

The **GSE** REPORT TM

Contents of GSE Report TM

“Congress has given them [GSEs] a clear mission. Are they performing that mission or are they getting far beyond it? To what degree is the taxpayer on the hook as a potential holder of contingency liabilities? These are all things that periodically need to be looked at.” - Senate Banking Committee Chairman Phil Gramm (R-TX) (Bloomberg, 1/22/01)

“Congress ought to make clear the extent of its willingness to underwrite or guarantee the obligations of the GSEs, and if the guarantees are to be made explicit, Congress ought to examine carefully whether the GSEs are managing their affairs in a way that is consistent with the inherent risks they face.” - St. Louis Federal Reserve Bank President William Poole (Dow Jones Newswire, Brian Blackstone, 1/18/01)

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 - US federal regulators are considering a proposal that would lower the risk weighting for all US AAA-rated and AA-rated asset-backed securities (ABS) and mortgage-backed securities (MBS) to the same risk weighting capital treatment as Fannie & Freddie’s MBS
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Fannie Mae and Freddie Mac

- As Fannie & Freddie become giants in derivatives, some market professionals see risk (*p. 12*)
 - Jeff Wallace with Greenwich Treasury Advisors warns that Fannie & Freddie could suffer derivatives losses like the failed hedge fund Long Term Capital Management
 - Fannie has an “eye-popping” debt-to-income ratio of 2019% - the average for the financial services industry is 506%
 - The rapid growth of Fannie & Freddie’s outstanding derivatives has led some to wonder whether one or more of the GSEs’ counterparties may limit their exposure to the GSEs (a fate which often befalls hedge funds that have grown too large)
 - “That is definitely the theoretical concern. And it may not be so theoretical in the sense that more and more people believe that those companies [Fannie & Freddie] are no longer real AAA credits,” says Wallace.
- AEI’s Peter Wallison says Fannie & Freddie’s dual role of a public mission and maximizing profits to shareholders is a fundamental inherent conflict of interest (*p. 13*)
 - “It should be obvious that they cannot achieve both objectives.”
 - Congress and the executive branch have no effective control over Fannie & Freddie’s growth and no control over the risks they create for the taxpayers.” This is a “vicious and dangerous cycle...these agencies are literally out of control.”
 - “By combining the government’s exemption from market discipline with the aggressiveness of private-sector management, Congress has created a financial monster.”
- Fannie & Freddie announce record 2000 earnings (*p. 15*)
 - Fannie & Freddie’s earnings up 15% in 2000
 - Fannie boasts about its 14th consecutive year of record earnings; Freddie boasts about its 30th consecutive year of profitability, and 19th straight year of returns on common equity exceeding 20%
- Fannie begins issuing subordinated debt (*p. 16*)
 - Fannie’s first sale of subordinated debt attracted a broad investor base
 - Questions remain whether the market perceives Fannie’s subordinated debt as carrying an implied government guarantee (like the GSEs’ senior debt)
 - Freddie’s subordinated debt receives a prospective rating of AA- from Standard & Poor’s and a rating of Aa2 from Moody’s Investors Service
 - Merrill Lynch creates new index to accommodate Fannie & Freddie’s subordinated debt
- DC Mayor Anthony Williams signs DC predatory lending bill that gives a blanket exemption to only Fannie & Freddie (*p. 18*)
 - Fannie Chairman Franklin Raines personally lobbied for Fannie to be exempt from the DC bill
 - Industry and consumer groups oppose a blanket exemption for Fannie & Freddie
- Fannie & Freddie expand their technology to brokers, realtors, and consumers (*p. 19*)
 - [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 customers of 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*)]
- MBA, ABA, ACB and ICBA ask HUD to withdraw its proposal requiring Fannie & Freddie to collect and report additional data on mortgage loans (*p. 22*)
 - Proposed rule is part of HUD’s new affordable housing goals for Fannie & Freddie
 - Financial services trade groups believe it would burden primary mortgage lenders without giving them a chance to comment – groups say the notice does not spell out the specific data elements to be collected
- Customized home loans are starting to appear in the market, but consumer groups worry that if customized mortgage loans rely on the automated underwriting systems of Fannie & Freddie, minority homebuyers could suffer (*p. 24*)
 - HUD was expected to close its fair lending review of Fannie & Freddie’s automated underwriting systems by the end of 2000
 - An independent study by the Urban Institute in March 1999 found that Fannie & Freddie’s underwriting guidelines might inadvertently have a disparate impact on minority borrowers

- Economists question whether America is “overinvesting in housing” (p. 25)
 - US government’s sponsorship of Fannie & Freddie is one of the more controversial ways the US government supports homeownership
 - When Fannie & Freddie were first created, far fewer Americans owned homes, but now many of the beneficiaries of housing subsidies are relatively wealthy and can easily pay a slightly higher interest rate on their mortgages

Fannie Mae

- Fannie launches pilot program that offers 1% down-payment mortgages with no mortgage insurance (p. 26)
- Fannie announces partnership with America’s Community Bankers (p. 26)
 - ACB and Fannie declined to discuss whether there would be any guarantee fee discounts involved
- Fannie is losing two top-level communications staff (p. 27)
- Fannie involved in a dispute with District of Columbia officials over the city-owned John Wilson Building (p. 27)
- Fannie forms partnership with the Neighborhood Reinvestment Corp. (p. 28)
 - Fannie will sponsor HomeOwnership Centers for one-stop shopping for services and training needed to shop for, buy, rehabilitate and insure a home
- Fannie’s national disposition center will manage the renovation and sale of San Antonio-owned vacant properties (p. 28)
 - [Editorial Note: This appears to run counter to Fannie’s claims last year that it was exiting the business of selling foreclosed properties for third parties.]
- Fannie invests \$100,000 in two credit unions (p. 29)
 - [Editorial Note: Investing in lending institutions seems outside of Fannie & Freddie’s mission of providing liquidity to the secondary mortgage market.]
- Fannie announces \$14 million construction loan pilot program in New Jersey (p. 29)
- DC Housing Authority obtains \$33 million loan from Fannie and Bank of America (p. 29)
 - First time a public housing entity has been approved for a loan leveraged against future funds to be allocated to the DC Housing Authority by HUD
- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its partnership offices in press events (p. 30)
 - Fannie has 44 Partnership Offices open across the country
 - Financial consultant Bert Ely believes Fannie’s media events raise ethical questions. “This is an extension of not only their lobbying, but also their political action committee contributions,” he said. “Everybody knows what they’re doing. It’s something that many of us find offensive, but that’s how they play the political game.”
 - Fannie claims its partnership offices were created “to get away from Washington,” yet *Real Estate Finance Today* reports that during the first eight months of 2000, Fannie held no fewer than 87 media opportunities across the county with Congressional Members

Freddie Mac

- *American Banker* article reports that “Freddie showed it can play lobbying game effectively” (p. 33)
 - Article reports on Freddie’s efforts to weaken HUD’s newly issued affordable housing goals for Fannie & Freddie
 - Allen Fishbein with the Center for Community Change notes that “Freddie’s lobbying game will hurt poor households
 - Freddie’s action is “likely to reinforce the view shared by many, both inside and outside of government, that these publicly chartered housing enterprises have far too much influence over public policy”
- Freddie’s new CFO provides expectations for Freddie’s business prospects in 2001 (p. 34)
 - Company will expand into new markets, move further into subprime, and use its technology to move closer to the point-of-sale
- Freddie guarantees a \$1.39 billion home equity deal by Option One (p. 34)
 - [Editorial Note: The majority of home equity loans are made to middle- to higher-income, non-minority homeowners for debt consolidation. Home equity borrowers already own their own homes. Home equity loans are a consumer product, not a product that helps homebuyers purchase a home.]

- Freddie issues new guidance to seller/servicers on its policies regarding predatory lending (*p. 34*)
 - Guidance issued in response to HUD's new affordable housing goal for Fannie & Freddie that prohibit the GSEs from receiving affordable housing credit toward their affordable housing goals for mortgages subject to HOEPA and with certain predatory features
- Freddie launches \$100 million initiative to increase homeownership in eastern North Carolina (*p. 35*)

Federal Home Loan Banks

- Freddie's former CFO, John Gibbons, joins the FHLBank of Chicago (*p. 35*)
 - Gibbons will focus on business strategy, including the FHLBanks' Mortgage Partnership Finance (MPF) program
 - FHLBanks' MPF program grew 760% in 2000
 - MPF program is becoming a strong competitor to Fannie & Freddie in the secondary mortgage market
 - *Crain's Chicago Business* says MPF program is giving Fannie & Freddie "a run for billions"
- Federal Housing Finance Board (FHFB) extends comment period on whether to permit Washington Mutual Bank – a member of the FHLBank of San Francisco – to also join the FHLBank of Dallas (*p. 36*)
 - HHFB will also allow any interested persons to comment
- Federal Housing Finance Board publishes final capital rule for the FHLBank System in the *Federal Register*(*p. 36*)

Farm Credit System/Farm Credit Banks

- Farm Credit Administration (FCA) releases pre-publication of its controversial proposed rule on granting national charters to Farm Credit System banks (*p. 37*)
 - The proposal varies little from the original guidance FCA issued on national charters
 - Former House Banking Committee Chairman Jim Leach (R-IA), the Treasury Department, the Government Accounting Office, the American Bankers Association, and the Independent Community Bankers of America criticize the proposal

Ginnie Mae

- Ginnie Mae is considering "Ginnie Mae Choice" program that would allow Ginnie Mae to securitize high LTV loans that Fannie & Freddie won't securitize (*p. 39*)
 - One mortgage industry professional says, "I think we'll hear Fannie Mae scream a bit about this"

Major Events

Senate Banking Committee Chairman Phil Gramm (R-TX) plans to “take a long, hard look” at the GSEs but will proceed cautiously

Senator Gramm plans to hold private meetings with the GSEs

Senator Gramm wants to examine how well the GSEs fulfill their Congressional mandate to lower the cost of purchasing a home, whether the GSEs are unfairly competing, and whether any legislative changes are needed

- Senator Phil Gramm briefed reporters on January 22 about his Committee’s agenda for the 107th Congress. Among other things, Senator Gramm said he would like to evaluate and “take a long, hard look” at the activities of the GSEs. Senator Gramm emphasized he will proceed cautiously and that he is “going to try to do it in such a way that nothing we do or say is going to have an impact on their ability to market securities.” Senator Gramm acknowledged the work of Cong. Richard Baker (R-LA), who introduced a GSE bill and held extensive hearings on the GSEs during the 106th Congress. Last year, Fannie officials complained that GSE hearings by Cong. Baker raised their borrowing costs and drove down their stock prices. Senator Gramm said he has followed Cong. Baker’s GSE hearings “very carefully.”
- Senator Gramm said that any Committee activities related to the GSEs would be wholly bipartisan, and said he intended to ask Senate Banking Committee Ranking Member Paul Sarbanes (D-MD) to join him in “private discussions with each [GSE] about... what it is doing and what its plans are.” Senator Gramm said he would like to assess the GSEs’ ways of doing business. Specifically, he wants to examine how well the GSEs fulfill their Congressional mandate to lower the cost of purchasing a home, whether the GSEs are unfairly competing with commercial banks, and to determine if any legislative changes are needed. **He stated, “I think we ought to begin with private discussions with them [GSE chiefs] about GSEs; their role in America, what they’re doing, to what degree are they staying within the mandate that Congress set out, to what degree are they using potential subsidies to get into other business where they’re advantaged over other competitors, to what degree is there any need for legislative change.”** He also stated, “Congress has given them a clear mission. Are they performing that mission or are they getting far beyond it? To what degree is the taxpayer on the hook as a potential holder of contingency liabilities? These are all things that periodically need to be looked at.”
- He said he would make no decision about public hearings on GSEs until the conclusion of those private meetings. “I want to be sure that nothing I do or say will have an impact in the market,” he said. “Although it’s hard to believe the markets would move on what some politician in Washington says.” **Wrapping up his comments on the GSEs, Senator Gramm stated, “It’s something we’re going to look at, but we’re going to do it in a very responsible manner and we’re going to do it on a bipartisan basis.”** (*Dow Jones Newswire*, John Connor, 1/22/01; *BNA Daily Report for Executives*, Adam Wasch, 1/23/01; *National Journal’s Congress Daily*, 1/22/01; *Wall Street Journal*, Nicholas Kulish, 1/23/01; *Dow Jones Newswire*, Dawn Kopecki, 1/22/01; *Bloomberg*, Rob Wells, 1/22/01; *American Banker*, Rob Blackwell, 1/23/01; *National Mortgage News Daily*, 1/22/01; *National Mortgage News*, Brian Collins, 1/29/01; *Real Estate Finance Today*, Mike Sorohan, 1/29/01)

Fannie comments about Senator Gramm's statements

- “The emphasis on there being a bipartisan private conversation...is from our perspective very positive,” said Fannie Spokesman John Buckley. Buckley further noted that Senator Gramm did not commit to hold public hearings or to any kind of legislative approach. (*National Mortgage News*, Brian Collins, 1/29/01)

