
- (2) *Dow Jones Newswire* reports that the Fed regards GSE debt as a substitute for Treasurys, but the Fed appears wary of the GSEs' growth and its highly political sensitivity**
- (3) Former Treasury Department official says the status of GSE debt needs to be more clearly defined because foreign central banks may not understand the status of GSE debt [whether GSE debt enjoys an implied government guarantee]; urges an aggressive educational campaign to inform foreign central banks of the risks involved in investing in GSE debt**
- (4) Foreign investors dumped a large amount of Treasurys last year and offset those sales with purchases of GSE agency debt securities; Foreign central banks continue to increase their purchasing of GSE agency debt securities**
- (5) Freddie's debt issuance in Europe is costing more than anticipated**
- (6) Freddie's long-term debt attracts an unusual number of foreign buyers**
- (7) Freddie offers multi-family borrowers the option of benchmarking their interest rate to Freddie's Reference bill debt, using Freddie's debt as an index instead of the London interbank offered rate (LIBOR)**
- (8) Freddie expands its Internet debt auctions**
- (9) Freddie ties its biggest-ever debt sale in a single day**
- (10) Chicago Board of Trade to launch newest GSE futures on March 23**
- (11) New bond service, AgencyPX, will provide up-to-the-minute pricing of GSE agency securities**

Background on GSE debt

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

Federal Reserve Chairman Alan Greenspan says as the supply of Treasuries dwindles, the Fed is looking at alternatives to Treasuries for its monetary policy, including bonds from US states and foreign governments

- On February 13 in his semi-annual report to Congress, Federal Reserve Chairman Greenspan said that as the supply of Treasuries falls, the Fed is looking at alternatives for its day-to-day administration of monetary policy, including bonds from US states and foreign governments. Greenspan testified that the Fed last year “initiated a study of alternative approaches to managing our portfolio.” Officials throughout the system, both at the 12 regional Federal Reserve Banks and at the Fed board in Washington, are involved. Greenspan further noted that on January 31, the Federal Open Market Committee (FOMC) asked staff members “to explore the possible mechanisms for backing our usual repurchase operations with the collateral of certain debt obligations of US states and foreign governments.” Greenspan said, however, the Fed will consult with Congress before taking any further consideration of such transactions. One of the Fed’s key concerns is that it does not want its operations to affect the prices of any private-sector securities.
- Merrill Lynch & Co.’s Chief Municipal Strategist Philip Fischer said “The Fed needs tools for monetary policy, and municipals are under consideration because they are a sovereign market.” Fischer confirmed that the Fed has been discussing the plan to use municipal bonds with Merrill Lynch for several months. According to a Merrill Lynch research report released on February 23, Merrill expects the Fed to ask Congress to buy long-term municipal bonds for use in open market operations this year or next. The report also indicates that the Fed is considering purchasing “better credits” – or the debt of higher-rated and therefore better-managed states – and called the idea “problematic politically.” The report, written by Senior Government Strategist Gerald Lucas and Senior Municipal Strategist Philip Fischer, noted that the Fed is only allowed to purchase short-term municipal securities with maturities of six months and shorter. The Merrill team does

not expect Congress to step in the way of the Fed, given that Fed purchases of state debts would lead to lower interest rates on state borrowings.

- Already, the trading desk at the Federal Reserve Bank of New York, which conducts open market operations, has used mortgage-backed securities guaranteed by US agencies like Fannie and Freddie instead of Treasuries. That change was made in August 1999 in preparation for the Year 2000 changeover. On January 31, the Federal Open Market Committee renewed that authority.
- In the Fed's separate report to Congress, it noted that the Treasury market has become "somewhat less liquid" than several years ago and noted that the GSEs continue to issue large amounts of debt. "Trading volume and dealer positions in agency securities have risen considerably since 1998," said the report. "Fannie Mae and Freddie Mac continued to issue large amounts of debt under their Benchmark and Reference debt programs, which are designed to mimic characterizations of Treasury securities – such as large issue size and regular calendar of issuance – that are believed to contribute to their liquidity," the Fed said. "By the end of 2000, the two firms together had more than \$300 billion of notes and bonds and more than \$200 billion of bills outstanding under these programs," the Fed observed. "Also," several exchanges are listing options and futures on agency debt securities, said the Fed. "Open interest on some of those futures contracts has picked up significantly, although it remains small compared to that on futures contracts on Treasury securities." (*Reuters*, Chris Sanders, 2/13/01; *Reuters*, 2/23/01; *Dow Jones Newswire*, Jonathan Nicholson, 2/13/01; *Dow Jones Newswire*, John Connor, 2/13/01; *Washington Post*, John Berry, 2/20/01)

Dow Jones Newswire reports that the Fed regards GSE debt ("agency debt") as a substitute for Treasuries, but the Fed appears wary of the GSEs' growth and its highly political sensitivity

- As noted in the previous story, the Fed is considering alternatives to Treasuries for its administration of monetary policy. Tyler Lifton with *Dow Jones Newswire* notes that the Fed is "walking a delicate line in its public stance towards the agency debt market." The Fed has recognized that agency debt is a viable alternative to Treasuries and recognizes the value of agencies in providing liquidity but the Fed "appears wary of the sector's growth and cognizant of the highly sensitive political cauldron that the agency market currently stews in." "There's no chance (agencies) will be singled out as an asset class" to be purchased outright by the Fed, said Chief Economist Lou Crandall at Wrightson Associates. Some market pros argue that part of the reason why the Fed hasn't been purchasing agencies is because it doesn't want to be perceived as endorsing agency credit. Yet, the Fed seems to recognize the value of agencies in providing liquidity in its report to Congress. Glenn Baker, the head of fixed-income at Brown Brother Harriman & Co., noted that as a matter of necessity the Fed may eventually have to begin purchasing agencies. Baker stated, "The Fed will ultimately find itself in the position of needing to buy agency securities in the same way it buys Treasuries now." However, Wrightson's Crandall noted that Greenspan's recent comments to Congress indicating that the Fed was considering accepting municipal and foreign government debt as alternatives to Treasuries "lessens the sense that agencies have a privileged position." (*Dow Jones Newswire*, Tyler Lifton, 2/21/01)

Former Treasury Department official says the status of GSE debt needs to be more clearly defined because foreign central banks may not understand the status of GSE debt [whether GSE debt enjoys an implied government guarantee]; urges an aggressive educational campaign to inform foreign central banks of the risks involved in investing in GSE debt

- **Former Assistant Treasury Secretary for International Affairs Edwin Truman stated that foreign central banks may not understand the status of securities issued by Fannie and**

Freddie, a potential problem as the supply of US Treasuries falls. “It is highly desirable that the status of the government-sponsored enterprises and of their debt obligations is established clearly and promptly because of the potential for the obligation of these entities to be treated as close substitutes for US Treasury securities with a de facto official guarantee,” stated Truman, who now is a Senior Fellow at the Institute for International Economics. Truman gave his remarks at a panel discussion sponsored by the American Enterprise Institute on February 23.

