

# The **GSE** REPORT™

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- GAO suggests Fannie & Freddie pay for their mission oversight ([p. 20](#))
  - GAO estimates it would save the government \$10 million a year and enable HUD to strengthen its oversight activities
- American Enterprise Institute (AEI) holds April 23 book forum on Tom Stanton’s book, “*Government-Sponsored Enterprises: Mercantilist Companies in the Modern World*” ([p. 21](#))
  - Stanton’s book finds the following:
    - (1) GSEs have major advantages over their competitors
    - (2) GSEs are no longer suited for today’s financial markets and may impede competition and innovation

- (3) Exit strategies to transform the GSEs into private companies are needed as they come to the end of their usefulness
- (4) Government is largely unable to address the risks inherent in these highly leveraged GSEs
- Panelists included Freddie's Chief Economist Robert Van Order, University of Michigan Law School Professor Sallyanne Payton and OFHEO's General Counsel Alfred Pollard

### **Fannie Mae and Freddie Mac**

- *DiversityInc.com* finds Fannie falls short of its affordable housing mission ([p. 23](#))
  - Notre Dame sociology professor Richard Williams states, "The GSEs are clearly getting substantial government benefits. Whether the American people are getting enough in return for those benefits is debatable. I'd say no."
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- Fannie & Freddie report second quarter earnings ([p. 26](#))
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  - Fannie & Freddie purchased 68% of all mortgages originated in the first quarter
  - Sanford C. Bernstein analyst raises concerns about Fannie's slow growth in its retained portfolio
- Fannie & Freddie's executive salaries continue to increase ([p. 27](#))
  - Fannie's Chairman earned \$10.8 million in compensation last year; Freddie's Chairman earned \$8.28 million
- American Securitization Forum opens its membership for the first time to Fannie & Freddie ([p. 28](#))
- President Bush nominates 10 people to serve on Fannie & Freddie's boards ([p. 29](#))
  - Fannie & Freddie have 13 board members elected by shareholders and five appointed by the President
  - "Supposedly the presidential appointees give the public a voice in how the companies are run. In reality they give the companies the political advantage of having board members wired into the Washington power elite," reports Jerry Knight with the *Washington Post*

### **Fannie Mae**

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- Fannie has new top lobbyist - Fannie's Senior Vice President of Government and Industry Relations William Maloni to become a Senior Advisor; Fannie Vice President Duane Duncan promoted to Maloni's position ([p. 31](#))
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- Freddie's Senior Vice President in charge of national sales is leaving the company ([p. 32](#))

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- American Bankers Association (ABA), America's Community Bankers (ACB), and Independent Community Bankers Association (ICBA), oppose a provision in a regulatory relief bill that would allow privately insured credit unions to join the FHLBank System ([p. 32](#))
  - Credit Union National Association (CUNA) strongly supports the provision; National Association of Federal Credit Unions (NAFCU) has reservations about the provision
- FHFB Chairman John Korsmo believes the FHLBank System will eventually become a major competitor to Fannie & Freddie ([p. 34](#))
  - FHLBank of Chicago President Alex Pollock claims the FHLBank System's Mortgage Partnership Finance (MPF) program is a more efficient use of GSE advantages than Fannie & Freddie
  - MPF volume grows to \$27 billion during the first quarter of 2002
  - MPF is a competitor to Fannie & Freddie in the secondary mortgage market
- FHFB profiles the FHLBank System in a new report ([p. 35](#))
- FHFB will likely allow the FHLBank of Chicago to continue operating its MPF program without a stock purchase requirement in its capital plan ([p. 35](#))
  - FHLBank of Chicago believes a stock purchase requirement would hurt the MPF program
  - FHFB is considering the FHLBanks of Boston and Pittsburgh's capital plans at its May 8 open meeting
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- Farmer Mac sets earning record in the first quarter ([p. 37](#))

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## Major Events

**Federal Reserve Board Chairman Alan Greenspan says government support for Fannie & Freddie might be leading investors to underestimate the risk of dealing in their securities**

**“The broader risks for financial markets and the economy result from the perception of government support for these corporations and the resulting implicit subsidization of GSEs...In this case, the perception of government support may induce the counterparties of GSEs to apply less vigorously some of the risk controls that they apply to manage their over-the-counter derivatives exposure.”**

**Wall Street Journal editorial says that translating Greenspan’s comments, “this means that Fred and Fannie’s financial acrobats may be jumping without parachutes”**

- **Federal Reserve Chairman Alan Greenspan said government support for mortgage agencies, such as Fannie and Freddie, might be leading investors to underestimate the risk of dealing in their securities**, reported Greg Ip with the *Wall Street Journal*. Chairman Greenspan has previously criticized the GSEs’ implicit government support as a subsidy to housing that distorts the economy’s allocation of resources. However, in an April 22 speech before the Institute of International Finance, Greenspan went further, suggesting that subsidy might also be causing the risk in their derivatives transactions to be understated, though he didn’t say that had actually happened. (*Wall Street Journal*, Greg Ip, 4/23/02)
- **The perception that the U.S. backs the government-sponsored enterprises -- or GSEs -- could encourage investors “to apply less vigorously some of the risk controls that they apply to manage their over-the-counter derivatives exposures,”** he said in a speech, via satellite, to the Institute of International Finance. The association of global financial institutions includes some of Fannie and Freddie’s critics. (*Wall Street Journal*, Greg Ip, 4/23/02)
- Chairman Greenspan’s speech extolled the benefits of derivatives to the economy. **He acknowledged that concerns have been raised about the risks assumed by Fannie and Freddie’s counterparties -- the mainly large, sophisticated investors with whom the agencies trade -- due to the mortgage companies’ hedging activity, but he said “Presumably, counterparties can manage this risk effectively” through existing risk-management tools. “The broader risks for financial markets and the economy result from the perception of government support for these corporations and the resulting implicit subsidization of GSEs,”** he said. (*Wall Street Journal*, Greg Ip, 4/23/02)

### Text of Chairman Greenspan’s remarks on Fannie & Freddie

- The following is the text of Chairman Greenspan’s April 22 remarks at the Institute of International Finance on Fannie and Freddie:

“...concerns have been raised about potential counterparty risks in the large interest rate hedging efforts of government sponsored enterprises (GSEs) in support of their secondary mortgage market operations. Presumably, counterparties can manage this risk effectively through the use of credit limits, netting, and collateral agreements. The broader risks for financial markets and the economy result from the perception of government support for these corporations and the resulting implicit subsidization of GSEs. Subsidies, by intent, distort the normal balance of markets. In this case, the perception of government support may induce the counterparties of GSEs to apply less vigorously some of the risk controls that they apply to manage their over-the-counter derivatives exposure. More generally, we need to be careful not to allow subsidies to unduly disturb an efficient financial structure

that has so clearly contributed to increased economic stability.” (*Remarks by Federal Reserve Chairman Alan Greenspan at the Institute of International Finance (via teleconference), 4/22/02*)

#### Wall Street Journal editorial

- In an April 24 editorial on Chairman Greenspan’s comments, the *Wall Street Journal* noted that “It was lonely out there for a while. But all of a sudden some very important people are joining us in asking questions about the risk portfolios of Freddie Mac and Fannie Mae.”
- “The latest is Fed Chairman Alan Greenspan, who slipped into a Monday night speech a little lesson about the danger of federal subsidies for these ‘government-sponsored enterprises.’ Both Fannie and Freddie use financial derivatives to hedge their risks, which can be a good thing but only if the counterparties to these trades are vigilant.”
- Greenspan stated, “The perception of government support may induce the counterparties of GSEs to apply less vigorously some of the risk controls that they apply to manage their over-the-counter derivatives exposures.”
- **The *Journal* stated, “Translated from the hieroglyphics, this means that Fred and Fannie's financial acrobats may be jumping without checking their parachutes. And why not, since they know there is probably a taxpayer cushion to catch them if their leaps of faith don't pay off. This is a classic problem with government subsidies that shift risk to third parties, in this case to taxpayers.”** (*Wall Street Journal editorial, 4/24/02*)

#### Fannie & Freddie’s comments

- Fannie’s spokeswoman Janice Daue said, “We see no evidence that our derivatives counterparties are not applying careful credit judgment in their transactions with us. ... Indeed, the vast majority of the credit risk faced by derivatives counterparties stems from transactions with entities with lower [credit] ratings than Fannie Mae.” (*Wall Street Journal, Greg Ip, 4/23/02*)
- Freddie’s spokesman David Palombi said, “Our counterparties ... fully understand how we use derivatives, that we're an end user rather than a speculator, and the management of this has been extraordinarily conservative.” (*Wall Street Journal, Greg Ip, 4/23/02*)

#### Previous comments by Chairman Greenspan on Fannie & Freddie

- **In a letter to Capital Markets Subcommittee Chairman Richard Baker (R-LA) in 2000, Chairman Greenspan wrote, “Subsidies accorded to GSEs are, of necessity, at the expense of other federal or private-sector initiatives.”** (*Wall Street Journal, Greg Ip, 4/23/02*)

