

The **GSE** REPORT™

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- Fannie & Freddie are accused of threatening to pull business from several major banks and financial services firms as punishment for criticizing the GSEs ([p. 5](#))
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 - In response to the threats, FM Watch is dissolving its board so its members cannot be retaliated against by the GSEs - FM Watch says their members are committed more than ever to its goals
 - “Members of the FM Watch board of directors have been subject to attempts of intimidation and threats by both Fannie Mae and Freddie Mac,” said FM Watch’s Chairman Gerald Friedman. “The message was the same: stop supporting the activities of FM Watch or be prepared to see your business opportunities and products suffer.”
 - Senate Banking Committee Chairman Phil Gramm (R-TX) asks his staff to examine the allegations. “Any allegations of bullying by entities that enjoy the support of the federal government has to be taken seriously,” said Senator Gramm
 - Capital Markets Subcommittee Chairman Richard Baker (R-LA) calls the allegations “a very serious problem that warrants serious attention.”
 - “This stealth intimidation and well-founded fear of retribution has been part of the debate since I turned up in this town in 1999,” said Steve Bartlett, President of the Financial Services Roundtable. “I’ve heard these well-founded fears from all my members.”
 - These allegations highlight how much is at stake for companies in criticizing the market-dominating GSEs
 - “The mortgage market is the largest financial market in the world,” said Sanford C. Bernstein analyst Jonathan Gray. “Quite frankly, the banks are struggling for survival. Fannie Mae and Freddie Mac are like the terminator.”
 - “Congress needs to exert its authority and not let these quasi-government agencies parade around like the Sopranos of the financial world.” – Citizens Against Government Waste
 - “Whether these allegations about Fannie Mae and Freddie Mac are true or not, regulators and elected officials have a special responsibility to taxpayers to find out...The slightest hint that firms supported with tax dollars might be involved in shaking down competitors ought to shake up Congress as well.” – National Taxpayers Union
 - A 1999 *International Economy* article reported that Fannie’s then-Chief Spokesman John Buckley didn’t deny that Fannie can be aggressive when its self-interest is at stake, even if it means trying to hurt opponents financially. “We’re in a tough business,” he says. “We’re not shy about protecting our turf. But brutish? No.”

- Coalition of chief executives from more than a dozen financial institutions has decided to press for reform of Fannie & Freddie ([p. 11](#))
 - The group – the Financial Services Forum – is an intentionally low-profile organization of chief executives from the country’s largest financial institutions
- President Bush’s top economic advisor Lawrence Lindsey says he is concerned about using GSE debt as a benchmark ([p. 12](#))
 - Lindsey says, “I think it is an invitation for trouble.”
 - With the fading supply of Treasurys, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasurys as the new benchmark in the bond market
- Warren Buffet’s Berkshire Hathaway sells nearly all of its shares of Fannie & Freddie in 2000 ([p. 12](#))
 - Buffet blasted unnamed companies that make “fancy” earnings predictions. “For a major corporation to predict that its per-share earnings will grow over the long term at, say 15% annually is to court trouble...I tend to be leery of companies run by CEOs who woo investors with fancy predictions...A few of these managers will prove prophetic – but others will turn out to be congenital, or even charlatans.”
 - *Bloomberg* notes that in May 1999, Fannie’s Chairman Franklin Raines promised investors that the company would double its earnings-per-share over the next five years, or 15% a year
 - Regarding Buffet’s Berkshire Hathaway sale of nearly all of its shares of Fannie last year, Raines states, “I can’t imagine what he [Buffet] was thinking.”
- Capital Markets Subcommittee Chairman Richard Baker (R-LA) releases GAO report showing that GSE regulators lack the power of bank regulators ([p. 14](#))
 - GAO report finds significant differences in the safety and soundness powers granted to OFHEO and the FHFH in comparison with bank regulators
 - “GAO’s report confirms that the legal authorities of the GSE regulators, particularly OFHEO as the regulator of Fannie Mae and Freddie Mac, are significantly weaker than federal bank regulators for taking action when capitalization and safety and soundness issues arise,” said Cong. Baker
 - GAO finds there is no specific authority for OFHEO to issue a cease and desist order if Fannie or Freddie were to violate conditions imposed in writing
 - Fannie & Freddie are currently objecting to a “cease and desist” proposal by their regulator (see story in this *GSE Report* ([p. 20](#)))
- Cong. Baker (R-LA) plans March 27 hearing to assess how well Fannie & Freddie are fulfilling their voluntary risk management agreement reached last October ([p. 15](#))
 - Fannie & Freddie say they will fulfill the promises made to Cong. Baker by the end of the month

Fannie Mae and Freddie Mac

- *Financial Times* columnist says “it’s time for Fannie and Freddie to grow up” ([p. 17](#))
 - Fannie & Freddie are gaining unfairly from their association with the federal government
 - Fannie & Freddie “are growing so fast that they now threaten to consume the entire mortgage market, doing the damage of classic monopolies”
- Commentary in *Washington Times* and *Miami Herald* calls for an end to Fannie & Freddie’s corporate welfare ([p. 18](#))
 - Nationally syndicated columnist Michelle Malkin calls Fannie & Freddie “two of the fattest corporate-welfare targets on the block”
- *Grant’s Interest Rate Observer* explains that Fannie & Freddie’s extraordinary earnings do not occur in nature, but rather from their GSE status. The GSEs are not “natural enterprises.” ([p. 19](#))
 - “The GSEs are allowed to get by on a much smaller cushion of equity capital than is permitted to ordinary worldlings [private market competitors]. A tower of assets rests on a sliver of net worth.”
 - Fannie & Freddie “will be hard-pressed to overcome the arithmetic problem of growing at 15% a year in a 10% marketplace...Nor will it be easy to explain away the generation-long record of extraordinary returns on substandard equity capital.”
- Fannie & Freddie are currently objecting to a “cease and desist” proposal by their regulator (OFHEO) ([p. 20](#))
- Fannie & Freddie receive AA-minus “risk-to-the-government” rating from Standard & Poor’s, which they claim fulfills part of their voluntary risk management agreement with Cong. Baker ([p. 21](#))
 - [Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]
- Fannie & Freddie claim they can maintain at least three months’ liquidity to withstand three months without debt market funding, which they claim fulfills part of their voluntary risk management agreement with Cong. Baker ([p. 22](#))
 - [Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]

- As the national debt shrinks, GSE debt skyrockets ([p. 23](#))
 - With the fading supply of Treasuries, Fannie & Freddie are issuing massive amounts of debt in an effort to have GSE debt replace Treasuries as the new benchmark in the bond market

GSE debt news:

 - (1) President Bush's top economic advisor Lawrence Lindsey says he is concerned about using GSE debt as a benchmark (see earlier story in this *GSE Report* ([p. 12](#)))
 - (2) Wrightson Associates estimates that the amount of GSE debt outstanding could surpass the amount of Treasury debt in 2002 ([p. 24](#))
 - "Some bankers now wonder what will happen should agency debt become absolutely critical to the bond markets. Will [Wall] Street firms be even more afraid of the agencies' power, or further emboldened to criticize that power?"
 - (3) Major Wall Street firms dominated the buying of Freddie's recent two-year note – *Dow Jones Newswire* reports that "some said that Wall Street firms had participated aggressively to put themselves in Freddie Mac's good graces in hopes of securing future underwriting business." ([p. 24](#))
 - (4) Freddie begins issuing subordinated debt ([p. 25](#))
 - Questions remain whether the market perceives the subordinated debt as carrying an implied government guarantee (like Fannie & Freddie's senior debt)
 - (5) Fannie says it has no plans to issue euro-denominated bonds like Freddie because it is too expensive ([p. 26](#))
 - (6) Central banks are increasingly using GSE debt to adjust their portfolios ([p. 26](#))
 - (7) Money managers have been increasing their GSE debt holdings since autumn (when GSEs reached voluntary risk management agreement with Cong. Baker) ([p. 27](#))
 - (8) Long-term GSE debt issuance decreased 23.9% from last year; short-term debt increased 4.6% ([p. 27](#))

Fannie Mae

- Fannie's new reinsurance arrangement between mortgage insurance companies and Fannie is causing a split in the mortgage insurance industry and provoking some GSE critics to claim that Fannie is engaging in "mission creep" ([p. 28](#))
 - United Guaranty's President Charlie Reid calls the new arrangements a "major threat" to the MI industry. Reid states, "Fannie and Freddie will take over total control of the MI transaction and that is something that is not in the best interest of the consumer."
 - GECMI Chief Tom Mann says the new arrangements "are designed for the primary purpose of enhancing (GSE) investor revenue. They won't increase homeownership, and our customers are justifiably wary of them."
- Does Fannie plan to sell its own credit scoring system to compete against FICO? ([p. 29](#))
 - One industry executive speculates that Fannie could financially exploit its database on millions of consumers and could blow FICO "out of the market"
- Fannie may move its headquarters on Wisconsin Avenue to another location in the District because it needs more space and is "continuing to grow" ([p. 30](#))
 - Fannie is already relocating 600 employees to a new office building for its Web site and e-business operations
- Despite opposition from some people at Fannie, John Weicher still looks to be the choice of HUD Secretary Mel Martinez for FHA Chief ([p. 30](#))
- Fannie touts progress on its \$2 trillion commitment ([p. 30](#))

Freddie Mac

- Freddie's Chairman Leland Brendsel says he would prefer a regulator that only regulates Fannie & Freddie, rather than a single regulator, which would also regulate the FHLBanks ([p. 31](#))
- Freddie publishes a second draft of its electronic mortgage guidelines ([p. 31](#))
- Freddie increases its quarterly stock dividend ([p. 31](#))
 - Freddie's next annual shareholders meeting is May 3 – will elect 13 of its 18-member board (President of the United States appoints remaining directors to the board)

Federal Home Loan Banks

- FHFB seeks further comment on its FHLBank capital standards ([p. 32](#))
- FHFB reverses itself and lifts a recently imposed limit on FHLBanks' credit exposure to GSE debt ([p. 33](#))
- More credit unions are using FHLBanks than corporate credit unions for funding assistance ([p. 33](#))
- Community bankers survey finds that more community banks are using FHLBank advances for funding assistance ([p. 34](#))

Farm Credit Administration/Farm Credit Banks/Farmer Mac

- House Agricultural Committee holds March 7 hearing on the Farm Credit Administration's (FCA) controversial national charter proposal [\(p. 34\)](#)
 - Independent Bankers Association of America testifies that the proposal is not necessary and should be “thrown on the scrap pile of bad policy ideas”
 - American Bankers Association testifies that the proposal would hurt farmers and ranchers and should be stopped
- Farmer Mac's earnings up in the 4th quarter [\(p. 36\)](#)
 - Zions is the top Farmer Mac lender
- FCA issues final rule designed to reduce report dissemination costs [\(p. 36\)](#)

Major Events

Fannie & Freddie are accused of threatening to pull business from several major banks and financial services firms as punishment for criticizing the GSEs

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In response to the threats, FM Watch is dissolving its board so its members cannot be retaliated against by the GSEs – FM Watch says their members are committed more than ever to its goals

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Senate Banking Committee Chairman Phil Gramm (R-TX) asks his staff to examine the allegations. “Any allegations of bullying by entities that enjoy the support of the federal government has to be taken seriously,” says Senator Gramm

Capital Markets Subcommittee Chairman Richard Baker (R-LA) calls the allegations “a very serious problem that warrants serious attention.”

“This stealth intimidation and well-founded fear of retribution has been part of the debate since I turned up in town in 1999,” said Steve Bartlett, President of the Financial Services Roundtable. “I’ve heard these well-founded fears from all of my members.”

These allegations highlight how much is at stake for companies in criticizing the market-dominating GSEs

“The mortgage market is the largest financial market in the world,” said Sanford C. Bernstein analyst Jonathan Gray. “Quite frankly, the banks are struggling for survival. Fannie Mae and Freddie Mac are like the terminator.”

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“Whether these allegations about Fannie Mae and Freddie Mac are true or not, regulators and elected officials have a special responsibility to taxpayers to find out...The slightest hint that firms supported with tax dollars might be involved in shaking down competitors ought to shake up Congress as well.” - National Taxpayers Union

A 1999 *International Economy* article reported Fannie’s then-Chief Spokesman John Buckley didn’t deny that Fannie can be aggressive when its self-interest is at stake, even if it means trying to hurt opponents financially. “We’re in a tough business,” he says. “We’re not shy about protecting our turf. But brutish? No.”