- **Truman recommends that Congress pass “appropriate legislation” setting GSE capital requirements and defining the status of GSE debt. “Absent such legislation, the US monetary authorities should conduct an aggressive educational campaign to address in advance the moral-hazard issues involved. This campaign should focus on foreign monetary authorities because too many of them operate in domestic environments where government guarantees are both implicit and frequently and successfully implemented,” he said.**
- In an interview with *Dow Jones Newswire*, Truman noted that the need for GSE legislation increases as the US nears the paydown of all of its Treasury debt in coming years. “It’s an issue that needs to be addressed,” he stated. (*Dow Jones Newswire*, Jonathan Nicholson, 2/23/01)

Foreign investors dumped a large amount of Treasuries last year and offset those sales with purchases of GSE agency debt securities; Foreign central banks continue to increase their purchasing of GSE agency debt securities

- According to a February 13 monetary policy report issued to Congress by the Federal Reserve, private foreign investors sold a large amount of US Treasuries last year and fully offset those sales with purchases of GSE agency debt securities. Foreign investors set a record for purchases of agency debt securities in 2000. Net purchases totaled more than \$100 billion, way above the previous record of \$72 billion set in 1999. On the other hand, foreign investors sold on net about \$50 billion in Treasuries, compared with net sales of \$20 billion in 1999.
- Foreign central banks also increased their purchasing of GSE agency debt securities. As of the week of February 5, the New York Federal Reserve held \$106.5 billion of agency securities in custody for foreign accounts, largely central banks – which is \$23.6 billion more than was held in custody by the New York Fed in 2000, when it first began releasing the numbers. In comparison, the New York’s Fed’s custody holdings of Treasuries over the same time period decreased by \$16.6 billion to \$595.3 billion. (*Dow Jones Newswire*, Tyler Lifton, 2/13/01)

Freddie’s debt issuance in Europe is costing more than anticipated

- Freddie’s European benchmark program has been costlier than anticipated and may be getting even more expensive with the entrance of new competition. The premier German agency Kreditanstalt fuer Wiederaufbau (KfW) now plans to offer a benchmark bond in the euro sector. Analysts believe KfW and Freddie will be fighting for the same buyers, and “homegrown” KfW could be more attractive to European players. “Freddie has a relatively arrogant attitude in the US, which they can afford to have,” said one European banker. “In Europe, investors say I can buy KfW, which carries an explicit guarantee.” The article notes that if faced with a choice between KfW and Freddie, it appears European investors would prefer the German securities “hands down,” which cannot be comforting to Freddie.
- Freddie’s euro deals have already been more expensive than anticipated. One reason is that investors are confused about Freddie Mac bonds’ stability as a benchmark. While KfW bonds are

explicitly guaranteed, Freddie's recent political challenges have convinced some European traders that the bonds do not enjoy the full support of the federal government.

- On February 27, Freddie launched its third euro reference note deal, a euros 5 billion, 3-year issue. Freddie priced its offering at 0.09 percentage point under swaps, or 0.17 percentage points over the French government bond, a level deemed by some market participants as expensive. When Freddie established its euro reference deal last year, it hoped that generous pricing on the initial deals would soon give way to more cost-effective funding as European investors became more familiar with its name and credit quality. While Freddie's first two euro reference deals were considered successful, they also cost the company more than expected because of the differential between dollar funding and euro funding. For example, the first deal in September 2000 essentially forced Freddie to give up about eight basis points in spread by issuing in euros rather than in dollars. After three deals, Freddie is still paying investors a yield premium of around 4 basis points to comparable European borrowers such as KfW and the European Investment bank. (*Investment Dealers Digest*, Simon Boughey, 2/19/01; *Financial Times-London*, Rebecca Bream, 2/28/01; *Wall Street Journal*, 3/1/01)

Freddie's long-term debt attracts an unusual number of foreign buyers

- Freddie sold \$1 billion of 30-year bonds on February 13, placing an unusually high number (10%) of the long-term debt overseas. "This is pretty rare. Generally, the long bonds are thought of as an American instrument and I think 100 percent so...placed, distributed and traded in the United States," said Jon Prince, Managing Director of Debt Marketing at Freddie. "This represents a break," said Prince. "It's a sign of a forthcoming trend, I think, toward full use of the GSE yield curve by foreign investors." (*Reuters*, Lynn Adler, 2/13/01)

Freddie offers multi-family borrowers the option of benchmarking their interest rate to Freddie's Reference bill debt, using Freddie's debt as an index instead of the London interbank offered rate (LIBOR)

- According to Poonkulali Thangavelu with *National Mortgage News*, borrowers who use Freddie's multifamily adjustable-rate mortgage or Freddie's multifamily revolving credit facility can now choose to base their interest rate on a Freddie Reference bill instead of the LIBOR. Freddie's Reference bill-based ARM is available in 3-, 5-, 7-, or 10-year long terms and can be converted to a Freddie fixed-rate loan at any time without a conversion fee. Borrowers can base their interest rates to either a one-month or three-month Reference note. Freddie said its revolving credit facility using the Reference bill index will offer a 1-month and 3-month Reference bill index option. (*National Mortgage News*, Poonkulali Thangavelu, 2/26/01)

Freddie expands its Internet debt auctions

- Freddie expanded its Internet debt auctions to include two- and three-year Reference Notes on February 9. Previously, the Internet auctions had been limited to 12-month bills. The February 9 issue was the first in a series of Internet-based Dutch auctions and represents the first time the new term-debt global issues have been priced and distributed by a GSE via Dutch auction. "We had our [12-month bills] available for the last year, but, this year, we're beginning the two- and three-year dollar-denominated Reference Notes," said Gazella Vallandingham, Freddie's spokesperson. "As for the euro-denominated Reference Notes, it will continue to be conducted in a more traditional selling group construct." Jerome Lienhard, Freddie's Senior Vice President for Investment Funding, stated "This inaugural Reference Note auction is a milestone in the ongoing development of the agency market." (*Real Estate Finance Today*, Chris De Reza, 2/19/01; *National Mortgage News Daily*, 2/9/01)

Fannie ties its biggest-ever debt sale in a single day

- Fannie sold \$11.5 billion of two- and five-year Benchmark notes, matching its biggest-ever debt sale in a single day (\$6 billion of two-year notes and \$5.5 billion of five-year notes). The company sold the same volume of Benchmark debt in August 2000, but that offering consisted of three maturities: two-years, 10-years, and 30-years. (*Washington Post*, 2/23/01; *Reuters*, Lynn Adler, 2/22/01)

Chicago Board of Trade to launch newest GSE futures on March 23

- The Chicago Board of Trade (CBOT) said it will launch open-outcry trading in its newest mortgage futures and options contracts on March 23. The proposed new futures and contracts are based on conventional 30-year mortgage-backed securities issued by Fannie and Freddie. The CBOT Board approved the new contracts on November 30 under the CFTC's recently adopted exchange certification procedures. (*Reuters English News Service*, 2/21/01; *Dow Jones Newswire*, Daniel Rosenberg, 2/21/01)

New bond service, AgencyPX, will provide up-to-the-minute pricing of GSE agency securities

