

The **GSE** REPORT™

The acts of terrorism that have been taken against our country are without question beyond description. Our thoughts and prayers continue to be with the families, friends and colleagues of the innocent victims, as well as the many rescue workers lost in these tragic events and in praying for the recovery of the many injured.

A number of financial institutions, including the GSEs, were directly and indirectly affected by these tragic events, as well as colleagues, analysts, and news organizations that follow these institutions, and our deepest sympathies are extended to all. We are committed to continuing to deliver information on the GSEs and the mortgage industry, as the US economy and capital markets respond to these tragic events.

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Major Events

FHLBank of New York headquarters was destroyed as a result of the terrorist attacks in New York, but all of the FHLBank employees were safely evacuated

The FHLBank of New York is continuing to provide funding and other services to member institutions from its disaster recovery site

- The headquarters of the FHLBank of New York at 7 World Trade Center was destroyed as a result of the terrorist attacks in New York, but all of the 150 FHLBank employees and four visiting bank examiners were safely evacuated, according to J. Timothy O'Neill, head of the Federal Housing Finance Board. A spokesperson for the FHLBank of New York, Eric Amig, said approximately 150 people worked at the headquarters. "They all made it out OK," he said. Amig said the FHLBank of New York is currently operating at an existing FHLBank facility at 30 Montgomery Street in Jersey City, NJ. Amig noted that many paper documents were lost, however "all the records and data would be backed up" at the bank's New Jersey City office, which already served as an alternative facility. "We had redundancy for any critical information," he said. When asked how his employees were holding up, FHLBank of New York President Alfred DelliBovi stated, "It's going to take a little while. We're all affected by this in different ways," he said. "I don't think we have a single employee who won't know someone who perished in this tragedy. As it sets in, it's going to be a real challenge."
- Operating from the disaster recovery site in New Jersey, the FHLBank of New York is providing funding and other services to member institutions. "In seeking with the cooperative nature of the FHLBank System, the other 11 Federal Home Loan Banks stand ready to provide assistance as needed," assured O'Neill. "The FHLBank System is taking all steps necessary to ensure it maintains its ability to access funds and provide necessary liquidity to its 7,800 members." O'Neill stated, "our hearts and prayers are with those affected by this terrible tragedy," and that the FHFBS "will do its part to ensure that the system continues to run smoothly by being supportive and responsive to any situation that may arise from this incident." (*Dow Jones Newswire*, John Connor, 9/12/01; *BNA Daily Report for Executives*, 9/13/01; *Real Estate Finance Today*, Mike Sorohan, 9/17/01)

Washington Post columnist Kenneth Harney reports that loans with low down payments may get cheaper for homebuyers under a new “Choice” proposal [also referred to as “Ginnie Mae Choice”]

The “Choice” proposal would expand homeownership by allowing Ginnie Mae to compete with Fannie & Freddie and would bring additional revenue to the federal government

A new study by mortgage economists finds that the savings to homebuyers could be significant under the “Choice” proposal and that the program would not harm FHA

Two senior lawmakers plan to introduce the proposal in upcoming legislation

“We come from a perspective that says that the more competition out there, the better,” said an aide to Senator Wayne Allard (R-CO), who is planning on introducing the legislation. “Getting Ginnie Mae more flexibility is good for the market place, good for the consumers.”

Congresswoman Marge Roukema (R-NJ) plans to introduce similar legislation

- As reported in the September 7 *GSE Report*, two senior lawmakers plan to introduce legislation that would increase competition in the secondary mortgage market for conventional loans, which is currently dominated by Fannie and Freddie. Senator Wayne Allard (R-CO) has discussed the proposal with colleagues and expects to find co-sponsors for the legislation before introduction, a staffer for Allard said. Senator Allard is the senior Republican member of the housing subcommittee of the Senate Banking Committee. Congresswoman Marge Roukema (R-NJ), Chair of the House Financial Services subcommittee on housing and vice chair of the full committee, plans to introduce similar legislation, one of her staff members said. **“We believe it would expand the pool of mortgages for first-time lower-income borrowers and borrowers in the moderate income range,”** the Allard aide stated. **The goal of the legislation is to expand home ownership by creating greater competition in the secondary mortgage market, including competition to Fannie and Freddie, according to the Allard aide. “We come from a perspective that says that the more competition out there, the better,”** the aide said. **“Getting Ginnie Mae more flexibility is good for the market place, good for the consumers.”** A financial services industry representative, who spoke on condition of anonymity, said **“If you have more outlets competing for mortgage products, you have better prices, and better prices for consumers.”** (*Reuters*, Mark Felsenthal, 8/21/01, 8/27/01)
- *Washington Post* columnist Kenneth Harney reported that the proposal, referred to as “Choice,” promises to cut interest rates and application costs for homebuyers who can’t afford a large down payment. The proposal is aimed at borrowers with down payments of less than 20%. The intended beneficiaries of the proposal are first-time homebuyers, consumers with high debt-to-income ratios, minorities, and consumers with slightly imperfect credit histories.
- Harney noted, “[b]y broadening the base of capital market sources of money available to fund such buyers, the plan would try to generate greater competition -- and better terms -- on mortgages with low down payments.” Supporters of the Choice proposal said some borrowers would cut up to 1.5 percentage points off their mortgage rates, as well as hundreds of dollars in loan fees.
- The Choice proposal would allow Ginnie Mae to compete with Fannie and Freddie [which currently dominate the conventional mortgage market] on pricing and terms for low down payment mortgages. Currently, Ginnie Mae purchases and guarantees only federally insured FHA and VA loans. Under Senator Allard and Congresswoman Roukema’s legislation, Ginnie Mae would be allowed to

purchase conventional loans that carry private mortgage insurance, allowing Ginnie Mae to securitize privately insured conventional mortgage loans in competition with Fannie and Freddie. Loans covered by the legislation could go as high as \$275,000 under current rules, and allow down payments of less than 3 percent. According to Harney, the bills are expected to be introduced soon.