- **Several major banks and financial services firms have been threatened by Fannie and Freddie for criticizing the GSEs' market power and expansion efforts, according to a *Wall Street Journal* article by John Wilke and Patrick Barta.** The chief executives of Wells Fargo & Co., American International Group (AIG), and GE Capital report that they have faced threats of retaliation in their business relationships with Fannie and Freddie for participating in FM Watch.
- **“They use their muscle to threaten competitors, and that’s an outrage,” stated Maurice “Hank” Greenberg, Chairman of American International Group (AIG). “They want us to back off criticism...They’re using their systems and market position to pressure institutions they do business with.”**
- **Richard Kovacevich, President and CEO of Wells Fargo said, “Fannie Mae has used its ability to allocate business to the detriment of institutions that have executives on the FM Watch Board.” While Wells Fargo is only a minor player in the mortgage-backed securities, he said, “I am personally aware of an instance involving our company in which we were removed, without cause, from the list of approved bidders for Fannie Mae bonds based, we were told, on our overall relationship with Fannie Mae. It is one more example of tactics Fannie Mae has used to restrain or influence the market.” He noted that the cut-off was two years ago. [Editorial Note: This *Wall Street Journal* quote by Kovacevich was expanded to include Kovacevich’s written statement to *Bloomberg*, 3/8/01 article by Rob Wells.]**
- **GE Capital CEO Denis Nayden said, “Like Wells Fargo and AIG, GE executives have, in the past, also been on the receiving end of multiple communications from Fannie Mae indicating that GE would suffer financial consequences if GE remained a member of FM Watch.”**
- The chief executive of J.P. Morgan Chase & Co., William Harrison, Jr., recently made similar statements about threats from the GSEs to a group of fellow Wall Street executives, according to participants in the meeting. Allegedly, Fannie threatened to reduce the amount of business it does with J.P. Morgan Chase’s Morgan unit unless Mr. Harrison resigned from the FM Watch board. According to participants at the meeting, other executives at the meeting also complained of threats from Fannie and Freddie. Mr. Harrison recently resigned from the board of FM Watch. A spokesman for Mr. Harrison declined to comment for the article.
- In response to the news, FM Watch’s Chairman Gerald Friedman said, “It’s my opinion Bill Harrison resigned for fear Fannie and Freddie would retaliate against J.P. Morgan.” Friedman announced that the board would be dissolved because other members of the board are also facing pressure from the GSEs. He noted, however, that because the board serves as an advisory role, the group did not plan to curtail its work.
- Mr. Harrison’s departure from the FM Watch board reportedly spurred other executives to speak out about the GSEs. (*Wall Street Journal*, John Wilke and Patrick Barta, with contributions by Jacob Schlesinger, 3/8/01; *Wall Street Journal*, Patrick Barta and John Wilke, 3/9/01)

Allegations of intimidation have been widespread

- **According to the *American Banker*, “allegations of intimidation by the GSEs have been widespread for some time,” but until recently “no financial services executives had been willing to go on the record attacking the practices of companies that control the multibillion secondary mortgage market.”**

- **“This stealth intimidation and well-founded fear of retribution has been part of the debate since I turned up in town in 1999,” said Steve Bartlett, President of the Financial Services Roundtable. “I’ve heard these well-founded fears from all of my members.” Mr. Bartlett noted that he has encountered unwillingness to challenge the GSEs at the highest levels of companies he represents. “If I talk with a chief executive officer about Fannie and Freddie, whether they are on FM Watch’s side or Fannie’s side, they say ‘don’t use my name.’ And I don’t think they were afraid of FM Watch retaliating...In Washington, you don’t tug on Superman’s cape – and Fannie is Superman.” (*American Banker*, Rob Garver and Rob Blackwell, 3/9/01)**

Bloomberg follows-up on story

- As a follow-up to the *Wall Street Journal* article, Rob Wells with *Bloomberg* reports that FM Watch says Fannie and Freddie threatened to pull business from several financial institutions as punishment for criticizing the GSEs. **“Members of the FM Watch board of directors have been subject to attempts of intimidation and threats by both Fannie Mae and Freddie Mac,” said FM Watch Chairman Gerald Friedman. “The message was the same: stop supporting the activities of FM Watch or be prepared to see your business opportunities and products suffer.”** In an interview with *Bloomberg TV*, Rob Wells stated, **“It is unusual to have bank CEOs on record making allegations like this.”**
- **FM Watch Spokeswoman Beneva Schulte said J.P. Morgan Chase & Co. Chairman and Chief Executive William Harrison, Jr. resigned from FM Watch’s board this week because of pressure from Fannie and Freddie.**
- **GE Capital said it’s been disappointed with the tone of its conversations about FM Watch with Fannie Mae executives. When asked if the conversations contained threats, GE Capital Spokeswoman Marcy Brucellaria said, “I’m not saying they weren’t, but we’re not talking about them at this time.”** (*Bloomberg*, Rob Wells, 3/8/01; *Transcript from Bloomberg TV*, 3/8/01)
- Fox-Pitt Kelton Inc. analyst Chad Yonker noted that since Mr. Harrison’s Chase Manhattan Corp. bought J.P. Morgan & Co. in December, Mr. Harrison has more at stake with the GSEs. “From a Chase perspective to a Chase and J.P. Morgan perspective, the tables have turned,” said Yonker. While Chase is in the mortgage business, “J.P. Morgan is obviously a huge issuer of Fannie and Freddie debt,” he said. “Mortgage lending is the lower profit margin business. There’s much more to lose on the investment banking side.” (*Bloomberg*, Rob Wells, 3/8/01)

Senator Gramm asks his staff to examine the allegations

- **A spokeswoman for Senate Banking Committee Chairman Phil Gramm (R-TX) said that the Chairman has asked the Committee staff to look into the matter. “Any allegation of bullying by entities that enjoy the support of the federal government has to be taken seriously,” said Senator Gramm.** (*Wall Street Journal*, Patrick Barta and Richard Wilke, 3/9/01)

Cong. Baker calls the allegations “a very serious financial problem that warrants serious attention.”

- Cong. Baker issued the following statement in response to the press reports on alleged retaliation by the GSEs against their business partners and competitors: “I have read news reports...relating to the accusations that are troubling concerning inappropriate business conduct by a government-sponsored enterprise. I would be very surprised to discover that a GSE’s past record of professional conduct would have deteriorated to the level described in the reports.” However, if

true, “the allegations that a government-sponsored enterprise has threatened retaliation against other business interests does require careful examination.” He said he would not allow these new concerns to “upset the content or timing” of the GSE legislation that he is currently drafting nor conflict with his agenda or schedule of hearings related to his GSE legislation. “However, I will examine whatever is on the public record and take such necessary steps that I find to be in the public interest. I am not saying that these allegations, even if true, would represent a clear case of unlawful anti-trust activity. I am saying that at the very least they may require review by people with greater expertise in these matters.” (*Press release by Cong. Richard Baker, 3/8/01*) **Cong. Baker called the allegations “a very serious financial problem that warrants serious attention.” He added that at the very least, there will be formal hearings in Washington on the harassment allegations.** (*The Advocate (Baton Rouge), Randy McClain, 3/13/01*)

Fannie & Freddie deny the allegations

- Spokespersons for Fannie and Freddie deny the allegations of threats. Freddie’s Chairman Leland Brendsel said the allegations are “totally false” and that Freddie “does not do business that way.” He stated, “we don’t trade business for political support.” (*Dow Jones Newswire, Jennifer Corbett Dooren, 3/8/01*) “I think this just reflects the loss of momentum that FM Watch is experiencing,” said a Spokesperson for Freddie. (*National Mortgage News Daily, 3/8/01*) A Spokeswoman for Freddie stated, “we don’t issue threats,” adding that the allegations showed “air coming out of the tires” at FM Watch. (*Wall Street Journal, John Wilke and Patrick Barta, with contributions by Jacob Schlesinger, 3/8/01; Wall Street Journal, Patrick Barta and John Wilke, 3/9/01*)
- In an interview with *Bloomberg*, Fannie Chairman Franklin Raines states, “Our reaction to all of this, it is bizarre. First, these allegations are false. Second, they are a diversion to take attention away from the fact that FM Watch apparently has problems. And third, this is consistent with the kind of strategy FM Watch has had from the beginning, which is an anti-consumer strategy and is about them making money.” (*Bloomberg, Rob Wells, 3/9/01*) Raines later states, “We have done the inquiries necessary to stand behind our absolute denial” of any intimidation. “In the absence of anything more than press spin, we will wait for evidence that goes beyond the fact that FM Watch was disintegrating and they wanted to change the subject.” (*American Banker, Tom Fernandez, 3/15/01*) “It’s absolutely not true and it’s outrageous,” said Janice Daue, Fannie’s VP for Public Affairs Daue. “We do a lot of business with these folks.” (*Bloomberg, Rob Wells, 3/8/01*) She later added that the allegations were “a blatant public-relations effort” by FM Watch and its members to divert attention from “the collapse of the board” of the group. (*Wall Street Journal, Patrick Barta and John Wilke, 3/9/01*) She has also stated that FM Watch is spreading “baseless” allegations “because it is a failure.” (*National Mortgage News Daily, 3/9/01*)

FM Watch releases written statement that the associations belonging to FM Watch are more committed than ever to its goals

- **FM Watch Chairman Gerald Friedman issued the following written statement on the dissolving of the FM Watch board: "In order to remove the focal point of Fannie Mae and Freddie Mac's threats, we are today disbanding the FM Watch Board. FM Watch will persist in shining the light on the activities of the GSEs. The associations that belong to FM Watch are more committed than ever to its goals. The policies and strategies of the organization, as they have in the past, will continue to be managed and implemented by the members of our Executive Committee."** (*FM Watch press release, 3/8/01*)

Trade groups says they will continue to support FM Watch

- **Several trade groups that belong to FM Watch said they plan to continue their support of FM Watch. A Spokesman from the Consumer Bankers Association said, “We think that our members continue to have the same concerns. So we will remain a part of FM Watch.”** (*American Banker*, Rob Garver and Rob Blackwell, 3/9/01) **FM Watch and its supporters say the organization will continue to do battle and that funding for its activities has not been disrupted. “FM Watch is not going away at all,” said one trade group official. “That’s just plain wrong.”** (*National Mortgage News*, Paul Muolo, 3/12/01)

OFHEO’s comments about the *Wall Street Journal* article

- A spokeswoman for Fannie and Freddie’s safety and soundness regulator, OFHEO, refused to comment on the article, but said “like other regulators if we receive specific allegations of improper conduct by our regulatees we will look into the matter.” (*Dow Jones Newswire*, 3/8/01)

The rift in the mortgage industry highlights how much is at stake for companies in criticizing GSEs

- *Bloomberg* reports that the current “rift” in the mortgage industry between financial services firms and the GSEs underscores how much is at stake. **“The mortgage market is the largest financial market in the world,”** said Jonathan Gray, an analyst with Sanford C. Bernstein. **“Quite frankly, the banks are struggling for survival. Fannie Mae and Freddie Mac are like the terminator.”**
- *Bloomberg* reports that Fannie and Freddie’s relationship with lenders “has always been strained” and that concerns have increased over the past year as the GSEs move into other markets such as subprime loans, home-improvement and home-equity loans. **“Any part of the mortgage market Fannie and Freddie are allowed to compete in they will drive everyone out,”** said Gray at Bernstein. **“You can’t compete against them.”** (*Bloomberg*, Jonas Bergman, 3/8/01)
- *The American Banker* reports that most sources agree that a congressional investigation of the GSEs would have broad industry support, but that few executives are willing to be seen as its prime movers, for fear of retaliation in the form of lost business from the GSEs. **“To go as far as they [Wells Fargo, AIG, GE Capital] have took a lot of courage,”** said one mortgage industry source. **“Everybody has to truly understand how many touch points the agencies have where they can impact your financial viability. If you are a lender and they [GSEs] decide to give you a couple of basis points more on a guarantee fee, you are significantly advantaged in the market. A few basis points less, and you can be significantly disadvantaged.”** (*American Banker*, Rob Garver and Rob Blackwell, 3/13/01)

Citizens Against Government Waste blasts GSEs for threatening critics

- **CAGW blasted Fannie and Freddie in response to reports of alleged threats by the two GSE against critics in the mortgage banking business. “Where is Joel Klein when we need him?”** said CAGW Vice President Leslie K. Paige. **“The same government that spent at least \$35 million...needlessly to harass Microsoft...continues to fortify Fannie Mae and Freddie Mac with massive tax breaks.”** She adds, **“Congress needs to exert its oversight authority and not let these quasi-government agencies parade around like the Sopranos of the financial world.”**
- **“That Fannie and Freddie are allegedly using their government-enhanced positions to strong-arm detractors is no surprise: Subsidies breed arrogance and abuses,”** Paige stated. **“This is of concern not only to free-marketeers, congressional leadership, and friends of the private**

banking and investment industries, but to every taxpaying American who worries about Big Brother bossing them around,” she added. “Fannie Mae and Freddie Mac are government-supported duopolists, and these allegations underscore the dangers posed by such mammoth government ‘corporations.’”