**Federal Reserve Bank of San Francisco President says the economic role of Fannie & Freddie should be closely monitored**

**“I think that is something that should be looked at very closely...It seems to me the GSEs are now playing a role in the economy that they were not originally intended to.”**

- Echoing the warning by Federal Reserve Board Chairman Greenspan recently that government support for Fannie and Freddie encourage investors to underestimate the riskiness of their debt, Federal Reserve Bank of San Francisco President Robert Parry said the economic role of these GSEs should be closely monitored, reported *Reuters*. **“I think that is something that should be looked at**

very closely, to be honest with you. It seems to me the GSEs are now playing a role in the economy that they were not originally intended to.” (Reuters, 4/23/02)

### Federal Reserve asks its Federal Advisory Council to discuss Fannie & Freddie at its May 3 meeting

- The Federal Reserve has asked a private-sector advisory body to discuss Fannie and Freddie at its May 3 meeting, industry sources said, a sign the central bank is taking seriously recent concerns about the GSEs’ roles in the mortgage finance system. (Reuters, 4/25/02)
- The Federal Advisory Council is a group of senior financial services industry officials from each of the Fed’s 12 national districts. The group meets at least four times a year for several days in Washington, DC and keeps the sessions closed to the public. Even the minutes of the meetings are kept confidential for three years. The Federal Advisory Council also discussed the GSEs a year ago. At the time, the Fed asked council members whether they felt Fannie and Freddie had expanded beyond their charters, competing directly with banks, or using their leverage as buyers of large quantities of mortgages to obtain better terms in transactions. (Reuters, Mark Felsenthal, 4/25/02; Dow Jones Newswire, Dawn Kopecki and Joseph Rebello, 4/26/02)
- Fed spokesman David Skidmore declined to comment on the issue, saying the committee’s meetings are private. (Dow Jones Newswire, Dawn Kopecki and Joseph Rebello, 4/26/02)

### Fannie & Freddie’s response

- Fannie and Freddie downplayed the reports about the Federal Reserve’s request for the Federal Advisory Council to discuss the GSEs. “They regularly have us on the agenda every few months as they scan the financial landscape,” said Fannie’s spokeswoman Janie Daue. “As one of the largest investors in home mortgage financing, it would be understandable that we would be on their agenda.” Freddie’s spokeswoman Sharon McHale said, “We’ve been on their agenda before. The role of the Federal Advisory Council and, of course, the Fed itself is to look at issues going on in the broader economy. We have been on their agenda in the past; It’s not unprecedented,” McHale said. (Dow Jones Newswire, Dawn Kopecki and Joseph Rebello, 4/26/02)

### Former Federal Reserve Board Chairman Paul Volcker suggests Fannie & Freddie may be too big

- Former Federal Reserve Board Chairman Paul Volcker suggests Fannie & Freddie may be too big. Volcker told the Bond Market Association on April 25 that, from his knowledge, the GSEs have good accounting and risk management systems. He added, however, that when Congress established them, their mandate was not to dominate the mortgage market. **“Their mandate originally was not to dominate the home mortgage market,” Volcker said in response to questions after remarks at the Bond Market Association on April 25. “It was solely to develop a secondary market, and they’ve gone way beyond that.”** He stated, **“I think the issue with Fannie Mae and Freddie Mac is one of size.”** (Dow Jones Newswire, Judith Burns, 4/26/02; Financial Times, Jenny Wiggins, 4/26/02)

## AFL-CIO opposes Fannie & Freddie's mission creep

**AFL-CIO is concerned about the GSEs' push to automate real estate appraisals in place of traditional appraisals**

**The union may direct its \$5 trillion in pension funds away from GSE paper**

- **The AFL-CIO opposes Fannie and Freddie's mission creep, according to Tommy Fernandez with the *American Banker*. Specifically, the AFL-CIO is concerned about Fannie and Freddie's push to automate real estate appraisals, which they believe could add risk into the GSEs' loan portfolio and could harm individual traditional appraisers.** "With the growing use of automated appraisals, led in part by the GSEs, concern is growing that the livelihoods of real estate appraisers — a fair number of whom belong to an AFL-CIO affiliated union — could be at stake," reported Fernandez. **Citing these concerns, the AFL-CIO officials confirmed that it may direct its \$5 trillion in pension funds away from GSE paper.** The AFL-CIO federation's 66 unions are major investors in mortgage-backed securities. Damon Silvers, an associate general counsel for the AFL-CIO, said it plans to make its decision in less than six months. (*American Banker*, Tommy Fernandez, 4/25/02)
- The appraisers used a grassroots campaign to persuade the AFL-CIO's leadership to use its vast pension holdings as a lobbying tool to change the corporate strategies of Fannie and Freddie, according to AFL-CIO officials. "There is a lot of pension money tied up in mortgage financing," said Michael Goodwin, a vice president of the AFL-CIO's executive council and president of the 145,000 member Office and Professional Employees International Union. "We are going to try to use that leverage we have with the billions of dollars that are controlled by the AFL-CIO funds and turn it into a voice that can be heard." (*American Banker*, Tommy Fernandez, 4/25/02)
- Fannie and Freddie are encouraging a wider acceptance for automated appraisal systems and are waiving traditional appraisals on some deals considered very low risk. "The notion that you would automate an appraisal process for a home doesn't strike us as making any sense at all," Silvers said. "We are generally skeptical of claims that you can automate the valuation of any particular asset." The AFL-CIO "has been very focused" on the issue of financial transparency and disclosure, as well as on the safety and soundness of the asset classes in its pension funds. "MBS are pretty widespread in the portfolios of a lot of worker's pensions, including union-sponsored funds, because they have a certain credit quality," he said. "People treat senior MBS ... as a very secure investment, just short of U.S. Treasuries. They have to be what issuers claim they are." (*American Banker*, Tommy Fernandez, 4/25/02)
- **William Sentner, the president of AFL-CIO affiliate – the American Guild of Appraisers - said that the issue was not the use of the automated systems but the idea that they can replace traditional appraisals. Without human input, automated appraisals are liable to overvalue homes, he said. He believes the AFL-CIO's action may be necessary to protect the livelihood of the appraisal industry. Appraisers' objectivity is crucial for the mortgage lending industry, Sentner said, and the growing acceptance of automated systems is already hurting many "mom-and-pop" appraisal firms.** (*American Banker*, Tommy Fernandez, 4/25/02)

### AFL-CIO sends letter to Freddie

- AFL-CIO's Goodwin sent a letter to Freddie's Chairman Leland Brendsel last May saying that unions "do not have a comfort level" with Freddie's push for automated appraisals. He said he received no

response. The union Goodwin leads approved a resolution last June instructing its pension funds to invest in no mortgage bonds backed by loans that involved automated appraisals. (*American Banker*, Tommy Fernandez, 4/25/02) **The letter stated that the 13 million-member AFL-CIO was unhappy with Freddie’s appraisal waiver pilot program, not only because the union represents appraisers but also because it holds substantial amounts of Freddie’s debt. “Please note that many affiliated unions of the AFL-CIO collectively manage pension fund assets of over 1.3 trillion dollars, of which 40% is invested in mortgage financing in Freddie Mac, Fannie Mae or Ginnie Mae,” the letter said. While Freddie called the change consumer-friendly, Goodwin noted in the letter that consumers would prefer accuracy over speed “when valuing the largest single investment most individuals and families will make in their lifetime.”** (*Dow Jones Newswire*, Christine Richard, 7/20/01)

AFL-CIO claimed it did not receive a response from Freddie, however, the GSE said it sent a letter last August

- Goodwin said he has not received a response from Freddie. (*American Banker*, Tommy Fernandez, 4/25/02) However, Freddie located a letter it sent last August to Goodwin. In the letter, a copy of which was provided to *American Banker*, Dwight P. Robinson, Freddie’s senior vice president in charge of corporate relations, outlined some of Freddie’s views on the use of automated appraisals and offered to meet with the federation. “I would be pleased to arrange a meeting for you and other representatives of OPEIU so that we can show you how technology — together with consumer choice — is helping us to lower home-loan costs and open doors to homeownership for more of America’s families while making sound credit standards,” he wrote. (*American Banker*, Tommy Fernandez, 5/6/02)
- Goodwin said the letter never arrived at the federation’s offices or got lost there. Had he received the letter, he said, it may well have defused the situation. “I’ve never seen such a letter,” he said last week when told of its existence. “If I had received the letter I wouldn’t have raised such a fuss.” (*American Banker*, Tommy Fernandez, 5/6/02)