- **Supporters argue that the entry of Ginnie Mae into the market would give lenders an alternative to selling their low down payment mortgage loans to Fannie and Freddie and would virtually guarantee lower rates for some borrowers. According to a new study by mortgage economists Ann B. Schnare and Susan E. Woodward, the savings to homebuyers could be significant and could even turn applications rejected for regular interest rate pricing by Fannie or Freddie into loans funded at prevailing market rates by Ginnie.**
- Woodward noted that the Choice proposal could provide substantial savings to low down payment borrowers with slightly damaged credit. For example, an 8.5 percent mortgage at Freddie could be as low as 7 percent at Ginnie under the Choice plan. **Woodward and Schnare's study estimates that the federal budget would also benefit from Ginnie Mae's entry into marketplace competition.** If Ginnie Mae purchased \$30 billion a year of low down payment loans, the federal government would gain \$219 million in revenue over the life of the mortgages.
- Under the proposal, private mortgage insurers would provide most of the insurance on the mortgages and protect Ginnie Mae from losses on defaults. Harney reported that private insurers have been the key proponents of the Choice proposal for more than a year, arguing that their electronic automated underwriting systems approve higher percentages of loan-worthy, low down payment applicants than Fannie and Freddie's automated underwriting systems. The mortgage insurers cited a study of more than 150,000 loans that found Fannie and Freddie's "accept" rates on low down payment applications from homebuyers with moderate FICO scores in the range of 620 to 660 to be just 61 percent, compared with 72 percent by private mortgage insurers' electronic systems. (FICO scores of 620 to 660 indicate an applicant with slight to moderate credit-history blemishes.) The same study found Fannie and Freddie's "accept" rates on African American borrowers to be 65.8 percent, compared with 76 percent for the private insurers. Hispanic "accept" rates by the private systems was 77 percent, by Fannie and Freddie, 72 percent. As Harney noted, "accept" decisions by the private insurers and Freddie and Fannie generally qualify the borrower for the standard interest rate and terms available at the time. Applicants that are not accepted either pay higher interest rates or are rejected.
- Under the proposal, private insurers say they want to compete for the low down payment loans they claim are now priced too high by Fannie and Freddie. Choice supporters argue, "give us a shot to fund those loans, and thousands of borrowers will pay less."
- According to Harney, Fannie and Freddie executives said they were "studying" the Choice proposal, and had no immediate comment. (*Washington Post*, Kenneth Harney, 9/15/01) However, earlier in the month, Doug Robinson, a spokesman for Freddie, said the plan would hurt Ginnie Mae and would not help underserved borrowers. It would hurt Ginnie Mae, he explained, by exposing it to mortgage credit risk for the first time; by letting it into the subprime market; and by weakening Ginnie's FHA and VA loan securities as the strongest customers for such loans went instead for loans made possible by the charter change. (*American Banker*, Tommy Fernandez, 8/30/01) "From what we have seen, the draft proposal does not seem to provide a clear homebuyer benefit. And it might increase the risk to taxpayers," said Robinson. He also suggested that the Choice proposal could "cherry pick" the FHA and VA's best borrowers. "We think any major change in the way that Ginnie Mae does business should be looked at very carefully from a public policy point of view," said Robinson. (*National Mortgage News*, Brian Collins, 9/3/01)

Mortgage economists find that the “Choice” proposal would not harm FHA

- **Choice supporters believe the proposal could have generated \$30 billion in low down payment conventional mortgages in 2000 and taken most of its market share from Fannie and Freddie, as opposed to the FHA program. According to a financial analysis by mortgage economists Ann Schnare and Susan Woodward, the Choice proposal would draw only 3% of its customers from the FHA program, which insured nearly \$95 billion in single-family loans last year. Most of the privately insured Choice loans would come from competing with Fannie and Freddie for A-paper borrowers seeking mortgages with loan-to-value ratios of up to 97%. Supporters also believe the Choice proposal will allow some A-minus borrowers and some subprime borrowers to qualify for A-paper pricing.** Critics have complained that Choice proposal will cannibalize the FHA program. **However, supporters argue that it will strengthen the FHA and diversify its revenue base.** The FHA would receive 10 basis points for taking a second-loss position on Choice loans behind the private insurers and Ginnie Mae would receive an 8 basis point guarantee fee for securitizing the mortgages. On a \$30 billion pool, the financial analysis found that the two agencies would gain \$219 million in fees over the life of the loans. **Schnare commented that FHA has been losing market share and its best customers over the past six years. “This program is one way of bringing those borrowers back to FHA and making FHA's book of business more balanced,” she told *National Mortgage News’ MortgageWire*. (*National Mortgage News Web site, 9/18/01*)** [Editorial Note: Schnare is a former Senior Vice President for Corporate Relations at Freddie.]

OFHEO’s final risk-based capital rule for Fannie & Freddie became effective on September 13, 2001

The rule is not enforceable for one year

[OFHEO – the Office of Federal Housing Enterprise Oversight – is Fannie & Freddie’s safety and soundness regulator. The rule was originally due December 1, 1994]

Background on OFHEO’s risk-based capital rule for Fannie & Freddie

- After nine years in the making, OFHEO’s final risk-based capital rule was published September 13 in the *Federal Register*. The final rule was first released on July 19. The rule establishes the level of capital Fannie and Freddie must maintain to survive a 10-year “stress test” mandated by Congress in the 1992 Act. OFHEO’s risk-based capital rule was originally due December 1, 1994. The rule was subject to several rounds of comments over the nine-year period. The rule became effective once it was published in the *Federal Register*, however the rule will not be enforceable until one year after publication. (*Federal Register*, pages 47730-47875, 9/13/01)
- Those most affected by OFHEO’s rule, said it’s still too early to comment on the risk-based capital rule. “OFHEO did a lot of good work, but it’s going to take time to really digest it,” said a Senate Banking Committee economist. Others said the tragic terrorist attacks on September 11 diverted attention and they haven’t had the opportunity to take a close look at the rule. (*Housing Affairs Letter*, 9/21/01)
- During an August 1 Congressional hearing, OFHEO Director Armando Falcon said OFHEO is open to changes in the risk-based capital rule. However, substantive changes to the rule after its publication in the *Federal Register* (September 13), would be subject to the Administrative Procedures Act (APA), and may be done through an expedited rule-making process. Falcon said he would be willing to reconsider the capital rule’s treatment of AAA-rated and AA-rated mortgage insurance companies, through the rule-making process. (*National Mortgage News*, 9/17/01) OFHEO plans to run the first

public test of the rule in February 2002, using Fannie and Freddie's fourth quarter 2001 numbers. Fannie and Freddie are also currently testing the risk-based model, however, it is not known if they will release their results before OFHEO. (*National Mortgage News*, 9/17/01)

Fannie Mae & Freddie Mac

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OFHEO disagrees with Fannie & Freddie's assertions that OFHEO's authority over executive compensation is separate and distinct from its safety and soundness authority

Executive Compensation – Final rule

- OFHEO issued a final rule clarifying procedures OFHEO uses in supervising compensation offered by Fannie and Freddie to their executive officers. The rule formalizes the process OFHEO uses in reviewing compensation and termination benefits for Fannie and Freddie's executives. The rule takes effect on October 29, 2001.
- OFHEO is required by law to prohibit Fannie and Freddie from providing compensation to any executive officer that is not reasonable and comparable with what is paid by similar businesses to executives doing similar work. Businesses used for comparison include publicly held financial institutions or major financial services companies. In addition to prohibiting excessive executive compensation, OFHEO is empowered to approve individual termination packages provided by the GSEs to their executive officers.
- OFHEO issued the rule on December 27, with comments due by March 27, 2001. During the comment period, Fannie and Freddie took issue with OFHEO's view that executive compensation can raise safety and soundness concerns. (*Dow Jones Newswire*, John Connor, 12/20/00, 9/13/00; *Federal Register*, pages 81771-81776, 12/27/00; *Federal Register*, pages 47550-47556, 9/12/01)

Fannie's comments

- In a comment letter to OFHEO, Fannie's Anne Kapler wrote, "because the information requested by OFHEO in the proposed rule is of a non-public nature, Fannie Mae is highly concerned about the possibility that such information could be inadvertently released to the public, and cause Fannie Mae competitive and economic harm. For example, if compensation information about individual executive offers were to become publicly available, other employers and executive search firms could calibrate exactly what it would take to make an attractive compensation proposal to our executives." The letter added that "Because of this concern, we request that, with respect to all compensation information, excluding the information we disclose in the proxy statement and the annual report to

Congress, OFHEO follow the procedures adopted by OFHEO examiners who conduct their examinations on site when reviewing highly sensitive information. Of course, this information is exempt under the Freedom of Information Act exemptions that bar release of trade secrets or examination, operating of condition materials.”