FM Watch comments about Senator Gramm's statements

- **FM Watch Executive Director Mike House noted that Senator Gramm's statements shows “people continue to appreciate and understand that the GSEs are a problem that has to be dealt with. It also shows that the problem is not going away and GSEs cannot wish it away or talk it away,” he said.** (*National Mortgage News*, Brian Collins, 1/29/01)

Senator Gramm names five Subcommittee Chairmen

- In related news, Senator Gramm announced the Chairmen who will preside over the five Subcommittees within the Senate Banking Committee, with jurisdiction over Fannie, Freddie, and the FHLBanks split between two Subcommittees. Senator Wayne Allard (R-CO) will head the Subcommittee on Housing and Transportation, which will have jurisdiction over Fannie, Freddie, and HUD. Senator Robert Bennett (R-UT) will chair the Subcommittee on Financial Institutions, which will focus on matters including e-commerce, banks and savings associations, deposit insurance, the regulatory activities of the Federal Reserve System, and the FHLBank System. (*Dow Jones Newswire*, John Connor, 2/1/01)

Cong. Richard Baker (R-LA) to chair subcommittee with jurisdiction over GSEs

Cong. Baker says he will move “aggressively” on GSE legislation, and plans to introduce a bill in March

Cong. Baker plans to hold hearings before his panel probably in February

- Congressman Richard Baker was officially named the new Chairman of the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises with jurisdiction over the capital markets, securities, insurance generally, and government-sponsored enterprises. (*Financial Services Committee press release*, 1/26/01) According to *Dow Jones Newswire*, Cong. Baker stated that he plans to move “aggressively” on GSE legislation that would create a new, more powerful GSE regulator. **“The message to taxpayers, GSEs and the markets is that we are going to have a new regulator that is fully funded with time lines” for implementing capital standards and conducting various studies,” he stated.**
- Cong. Baker, who introduced a GSE bill during the 106th Congress, claims that his chances for passage of a GSE bill in the 107th Congress “are measurably improved” from the last Congress and he plans to introduce a bill in March. **Cong. Baker asserted that the climate for moving GSE legislation was significantly improved because of the new GOP White House and, more important, Treasury Department. “I feel like there’s an armada of ships coming over the horizon,” he said. Cong. Baker’s press secretary Michael Diresto said Cong. Baker wants to take a “modest approach” and he is “pretty confident” he can pass a bill that sets up a strong independent regulator.**
- Cong. Baker stated that his GSE bill would aim to create a single, better-funded GSE regulator, perhaps within the Treasury Department. The new regulator, like OFHEO (currently Fannie and

Freddie's safety and soundness regulator), would be charged with assuring that Fannie and Freddie hold enough capital to withstand a nationwide, economic downturn. Further, the new GSE regulator would be charged with reporting to Congress on specific items, such as what effect eliminating the GSEs' lines of credit to Treasury would have on the GSEs, and whether limits should be placed on the amount of GSE debt held by financial institutions. The bill might also instruct the regulator to study Fannie and Freddie's practice of buying back their own guaranteed mortgage-backed securities.

- Cong. Baker noted that he would like to have the Chairmen and the CEOs of the GSEs testify before his Subcommittee probably in February. The hearing will focus on whether the GSEs are living up to the voluntary risk-management agreement made with Baker late last year. Baker said if there's any indication that the GSEs aren't living up to the agreement, or if they "resist" legislation creating a new GSE regulator, he will move to implement stricter legislation. Cong. Baker also indicated that he might also hold a hearing in February that would examine a soon-to-be-released study by the Congressional Budget Office (CBO) on how much Fannie and Freddie's ties to the government are worth. Cong. Baker hopes to meet with CBO Director Dan Crippen soon to discuss the study. (*Dow Jones Newswire*, Jennifer Corbett Dooren, 1/26/01, Nicholas Kulish, 1/31/01; *National Mortgage News*, Brian Collins, 1/29/01)

St. Louis Federal Reserve Bank President William Poole would like Congress to mitigate any uncertainty over the government's support of GSEs

"Congress ought to make clear the extent of its willingness to underwrite or guarantee the obligations of the GSEs, and if the guarantees are to be made explicit, Congress ought to examine carefully whether the GSEs are managing their affairs in a way that is consistent with the inherent risks they face"

- In a speech before the Risk Management Association in Memphis, St. Louis Federal Reserve Bank President William Poole recommended that Congress mitigate any uncertainty about the government's support of GSEs. **Poole stated the following: "The market prices debt obligations of GSEs as if there is a federal guarantee of these obligations, and yet legally no such guarantee exists for most of these enterprises. Should there be an unpredicted shock of some sort to one of these firms, the likely outcome is a substantial market disruption as a consequence of the uncertainty over the government's role. This vulnerability in our financial system can be and should be repaired,"** Poole continued. **"Congress ought to make clear the extent of its willingness to underwrite or guarantee the obligations of the GSEs, and if the guarantees are to be made explicit, Congress ought to examine carefully whether the GSEs are managing their affairs in a way that is consistent with the inherent risks they face,"** he added. (*Dow Jones Newswire*, Brian Blackstone, 1/18/01; *Dow Jones Newswire*, John Connor, 1/24/01)

Fed's Federal Open Market Committee to discuss GSE mortgage-backed securities

Concerns have been raised in the past that the Fed's purchasing of GSE securities could strengthen the GSEs' implied government guarantee

- According to a Federal Reserve Spokesman, during its January 30-31, 2001 meetings, the Federal Reserve's Open Market Committee (FOMC) will hold "preliminary discussions" on what types of collateral they should use for repurchase agreements. A Fed spokesman noted, however, that no announcements were expected until later this year. The central bank holds a large portfolio of Treasuries to manage the growth of the nation's money supply and influence interest rates. The FOMC must decide what to do since there is a shrinking supply of Treasury securities. In August 1999, the FOMC temporarily authorized the New York Federal Reserve Bank to use Fannie Mae, Freddie Mac, and Ginnie Mae mortgage-backed securities as collateral to prevent a possible year-2000 liquidity crisis. The authority was extended last year due to larger-than-expected budget surpluses and the buybacks of US treasuries by the Treasury Department. The authority, renewed last spring, expired January 30. According to Michael Cloherty, Money-Market Strategist at Credit Suisse First Boston, market participants assume it will be extended again.
- During testimony recently before the Senate Banking Committee, Fed Chairman Alan Greenspan warned that a sharp reduction in Treasuries would force the US government to purchase corporate assets to manage its finances. "I believe, as I have noted in the past, that the federal government should eschew private asset accumulation because it would be exceptionally difficult to insulate the government's investment decisions from political pressures." (*National Mortgage News Daily*, 1/30/01; *Wall Street Journal*, Greg Ip, 1/30/01)

Concerns raised that the Federal Reserve Bank of New York move to purchase GSE MBS is "risky" and strengthens the GSEs' implied government backing

- Back in August 1999, when the FOMC temporarily authorized the New York Federal Reserve Bank to use Fannie Mae, Freddie Mac, and Ginnie Mae mortgage-backed securities as collateral, concerns were raised that this would strengthen the GSEs' implied government guarantee. As noted in the September 10, 1999 *GSE Report*, Cong. Ron Paul (R-TX) issued a press release stating that the Federal Reserve Bank of New York's decision "raises troubling questions." He further stated, **"This decision, though approved only through April 2000, bolsters the value of the implied government guarantee – this action is highly risky when viewed from the perspective of potential taxpayer liability. These highly leveraged institutions are already leveraged off the Treasury balance sheet. A further expansion of collateral with mortgage securities, which the Fed can use as collateral for monetary expansion, must be closely scrutinized."**
- Thomas Stanton, a Washington lawyer who has written extensively on the GSEs, noted that there is already an implied, or mistakenly inferred, federal guarantee on the GSEs. **By having the Fed actively use GSE securities in open market operations, the implied federal guarantee would be strengthened and would put the Fed in the position where it would pay for potential shortfalls in the GSEs' financial safety and soundness rather than be free to make decisions on the good of the financial system.**
- A *Barron's Online* article notes the following: **"Fed purchases of Fannie or Freddie securities arguably would be only a step away from the Hong Kong Monetary Authority's buying of stocks...with the express intent of pushing up the Hang Seng. Fannie and Freddie's common**

shares both trade on the New York Stock Exchange. State capitalism, anybody?” (*Barron's Online*, 11/9/98; *Dow Jones Newswire*, 9/9/99, 10/30/98; *Cong. Ron Paul press release*, 9/9/99; *Federal Reserve Bank of New York press release*, 9/8/99; *National Mortgage News Daily*, 9/9/99)

Europe's mortgage banks criticize GSEs for unfair competitive advantage – European banks want to be on a level playing field with the GSEs

Europe's mortgage banks urge the Basel Committee to provide the same risk weighting for their securities to match the risk weighting of the GSEs

European mortgage banks were “stunned” by Freddie's issuance of debt in the euro debt market

US financial institutions also argue that the GSEs have an unfair competitive advantage and would like privately issued MBS to receive the same risk weighting as the GSEs

US federal regulators are considering a proposal that would lower the risk weighting for all US AAA-rated and AA-rated asset-backed securities (ABS) and mortgage-backed securities (MBS) to the same risk weighting capital treatment as Fannie & Freddie's MBS

Comment letters to US federal regulators indicate widespread support for leveling the playing field – with the exception of Fannie & Freddie. The GSEs are “up in arms” over the proposal

- According to *Reuters English News Service*, Europe's mortgage banks called for a level playing field with US issuers of mortgage-backed securities under a new capital agreement being negotiated by the Basel Committee for Banking Supervision. “The current proposals, influenced by the American off balance sheet approach, could put European mortgage lenders at a disadvantage,” said Michael Zell, President of the European Mortgage Federation. Zell, who is also head of Sweden's Stadshypotek (the country's leading mortgage institution) said European borrowers were worried that under the Basel proposal their debt would be saddled with a 50 percent risk weighting whereas securities issued by US borrowers, such as Fannie and Freddie, would carry a 20 percent risk weighting, and Ginnie Mae a zero percent risk weighting. This “could create opportunities for capital arbitrage and could put portfolio lenders at a competitive disadvantage as it would be less capital intensive to buy mortgage-backed securities than to have a mortgage book,” said Zell. “We would like the Basel Committee and [European] Commission to recognise the inherent character of mortgage loans with a risk weighting below the 50 percent standardised approach,” said Zell.
- European mortgage banks were reportedly “stunned” by Freddie's entry into the euro debt market, where it has already issued half of its planned 20 billion euros borrowing program. “We want to achieve a level playing field, not least in terms of funding instruments,” said Zell. (*Reuters English News Service*, Nick Antonovics, 12/1/00)

US financial regulators are considering lowering the risk weighting for private MBS to level the playing field with Fannie & Freddie's MBS

- According to Erick Bergquist with the *American Banker*, Fannie and Freddie “are up in arms” over a proposed rule by US financial regulators that would reduce the amount of capital banks must hold against investment-grade private-label MBS. Under the proposed rule, privately issued mortgage-backed securities rated AAA and AA would be risk weighted at the same level as Fannie and Freddie's mortgage-backed securities. As Bergquist noted, under current rules, Fannie and

Freddie's lower risk weighting has long supplied a strong incentive to buy their securities instead of privately issued MBS.