- The National Taxpayers Union joined CAGW in expressing concern. “Whether these allegations about Fannie Mae and Freddie Mac are true or not, regulators and elected officials have a special responsibility to taxpayers to find out,” said Pete Sepp, NTU Vice President for Communications. “The slightest hint that firms supported with tax dollars might be involved in shaking down competitors ought to shake up Congress as well.” (CAGW press release, 3/9/01)

Previous news articles about alleged intimidation by GSEs

- “When reason fails, opponents claim, Fannie plays hardball,” reported Owen Ullman for the *International Economy*. He adds, “It [Fannie] will hire key government critics to buy their silence, and it will intimidate lawyers, consultants and financiers who go up against it by pressuring clients of the opponents to withdraw their business.” A congressional source states, “Fannie has this grandmotherly image...but they’ll castrate you, decapitate you, tie you up and throw you in the Potomac. They’re absolutely ruthless.” Ullman reports, that Fannie’s then-Chief Spokesman John Buckley, doesn’t deny that Fannie can be aggressive when its self-interest is at stake, even if it means trying to hurt opponents financially. “We’re in a tough business,” Buckley says. “We’re not shy about protecting our turf. But brutish? No.” Buckley claims what is intimidating to members of Congress is not its lobbying tactics but its spectacular accomplishments. (*International Economy*, Owen Ullman, July/August 1999).
- Fannie Mae has the reputation of scaring its critics silent. “The company is famous for its vindictiveness toward those who cross it, with perhaps the most oft-told story being Fannie’s decision to stop doing business with investment powerhouse Salomon Brothers for a period after folks at Salomon spoke out against Fannie’s operations.” No one in the mortgage market or staffers on Capitol Hill would comment for the *Washington Monthly* article, and one mortgage company executive noted that “You’ll have to find someone who has nothing to lose.” The press is also not immune to Fannie’s scare tactics: “Press attention tends to make the company unhappy – unless, of course, reporters are covering one of the foundation’s PR events. No scrap of information is released by Fannie, or its foundation, without the requester first undergoing a thorough grilling.” (*Washington Monthly*, Michelle Cottle, June 1998)
- According to *Congressional Quarterly*, when Charles Lewis of the Center for Public Integrity began to study Fannie’s political influence, he was not prepared for the angst his probing questions would prompt on Capitol Hill. “We had folks who would only meet us in strange places,” such as parking garages, he said. “No one wanted to talk on the record.” He added, “Usually...people are a little cautious and a little squirrely, but this was almost the next step.” Fannie official claim much of the company’s influence and the political experience of its employees are “wildly exaggerated.” (*CQ Weekly*, Lori Nitschke, 6/13/98)

Coalition of chief executives from more than a dozen financial institutions has decided to press for reform of Fannie & Freddie

The group – the Financial Services Forum – is an intentionally low-profile organization of chief executives from the country’s largest financial institutions

- At a recent meeting of the Financial Services Forum, the group decided to press for reform of Fannie and Freddie, according to an article by Patrick Barta and John Wilke with the *Wall Street Journal*.
- The *Wall Street Journal* reports that Fannie and Freddie can “exert enormous leverage” over financial institutions, if they choose, because they use Wall Street institutions to underwrite their debt. Fannie and Freddie reportedly have paid as much as \$460 million in underwriting fees to Wall Street firms in recent years. Fannie and Freddie also negotiate fees with banks for the loans they buy.
- Fannie Spokeswoman Janice Daue stated, “when people raise questions we take them seriously.” She added: “If this organization wants to address [GSE] reform, we welcome having conversations with them. I can’t comment on what they’re saying when I don’t know the context.” However, she then noted that the new interest of the Financial Services Forum is just “the same old cast of characters who consistently make these points – there is no news here.”
- It is unclear what specific course the Financial Services Forum plans to take. However, according to people familiar with the meeting, the group’s members discussed their concerns about Fannie and Freddie, including their fear that the companies are expanding into new businesses such as home equity lending and mortgage insurance. They claim this is unfair because Fannie and Freddie are able to borrow money more cheaply than private organizations because of their perceived ties to the federal government. One person said the members also discussed developing strategies to contain the growth of the GSEs, and finding a workable model for their eventual privatization. (*Wall Street Journal*, Patrick Barta, John Wilke, with contributions by Paul Beckett, John Hechinger and Jacob Schlesinger, 3/9/01)
- The *American Banker* reported that the Financial Services Forum has not taken a position on the GSEs. President of the Forum George J. Vojta said, “We have not taken a position on the question as a group...The Forum is not involved in the GSE question. Some members have chosen to comment publicly.” (*American Banker*, Rob Garver and Rob Blackwell, 3/13/01)
- The Financial Services Forum is an intentionally low-profile organization of chief executives from the country’s largest financial institutions, many of which do business with Fannie and Freddie. The forum includes the leaders of Bank of America, Citigroup Inc., J.P. Morgan Chase & Co., GE Capital Services Inc., Allstate Insurance Co., and American Express Co. The Financial Services Forum, based in Washington, was founded in January 2000 by the chief executives of 19 companies, including Goldman Sachs Group Inc., Bank One Corp. and other big lenders and securities brokers. (*Bloomberg*, Vernon Silver, 3/9/01)

President Bush's top economic advisor Lawrence Lindsey says he is concerned about using GSE debt as a benchmark

Lindsey says, "I think it is an invitation for trouble."

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

- President Bush's top economic advisor Lawrence Lindsey says he is concerned about the possible use of GSE debt as a substitute benchmark for Treasurys. Speaking at a MBA Housing Summit, Lindsey said that the costs associated with Treasurys serving "double duty" as a benchmark for interest rates are negligible, but that the same cannot be said about GSE debt. He said he gets "nervous" about the idea of having the securities of an institution with a dedicated purpose – like a GSE – "carry double duty" the way Treasurys do. "I think it an invitation for trouble," he stated. "The trouble may never materialize, but it is something less than ideal." He further stated that he did not think mortgage-backed securities are a good alternative to Treasurys. He noted that interest rates on mortgage-backed securities could either move rapidly higher or lower for reasons due entirely to the mortgage market. "But we will see which way the market goes to find a substitute," he said. (*National Mortgage News Daily*, 3/13/01; *Reuters*, 3/13/01)

Warren Buffet's Berkshire Hathaway sells nearly all of its shares of Fannie & Freddie in 2000

Buffet blasted unnamed companies that make "fancy" earnings predictions. "For a major corporation to predict that its per-share earnings will grow over the long term at, say, 15% annually is to court trouble...I tend to be leery of companies run by CEOs who woo investors with fancy predictions...A few of these managers will prove prophetic – but others will turn out to be congenital optimists, or even charlatans."

***Bloomberg* notes that in May 1999, Fannie's Chairman Franklin Raines promised investors that the company would double its earnings-per-share over the next five years, or 15% a year**

Regarding Buffet's Berkshire Hathaway sale of nearly all of its shares of Fannie last year, Raines states, "I can't imagine what he [Buffet] was thinking."

- Investor Warren Buffet's Berkshire Hathaway Inc. sold nearly all of its holdings in Fannie and Freddie last year, according to his annual letter to shareholders. During last year, Berkshire sold nearly all its shares of Freddie, which were worth about \$2.8 billion in 1999. Berkshire now only owns 0.3 percent of Freddie Mac, down from 8.6 percent at the end of 1999. Buffet provided no explanation for the decision to shed the issues in an equity portfolio he described as "only mildly attractive." (*Dow Jones Newswire*, Richard Gibson, 3/10/01; *Reuters*, Bill Rigby, 3/1/01)
- Though Buffet did not mention any companies by name, he blasted unnamed companies that make "fancy" earnings predictions. "For a major corporation to predict that its per-share earnings will grow over the long term at, say, 15% annually is to court trouble," he stated in his letter. "I tend to be leery of companies run by CEOs who woo investors with fancy predictions," he said. "A few of these managers will prove prophetic – but others will turn out to be congenital optimists, or even charlatans." (*Bloomberg*, Jonas Bergman, 3/14/01)

- In May 1999, Fannie’s Chairman Franklin Raines promised investors that the company would double its earnings-per-share over the next five years, or 15 percent a year. (*Bloomberg News*, 3/14/01) In an October 2000 speech, Raines stated, “We are on track to deliver our second consecutive year of 15 percent operating EPS growth, keeping us on track to meet our goal of doubling EPS by 2003. (*Raines speech before New York Society of Security Analysts*, 10/11/00) In a press release announcing its fourth quarter 1999 earnings, Freddie’s Chairman Leland Brendsel states, “we remain committed to mid-teens earnings growth over the next few years.” (*Freddie press release*, 1/18/00)
- **In response to the news that Buffet’s Berkshire Hathaway sold “nearly all” of his Fannie shares last year, Fannie Chairman Franklin Raines stated, “I ought to talk to Warren, he must have been having a bad day.” He added, “Depending on when he sold it last year, it was a very bad idea if he sold it any time up until the very end of the year, because our stock rose dramatically...Some people are saying Fannie Mae growth will be twice that of the S&P 500 over the next five years. I can’t imagine what he was thinking.”** (*Bloomberg News*, 3/14/01)

Excerpt from Buffet’s letter to shareholders:

“One further thought while I’m on my soapbox: Charlie [Charlie Munger, Berkshire’s Vice Chairman and Warren Buffet’s partner] and I think it is both deceptive and dangerous for CEOs to predict growth rates for their companies. They are, of course, frequently egged on to do so by both analysts and their own investor relations departments. They should resist, however, because too often these predictions lead to trouble.

“It’s fine for a CEO to have his own internal goals and, in our view, it’s even appropriate for the CEO to publicly express some hopes about the future, if these expectations are accompanied by sensible caveats. But for a major corporation to predict that its per-share earnings will grow over the long term at, say, 15% annually is to court trouble.

“That’s true because a growth rate of that magnitude can only be maintained by a very small percentage of large businesses. Here’s a test: Examine the record of, say, the 200 highest earning companies from 1970 or 1980 and tabulate how many have increased per-share earnings by 15% annually since those dates. You will find that only a handful have. I would wager you a very significant sum that fewer than 10 of the 200 most profitable companies in 2000 will attain 15% annual growth in earnings-per-share over the next 20 years.

“The problem arising from lofty predictions is not just that they spread unwarranted optimism. Even more troublesome is the fact that they corrode CEO behavior. Over the years, Charlie and I have observed many instances in which CEOs engaged in uneconomic operating maneuvers so that they could meet earnings targets they had announced. Worse still, after exhausting all that operating acrobatics would do, they sometimes played a wide variety of accounting games to ‘make the numbers.’ These accounting shenanigans have a way of snowballing: Once a company moves earnings from one period to another, operating shortfalls that occur thereafter require it to engage in further accounting maneuvers that must be even more ‘heroic.’ These can turn fudging into fraud. (More money, it has been noted, has been stolen with the point of a pen than at the point of a gun.)