- A new bond service, Agency PX, will offer up-to-the-minute pricing of federal agency securities, as well as selected news from *Dow Jones Newswire*. The service will also list trading levels in the recently established when-issued market in agencies, where bonds trade after an issue has been announced but before it has been priced. Agency PX will be offered through GovPX, a fixed-income pricing and data service, and interdealer broker Garban Intercapital plc. It will be available via the Internet and through more traditional financial data vendors. Agency PX will be available on terminals of vendors including Bridge Information's Telerate, Bloomberg LP and Reuters Groupo plc. (*Dow Jones Newswire*, Tyler Lifton, 2/12/01)

Fannie & Freddie expand their technology to brokers, realtors, and consumers

[Editorial Note: Such expansion conflicts with the Mortgage Bankers Association's (MBA) policy statement on the GSEs – "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)]

GSE technology news:

- (1) Fannie, Univision, and Countrywide launch Web channel for consumers**
- (2) HomeStore.com [of which Fannie is an investor] has acquired substantially all the assets of Homebid.com which allows real estate professionals to manage offers and negotiate home sales**
- (3) Finet.com which was the first Web site to allow consumers to use Fannie's automated underwriting technology directly, announces reverse stock-split to boost its stock**
- (4) Fannie announces new enhanced "lender- and consumer-friendly" version of its automated underwriting system**
- (5) Fannie enhances its "true-cost calculator" for consumers**
- (6) ByOwner.com will approve customers using Fannie's automated underwriting technology**
- (7) Microsoft is selling HomeAdvisor Technologies – Will Freddie, which is already an investor, purchase HomeAdvisor?**
- (8) Freddie claims more than 10 million loans have now been processed through its automated underwriting system**
- (9) Freddie offers awards to brokers, including trips to Hawaii and a new car, when they use Freddie's technology**

Fannie:

Fannie, Univision, and Countrywide launch Web channel for consumers

- According to *National Mortgage News*, Univision Online, Countrywide Home Loans, and Fannie have launched "Casa," a new channel on Univision.com. The organizations claim the channel will be the first online Spanish-language resource for homebuying and homeownership. "Casa" will offer users homebuying information, tools, and the ability to apply for a loan on the Internet. Countrywide will provide consumers with mortgage information and the ability to apply for a loan online and Fannie will provide technology enabling Countrywide to provide additional mortgage products on the Web site. Univision Online is a subsidiary of Univision Communications Inc. (*National Mortgage News*, 2/6/01, 2/19/01)

HomeStore.com [of which Fannie is an investor] has acquired substantially all the assets of Homebid.com which allows real estate professionals to manage offers and negotiate home sales

- HomeStore.com has acquired substantially all of the assets of HomeBid.com, an application service provider specializing in Web-based tools for the real estate industry. The purchase includes the intellectual property rights for HomeBid's Offer Manager Technology, which allows real estate professionals to manage offers and negotiate home sales online. Office Manager is expected to become part of HomeStore.com and the National Association of Realtors' eREALTOR.com, an electronic transaction platform to enable Realtors to help consumers move from pre-contact through home closing. eREALTOR.com is part of the first phase of the Realtors® Electronic

Transaction Platform. The eREALTOR.com transaction platform promises to enable Realtors to use the Internet in serving their customers' moves from initial contact through the home's closing and beyond into affinity services. The platform has an automated scheduling and workflow engine, an order center linked to real estate brokers' key trading partners, including title and escrow service providers, mortgage brokers, and inspection companies – and an electronic document storage and transaction archive. Collaborating on the platform are TOP PRODUCER, WyldFyre, REFormsNet as well as strategic and equity partners including the National Association of Realtors, GMAC Real Estate and GMAC Mortgage, Fannie Mae, the California Association of Realtors, and Cendant Corporation and its CENTURY 21, COLDWELL BANKER and ERA real estate brands. Other features include providing each buyer and seller with a private Web site and tools to track each step of their transaction so they can determine if it is on-time, and communicate with their agents or brokers to provide feedback and order services electronically. The consumer interface can be integrated seamlessly with brokers' or franchises' regional and national Web sites. In the first quarter of 2001, eREALTOR.com will be customized for brokers and national real estate franchisers to enable them to tailor the system to match their business and local market requirements. (*Inman News Features*, 2/26/01; *PR Newswire*, 1/15/01; *Inman News Feature*, 11/15/00; *Realty Times*, 11/15/00)

Finet.com, which was the first Web site to allow consumers to use Fannie's automated underwriting technology directly, announces reverse stock-split to boost its stock

- Finet.com announced a reverse stock split, as the company tries to boost its stock price. The split went into effect February 20 at a rate of 1-for-12 and as the company's stock was listed on NASDAQ under the new symbol of FNCCD. The stock had previously been listed as FNCCM, while the company was trying to boost its stock price to NASDAQ's minimum \$1 price so it could remain listed on NASDAQ. Analysts said the stock would get a boost, but it was uncertain how long that would last. Finet.com faces the possibility of being removed from NASDAQ because its stock has traded below \$1 since July 19, 2000. In early February, Finet's stock was trading at 18.75 cents per share. (*Inman News Feature*, 2/21/01)

Fannie announces new enhanced "lender- and consumer-friendly" version of its automated underwriting system

- Fannie announced enhancements to its automated underwriting system. According to Fannie, the new version, Desktop Underwriter 5.1, includes many new "lender- and consumer-friendly" features and capabilities. Lenders using the system will be able offer borrowers with good credit a Flexible 100 product, an extension of Fannie's Flexible 97 product. [Editorial Note: It is unclear whether lenders must use Fannie's automated underwriting system in order to offer consumers the Flexible 100 product. Lenders are required to use Fannie's system in order to offer consumers the Flexible 97 product.] Flexible 100 can be either a 30- or 15-year fixed rate product or can be offered as a 7/1 or 10/1 adjustable-rate mortgage that requires 3 percent from the borrower to be used toward transaction costs of their choosing. Additional changes to Desktop Underwriter 5.1 include making the financing terms available for nonpermanent resident aliens the same as those currently offered to US citizens and permanent resident aliens and increasing the amount of "cash back" that the borrower may receive from a limited cash-out refinance transaction to the lesser of 2 percent of the new loan amount or \$2,000. The new version also includes removing the limit on the number of financed properties for borrowers that purchase or refinance second homes or investment properties; modifying the evaluation of mortgages for borrowers with recent bankruptcies, foreclosures, or past due mortgages; and eliminating the minimum reserve requirements for all owner-occupied two- to four-unit properties. (*Fannie press release*, 2/6/01)

Fannie enhances its “true-cost calculator” for consumers

- Fannie introduced its newest version of the True Cost Calculator, an online tool that allows consumers to calculate all the costs of getting a mortgage including interest rate and points, mortgage insurance costs, appraisal fees, title insurance fees, and miscellaneous settlement charges. According to Fannie, the new version, True Cost Calculator 2.0, allows consumers to create a file and save multiple loan scenarios for comparison purposes without having to re-enter data. Fannie plans to add the True Cost Calculator to its consumer Web site, homepath.com in the coming weeks. (*Fannie press release, 2/7/01*) **An editorial in the April 2000 Mortgage Originator magazine stated that “I don’t mind Fannie Mae coming out with their new True Cost Calculator. I just wish they had named it something else. It makes all other cost calculators sound like they aren’t true. What I want to know is, did any government agency check Fannie’s calculator for accuracy? Or are they exempt under the Secondary Market Arrogance Act? I hope they don’t forget about all the regional differences in loan charges.** (*Mortgage Originator, April 2000*) [Editorial Note: Guaranty fees and technology delivery fees that Fannie and Freddie charge for their mortgage products should also be disclosed as part of the consumer’s cost of obtaining a mortgage.]