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

Widespread support for the proposal

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

Fannie & Freddie oppose the proposal

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

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

- Arthur Frank, head of MBS Research at Nomura Securities International said the proposed changes to level the playing field on risk weightings would “likely diminish bank portfolio appetite for agencies.” The changes would probably “increase bank portfolio demand for investment-grade ABS, CMBS, and private-label MBS, while reducing demand for agency MBS and GSE debt.” Frank also noted that he believes the proposed rule will likely be permanent, based on a favorable

comment letter by the Bond Market Association. (*American Banker*, Erick Bergquist, 6/30/00; *Mortgage-Backed Securities Letter*, Frank Musero, 6/12/00)

All GSEs

John Connor with *Dow Jones Newswire* says attention paid to GSEs is unlikely to fade this year

- **John Connor with *Dow Jones Newswire* believes that “a new season is underway on the Fannie Mae – Freddie Mac political risk watching front, and the early going suggests there will be no shortage of blather this year.”** Connor notes that already St. Louis Federal Reserve Bank President William Poole recommended that Congress examine the GSEs and that Senator Phil Gramm (R-TX) said his panel will take a long, hard look at Fannie and Freddie. [See earlier stories in this *GSE Report*.] Other upcoming events include a subsidy study by the Congressional Budget Office and the eventual emergence of the final risk-based capital rules for Fannie and Freddie. **Some people claim that the political risk for the GSEs “was last year, ancient history.”** However, as Connor argues, **“One problem for Fannie and Freddie is that once something has been ‘in the market,’ it’s sometimes hard to get rid of the vapor trail, especially when you have Federal Reserve officials chipping in their two cents worth from the sidelines every now and then.”** Connor concludes, “somewhere along the line, the new Administration specifically the Treasury Department, might be heard from on the GSE issues. At that point, the perceived political risk could either trail off to inconsequential pre-Gensler levels or spike big time, as Dick Cheney might say.” (*Dow Jones Newswire, Capital Markets Report*, 1/24/01)

Fannie Mae and Freddie Mac

As Fannie & Freddie become giants in derivatives, some market professionals see risk

Jeff Wallace with Greenwich Treasury Advisors warns that Fannie & Freddie could suffer derivatives losses like the failed hedge fund Long Term Capital Management

Fannie has an “eye-popping” debt-to-income ratio of 2019% - the average for the financial services industry is 506%

The rapid growth of Fannie & Freddie’s outstanding derivatives has led some to wonder whether one or more of the GSEs’ counterparties may limit their exposure to the GSEs (a fate which often befalls hedge funds that have grown too large)

“That is definitely the theoretical concern. And it may not be so theoretical in the sense that more and more people believe that those companies [Fannie & Freddie] are no longer real AAA credits,” says Wallace

- **A *Dow Jones Newswire* article by Michael Mackenzie and Tyler Lifton reports that with interest rates swinging wildly, some market professionals are questioning whether the GSEs’ rapidly growing derivatives books can continue unabated without triggering concerns among Fannie and Freddie’s counterparties in the derivatives markets. Some wonder whether Fannie and Freddie could overwhelm the derivatives market and stoke credit fears among participants, since both Fannie and Freddie expect to continue growing their earnings at around 15% a year.**
- **“With volatile interest rates, there could be losses in their derivatives that, while offset elsewhere, would cause their counterparties to reduce their exposure, starting a liquidity squeeze, just like Long Term Capital Management,” said Jeff Wallace, Managing Partner of Greenwich Treasury Advisors, a consulting firm. Long Term Capital Management was the hedge fund whose failure in 1998 prompted a \$3.6 billion bailout by a group of US banks.**
- **Mackenzie and Lifton report that the GSEs’ derivatives portfolios are the “glue that holds together their enormously leveraged businesses.” Fannie has an “eye-popping” debt-to-income ratio, or degree of leverage of 2019%, according to Media General Financial Services. The average for the financial services industry is 506%. This dynamic hedging model and this sort of leveraging leads many to compare Fannie and Freddie’s business models to mortgage hedge funds.**
- **The article notes that Fannie and Freddie have been growing their derivatives by “leaps and bounds.” As of September 30, Fannie held a notional amount of derivatives outstanding totaling \$285 billion, a 30% increase from the year before, while Freddie increased its total during the same period by 25% to \$458 billion. The rapid growth of Fannie and Freddie’s outstanding derivatives has led some to wonder whether one or more of the GSEs’ counterparties will at some point choose to limit their exposure to the GSEs (a fate which often befalls hedge funds that have grown too large). “That is definitely the theoretical concern. And it may not be so theoretical in the sense that more and more people believe that those companies are no longer real AAA credits,” said Wallace. Mackenzie and Lifton note that the majority of the GSEs’**

derivatives exposure is in the hands of just a few counterparties, such as the large banks that dominate the interbank interest rate swap market.

- Today's wildly swinging interest rates are a concern because Fannie and Freddie have been increasingly holding mortgages as assets on their balance sheets to boost profits, but this also increases risk. "Freddie Mac's revenues have become more interest rate-sensitive as the company has steadily grown its retained mortgage portfolio," said Standard & Poor's in a recent press release assigning credit to its subordinated debt. Mackenzie and Lifton note that the drop in interest rates speaks to one of the biggest risk to the GSEs: swings in the rate of prepayments of the mortgages they hold. As interest rates fall, the more quickly consumers refinance to a lower rate and the GSEs must hedge these prepayment risks and other interest-rate risk by entering the interest swaps market. Lately Fannie and Freddie have had to purchase a huge amount of swaps and options on swaps to cover their prepayment risk. **"Clearly a constraint to the long-term growth of [Fannie and Freddie] is the growth of their derivatives business,"** said Wallace. **"The question is, how close are they to being constrained?"**
- **The GSEs are known as expert risk managers, however, at some point, says Stanislas Royer, Vice President and Senior Credit Officer for Moody's Investors Service, the question must be asked: "To what extent are they [Fannie and Freddie] going to find enough liquidity in the market for the derivative exposure that they need?...As they grow bigger, these issues are going to become more pertinent."** (*Dow Jones Newswire*, Michael Mackenzie and Tyler Lifton, 1/22/01)

AEI's Peter Wallison says Fannie & Freddie's dual role of a public mission and maximizing profits to shareholders is a fundamental inherent conflict of interest

"It should be obvious that they cannot achieve both objectives.

Congress and the executive branch have no effective control over Fannie & Freddie's growth and no control over the risks they create for the taxpayers." This is a "vicious and dangerous cycle...these agencies are literally out of control."

"By combining the government's exemption from market discipline with the aggressiveness of private-sector management, Congress has created a financial monster."

- Peter Wallison, resident fellow at the American Enterprise Institute, wrote a position paper on the fundamental problem with the GSEs. **According to Wallison, the GSEs' dual role of serving a public mission, while at the same time maximizing profits for their shareholders creates a fundamental inherent conflict of interest with potentially adverse consequences for taxpayers and the financial markets. "It should be obvious that they cannot achieve both objectives."** He writes, **"If they maximize profits, they will fail to perform their government mission to their full potential. If they perform their government mission fully, they will fail to maximize profits."**
- A 1996 Congressional Budget Office report found that the GSEs receive an annual federal subsidy of \$6.5 billion – of which, only 2/3 was passed on to the mortgage market. The remaining \$2 billion was passed on to executives and shareholders. "That is exactly what one would expect from this hybrid form. If Fannie and Freddie were fully performing their government mission, their entire subsidy would have gone to the mortgage markets. The fact that they retained a portion for

themselves reflects their obligation to their shareholders and the incentives of their executives to increase their own compensation.”

- This conflict of interest has direct practical consequences. Since 1992, the GSEs have had an obligation to purchase affordable and low-income mortgages. Most of these mortgages perform far worse than middle-income mortgages, and will “reduce their profitability.” Therefore, despite the fact that the GSEs receive government subsidies to perform a public duty, their need to make a profit impedes with their mandate to purchase low-income mortgages.
- To add to this problem, the GSEs’ unique status allows them to control the size of their own subsidies. Since Fannie and Freddie have no “effective restriction” on their debt issuance, and since every bond or note they issue reflects the subsidy they receive, they can increase their subsidy without a vote by Congress. Fannie and Freddie’s subsidy is now probably in the range of \$10 billion and will probably continue to grow as the GSEs borrow more money in the capital markets and increase the size of their portfolios. **“Because Fannie and Freddie are not on-budget agencies...Congress does not appropriate funds for their activities...Congress and the executive branch have no effective control over their growth and hence no control over the risks they create for the taxpayers.”** Wallison calls this activity a **“vicious and dangerous cycle: Fannie and Freddie must grow in order to maintain their profitability, but there is no countervailing check on their growth – no effective competition, no required government approvals, and no fear in the financial markets that there is any substantial risk associated with financing this growth. In other words, these agencies are literally out of control.”**
- Taxpayers are facing a growing risk, added Wallison. Today both GSEs are financially healthy with no immediate risks for taxpayers. However, the economy has been in a period of unprecedented growth and expansion and no company is fully isolated from market forces. In addition, Fannie and Freddie are growing so fast that they will likely run out of high-quality mortgages to buy. Wallison noted that in his study with Bert Ely, *Nationalizing Mortgage Risk: The Growth of Fannie Mae and Freddie Mac*, it was concluded that by 2003, the GSEs will own or bear the risk for 90% of all conventional mortgages, and half of all mortgages in the US. This figure is only going to grow as Fannie and Freddie must grow in order to remain profitable and at some point, in theory, they will bear the credit risk of all mortgages, which could amount to an \$8 trillion liability.
- Because the GSEs are implicitly backed by the US government, any financial risk will ultimately be borne by the taxpayers. **“The story of Fannie and Freddie is a classic case of privatizing the profits but socializing the risk. Their executives and shareholders are benefiting now from government support, but if these companies ever stop growing or assume too much risk, or if interest rates spike, their losses will belong to the taxpayers.”**
- The GSEs’ ability to acquire all the mortgages in the US will also have a serious impact on the private sector, noted Wallison. It should be obvious that they will not let themselves run out of mortgages to buy – they will seek out new businesses to enter. Fannie and Freddie have begun to do this already by purchasing their own mortgage-backed securities. And new businesses such as mortgage origination, home improvement loans, and offering lines of credit to consumers through home equity loans are also likely on the agenda for the GSEs. **“It may be possible for them to enter the commercial mortgage markets and perhaps at some point, commercial lending. If they are able to do these things, their existence will continue indefinitely and they will be able**

to further exploit their implicit subsidy. Without some form of control – given their incentives – no end is in sight.”

- **Wallison concluded by warning that the mortgage markets are in danger of being nationalized. In addition, if the GSEs are not reined in by the government, the entire private sector may be at risk.** And while some supporters of Fannie and Freddie sometimes try to claim that the GSEs are the perfect form of organization, Wallison disagrees. **“By combining the government’s exemption from market discipline with the aggressiveness of private-sector management, Congress has created a financial monster.”** (Peter Wallison, *“The Fundamental Problem with Fannie Mae and Freddie Mac,”* American Enterprise Institute, December, 2000)

Fannie & Freddie announce record 2000 earnings

Fannie & Freddie’s earnings up 15% in 2000

Fannie boasts about its 14th consecutive year of record earnings; Freddie boasts about its 30th consecutive year of profitability, and 19th straight year of returns on common equity exceeding 20%

Fannie

- Fannie reported record earnings for 2000 of \$4.448 billion, or \$4.29 per diluted common share. This compares to \$3.912 billion, or \$3.72 per diluted common share for 1999. Earnings per diluted common share in 2000 were up 15.3% compared with 1999. Fannie Chairman Franklin Raines noted that Fannie posted its 14th consecutive year of record earnings and that the company increased its earnings per share by over 15% for the second year in a row. Raines added that Fannie’s financial results kept Fannie ahead of the pace required for meeting its goal of doubling EPS over the five years ending in 2003. Fannie’s fourth-quarter net income was \$1.164 billion, or \$1.12 per diluted common share. This compares with net income of \$1.124 billion, or \$1.09 per diluted common share, for the third quarter of 2000 and \$1.038 billion, or \$0.99 per diluted common share, for the fourth quarter of 1999. Fannie’s Executive Vice President Timothy Howard said the increase in net income resulted from a 16.4% rise in the average investment balance and an average net interest margin that held at 101 basis points. Average net mortgage-backed securities outstanding increased by 4.4%, and the average effective guaranty fee rose to 19.5 basis points. Fannie’s retained portfolio grew to \$607.4 billion (up 25.2% from the third quarter). [Editorial Note: The GSEs’ repurchasing of its own MBS increases interest rate risk for the GSEs and does little for homeownership. The Congressional Research Service noted that the GSEs’ repurchasing of their own MBS provides profit and risk for the GSEs and does little for homeownership. “While it is clear that this increases shareholder value, it is difficult to understand what, if anything, it does for mortgage markets.” - Barbara Miles, Congressional Research Service Testimony before House Budget Committee Housing Task Force, 7/25/00] Fannie’s total book of business rose to \$1.3 trillion (13.1% sequential quarter growth). (*Fannie press release, 1/11/01; National Mortgage News Daily, 1/11/01; Washington Post, 1/19/01; Morgan Stanley Dean Witter Report on Fannie Mae, 1/12/01, Kenneth Posner, Michael Courtian, and Gain Daniel*)

Freddie

- Freddie announced record diluted earnings per common share of \$3.40 for 2000, a 15% increase over 1999 earnings per common share of \$2.96. Net income for 2000 was \$2.547 billion, a 15% increase over 1999 net income of \$2.223 billion. Fourth quarter 2000 diluted earnings per common share of \$0.89 represents a 13% increase over fourth quarter 1999 diluted earnings per common

share of \$0.79. Net income for the fourth quarter 2000 was \$663 million, compared to \$594 million for the same period a year ago and \$645 million for third quarter 2000. Freddie's retained portfolio expanded to \$386 billion at the end of the fourth quarter from \$362 billion at the end of the third quarter and \$324 billion a year earlier. Mortgage-backed securities outstanding grew to \$822 billion from \$791 billion in the third quarter and \$749 billion a year earlier. Income from fees the company charges for securitizing and guaranteeing mortgages rose to \$383 million from \$372 million in the third quarter and \$362 million a year earlier. Freddie's total book of business rose to \$962 billion, a 17.8% sequential quarter growth on an annualized basis. Freddie's Loan Prospector on the Internet now boasts 11,000 registered mortgage broker users. Freddie Chairman Leland Brendsel stated, "We achieved our 30th consecutive year of profitability, and our return on common equity exceeded 20% for the 19th year in a row." (*Freddie press release*, 1/18/01; *Wall Street Journal*, Patrick Barta, 1/19/01; *Morgan Stanley Dean Witter report on Freddie Mac*, Kenneth Posner, Michael Courtian, Gail Daniel, 1/22/01)