- Fannie recognized that Congress authorized OFHEO to prohibit the company from engaging in excessive compensation practices, but argued that this authority is separate and distinct from OFHEO’s authority regarding safety and soundness matters. Fannie wrote, “OFHEO has inappropriately intertwined these issues in the proposed regulation. OFHEO’s proposal states that any violation of the proposed executive compensation regulations...would constitute an ‘unsafe and unsound’ practice and thus warrant ‘corrective or remedial action.’ As currently drafted, the rule could be interpreted to enable OFHEO to take far more drastic measures in response to a violation of the executive compensation regulations than simply preventing the compensation from occurring – even if those violations do not threaten a company’s safety and soundness.” (*Dow Jones Newswire*, John Connor, 3/30/01; *Fannie Mae letter by Ann Kapler to OFHEO*, 3/27/01)

Freddie’s comments

- In Freddie’s letter to OFHEO, Maud Mater also took issue with OFHEO’s view that executive compensation raises safety and soundness concerns. Freddie suggests that OFHEO delete from its final rule that a GSE’s failure to comply with executive compensation submission requirements may constitute an unsafe and unsound practice. (*Dow Jones Newswire*, John Connor, 3/30/01; *Freddie Mac letter by Maud Mater to OFHEO*, 3/27/01)

OFHEO disagreed with Fannie & Freddie’s comments

- **In the end, OFHEO disagreed with Fannie and Freddie’s assertions that OFHEO’s authority over executive compensation was separate and distinct from its safety and soundness authority. OFHEO said “the executive compensation practices of corporations are widely acknowledged to reflect the integrity of management and soundness of corporate governance practices.” OFHEO said it “recognizes the sensitive, nonpublic nature of certain information submitted by the enterprises regarding their executive compensation practices” and therefore “has established appropriate safeguards.”** (*Dow Jones Newswire*, John Connor, 9/13/01)

Corporate Governance – Proposed regulation

- OFHEO issued a proposed regulation September 12 setting forth minimum requirements with respect to the corporate governance practices and procedures of Fannie and Freddie. “OFHEO invites comments on all aspects of the proposed regulation, including legal and policy considerations, and will take all comments into consideration before issuing the final regulation,” said OFHEO, which previously withdrew the proposed rule. OFHEO said the proposed practices and procedures “are substantially similar to those required by federal banking agencies with respect to regulated financial institutions.” The deadline for comments is November 13, 2001. (*Dow Jones Newswire*, John Connor, 9/13/01; *Federal Register*, pages 47557-47563, 9/12/01)

Flood Insurance – Proposed regulation

- OFHEO issued a proposed regulation September 12 codifying its authority and responsibility to oversee and enforce the statutory requirements affecting the operations of Fannie and Freddie under the National Flood Insurance Reform Act of 1994, and to effect congressionally mandated adjustments to the civil money penalties applicable to violations of that law. The deadline for comments is October 12, 2001. (*Dow Jones Newswire*, John Connor, 9/13/01; *Federal Register*, pages 47563-47566, 9/12/01)

As the national debt shrinks, GSE debt skyrockets

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

(1) “Senior government officials” to ask Congress for legislation within the next two years that would enable the Fed to purchase bonds from the private markets by 2005 – first time private markets mentioned (previously securities issued by Fannie, Freddie, and Ginnie had been mentioned)

- According to Mike Sorohan with *Real Estate Finance Today*, “senior government officials” were reportedly prepared to ask Congress for legislation that would enable the Fed to purchase bonds from private markets by 2005. Sorohan noted it is not the first time that the Fed has expressed interest with investing in alternatives to Treasuries, however, it is the first time that private markets have been mentioned. Previously, speculation focused on securities issued by Fannie, Freddie, and Ginnie Mae.
- Sorohan reported that Federal Reserve Board Chairman Alan Greenspan has hinted several times over the past year that the Fed might consider alternatives to Treasuries. Speaking before a conference in May, Chairman Greenspan appeared to challenge the private markets to create alternatives to Treasuries. “Alternative assets, of course, involve some degree of credit risk. However, given sufficient demand, it seems likely to me that you or your colleagues could produce a nearly riskless security,” Greenspan said. “For example, this could be accomplished with a very senior tranche of collateralized debt obligation backed by high-grade corporate debt.” (*Real Estate Finance Today*, Mike Sorohan, 9/17/01)

(2) Freddie issues long-term debt after tragic terrorist events – investor views were mixed

- Several corporate stock and bond offerings planned for the weeks of September 10 and September 17 were put on hold after the destruction of the World Trade Center on September 11 paralyzed trading in New York, according to executives at Wall Street firms. Corporate bond sales were in a limbo, despite the opening of the bond market on September 13. As much as \$6.5 billion in corporate bond sales planned for the week of September 10 were on hold, as syndicates waited to see if demand would materialize. “Everybody is waiting to see how the markets unfold,” said one syndicate official.

Bond market shaky on the day Freddie issued its debt

- The first test of the fixed-income bond markets’ ability to handle new debt since the World Trade Center was destroyed was Freddie’s sale of \$5 billion of its Reference notes (debt) on Friday, September 14. This was the first agency or corporate debt sale since the September 11 events caused Fannie and Freddie to cancel or postpone billions of dollars in debt issues. According to Lynn Adler with *Reuters*, **Freddie’s was the first debt offering from a company in the devastation’s wake.** Many dealers and inter-dealer broker operations were crippled and turned to backup operations during quiet bond trading on September 13, when the bond market first opened, with the US stock market closed until September 17. (*Reuters English News Service*, Elena Molinari, 9/13/01; *Reuters*, Lynn Adler, 9/13/01; *Reuters English News Service*, Lynn Adler, 9/20/01)
- On Friday, September 14, Freddie sold a new \$5 billion, two-year Reference note bond offering, due September 15, 2003, and on Monday, September 17, it sold a new \$5 billion, 10-year Reference note offering due September 15, 2003. Freddie had originally planned to sell the 10-year offering on Wednesday, September 12 and the two-year on Thursday, September 13. (*Dow Jones Newswire*, Tyler Lifton, 9/13/01) On the day Freddie sold its \$5 billion, 10-year Reference notes, the non-Treasury debt markets were open but fractured. Wall Street stood ready to make markets of all manner of debt despite massive relocations of employees and equipment, concerns over settlement issues, uncertainty over how the stock market would react when it opened on Monday, September 17, and a profoundly distracted and distraught Wall Street community. Investors also noted that the reduced presence of bond brokers, particularly from Cantor Fitzgerald, which suffered terrible losses during the World Trade Center attack, also affected the bond market. (*Dow Jones Newswire*, Christine Richard, 9/14/01)

As the debate grew in the investment community as to whether Freddie would and should issue its debt, some talk circulated that Freddie was pushing the deal out during the week of September 10 because it was in a funding crunch. Freddie denied this and said it was their “leadership responsibility” to continue with the issuance