“Charlie and I tend to be leery of companies run by CEOs who woo investors with fancy predictions. A few of these managers will prove prophetic — but others will turn out to be congenital optimists, or even charlatans. Unfortunately, it’s not easy for investors to know in advance which

species they are dealing with.” (*Berkshire Hathaway 2000 Annual Report*, <http://www.berkshirehathaway.com/2000ar/2000ar.pdf>)

Capital Markets Subcommittee Chairman Richard Baker (R-LA) releases GAO report showing that GSE regulators lack the powers of bank regulators

GAO report finds significant differences in the safety and soundness powers granted to OFHEO and the FHFB in comparison with bank regulators

“GAO’s report confirms that the legal authorities of the GSE regulators, particularly OFHEO as the regulator of Fannie Mae and Freddie Mac, are significantly weaker than federal bank regulators for taking action when capitalization and safety and soundness issues arise,” said Cong. Baker

GAO finds there is no specific authority for OFHEO to issue a cease and desist order if Fannie or Freddie were to violate conditions imposed in writing

Fannie & Freddie are currently objecting to a “cease and desist” proposal by their regulator (see story in this *GSE Report* [\(p. 20\)](#))

- Cong. Baker released a GAO report entitled, “Comparison of Financial Institutions Regulators’ Enforcement and Prompt Corrective Action Authorities,” which concluded that the GSE regulators lack certain key enforcement and prompt corrective action authorities of bank regulators. The report compared the legal authorities available to federal bank regulators, the Office of Federal Housing Enterprise Oversight (OFHEO) (regulates the safety and soundness of Fannie and Freddie), and the Federal Housing Finance Board (FHFB) (oversees the safety and soundness of the FHLBank System). [HUD, which oversees mission compliance for Fannie and Freddie, was not included in the comparison.]
- Cong. Baker said he requested the report after hosting a GSE Roundtable in September of last year, at which there was a general consensus that the GSEs need stronger oversight, and that “two of the largest financial institutions [Fannie and Freddie] in America should at least have more ‘bank-like’ supervision.” Cong. Baker stated that “the GAO report puts an objective stamp on that general impression and points out the steps we need to take to make the GSE regulators comparable in strength to bank regulators.”
- Cong. Baker is working on legislation to consolidate and strengthen the regulation of the GSEs, and this new regulator is expected to be given a full complement of bank regulator-like enforcement powers.
- Among GAO’s findings:
 - (1) Unlike other bank regulators, which include the Federal Reserve Board and the Federal Deposit Insurance Corp., OFHEO lacks the authority to remove officers and directors, place an agency in receivership and pursue litigation. The US Attorney General must sue on behalf of OFHEO.
 - (2) There is no specific authority for OFHEO to issue a cease and desist order if Fannie or Freddie were to violate conditions imposed in writing.

(3) There are differences in regulations regarding how OFHEO and other banking regulators use prompt corrective action (PCA) provisions. PCA is designed to allow a regulator to take certain actions if an institution is in financial trouble. The report found that “OFHEO’s PCA scheme, as compared to the bank regulators, may provide for regulatory action later (in terms of capital classification) than the bank regulators’ PCA scheme, has fewer required actions imposed, and provides OFHEO more discretion in determining what action to take.” The report found that the notice and comment provisions required for OFHEO’s PCA scheme “may result in a longer PCA process for OFHEO.”

- Cong. Baker clarified that the GAO report should in no way be seen as a criticism of the operation and management of the current GSE regulators, but rather as an indication of the limitations placed upon them in respect to the powers they have been provided.
- OFHEO Director Armando Falcon noted in a statement that the GAO report showed that his agency had “properly employed its current informal and formal authorities to address any ambiguities and uncertainties in the law.” Further, Falcon has asked Congress for additional enforcement powers and strengthen OFHEO by removing it from the Congressional appropriations process, a funding procedure that has in the past tied up funding to the regulator. “OFHEO continues to encourage passage of legislation to enhance OFHEO’s authority and remove OFHEO from the appropriations process as is the case for other safety and soundness regulators,” Falcon stated. (*Press Release by Cong. Baker, 3/1/01; GAO Report, GAO-01-322R: Financial Regulators’ Enforcement Authorities, 1/31/01* (<http://www.house.gov/baker/News/01-322R.pdf>) ; *Dow Jones Newswire, Jennifer Corbett Dooren, 3/1/01; National Mortgage News Daily, 2/2/01, National Mortgage News, 3/5/01; Reuters, 3/1/01*)

Cong. Baker (R-LA) plans March 27 hearing to assess how well Fannie & Freddie are fulfilling their voluntary risk management agreement reached last October

Fannie & Freddie say they will fulfill the promises made to Cong. Baker by the end of the month

- Capital Markets Subcommittee Chairman Cong. Richard Baker (R-LA) plans to hold a March 27 hearing to assess how well Fannie & Freddie are fulfilling their voluntary risk management agreement reached last October to improve the GSEs’ safety and soundness. A spokesman for Cong. Baker said the Congressman has no plans to expand the hearing to address allegations that financial services firms have been threatened by the GSEs.
- Spokesman for both Fannie and Freddie indicated that they would fulfill the six-points of the voluntary risk management agreement by the end of the month. To date, Fannie and Freddie claim they have carried out three of the six-points.
- The components of the voluntary initiative are as follows:
 - (1) Issue subordinated debt – after a three-year phase in - on a semi-annual basis equal to or in excess of 4% of on-balance-sheet assets. (In January, Fannie issued \$1.5 billion of subordinated debt, which was rated “AA-minus” by Standard & Poor’s. Freddie announced its first sale of subordinated debt this month. Further information in this *GSE Report*. ([p. 23](#)))

- (2) Maintain more than three months' worth of liquidity assuming the GSEs have no access to public debt markets. (Fannie and Freddie recently announced that they have met this requirement. Further information in this *GSE Report*. ([p. 22](#)))
- (3) Implement an interim risk-based capital stress test until permanent risk-based capital regulations are finalized by OFHEO. (Fannie and Freddie expect to fulfill this requirement by the end of the month.)
- (4) Initiate public disclosure of interest-rate risk sensitivity analyses and results on a monthly basis. (Fannie and Freddie expect to fulfill this requirement by the end of the month.)
- (5) Initiate public disclosure of credit-risk sensitivity analyses and results on a quarterly basis. (Fannie and Freddie expect to fulfill this requirement by the end of the month.)
- (6) Obtain an annual "risk to the government" rating of the independent financial strength of each of the companies from a rating organization and disclose the rating to the public. (In February 2001, Fannie and Freddie both announced that they had obtained AA-minus corporate "risk to the government" credit ratings from Standard & Poor's. Further information in this *GSE Report* ([p. 21](#))) (*American Banker*, Erick Bergquist, 3/14/01)

Fannie Mae & Freddie Mac

***Financial Times* columnist says “it’s time for Fannie and Freddie to grow up”**

Fannie & Freddie are gaining unfairly from their association with the federal government

Fannie & Freddie “are growing so fast that they now threaten to consume the entire mortgage market, doing the damage of classic monopolies”

- In her *Financial Times* column, “It is time for Fannie and Freddie to grow up,” Amity Shlaes writes that Fannie and Freddie “are gaining unfairly from their association with the federal government.” She claims that Fannie and Freddie were never completely privatized and that they enjoy a number of advantages over their wholly private competitors (such as exemption from state and local taxes and a \$2.5 billion line of credit to the Treasury). Most significantly, she says is that there is a general feeling that “because of their social value and their size, the pair [Fannie and Freddie] must not be allowed to fail.” She notes that “Fannie and Freddie play down their public link, swearing they are as much subjects of market discipline as the next fellow. But the markets do not believe them. For one thing, Americans recall the savings and loan bail-out. The proof of investors’ faith that the government stands behind Fannie and Freddie is the lower cost of borrowing.”
- Shlaes notes that the Federal Reserve and Congress have raised concerns about the GSEs but “Fannie and Freddie are wealthy enough to strike back,” noting that the GSEs “sought to assure their unique status by pouring more than \$4m into political contributions to both parties.”
- She claims that Fannie and Freddie “may already be distorting markets” by “luring Americans into homebuying when they might better invest elsewhere.” **She adds that Fannie and Freddie “are growing so fast that they now threaten to consume the entire mortgage market, doing the damage of classic monopolies.”**
- Shlaes also claims that “Fannie and Freddie’s assets are held by so many US banks that their weakening would pose the threat of systemic risk” and it “is possible they would require a federal bailout” that “would be hard to refuse, and far costlier than the savings and loan rescue, which ran no less than \$220bn.” The biggest danger, she claims, is America’s emerging federal surplus and she warns about the problems with the US investing in Fannie and Freddie securities (due to dwindling supply of Treasuries).
- **She concludes, “Fannie and Freddie are evidence of a special double hazard – that of allowing ‘public-private’ entities to become players in financial markets.”** (*Financial Times*, Amity Shlaes, 2/27/01)
- In response to the *Financial Times* piece, Fannie Chairman Franklin Raines claims that Fannie enhances competition, provides stability and liquidity in the mortgage market and disperses mortgage risk to other private entities. He claims that Shlaes “sets up a false distinction between Fannie Mae and banks and thrifts by ignoring the federal benefits enjoyed by banks and thrifts. He claims that reducing Fannie’s role in housing finance would reduce competition among lenders and concentrate mortgage debt back into depository institutions with “direct taxpayer exposure.” (*Fannie Chairman Franklin Raines, Letter-to-the-Editor, Financial Times*, 3/8/01)

Commentary in *Washington Times* and *Miami Herald* calls for an end to Fannie & Freddie's corporate welfare

Nationally syndicated columnist Michelle Malkin calls Fannie & Freddie “two of the fattest corporate-welfare targets on the block”

- A recent commentary by nationally syndicated columnist Michelle Malkin in the *Washington Times* and *Miami Herald* calls for the removal of the GSEs' government subsidy. According to Malkin, the Bush Administration is already making moves to cut corporate welfare, even receiving praise in a recent *Wall St. Journal* editorial by consumer advocate Ralph Nader. Malkin notes that the Bush Administration's budget proposal targets the Overseas Private Investment Group, the Export-Import bank, and the Advanced Technology Program, all “corporate-welfare poster children” that receive millions of dollars in taxpayer-funded loans, loan guarantees, budget support and research subsidies.
- **Nader notes that there is still “much, much more to do to rein in corporate welfare,” however, Malkin points out that Nader neglects to include “two of the fattest corporate-welfare targets on the block: Fannie Mae and Freddie Mac.”** [Editorial Note: Ralph Nader testified at a June 15, 2000 House Capital Markets Subcommittee hearing that Congress has “played the role of indulgent parent” to the GSEs for too long. Mr. Nader stated, “The GSEs have long since grown beyond adolescence. It is time for GSEs to give up ties to the federal government that have made them poster children for corporate welfare.”]
- Malkin notes that the two GSEs receive an estimated \$6.5 billion in hidden taxpayer subsidies each year, and that an updated CBO report is expected to raise that number to \$10 billion annually. And while both Senate Banking Committee Chairman Phil Gramm (R-TX) and House Capital Markets Subcommittee Chair Richard Baker (R-LA) have called for reform, she believes there is little hope that these reforms will be implemented. She notes that Bush Treasury Secretary Paul O'Neill did not acknowledge that Fannie and Freddie receive government subsidies. “The market might give them a preferential rate because of the prospect of government support, but they don't really receive a subsidy,” O'Neill is quoted as stating in a recent interview with *Bloomberg Television*. Malkin writes, “Uh-huh. Guess it depends on what the meaning of really is.”
- Malkin notes that Fannie and Freddie receive various benefits such as an exemption from state and local income taxes, an exemption from registering their securities with the SEC, a \$2.25 billion line of credit with the US Treasury, and are subject to lower capital requirements than other private sector financial institutions. Malkin writes, **“These special pipelines give the institutions an implied federal guarantee available to no other private-sector competitor in the mortgage market.”** According to Malkin, **“this is a textbook case of government aid to dependent corporations that couldn't do business without their taxpayer fix.”**
- In addition, notes Malkin, the GSEs thrive on political “back-scratching” -- current Fannie Mae board members include Marc Rich's attorney Jack Quinn and former Reno Assistant Attorney General Jamie Gorelick. Fannie's CEO Franklin Raines was director of the Office of Management and Budget for Clinton and “just happens to be a buddy of Bush Treasury Secretary O'Neill.” **She concludes, “So much for changing the culture in Washington. For Fannie Mae and Freddie Mac, it's taxpayer-supported business as usual.”** (Michelle Malkin, *Washington Times*, 3/13/01 – also ran in the *Miami Herald* on 3/12/01)

***Grant's Interest Rate Observer* explains that Fannie & Freddie's extraordinary earnings do not occur in nature, but rather from their GSE status. The GSEs are not "natural enterprises."**

"The GSEs are allowed to get by on a much smaller cushion of equity capital than is permitted to ordinary worldlings [private market competitors]. A tower of assets rests on a sliver of net worth."