Fannie begins issuing subordinated debt

Fannie's first sale of subordinated debt attracted a broad investor base

Questions remain whether the market perceives Fannie's subordinated debt as carrying an implied government guarantee (like the GSEs' senior debt)

Freddie's subordinated debt receives a prospective rating of AA- from Standard & Poor's and a rating of Aa2 from Moody's Investors Service

Merrill Lynch creates new index to accommodate Fannie & Freddie's subordinated debt

- Fannie announced on January 23 the inaugural offering of its new Subordinated Benchmark Notes program – consisting of \$1.5 billion of 6.25% 10-year securities. The new subordinated notes received ratings of Aa2 from Moody's Investors Service and AA- from Standard & Poor's. (Fannie and Freddie announced they would be issuing subordinated debt in 2001 as part of last year's voluntary risk-management initiative agreement with Cong. Richard Baker.)
- **According to Tyler Lifton with *Dow Jones Newswire*, Fannie's inaugural issue was extremely popular with investors, but "its popularity brings into question the extent to which Fannie Mae achieved its stated goal in issuing subordinated paper: creating a new credit that is understood not to carry an implied government backing in the hopes that it would provide a better barometer of the company's actual credit profile."** The yield spread between the subordinated and senior notes (which carry a AAA rating based on the perception that the federal government would not allow Fannie to default) almost immediately collapsed to as little as 16 basis points before finding an equilibrium of 18 basis points. **"There is definitely a degree of implied support that is imbedded in the valuation" of the subordinated debt, said Carl deJounge, Vice President Global Credit Research at Deutsche Banc Alex. Brown.** (*Fannie press release*, 1/23/01; *Dow Jones Newswire*, Tyler Lifton, 1/25/01)
- According to Lynn Adler with *Reuters*, Fannie's first sale of subordinated debt attracted a broad investor base. Mehmood Nathani, Vice President and Assistant Treasurer at Fannie said the deal attracted new accounts and crossover buyers, those who do not typically buy Fannie debt. "It was encouraging to see the corporate buyer base, and I think that was primarily as a result of them being familiar with the credit rating of double-A, liking the spread and being comfortable with

Fannie Mae's name as a good credit," he said. The notes were placed mainly with US investors. Money managers were by far the biggest buyers, followed by insurance companies. Banks, state accounts, corporates and others bought roughly equal amounts. Eighty-eight percent of the deal was bought in the United States, 9 percent in Europe, 1 percent in Asia, and 2 percent in other regions. Fannie expects foreign demand for subordinated debt will increase. (*Reuters English News Service*, Lynn Adler, 1/25/01)

- In related news, Freddie announced that its upcoming Subordinated Debt Securities, Freddie SUBS have received a prospective rating of Aa2 from Moody's Investors Service and AA- from Standard & Poor's. Freddie expects to make its initial entry into the market in the first quarter of 2001 with a minimum \$1 billion offering of a ten-year bullet-maturity issue. (*Freddie press release*, 1/17/01) Fannie also received the same split prospective ratings from Moody's and Standard & Poor's on its subordinated debt. Tyler Lifton with *Dow Jones Newswire* noted that preliminary ratings from Moody's and Standard & Poor's were technically a split rating, although many in the market downplayed the ratings difference. **Lifton wrote, "The difference in opinion between the two ratings agencies, though not large, speaks to the perception of an implied guarantee."** (*Dow Jones Newswire*, Tyler Lifton, 1/4/01)

Joint Treasury/Fed report on subordinated debt and market discipline

- According to the *American Banker*, a joint report issued by the Treasury Department and the Federal Reserve on January 12 found that, while there is evidence that subordinated debt encourages market discipline, "the net benefits of a mandatory policy...are currently too uncertain to justify" adopting one. "What the Fed and Treasury report did was dump buckets and buckets of cold water on the idea of using subordinated debt as a tool for market discipline," said financial consultant Bert Ely. "They are not rejecting it, but are saying we don't think subordinated debt is the answer." (*American Banker*, Rob Garver, 1/22/01) In a Letter to the Editor, Freddie's Chairman Leland Brendsel said the *American Banker* article misinterpreted the Treasury and Federal Reserve report on the subject of market discipline. Brendsel claims that the reports support the consensus among regulators and policymakers that market discipline is a powerful tool to enhance the safety and soundness of financial institutions. He noted that the Treasury/Fed study on subordinated debt concludes, "The Board and the Secretary believe that existing evidence supports efforts to use subordinated debt as a way to encourage market discipline." Brendsel claims that the *American Banker's* quote by Ely "distorts the findings of the report," which he believes calls for more study of whether subordinated debt issuance should be legislatively mandated but also concludes that subordinated debt pricing helps regulators conduct financial supervision. He does not believe that the Treasury/Fed report goes as far as Fannie and Freddie's voluntary risk management package introduced last year to encourage market discipline. (Letter to the Editor, *American Banker*, Leland Brendsel, 2/2/02)

Merrill Lynch creates new index to accommodate Fannie & Freddie's subordinated debt

- According to Tyler Lifton with *Dow Jones Newswire*, Merrill Lynch has created a new index to accommodate Fannie and Freddie's subordinated debt securities. The change was made to portfolio managers whose performance is measured against Merrill Lynch US agency index and who are precluded from purchasing debt carrying less than triple-A rating. The new index – the Composite US Agency Index – will have the same inclusion guidelines as Merrill Lynch's existing agency index with the exception of the minimum-rating criterion. It will be expanded to include all investment-grade-rated US agency debt, while the original index will explicitly require a triple-A rating for inclusion. (*Dow Jones Newswire*, Tyler Lifton, 1/29/01)

DC Mayor Anthony Williams signs DC predatory lending bill that gives a blanket exemption to only Fannie & Freddie

Fannie Chairman Franklin Raines personally lobbied for Fannie to be exempt from the DC bill

Industry and consumer groups oppose a blanket exemption for Fannie & Freddie

- On December 15, 2000, DC Mayor Anthony Williams signed into law the “Predatory Lending Protections and Mortgage Foreclosure Improvements Act of 2000,” a bill drafted by the Office of Banking and Financial Institutions to prevent District residents from losing their homes through foreclosure or corrupt lending practices. (*Mayor Williams press release, 12/15/00*) According to the *Washington Post*, the bill must be reviewed by Congress for 30 days. The bill, which the DC Council unanimously passed on December 5, takes effect 60 days after regulations are issued or 150 days after clearing Congress. (*Washington Post, Sandra Fleishman, 12/8/00*)
- The bill automatically exempts all loans purchased by Fannie and Freddie on the secondary mortgage market. The bill allows lenders with a net worth of \$10 million or more to submit higher-cost loan programs to the Mayor. Those found not to include predatory provisions would be exempt from later challenges by homeowners. (*Washington Post, Sandra Fleishman, 12/8/00*)

Fannie lobbied for exemption from DC predatory lending bill

- According to Sandra Fleishman and Kathleen Day with the *Washington Post*, Fannie sought this exemption to the DC predatory lending bill, which was designed to prevent predatory lending practices targeted primarily at the elderly, minorities and the poor. “We can live with whatever the city decides to do but it may be harmful to the residents of the District,” said Fannie Chairman Franklin Raines, who personally lobbied for Fannie to be exempt from the proposed law.
- Two years ago, DC officials brought together a broad coalition of industry and consumer activists to develop a bill. Although the task force forwarded the bill to the DC Council in July, the final drafted language forced many task force members to fight for changes. Raines angered others in the task force when he called DC Councilwoman and Economic Development Committee Chairman Charlene Drew Jarvis (D-Ward 4) to ask for an exemption from the bill. According to the *Washington Post*, Jarvis was the driving force behind the bill. Raines, who said he personally gets involved in any Fannie issue related to the District, said task force members “should blame me personally” for reviving the debate with Jarvis. Raines claims that loans that are eligible to be sold to Fannie and Freddie should be exempt from the District bill because the two companies already have tough restrictions against predatory lending. (*Washington Post, Sandra Fleishman and Kathleen Day, 12/4/00*)
- Fannie officials defended their blanket exemption from the bill. Fe Morales Marks, Vice President of Housing Impact, acknowledged that Fannie does not ban some of the dozen lending practices barred under DC’s bill. She noted, however, that the “core issues” were covered. Others in the mortgage industry oppose the exemption, claiming it offers an unfair competitive advantage to lenders who sell to Fannie and Freddie. “We don’t end up controlling the market,” said Marks. “Anyone can come in and ask the mayor to show the proof we do” that loans are not predatory. Industry officials note, however, that Fannie and Freddie’s exemption is automatic and does not have to be appealed to the Mayor. A Spokesman for Freddie said the company had agreed not to lobby for a blanket exemption. (*Washington Post, Sandra Fleishman, 12/8/00*)

Industry and consumer groups oppose an exemption for Fannie & Freddie

- **“I think it’s bad public policy,”** said Stephen Verdier, a lawyer for America’s Community Bankers. He questioned Fannie and Freddie’s ability to police against predatory lending because many unfair practices, such as excessive fees paid directly to brokers do not appear in the written material that Fannie and Freddie receive on the loans they buy.
- **“Fannie Mae and Freddie Mac had representatives on the task force and there was a lot of discussion about whether to exempt them,”** said Bill Washburn, head of the Metropolitan Washington Planning and Housing Association (a non-profit that spearheaded work on the bill). **“Our consensus was that they should not be exempt. They are starting to get involved in the subprime market. As they do that, that probability gets stronger that their portfolio may include loans from predatory lenders.”**
- **“We do not think it is appropriate to only exempt these two giant corporations which dominate the housing mortgage market,”** said Wright Andrews of Butera and Andrews who represents the National Home Equity Mortgage Association. **“This gives an unfair business advantage to them and raises a fundamental question: Should a law give an outright exemption to any private business?”** (*Washington Post*, Sandra Fleishman and Kathleen Day, 12/4/00)

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 of 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)]

Fannie:

Fannie Chairman Franklin Raines says Fannie will set up and host Web sites

- In a speech to the Mortgage Bankers Association on October 30, 2000, Fannie Chairman Franklin Raines says Fannie will help lenders move online. **“We will provide everything from the classic DO [Desktop Originator] and DU [Desktop Underwriter], to DO and DU on the Web, all the way to helping you sponsor your own Web sites. We can help you set up your own Web site, help you provide content for your Web site and the hosting of your Web sites...Fannie Mae is ready to help you move online.”** (*Fannie Chairman Franklin Raines Speech before Mortgage Bankers Association*, 10/30/00) [Editorial Note: Setting up and hosting Web sites for outside parties appears to be outside Fannie and Freddie’s mission of providing liquidity to the secondary mortgage market.]

HomeStore.com [of which Fannie is an investor] and the National Association of Realtors unveil an electronic transaction platform to enable Realtors to help consumers move from pre-contact through home closing

- HomeStore.com and the National Association of Realtors have unveiled eREALTOR.com, which 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. (*PR Newswire*, 1/15/01; *Inman News Feature*, 11/15/00; *Realty Times*, 11/15/00)

HomeStore.com forms alliance with OnePipeline, which *Real Estate Times Online* claims will mean Realtors will be able to originate loans legally

- HomeStore.com has formed a two-year, multi-million dollar technology and marketing alliance with OnePipeline, Inc., the leading provider of automated legal compliance software and services related to mortgage origination and related compensation. According to *Real Estate Times Online*, that means that Realtors will be able to originate loans legally. OnePipeline reportedly trains and enables real estate agents to originate loans themselves, instead of handing their buyers off to a lender. Under the terms of the deal, HomeStore.com will use OnePipeline as its provider of automated legal compliance technology related to compensation for real-estate professionals that assist with mortgage loan origination. HomeStore.com will also acquire equity in OnePipeline, but neither company said how much or if money has already changed hands, or if the equity is above and beyond the revenue sharing of such strategic partnerships. (*Real Estate Times Online*, 10/25/00)

Fannie enters alliance with NetUpdate to allow mortgage brokers and borrowers to create customized webpages through Freddie's Desktop Originator

- NetUpdate will integrate its LoanUpdate software into Fannie's Desktop Originator on the Web as part of a joint marketing and technology alliance. Mortgage lenders and brokers who use DO on the Web will be able to create their own customized webpages and have the status of borrower's loans automatically made available to the customers. LoanUpdate will also provide personalized Web sites for borrowers to check the status of their loans and collaborate with originators throughout the loan process. (*Origination News*, 12/00)

NewHomes.com (online relocation firm) will approve customers using Fannie's automated underwriting technology