- Freddie said its decision to go through with the September 14 offering was its duty. “We feel a bit of a leadership responsibility in that we had transactions that were already in the market when this occurred, so we needed to be the first ones to follow through with the transactions that we had bought,” said Phil Guth, Senior Director of Global Funding at Freddie. “We certainly wouldn’t put something out there if we thought it would be highly disruptive,” said Guth. “The capability of the interdealer-broker community is greatly impaired. But that being said, we’ve gotten strong indications from our dealer groups that they are able and willing to participate in the auction.” (*Reuters English News Service*, Elena Molinari, 9/13/01; *Reuters*, Lynn Adler, 9/13/01) Louise Herrle, Freddie’s Treasurer, said the September 14 bond offering wasn’t only to fund operations, but “From a public standpoint, it’s important to demonstrate that the markets are working.” (*Wall Street Journal*, Nicholas Kulish, Jeffrey Ball and Andrew Caffrey, 9/14/01) The *Financial Times* reported that Freddie “defied the virtual closure of US financial markets” to sell its debt on September 14. While Freddie had to pay a slight premium to get the deal done in difficult circumstances, its Chief Investment Officer Greg Perseghian stated: “We salute the many Wall Street dealers and investment management firms who participated in this auction. Beyond any shadow of a doubt, it proves that America’s financial system is open for business.” (*Financial Times (London)*, Vincent Boland, Charles Pretzlik, Lina Saigol and Peter Thal Larsen, 9/17/01)
- **The investors’ views prior to Freddie’s offering were mixed. Even if dealers were ready to take on new securities, it is unclear how many investors were prepared to do the same. “We won’t participate,” said Colin Lundgren, Portfolio Manager at American Express Asset Management in St. Paul, MN. “People are very distracted. Right now, it’s all about price discovery and risk management. Relative value is taking a back seat.” Lundgren noted that “With the backdrop of this national tragedy and uncertainty in equity markets, any new issues hitting the market become fairly trivial in the grand scheme of things.”** (*Reuters*, Lynn Adler, 9/13/01)
- According to Lynn Adler with *Reuters*, Freddie was determined to send the world a signal that the markets were operational and recovering. Freddie noted that the September 14 offering drew the most bids and the lowest interest rates in the Reference debt program’s three-year history. “A bad experience on this issue would have really set a bad tone going into next week,” said Dick Waugh, Executive Director at Principal Capital Income Investors in Des Moines, IA. “This gets us on solid footing. Get the stock market open and it’s a good first step.” Robust demand in the midst of crisis was a “very important sign that the markets are functioning at a significant level and we can continue to build from this,” said Freddie’s Treasurer Herrle. “We had a connection with every single dealer, whether in their regular offices or disaster recovery sites,” Herrle said. The buy-side was reportedly “spotty,” with some fund managers waiting until the stock market opened to gauge price levels. “In normal conditions (Freddie Mac) is an issue we hold and would consider, but unfortunately we are trying not to trade at all if possible,” said Marino Valensise, head of credit at Baring Asset Management in London. “We are trying not to trade in the circumstances because the market environment is not liquid enough and because prices are moving very fast,” he added. “I think some would have clearly wanted (Freddie Mac to) wait until next week,” Herrle said. “But quite frankly more from an emotional aspect than a capability aspect.” Lynn Adler with *Reuters* noted that as the debate grew in the investment community as to whether Freddie would and should issue its debt, some talk circulated that the GSE was pushing the deal out during the week of September 10 because it was in a funding crunch. Freddie’s Treasurer Herrle denied this and said Freddie “was not dependent on

this auction” for cash. Among those who hoped that the Freddie’s debt deal would be delayed until September 17 was Andy Brenner, the head of global fixed income at Investec, a dealer and money manager. “These are days you’re here because you feel you have to...but to actually go out and do something new – no one needed to buy the two-year Freddie Mac today,” he said. However, he commended Freddie for “waving the flag.” Salomon Smith Barney said the debt deal was good for business and morale. Bill Oliva, Managing Director of Capital Markets, said in an interview from his home that on a more personal level, “the ability to have transactions like Freddie Mac to work on and other items is really the best therapy we can have.” (*Reuters*, Lynn Adler, 9/14/01)

Freddie’s debt met with excellent demand despite the uncertain environment

- Despite the uncertain environment, Freddie’s September 14 \$5 billion two-year debt offering reportedly met with surprising and excellent demand though the secondary market was subdued. (*Dow Jones Newswire*, Christine Richard, 9/14/01; *Dow Jones Newswire*, Tyler Lifton, 9/14/01) The bid-to-cover ratio for the auction, or amount of bids, versus the amount of securities available, was 3.69. That’s the highest it has ever been for a Reference note auction, versus an average of 3.15, said Freddie’s Treasurer Herrle. “We definitely saw more customer activity than in prior auctions,” said Herrle, adding that Freddie chose to auction the securities on Friday, September 14, rather than wait till the week of September 17, “to give the market something to focus on.” The notes carried a 3.5% coupon, the lowest ever for a Reference note, however they sold at a discount at 99.952 to yield 3.525%. The notes will mature on September 15, 2003 and will settle Monday, September 17. (*Dow Jones Newswire*, Tyler Lifton, 9/14/01) The yield margin that Freddie paid on those notes was significantly larger than it would have been had Freddie waited to sell the notes. However, Guth told *Dow Jones Newswire*, “if we hadn’t done that transaction, would the (agency) market be where it is right now?” (*Dow Jones Newswire*, Tom Sullivan, 9/20/01)

Discrepancy of opinion on how much Freddie’s debt yielded over the two-year Treasury

- There was a discrepancy of opinion as to how much the notes yielded over the two-year Treasury. Real-time pricing information has been much harder to gauge, since the offices of several dealers and interdealer brokers were shut down after the September 11 terrorist attacks. According to Freddie, the notes were sold at a 0.61 percentage point spread to the two-year Treasury, or about 0.005 percentage point tighter than the yield spread at which they traded prior to auction. A couple of dealers, however, stated that the yield spread to Treasuries at auction was about 0.02 percentage points less than it was when-issued trading before the auction. (Freddie’s two-year and three-year Reference note issues trade in the when-issued market after they are announced but before they are sold.) In the afternoon, the notes were yielding about 0.57 percentage points over Treasuries, dealers said. (*Dow Jones Newswire*, Tyler Lifton, 9/14/01) A September 20 *Dow Jones* article reported that Freddie sold \$5 billion of 5.5% notes to yield 5.517%, or a somewhat more affordable 83 basis points over the 10-year Treasury. The deal was more than 50% oversold. (*Dow Jones Newswire*, Tom Sullivan, 9/20/01) One third of the new notes were sold outside of the United States, up from the 20 to 25% that global investors typically buy in a Freddie Mac 10-year note sale. (*Reuters English News Service*, Lynn Adler, 9/20/01)