ByOwner.com will approve customers using Fannie’s automated underwriting technology

- ByOwner.com and HomeSide Lending formed a partnership that links their two Web sites. The online platform will be powered by Fannie’s automated underwriting technology, and will offer an online approval before customers select a property and promises users loan application information and documentation reductions of up to 50%. (*National Mortgage News Daily, 2/2/01*)

Freddie:

Microsoft is selling HomeAdvisor Technologies – Will Freddie, which is already an investor, purchase HomeAdvisor?

- Microsoft is selling the mortgage technology division of its joint venture, HomeAdvisor Technologies Inc. (HTI), and absorbing the venture’s other operations into Microsoft’s network. According to Microsoft, the company has reached agreements with its two remaining equity partners, J.P. Morgan Chase & Co. and GMAC-Residential Funding Corp. to dissolve their equity participation in the venture. Bank of America and Wells Fargo Home Mortgage pulled out of the venture after examining the start-up. (Freddie has provided significant technology contributions to HomeAdvisor Technologies and has a financial interest in the company.) While Microsoft seeks a buyer for HTI, Microsoft will integrate the HomeAdvisor.com consumer Web site and Realty Desktop, a transaction management product for the real estate industry, back into Microsoft’s portal, MSN, where both started before becoming pieces of HTI. Microsoft spokesman David Chase said the move was driven by Microsoft’s desire to concentrate more on core business. (*American Banker, Erick Bergquist, 2/20/01; National Mortgage News Daily, 2/16/01*)
- According to *National Mortgage News*, possible purchasers of HomeAdvisors mentioned include the Wendover subsidiary of EDS and Freddie Mac. Sources says Freddie needs a platform to match Fannie’s SBA (service-based-initiative). (*National Mortgage News, Scott Kersnar, 2/26/01*)

Freddie claims more than 10 million loans have now been processed through its automated underwriting system

- Freddie announced that its Loan Prospector and its Loan Prospector on the Internet processed the 10 millionth mortgage loan since the automated underwriting services’ original launch in 1995. In addition, Loan Prospector set a monthly volume record in January 2001 by processing more than

500,000 individual loan applications. Loan Prospector processed 3.8 million loans in 2000, almost one million more than in 1999. In its first year, Loan Prospector evaluated more than 38,000 loans. Today, it reaches that figure in one day, especially during the current increase in mortgage refinancing. Freddie's Vice President of Origination Services Patricia McClung said Loan Prospector on the Internet accounts for a third of all of the loans processed using Loan Prospector tools. (*National Mortgage News*, 2/19/01; *Freddie press release*, 1/31/01)

Freddie offers awards to brokers, including trips to Hawaii and a new car, when they use Freddie's technology

- According to *Origination News*, Freddie announced that it is awarding 10 brokers a trip to Hawaii and one broker a new Chrysler. Brokers that use Freddie's automated underwriting system, Loan Prospector on the Internet, will be eligible for the second annual Service Award. Freddie, with the help of the National Association of Mortgage Brokers, will select the 10 brokers from award entries and send them to the NAMB Annual Convention June 16-20 in Hawaii. At the conference, a drawing will determine the winner of a 2001 Chrysler PT Cruiser. (*Origination News*, 2/23/01)

OFHEO announces it intends to routinely disclose Fannie & Freddie's critical capital levels

OFHEO also announces a clarification of FAS 133 (new accounting rule for derivatives)

In related news, FAS 133 will decrease Freddie's stockholders' equity by \$2.5 billion, or about 16.8%

Some market pros note that the "volatility stemming from the accounting change underscores the antiquated nature of the regulatory rules" governing Fannie & Freddie

OFHEO to disclose critical capital levels

- OFHEO announced that it intends to routinely disclose Fannie and Freddie's critical capital levels as part of OFHEO's quarterly capital classifications beginning with the fourth quarter 2000. If the amount of Fannie and Freddie's core capital falls below this level, the company would have to be classified as critically undercapitalized and probably placed in conservatorship. (OFHEO also measures the GSE's minimum capital requirements and is in the process of finalizing risk-based capital requirements.)
- OFHEO Director Armando Falcon stated that Fannie and Freddie's decision to issue subordinated debt with a provision that ties possible suspension of interest payments to critical capital adds to the significance of that capital figure. OFHEO plans to incorporate the calculation of critical capital levels in a regulation later this year.
- As in interim measure, OFHEO also calculated Fannie and Freddie's critical capital level for the third quarter 2000: Fannie's core capital of \$19.870 billion exceeded its critical capital level of \$9.881 billion by \$9.989 billion; Freddie's core capital of \$13.866 billion exceeded its critical capital level of \$6.913 billion by \$6.953 billion. (*OFHEO press release*, 2/13/01; *American Banker*, Erick Bergquist, 2/20/01; *National Mortgage News*, Brian Collins, 2/19/01)

OFHEO clarifies FAS 133

- OFHEO announced that with the recent adoption of the Statement of Financial Accounting Standards 133 (FAS 133), both Fannie and Freddie will begin reporting certain amounts associated with their hedging activities through a separate component of equity known as "other

comprehensive income (OCI).” OFHEO has held that these amounts will be excluded from the companies’ calculation of statutory minimum capital. (*OFHEO press release, 2/13/01*)

FAS 133 will decrease Freddie’s stockholders’ equity

- According to Tyler Lifton with *Dow Jones Newswire*, FAS 133 will decrease Freddie’s stockholders’ equity by \$2.5 billion, or about 16.8%. **Some market pros note that the “volatility stemming from the accounting change underscores the antiquated nature of the regulatory rules” governing Fannie and Freddie.** One firm that watches the companies closely said it may even prompt OFHEO to update its regulations. “The volatility in Freddie’s book capital and changing accounting standards may force OFHEO to issue more guidance to both the GSEs and the public on the treatment of asset values,” wrote Federal Financial Analysts in a recent report. “FAS 133 might permit OFHEO to revise its regulatory capital calculation, now that the accounting standards have been formally issued,” according to the report. Some market professionals note that though Freddie’s decrease in capital from FAS 133 is currently retained under Freddie’s equity account, it could eventually affect earnings as the cash flow from items that had been hedged are reported in earnings. “The loss that’s in Freddie Mac’s stockholders’ equity is a loss that will eventually flow through to the income statement and affect retained earnings,” said Tom Linsmeier, Associate Professor of Accounting at Michigan State University. However, it is not possible to ascertain the time period over which this will occur, he said. Linsmeier said the potential effect on retained earnings means FAS 133 would impact regulatory capital because retained earnings are one of the items included in regulatory capital.
- Fannie did not disclose any information in its fourth quarter financial information statement regarding the effect of FAS 133. A spokeswoman for Fannie indicated that the company will publish a transition adjustment on its first quarter income statement. (*Dow Jones Newswire, Tyler Lifton, 2/8/01*)

ACB survey shows that thrifts sold a lower percentage of loans to Fannie & Freddie in 2000 as compared to 1999

- A survey by the America’s Community Bankers reported that thrifts and savings banks sold only 17% of their loan production into the secondary mortgage market in 2000. Nearly two-thirds of those loans were sold to private conduits/wholesalers and other financial institutions, while Freddie got a 21% share and Fannie received only a 12% share. The previous ACB survey showed that Fannie received 43% share sold in 1999, while Freddie received 21%. There were 223 respondents to the ACB survey. As noted by *National Mortgage News Daily*, Fannie entered into a partnership agreement with the ACB recently to increase its market share of the thrift market. (*National Mortgage News Daily, 2/2/01*)

Fannie Mae

Did Fannie pull its “FM Watch-bashing” Web site, FM Watch-Observer?