- NewHomes.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 commit to a loan or pay any fees. NewHomes.com customers will be able to apply online and call HomeSide's loan specialist with questions. HomeSide said they worked with Fannie to deliver the loan applications with 50 percent less information required than traditional applications. (*Real Estate Finance Today*, Chris De Reza, 1/15/01)

Consumers will be able to receive approvals online on BET.com through Fannie's automated underwriting system

- HomeSide Lending has developed an interactive homebuyer program for the Home Center channel on African-American Web site BET.com. The site will offer users the ability to secure loan approvals online. HomeSide said its lending solution is powered by Fannie's automated underwriting system. The partnership allows HomeSide to require 50% less application data than traditional and other online lenders and provides loan approval whether or not a property has been selected. (*National Mortgage News Daily*, 1/31/01)

Fannie will provide computers, printers and software to the National Urban League for homebuying services to consumers

- Under a partnership with the National Urban League, Fannie will provide the league with \$50 million in mortgage products, and will also supply more than 1000 league affiliates across the country with training, materials, and technology, including computers, printers, and software to build their capacity to provide homebuying services to consumers. (*Inman News Feature*, 11/13/00)

Finet.com, which was the first Web site to allow consumers to use Fannie's automated underwriting technology directly, may be de-listed from NASDAQ because its stock has traded below \$1 since July 19

- Finet.com faces the possibility of being kicked off NASDAQ because its stock has traded below \$1 since July 19, 2000. Finet.com argued its case for continued listing on December 19, 2000 at a hearing before the NASDAQ Listing Qualifications Panel in Washington. The panel can de-list Finet, reduce the requirements for the company to maintain listing status, or do nothing. If it is bounced from NASDAQ, Finet.com would likely end up as a penny stock on the Over the Counter Bulletin Board. (*Inman News Feature*, 12/19/00)

Freddie:

Consumers able to apply online for mortgages on the HomeAdvisor.com Web site using Freddie's automated underwriting system

- According to *National Mortgage News Daily*, Lehman Brothers reported that it will join Electronic Data Systems, Freddie, and Microsoft subsidiary HomeAdvisor Technologies in an Internet-based lending service. (Freddie has provided significant technology contributions to HomeAdvisor and has a financial interest in the company.) Consumers will be able to use the HomeAdvisor.com Web site to apply online for mortgage loans, which will be processed through EDS's Wendover Financial Services using Freddie's automated underwriting technology, Loan Prospector. Wendover will fund and close the loans. Freddie will purchase mortgages originated by Wendover that match Freddie's specifications. Lehman Brothers will buy the nonconforming loans. Jon Voitman, Senior Vice President on Lehman's mortgage trading desk said that Lehman will purchase jumbo and subprime loans, but the majority of loans will be jumbos. Freddie allowed Lehman to reconfigure Loan Prospector with Lehman's models. Freddie has also provided the partners technology to automate the property evaluation process. (*National Mortgage News Daily*, 11/10/00; *American Banker*, Erick Bergquist, 11/15/00)

Partnership with Wendover Financial Services allows mortgage broker customers to receive loan approvals through Freddie's automated underwriting tools

- According to *National Mortgage News*, Home Link Services said its licensed real estate brokers working with Wendover Financial Services will be able to offer customers mortgage applications, customized pricing and loan approvals using Freddie's automated underwriting technology, Loan Prospector. Home Link is offering the LP tools as the result of an agreement between the two companies. LendingTree's Lend-X technology platform will power the information exchange between Home Link and Wendover. (*National Mortgage News*, 1/22/01)

LoanTrader.com connects with Freddie's automated underwriting technology to allow brokers access to Freddie's technology

- According to *National Mortgage News*, LoanTrader.com, which made its name as a transactional marketplace for subprime lenders and brokers, is integrating Freddie's Loan Prospector on the Internet. "Having made our mark in the subprime niche, we are aggressively pursuing the conforming market, and enabling automated decisions for our brokers and lenders through Freddie Mac is a great enhancement to our marketplace," said John Le, CEO of LoanTrader. LoanTrader charges brokers nothing to participate on the system, but does charge lenders \$25 for each offer they make on a broker's loan package. LoanTrader uses specific lender filters to ensure that loans that meet pre-existing lender criteria prior to being sent for automated underwriting or being sent directly to the lender. (*National Mortgage News*, Scott Kersnar, 10/2/00)

Freddie will allow mortgage brokers who are members of the National Association of Hispanic Real Estate Professionals to use its automated underwriting technology

- According to *Inman News Feature*, Freddie will deliver its automated underwriting service and other mortgage underwriting technology and training to mortgage brokers who are members of the National Association of Hispanic Real Estate Professionals, through the association's official Web site (RealEstateEspanol.com). (*Inman News Feature*, 1/30/01)

MBA, ABA, ACB and ICBA ask HUD to withdraw its proposal requiring Fannie & Freddie to collect and report additional data on mortgage loans

Proposed rule is part of HUD's new affordable housing goals for Fannie & Freddie

Financial services trade groups believe it would burden primary mortgage lenders without giving them a chance to comment – groups say the notice does not spell out the specific data elements to be collected

- In November, HUD issued new affordable housing goals for Fannie and Freddie. As part of that effort, HUD issued a Notice of Proposed Information Collection for Fannie and Freddie that would require Fannie and Freddie to collect and report new categories of loan data in an effort to battle predatory lending. The notice was published in the November 8, 2000 *Federal Register* with a comment period that ended on January 8, 2001.
- The American Bankers Association, America's Community Bankers, the Independent Community Bankers of America and the Mortgage Bankers Association want HUD to withdraw the notice because they fear the loan-level reporting burden will fall on their members – primary mortgage lenders. "We are interested parties because Fannie Mae and Freddie Mac will look to their customers, primary market lenders, to supply them with the additional data necessary to meet their reporting requirements," according to the January 5 joint trade association letter to HUD. The

trade groups would like HUD to issue a formal proposal for a 90-day public comment period that spells out the new data collection requirements. According to the trade groups, the specific data elements to be collected weren't listed in the notice. "Due process and fundamental fairness require that those who will bear the burden be notified specifically of what that burden will be and given a reasonable opportunity to assess the implications of the proposal and comment on its reasonableness, particularly in light of the potential burden of dual reporting regimes for a single objective," the groups wrote in its letter to HUD. "Because HUD has not provided adequate notice and comment to all interested parties on the full range of this proposal, we strongly urge that, at a minimum, the proposal be withdrawn at this time and republished in the *Federal Register* with a list of all of the data elements proposed to be collected," said the letter.

- Mortgage lenders are concerned that the new data requirements will burden them hardest since Fannie and Freddie will have to come to them for loan data that presently is not being reported. And because most reporting is now done electronically, the new data could not be generated without costly modifications to data systems. "HUD, in its proposal, looked at this as affecting only two institutions [Fannie and Freddie]," said Ann Grochalla, Director of Bank Operations for the ICBA. "To consider the true impact of the proposal, you've got to know what it's going to do to the lenders that provide the loan data to Fannie Mae and Freddie Mac," she said. "The reality is that Fannie Mae and Freddie Mac are going to have to get that information from lenders," said ABA Senior Counsel Joe Pigg.
- In a comment letter to HUD, Fannie claims that the proposed data collection requirements impose "unnecessary costs and reporting burdens on Fannie Mae and thousands of our lender customers." Freddie recommends that HUD withdraw the reporting proposal until the Federal Reserve Board acts on a proposal to expand Home Mortgage Disclosure Act (HMDA) reporting.
- In early January, then-HUD Assistant Secretary William Apgar said HUD was still working on the new data collection regime, but intends to forward a proposal to the Office of Management and Budget for approval. "The data collection will not begin before this [Clinton] administration is over, and it will be the responsibility of the new guys to concur or disagree," said Apgar. Apgar rejected claims that the effort was late action by the administration, saying the affordable housing rules for Fannie and Freddie have been in the works since July 1999. "The label of 'last-minute rulemaking' just doesn't apply," he said. Apgar said HUD is aware of the concerns about the burden being placed on primary lenders and said HUD will try to take the extra burdens into account if the new loan data elements are included in the reporting requirements. If current systems cannot recognize and handle the data, he said, HUD would build in a transition period. (*National Mortgage News Daily*, 1/9/01; *BNA Daily Report for Executives*, 1/9/01; *National Mortgage News*, 1/15/01; Brian Collins; *Inman News Feature*, 1/9/01; *Dow Jones Newswire*, John Connor, 1/8/01; *Real Estate Finance Today*, Mike Sorohan, 1/15/01)

Customized home loans are starting to appear in the market, but consumer groups worry that if customized mortgage loans rely on the automated underwriting systems of Fannie & Freddie, minority homebuyers could suffer

HUD was expected to close its fair lending review of Fannie & Freddie's automated underwriting systems by the end of 2000

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

- According to a *Wall Street Journal* article by Patrick Barta, a group of pioneer lenders and loan brokers – mostly operating on the Internet (e.g., Priceline.com), are using new computer programs to customize mortgages for individual homebuyers – sometimes referred to as risk-based pricing or an individualized pricing. Barta notes that if the customized-mortgage approach is adopted broadly, there could be changes in the mortgage lending industry. The change could mean that fewer people would flat-out be denied a home loan. Borrowers with excellent credit histories could enjoy savings of tens of thousands of dollars over the course of their mortgages. However, rates for some borrowers with mixed financial histories and borrowers with shaky financial pasts might receive loans from mainstream lenders but at higher prices based on their higher risk.
- The article notes, however, that consumer advocates warn that if customized mortgages rely on Fannie and Freddie's automated underwriting systems [which control 95% of the automated underwriting market], minority applicants could suffer. [Editorial Note: Priceline.com was used as an example by the *Wall Street Journal* as a site that provides customized mortgages. Priceline.com uses Fannie's automated underwriting system to customize mortgages and allow consumers direct online access to Fannie's automated underwriting system.] Fannie and Freddie's automated systems' statistical models incorporate data from millions of home loans made over the past 20 years, but during that period, blacks and other nonwhites received a disproportionately low percentage of home loans, according to statistics gathered by the Federal Reserve and HUD. If customized-mortgage software relies on the historical data to disfavor some areas, in theory, this could perpetuate discriminatory patterns. Fannie and Freddie claim that their systems are more fair than the traditional human-review process. However, HUD has been reviewing the systems for over a year for potential race bias. (*Wall Street Journal*, Patrick Barta, 1/5/01)

HUD was expected to complete its fair-lending investigation at year-end 2000

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

Background:

- HUD has been investigating Fannie and Freddie's automated underwriting systems (which control 95% of the automated underwriting market share) for more than a year. In February 1999, HUD sent letters to Fannie and Freddie requesting information to ensure that the GSEs' systems comply with fair-lending standards. **In March 1999, HUD commissioned an independent study by the Urban Institute, which found that Fannie and Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers. The report also noted that**

Fannie and Freddie “do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities.” The report noted that “Primary lenders are making more aggressive efforts” to serve the lower income and minority homebuyers “by offering loan products with underwriting guidelines that are more flexible than the GSEs’ guidelines.” Further, the report noted that “depository lenders are serving low- and moderate-income borrowers better than the GSEs and so the percentage of loans purchased by the GSEs that are originated to low- and moderate-income borrowers is less than the percentage of loans originated in the primary market.” The report also noted that “there is some evidence that the GSEs’ purchase of loans made to black and Hispanic homebuyers have actually declined (in share and absolute number) over the last two years.” (HUD/Urban Institute Study, “A Study of the GSEs’ Single Family Underwriting Guidelines,” April 1999)

Economists question whether America is “overinvesting in housing”

US government’s sponsorship of Fannie & Freddie is one of the more controversial ways the US government supports homeownership

When Fannie & Freddie were first created, far fewer Americans owned homes, but now many of the beneficiaries of housing subsidies are relatively wealthy and can easily pay a slightly higher interest rate on their mortgages

- A *Wall Street Journal* article by Patrick Barta and Gregory Zuckerman reports that economists are questioning whether America is becoming “too fixated on housing.” Currently over 71.6 million American families own homes, which translates into a 68% homeownership rate. Housing advocates, big lenders, Washington politicians, and Fannie and Freddie would like to push those numbers even higher. Homeownership has produced tremendous economic and social benefits and few economists would suggest that the US should stop supporting housing, but some are starting to wonder whether the US should continue to divert ever-growing amounts of capital into increasing homeownership beyond its current level, at the expense of other worthy needs. “We’re over-investing in housing relative to other things,” said Edwin Mills, an emeritus professor at Northwestern University’s Kellogg School of Management.
- Barta and Zuckerman note that the US government supports homeownership in many ways. The home mortgage interest deduction saves homeowners an estimated \$55 billion a year. However, **“more controversial is the government’s sponsorship of Fannie Mae and Freddie Mac... That sponsorship allows the two companies to borrow more cheaply than other concerns do, resulting in lower mortgage rates for home buyers.”** While this sounds good in theory, Barta and Zuckerman quote economists who claim that a problem exists with the supply and demand of capital. **“Direct or indirect subsidies earmarked for housing probably make it more expensive for the broad swath of companies to borrow to pay for everything from manufacturing plants to more computer equipment, which can in turn enhance productivity and boost employment.”**
- Many economists believe that a natural ceiling exists for homeownership rates, beyond which there may be little benefit in subsidizing so many home purchases. Karl “Chip” Case, a professor at Wellesley College is quoted as stating, “No one knows what the ceiling is, but I fear we’re getting perilously close.” Case believes that lower-income people would benefit from increased subsidies toward renting. At the current high level of homeownership, Case worries, the existing subsidies

could be encouraging people with bad credit to buy homes, increasing the likelihood they will only end up in default in a recession.