Fannie & Freddie "will be hard-pressed to overcome the arithmetic problem of growing at 15% a year in a 10% marketplace...Nor will be easy to explain away the generation-long record of extraordinary returns on substandard equity capital."

- In the February 2nd issue of *Grant's Interest Rate Observer*, author Jim Grant asks: "Is there any imaginable adverse consequence of the massive longstanding subsidy of residential housing?" He answers, "yes."
- Freddie's Chairman Leland Brendsel recently boasted that his company achieved 30 years of profitability, a 19-year return on common equity that exceeds 20%, and an earnings growth of over 20% for the year 2000. **For so long Freddie delivered such extraordinary returns that people have stopped wondering how the company does it. However, what some people have not yet realized is that the GSEs are not a naturally occurring phenomenon and such a record "does not occur in nature." In contrast, he believes that no companies in the "civilian economy" have sustained a 20% ROE through "thick and thin."**
- **Fannie and Freddie are not "natural enterprises." They are federally chartered duopolists that have advantages conferred by their "semi-federal status" such as the ability to borrow at relatively low rates and lend at a relatively high rate. The GSEs are also "allowed to get by on a much smaller cushion of equity capital than is permitted to ordinary worldlings [private market competitors]. A tower of assets rests on a sliver of net worth."**
- **Grant notes that the "long-simmering controversy of the appropriate relationship" between the GSEs and the federal government is bound to heat up again this year with the impending release of a Congressional Budget Office study estimating the GSEs' government subsidies.** While the report has yet to be released, government leaks place the GSE subsidy around \$10 billion annually. This is notable because Freddie Mac only earned around \$2.5 billion last year
- Another cause of concern is the future shortage of Treasuries. Since the Fed may be forced to purchase GSE debt in place of Treasury debt, Grant notes, "it cannot be lost on the FOMC [Federal Open Market Committee] that these institutions are highly leveraged. Therefore, by acquiring their bonds and notes, the Fed would be introducing credit risk onto its own ultra-leveraged balance sheet." Grant also notes "the Fed, we think, doesn't like to imagine the agencies' securities despoiling its balance sheet."
- According to Grant, the GSEs have thrived in a rare long-standing area of bi-partisan agreement in the form of "financial socialism." The majority of the \$5.4 trillion residential mortgages are held by the GSEs and federally insured thrifts and banks. The GSEs even have a \$2.25 billion line of credit with the Treasury. He notes that it is not the size of the Treasury's credit line that is important but rather the simple existence of it. "Knowing that...the GSEs are virtual federal protectorates, the capital markets charge them accordingly lenient terms to borrow."

- **Grant notes that the GSEs “are blessed in the structures of their balance sheets” and are earning extraordinary returns on substandard equity capital.** He writes, “Instead of common equity capital equivalent to 5% or so of assets (as is the case for many banks and thrifts), Mac and Mae are permitted to get along with less than 3%.” Last year, Freddie’s return on average equity totaled 23.7%, which compares to the 21.2% earned by the nation’s largest thrift, Washington Mutual, or an estimated 15% to 16% posted by the leading independent mortgage banker, Countrywide Credit.” Grant further notes that if Washington Mutual and Countrywide were allowed to keep a base equivalent to 2.5%, their assets would earn around 39% and 79% respectively. And alternatively, if the GSEs were forced to hold 5%, Freddie’s ROE would shrink to 11% -- half of what it earned last year.
- Financial consultant Bert Ely is quoted as stating “what troubles me more (than the consistently high ROE by the GSEs)...is that rate of earnings growth. They are promising a growth rate – 15% -- that exceeds the growth rate in that mortgage market, which is about 10%. If mortgage growth slows down, it will be even harder to meet their earnings objective. What does that mean? They will have to take additional risk...They have driven their credit losses basically to zero, and, at the same time, they have taken on more risk as they are pressured to keep up earning growth. Some of the risk they pass on to mortgage insurers, but more and more they keep for themselves. It’s not clear to me how long this can continue...particularly if we get a lengthy slowdown in the economy.”
- **Grant concludes that Fannie “will be hard-pressed to overcome the arithmetic problem of growing at 15% a year in a 10% marketplace.”** He adds, “Nor will it be easy to explain away the generation-long record of extraordinary returns on substandard equity capital.” In addition, Grant asks: “What role has subsidized mortgage credit played in the great bull stock market? And...where would Fannie and Freddie be if house prices took an unexpected (indeed, unimagined) spill?” (*Grant’s Interest Rate Observer*, Jim Grant, 2/2/01)

<p>Fannie & Freddie are currently objecting to a “cease and desist” proposal by their regulator (OFHEO)</p>
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- According to John Connor with *Dow Jones Newswire*, Fannie and Freddie are objecting to a proposal by OFHEO that the GSEs claim is overly broad and could stifle innovative practices. OFHEO’s proposal would allow it to initiate “cease and desist” enforcement proceedings against Fannie and Freddie based on “any unsafe and unsound practice” or “any unsafe or unsound condition.”

Fannie’s comments

- “Since nearly all business initiatives present some possibility of loss, the proposed definition effectively covers any business activity, regardless of whether the risk it presents is ‘abnormal’ or threatens the financial welfare of a company,” says Fannie in a comment letter to OFHEO. Fannie says the proposal is contrary to Congress’ intent that the day-to-day business of the companies be “free from micro-management.” Fannie also claims the OFHEO proposal has a far broader definition of “unsafe and unsound practice” than the judicially accepted definition of the term. Fannie claims this broader definition would limit the companies’ innovative practices.

Freddie’s comments

- “Adopting the proposed standard for initiating a cease-and-desist proceeding would suggest that OFHEO possesses unfettered authority to impose its business judgment on any business initiative

or process improvement of Freddie Mac or Fannie Mae and to prohibit an enterprise from going forward with its plans.” Freddie further claims that OFHEO’s proposal is more expansive than that applying for bank regulatory agencies. (*Dow Jones Newswire*, John Connor, 3/2/01)

Background

- Fannie and Freddie’s comment letters were in response to a proposed rule by OHFEO on revisions to its rules governing administrative enforcement proceedings. The rule is intended to clarify the scope of OFHEO’s authority to issue cease and desist orders and to impose various corrective and remedial sanctions, including civil money penalties, on Fannie and Freddie, and their executive officers and directors. OFHEO says it seeks to promote greater transparency by describing the grounds on which enforcement actions may be instituted and examples of the terms and conditions it may impose.
- According to OFHEO, the 1992 Act that created the agency essentially grants OFHEO the same administrative enforcement authority as the Federal bank regulatory agencies, including the power to issue cease and desist orders and to impose civil money penalties. Grounds for issuing cease and desist orders include unsafe or unsound practices or conditions, any conduct that violates a written agreement between the GSEs and OFHEO, and any action that violates the charters of the companies. Civil money penalties may be imposed if OFHEO finds that “a violation or conduct was knowing and caused or would be likely to cause a substantial loss to the enterprise, and the director may impose penalties on an enterprise of up to \$1,000,000 per day of violation or conduct or on an executive officer or director of up to \$100,000 per day of violation or conduct.” Prior to issuing a cease and desist order or imposing civil money penalties, OFHEO must conduct a public hearing, unless its director determines that an open hearing would be contrary to the public interest. Final orders in cease and desist proceedings or civil money penalty proceedings are to be made public, unless the Director determines in writing to delay public disclosure for a reasonable time if immediate disclosure would seriously threaten the financial health or safety of the GSEs. The deadline for comments was February 26, 2001. (*Dow Jones Newswire*, John Connor, 12/20/00; *Federal Register*, pages 81775-81780, 12/27/00)

Fannie & Freddie receive AA-minus “risk-to-the-government” rating from Standard & Poor’s which they claim fulfills part of their voluntary risk management agreement with Cong. Baker

[Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]

- Fannie and Freddie were both assigned AA-minus “risk-to-the-government” ratings by Standard & Poor’s. Fannie and Freddie have both asked that the rating be maintained on a continuous, “surveillance” basis rather than an annual “point-in-time” rating. Fannie and Freddie claim that they are fulfilling part of the voluntary risk management agreement Fannie and Freddie made with Cong. Richard Baker (R-LA) last October. As part of this agreement, Fannie and Freddie agreed to obtain and release on an annual basis a rating of the GSEs’ “risk-to-the-government” or independent financial strength from a nationally recognized statistical rating organization. The GSEs claim they have fulfilled this commitment and have gone even beyond the voluntary agreement. While the voluntary agreement called only for an annual “point-in-time” rating, the GSEs requested that the rating be maintained on a continuous “surveillance” basis and that Standard & Poor’s will report to the public if there are changes in the GSE’s financial strength that affects the rating. The GSEs claim that the rating measures the financial strength of the GSEs assuming there will be no government assistance. The new “risk-to-the-government” ratings do

not apply to any securities the GSEs issue. Both companies' senior debt is rated AAA. (*Freddie press release, 2/27/01; Fannie press release, 2/27/01*)

- Cong. Baker issued a statement praising Freddie for its "leadership and commitment." His statement was issued before Fannie's rating was released later in the day. "I look forward to working with Freddie Mac this year both in implementing these voluntary commitments and in discussing the need for and possible framework of common sense regulatory reform," he stated. (*Wall Street Journal, 2/28/01; Cong. Baker press release, 2/27/01*)

[Editorial Note: Despite assertions by both GSEs to the contrary, it is questionable that the new S&P rating truly reflects the financial strength of the GSEs without its GSE status and without any tie to the U.S. government. While the recent S&P rating has not been made public, a similar S&P "risk-to-the-government" rating that was issued in 1997 gave both companies AA- ratings, like the ratings that were just issued. Importantly, however, these ratings overstated the GSEs' financial strength because they took into account the fact that the federal government is the implied guarantor of their debts.]

In the words of S&P:

Both companies maintain capital levels that are relatively low when compared with what Standard and Poor's would expect to see at fully private companies with similar risk profiles at the "AA-" rating level.

S&P later added:

Their ability to issue debt instruments with "agency status" enables Fannie Mae and Freddie Mac to access the capital markets even in time of financial stress, resulting in a high level of financial flexibility not experienced by fully private companies.

Thus, S&P's rating was not based solely on their capital adequacy, but rather on their ability to issue debt, even in times of financial stress, because of their status as a government-sponsored enterprise.]

[Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]

Fannie & Freddie claim they can maintain at least three months' liquidity to withstand three months without debt market funding, which they claim fulfills part of their voluntary risk management agreement with Cong. Baker

[Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]

- Fannie and Freddie claim that they are fulfilling part of the voluntary risk management agreement they made with Cong. Richard Baker (R-LA) last October. As part of this agreement, the GSEs agreed to maintain at least three months of liquidity, such as a reserve of securities easily convertible to cash, assuming no access to the debt markets.

- Speaking at a Women in Housing and Finance meeting, Freddie's Chairman Leland Brendsel said the company had met its commitment to hold sufficient liquid, high-quality assets to operate for three months without debt market funding. "Regardless of disruptions in the capital markets that may make it impossible to borrow, Freddie Mac has the means to meet our financial obligations for at least three months," said Brendsel. (*National Mortgage News Daily*, 3/9/01; *Reuters*, 3/8/01)
- Just a few days later, Fannie announced that it had also fulfilled the liquidity portion of its voluntary agreement and could maintain at least three months of liquidity without access to the debt markets. (*Fannie press release*, 3/12/01)

[Editorial Note: See *The GSE Report Special Supplement* published in March 2001 for further analysis.]