- [Editorial Note: Attempts to log in on Fannie’s FM Watch-Observer.com Web site over the past month have been unsuccessful. Did Fannie decide to discontinue the use of this Web site?] Background: Fannie launched the Web site back in December 1999 to voice its complaints about the then-new Fannie/Freddie watchdog group, FM Watch. Although Fannie claimed that the Web site was created by a bunch of “twenty somethings” that “threw this thing together,” the ultimate arbiter of content was Fannie’s Chief Communications Chief John Buckley. [Mr. Buckley recently left the company to take a new position at AOL.] Fannie’s then spokesperson David Jeffers said Fannie “sanctioned” the effort but didn’t direct it. [Mr. Jeffers recently left the company to head Fannie’s Northern Virginia Partnership office.] (*Dow Jones Newswire*, 11/23/99; *American Banker*, 12/3/99; *Mortgage-Backed Securities Letter*, 11/29/99; *National Mortgage News Daily*, 11/24/99; *National Mortgage News*, 11/29/99)

Fannie continues to try to exempt itself from predatory lending laws

- According to Brian Collins with *National Mortgage News*, the FDIC has issued draft guidance on the purchasing of “predatory” loans. Fannie reportedly supports the FDIC’s draft guidance but wants the FDIC to clarify that banks don’t have to worry about purchasing predatory loans when they purchase Fannie mortgage-backed securities. “(W)e respectfully urge you to advise your financial institutions that taking into account Fannie Mae’s anti-predatory lending policies and other distinguishing characteristics described above alleviates any concern regarding predatory lending,” Fannie says in its comment letter to the FDIC. (*National Mortgage News*, Brian Collins, 2/19/01)
- As reported in previous *GSE Reports*, Fannie successfully lobbied for a blanket exemption for Fannie and Freddie from a DC predatory lending bill. Also, the New York State Banking Department proposed new predatory lending rules exempting loans sold to Fannie and Freddie. However, the regulators received so many protests that they revised the law, and are seeking public comments on whether to exempt the loans.

The Mortgage Industry Standards Maintenance Organization (Mismo) – a coalition set up by the MBA - is working to create universal data exchange standards so that all mortgage participants can send electronic data in a common language and format

Fannie is objecting to Mismo’s automated underwriting standards

It is not clear if Fannie will develop its own standard and then require the rest of the industry to comply or will compromise with Mismo

- According to Erick Bergquist with the *American Banker*, the coalition, Mismo, was set up by the MBA to create universal data exchange standards so that all industry participants could send data in a common language and format, instead of having to calibrate their computer systems to accept and send data from multiple business partners using multiple formats. Observers note that if there is any hope for the industry to connect all the disparate players in the mortgage industry to handle paperless mortgages from origination to closing, it must agree on standards. In July, Mismo

released standards for several transactions, however, Fannie objected to Mismo's automated underwriting standard. Fannie's Managing Director Harvey Trimble claims the standards are overly complex and a "nightmare" to implement. Two months after Fannie's announcement, it became known that Fannie was developing its own standards. On December 5, the GSE sent out its own specifications to a few lenders and vendors for comment.

- "Our position is that we have been working with Mismo to help everyone understand the complexities of this, but we've never signed up to use and agree to transact with standards where we're the primary source of that transaction," said Fannie's Trimble. "It's the one-size-fits-all standard that we are really skeptical about. If one size were to fit all, and we were able to efficiently fit our transactions into it, no problem. But we haven't seen one size fit all, ever." Mismo's Chairman Gabriel Minton claims the group made the standards complex so that they would be flexible. A simple standard calling for the same data required to submit a loan to Fannie's Desktop Underwriter automated underwriting system would cause complications when sending the data to Freddie, he said. "The more parties you bring into it, the more complicated it gets." Mismo's Vice Chairwoman Lisa Bolelli said creating a different automated underwriting standard could cause a proliferation of different data exchanges and throw a wrench in the machinery of adopting an industrywide standard.
- Bergquist noted that it is not clear whether Fannie will develop its own standard and then require the rest of the industry to comply or will compromise with Mismo. Nick Karris, a Senior Analyst with Gomez Advisors, said he doubts that Fannie's development of its own standard would maximize adoption of a universal data standard for the mortgage business. According to Karris, if Fannie wants to develop its own standard, it must persuade others to follow, which may be challenging given the potentially competing interests in the market. "It will take a leader to bring cooperation and consensus, and that requires some openness, rather than simply forcing the standard onto other firms," said Karris. (*American Banker*, Erick Bergquist, 1/22/01)

***American Banker* runs profile piece on Fannie Mae CEO Franklin Raines**

Raines says his critics may have raised some legitimate issues, but despite criticisms, Raines says Fannie has no plans to change its ways. *American Banker* article says that "Raines is riding a growth machine...and he has no intention of reining it in."

Raines states, "Our view is that we should do more."

- Hillary Rosenberg profiled Fannie Mae CEO Franklin Raines in a recent *American Banker* article. Rosenberg noted that in the two years since Raines has taken over Fannie Mae, the GSE has faced a number of businesses and government interests that would like to contain the growth of the GSEs. Although he has had to defend the company from critics, Raines spoke "with equanimity about his opponents" and "even said he thought they had raised some legitimate issues."
- Rosenberg lists Raines' main opponents as Cong. Richard Baker (R-LA), Chairman of the House Financial Services Capital Markets Subcommittee that oversees the GSEs, and lobbying groups such as FM Watch. According to Rosenberg, Congressman Baker plans to follow up on the bill he proposed last year to increase regulation of the GSEs, despite receiving concessions from the GSEs that they would install additional financial safeguards.