Treasuries faced pressure in part from Freddie’s issuance

- According to a September 21 *Wall Street Journal* article, the \$3 trillion bond market “is more troubled than at any time since the autumn of 1998, when the losses from the Long-Term Capital Management hedge fund threatened to cripple global markets.” The article noted that the bond market is not as bad as it was in 1998 but it is difficult to make trades. Prices are uneven, at best and some traders have simply stopped trading until the market recovers a bit. And it is getting hard for companies to sell bonds. **The article notes, however, that unlike 1998, “Treasury securities are not rallying as they were in 1998, which is keeping a lid on mortgage rates and undercutting the Federal Reserve’s**

efforts to give the US economy a shot in the arm.” Treasuries fell amid profit-taking competition from swelling issuance of corporate bonds, weaknesses in the dollar and concerns about rising government spending. At 4 p.m. Eastern time on September 20, the benchmark 10-year Treasury note was down 9/32 point, or \$2.81 for each \$1,000 invested, at 102 5/32. The yield rose to 4.724% from 4.658 September 19, as yields move inversely to prices. The price of the 30-year Treasury bond was down 25/32 at 96 17/32, pushing the yield up to 5.621% from 5.556%. Treasuries’ prices often increase when stocks fall sharply, amid expectations that investors will shift money to the relative safety of the government securities markets. However, Treasuries weakened, even as the Dow Jones Industrial Average was heading toward a decline of 382.92 points. Analysts said that was because maturities other than the 30-year bond already had rallied strongly the week of September 17, leaving the market ripe for profit taking. **The *Wall Street Journal* article noted that Treasuries also faced pressure from other directions, including selling issuance by nongovernment entities from Freddie Mac to IBM.** Underwriters often sell Treasuries ahead of such offerings to lock in yield curves. (*Wall Street Journal*, Gregory Zuckerman and Mitchell Pacelle, 9/21/01) [IBM tapped the market on September 20, priced a \$1.5 billion five-year issue upsized from \$1 billion. On Friday, September 14, Freddie sold a new \$5 billion, two-year Reference note bond offering, due September 15, 2003, and on Monday, September 17, it sold a new \$5 billion, 10-year Reference note offering due September 15, 2003.]

(3) In contrast to Freddie, Fannie announces it will not sell its long-term callable debt in September, but will continue to sell its short-term debt

- Fannie announced that it would not reschedule the callable Benchmark Notes® (long-term debt) it postponed the week of September 10 due to terrorist attacks. Fannie will resume its monthly callable Benchmark Notes® issuance with an announcement October 9 for pricing October 11, and expects to issue each month as scheduled for the remainder of the year. Fannie also announced it will resume its weekly Benchmark Bills (SM) bill debt auctions (short-term debt), with the scheduled 3-month and 6-month maturities. The Benchmark Bills (SM) auction was canceled the week of September 10 due to the tragic events on September 11. On September 19, Fannie auctioned \$7 billion of the 3-month Benchmark Bills and \$2 billion of the 6-month Benchmark Bills through its Dutch auction format. (*Fannie press release*, 9/18/01)

Executives at Fannie & Freddie claim the loans they own or securitize average a loan-to-value ratio of just over 60%

- Executives at Fannie and Freddie claim the loans they own or securitize average a loan-to-value ratio of just over 60%, supplying an adequate cushion for whatever credit deterioration could occur in a recession. Both companies boasted that their credit losses during the second quarter were at historic lows. Fannie’s Senior Vice President for Credit Policy Robert Engelstad said Fannie’s credit loss reached the 17-year low of \$16 million, or a loss rate of half a basis point. Freddie’s Vice President for Finance Joseph Amato said Freddie’s credit loss was \$14 million, or a rate of 0.6 basis point. (*American Banker*, Tommy Fernandez and Erick Bergquist, 9/11/01) [Editorial Note: Freddie recently announced that it plans to raise the guarantee fees that it charges lenders for selling their loans to the GSE. This seems to be an arbitrary increase in pricing since Freddie claims that its losses are low and the loans it owns or securitizes averages a LTV of just over 60%.]

Fannie & Freddie have implemented their disaster relief programs and called on servicers to provide forbearances to the families of borrowers who have been affected by the terrorist attacks, similar to the manner in which the GSEs handle natural disasters

Many others in the mortgage community have provided assistance to the relief efforts

- Fannie and Freddie implemented their disaster relief programs and called on servicers to provide forbearances to the families of mortgage borrowers who have been affected by the tragedies in New York, Washington, and Pennsylvania. Fannie said in a statement that its servicers should apply the natural disaster relief provisions outlined in its servicing guide. The statement noted, “Fannie Mae’s disaster relief provisions give mortgage servicers the discretion to help borrowers in several ways, including suspending or reducing mortgage payments for a time, or, in some circumstances, creating longer loan payback plans, resulting in a lower monthly payment. All changes will be made on a case-by-case basis.” Douglas Robinson, a Freddie spokesman, said the GSE is working with its servicers “in the same way we would handle natural disasters.” Servicers are to “give borrowers the benefit of the doubt with respect to delinquencies related to this tragedy,” Mr. Robinson emphasized. (*National Mortgage News Web site, 9/13/01*)
- Freddie also announced a “Peace of Mind Plan” so no borrowers with a Freddie Mac-owned mortgage would lose their homes as a result of the terrorist attacks. Freddie called on lenders servicing its mortgages to extend every option available under Freddie’s business policies to help borrowers directly or indirectly affected by the attacks. Freddie also asked its servicers to protect the credit of affected borrowers by not reporting their delinquencies to credit bureaus. (*Inman News Feature, 9/18/01*)
- The Fannie Mae Foundation gave an initial \$50,000 grant in support of the September 11th Fund established to aid Washington, DC-area victims and families of the Pentagon tragedy. The effort is organized by the United Way of the National Capital Area, which will work with the Community Foundation for the National Capital Region, to administer the fund. The Foundation will also match each dollar contributed by its employees and those of Fannie and will organize an employee blood drive as part of the relief effort. (*Inman News Feature, 9/12/01*)

Many others in the mortgage community have provided assistance to the relief efforts including the following:

- HUD Secretary Mel Martinez announced he will direct all FHA-approved lenders to provide relief to families with FHA-insured mortgages affected by the terrorist attacks. Secretary Martinez also asked all major mortgage lenders, including those that are not insured by FHA, to consider providing relief to the families as well.
- In the past during national disasters, HUD has issued letters directing lenders to work with affected families who have FHA-insured mortgages, to provide additional mortgage flexibility. The letters specifically ask lenders not to start or threaten foreclosure for at least 90 days, while the families are recovering from the financial problems caused by the loss of a family member. “This extraordinary period requires all of us to go the extra mile and a little beyond,” said Martinez.
- Ginnie Mae, will also encourage lenders to follow HUD's homeowner relief guidance by advancing payments to Ginnie Mae securities investors that a lender otherwise makes from homeowner mortgage payments. Ginnie Mae will soon be issuing this guidance to affected lenders.
- HUD's assistance to the victims of the terrorism also includes:
 - A hotline for HUD's Housing Counseling Clearinghouse (1-800-217-6970);
 - Temporary housing and shelter for disaster victims - HUD will work with FEMA to identify vacant HUD-owned homes and multi-family units that can be used as temporary housing for those forced from their homes;