AFL-CIO and Freddie to meet on the issue

- A meeting between the AFL-CIO and Freddie could come soon. Freddie’s spokeswoman Sharon McHale reiterated the letter’s contents. “We’ve offered to speak with him,” she said. “We would still welcome that meeting.” Goodwin said he looked forward to meeting with Freddie officials, and Fannie officials said they were confident the current appraisal flap would not hurt their relationship with the AFL-CIO. “We have a strong relationship with the AFL-CIO,” said Fannie’s spokeswoman Raschelle Burton. “We are happy to engage with them on the automated appraisal issue. We’re happy to talk with them on any issues.” (*American Banker*, Tommy Fernandez, 5/6/02)

Other appraisers are concerned about the GSEs’ waiving of traditional appraisals

- As noted in the April 19, 2002 *GSE Report*, the President of the Wisconsin chapter of the Appraisal Institute wants his trade group to seek a congressional end to the federal subsidies given to Fannie and Freddie. Appraiser Donald J. Moore, President of the Appraisal Institute’s Wisconsin chapter, thinks Fannie and Freddie are too powerful for the public good. He has his state board’s authorization to present the issue at the trade group’s regional convention in June and, if approved, to the national convention in July. He charges that “Fannie Mae and Freddie Mac have allowed a corrupt system to develop” and that Fannie and Freddie want to eliminate appraisals entirely. “For the last 40 years, appraisers have been looking at every housing transaction. That has prevented fraud,” Moore said. “When you eliminate this oversight, and people know there’ll only be a little computerized check on the market, maybe they’ll throw in the boat and some other undisclosed personal property into the

mix.” Automated valuations are “an invitation to fraud,” Moore said. (*Milwaukee Journal Sentinel*, 4/14/02)

- As noted in the January 4, 2002 *GSE Report*, appraisers are upset with Fannie’s pilot program which in some cases totally eliminates the need for any form of appraisal on home purchases and refinancings in exchange for lenders paying a \$50 waiver fee. Frank K. Gregoire, chairman of the Appraisal Committee of the National Association of Realtors, calls the idea “radical” and worrisome. “People seem to have forgotten the lessons of the savings and loan crisis of the 1980s,” said Gregoire. According to columnist Kenneth Harney, during the savings and loan crisis, thrift institutions racked up multi-billion dollar losses on the basis of inaccurate or fraudulent property appraisals.
- Patrick Turner, a professional real estate appraiser in Richmond, VA, called Fannie's pilot program “ridiculous” and “dangerous.” “Common sense will tell you,” said Turner, “that you can't know what a house is worth” without some form of appraisal. He cited the example of a home he examined that appeared normal from the outside, but had multiple building code violations including no enclosed bathroom in the entire house. “[Fannie Mae is] trying to pull rabbits out of hats” by eliminating appraisals, said Turner, but “they’re going to hurt the consumer and hurt themselves.” Homebuyers need professional appraisals, said Turner, “so that they've got an independent judgment that what they're paying [for the property] is the correct price.” (*Realty Times*, Kenneth Harney, 12/14/01; *Washington Post*, Kenneth Harney, 1/6/02)
- As noted in the August 10, 2001 *GSE Report*, many of the nation’s 85,000 appraisers worry that automated appraisal systems, in many cases provided by Fannie and Freddie, are not always accurate and could put them out of business, according to Patrick Barta with the *Wall Street Journal*. “We’re risking catastrophic losses in the residential real-estate market” if the automated appraisal systems turn out to be inaccurate on a widescale basis, warned Don Kelly, a spokesman for the Appraisal Institute. The appraisers also view the systems as the latest effort by Fannie and Freddie to expand into areas of the mortgage market that they don’t already dominate. Fannie and Freddie “have just found another way to make a buck,” said Joseph Murin, CEO of Lender’s Service. (*Wall Street Journal*, Patrick Barta, 7/20/01)

**Government Accounting Office (GAO) to conduct comprehensive review of the FHLBanks and re-examine the possibility of consolidating the regulation of all of the housing GSEs (Fannie, Freddie, and the FHLBanks) into a single regulator**

**Review requested by Senate Banking Committee Chairman Paul Sarbanes (D-MD) and House Capital Markets Subcommittee Chairman Richard Baker (R-LA)**

**Review may take nine months to complete – Senator Sarbanes may ask the GAO to testify on aspects of the study as they become available**

- The GAO is conducting a comprehensive review of the FHLBank System, the competency of its regulator (Federal Housing Finance Board (FHFB)) and management, as well as its future stability, reported Dawn Kopecki with *Dow Jones Newswire*.
- “The growth of the System, coupled with the changes required under (1999 laws) and the underlying changes in the System’s member base, raise several questions regarding the future shape of the System as well its ongoing ability to support its primary mission,” Senate Banking Chairman Paul

Sarbanes wrote to GAO Comptroller David Walker when he ordered the study in February. Congressman Richard Baker joined with Senator Sarbanes in requesting the review.

- Thomas McCool, the GAO's managing director for financial markets and community investment said the GAO just recently started the review, which could take nine months or more to complete. Senator Sarbanes said that he may call on GAO Comptroller Walker to testify on aspects of the study as they become available.

#### Single housing GSE regulator

- The Congressional Members specifically asked the GAO to re-examine an old GAO report examining the possibility of consolidating the regulation of all of the housing government-sponsored enterprises (Fannie, Freddie, and the FHLBanks), into a single regulator.
- "We did some work on the Finance Board four years ago and some problems did exist. I think they want to see if those problems still exist," said Thomas McCool, the GAO's managing director for financial markets and community investment.
- McCool said the GAO has long favored abolishing the FHLBank's Federal Housing Finance Board (FHFB) as well as Fannie and Freddie's Office of Federal Housing Enterprise Oversight (OFHEO) in favor of a new regulator that incorporates the functions of both. "That's something we've been in favor of for a long time just because we think that the Finance Board and OFHEO don't have the clout or proficiency alone that they would combined," McCool said.

#### Concentration of assets

- Senator Sarbanes asked the GAO to thoroughly analyze the FHLBank System's concentration of assets, which topped \$699 billion last year, among a handful of institutions and whether it posed a problem to smaller banks, the system's overall safety and soundness as well as its ability to fulfill its affordable housing mission.

#### Review of FHFB

- The GAO was asked to review the finances and management of the 12 regional FHLBanks and the FHFB. Senator Sarbanes specifically asked the GAO to determine the effectiveness of the FHLBank's board of directors, the salaries of the regional bank presidents and their use of investments to generate income. The GAO will also examine the inner workings of the FHFB, including a review of its staffing, salaries, compliance with federal procedures, oversight functions and other requirements for independent agencies.
- A September 1998 GAO Report "identified a number of deficiencies in the FHFB's examination program to ensure that the FHLBanks operate in a safe and sound manner and comply with their mission. In light of that report, I would like you to examine the current status of the FHFB's safety and soundness oversight, and also analyze the procedures for and the effectiveness of the FHFB's oversight of the System's compliance with its mission," Senator Sarbanes wrote.

#### Multi-district FHLBank membership

- Senator Sarbanes asked the GAO to analyze the FHFB's legal authority to modify membership requirements to allow institutions to belong to more than one FHLBank. (*Dow Jones Newswire*, Dawn Kopecki, 4/19/02)

**Treasury Department does not believe the FHFB has the legal authority to allow institutions to belong to more than one FHLBank (multi-district FHLBank membership)**

**FHFB Chairman John Korsmo hopes for a vote by FHFB board members on multi-district memberships before the end of the year**

**FHFB – the Federal Housing Finance Board – regulates the FHLBank System**

- Assistant Secretary of Treasury for Financial Institutions Sheila Bair sent an April 9 letter to the FHFB on permitting a single institution to belong to more than one FHLBank (multi-district membership). “A clear reading of the relevant language of the Federal Home Loan Bank Act strongly suggests that the Finance Board does not have the legal authority to grant multi-district membership,” she wrote. “We believe that multi-district membership must be considered in the larger context of evaluating the [FHLBanks’] charters, which is a process Congress should undertake.” (*American Banker*, Rob Blackwell, 4/25/02)
- Assistant Secretary Bair said the language and legislative history “raise considerable doubt as to whether the Finance Board has the authority to approve multi-district membership.” Bair told the FHFB that “whether or not multi-district membership is an appropriate policy choice toward FHLBank modernization is a question for Congress to answer.” (*Dow Jones Newswire*, John Connor, 4/30/02)
- In response to Assistant Secretary Bair’s comment letter, the FHFB sent Treasury a form letter, which also went to other parties whose comment letters arrived after the formal comment period ended on the issue of multi-district membership. The letter stated in part, “Your comments will not be considered part of the official record” but that the FHFB staff “will take note of and consider your comments as appropriate.” (*Dow Jones Newswire*, John Connor, 4/30/02)
- The letter was overshadowed by news that Assistant Secretary Bair plans to step down from her position in June. Sources said that Bair has accepted a teaching position in Amherst, MA. Supporters of multi-district FHLBank membership were claiming that Bair’s departure from the Treasury Department makes the Treasury Department letter to the FHFB moot because her successor could have different views. (*American Banker*, Rob Blackwell, 4/25/02)
- Although the FHFB has never approved a bank for multi-district FHLBank membership, more than 100 bank holding companies have financial institutions in more than one of the 12 FHLBank System districts, and nearly 200 members of the FHLBank System have branches extending beyond district lines, according to Scott Smith, acting director of the FHFB’s Office of Policy Research and Analysis. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) FHFB Chairman John Korsmo said his intention is that FHFB board members vote before the end of this year on the question of multi-district memberships within the FHLBank System. (*Dow Jones Newswire*, John Connor, 3/12/02) He told members of the ACB that his reading of the statute that created the FHLBank System does not give the FHFB clear authority to allow a single thrift or bank to become a member of two or more FHLBanks. He does not, however, have a closed mind. He said the FHFB may hold public hearings on multi-district memberships and may hire its own attorney to advise the FHFB on the issue. (*National Mortgage News*, 3/18/02)