- In addition to Cong. Baker, the addition of a Republican President and a conservative HUD secretary may pose problems for Raines and the GSEs. Also Senator Phil Gramm (R-TX), chairman of the Senate Banking Committee has announced that he may hold hearings on the GSEs. Rosenberg also notes that Federal Reserve Board Chairman Alan Greenspan's recent "pro-Republican tilt" on tax cuts could signal more critical questions from the Chairman regarding the GSEs' subsidies and that other groups such as the Citizens Against Government Waste also plan to address concerns about the GSEs this year. "We have no intention of backing off. Our ultimate goal is for them to be privatized," noted CAGW vice president Leslie Paige.
- However, Raines told Rosenberg that despite criticisms, Fannie has no plans to change its ways. Rosenberg writes that "Raines is riding a growth machine...and he has no intention of reining it in." Raines stated, "Our view is that we should do more."
- Fannie is particularly growing in profits. Raines pledged an ambitious goal to double earnings by 2003, with the company already halfway there. **The company's 14-straight years of growth can be traced to Raines' insistence that Fannie push the use of technology to all aspects of the mortgage industry – allowing for reduced risks and costs and rapid expansion. Raines explained to Rosenberg that he knew technology was the key after only a few days of work at Fannie Mae. It occurred to him that, "all of the company's billions of dollars are in the computers down in the basement...From there it struck me that our major competitive tool was technology and mating technology to mortgages." Rosenberg added, "technology, once considered a back-office function, would now be a key strategic resource."**
- **"But perhaps Mr. Raines has done too well. Fannie has grown faster than its historical market, prime residential real estate mortgages, and Mr. Raines has taken it deep into the subprime category – partly to keep up the 15% growth rate that investors have come to expect from the company."** Rosenberg notes that alarmed subprime lenders are protesting the GSEs' entry into this market, claiming their government subsidies give them an unfair advantage. **"Similarly, conservative political interest groups have taken aim, saying taxpayers funds should not support a giant growing like Topsy that has money of its own to invest."**
- Rosenberg noted that Raines has met with many critics, including Cong. Baker, members of FM Watch, the Treasury Department and the Federal Reserve, in order to explain Fannie's point of view.
- Rosenberg concluded the article by noting that Raines does not see much that could prevent him from meeting his goals for Fannie. He does not think that harsh legislation is possible with a divided Congress. Rosenberg notes that **"while the lobbyists will continue trying to weaken Fannie Mae in the marketplace, he [Raines] says he is ready to take them on."** Raines noted that, **"there is a school of thought that if you harass Fannie Mae, maybe they'll pull their punches...slow down...be not as good a company...But anybody who knows me knows that would be a very large tactical error. Anyone who thinks that trying to intimidate us would be productive be (sic) making a mistake."** (*American Banker*, Hillary Rosenberg, 1/31/01)
- In response to the profile piece, Raines wrote a letter-to-the-editor in which he states that he is prepared to defend Fannie against groups who have organized to prevent Fannie from "fulfilling its mission." However, he does not consider Cong. Baker or any other Congressional Member to be their "opponent." He expects to work with Cong. Baker this year. He states, "To suggest

otherwise constitutes a misrepresentation of the facts, and of what I said to your reporter.”
(*Franklin Raines letter-to-the-editor, American Banker, 2/2/01*)

- Despite Raines’ claim that he does not consider Cong. Baker his opponent, the *American Banker* ran a special report on the Year 2000. In its “Best of Banking” awards, the newspaper gives the title of “Brawl of the Year” to Congressman Baker vs. Chairman Raines.” The article gave an extensive timeline description of the GSE debate between Cong. Baker and Raines over the past year. (*American Banker, Dean Anason, 2/1/01*)

Fannie expands its lobbying team

- Fannie has hired three new outside lobbyists since the beginning of the year: Alison McSlarrow (McSlarrow Consulting), who was a former top aide to Senate Majority Leader Trent Lott (R-MS); Tony Rudy (Greenberg Traurig), who worked as a key aide to House Majority Whip Tom DeLay (R-TX); and Steve Ricchetti (Ricchetti Inc.), who was most recently a Deputy Chief of Staff in the Clinton White House. Fannie also ended its contract with Boland & Madigan, whose two name partners left the lobbying firm recently.
- In related news, the Fannie/Freddie watchdog group, FM Watch, hired Patton Boggs for its lobbying efforts. Tommy Boggs will be involved and Dan Moorehead will handle the day-to-day work. (*National Journal, Peter Stone, 2/24/01*)

Fannie claims it exceeded its affordable housing goals

- Fannie said it exceeded HUD’s affordable housing goals. Fannie said 49% of the \$259 billion mortgages it financed last year went to families with an income at or below the median income of the area in which they lived. HUD’s target was 42%. Fannie said nearly 31% of the housing units it helped finance were in “underserved” areas, which are areas with low incomes, high percentages of minorities or other factors. HUD’s target was 24%. Fannie and Freddie have been criticized in recent years for not doing enough to help low-income homeowners. (*National Mortgage News Daily, 2/5/01*)

Fannie will no longer require individual property appraisals for single-family new home construction

- Under the Master Residential Appraisal Process, Fannie announced that individual property appraisals are not required for each home in the project or subdivision. “The appraiser is allowed to perform an examination of the project subdivision site and neighborhood and provide an estimate of the value of the models to be built as well as the options or upgraded items to be offered,” Fannie said. (*National Mortgage News, 2/12/01*)

Freddie Mac

Citizens Funds, a socially conscious money management firm, adds Freddie to its list of “sin stocks” because of charges of racial discrimination at the company

- According to Jeff Benjamin with *Investment News*, Freddie has been officially added to the list of “sin stocks” by Citizens Funds, a socially conscious money management firm based in Portsmouth, NH. Citizens Funds’ President and CEO John Shields said the company is eliminating Freddie’s stock from the \$800 million Large Cap Core Growth Fund, despite Freddie being one of the better stocks in its portfolio last year (gaining nearly 48% over the past 12 months). **Citizens Funds has been watching Freddie since 1997, when the Equal Employment Opportunities Commission began a two-year investigation into charges of widespread discrimination at the company. Last November, a year after the EEOC confirmed the violations, Citizens conducted a final screen of the company to see if the situation had been remedied. “We started talking to management, and they weren’t moving,” said Shields. “This sends a message that these practices are being condoned.”** Shields further stated, “We recognize that there are no perfect companies...but it is a matter of how they react to it. “We think a company that behaves like this will underperform over the long term,” he said. (*Investment News*, Jeff Benjamin, 2/19/01)

Freddie was one of the top 10 corporate campaign contributors to the 1999-2000 election cycle

- According to a *CongressDaily* analysis, Freddie was the ninth largest corporate campaign contributor during the 1999-2000 election cycle. Freddie contributed a total of \$2,148,000 in soft money. The figures for the *CongressDaily* analysis were gathered from data provided by the FEC, Vote.net Solutions, and the companies themselves. (*CongressDaily*, 2/9/01)

Freddie names new Vice Presidents for Government Relations and Legislative and Regulatory Affairs

- Freddie announced that Jill Showell has been promoted to the position of Vice President, Government Relations. Freddie also promoted Peter Mahoney to the position of Vice President and Deputy General Counsel, Legislative and Regulatory Affairs. Prior to joining Freddie, Showell was the Mortgage Banking Association of America’s Legislative Director. She also held positions with Cong. Richard Lehman and the Democratic Congressional Campaign Committee. Mahoney came to Freddie in 1993 after working for a number of private law firms. (*Freddie press release*, 2/1/01)

Freddie’s former Assistant General Counsel joins Goodwin, Procter law firm

- R. David Whitaker, the former Assistant General Counsel at Freddie, joined the Goodwin Procter law firm’s Washington office on January 22. Mr. Whitaker is a specialist in laws and regulations governing electronic banking, specifically digital signatures and payment systems. (*American Banker*, 2/12/01)

Federal Home Loan Banks

Federal Housing Finance Board (FHFB) is “proceeding cautiously” on WaMu’s request to join the Dallas FHLBank while retaining membership in the Seattle FHLBank