As the national debt shrinks, GSE debt skyrockets

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

GSE debt news:

- (1) **President Bush's top economic advisor Lawrence Lindsey says he is concerned about using GSE debt as a benchmark (see earlier story in this *GSE Report* ([p. 12](#)))**
- (2) **Wrightson Associates estimates that the amount of GSE debt outstanding could surpass the amount of Treasury debt in 2002**
 - "Some bankers now wonder what will happen should agency debt become absolutely critical to the bond markets. Will [Wall] Street firms be even more afraid of the agencies' power, or further emboldened to criticize that power?"
- (3) **Major Wall Street firms dominated the buying of Freddie's recent two-year note - *Dow Jones Newswire* reports that "some said that Wall Street firms had participated aggressively to put themselves in Freddie Mac's good graces in hopes of securing future underwriting business."**
- (4) **Freddie begins issuing subordinated debt**
 - Questions remain whether the market perceives the subordinated debt as carrying an implied government guarantee (like Fannie & Freddie's senior debt)
- (5) **Fannie says it has no plans to issue euro-denominated bonds like Freddie because it is too expensive**
- (6) **Central banks are increasingly using GSE debt to adjust their portfolios**
- (7) **Money managers have been increasing their GSE debt holdings since autumn (when GSEs reached voluntary risk management agreement with Cong. Baker)**
- (8) **Long-term GSE debt issuance decreased 23.9% from last year; short-term debt increased 4.6%**

Background on GSE debt

- As reported in previous *GSE Reports*, as the national debt shrinks, GSE debt has been skyrocketing. As the national debt is paid down, the supply of Treasury securities shrinks. Investors, traders, borrowers, and even the US Federal Reserve are being forced to find new benchmark securities to replace the shrinking number of Treasuries. Among possible alternatives as a benchmark are the debt securities of Fannie and Freddie. Investors view them as "almost" as good as US Treasuries because of the implicit government guarantee of Fannie and Freddie's securities. Fannie and Freddie would like to replace Treasuries as a benchmark security and the

agencies both have bond issuance programs (Fannie – Benchmark bond program; Freddie-Reference bond program) that mirror traditional Treasury operations in size and regularity.

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

Wrightson Associates estimates that the amount of GSE debt outstanding could surpass the amount of Treasury debt in 2002 - "Some bankers now wonder what will happen should agency debt become absolutely critical to the bond markets. Will [Wall] Street firms be even more afraid of the agencies' power, or further emboldened to criticize that power?"

- Analysts at the research firm Wrightson Associates estimate that if Treasuries decrease and agencies increase at their recent levels, the amount of agency debt outstanding could surpass Treasury debt sometime in 2002. Their current best guess is the change will occur during April or May of 2002, when Treasury debt is expected to fall sharply due to tax receipts. According to *Investment Dealers Digest*, "the increased importance of agency debt could impact relations between dealers and the agencies at a time when those relations appear to be fraying." Referencing reports that several prominent financial services firm allege that Fannie and Freddie have been threatening them with the loss of business for criticizing the GSEs, the article notes "regardless of where the truth lies, it is apparent that there is no love lost between a number of dealers and the agencies." **The author of the article, Christopher O'Leary, writes, "Some bankers now wonder what will happen should agency debt become absolutely critical to the bond markets. Will [Wall] Street firms be even more afraid of the agencies' power, or further emboldened to criticize that power?...Bankers now wonder what the impact of the growing importance of agency debt will be on relations between the agencies, the Street and the government."** (*Investment Dealers Digest*, Christopher O'Leary, 3/12/01)

Major Wall Street firms dominated the buying of Freddie's recent two-year note - Dow Jones Newswire reports that "some said that Wall Street firms had participated aggressively to put themselves in Freddie Mac's good graces in hopes of securing future underwriting business."

- Freddie sold \$10 billion of notes in its largest one-day reference debt sale ever. Half of that amount was in two-year notes and the other half in 10-year notes. Freddie's previous one-day sale record was \$6 billion. Thirty percent of Freddie's 10-year deal was placed with foreign investors, up from the traditional 20 percent. Eighteen percent of the total went to European accounts and 12 percent to Japan/Asia. (*Reuters*, Lynn Adler, 3/8/01)
- **For the two-year debt portion, major dealers dominated the buying. Only \$85 million of those notes were sold on a noncompetitive basis, or to people outside of Wall Street. According to *Dow Jones Newswire*, "some said that Wall Street firms had participated aggressively to put themselves in Freddie Mac's good graces in hopes of securing future underwriting business." Freddie used an Internet-based Dutch auction to sell its two-year**

notes. In Dutch auctions, bids with progressively higher yields are accepted until all the orders are filled, and all the securities are awarded at the most attractive yield necessary to sell all of them. Freddie's two-year notes sold at a yield around 0.42 percentage point over Treasurys – about 0.01 percentage point less than what the notes were fetching in when-issued, or prospective trading, prior to the auction. Referring to the low yield awarded in the auction, Jim Evans, Vice President in the money management arm of Brown Brothers Harriman said, "It seems like the Dutch auction process is a lousy way to buy bonds." Freddie's Vice President and Treasurer said Freddie is monitoring the situation and believes that it is too early to determine why people are bidding at the levels they are. She said that if Freddie finds that dealer firms are bidding in the auctions only to position themselves among the largest underwriters of its securities, "we will stop allowing them to be used" for that purpose. (*Dow Jones Newswire*, Tyler Lifton, 3/9/01)

- Dealers noted that the book of sales on Freddie's largest one-day sale "didn't start shaping up until a just a few days before the pricing." According to *Dow Jones Newswire*, one reason is that agencies are facing competition from corporate securities, such as France Telecom SA's sale of \$16.4 billion in securities, the largest-ever corporate debt sale. Some fund managers believe that, at this point, corporates are a better bet. Joe Portera, a Managing Director with fund manager Mackay Shields, stayed away from the Freddie sale. Portera is not selling off his agency holdings, but is opting for the high-grade corporates when he wants to increase his exposure to bonds that trader at a higher yield than Treasurys. He believes corporates likely have more upside at this point. He stated, "You've had a pretty good run in agencies." (*Dow Jones Newswire, Capital Markets Report*, Tyler Lifton, 3/8/01)

Freddie begins issuing subordinated debt

- Freddie announced its first sale of subordinated debt, consisting of \$2 billion of 5.875% 10-year securities. The issue, due March 12, 2011, was priced at 99.389 to yield 5.957%, or 113 basis points, over the on-the-run 5% ten-year Treasury security, due February 2011. The new subordinated notes received ratings of Aa2 from Moody's Investor Service and AA- from Standard & Poor's. Fannie and Freddie announced plans last year to issue subordinated debt as part of their voluntary risk management agreement with Cong. Baker. Fannie sold \$1.5 billion of subordinated notes on January 25. (*Freddie press release*, 3/14/01; *Bloomberg News*, 3/12/01; *Dow Jones Newswire*, Tyler Lifton, 3/13/01)

Questions remain as Fannie & Freddie prepare to issue subordinated debt

- According to Tyler Lifton with *Dow Jones Newswire*, an unanswered question is the extent to which the market perceives the GSEs' subordinated debt as carrying an implied government guarantee. Lifton 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)
- Fannie's and Freddie's subordinated debt received ratings of Aa2 from Moody's Investor's Service and a rating of AA- from Standard & Poor's. S&P said its rating is based on the Fannie's consistently strong operating performance, low risk asset profile, extraordinary access to low-cost funding and adequate risk adjusted capitalization. S&P said management of interest rate risk is facilitated by Fannie's status as a government-sponsored enterprise, which allows it to source funds at an economical cost over a wide array of maturities and terms on a global basis. Moody's said that Fannie's government-sponsored status and significant public policy role in US housing were

important credit considerations in its rating. Standard & Poor's said the rating reflects Freddie's high level of liquidity due to its broad access to the capital markets as a government-sponsored enterprise. (*Fannie press release*, 12/22/00; *Reuters*, Lynn Adler, 12/22/00; *S&P press release*, 12/22/00; *National Mortgage News*, Brian Collins, 1/2/01; Standard & Poor's press release, 3/14/01)

- **Tyler Lifton with *Dow Jones Newswire* noted that for the subordinated debt to be viewed as an indicator of the GSEs' financial strength – it must be viewed as completely subordinate and with no implied government guarantee.** Some market professionals note that this is where the program could fall short. In fact, Moody's raised the issue of the assumed government support that the market prices into the senior GSE notes. Moody's said its ratings of Fannie's subordinated debt reflects "the effective subordination and lower implied support enjoyed by this financial institution relative to senior debt," but Fannie's GSE status and its significant public policy role in the US housing marketplace are also important credit considerations.
- One market watcher agreed that it may be difficult to differentiate the senior and subordinated GSE debt. Lou Crandall, Chief Economist for Wrightson Associates, noted that while the interest rate payments will be subordinated, the principal payments will not. "You could make an argument for not differentiating between it and the senior debt," he said. This is because any potential government bailout of a GSE would entail not making bondholders whole but rather taking steps to prevent the GSE from failing. Therefore, it is highly unlikely, in the event of a GSE insolvency, that the senior debt holders – but not the subordinated debt holders - would receive their principal payments, said Crandall. (*Dow Jones Newswire*, Tyler Lifton, 1/4/01)

Fannie says it has no plans to issue euro-denominated bonds like Freddie because it is too expensive

- Fannie's Chief Financial Officer Timothy Howard says Fannie has no plans to issue euro-denominated debt like Freddie because the all-in cost remains too high. They would, however, consider tapping the euro market if costs become competitive. (*Reuters*, Catherine Evans, 3/2/01)
- As noted in the March 2nd *GSE Report*, Freddie's European benchmark program has been costlier than anticipated and may be getting even more expensive with the entrance of new competition. The premier German agency Kreditanstalt fuer Wiederaufbau (KfW) now plans to offer a benchmark bond in the euro sector. Analysts believe KfW and Freddie will be fighting for the same buyers, and "homegrown" KfW could be more attractive to European players. "Freddie has a relatively arrogant attitude in the US, which they can afford to have," said one European banker. "In Europe, investors say I can buy KfW, which carries an explicit guarantee." The article notes that if faced with a choice between KfW and Freddie, it appears European investors would prefer the German securities "hands down," which cannot be comforting to Freddie. Freddie's euro deals have already been more expensive than anticipated. One reason is that investors are confused about Freddie Mac bonds' stability as a benchmark. While KfW bonds are explicitly guaranteed, Freddie's recent political challenges have convinced some European traders that the bonds do not enjoy the full support of the federal government. (*Investment Dealers Digest*, Simon Boughey, 2/19/01; *Financial Times-London*, Rebecca Bream, 2/28/01; *Wall Street Journal*, 3/1/01)

Central banks are increasingly using GSE debt to adjust their portfolios

- According to a report issued by the Bank for International Settlements, central banks appear to be increasingly using agency securities (GSE debt) in place of Treasuries to make adjustments to their portfolios. The BIS acts as the central bank for the world's central banks. As the US government

pays down its debt, the amount of Treasuries is decreasing while the number of agency securities is increasing. Central banks have been decreasing their holdings of Treasuries while increasing their exposures to agencies. “If the trends for the turnover of US Treasury and agency securities continue, official monetary institutions may soon become more active managers of their holdings of agency securities than of their holdings of Treasury securities,” said the BIS report. Central banks still hold far more Treasuries than agencies at this time, however, the central banks have purchased more agencies than Treasuries in recent years. “Such developments might signal that central banks have been increasingly using their portfolio of US agencies to manage the duration of their overall portfolio. Heretofore this had been managed by adjusting the mix of US Treasury holdings,” said the BIS report. (*Dow Jones Newswire*, Tyler Lifton, 3/6/01)

Money managers have been increasing their GSE debt holdings since autumn (when GSEs reached their voluntary risk management agreement with Cong. Baker)

- According to *Dow Jones Newswire*, money managers have been steadily increasing their agency holdings since the fall, when the GSEs reached a voluntary risk management agreement with Cong. Baker. A survey by Stone & McCarthy Research Associates shows that throughout the past 12 months, money managers support of agency debt appeared to correlate with the political climate surrounding the GSEs. Since October (when GSEs reached the voluntary agreement), money managers increased their holdings of agencies to more than 21% from about 16%. During the same period, money managers decreased their holdings of Treasuries to about 26% from almost 30%.
- The survey found that in May 2000, money managers quickly dropped their agency holdings to 16% from about 18%. This was the first decrease after several months of steady increases. According to Stone & McCarthy’s agency market analyst Nancy Vanden Houten, the sell-off came about the time that Federal Reserve Chairman Alan Greenspan sent his letter to Cong. Baker on the GSEs’ subsidies. (*Dow Jones Newswire*, Tyler Lifton, 3/12/01)

Long-term GSE debt issuance decreased 23.9% from last year; short-term debt increased 4.6%

- According to the Bond Market Association, long-term debt issued by agencies (Fannie, Freddie, FHLBank System, Farm Credit System, Tennessee Valley Authority, and the Student Loan Marketing Association) decreased 23.9% last year, dropping to \$407.9 billion in 2000 from \$536.2 billion in 1999. Short-term agency debt outstanding rose 4.6% last year, increasing to \$583.5 billion in 2000 from \$557.8 billion in 1999.
- The largest short-term agency debt issuer in 2000 was the FHLBank System at \$190.8 billion, down 20.5% from the \$239.9 billion in long-term debt issued in 1999. The next largest issuers were Fannie and Freddie. Fannie issued \$110.2 billion in long-term debt in 2000, down 20.7% from the \$139 billion sold in 1999. Freddie issued \$75 billion in long-term debt in 2000, down 38% from the \$121 billion in 1999. (*Dow Jones Newswire*, John Connor, 3/1/01)

Fannie Mae

Fannie’s new reinsurance arrangement between mortgage insurance companies and Fannie is causing a split in the mortgage insurance industry and provoking some GSE critics to claim that Fannie is engaging in “mission creep”

United Guaranty’s President Charlie Reid calls the new arrangements a “major threat” to the MI industry. Reid states, “Fannie and Freddie will take over total control of the MI transaction and that is something that is not in the best interest of the consumer.”