**Battle lines are being drawn on the “Shays-Markey” bill (HR 4071)**

**The bill, introduced by Congressmen Chris Shays (R-CT) and Edward Markey (D-MA), would repeal Fannie & Freddie’s exemption from Securities and Exchange Commission (SEC) requirements**

**Issue will likely be discussed during a Congressional hearing on the GSEs in June**

**Congressional Members send joint “Dear Colleague” letter asking their fellow Congressional Members to support HR 4071**

**Consumer groups send joint letter to Capitol Hill in support of HR 4071**

**Treasury Secretary Paul O’Neill speculates that Fannie & Freddie will be able to address the issue by increasing disclosures**

**Other Congressional Members and trade groups line up in opposition to HR 4071**

**Fannie & Freddie are the only two Fortune 500 companies not subject to SEC disclosure and registration rules**

- Congressmen Shays and Markey introduced a bill (HR 4071) on March 20 that would repeal Fannie and Freddie’s exemption from SEC requirements. (*National Mortgage News Daily Web site*, 3/21/02)
- **“It is pretty outrageous that these two companies are exempt from disclosure,” said Congressman Shays in an April 26 interview. “It defies logic. The fact that they [Fannie and Freddie] are so opposed to this bill makes me absolutely intrigued and somewhat suspicious.” He said the issue is simply about disclosure, which he noted was particularly important after Enron, and because Fannie and Freddie deal “in a trillion dollars worth” of transactions. “To think that somehow we would ask this of everyone else but Fannie and Freddie speaks volumes,” he said. “I happen to like Fannie Mae – but I don’t like the fact that they don’t want to disclose. “I consider Fannie and Freddie to be extraordinarily important,” he said. “They have developed many friends over the years. But it is a battle that I am willing to fight.”** (*American Banker*, Tommy Fernandez, 4/29/02)

**Issue will likely be discussed during a Congressional hearing on the GSEs in June**

- The Shays-Markey SEC bill is expected to be a topic that “figures prominently” in plans for hearings on the GSEs in the House in June, a Republican staffer told *BNA* April 30. Capital Markets Subcommittee Chairman Richard Baker (R-LA) is putting together topics for a hearing that could take place in June, a Baker spokesman told *BNA* April 30. (*BNA Daily Report for Executives*, Karen Werner, 5/2/02)
- *BNA* also reported that an SEC spokesman April 30 said his agency does not favor any changes to current law on the registration and disclosure requirements for Fannie and Freddie. (*BNA Daily Report for Executives*, Karen Werner, 5/2/02)
- In addition to the SEC bill, other topics being evaluated for hearings include hedging activities in the derivatives markets by Fannie and Freddie, in light of an April 22 speech by Federal Reserve Board Chairman Alan Greenspan, and the results of a test of risk-based capital standards expected from the

Office of Federal Housing Enterprise Oversight in June, the Baker spokesman said. OFHEO spokeswoman Stefanie Mullin told *BNA* April 30 her agency is already acting on some of the issues cited by Congressman Baker. (*BNA Daily Report for Executives*, Karen Werner, 5/2/02)

- Despite discussion of H.R. 4071 as a hearing topic, a House Republican aide said April 30 the SEC bill is unlikely to advance this congressional session. Although the legislation is a “good idea, it won’t see the light of day before the elections,” since it is not “pressing,” the Republican aide said. There are too many “priority” issues, such as trade, prescription drugs, tax relief, and the war on terrorism, along with appropriations bills that are expected to be acted upon, the aide said. The Baker spokesman said it is too soon to know about prospects for the bill this session until hearings are held on it. (*BNA Daily Report for Executives*, Karen Werner, 5/2/02)
- A Shays spokeswoman told *BNA* April 30 that Shays sees the legislation as “common sense” and finds it absurd that Fannie and Freddie are the only two Fortune 500 companies exempted from SEC registration and disclosure requirements. The contentious nature of the legislation makes it unlikely to advance to the floor this session although it could continue to get cosponsors, the Republican aide said. However, the aide said, some in Congress are unlikely to sign on to the bill because of the lobbying power of Fannie and Freddie and the chance of the agencies “coming down” on them. Fannie and Freddie are powerful lobbies that dole out a lot of money and yield a lot of influence, the aide said. (*BNA Daily Report for Executives*, Karen Werner, 5/2/02)

#### **Congressional Members send joint “Dear Colleague” letter asking their fellow Congressional Members to support HR 4071**

- The following Congressional Members sent an April 25 “Dear Colleague” letter asking their fellow House Members to support HR 4071: Congressman Chris Shays (R-CT); Congressman Ed Markey (D-MA); Congressman Paul Ryan (R-WI); Congressman Pete Stark (D-CA); Congressman Pete Hoekstra (R-MI); and Congresswoman Jan Schakowsky (D-IL). The letter was sent in response to an April 23 “Dear Colleague” letter circulated by Congressman Bob Ney (D-OH) asking Congressional Members to oppose HR 4071. [More information on the Congressman Ney “Dear Colleague” letter is available in this report.]
- The April 25 “Dear Colleague” letter in support of HR 4071 noted that “arguments against this common-sense legislation are based on a number of myths, which we would like to dispel.”

Excerpts from the April 25 letter are as follows:

**“Myth:** Freddie Mac and Fannie Mae already meet or exceed the Securities and Exchange Commission's reporting requirements.”

**“Fact:** Fannie and Freddie claim to meet or exceed SEC reporting requirements, yet within the last six weeks, both companies announced they would *begin* to post information about insider trading. This is basic investor information all other publicly-traded companies have been filing with the SEC since the first day they went public.”

**“Myth:** Requiring Fannie and Freddie to register with the SEC would hinder their ability to achieve their mission.”

**“Fact:** Nothing in H.R. 4071 would limit these companies’ ability to provide liquidity to the secondary mortgage market and promote affordable housing, any more than federal securities laws

hinder Coca-Cola's ability to sell soft drinks or IBM's ability to sell home computers. If Farmer Mac -- the only other publicly-traded government-sponsored enterprise -- files with the SEC, and every other publicly-traded Fortune 500 firm files with the SEC, why can't Fannie and Freddie?"

**“Myth:** H.R. 4071 would not improve disclosure.”

**“Fact:** We're convinced it will, but the point is not whether *today* Fannie and Freddie choose to report more or less information than other companies subject to SEC registration. Rather, the point is to assure that as reporting requirements change over time, investors receive consistent, timely and correct information and that they do not rely on the voluntary compliance of these two firms.”  
“For instance, the auditing reform bill passed by the House this week (CAARTA) imposes new requirements on all publicly-traded companies. Regardless of your views on the nature and adequacy of these new requirements, once again, just two companies would be exempt: Fannie and Freddie. There is no public policy reason to continue to exempt these two firms from federal securities laws.”

**“Myth:** H.R. 4071 creates unnecessary costs. While the bill provides no disclosure benefits, it would introduce costs, delays and inefficiencies into today's highly efficient, liquid and transparent mortgage market - the best in the world.”

**“Fact:** Fannie Mae and Freddie Mac are two of the nation's most profitable companies. They have had double-digit rates of return to their investors since 1987 and 1989, respectively. Their combined profits for 2001 were \$9.7 billion. They are more than capable of absorbing the same costs of issuing securities that are borne by every other publicly-traded company.”  
“Furthermore, if Fannie and Freddie already voluntarily disclose this information, as they claim, the cost of compliance with SEC regulations should be minimal.”

**“Myth:** H.R. 4071 would make it more difficult, costly or even impossible for consumers to ‘lock-in’ their interest rate when getting a mortgage.”

**“Fact:** Both Fannie and Freddie are confined to the "conventional" mortgage market (i.e. they cannot purchase single-family mortgages in excess of \$300,700). In the so-called "jumbo" market, where Fannie Mae and Freddie Mac do not purchase loans, homebuyers are able to "lock in" their interest rate when getting a mortgage and do so every day in the normal course of business. And the publicly-traded companies that offer jumbo mortgages register with the SEC.”