FHLBank of Dallas says it will face “real challenges” if WaMu is not allowed to join the FHLBank of Dallas

FHLBank of San Francisco and World Savings objects to WaMu’s request for dual membership

- A Spokesman for the FHFB said it is “proceeding cautiously” and that is not clear at this point how long it will take for the FHFB to decide on WaMu’s request to join the FHLBank of Dallas while retaining membership in the San Francisco FHLBank. WaMu wants to join the FHLBank of Dallas because it recently acquired Bank United, which was a member of the FHLBank of Dallas. The FHFB is reportedly working on a proposal entitled “Systemwide Implications of Multi-District Member Operations” to address the issue, and is asking for comment on how and if regulators should ease the current rules, which allow institutions to join only the FHLBank district where its main office is located. The current rule provides one exception: different banks owned by the same holding company might be members of separate FHLBanks (e.g., a separately chartered WaMu subsidiary belongs to the Seattle FHLBank). However, WaMu’s case is open to challenge because it plans to fold Bank United into its existing charter. “There are 98 banks that, through their holding companies, already have multiple membership,” said John Von Seggern, President of the Council of FHLBanks. “That is not precedent setting. Having one bank under one charter is.”
- Opponents to WaMu’s dual membership request argue that dual membership would allow WaMu to play the different FHLBanks off each other in an effort to get more favorable loan and dividend rates. “It is a dangerous, dangerous precedent they are asking to set here,” said Dale Torpey, President and CEO of Community State Bank and Chairman of the FHLBank of Des Moines. “It would be to the advantage of one and the disadvantage of thousands.” WaMu’s Senior Vice President for Government Relations Benson Porter disagrees and notes that WaMu has never engaged in such behavior with the San Francisco and Seattle FHLBanks. Other FHLBank officials claim that WaMu’s request is simply a necessary modernization of the FHLBank System. FHLBank of Chicago President Alex Pollock noted in a press statement, “I view the Dallas application favorably, as part of the adjustment of the FHLBanks to the strategic fact of the consolidation of the American financial system.” (*American Banker*, Rob Garver, 2/14/01; *Dow Jones Newswire*, John Connor, 2/23/01)

FHLBank of Dallas says it will face “real challenges” if WaMu not allowed to join

- The FHLBank of Dallas says it would face “real challenges” if WaMu is not allowed to join the Dallas Bank. Bank United (which WaMu acquired) owns 25% of the Dallas FHLBanks’ capital stock and 18% of its outstanding advances. With Bank United’s departure, the Dallas Bank says it would have to reduce overhead and dividends, replace Bank United’s advance assets through an expanded mortgage purchase program, and possibly increase the cost of advances to small borrowers. However, the Dallas Bank argues that WaMu’s membership in the Dallas Bank would allow WaMu to “seamlessly” step into the place of Bank United. (*National Mortgage News Daily*, 2/14/01)

FHLBank of San Francisco objects

- According to *National Mortgage News Daily*, the FHLBank of San Francisco has filed an objection to the FHFBS on WaMu's application to become a member of the FHLBank of Dallas, until the whole issue of dual membership is fully resolved. WaMu is the FHLBank of San Francisco's largest member. The FHLBank of San Francisco warns that current law does not provide for dual membership and that the FHFBS may not have the authority to make a "special determination" for WaMu. "We do not believe that the arguments and information provided by the Dallas Bank...provide enough support for the Finance Board to take a step as far-reaching as approving the first-ever dual membership, and establishing the precedent thereby created, without going through a comprehensive rulemaking procedure," said FHLBank of San Francisco President Dean Schultz in a letter to the FHFBS. (*National Mortgage News Daily*, 3/1/01)

World Savings objects

- World Savings Bank is objecting to WaMu's application for dual FHLBank membership. World Savings argues that WaMu has not made a legal case for dual membership and that "the legal underpinnings of the petition are wrong." World Savings notes that "Simply because an entity is large should not be sufficient reason to disregard the basic structure of the FHLBank System, especially when so much is at stake," according to a World Savings letter to the FHFBS. "The result, they note, "will adversely affect us and other FHLB members," and that "all members of the FHLB System should be treated alike." World Savings argues that the "only outcome under the Finance Board's own regulations" is for the combined WaMu/Bank United to become a member solely of the FHLBank of San Francisco. (*National Mortgage News Daily*, 2/27/01; *Dow Jones Newswire*, John Connor, 2/23/01)

America's Community Bankers and 16 state trade groups urge changes in the final capital regulation for the FHLBanks

Groups would like FHFBS to publish for a 30-day comment period the capital plans of each of the 12 FHLBanks as they are submitted to the FHFBS for approval and to wait until all 12 plans are submitted before approving any plan

Groups urge FHFBS to require FHLBank members to purchase activity based stock for activities and programs, like the mortgage partnership programs

- America's Community Bankers and 16 state trade groups submitted a February 13 comment letter urging the FHFBS to modify its final capital rule for the FHLBank System. "While the final rule should give the FHLBanks the necessary flexibility to develop capital plans appropriate for their stockholders and ensure that a suitable degree of commonality exists, we request that the Finance Board make a couple of modest, but important changes," said the letter. To ensure the commonality among the FHLBanks' capital plans, adequate financial transparency for members across the 12 FHLBanks, and to avoid unintended competition among the capital plans, the groups asked the FHFBS to publish for a 30-day comment period the capital plans as they are submitted by the 12 individual FHLBanks and to wait until all plans are submitted before approving any FHLBanks' plan. The FHFBS was also urged to require (not just encourage) FHLBank members to purchase activity-based stock for such significant activities or programs as the mortgage partnership programs. The following groups signed the letter:

America's Community Bankers
Minnesota League of Savings & Community Bankers

Connecticut Bankers Association
Missouri League of Financial Institutions
Community Bank League of New England
New Jersey League Community & Savings Bankers
Community Bankers Association of New York State
Ohio League of Financial Institutions
Community Bankers Of Louisiana
Pennsylvania Association of Community Bankers
Heartland Community Bankers Association
Texas Savings & Community Bankers Association
Illinois League of Financial Institutions
Washington Financial League
Massachusetts Bankers Association
Western League of Savings Institutions
Michigan League of Community Banks

(ACB press release, 2/14/01; Letter by ACB and state trade groups to FHFB, 2/13/01)

- On December 20, 2000, the FHFB approved a new capital rule for the FHLBanks. The rule, effective on March 1, 2001, was published in the January 30 *Federal Register*. The FHFB had planned to discuss the capital rule at an open board meeting on February 28 (a meeting that has since been canceled). FHFB Spokesman Bill Glavin said the purpose of the upcoming discussion is to allow consideration of questions that may have arisen since the rule's approval. "The Board is asking for comments and questions that may have come up since the rule was published," he said. Although the rule is final, he said, "that doesn't mean [the Board] is not willing to make changes." (*BNA Daily Report for Executives*, 2/15/01) [See January 12, 2001 *GSE Report* for more information on the FHFB's capital rules.]