- **The article notes that when Fannie and Freddie were first created, far fewer Americans owned homes, but now many of the beneficiaries of housing subsidies are relatively wealthy and can easily pay a slightly higher interest rate on their mortgages.** Fannie and Freddie, for example, are allowed to buy mortgages worth as much as \$275,000. Despite questions by economists, the US government will not likely change the structure of the housing subsidies, conclude Barta and Zuckerman. (*Wall Street Journal*, Patrick Barta & Gregory Zuckerman, 1/23/01)

Fannie Mae

Fannie launches pilot program that offers 1% down-payment mortgages with no mortgage insurance

- Cambridgeport Bank, Fannie and the North Carolina community group Self-Help launched a pilot program offering 1% down payment mortgages that do not require mortgage insurance. The 30-year fixed-rate loans will be available to first-time homebuyers and those who have not owned a home in the last three years. The program is available on homes purchased within Cambridgeport Bank's community reinvestment assessment area, which includes the towns of Arlington, Bedford, Belmont, Boston, Braintree, Brookline, Burlington, Cambridge, Canton, Dedham, Dover, Framingham, Lexington, Lincoln, Medford, Milton, Natick, Needham, Newton, Norwood, Quincy, Randolph, Sherbourne, Somerville, Stoneham, Walpole, Waltham, Watertown, Wayland, Wellesley, Weston, Westwood, Weymouth, Winchester, and Woburn. Closing costs may include borrower's own funds, gifts, grants, or down payment assistance programs (secured or unsecured). Cambridgeport Bank will originate the loans, which will then be sold to Self-Help and in turn to Fannie. Cambridgeport Bank will continue to service the loans. (*American Banker*, Robert Julavits, 1/31/01; *Business Wire*, 1/29/01)

Fannie announces partnership with America's Community Bankers

ACB and Fannie declined to discuss whether there would be any guarantee fee discounts involved

- Fannie announced that it has formed a three-year partnership with ACB. Under an affinity group agreement, ACB members will enjoy new benefits on residential mortgage loans delivered to Fannie including: (1) access to Fannie's underwriting technology, including access through the Internet; (2) enhanced access to Fannie products to help members meet CRA requirements; (3) in-depth portfolio analysis to identify secondary market sales opportunities; (4) educational and training support from both ACB and Fannie on how to expand access to the secondary market; and (5) expanded efforts to make use of Fannie's automated underwriting technology. Diane Casey, ACB's President and CEO said the ACB was motivated to establish the partnership in part by fact that about a third of its 1,200 members do not sell loans in to the secondary market. The benefits of the program will be exclusive to ACB members, said Casey. She noted that the agreement, however, does not prohibit its lenders from selling loans to Freddie or the FHLBanks. Jeff Hayward, Fannie's Vice President for Single-Family Business, said Fannie's goal was "to get as

much” business from the community banks as it can. Michael Young, Chairman of ACB’s Mortgage and Technology Committee said the alliance will set up a central “delivery mechanism” through which community bankers can sell their loans to Fannie. At a press conference announcing the alliance, panel members that were parties to the agreement declined to discuss whether there would be any guarantee fee discounts involved. (*ACB/Fannie press release*, 1/18/01; *BNA Daily Report for Executives*, Richard Cowden, 1/19/01; *Dow Jones Newswire*, Jennifer Corbett Dooren, 1/18/01; *National Mortgage News Daily*, 1/18/01)

Fannie is losing two top-level communications staff

- Fannie’s Senior Vice President of Communications John Buckley is leaving Fannie to take a position with AOL Time Warner as a Corporate Vice President, with responsibilities in the areas of corporate positioning and public policy communications. Buckley will assume his new position on March 12. He will report to Kenneth Lerer, Executive Vice President at AOL Time Warner. Buckley had been at Fannie Mae for 10 years. (Fannie’s Chairman Franklin Raines serves on the Board of Directors of AOL Time Warner.) (*National Mortgage News Daily*, 1/25/01; *AOL Time Warner press release*, 1/25/01; *Washington Post*, 1/26/01, 1/13/01)
- Long-time Fannie spokesman David Jeffers, who is currently a Vice President of Communications at Fannie, is leaving that department to open and run a Fannie Mae partnership office in Alexandria, VA. Jeffers said he is looking forward to actually working on housing policy rather than discussing it. Jeffers will begin his new position January 29. Jeffers has been at Fannie for 12 years. Successors to Buckley and Jeffers have not been named. (*National Mortgage News Daily*, 1/25/01; *Dow Jones Newswire*, Jennifer Corbett Dooren, 1/19/01)

Fannie involved in a dispute with District of Columbia officials over the city-owned John Wilson Building

- There is a legal dispute over the District of Columbia’s city-owned John A. Wilson Building between District officials and the Washington Development Group, a partnership led by private developer T. Conrad Monts. The three-year battle has spawned no fewer than four pending legal cases. The legal cases stem from a complex series of contracts signed by a then-nearly insolvent District government in 1996, three years after officials began abandoning the decrepit building. The city agreed to lease the structure to Monts for 40 years, who in turn struck a deal with the General Services Administration to sublease about two-thirds of the building for 20 years to use for federal offices. Now back on its feet financially, the District government wants to return to the restored building, but not as a minor tenant. The District government would like the entire Wilson building, including the federal portion. With President Clinton’s help, the city won agreement to let it occupy the federal space in exchange for covering the feds’ rent payments. The developer, Monts, however doesn’t like that deal, claiming it will cost his partner Fannie Mae millions of dollars in historical tax credits. Monts believes that deal will cost Fannie, which invested \$13 million in the project, up to \$20 million in historic preservation tax credits. Under federal rules, an historic building’s rehabilitation is ineligible for the tax write-off in the owner occupies more than 35% of the building. DC Council Chairman Linda Cropp (D) said she is hopeful that all disputes between the city and Monts can be resolved through a fair settlement. “What’s left is Fannie Mae and Conrad Monts,” she said. “We’re willing to work with Fannie Mae for anything they put into the building, but we don’t want to do anything that would give anyone a windfall, or for Conrad Monts to make millions of DC taxpayers’ dollars.” Meanwhile, the DC government is prevented

from returning to the city-owned landmark building at the corner of 14th Street and Pennsylvania Avenue until the legal cases have been settled. (*Washington Post*, 1/21/01, 1/19/01)

Fannie forms partnership with the Neighborhood Reinvestment Corp.

Fannie will sponsor HomeOwnership Centers for one-stop shopping for services and training needed to shop for, buy, rehabilitate and insure a home

- Fannie and the Neighborhood Reinvestment Corp. announced a four-year partnership in which Fannie will sponsor NeighborWorks HomeOwnership Centers and support training and scholarships through the NRC Training Institute. Fannie expects to provide \$850,000 in grants to support the activities of 50 NeighborWorks centers, which provide one-stop access to all of the services and training that customers need to shop for, buy, rehabilitate, and insure their homes. Services also include pre- and post-purchase homeownership counseling, down payment and closing cost assistance, and referrals to Fannie designated lenders. Fannie will also provide \$160,000 to the NRC Training Institute and \$60,000 to upgrade computer systems and staff training at 10 NeighborWorks HomeOwnership Centers. Fannie said it expects to buy up to \$250 million in mortgages over the next four years as part of the partnership. (*National Mortgage News Daily*, 12/14/00; *Fannie press release*, 12/13/00)

Fannie's national disposition center will manage the renovation and sale of San Antonio-owned vacant properties

[Editorial Note: This appears to run counter to Fannie's claims last year that it was exiting the business of selling foreclosed properties for third parties.]

- Fannie announced a partnership with the city of San Antonio, TX to rehabilitate vacant and blighted properties owned by the city and other public entities. The newly created Housing Asset Recovery Program will utilize the services of Fannie's National Property Disposition Center to manage the renovation and sale of city-owned vacant properties. Fannie will manage repairs and renovations through its network of approved contractors and then market the properties through local real estate professionals. The program expects to rehabilitate and market 75 homes within 12 to 18 months. In addition the San Antonio City Council has authorized the city to enter into a line of credit agreement with Fannie's American Communities Fund to offer short-term financing to the city to facilitate the renovations and repairs of these properties. The terms of the line of credit are currently under discussion. (*Fannie press release*, 12/15/00)
- As noted in the August 18, 2000 *GSE Report*, Brian Collins with *National Mortgage News* reported that Fannie planned to exit the business of selling foreclosed properties for third parties. At the time of the article, both Fannie and Freddie offered real estate owned (REO) disposition services for banks, mortgage companies and government agencies, and Fannie managed and sold REO seized by US Marshals. However, Fannie claimed it was exiting the business of selling foreclosed properties for third parties, including the contract with the US Marshals. "We will complete the contracts we have in place right now and we won't be bidding on any future third-party REO contracts. But we will continue to do our own REO disposition," said Fannie Spokeswoman Janice Daue. The decision by Fannie coincided with a Congressional hearing in which the National Association of Realtors President Dennis Cronk criticized the GSEs for expanding their REO services. The Fannie spokeswoman stated that Fannie's decision to exit the business of selling foreclosed properties for third parties was a business decision not a political concession. As

Collins notes, however, the NAR is a traditional ally of Fannie, and the company wanted NAR to join the Homeownership Alliance it started. Reportedly, Freddie conceded little ground on the issue of selling foreclosed properties for third parties. (*National Mortgage News*, Brian Collins, 8/14/00)

Fannie invests \$100,000 in two credit unions

[Editorial Note: Investing in lending institutions seems outside of Fannie & Freddie's mission of providing liquidity to the secondary mortgage market.]

- Fannie announced a \$100,000 deposit stock-purchase in West Texas Credit Union, a Community Development Financial Institution. (*Fannie press release*, 12/6/00)
- Fannie invested \$100,000 in Choice One Federal Credit Union, a CDFI in Wilkes-Barre. (*Fannie press release*, 12/18/00)

Fannie announces \$14 million construction loan pilot program in New Jersey

- Fannie and the New Jersey Department of Community Affairs and Public Service Electric & Gas Co. announced a \$14 million pilot program – “Cool Cities” - in seven New Jersey cities. The program provides incentives for the construction, rehabilitation, and purchase of energy-efficient homes in the seven cities: Camden, East Orange, Jersey City, New Brunswick, Newark, Paterson, and Trenton. The NJDCA will pledge up to \$45,000 per property as a forgivable loan to the participating city for initial construction costs, and the city will funnel the money to a developer, who will build the home. The participating lenders – The Bank of New York and Valley National Bank – will provide one mortgage instead of two, to be held by the lender as a construction-to-permanent loan for the developer. After the home is bought, the loan will be assumed by the low-to-moderate income homebuyer. PSE&G will guarantee 5.3% of each mortgage up to a maximum of \$500,000 and Fannie will purchase the loans. (*National Mortgage News Daily*, 12/7/01)

DC Housing Authority obtains \$33 million loan from Fannie and Bank of America

First time a public housing entity has been approved for a loan leveraged against future funds to be allocated to the DC Housing Authority by HUD

- The District of Columbia Housing Authority has obtained a \$33 million loan from Bank of America and Fannie that will be repaid over five years through a first-of-its-kind financing vehicle. Fannie's American Communities Fund purchased a \$16.5 million participation in the loan from Bank of America, the lead lender. The DC Housing Authority will borrow \$29 million to complete extensive renovation and repair work that began five years ago after the department was placed in court-ordered receivership. According to the *Washington Post*, the arrangement marks the first time a public housing entity has been approved for a loan leveraged against future funds to be allocated to the DC Housing Authority by HUD. An additional \$4 million will be kept in reserve in case of any interruption in the disbursement of federal funds. The terms of the loan stipulate that the principal and interest are to be repaid to Fannie and Bank of America over five years. (*National Mortgage News Daily*, 12/21/00; *Washington Post*, Steve Kovaleski, 12/21/00)

Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its Partnership Offices in press events