- A request that all HUD-approved agencies reach out to affected families and provide comprehensive housing counseling services to all those in need of shelter and/or financial assistance; and,
 - Counseling grants for counseling agencies that need additional resources to provide services. (*Inman News Feature*, 9/17/01)
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- A group of mortgage lenders said its members are assisting those affected by the terrorist attacks with steps that include reductions in payments, suspension of foreclosure proceedings and pledges of millions of dollars for relief efforts. “Our members, along with many others in the industry, have taken steps to protect the homeowners affected by the tragedy,” wrote the Executive Director of the Consumer Mortgage Coalition, Anne Canfield, to HUD Secretary Mel Martinez. Members of the trade association have suspended foreclosure proceedings for 90 days from the time of the Sept. 11 attacks, have temporarily suspended or reduced mortgage payments, and created longer loan payback plans for people affected by the attacks, Canfield said. The companies have also provided information to borrowers of payment relief options available from the government and have further pledged millions of dollars worth of contributions to aid and relief efforts, she said. (*Reuters*, Mark Felsenthal, 9/19/01)
 - The National Association of Realtors created the Realtors Housing Relief Fund to help pay mortgage or rental costs for the families impacted by the attacks. NAR made an initial contribution of \$1 million to the fund, and is seeking further contributions from its members. (*National Mortgage News*, Brad Finkelstein, 9/17/01) NAR reported on September 18 that it had raised approximately \$1.74 million so far in donations and pledges to help pay housing costs. (*National Mortgage News Web site*, 9/19/01)
 - The National Association of Home Builders has established the Home Builders Care Victims’ Relief Fund in conjunction with its philanthropic arm, the National Housing Endowment, to help the victims of recent terrorist attacks in New York City, Washington, D.C., and rural Pennsylvania. NAHB will start the fund with an initial contribution of \$250,000, and the National Housing Endowment will contribute an additional \$125,000. NAHB’s members will be encouraged to contribute as well by writing checks to the Home Builders Care Victims’ Relief Fund and making donations through the local home builders’ association. (*Inman News Feature*, 9/21/01)
 - A coalition of housing groups and companies pledged \$25 million to support victims, families, rescue workers, and others affected by the terrorist attacks. The goal of the effort is to provide relief, including counseling, financial support for housing-related rebuilding in Lower Manhattan, and rental payment assistance. The group includes Fannie Mae, Freddie Mac, the National Association of Home Builders, the Mortgage Bankers Association of America, the Independent Community Bankers of America, the National Multi Housing Council, and the Homeownership Alliance. (*National Mortgage News Web site*, 9/17/01)
 - Union State Bank in Orangeburg, NY, announced the formation of a disaster relief fund with the Independent Community Bankers of America. Tax-free donations collected by the fund will be donated to disaster victims, their families, and organizations engaged in rescue efforts. (*National Mortgage News Web site*, 9/19/01)
 - Wells Fargo & Co. is making a \$1 million donation to the American Red Cross. Washington Mutual Inc. is making a \$250,000 donation. (*National Mortgage News*, Brad Finkelstein, 9/17/01) Bank One Foundation announced it would donate up to \$1 million to relief efforts. The company will also

match donations of the company's employees, dollar-for-dollar, up to \$1 million. (*Inman News Feature*, 9/12/01) General Electric pledged \$10 million for a fund for the families of New York City firefighters and police officers missing and presumed dead from the terrorist attacks. (*Washington Post*, 9/14/01)

- Irwin Mortgage announced it will waive late fees, forgo credit reporting, and suspend foreclosure activity at least until Dec. 13 for mortgage customers affected by the terrorist attacks, including persons employed in or near the World Trade Center or at the Pentagon; police officers, firefighters, medical personnel, and others who have assisted in rescue efforts; and all other customers who have been financially affected. PMI Mortgage Insurance Co. and CMG Mortgage Insurance Co. said they will give servicers additional time to work out solutions with insured borrowers directly affected by the terrorist attacks whose home loans become past due. Wachovia Corp. is offering a special loan program under which affected parties can obtain an unsecured loan of \$3,000 to \$15,000 for up to 36 months with no origination fee at an annual percentage rate of 9.99%. The loan's first payment will be deferred for 60 days. The program is being offered via Wachovia's subsidiaries First Union National Bank and Wachovia Bank NA. (*National Mortgage News Web site*, 9/17/01)
- California Federal Bank will contribute \$100,000 to the September 11th Fund established by the United Way and The New York Community Trust to aid the victims and their families. (*National Mortgage News Web site*, 9/17/01)
- RemoteDocs.com, a document preparation service, established a free transmittal account for any institution that is unable to send documents using overnight couriers. CoStar Group in Bethesda, MD is seeking to contact commercial real estate brokers in New York to find where and how much office space is available to house those who were displaced by the attacks. Worth Funding Inc., a mortgage broker based in Calabasas, CA will make a donation of \$1000 for each \$1 million in production it does this month to the Red Cross. (*National Mortgage News*, Brad Finkelstein, 9/17/01)

Fannie Mae

America's Community Bankers expands its "affinity partnership" with Fannie by adding a private label loan servicing option

- ACB and Fannie expanded their "affinity partnership," available only to ACB members, to offer community bankers the option of a low-cost loan servicing program. The enhancement is a special private label loan-servicing program offered by Cenlar FSB, Ewing, N.J., a leading loan servicer. The Cenlar product is available only to ACB-member community banks that are Fannie Mae seller/servicers and have signed a membership agreement to participate in the ACB/Fannie Mae Affinity Partnership.
- There are two key features to this program: (1) Cenlar imposes no minimum servicing volume requirement; (2) ACB members can access this option one loan at a time. Also, participants retain exclusive marketing rights, including the right to refinance customers' mortgage loans. The affinity partnership, first launched in January, "has become a huge success in a very short period of time," said ACB President and CEO Diane M. Casey. "We are now adding another vital building block with this unique loan servicing program provided by an ACB member for ACB members. This program enables ACB members to improve the profitability of their mortgage operations without giving up their customers."
- "We are thrilled to be working so well with ACB-member banks," said Fannie Mae's Jeffery Hayward, vice president of single-family business. "This is a great opportunity for Fannie Mae to maintain its leadership in the secondary mortgage market and for ACB-member banks to serve their customers."
- Cenlar offers participants two servicing options: (1) Subservicing - Cenlar services the loan on the bank's behalf, while the bank originating the loan remains the servicer of record; and (2) Servicing-released - The bank sells the servicing rights to Cenlar but the loan is serviced in the bank's name.
- Cenlar's claims that its service is designed so that it is not competing with participating banks for loan originations or the offering of retail bank products.
 - The bank's name and logo is on all outbound correspondence, including notices, letters, statements and coupon books.
 - Cenlar accepts payments by check made out to the bank or by draft from the borrower's bank account.
 - Cenlar sends a customized welcome letter to all new loan customers.
 - Cenlar operates a dedicated toll-free number that greets customers with the bank's name.
 - Cenlar provides live-call transfer to the bank's retail center for sales or refinance opportunities.
 - Around-the-clock Internet access to loan data is provided for both bank management and borrowers.
- "What clinches our decision to use Cenlar is how they make everything transparent to the borrower," said Kevin Dunne, senior vice president, Roslyn Savings Bank, Jericho, N.Y. "Our customers will think they're dealing with us, and that's the way we want it. Also, Cenlar isn't competing with us for loans or other products, so there is no conflict of interest." (*ACB press release, 9/19/01; Dow Jones Newswire, John Connor, 9/19/01*)