**“Myth:** H.R. 4071 is a "solution in search of a problem." It serves neither the interests of America's homebuyers or investors.”

**“Fact:** Congress has long recognized that properly-functioning capital markets require the disclosure of timely and accurate information to investors. This policy was echoed by the Federal Reserve, Treasury Department, and SEC, which jointly recommended that Congress repeal Fannie and Freddie's exemptions from securities laws:

‘[T]he debt securities of GSEs do not have a government guarantee.... Debt securities issued by GSEs thus do not have the unquestioned credit quality that justifies the exemption for government securities under the federal securities laws.... [I]nvestors need the same basic financial and operational information about GSEs as they would need from any company in order to evaluate the merits of an investment in its equity securities. All this information

should be provided in the same form, and under the same time frames, as for similar securities of other issuers.” (*Dear Colleague* letter on HR 4071, 4/25/02)

### **Consumer groups send joint letter to Capitol Hill in support of HR 4071**

- The following consumer groups sent an April 25 joint letter to Capitol Hill in support HR 4071 and request Congressional Members to co-sponsor the bill: **Council for Citizens Against Government Waste; Consumers Union; Competitive Enterprise Institute; National Taxpayers Union; and Project on Government Oversight.**
- **The consumer groups believe the Shays-Markey bill “would protect investors and increase transparency” by requiring Fannie and Freddie “to do what every other company with publicly-traded stock in the United States does.”** Since Fannie and Freddie provide voluntary disclosures and claim to exceed those disclosures required by the SEC, “submitting to SEC regulation should be a simple matter” for these two GSEs. “More importantly, the times has long since past when two companies of the size of Fannie Mae and Freddie Mac can choose to voluntarily comply with regulations aimed at protecting shareholders, while thousands of other companies – offering goods and services at least as important as those provided by the GSEs – are required by law to comply with these rules.”
- The consumer groups noted that in 1992 the Federal Reserve, Treasury Department, and the SEC recommended that Congress repeal the provisions exempting Fannie and Freddie from SEC registration. **The consumer groups believe that Fannie and Freddie’s claim that registration fees would increase housing costs “is sheer nonsense.”** The Congressional Budget Office has stated that requiring Fannie and Freddie to register with the SEC would not increase the cost of housing. **“The GSEs have used this tired argument to fend off each and every attempt to alter their political status, even when a change would bring greater transparency and accountability.”**
- **The consumer groups concluded, “Fannie Mae and Freddie Mac should be subject to the same rules, and their disclosures should not be dependent upon their voluntary interpretation of what should be disclosed.”** The Shays-Markey bill **“will close a gaping hold in our nation’s securities laws.”** (*Joint consumer group letter to Capitol Hill, 4/25/02*)

### **Congressman Shays makes statement on House floor regarding GSEs’ exemption from SEC requirements**

- **In remarks during an April 24 House debate on a separate Enron-inspired bill (the Corporate and Auditing Accountability, Responsibility and Transparency Act) that would enhance corporate and accounting responsibility, Congressman Shays praised the legislation for improving the market transparency and for protecting investors – “unless they’re investing in Fannie Mae and Freddie Mac securities.”** The bill prohibits accounting firms from offering certain controversial consulting services to companies they’re also auditing and establishes a new, public regulatory board to certify any accountant wishing to audit the financial statement required from public issuers of stock. This board will have enforcement powers and will be under the direction of the SEC. Under the bill, all publicly-traded companies (with the exception of Fannie and Freddie will be responsible for ensuring that their accounting firms are in good standing and for having their financial statement certified by the regulatory board. Congressman Shays stated, “the important improvements this legislation makes won’t apply one iota to them [Fannie and Freddie].”
- He added, “The reforms contained in this legislation will strengthen securities laws and accounting standards—except when it comes to Fannie and Freddie. This legislation improves transparency in

our capital markets and protects investors—unless they’re investing in Fannie Mae and Freddie Mac securities.” **Congressman Shays stated, “What this legislation highlights is that we have two separate rules in corporate America: Those that apply to Fannie and Freddie, and those that apply to every other publicly traded company.” He concluded, “I hope we can continue to ask Fannie Mae and Freddie Mac why they can’t play by the same rules as all other companies and why they continue to seek exemptions from federal laws designed to protect investors.”** (*Congressional Record*, 4/24/02, H1557)

### **Treasury Secretary Paul O’Neill speculates that Fannie & Freddie will be able to address the issue by increasing disclosures**

- In an interview with CNBC’s Market Week on April 29, host Maria Bartiromo asked Treasury Secretary Paul O’Neill the following question:

“Let me ask you about the rhetoric surrounding...Freddie Mac and Fannie Mae. It seems to be heating up on the negative side. Here you have two companies whose stock prices seem to suggest 15-percent earnings growth at the business, when, in fact, you’re seeing subprime lending becoming an issue. Also, in the age where corporate transparency could not be more important, neither Freddie Mac nor Fannie Mae release quarterly or annual reports because they’re government-sponsored. Is there any thought within the administration to tighten some of the regulations that oversee these two companies?”

Secretary O’Neill responded:

“Yes, [Fannie Chairman] Frank Raines is very sensitive to the comments that people are making. And, you know, the indication that I’ve seen from Frank is that he intends to not only meet, but exceed the standards that exist for o--other companies in the private sector with regard to disclosure. So I think he--he and his people will take that issue away.” (*CNBC News Transcripts, Market Week with Maria Bartiromo*, 4/29/02)

- In related news, Secretary O’Neill was asked at an economists’ group meeting on April 30 whether he believed Fannie and Freddie were becoming too large. Secretary O’Neill said a cautious approach is best, but said policymakers must look for new ways to assess risks associated with the two GSEs, and derivatives in general. “When I hear people say oh my God we’ve got to do something with Fannie and Freddie, I start with the medical proposition, which is first do no harm,” he said. (*Dow Jones Newswire*, Elizabeth Price, 4/30/02)

### **Other Members express opposition to HR 4071**

- Fannie released on April 10 public letters from lawmakers expressing concerns about HR 4071. “I am very concerned with the direction of the Shays-Markey legislation and the effect it may have on liquidity and on access of capital to promote homeownership,” said Housing Subcommittee Chair Marge Roukema (R-NJ) in a letter to House Financial Services Committee Chairman Michael Oxley (R-OH). “No other financial institution discloses as much,” she wrote. (*Reuters*, 4/11/02; *Bloomberg News*, Rob Wells and Albert Yoon, 4/15/02; *National Mortgage News Daily Web site*, 4/25/02)
- “The repeal of this longstanding exemption would serve no public policy purpose, would increase the cost of buying a home, and in turn, would prove harmful to consumers,” wrote Congresswoman Maxine Waters (D-CA) in a letter to Chairman Oxley. Congresswoman Stephanie Tubbs Jones (D-OH) and Luis Gutierrez (D-IL) also sent letters to Chairman Oxley opposing HR 4071. (*Reuters*, 4/11/02; *Bloomberg News*, Rob Wells and Albert Yoon, 4/15/02; *National Mortgage News Daily Web*

site, 4/25/02) Congresswoman Carolyn Maloney (D-NY) sent an April 24 “Dear Colleague” letter opposing HR 4071, in which she claimed the bill would “make it more difficult for government sponsored enterprises to carry out their affordable housing mission and risk unsettling the mortgage market.” (*Dear Colleague Letter by Congresswoman Maloney on HR 4071, 4/24/02*)

- Chairman of the House Administration Committee Congressman Bob Ney (R-OH) also circulated an April 23 “Dear Colleague” letter asking Members to oppose HR 4071. The letter argued that the bill would not improve disclosures because Fannie and Freddie already meet or exceed SEC disclosure requirements. The letter further argued the bill would create unnecessary costs. “While the bill provides no disclosure benefits, it would introduce costs, delays and inefficiencies into today’s highly efficient, liquid and transparent mortgage market -- the best in the world,” the letter said. The letter claimed the bill would “fail to improve disclosures” and “would significantly hinder the GSEs from achieving their important Congressional mission.” The letter warns that the bill would “make it more difficult, costly or even impossible for consumers to ‘lock-in’ their interest rate when getting a mortgage.” Finally, the letter called the bill “a ‘solution’ in search of a problem.” The letter was signed by Congressman Bob Ney (R-OH); Congressman Peter King (R-NY); Congressman Bob Barr (R-GA); Congresswoman Judy Biggert (R-IL); Congressman Mark Green (R-WI); Congressman William Lacy Clay (D-MO); Congressman Harold Ford, Jr. (D-TN); Congresswoman Julia Carson (D-IN); Congressman Max Sandlin (D-TX); Congressman Rubin Hinojosa (D-TX); Congressman Joseph Crowley (D-NY); and Congressman Steve Israel (D-NY). (*Dear Colleague Letter on HR 4071, 4/23/02; National Mortgage News Daily Web site, 4/25/02*)