Fannie has 44 Partnership Offices open across the country

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

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

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

- Fannie's Betsy Hildebrandt claims that Fannie's media events with Congressional Members "are not directed from Washington." She said most of the events happen in their Partnership Offices and "are basically product introductions where the member of Congress has asked us to participate in a program." She claims the Partnership Offices were created to develop relationships in local communities. "The idea of the Partnership Offices was to get away from Washington," she said. "It's been a wildly successful initiative."
- Research by *Real Estate Finance Today* found that during the first eight months of 2000, Fannie held no fewer than 87 media opportunities across the US with Congressional Members. This compares with 60 media events in all of 1999. The events in both years have involved 29 members of the Senate (of whom 12 were up for re-election in 2000) and 95 Members of the House (most of whom face contested re-election bids). Since 1999, Fannie has held media events with at least 13 Members of the House Banking Committee and seven Members of the Senate Banking Committee. However, according to *Real Estate Finance Today*, Fannie has held no events with Cong. Richard Baker who has introduced a bill to strengthen regulation of the GSEs. (*Real Estate Finance Today*, Michael Sorohan, 9/11/00)

Fannie's media events raise ethical questions

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

Fannie has 44 partnership offices

- According to Fannie's Web site, the company has 44 partnership offices open across the country. (http://www.fanniemae.com/contact/partnership_offices.html, 2/1/01)

Chairman of Orange County Board of County Commissioners Mel Martinez (newly appointed HUD Secretary)

- Fannie and CTX Mortgage announced a new low down payment mortgage product – “Platinum Plus” - a low down payment mortgage for homebuyers that earn at or below 100% of the local area median income. The mortgage requires a 3% down payment, of which 2% must come from the borrowers’ own funds, and 1% from a gift, grant, or an unsecured or secured loan from a nonprofit organization, government agency or employer. Fannie will purchase the loans originated under this pilot. A statement commending CTX and Fannie by then-Chairman of the Orange County Board of County Commissioners Mel Martinez was included in the press release. (*Fannie press release, 12/13/01*)

Senator Richard Shelby (R-AL) and Mobile, AL Mayor Mike Dow

- The Fannie Mae Foundation held a press conference with the above officials and Fannie Chairman Franklin Raines to present the Oakleigh Venture Revolving Fund with a check for \$450,000 on the steps of a home being rehabilitated in Mobile’s Oakleigh Garden district. The check presented – a \$150,000 grant and a \$300,000 low-interest loan – will go towards the revitalization of the Oakleigh Garden neighborhood. (*PR Newswire, 1/29/01*)

Cong. John LaFalce (D-NY)

- Cong. LaFalce, Fannie, Kaleida Health, and Catholic Health Systems announce the availability of reverse mortgages for funding in-home care for seniors. Seniors staying at hospitals within the Kaleida Health or the Catholic Health System will receive information on using reverse mortgages as a means of funding extended in-home care before they are discharged. (*Fannie press release, 11/27/00*)

Cong. Paul Kanjorski (D-PA)

- Cong. Kanjorski joined Fannie Vice Chair Jamie Gorelick in a press conference announcing a five-year \$5 billion housing and community development investment plan - “House Northeastern and Central Pennsylvania.” The investment plan will be coordinated through Fannie’s Partnership Office in Wilkes-Barre, PA. (*Fannie press release, 12/18/00*)

Cong. Loretta Sanchez and Garden Grove, CA Mayor Bruce Broadwater

- Fannie held a press conference with the above officials to “raise the walls” of new homes to be built in a city redevelopment effort. (*Fannie press release, 12/19/00*)

Cong. Nydia Velazquez (D-NY)

- Fannie held a press conference with Cong. Velazquez to celebrate the graduation of the first ten families from a Spanish-language homebuyer education program in the Williamsburg section of Brooklyn. (*Fannie press release, 12/16/00*)

Cong. John Thune (D-SD)

- Fannie and Security Mortgage announced the availability of Fannie’s Timely Payments Reward mortgage for South Dakota families. A statement of support by Cong. Thune was included in the press release. (*Fannie press release, 12/19/00*)

Cong. Mike Capuano (D-MA)

- Cambridgeport Bank, Fannie and the North Carolina community group Self-Help launched a pilot program offering 1% down payment mortgages with no mortgage insurance. A statement of support by Cong. Capuano was included in the press release. (*Business Wire, 1/29/01*)

Cong. Chris Cannon (R-UT)

- Fannie held a press conference with Cong. Cannon and local housing partners to unveil the Rural Housing Loan Partnership (RHLP) for low-income residents of five rural counties in Southern Utah. The RHLP is a public/private partnership between the United States Department of Agriculture Rural Housing Development Agency, the Community Development Corporation of Utah, the Utah Housing Finance Agency, the Olene Walker Housing Trust Fund, Zions Bank, Washington Mutual, HUD, and Fannie. (*Fannie press release, 1/29/01*)

Cong. Sheila Jackson Lee (D-TX)

- Fannie held a press conference with Cong. Lee, CTX Mortgage, Dominion CDC, and 12 African American churches to celebrate increased homeownership opportunities under a Houston faith-based initiative. Through this initiative, CTX Mortgage will offer flexible Fannie mortgage products. Also available is city down payment and closing cost assistance of up to \$9500, committed pastors of the participating churches, relationship building between CTX Mortgage and the churches, and substantial guidance from Dominion CDC. Dominion CDC will offer introductory seminars to potential homebuyers, one-one-one counseling, credit counseling, access to city and state funds for down payment and closing cost assistance, and in-depth information about the best mortgage financing options available. A \$15,000 grant from Fannie is being used to support CDC's efforts. (*Fannie press release, 1/29/01*)

Cong. Mel Watt (D-NC)

- Fannie held a press conference with Cong. Watt and housing partners to break ground on the Gables of Wingate, a new 29-home development in City West. The Gables of Wingate is funded under a participation agreement between Fannie and the Wachovia Community Development Corporation (WCDC). Under the agreement, Fannie will purchase up to \$2.5 million of \$5 million in acquisition, development and construction loans originated by WCDC for single-family and rental housing in North Carolina, South Carolina, Virginia, Georgia, and Florida. Together, Fannie and the WCDC will invest \$336,000 each in the Gables of Wingate for a total loan of \$672,000. (*Fannie press release, 1/27/01*)

Cong. Silvestre Reyes (D-TX)

- Fannie held a press conference with Cong. Reyes and El Paso City Representative Elvia Hernandez to announce a \$100,000 deposit stock-purchase in West Texas Credit Union, a Community Development Financial Institution. (*Fannie press release, 12/6/00*)

Cong. Heather Wilson (R-NM) and Albuquerque, NM Mayor Jim Baca and City Councilor Adele Baca-Hundley

- Fannie held a press conference with the above officials and the New Mexico Mortgage Finance Authority, GSL Properties and the Downtown Action Team to break ground on the Villa de San Felipe Apartments, an affordable multi-family housing construction in downtown Albuquerque. Fannie made a \$5.5 million investment in the project. (*Fannie press release, 1/29/01*)

DC Mayor Anthony Williams and Cong. Eleanor Norton (D-DC)

- Mayor Williams, Cong. Norton, Howard University President Patrick Swygert, Verizon Washington President Marie Johns and Fannie Vice Chair Jamie Gorelick held a press conference to celebrate the completion of 40 homes in Howard University's LeDroit Park area. (*Fannie press release, 12/14/00*)

Pittsburgh Mayor Tom Murphy

- Fannie held a press conference with Mayor Murphy and the Pittsburgh Community Reinvestment Group to celebrate the availability of the National Training and Information Center's \$50 million low down payment home mortgage initiative, through an expanded group of lender partners for the city of Pittsburgh/Allegheny County residents. (*Fannie press release*, 1/12/01)

Freddie Mac

***American Banker* article reports that “Freddie showed it can play lobbying game effectively”**

Article reports on Freddie's efforts to weaken HUD's newly issued affordable housing goals for Fannie & Freddie

Allen Fishbein with the Center for Community Change notes that “Freddie's lobbying game will hurt poor households”

Freddie's action is “likely to reinforce the view shared by many, both inside and outside of government, that these publicly chartered housing enterprises have far too much influence over public policy”

- An *American Banker* article by Erick Bergquist reported that Freddie “displayed a new prowess on Capitol Hill” when it won a battle against HUD and weakened HUD's affordable housing goals for Fannie and Freddie. As reported in the January 12 *GSE Report*, Freddie was able to secure a provision in the Omnibus Appropriations bill (HR 4577) that ordered HUD to increase Freddie's temporary adjustment factor/bonus points from 1.20 to 1.35 in counting multifamily units towards the new affordable housing goals. Freddie claimed it needed the change because its multifamily portfolio is smaller than Fannie's and should be considered proportionately. Observers say that Freddie's victory to weaken its affordable housing goals “can be seen as the second such victory for Freddie” in recent months. Bergquist notes that the second victory was Fannie and Freddie ability to reach a voluntary risk management agreement with Cong. Richard Baker last October. (*American Banker*, Erick Bergquist, 1/25/01)
- **In a Letter to the Editor by Allen Fishbein with the Center for Community Change, Fishbein notes that the real loser from Freddie's actions to weaken HUD's affordable housing goals for the GSEs was not HUD, but affordable housing. “Through its stealth maneuvering, Freddie Mac succeeded in reducing its commitment to service low- and moderate-income families by as much as 40% over the next three years. This means that the GSE could meet the new goals while financing rental housing for 130,000 fewer lower-income households.” HUD decided that higher adjustment factor Freddie sought was not justified by the record. “Whereupon the GSE chose to play power politics and circumvent the duly constituted administrative process,” said Fishbein.**
- **Fishbein concluded, “The action is likely to reinforce the view shared by many, both inside and outside of government, that these publicly chartered housing enterprises have far too much influence over public policy.”** (Allen Fishbein, Letter to the Editor, *American Banker*, 2/1/01) [*American Banker* noted that Fishbein worked at HUD from February 1999 to November 2000 as a Senior Adviser for GSE oversight.]

Freddie's new CFO provides expectations for Freddie's business prospects in 2001

Company will expand into new markets, move further into subprime, and use its technology to move closer to the point-of-sale

- When asked by the *Washington Post* about his expectations for business prospects in 2001, Freddie CFO Vaughn Clarke said he anticipates the company will grow its total portfolio at a faster rate than the estimated residential growth mortgage debt outstanding. Clarke said the company would grow its portfolio by “continuing to penetrate existing markets more fully” and “penetrating new markets.” He noted that there would be more “point-of-sale initiatives” like Freddie’s agreements with LendingTree and credit unions’ national association, which relies on Freddie’s suite of automated underwriting tools. He added that they would also penetrate the subprime market. (*Washington Post*, Judith Mbuya, 1/15/01)

Freddie guarantees a \$1.39 billion home equity deal by Option One

[Editorial Note: The majority of home equity loans are made to middle- to higher-income, non-minority homeowners for debt consolidation. Home equity borrowers already own their own homes. Home equity loans are a consumer product, not a product that helps homebuyers purchase a home.]

- Option One Mortgage Corp. priced about \$1.39 billion asset-backed securities, supported by home equity loans. The transaction featured a \$1.26 billion portion guaranteed by Freddie, and a \$127 million floating-rate portion. Among the AAA-rated Freddie-wrapped portion, the \$70 million Class A1, with a 0.90-year average life, was priced at 21 basis points over eurodollar futures and a coupon rate of 5.714 percent. (*Reuters*, 1/24/01)

Freddie issues new guidance to seller/servicers on its policies regarding predatory lending

Guidance issued in response to HUD's new affordable housing goals for Fannie & Freddie that prohibit the GSEs from receiving affordable housing credit toward their affordable housing goals for mortgages subject to HOEPA and with certain predatory features

- Fannie issued guidance to its seller/servicers in a December 28 letter on its policies regarding predatory lending. The guidance was issued to ensure that seller/servicers understood Freddie’s position on predatory lending practices, and in response to HUD’s affordable housing goals, which took effect on January 1, 2001. HUD’s new affordable housing goals prohibit Fannie and Freddie from receiving affordable housing goal credit for the purchase of mortgages subject to HOEPA and mortgages with predatory features.
- Included in its guidance, Freddie states that lenders should avoid delivering loans to Freddie where the total points and fees charged to a borrower exceed 5 percent of the loan amount, except when this restriction would result in an “unprofitable origination.” Freddie’s Spokeswoman Sharon McHale said the company was working with HUD to clarify the definition of “unprofitable origination.” Points and fees include: origination fees; underwriting fees; broker fees; finder’s fees and charges that the seller imposes as a condition of making the loan, whether they are paid to the seller or to a third party. McHale cautioned that Freddie is not instituting an outright ban on higher cost loans, but Freddie will not get credit toward its affordable housing goals if it purchases loans

that fail to meet HUD's standards. (*National Mortgage News*, Brian Collins, 1/15/01; *Freddie's Seller Industry Letter*, 12/28/00)

Freddie launches \$100 million initiative to increase homeownership in eastern North Carolina

- Freddie announced a \$100 million public/private partnership called CarolinaGold to increase homeownership in eastern North Carolina. The collaboration includes low down-payment mortgages products, the national anti-predatory lending campaign "Don't Borrow Trouble," pre- and post-purchase counseling, and real estate services including referrals and financing for home rehabilitation. Freddie has agreed to purchase up to \$100 million of mortgages through the program. (*Freddie press release*, 1/29/01)