Freddie Mac

Freddie issues a statement after the terrorist attacks saying stock prices and interest rates will decline and that the housing market in New York will be turbulent for a while

That same day, Freddie issued a second statement saying the first statement was “a bit too strong”

- In the early afternoon of September 12, Freddie issued a statement saying it anticipated a decline in both stock prices and interest rates. “Financial markets are in turmoil at this point, and will be for a while,” said the GSE. “We expect that stock prices will fall and interest rates will probably drop. The effect on interest rates will depend on the extent to which traders try to get out of dollars and the actions of the Fed and foreign central banks, which are difficult to predict at this time. Our guess about the effects on the housing market is that it will also be turbulent for a short while and then stabilize. It will obviously take much longer for the housing market to settle down in the New York area, where damage is the most severe.” (*National Mortgage News Web site, 9/12/01*)
- Late on September 12, Freddie tempered its post-attack statement. “The first statement was a bit too strong,” said a Freddie spokeswoman. The new forecast said: “Global financial markets are experiencing volatility, and short rates will most probably fall, at least for a while.” The new forecast did not mention stock prices specifically, but said that in the short term, “markets will see a good deal of turbulence.” (*National Mortgage News Web site, 9/13/01*)

Freddie expects to increase its guarantee fees that it charges lenders for selling their loans to the GSE

- Freddie’s Chief Credit Officer David Andrukonis said that Freddie will increase its guarantee fees in the foreseeable future. Guarantee fees are the fees that the GSEs charge lenders for selling their loans to Fannie and Freddie. Speaking at an investor conference sponsored by Friedman Billings Ramsey & Co., Mr. Andrukonis said Freddie’s guarantee fees would not fall even though many medium-sized companies are selling out to larger ones, increasing the power these companies might have in negotiating guarantee fees with the GSEs. Lenders that sell a large portion of their loans to either Fannie or Freddie may be able to negotiate a lower guarantee fee based on volume. Mr. Andrukonis, however, said that although the servicing side of the mortgage business is consolidating, the production side is not. “I think we are going to see our g-fees [guarantee fees] going up.” According to a Morgan Stanley Dean Witter report, Freddie’s guarantee fees slipped to 18.8 basis points in the second quarter compared to 19 basis points in the first. (*National Mortgage News, 9/10/01*)

Freddie increases the maximum purchase amount for VA mortgages

- Freddie announced in a September 10 bulletin that it has raised the loan limit on loans guaranteed by the Department of Veterans Affairs that it will purchase. Freddie said its sellers and servicers could now sell VA mortgages with original principal balances up to \$275,000 (the conforming loan limit), or \$412,500 for high-cost areas. The previous amount Freddie would purchase for VA loans was \$203,000 and up to \$275,000 in high-cost areas. (*National Mortgage News Daily, 9/13/01*)

Freddie announces that a former Price Waterhouse Chairman joins its board

- Freddie announced that Shaun O’Malley was appointed to its Board of Directors. O’Malley is a former Chairman of Price Waterhouse, now part of PricewaterhouseCoopers. O’Malley served as a

member and chair of the board of trustees of the Financial Accounting Foundation. In 1999, he was appointed Chair of the Public Oversight Board's panel on Audit Effectiveness. He has also been active in the governance of educational institutions, serving as a member of the board of trustees at the University of Pennsylvania. (*Inman News Features*, 9/11/01)

Federal Home Loan Banks

White House nominates Shirlee Bowne as the new Chairman of the FHFB

- The White House announced the nomination of Shirlee Bowne as the new Chairman of the five-member FHFB. The nomination will now go to the Senate Banking Committee for review and approval. "It is comforting in light of this week's tragedy that the US government continues to function smoothly and announce nominations like the one made today for Shirlee Bowne as Chairman of the Federal Housing Finance Board," said the Council of Federal Home Loan Banks, which represents 10 of the 12 FHLBanks. Bowne was Vice Chairman of the National Credit Union Administration and the Neighborhood Reinvestment Corp. from 1991 to 1997. Bowne is the President of S. Bowne & Co., a Tallahassee, FL, planning and housing firms, and she serves on the board of the Florida Central Credit Union. Bowne will succeed J. Timothy O'Neill as the Chairman of the five-member FHFB. The *American Banker* reported that O'Neill is expected to leave the board if Bowne is confirmed. Last month, President Bush nominated John Thomas Korsmo as a member of the FHFB and HUD designated HUD Assistant Secretary John Weicher to be HUD's representative on the FHFB. The remaining members of the FHFB include Franz Leichter and Allan Mendelowitz, who President Clinton installed last year as recess appointments. Their terms will expire when Congress adjourns at year-end. It is not clear if President Bush will re-nominate them. (*American Banker*, Michele Heller, 9/18/01; *Dow Jones Newswire*, John Connor, 9/14/01)

FHLBanks' Mortgage Partnership Finance (MPF) program to add servicing-release option

FHLBank of Atlanta President believes the MPF program needs to refocus its emphasis on conventional loans

- According to Lew Sichelman with *National Mortgage News*, the Chicago FHLBank hopes to add servicing released transactions to the MPF program it began four years ago. Such a product "is critical" to the continued success of the MPF program, said Raymond Christian, President of the FHLBank of Atlanta, who announced the initiative at the Eastern Secondary Mortgage Market Conference. Due to consolidation in the servicing arena and the aggressive servicing multiples that are being paid, Christian said many members have found it more economical to sell their loans on a servicing-released basis. The MPF program provides lenders an alternative to selling fixed-rate, conventional and guaranteed loans to Fannie and Freddie.
- Christian also noted that the MPF program needs to refocus its emphasis on conventional mortgages to assist smaller and medium-sized FHLBank members compete with larger institutions. Christian claims that the inclusion of government loans to the MPF program has benefited mostly larger institutions. He believes that the MPF program should focus "more sharply" on conventional mortgages, where small and medium-sized lenders could use the most help. Christian stressed that these were his own personal views and not those of the other FHLBanks in the System. (*National Mortgage News*, Lew Sichelman, 9/17/01)

America's Community Bankers asks FHFBS to make changes to the FHFBS's capital rule for the FHLBank System