### **Trade groups express opposition to HR 4071**

- The National Association of Hispanic Real Estate Professionals, National Association of Home Builders, National Association of Real Estate Brokers, and the National Association of Realtors sent an April 10 joint letter to House Financial Services Committee Chairman Michael Oxley (R-OH) and Ranking Member John LaFalce (D-NY) opposing HR 4071. The groups opposed the bill saying it “would have consequences that would make homeownership more expensive, harm consumers, and damage the housing industry.” (*Joint Trade Letter on HR 4071, 4/10/02*)
- The Independent Community Bankers of America and National Bankers Association sent an April 10 joint letter to House Financial Services Committee Chairman Michael Oxley (R-OH) and Ranking Member John LaFalce (D-NY) opposing HR 4071. The groups said the bill “does not serve any public purpose, but the disruptions that would result from this legislation could cause significant harm to the US residential mortgage market and result in an actual increase in mortgage rates for consumers, including low and moderate income and minority Americans.” (*Joint Trade Letter on HR 4071, 4/10/02*)
- The Council of State Community Development Association, Enterprise Foundation, League of United Latin American Citizens, Local Initiatives Support Corporation, National Association of Counties, National Association of Local Housing Finance Agencies, National Coalition of Asian Pacific American Community Development, National Council of LaRaza, National Community Development Association, National Congress for Community Economic Development, National Housing Conference, National Immigration Forum, and the National Urban League sent an April 11 joint letter to House Financial Services Committee Chairman Michael Oxley (R-OH) opposing HR 4071. The groups believe the bill would have adverse consequences for low- and moderate-income homebuyers. The groups believe the bill could jeopardize a lender’s ability to lock in interest rates, could negatively impact the ability of many small and medium sized lenders to access the secondary market, and would add about \$40 to the cost of a mortgage. The groups claim Fannie and Freddie already make

securities disclosures that meet or exceed SEC requirements. (*Joint Trade Letter on HR 4071*, 4/11/02)

- Other trade groups opposing HR 4071 include America's Community Bankers and America's Mortgage Cooperative. (*American Banker*, Tommy Fernandez, 4/29/02; *Bloomberg News*, Rob Wells and Albert Yoon, 4/15/02)

### **Hired by Freddie – the Former SEC General Counsel says Freddie's disclosures meet or exceed SEC standards**

- In an eight-page memo released in April, former SEC General Counsel Edward F. Greene – whom Freddie hired to evaluate its financial reporting methods – declared that “the scope and frequency of the annual, quarterly, and material event disclosure made in accordance with Freddie Mac's stated voluntary practices and commitments satisfies or exceeds the qualitative standards applicable to SEC registrants.” (*American Banker*, Tommy Fernandez, 4/29/02)

### **Consumer housing advocates and Congresswoman Jan Schakowsky (D-IL) are upset with Fannie's attempts to exempt itself from state predatory lending laws**

#### **After heated criticisms, Fannie claims it will no longer “take an active” role in shaping state predatory lending laws**

- Fannie's attempts at exempting itself from state predatory lending laws have angered consumer housing advocates and Congresswoman Schakowsky, reported the *Wall Street Journal*. Congresswoman Schakowsky objected to Fannie's efforts and sent a letter to Fannie's Chairman Franklin Raines on April 25. She wrote she felt “a sense of personal betrayal” after learning Fannie had asked to be exempted from predatory-lending laws in California and Georgia. Fannie later rescinded its request in Georgia and offered support for the state's effort, but Fannie was exempted in California. “You should immediately instruct your lobbyist to support efforts to end predatory lending, not stand in the way of reform,” she wrote. (*Wall Street Journal*, Patrick Barta, 4/26/02)
- Congresswoman Schakowsky's letter also cited other states where she says the company has sought or may seek such exemptions, including Florida, New York and New Jersey. A Fannie spokeswoman said that while the company's loans were in fact exempted from liability in Florida, she said the company isn't “actively seeking exemptions,” including in New York or New Jersey. “We're a national leader in this fight against predatory lending. We have the same goals as the Congresswoman, and we will work with her” to continue finding ways to crack down on unfair loans. [*Wall Street Journal* claims Fannie has also sought exemptions from predatory lending laws in Hawaii and the District of Columbia.] (*Wall Street Journal*, Patrick Barta, 4/24/02, 4/26/02)
- Housing advocates claimed Fannie is harming predatory lending reform efforts. Fannie said it has been actively fighting predatory lending with its own rules, although some housing advocates think it doesn't go far enough. Fannie said it doesn't want the mortgage market to get caught in a confusing patchwork of state laws. Fannie said it has in-house rules against certain predatory loans. (*Wall Street Journal*, Patrick Barta, 4/24/02, 4/26/02)
- Adding more legislation could “inadvertently hamper the ability of lenders to reach out to borrowers who are most in need,” said Ann Kappler, Fannie's general counsel. “We want to be able to define what we are not willing to purchase” rather than relying on others, she said. Housing advocates claimed Fannie has a strategy of cracking down on obviously abusive lending while lobbying to retain

the right to say what is predatory -- and possibly buy some of the less-egregious loans. "Why else would they be wanting an exemption?" asked Bruce Marks, chief of Neighborhood Assistance Corp. of America, a Boston mortgage firm and advocacy group. (*Wall Street Journal*, Patrick Barta, 4/24/02, 4/26/02)

#### Fannie sought and then rescinded its request for an exemption from a Georgia state predatory lending bill

- Fannie sent the Georgia Governor Ray Barnes a letter three weeks ago seeking an exemption from a bill aimed at predatory loans. In an April 4 letter to Governor Barnes, Fannie asked for an exemption that "will insure that Fannie Mae can continue to advance market-based solutions to the problem of predatory lending, which we believe is the most effective method of addressing this problem." (*National Mortgage News Daily Web site*, 4/8/02; *National Mortgage News*, 3/15/02) The governor's staff passed the letter on to housing advocates, which mobilized a campaign against Fannie's position. There were hints a public protest might result. (*Wall Street Journal*, Patrick Barta, 4/24/02)
- The reaction to the exemption request caused Fannie to quickly back down. Fannie held a Saturday April 6 meeting to discuss the matter and sent a second letter on April 6 to the governor. While repeating some of its concerns, the April 6 letter said Fannie "does not seek an exemption." The letter said, "It is our intent to support efforts" by the state to combat predatory lending, after which the bill was passed. Fannie's spokeswoman Janice Daue said the use of the word "exemption" was "inappropriate" and that Fannie has clarified its position in another letter. "We are not asking for an exemption," Daue said. (*National Mortgage News Daily Web site*, 4/8/02; *National Mortgage News*, 3/15/02; *Wall Street Journal*, Patrick Barta, 4/24/02)

#### Fannie claimed advocates misunderstood and that Fannie wasn't seeking an exemption from the Georgia predatory lending law

- Fannie stressed that advocates misunderstood the original letter, which it says was meant only to communicate that it already had national guidelines against predatory loans, and not to seek an exemption. A lower-level staff attorney wrote it. "It should have been shown to a few more people," Daue said. Kappler said, "I do not know how to explain it, except to say it happened late one night" and had to be written quickly to satisfy the governor's request. (*Wall Street Journal*, Patrick Barta, 4/24/02)

#### Housing advocates claim that this doesn't explain Fannie's successful exemption from a California predatory lending law – staffers claimed Fannie threatened to pull out of California market

- Housing advocates say none of that explains Fannie's position on a predatory lending bill in California. Legislative staffers such as Alan LoFaso, chief of staff for a co-sponsor, Democratic Assemblywoman Carole Migden of San Francisco said a Fannie lobbyist told him the company was concerned about relying on California standards for what counts as predatory, and was wary about potential liability if it ever was found to have bought a predatory loan. He said the company warned it might stop buying some mortgages in California if the law passed. Fannie's position was "'Look, we're good guys, we don't want predatory loans, but we have our own guidelines, so let us do our own thing,'" LoFaso said. (*Wall Street Journal*, Patrick Barta, 4/24/02)
- Fannie's Kappler said the company would "never" threaten to pull out of a market. She says Fannie didn't seek an exemption from the law, but she acknowledged that the company indicated it didn't think its loans ought to be covered. Kappler wrote to the bill's sponsors, calling the legislation "vague, ambiguous and imprecise." The letter warned that the law would make it "perilous to engage in the mortgage lending business in California." It called proposed criminal penalties "excessive."