Federal Home Loan Banks

Freddie's former CFO, John Gibbons, joins the FHLBank of Chicago

Gibbons will focus on business strategy, including the FHLBanks' Mortgage Partnership Finance (MPF) program

MPF program grew 760% in 2000

MPF program is becoming a strong competitor to Fannie & Freddie in the secondary mortgage market

***Crain's Chicago Business* says MPF program is giving Fannie & Freddie "a run for billions"**

- John Gibbons, former Executive Vice President and Chief Financial Officer at Freddie, has joined the FHLBank of Chicago as Senior Vice President of Strategy Development. He will concentrate on business strategy, including the MPF program, capital and risk management issues, and the long term development of the Bank. "We are very pleased to have John's talents and incisive understanding of the financial markets in general, and of the secondary mortgage market in particular," said Alex J. Pollock, President and CEO of the FHLBank of Chicago. "He will be an excellent member of our management team." (*FHLBank of Chicago press release*, 1/31/01)
- The FHLBank of Chicago reported that the outstanding balance of loans held in portfolio in the System's MPF program rose 760% during 2000, ending the year at \$15.4 billion, up from \$1.8 billion a year earlier. The MPF program is currently offered by nine of the 12 FHLBanks. The FHLBank of Chicago said another FHLBank is negotiating with the Federal Housing Finance Board to join. "**The MPF Program's rapid growth demonstrates that mortgage lenders welcome more competition in the GSE secondary market,**" said **FHLBank of Chicago President and CEO Alex Pollock**. (*FHLBank of Chicago MPF press release*, 1/29/01; *American Banker*, Erick Bergquist, 1/31/01)
- According to *Chicago Crain's Business Online*, the MPF program is giving Fannie and Freddie a "run for billions." Launched just three years ago, the program has reach \$15 billion in assets and is expected to surge to about \$100 billion this year, which would make the MPF program "a genuine rival to Fannie and Freddie," said the article's author, Anthony Burke Boylan. Already 196 banks sell loans to FHLBanks under the program and another 80 are expected to join as the program

expands this year. FHLBank of Chicago President Alex Pollock notes that the goal of the MPF program “is to make local lenders more vibrant competitors and bring more competition into the secondary market.” Pollock believed Fannie and Freddie were charging banks too much and needed some competition, so he devised the MPF program under which banks could make more money by agreeing to retain some default risk on loans sold to the FHLBank.

- The article notes that “it’s clear that many banks like the MPF’s rules better than the terms imposed by the giants [Fannie and Freddie] that control 90% of the secondary market for conventional home mortgages. Fannie and Freddie charge most banks a “guarantee fee” to cover losses on mortgages. However, the MPF charges no guarantee fee. Participating banks agree to absorb a portion of any losses on the loans, and can make more money if the default rate on their loans meets expectations. Community banks especially like the MPF program because they lack the leverage that bigger institutions have to negotiate more favorable deals with Fannie and Freddie. (*Crain’s Chicago Business*, Anthony Burke Boylan, 1/29/01)

Federal Housing Finance Board (FHFB) extends comment period on whether to permit Washington Mutual Bank – a member of the FHLBank of San Francisco – to also join the FHLBank of Dallas

FHFB will also allow any interested persons to comment

- The FHFB extended the deadline for comments on a petition to permit Washington Mutual Bank – a member of the FHLBank of San Francisco – to join the FHLBank of Dallas, upon completion of its acquisition of Bank United (a member of the FHLBank of Dallas). The FHFB published a notice of the petition for dual membership in December and invited FHLBanks and member institutions to file a “request to intervene” in the consideration of WaMu’s petition. On January 24, the FHFB extended the deadline for comments 30 days from January 25 to February 26. The FHFB also broadened the range of those eligible to comment to include any “interested persons.” To date, no financial institution has had membership in more than one of the 12 FHLBanks.
- WaMu’s lobbyist Benson Porter said he was pleased that the FHFB did not extend the comment period by 90 days as requested by the Council of FHLBanks. Porter acknowledged that the FHFB requested additional information on WaMu’s plans for running Bank United, as well as an analysis of the consequences of dual membership in the FHLBank System. No requests to intervene have yet been filed, however, by extending the deadline the FHFB acknowledged that “additional time is needed to fully consider the ramifications of the fundamental legal, political and policy issues of first impression raised by the petition that are critical to the structure and function of the Bank System.” (*National Mortgage News*, 1/29/01; *Dow Jones Newswire*, John Connor, 1/24/01; *Federal Register*, pages 7650-7651, 1/24/01) [See January 12, 2001 *GSE Report* for more information on WaMu’s request for dual FHLBank membership.]

Federal Housing Finance Board publishes final capital rules for the FHLBank System in the *Federal Register*

- The FHFB’s final capital rules for the FHLBank System were published in the January 30 *Federal Register*. The final rule is effective on March 1, 2001. (*Federal Register*, pages 8262-8321, 1/30/01) [See January 12, 2001 *GSE Report* for more information on the FHFB’s capital rules.]

Farm Credit System/Farm Credit Banks

Farm Credit Administration (FCA) releases pre-publication of its controversial proposed rule on granting national charters to Farm Credit System banks

The proposal varies little from the original guidance FCA issued on national charters

Former House Banking Committee Chairman Jim Leach (R-IA), the Treasury Department, the Government Accounting Office, the American Bankers Association, and the Independent Community Bankers of America criticize the proposal

- The FCA released a pre-publication copy of its proposed rule that would provide specific procedures for Farm Credit System institutions requesting national charters. The FCA Board approved the proposed regulation at its January 11 meeting. The proposed regulation is now with Congress for a 30-day review after which it will be submitted to the *Federal Register* for publication with a 30-day comment period. (*FCA press release*, 1/23/01)

Little change from previous guidance

- FCA Spokeswoman Christine Quinn told the *BNA* that although the proposed rule contains some changes in response to some 1,000 comment letters the FCA had already received on the topic, it varies little from the original guidance FCA issued in May, 1999. (*BNA Daily Report for Executives*, Adam Wasch, 1/12/01)
- The proposal would allow Farm Credit banks to apply for a national charter to make loans anywhere in the country, assuming the banks receive approval for a national charter from the FCA. Currently, the Farm Credit banks divide the country into exclusive territories in which they compete with commercial banks for farm loans.

Former House Banking Committee Chairman still has concerns over the proposal

- Former House Banking Committee Chairman Jim Leach (R-IA) had procedural as well as substantive concerns with the national charter proposal. **According to Cong. Leach's Spokesman Dave Runkel, Cong. Leach still has concerns with the newly issued proposal. "Unless they do away with national charters altogether, Mr. Leach still has concerns."** However, as *BNA* points out, the House Agriculture Committee has jurisdiction over the FCA. Newly appointed House Agriculture Committee Chairman Larry Combest (R-TX) would not comment on the proposal until it could be reviewed. (*BNA Daily Report for Executives*, Adam Wasch, 1/12/01)

ICBA still has concerns about proposal

- In a January 9 letter to Financial Services Committee Chairman Michael Oxley (R-OH), ICBA Vice President Kenneth Guenther wrote, "Safety and soundness risks will increase as large, aggressive FCS associations seek to do new types of loans in unfamiliar territories with borrowers growing different types of crops in different climates – loans in which FCS lenders officers have no previous experience." (*BNA Daily Report for Executives*, Adam Wasch, 1/12/01)

GAO found that FCA overstepped its authority by issuing national charter proposal without formal rule making

- By formally issuing the charter proposal as a proposed rule, the FCA is complying with a General Accounting Office (GAO) report that found that the FCA overstepped its authority by issuing the national charter proposal without submitting the plan to a formal rule-making process. The GAO

recommended that the FCA rescind its proposal. Cong. Leach had requested the GAO study following an October 3, 2000 hearing in the House Banking Committee on the FCA proposal. In light of the GAO's findings, Cong. Leach recommended that the FCA withdraw its proposal.

- **During his October 3 hearing, Cong. Leach said the implications of the national charter initiative are “extraordinary” and a “reflection of the continual self-generated urge of all GSEs [including housing GSEs] to use their governmentally privileged positions to expand the breadth and scope of their activities in ways that distort the American market system.” He further stated, “The irony is that this country has the largest, most vibrantly competitive private sector financial system in the world, but without governmental oversight and restraint, GSEs – whether they be in housing or agriculture – have a natural tendency to push into new market-skewing areas and activities. The question is whether this benefits or distorts our financial system. In this case of the FCA and national charters, I have my doubts about any benefits.”** (*Cong. Leach Statement at Hearing on FCA National Charter Initiative, 10/3/00*)

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

- In written testimony at the October 3, 2000 House Banking Committee hearing, Treasury Assistant Secretary for Financial Institutions Greg Baer said the national charter initiative raises “serious questions” about the mission of the Farm Credit System. Over the long-term, the initiative could reduce competition among lenders. “In particular, they will allow the expansion of a government-sponsored enterprise – which are traditionally created to correct a market failure – at a time when markets are functioning competitively and even growing. Originally intended to complement the banking and thrift industries, the Farm Credit System may grow to mimic them,” he wrote. While banks would likely compete against Farm Credit members “we are concerned that the advantages of GSE status could tip the balance in favor of the Farm Credit System.” Baer added that Congress should “reconsider the role of FHLBanks in agricultural credit markets” when reviewing GSE activities in the farm sector. (*Written Statement by Treasury Assistant Secretary Baer for House Banking Committee hearing, 10/3/01*)

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

- During the House Banking Committee's October 3 hearing, Dale Torpey, Chairman of ICBA's Lending Committee, testified that national charters are “bad public policy” that would allow large, aggressive lenders to cannibalize smaller associations and steal customers of local commercial banks through predatory pricing. ICBA objects to the initiative for the following reasons: (1) initiative has received inadequate public scrutiny and oversight; (2) will not benefit family farmers; (3) removes local control of Farm Credit System by farmer borrowers; (4) does not promote safety and soundness; (5) exacerbates Farm Credit System predatory pricing tactics; (6) suggests some Farm Credit System lenders should lose their privileged GSE status and special tax exemptions and that these benefits should be redirected to needed rural residents; (7) will lead to further consolidation and concentration in American agriculture; (8) local service plans are insufficient to ensure long-term service; (9) FCA's granting of cross-title charters is an inappropriate and questionable addition to national charters; and (10) no data or FCA analysis exists to justify national charters.
- Dennis Everson, Senior Vice President of First Dakota National Bank, testified on behalf of the ABA. He stated that national charter initiative “serves no credible public policy purpose, raises serious safety and soundness questions, exposes the American taxpayer to incalculable risk, and destroys any shred of the notion that the FCS is a borrower owned and locally controlled

cooperative lending organization.” He added that national charters are “not in the best interest of the farmers, ranchers and rural residents FCS was chartered to serve.”

- Financial consultant Bert Ely testified that the national charter initiative would serve no public purpose because large Farm Credit institutions would conduct cherry-picking and predatory pricing to serve the “most desirable agri-business customers.” He claims that national charters would accelerate the pace of consolidation within the Farm Credit System. He noted that larger Farm Credit System organizations will increasingly focus their lending on larger farms and ranches, as well as agribusiness – “the very enterprises which neither need nor deserve the \$1 billion-plus financing subsidy the FCS now delivers to American agriculture.” Ely stated, “most troubling, national charters will create the potential for another FCS-induced agricultural credit crisis, and a second taxpayer bailout of the FCS.” (*Written Testimony before House Banking Committee, 10/3/00*)

Ginnie Mae

Ginnie Mae is considering “Ginnie Mae Choice” program that would allow Ginnie Mae to securitize high LTV loans that Fannie & Freddie won’t securitize

One mortgage industry official says, “I think we’ll hear Fannie Mae scream a bit about this”

- According to *National Mortgage News*, industry officials note that Ginnie Mae is once again considering a private/public risk sharing arrangement on certain high loan-to-value ratio mortgages – often referred to as “Ginnie Mae Choice.” The “Choice” concept would allow Ginnie to securitize high LTV loans (between 90% and 97% LTVs) that Fannie and Freddie won’t securitize. The mortgages would carry both government insurance and private mortgage insurance. Currently, Ginnie Mae only guarantees securitizations involving FHA and VA loans. One mortgage industry official said that if Ginnie Mae Choice became a reality, it might cut into FHA loans purchased by Fannie and Freddie. “I think we’ll hear Fannie Mae scream a bit about this,” the official stated.
- *National Mortgage News* noted that in written remarks to Congress, new HUD Secretary Mel Martinez wrote that he will continue discussions “with the private sector to develop single-family risk sharing approaches that benefit the American consumer and provide financial stability to the FHA fund.”
- As reported in the September 23, 2000 *GSE Report*, Ginnie Mae was hiring a contractor to help the agency develop “Ginnie Mae Choice.” Ginnie Mae Executive Vice President George Anderson told *MortgageWire*, that the contractor “would assist us in considering that option among others.” The contractor will also help to develop other programs. (*National Mortgage News Daily, 8/31/00*)

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