GECMI Chief Tom Mann says the new arrangements “are designed for the primary purpose of enhancing (GSE) investor revenue. They won’t increase homeownership, and our customers are justifiably wary of them.”

- Paul Muolo with *National Mortgage News* wrote an article describing a new reinsurance-type arrangement between Fannie and several mortgage insurance companies. The new arrangement is causing a “rift” in the mortgage insurance sector and provoking some GSE critics to claim that Fannie is engaging in “mission creep.” However, the arrangements are growing in popularity because the lender delivering the mortgage to Fannie can receive significant guarantee fee discounts from Fannie.
- Most of the lenders that are involved in the new arrangements like the new structure for the simple reason that it reduces the guarantee fees charged by Fannie. One analyst noted that lenders might be paying guarantee fees as low as 11 to 14 basis points to Fannie – compared to Fannie’s average of 19.5 basis points – because of GSE restructuring deals and strategic alliances.
- The new arrangement – which Muolo refers to as “restructuring deals” (or “GSE Re”) – is complicated because the GSE Re deals come in many different forms and names. Reportedly, half of the mortgage industry is opposed to the arrangements. The mortgage insurance companies participating in the arrangements include MGIC, PMI, Radian, and Republic Mortgage Insurance. Those that are reportedly not participating in the arrangements include GE Capital Mortgage Insurance, United Guaranty, and Triad Guaranty.
- Muolo describes GSE Re deals as follows: a consumer purchases a private mortgage insurance (MI) policy; after a loan (or group of loans) is closed and sold to Fannie, an agreement is struck between Fannie and the participating mortgage insurer where the coverage is altered. The risk is then redistributed and the MI pays Fannie for certain services while Fannie takes on some of the loss risk. There are estimates that Fannie shares in 30% to 40% of the premium-related income and takes a loss position secondary to the MI company. The money that the MI uses to pay Fannie for certain services comes indirectly from the mortgage insurance premium. When a MI company agrees to this restructuring arrangement with Fannie, the participating lender (which chose the participating MI company on the primary level) then receives a guarantee fee discount from Fannie.
- If these GSE Re deals become more popular, it is expected that Freddie will also participate in the program, which will increase the overall usage of the program. Freddie has reportedly done at least one GSE Re deal and is considering expanding the program because if it does not, it may potentially lose business to Fannie.

Criticisms of the new arrangement

- The arrangement, on its face, may appear “benign.” **However, the concern, said United Guaranty’s President Charlie Reid is that Fannie by offering a lower guarantee fee to lenders can control how the lender picks the MI company. Reid called GSE Re a “major threat” to the MI industry, adding that his long-term concern is that “Fannie and Freddie will take over total control of the MI transaction and that is something that is not in the best interest of the consumer. Fannie Mae is going to take any kind of savings (on the premium) and channel it internally into its own pocket.” Reid notes that the product benefits only Fannie and that in the future it will result in the MIs having only two customers – Fannie and Freddie.**
- **GECMI Chief Tom Mann released a statement saying GSE Re structures “are designed for the primary purpose of enhancing (GSE) investor revenue. They won’t increase homeownership, and our customers are justifiably wary of them.”**
- **Another executive requesting anonymity said that these GSE Re deals could harm large correspondent lenders because they may have captive reinsurance units that already split the MI premium with mortgage insurers. “Fannie Mae is once again trying to dis-intermediate the power and capital of the large players,” said the official.**
- Some critics compare the GSE Re arrangements to pool insurance and claim that the arrangements may violate RESPA (Real Estate Procedures Act). (*National Mortgage News*, Paul Muolo, 3/5/01; *National Mortgage News*, 3/12/01)

Does Fannie plan to sell its own credit scoring system to compete against FICO?

One industry executive speculates that Fannie could financially exploit its database on millions of consumers and could blow FICO “out of the market”

- An article in *Mortgage Banking* by Lawrence Richter Quinn noted that there is a growing outcry by consumer activists and state lawmakers to disclose to consumers their credit scores. The most widespread credit scoring system is Fair, Isaac and Co’s FICO ® credit scoring system “which is to credit scoring what NASA is to space travel.” Critics claim that FICO is inherently discriminatory and in response, a number of state legislatures have begun to look at the issue of credit scores and how they are disclosed to consumers.
- In January 2000, Fannie promised as part of its “consumer bill of rights,” that it would stop using FICO in its credit decisions, calling Fair Isaac’s methodology “opaque.” One Fannie Executive said the decision had as much to do with politics as fairness. Fannie denies that that they are trying to be competitive with FICO, however, some have speculated that Fannie’s real reason for dropping FICO scoring was because it wants to get into the business of selling its own scoring system. Fannie’s move would represent stiff competition for FICO and other competitors. “There’s no question that jettisoning FICO is politically motivated, at least to some extent,” says one industry executive. “A larger reason, though, may be that it wants to exploit its database financially. The agency is always pushing to keep its earnings per share up. The mortgage securities market has reached the saturation point – all the old, seasoned product has been securitized now – and one of the obvious assets the agency has is its information on millions and millions of consumers. Credit scoring development specifically for mortgages by them would be appealing and compelling, and you’ve got to believe it would blow FICO and others out of the market.”

- Freddie has decided not to follow Fannie's lead in backing away from FICO. Freddie's Chief Credit Officer David Andrukonis says, "Rather than producing an alternative credit score, we've encouraged Fair, Isaac to disclose its variables in the FICO scoring. We think there's an advantage to this." (*Mortgage Banking*, Lawrence Richter Quinn, September 2000)

Fannie may move its headquarters on Wisconsin Avenue to another location in the District because it needs more space and is "continuing to grow"

Fannie is already relocating 600 employees to a new office building for its Web site and e-business operations

- According to the *Washington Business Journal*, rumors that Fannie was considering moving to the University of the District of Columbia (UDC) campus are "premature." Fannie is, however, considering moving its offices. District officials have been approaching companies about moving to UDC's Van Ness campus off Connecticut Avenue, NW. "It was presented to us," said Fannie Spokesman Alfred King. "I don't think we're going anywhere with it, but it's one of many offers we've heard."
- Fannie has reportedly "long outgrown" its headquarters and grounds at 3900 Wisconsin Avenue, NW and occupies an additional 375,000 square feet of spillover space at 4000 Wisconsin Avenue, but its lease expires in a few years. "We are looking around for more space, and it's tough to find contiguous space of this magnitude," said King. "It behooves us to always be on the lookout for property as we're continuing to grow."
- *Washington Business Journal* noted that Fannie "fueled the UDC rumor" when it acquired 4250 Connecticut Avenue, adjacent to UDC's campus. Fannie is relocating 600 employees to the 204,000 square-foot office building for its Web site and e-business operations.
- Fannie claims it is looking for a location in the District to relocate its 3,000 employees. "We get lots of offers, but haven't come close to making any decisions at this point," said King. (*Washington Business Journal – District Beat*, Thomas Hall, 3/2/01)

Despite opposition from some people at Fannie, John Weicher still looks to be the choice of HUD Secretary Mel Martinez for FHA Chief

- According to Al Kamen in the *Washington Post's* "In the Loop," Hudson Institute fellow John Weicher "despite opposition from some folks at Fannie Mae who say he's too conservative, still looks to the choice of Housing and Urban Development Secretary Mel Martinez for Federal Housing Administration Chief." (*Washington Post*, Al Kamen, 3/7/01)

Fannie touts progress on its \$2 trillion commitment

- Fannie says it has met the first-year target in its pledge to finance over \$2 trillion in mortgages for low-income and minority-families by 2010. Fannie purchased \$190 billion of home mortgages through its lender partners during 2000. Fannie claims the \$190 billion in loans represents 69% of Fannie's total business. (*National Mortgage News Daily*, 3/14/01; *Fannie press release*, 3/14/01)

- When Fannie first announced in March 2000 that it would underwrite \$2 trillion commitment, some critics were skeptical and questioned whether the new loans targeted at disadvantaged families are above and beyond what Fannie would have made anyway during the next several years. Mike House, Executive Director of Fannie/Freddie watchdog group FM Watch, said he has been told by lenders that “it’s not a stretch” for Fannie to make \$2 trillion in loans to disadvantaged families as part of its ordinary business. “If it’s nothing but their normal course of business, [the announcement] is nothing but a PR gimmick.” (*Wall Street Journal*, Patrick Barta, 3/16/00)

Freddie Mac

Freddie’s Chairman Leland Brendsel says he would prefer a regulator that only regulates Fannie & Freddie, rather than a single regulator, which would also regulate the FHLBanks

- Freddie Mac Chairman Leland Brendsel said he prefers a regulator that would only regulate Fannie and Freddie, rather than a single GSE regulator, one of the options that Cong. Richard Baker (R-LA) is considering for his new GSE bill creating a stronger GSE regulator. Brendsel noted that the FHLBank System’s charter is different that the charters that govern Fannie and Freddie. He claims the regulator would be more effective if it only regulates Fannie and Freddie. Fannie and Freddie are currently regulated by OFHEO for safety and soundness and HUD for mission compliance. The Federal Housing Finance Board currently regulates the FHLBank System. (*Dow Jones Newswire*, Jennifer Corbett Dooren, 3/8/01)

Freddie publishes a second draft of its electronic mortgage guidelines

- Freddie published the second draft of preliminary electronic mortgage guidelines for single-family mortgages on its Web site for review and comment. The new draft is based on comments received on the initial draft published in November 2000. Comments are due by April 6, 2001. The new draft is not the final word on Freddie’s electronic mortgage guidelines. The company expects as many as two additional revisions based on comments by mortgage industry participants, trade associations, and digital signature firms. “At the moment, this is a work in progress,” said Brad German, a Spokesman for Freddie Mac. (*Freddie press release*, 3/5/01; *Real Estate Finance Today*, Michael Murray, 3/12/01)

Freddie increases its quarterly stock dividend

Freddie’s next annual shareholders meeting is May 3 – will elect 13 of its 18-member board - (President of the United States appoints remaining directors to the board)

- Freddie announced that it is increasing the quarterly dividend on Freddie’s common stock to 20 cents per share, up from 17 cents per share in each of the four quarters of 2000. Freddie also declared quarterly dividends of 67 cents on its 1996 variable-rate preferred stock, \$0.765625 on its 6.125 percent preferred stock, \$0.7675 on its 6.14 percent preferred stock, \$0.72625 on its 5.81 percent preferred stock, \$0.6375 on its 1998 5.1 percent preferred stock, \$0.625 on its 5.0 percent preferred stock, \$0.67 on its 1998 variable-rate preferred stock, \$0.6625 on its 5.3 percent preferred stock, \$0.6375 on its 1999 5.1 percent preferred stock, \$0.72375 on its 5.79 percent preferred

stock, \$0.74625 on its 1999 variable-rate preferred stock, and \$0.4282 on its 2001 variable rate preferred stock. The first quarter dividends will be payable on March 30, 2001, to stockholders of record as of March 12, 2001.