The final law included specific language exempting Fannie and Freddie. (*Wall Street Journal*, Patrick Barta, 4/24/02)

After heated criticisms, Fannie claims it will no longer “take an active” role in shaping state predatory lending laws

- A week after the *Wall Street Journal* reported that housing advocates were criticizing Fannie’s lobbying efforts to exempt themselves from state predatory lending laws, Fannie released a statement saying it will no longer “take an active role” in shaping state predatory lending legislation. (*Wall Street Journal*, Patrick Barta, 5/2/02) “We will monitor anti-predatory-lending legislative efforts at the state level, but will not take an active role in shaping such legislation,” read the statement. (*American Banker*, Michele Heller, 5/2/02)
- Congresswoman Schakowsky released a statement on May 1 saying she had met with Fannie’s Vice Chair Jamie Gorelick on April 30 and is “pleased” that Fannie won’t seek to influence state legislation. (*Wall Street Journal*, Patrick Barta, 5/2/02) “Fannie Mae must not interfere with or seek exemptions from state and local regulations and statutes that protect consumers from predatory lending,” Congresswoman Schakowsky said. “I am very pleased that Fannie Mae, in no uncertain terms, has made it clear to me that they...will not seek to influence state legislation.” (*American Banker*, Michele Heller, 5/2/02)

**GAO suggests Fannie & Freddie pay for their mission oversight**

**GAO estimates it would save the government \$10 million a year and enable HUD to strengthen its oversight activities**

- The GAO suggested requiring Fannie and Freddie to reimburse HUD for its mission oversight, as an option that could be taken by Congress to address revived budget deficits, according to John Connor with *Dow Jones Newswire*. GAO estimated that the government could save \$10 million a year if Fannie and Freddie paid for their mission oversight. GAO noted that other federal organizations responsible for regulating the GSEs (OFHEO) are financed by assessments on the regulated entities. However, HUD’s Fannie and Freddie’s mission oversight is currently funded with taxpayer dollars from HUD appropriations. “Accordingly, HUD’s capability to strengthen its enterprise housing mission oversight may be limited because resources that could be used for that purpose must compete with other priorities,” GAO said. “For example, HUD’s capacity to implement a program to verify housing data, which would necessarily involve a commitment of additional resources, may be limited,” GAO said. GAO said requiring Fannie and Freddie to reimburse HUD for mission oversight would not only result in savings but would enable HUD to strengthen its oversight activities. (*Dow Jones Newswire*, John Connor, 4/26/02; *GAO Report: Supporting Congressional Oversight: Budgetary Implications of Selected GAO Work for Fiscal Year 2003*, GAO-02-576, April 2002)

**American Enterprise Institute (AEI) holds April 23 book forum on Tom Stanton's book, "Government-Sponsored Enterprises: Mercantilist Companies in the Modern World"**

**Stanton's book finds the following:**

- (1) GSEs have major advantages over their competitors**
- (2) GSEs are no longer suited for today's financial markets and may impede competition and innovation**
- (3) Exit strategies to transform the GSEs into private companies are needed as they come to the end of their usefulness**
- (4) Government is largely unable to address the risks inherent in these highly leveraged GSEs**

**Panelists included Freddie's Chief Economist Robert Van Order, University of Michigan Law School Professor Sallyanne Payton and OFHEO's General Counsel Alfred Pollard**

- In "Government-Sponsored Enterprises: Mercantilist Companies in the Modern World" (AEI Press, April 2002), Thomas H. Stanton explored how the GSEs' peculiar institutional structure enables them to use government backing to dominate markets and displace other private firms. Stanton is a Washington, D.C., attorney, the chairman of the Standing Panel on Executive Organization and Management of the National Academy of Public Administration, and a fellow of the Center for the Study of American Government at Johns Hopkins University. The AEI held an April 23 forum to discuss the book. (AEI press release, 4/2/02)

Major points of the book

GSEs have major advantages over their competitors

- Stanton's book takes a comprehensive look at the life cycles of six US GSEs - Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, the Farm Credit System, Farmer Mac, and Sallie Mae—which combine the characteristics of public and private organizations. While the GSEs' ownership and control are private, the government gives the GSEs significant subsidies, including tax and regulatory advantages. Government support gives the GSEs an implicit government guarantee, which allows the GSEs to borrow funds for their activities at lower rates than competitors—almost at the government rate, translating into huge profits for these GSEs. Many GSEs earn above 20 percent returns on equity every year; with their government backing they easily outperform their non-GSE competitors, which do not receive such benefits. (AEI press release, 4/2/02; *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World - Key Points*)

GSEs are no longer suited for today's financial markets and may impede competition and innovation

- **Many of the GSEs have provided valuable tools in the past. However, Stanton argued that the special purpose GSE charter is no longer appropriate for today's fast-moving financial markets and the actual and potential public costs are much greater.** For example, to the extent that GSEs wield market power, they can impede the emergence of more efficient competition and innovations. Further, because GSEs use their access to government subsidies to expand their market power, they impose burdens on market competition. These burdens would not be present if the government provided comparable subsidies to all competitors, instead of tying these benefits and preferences to a handful of institutions. (AEI press release, 4/2/02; *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World - Key Points*)

Exit strategies to transform the GSEs into private companies are needed as they come to the end of their usefulness

- Stanton offers exit strategies for the six GSEs as they come to the end of their usefulness. Alternatives to full privatization include creating an FDIC-type organization and an insurance fund to provide a cushion to pay for GSE financial failures and creating many smaller GSEs to compete with Fannie and Freddie to reduce the concentration of financial risk. (*Dow Jones Newswire*, John Connor, 4/23/02)
- The two dominant GSEs - Fannie and Freddie - are also the largest financial institutions in the US. They use federal subsidies to double in size every five years, and each now funds more than \$1 trillion of home mortgages. All of the GSEs are multibillion-dollar or even trillion-dollar financial institutions. Their profitability contributes to political influence, which the GSEs use to keep their federal oversight weak. Thanks to favorable legislation, they operate with greater financial leverage than virtually any other financial institution in the country. Nonetheless, studies by the General Accounting Office and HUD have found that Fannie and Freddie lag behind the rest of the mortgage market when it comes to providing affordable housing to minorities and low-income applicants. In the contest between profits and the public good, profitability has triumphed. (*AEI press release*, 4/2/02; *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World - Key Points*)

Government is largely unable to address the risks inherent in these highly leveraged GSEs

- Stanton traces the origins of these GSEs to mercantilist enterprises of the sixteenth century and notes that this old institutional form has taken on new vitality because of their growing political power that protects their government subsidies and allows them to expand in the marketplace. The GSEs resemble the first and second Banks of the United States and, in Europe, mercantilist enterprises of the sixteenth to eighteenth centuries. **As these GSEs expand, Stanton notes, their generally weak financial supervision and low capital standards become more alarming. While Stanton's earlier book on GSEs, *A State of Risk*, helped persuade policymakers to create a new government financial regulator for Fannie and Freddie, the author points out that the U.S. government remains largely unable to address the financial risks inherent in these highly leveraged institutions. Government supervision of GSEs is often weak because of their political influence. The situation is made worse because the government often abdicates to the GSEs themselves the power to affect their public benefits and costs.** (*AEI press release*, 4/2/02; *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World - Key Points*)

Other panelists

- **Freddie's Chief Economist Robert Van Order** said that GSE charters aren't so unique and referred to banks as GSEs. He felt it was difficult to determine the natural "life cycle" of a GSE and when the GSE had come to the end of its usefulness. He believes that the GSEs are far more regulated in the past twenty years than they were in the past. He noted that the more the GSEs are regulated by the government, the more this creates the perception of an implied government guarantee for the GSEs. (*Remarks during AEI book forum*, 4/23/02)
- **University of Michigan Law School Professor Sallyanne Payton** noted that the GSEs are not an optimal solution for the government to use to serve public purposes because the GSEs combine the deficiencies of the government with the deficiencies of private companies, creating an inherent conflict of interest. She believes the GSEs are enormously dangerous as instrumentalities of the government. The board of directors for Fannie and Freddie must act in the interests of shareholders, and are in fact bound by law and by fiduciary duty to act in the

**interest of shareholders, not the GSEs' public mission. When this is the case, the GSEs' public mission will slip, which means there will be some dead-weight economic loss and some misallocation of resources. Payton further noted a personal story of her work at the Administrative Counsel in which Fannie lobbyists used strong-armed political tactics in order to prevent the group from adopting strong recommendations on the GSEs. She said Fannie and Freddie were not "benign institutions."** (*Remarks during AEI book forum, 4/23/02*)

- **OFHEO's General Counsel Alfred Pollard** dismissed claims that OFHEO has not effectively regulated Fannie and Freddie. In the area of safety and soundness, he argued that Fannie and Freddie are regulated intensely and that there are no limits on OFHEO's regulatory discretion. Fannie and Freddie are also impacted by the financial markets. Pollard gave Fannie's recent MBS buyback as an example of how the markets forced Fannie to rescind the call-backs. He believes that all good companies must balance interests of multiple stakeholders and not just shareholders. (*Remarks during AEI book forum, 4/23/02*)

## ***Fannie Mae and Freddie Mac***

***DiversityInc.com* finds Fannie falls short of its affordable housing mission**

**Notre Dame sociology professor Richard Williams states, "The GSEs are clearly getting substantial government benefits. Whether the American people are getting enough in return for those benefits is debatable. I'd say no."**