- The ACB sent a letter to the FHFBS in response to its proposed rule on the capital requirements for the FHLBank System. The ACB strongly believes that two changes are essential: (1) mandate activity based stock purchase requirements and (2) provide better clarification and any necessary changes to ensure that the new capital rules do not create a taxable event for members of the FHLBank System.
- In its letter, the ACB said it believes that mandatory activity-based stock purchase requirements are vital to preserving the cooperative nature and risk-averse management of the FHLBank System. The ACB claimed that mandating an activity-based stock purchase requirement indemnifies the System against losses, helps ensure that the FHLBank meets its minimum capital requirements, and provides additional capital to the FHLBank when members require new funding. The ACB noted that the capital rule mandated that, when activity-based stock purchases are required, the FHLBank member engaged in the activity must maintain the stock for the life of the activity. The ACB letter stated, "This sound policy is based on the principle that the member engaging in the activity should provide the capital to support it. The Finance Board has recognized that new activities of the FHLBanks, acquired member assets ("AMA") that include products like the mortgage partnership programs, are the functional equivalent of advances. However activity-based stock purchase requirements are only recommended. The Finance Board's requirement to hold the stock for the life of the activity is a sound and prudent policy. ACB strongly requests that the policy be expanded to require activity-based stock purchases for advances and AMA programs like the mortgage partnership programs as part of the FHLBanks' capital requirements."
- The ACB is pleased that the FHFBS addressed comments from members of the System expressing concern about the impact of the capital rule's treatment of FHLBank members' ability to receive dividends in the form of stock under the tax deferred treatment allowed by Rev. Rul. 90-98. Unfortunately, the ACB was "not comforted by the response in the proposed rule and remain concerned that the language of the rule could result in the application of standards of Rev. Rul. 83-68, rather than the more favorable ones in Rev. Rul. 90-98." The ACB noted that the IRS issued the latter revenue ruling only after several courts disagreed with its contention that the issuance of stock dividends was a taxable event because the FHLBanks always redeemed the stock. The courts, and ultimately the IRS in Rev. Rul. 90-98, based their reasoning for allowing tax deferral on the purpose and structure of the FHLBank System. The "ACB fervently requests the Finance Board to consider this matter further as it finalizes the proposal." (*ACB letter to FHFBS Secretary Elaine Baker, 9/6/01*)

Background on the rule

- The FHFBS issued a rule on August 8 that would make a small number of modifications to the final capital rule that the FHFBS published January 30, 2001. Many of the changes were identified in response to an advance notice of proposed rulemaking (ANPR), published March 7, relating to unforeseen issues not addressed in the capital rule. The deadline for comments on the rule was September 7. (*FHFBS press release, 8/10/01; Federal Register, pages 41462-41474, 8/8/01*)
- According to John Connor with *Dow Jones Newswire*, the FHFBS's proposed rule that makes modifications to the final capital rule would do nothing to impede the ability of the FHLBanks to purchase obligations of Fannie and Freddie. The proposed rule would amend portions of the capital rule adopted last December that was viewed by some FHLBanks as potentially disruptive to their investment strategies and likely to force them to invest in instruments of lesser credit quality than the debt of other GSEs by tightening limits on the amount of unsecured credit FHLBanks could extend to a GSE counter-party. The offending portion of the capital rule was deleted by the FHFBS earlier this

year, and the proposal released by the FHFBS on August 8 would set a “limit on unsecured credit exposure to GSEs of 100% of the lesser of FHLBank capital or the counterparty’s capital.” The FHFBS said, “GSEs historically have been viewed more favorably by debt markets than the highest-rated corporate debt issuers.” (*Dow Jones Newswire*, John Connor, 8/8/01)

FHFBS schedules September 26 meeting to discuss dual FHLBank membership

The meeting was originally scheduled for September 12

- FHFBS Chairman Timothy O’Neill announced the FHFBS’s next meeting will be held on Wednesday, September 26 at 10:00 a.m. The FHFBS had originally announced the meeting date as September 12. “Unfortunately, we had to move the date of the meeting due to a family emergency of one of the board members,” said O’Neill.
- Among the items to be considered is a discussion of dual FHLBank membership and to issue a solicitation for comment on the effects dual FHLBank membership would have on the FHLBank System. The FHFBS has three applications where members of one FHLBank have acquired a thrift in another FHLBank district and would like to assume the acquired institution’s membership in the FHLBank: (1) Washington Mutual Bank, Stockton, CA (a member of the San Francisco FHLBank) acquired Bank United in Texas and wants to become a member of the Dallas FHLBank; (2) Fleet National Bank, Boston, MA (a member of the Boston FHLBank) acquired Summit Bank and wants to become a member of the New York FHLBank; and (3) Charter One, Cleveland, OH (a member of the Cincinnati FHLBank) acquired Alliance Bancorp and wants to become a member of the Chicago FHLBank. “This is the biggest issue that the Finance Board will face in 2001, so I want to make sure that we have an open process, a comprehensive process,” said O’Neill. The solicitation of comments from the public will enable the FHFBS to determine whether it should begin a subsequent rule-making process on the issue. (*Federal Register*, page 48683, 9/21/01; *National Mortgage News Daily*, 8/14/01; *National Mortgage News*, Brian Collins, 7/9/01; *FHFBS pres release*, 8/10/01, 9/6/01)

Farm Credit System/Farm Credit Banks

Farm Credit Administration (FCA) re-proposes amendments to its regulations for the approval of loans to designated parties

- The FCA issued a proposed rule that re-proposes amendments to its regulations for the approval of loans to designated parties. The term “designated parties” includes Farm Credit System “insiders” most likely to have a conflict of interest and those FCA and Farm Credit System Insurance Corporation employees who may legally borrow from the System. The re-proposed rule would require the lender’s board, or its delegated committee, to approve all loans to a designated party that exceed the greater of \$150,000 or 0.5 percent of permanent capital (not to exceed \$250,000). The re-proposed rule would also eliminate the System banks’ approval requirement and include an option allowing an association to enter into an agreement with its affiliated bank to permit the bank to perform the designated party loan approval. The deadline for comments on the rule is October 18, 2001. (*Federal Register*, pages 48098-48102, 9/18/01)

Postal Service

National Taxpayers Union calls for an end to the Postal Service monopoly

- As news of another possible postal rate increase has surfaced, the NTU released a new Issue Brief on September 20 examining the question of Postal Service privatization. **“The U.S. Postal Service tries to give the impression that it is run like a business, but anyone who looks beyond the rhetoric can clearly see that it is just another bloated government bureaucracy,”** said NTU Deputy Press Secretary and Policy Analyst Jerry Terry. **“Although the U.S. Postal Service has begun making positive changes, the only way to truly eliminate the typical government inefficiency and waste found in the Postal Service is to get the government out of the mail delivery business. Even the Postal Service has acknowledged this fact by signing an agreement to have a private company transport some mail.”**
- NTU noted that the U.S. Postal Service claimed that its recent partnership with FedEx will save about \$1 billion in air transportation costs over the next several years, in spite of the fact that, unlike the Postal Service, FedEx must pay taxes and other fees imposed on a private company while still making a profit. **“A private company that is subject to competition and that is accountable to its shareholders must be as efficient as possible to survive,”** observed Terry. **“Unfortunately, the Postal Service, with its government-imposed monopoly on First Class mail delivery, has no competition and is only accountable to big-spending politicians and powerful labor unions.”**
- The NTU noted that last year the Postal Service lost \$199 million and is expected to lose another \$1.65 billion this year. Yet, earlier this year Postal Service managers and executives received \$197 million in bonuses, and in September the U.S. Postal Service announced that it is seeking an 8.8 percent rate increase – the third in only 18 months – to cover its expenses.
- **“In light of the inefficiency and waste within the U.S. Postal Service, another postal rate increase would be a slap in the face to all Americans,”** noted Terry. **“The time has come to finally privatize the U.S. Postal Service.”** (NTU press release, 9/20/01)

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