Wall Street Journal reports that Fannie & Freddie are increasingly facing competition in the secondary mortgage market from the FHLBank System's Mortgage Partnership Finance (MPF) program

However, Fannie & Freddie still dominate 90% of the secondary market for conventional home mortgages

Many banks, especially smaller regional ones say in certain situations they would rather sell mortgages to the FHLBanks than to Fannie & Freddie

- According to Joy Shaw with the *Wall Street Journal/Dow Jones Newswire*, Fannie & Freddie – which control 90% of the secondary mortgage market for conventional home mortgages – could be facing competition from the FHLBanks System's MPF program. Shaw reports that the MPF program is winning over mortgage lenders which otherwise might deal with Fannie and Freddie. She reports, "Many smaller regional banks say in certain situations they would rather sell mortgages to the FHLBanks."
- Since its inception in 1997, the MPF program has been growing exponentially, reaching \$15.4 billion by the year-end in 2000, compared to \$1.8 billion in 1999. Some in the market expect the program's assets to reach \$100 billion in 2001, "making it a genuine rival to Fannie and Freddie."

- The similarities between the MPF program and Fannie and Freddie include the fact that all three GSE programs perform secondary mortgage market functions and fund their purchases by issuing debt with low rates, based on their GSE status. There are differences, however, in the program. Among them, Fannie and Freddie securitize the mortgages they purchase into mortgage-backed securities, while the FHLBanks hold the mortgages rather than securitize them. Also, lenders pay Fannie and Freddie on average 0.20 percentage points of “guarantee fees,” leaving credit risk to Fannie and Freddie. In comparison, lenders are paid about 0.10 percentage points by the FHLBanks for retaining that risk.
- According to Shaw, smaller regional banks, in particular, are finding the MPF program more appealing than Fannie and Freddie. Shaw noted that FHLBank member institutions receive equal treatment in pricing and terms, while Fannie and Freddie tend to provide favorable pricing to larger banks through negotiations. Among those companies that prefer the MPF program to Fannie and Freddie is Community National Bank, Oregon, Wisconsin, which sold loans to Freddie until 1998. Community National Bank Vice President Dan Behrend said the company found it could make more money selling mortgages to the MPF program, and still offer lower rates to customers. With the MPF program’s better mortgage purchase prices, Community National Bank was able to offer mortgage rates on average about three-eighths of a point lower than if it had sold mortgages through Freddie Mac, stated Behrend.
- However, as Shaw reports, despite the MPF’s impressive 760% annual growth in 2000, the MPF’s \$15.4 billion of assets still were only a fraction of Fannie’s \$607 billion and Freddie’s \$386 billion mortgage portfolios at year-end 2000. “I think the market impact is fairly limited, especially with an explosion of supply we’re getting with this refinancing wave,” said Art Frank, Director of Fixed-Income Research at Nomura Securities International Inc. “There’s a little bit of competition for Fannie and Freddie, no question. But the Fannie and Freddie program is so huge that I think the impact is pretty modest.” Still, some mortgage lenders welcome the competition in the secondary mortgage market. “Fannie and Freddie have taken notice of the program, and as a result, they’re working hard to be competitors as well. [The MPF program] provides benefit, because it can cause the other two [Fannie and Freddie] to pay more attention, to sharpen their pencils on pricing when they work with us,” said Ed Hjerpe, Executive Vice President at First Federal Savings Bank of America, a unit of FirstFed America Bancorp. (*Wall Street Journal*, Joy Shaw, 2/6/01)

<p>Lenders say a securitization program and servicing-release option would benefit the MPF program</p>

- According to Brian Collins and Ted Cornwell with *Mortgage Servicing News*, some lenders would like the option to sell loans into the MPF program and release the servicing rights and credit enhancement on the loans. Some mortgage lenders are urging the FHLBanks to develop a securitization program and to allow them to sell their loans servicing-released. According to Collins and Cornwell, some of the lenders do not believe the FHLBanks can handle large volumes of loans unless they develop a securitization program. A securitization program must receive regulatory approval and would put the FHLBanks in direct competition with Fannie and Freddie in the secondary mortgage market. The FHLBank of Chicago (which developed the MPF program) is examining securitization and other options. An official with the FHLBank of Chicago indicated that they were working to facilitate transfer of servicing rights to other MPF-participating lenders. “We can act as a clearinghouse,” said the official. The MPF program, however, does not lend itself to a standard servicing release transaction that Fannie and Freddie offer their seller/servicers. The

FHLBank of Chicago insists that any servicing transfers must include the credit enhancement obligation that is attached to the loans. “If you are getting the servicing then you are also responsible for the credit risk of those loans,” said the FHLBank of Chicago official. (*Mortgage Servicing News*, Brian Collins and Ted Cornwell, 2/16/01)

FHFB cancels its open board meeting to discuss capital rule and WaMu’s request for dual FHLBank membership

- As reported earlier, the FHFB announced the cancellation of its February 28 open board meeting. Among the items that were scheduled to be considered during the meeting: (1) interim final rule on amendments to bank meeting regulation; (2) updated and revised FHFB’s Strategic Plan for 2000-2005; (3) Notice of Proposed rulemaking – Technical Amendments on affordable housing program; (4) Advance Notice of Proposed Rulemaking on Capital; and (5) Advance Notice of Proposed Rulemaking on multi-district member operations (WaMu’s request to join the Dallas FHLBank while retaining its membership in the Seattle FHLBank). (*Federal Register*, 2/15/01, page 10503; *Federal Register*, 2/22/01, pages 1169-1170)

Farm Credit System/Farm Credit Banks

FCA approves risk-based capital rules for Farmer Mac

- According to *Dow Jones Newswire*, the FCA approved final regulations February 21 establishing risk-based capital rules for Farmer Mac. Under the rules, Farmer Mac will be required to establish a stress test to determine the amount of capital needed to hold during a 10-year period under stressful credit and interest rate conditions. Farmer Mac will be required to run the stress test at least quarterly to determine the adequacy of its capital and to report the results to the FCA. The principal components of the stress test include data requirements, specifications of credit risk and interest-rate risk, and a cash-flow generator. (*Dow Jones Newswire*, Jennifer Corbett Dooren, 2/21/01)

Ginnie Mae

Ginnie Mae hopes to have a rural rental housing program in place by year end

- Ginnie Mae is hoping to have a rental housing program for underserved rural markets in place by year end. The details are still being worked out with the Department of Agriculture’s Rural Housing Service, but the goal, said Ginnie Mae Executive Vice President George Anderson is to address a market that “seems to be have fallen off the radar screen.” He stated, “We’re looking for ways to jump start the market for these loans.” Ginnie Mae Vice President of Multifamily Programs Steven Rigg stated, “It’s easy to overlook these out-of-the-way small markets.” Rigg further noted that Ginnie Mae would soon be issuing its first REMIC backed by multifamily mortgages. The two Ginnie Mae officials also noted that the agency is searching for ways to help meet the needs of the homeless and other underserved markets. (*National Mortgage News*, 2/12/01)

Ginnie Mae proposes regulations governing payments on Ginnie Mae I Modified Pass-Through Securities

- Ginnie Mae proposed regulations governing payments on Ginnie Mae I Modified Pass-Through Securities (“Ginnie Mae I MBS”), which would require payments on Ginnie Mae I MBS to depositories be made in immediately available funds. This requirement would supersede current provisions allowing payments to be made by check. Comments on the proposed rules are due by March 28, 2001. (*Federal Register*, pages 12428-12431, 2/26/01)

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