- Freddie also announced that it has set May 3, 2001 as the date for its annual stockholders meeting. Holders of the corporation's common stock as of March 12, 2001 will be electing 13 members of the corporation's 18-member board of directors. The President of the United States appoints the remaining directors to the board. Current terms of the appointed and stockholder-elected directors will expire on May 3, 2001. All directors serve one-year terms ending on the date of Freddie's next annual stockholders' meeting. (*Freddie press release, 3/2/01*)

Federal Home Loan Banks

FHFB seeks further comments on its FHLBank capital standards

- On March 8, the FHFB approved an Advanced Notice of Proposed Rulemaking to seek comments on capital regulations it approved earlier to "recognize that there may be some unforeseen issues that may require the Board to amend its regulation."
- On January 30, the FHFB published a final rule on the new capital standards, which began a 270-day comment period whereby each FHLBank must submit its final capital plans to the FHFB for approval by an October 29 deadline. While the Advance Notice of Proposed Rulemaking approved by the Board on March 2, will have a 30-day comment period, it does not change the statutorily established deadline for the FHLBanks to submit their capital plans. The Advance Notice of Rulemaking requests comments on any issues that arise during the development of the capital plans, on actions by other regulatory agencies, or on any other circumstances that could affect the process and require appropriate FHFB action.
- Specifically, the FHFB is requesting comments on the following:
 - "Whether the Gramm-Leach-Bliley Act (GLB), which required the new capital structure, may limit an FHLBank's ability to pay dividends on its Class A stock (redeemable in six months) from retained earnings." In its Advance Notice of Proposed Rulemaking, the FHFB requests comments on how best to provide a basis for an FHLBank to pay dividends on its Class A stock.
 - "Capitalizing 'out-of-district' assets – the investment by one FHLBank in the assets of another FHLBank, or in transactions originated with a member of another FHLBank, such as Acquired Member Assets (AMA). Because the GLB Act states that an FHLBank can sell its stock only to its members and that only permanent capital can be used to satisfy minimum risk-based capital requirements, there are questions as to how the FHLBanks may capitalize their out-of-district assets."
 - The FHFB also seeks comments "on any other unforeseen issues associated with the final rule that may impede the development and implementation of capital plans. In particular,

the Finance Board is interested in any tax or accounting issues or other regulatory issues that my have come to light.”

- The Advance Notice of Proposed Rulemaking and the proposed rule on unsecured credit limits are both expected to be published in the *Federal Register* shortly. (FHFBS press release, 3/6/01)

FHFBS reverses itself and lifts a recently imposed limit on FHLBanks’ credit exposure to GSE debt

- According to John Connor with *Dow Jones Newswire*, the FHFBS reversed itself and lifted a recently imposed limit on the FHLBanks’ unsecured credit exposure to GSEs. According to the FHFBS’ notice in the *Federal Register*, some of the FHLBanks complained that they would have trouble developing new investment strategies to conform with the limits and that in the near future, GSE debt represents an attractive risk-return profile not available from other investments. Some FHLBanks have also suggested that GSEs are a better credit risk than other counterparties, even those counterparties with the highest investment grade ratings, and point to the premium over corporate debt at which GSE debt trades in the market as an indication of the GSEs’ special status. These FHLBanks also claim that the new limits may result in greater investments in instruments with a lesser credit quality.
- In accordance with the Gramm-Leach-Bliley Act, in December 2000, the FHFBS adopted a final rule to implement the new capital structure for the FHLBank System. As part of that rule, the FHFBS adopted new limits on the permitted amounts of a FHLBank’s unsecured credit exposures to a single counterparty or a group of affiliated counterparties. The regulation was to have taken effect on March 1.
- On February 28, 2001, the FHFBS approved a short-term waiver to allow more time for the FHLBanks to come into compliance with these limits and agreed to extend the deadline for the implementation of the new limits to July 2. The FHFBS also proposed an associated rule to encourage comment on certain limits on unsecured credit to government-related counterparties. The FHFBS proposes to “raise the limit on a Bank’s unsecured extensions of credit to a GSE and is requesting comment and supporting analysis concerning the appropriate level for this new limit.” The deadline for comments is April 23, 2001. Until a new limit is set, the FHLBanks System’s old Financial Management Policy (FMP) 100% limit will be in effect. Under the FMP policy, a FHLBank would maintain unsecured credit exposures with a single GSE in the amount of 100% of the Bank’s capital. The new unsecured credit limits would have superceded the FMP and would have treated GSEs like any other private counterparty. For highly rated counterparties such as GSEs, the FHFBS said, the maximum unsecured credit exposure under the new capital rule “cannot exceed 15% of the Bank’s total capital or of the counterparty’s regulatory capital, whichever is lower.” (*Dow Jones Newswire*, John Connor, 3/6/01; *Federal Register*, pages 13688-13689, 3/7/01)

More credit unions are using FHLBanks than corporate credit unions for funding assistance

- A greater number of credit unions are seeking funding assistance from the FHLBank System than from corporate credit unions. At mid-year 2000, for the first time, the FHLBank System had supplanted corporate credit unions as the number one funding source for credit unions’ loans.

Credit union members of the FHLBank System increased 23% last year to a total of 497 credit unions. (*Credit Union Journal*, 2/26/01)

Community bankers survey finds that more community banks are using FHLBank advances for funding assistance

- The American Bankers Association survey of community banks found that more than half look for nontraditional funding such as FHLBank advances, Fed funds, and repurchase agreements. FHLBank advances are used by 81.8% of banks, which is a significant increase from about 63% in the survey three years ago. While 77.8% of banks belong to a FHLBank, 25.4% of those that do not say they will join once the system accepts small business and farm loans as collateral. There were 1,034 respondents to the survey. (*American Banker*, Ben Jackson, 2/26/01)

Farm Credit System/Farm Credit Banks/ Farmer Mac

House Agricultural Committee holds March 7 hearing on the Farm Credit Administration's (FCA) controversial national charter proposal

Independent Bankers Association of America testifies that the proposal is not necessary and should be "thrown on the scrap pile of bad policy ideas"

American Bankers Association testifies that the proposal would hurt farmers and ranchers and should be stopped

- The House Agricultural Committee held a March 7 hearing on the FCA's controversial national charter proposal. Traditionally, institutions in the Farm Credit System have been limited to certain geographical regions. Under the controversial proposal, individual farm credit lending institutions would be able to apply for a national charter, which would let them lend beyond their current regional geographic boundaries. The FCA adopted the proposed rule at a January 11, 2000 meeting. In May 2000, the FCA issued a booklet to all system institutions providing guidance on applying for national charters. Several parties, including former House Banking Committee Chairman Jim Leach and the GAO raised procedural concerns that the FCA bypassed the formal rule-making process when issuing the rule. Responding to criticisms, in July 2000, the FCA published the booklet in the *Federal Register* for public comment. On January 11, 2001 the FCA adopted the proposed rule and sent it to the House and Senate agriculture committees for a 30-day review. The proposed rule was published in the *Federal Register* on February 16, 2001 for a 30-day comment period.
- ABA Agricultural Banker Phil Burns testified that the proposal would harm farmers and ranchers and should be stopped. Burns, Board Chairman of Farmers and Merchants National Bank (West Point, NE) stated, "We are concerned about the negative impact national charters will have on small, beginning and economically disadvantaged family farms as [FCS] institutions seek larger, more profitable loans at the expense of these farmers." (*ABA Daily Newsletter*, 3/8/01)
- John Dean, a member of ICBA's Agriculture-Rural America Committee testified that the proposal was unnecessary and should be "thrown on the scrap pile of bad policy ideas." Dean, Chairman and CEO of Glenwood State Bank of Glenwood, IA said the proposal "is geared to serving only large

borrowers, poses the threat of higher interest rates to family farmers, and will lead to rapid consolidation and concentration of economic power within the system and fewer credit choices for farmers.” Dean noted that the proposal will increase safety and soundness risks as Farm Credit System lenders make loans in unfamiliar territories, and will lead to predatory pricing of larger credits that will hurt the majority of smaller lenders and locally based lenders. He warned that the proposal would allow Farm Credit System lenders to expand into non-agricultural lending and alliances with large national businesses for a broad variety of consumer and business lending for activities targeting vaguely defined “rural areas.” (*ICBA press release, 3/7/01*)

- House Agricultural Committee Chairman Larry Combest (R-TX) stated, “[FCS] needs to respond adequately and appropriately to the credit needs of farmers and ranchers, but its regulator [FCA], should make sure that competition among lenders is fair and that farmers in local service areas are able to secure affordable credit.” He added, “The Ag Committee expects [FCA] to exercise its authority to make certain that system institutions always operate in a safe and sound manner.” (*BNA Daily Report for Executives, Adam Wasch, 3/8/01*)

FCA argues the proposal would reduce risk and modernize the system

- FCA Chairman Michael Reyna testified that the proposal “would help the System modernize its credit delivery structure, and at the same time, maintain safe and sound operations.” He disagreed with the claims that the farm credit lenders would expand into new products, stating that the proposal “will in no way expand the lending powers of System institutions.” He also denied that the proposal would allow Farm Credit System lenders to abandon production agriculture in favor of large agribusinesses and nonagricultural credit markets in rural communities. He also argued that the Farm Credit System’s farmer ownership and control “limit[s] the opportunity of associations to ‘cherry-pick’ large credits on a nationwide basis.” He concludes that the proposal “ensures that the System remains a dependable source of credit for farmers in a competitive and rapidly changing economy.” (*Written testimony of Michael Reyna, Chairman and CEO of Farm Credit Administration before House Agricultural Committee, 3/7/01*)

Senate Agricultural Committee held February 14 hearing – Cong. Leach testifies against proposal

- As noted in previous *GSE Reports*, the Senate Agricultural Committee held a February 26 hearing on the FCA’s proposal, and on February 14, the House Financial Services Committee adopted an oversight plan for the 107th Congress that includes among other items, an examination of the proposal. During the February 26 hearing, **Former House Banking Committee Chairman Cong. Leach (R-IA) testified that the proposal, if adopted, would “expand to 34 the number of government sponsored enterprises operating in the American economy and each of these new GSEs will have power greater than that of Fannie Mae or Freddie Mac.” He called the proposal “the single greatest act of administrative arrogance I have ever seen” and believed that the proposal “should be absolutely rejected.”**
- **Cong. Leach and commercial bankers argued that the proposal would lead to unfair competition with the private sector, jeopardize the system’s safety and soundness, and give farmers no benefit. Because of their unique GSE status, the proposal would raise unfair competition because the farm credit lenders can raise capital more cheaply.**
- **Cong. Leach claimed throughout the hearing that the national charter proposal would “socialize credit” and let farm credit lenders expand into auto, business, and “any other kind of loan you can visualize.” Cong. Leach stated, “You don’t know where the limit will be because each of them will have individual charters.” Cong. Leach further stated, “The**

history of GSEs is the demand for expanded power. All GSEs try to spread their wings.”
(BNA Daily Report for Executives, Adam Wasch, 2/27/01, 3/8/01; American Banker, Michele Heller, 2/27/01; Congress Daily, 2/27/01; Dow Jones Newswire, Mark Anderson, 2/26/01)

Farmer Mac’s earnings up in the 4th quarter

Zions is the top Farmer Mac lender

- Farmer Mac announced that its fourth quarter earnings per share in 2000 increased 47% over the fourth quarter of 1999. Net income in the fourth quarter was \$2.9 million, up from \$1.9 million in the fourth quarter of 1999. Net income for all of last year was \$10.4 million, up from \$6.9 million in 1999. The Farmer Mac I program purchased or guaranteed \$226 million of loans in the fourth quarter, a decrease from the \$451 million level of the third quarter. *(National Mortgage News, Ted Cornwell, 3/12/01)*
- Zions Agricultural Finance, a division of Zions First National Bank, announced that it ranked as the nation’s top originator of loans sold to Farmer Mac. Zions has sold \$311 million in loans to the Farmer Mac Cash window during the past four years. Zions also owns about 32% of Farmer Mac class A voting common stock and about 16% of Farmer Mac’s class C non-voting common stock. Zions Bank Executive Vice President David Hemingway is a member of the Farmer Mac Board of Directors. *(National Mortgage News, 3/12/01)*

FCA issues final rule designed to reduce report dissemination costs

- The FCA issued a final rule on March 12 designed to assure that farm credit association shareholders receive adequate information about their organization’s relationships with related banks, while reducing certain printing and mailing costs for the banks. The new rule amends the disclosure requirements in part 620 of the FCA’s regulations and will become effective 30 days after publication in the *Federal Register* during which either or both houses of Congress are in session. Notice of the effective date will be published in the *Federal Register*. *(BNA Daily Report for Executives, 3/12/01; Federal Register, pages 14299-14301, 3/12/01)*

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Canfield & Associates, Inc.
801 Pennsylvania Ave., NW, Suite 625
Washington, DC 20004
Phone: (202) 661-2100
Fax: (202) 661-2101
www.canfieldassoc.com