- *DiversityInc.com* released a two-part article on Fannie. The author, Eric Hinton, reported that *DiversityInc.com* examined the criticisms leveled at Fannie and found that **"Fannie Mae, while doing a great amount of good, falls short of fulfilling its critical purpose."** Hinton noted that Fannie has recently been under fire from the *Wall Street Journal*, Congressional Members, and several financial institutions for its business practices. According to Hinton, "it's been called a de facto monopoly that picks and chooses its consumers based on their risk quotient and leaves those with more undesirable credit deficiencies out in the cold, creating, in essence a redlined community subject to the whims of predatory lenders." Fannie's critics also criticized the inherent conflict between its government mandate to promote affordable housing in low-income communities and its profit-hungry investors looking for a profit. Hinton noted, "its less strident critics say Fannie is in dire need of reform. Its most ardent detractors believe the organization should be abolished all together."
- Hinton noted that Fannie spent over \$49.2 million on advertising in 2000. However, of that amount, only \$820,280 was spent on media in predominantly black magazines and television networks. The CBO found that Fannie and Freddie receive an estimated \$10.6 billion subsidy from their GSE status, and pass on about 63 percent to homeowners, while the rest goes to Fannie's executives and shareholders. AEI Resident Fellow Peter Wallison stated, "There is an inherent conflict of interest between their mission to make more housing available to the American people and their desire for profitability... You can't serve two masters... What are they doing to fulfill their housing mission? Freddie and Fannie are not servicing classically underserved markets in the United States, particularly minority communities."
- Hinton reported that the GSEs also face critics in Congress – Congressman Richard Baker (R-LA) has recommended stricter oversight of the institutions and recently a bipartisan bill was introduced by Congressmen Christopher Shays (R-CT) and Ed Markey (D-MA) that calls for the GSEs to register

their securities with the SEC. In addition to Congressional criticism, the GSEs have been the target of a watchdog group, FM Watch.

- Part two of *DiversityInc.com*'s article focuses on Fannie's response to their critics. Hinton noted that Fannie dismisses the charges of FM Watch, calling them "high-cost lenders and their allies" that want to roll back Fannie's policies that cut costs to consumers.
- Hinton noted that HUD issued a new rule in October 2000 that increased the percentage of business that the GSEs were to devote to affordable housing. Fannie and Freddie claim to have met these new goals. Fannie claims that it "leads the market" in minority lending, acquiring 17.5% of the minority market in 1998, compared to 16.9% of other lenders. However, Hinton asks, is this enough? **Hinton quoted Notre Dame sociology professor Richard Williams as stating, "There should be a distinction between what they're legally required to do and what they should be expected to do given the types of benefits they're receiving [from the government]...Legally, they can show they met whatever goals HUD set them up to meet. But anyone could have. So did every other lender in the world. It's not like they were being forced to stretch...I don't think it's an impressive accomplishment."**
- **Studying the impact of Fannie in Indiana from 1992-1999, Williams wrote, "While the GSEs made gains in underserved markets during this period, at no time were they ever meeting their mandate to lead the market. It is not enough for the GSEs to simply make efforts and offer programs. They must show that those efforts produce results that are at least as good or better as those produced by entities that do not receive the GSEs' special benefits."** In an interview with *Diversityinc.com*, Williams stated, "The GSEs are clearly getting substantial government benefits. Whether the American people are getting enough in return for those benefits is debatable. I'd say no."
- **Sydney King, CEO of Commonwealth Bank in Mobile, AL, the only African-American owned financial institution in the state, noted that while Fannie is present in the community—sponsoring seminars on homeownership and such, they are also very difficult to work with. "They put on a good show. They'll come down and meet with some of our customers and talk about some of the new programs and products that they have. But as far as the loan program, we have not had any real success in getting loans through Fannie...Their underwriting criteria is stringent and it makes it challenging for us to get loans approved...They don't really have 'special' products. They have traditional conforming loans. And if you [sic] eligible for a traditional conforming loan you can get it approved. But if there are some extraordinary circumstances, then that is not a Fannie Mae loan."**
- Hinton concluded by asking if Fannie is making a difference. On one level, he noted, it is hard to say they do not have an impact on some level. **"But it would be equally hard to argue that the organization is truly extending itself to those that need it the most. The financial risk for the organization may be greater, but it's time for Franklin Raines to get his Fannie directly in the line of fire."** ([DiversityInc.com](http://DiversityInc.com), Eric L. Hinton, 4/5/02 & 4/8/02)

### ***Credit Union Journal* editorial says Fannie & Freddie are “out of control”**

- A *Credit Union Journal* editorial noted that Fannie and Freddie have built one of the largest lobbying and campaign finance shops in Washington, DC. “To do what? To fight off new proposals by its creator [the US government] to trim back some of their benefits and stop them from growing out of control at the expense of the very mortgage market they were chartered to nurture.” The *Journal* noted that the GSEs enjoy many perks from their GSE status—the most beneficial of which is their implied government guarantee. However, there have been growing movements to curb the GSEs. Proposals have included ending their line of credit with the US Treasury; eliminating their local tax exemption; and forcing the GSEs to register their securities with the SEC.
- To fight these proposals, Fannie and Freddie have used their considerable lobbying power. The *Journal* noted that the two GSEs contributed over \$3.5 million in the last election cycle—Fannie gave \$1.2 million and Freddie offered up \$2.4 million. The numbers will certainly be higher this year, as the GSEs gave \$2.3 million in soft money through the first half of the 2001-2002 election cycle.
- A new legislative proposal to allow Ginnie Mae to back privately insured mortgages and create competition in the secondary mortgage market has also been generating a lot of heat from the GSEs. The *Journal* noted, “These government-created entities that have grown to become two of the biggest financial institutions in the world...are now fighting the very government that created them from creating still more offspring.” **The *Journal* noted that the GSEs’ attempts to stifle competition will hurt credit unions by limiting competition that might be able to offer the credit unions better deals for selling their mortgages. “Any time the government intervenes in the market to aid one entity in such a broad market as the mortgage market, it is at the expense of another,” noted the *Journal*. (*Credit Union Journal*, editorial, 4/1/02)**

### ***Credit Union Journal* reports on the theory that the GSEs would like to enter the mortgage origination business**

- Ed Roberts of *Credit Union Journal* noted that Washington, DC is a town of rumors and conspiracy theories. A recent theory centers around the GSEs – specifically that they want to enter the mortgage origination business. “The theory goes on to hypothesize that one or both of the government sponsored enterprises, among the biggest financial institutions in the world, will eventually spread their wings into loan originations by one of a number of methods. One...the creation of a nationwide network of agents, through already established relationships... Accomplished... through a network of already loyal Fannie and Freddie partners, such as community banks and credit unions. The victims of this grand conspiracy would be the same lenders, as well as their giant competitors.”
- Roberts noted that theorists point to the Sallie Mae transformation is an example of the GSEs being able to take over the market. He reported that in just two years, Sallie Mae has come to dominate the very market it was created to facilitate and has become the largest non-government originator of student loans. While both Fannie and Freddie vehemently deny such ambitions to enter the mortgage origination business, many competitors, such as FM Watch, believe otherwise and have found supporters in Congress, particularly Congressman Richard Baker (R-LA) who has introduced legislation to rein in the GSEs.
- Roberts warned that it is hard to predict where the battle of the large titans will end. Fannie and Freddie have deep pockets for lobbying, as does their competition. Roberts noted that the “stakes for credit unions are enormous in this battle. For one, both Fannie and Freddie have carefully cultivated

the credit union market to such an extent that they assist smaller institutions in setting up a mortgage loan program, often with the eye towards buying those loans. Of course, such cozy relationships, often discourage those credit unions from negotiating with Fannie and Freddie competitors that may offer similar or better deals.”

- Roberts concluded, **“Often, major changes, such as those contemplated by the FM Watch constituents, are precipitated by a major crisis. One need look no further than the S&L debacle, or more recently, the Enron scandal, for proof of that. If that were to happen in this market, the breadth of the mortgage market would make all prior financial crisis look tepid by comparison.”** *Credit Union Journal*, Ed Roberts, 4/22/02)

#### **Fannie & Freddie report second quarter earnings**

**Fannie’s net income declines 6.5%, reflecting FAS 133 accounting change; Freddie’s net income gains 69%, reflecting FAS 133 accounting change**

**Fannie & Freddie purchased 68% of all mortgages originated in the first quarter**

**Sanford C. Bernstein analyst raises concerns about Fannie’s slow growth in its retained portfolio**

#### Fannie

- Fannie reported operating net income for the first quarter of 2002 of \$1.519 billion, a 22.7% increase compared with the first quarter of 2001. Operating earnings per diluted common share (operating EPS) of \$1.48 were 23.3% above the same period in 2001. Operating net income and operating EPS exclude the variability in earnings from both changes in the market value of purchased options and the one-time cumulative change in accounting principle from the implementation of Financial Accounting Standard 133 (FAS 133) on January 1, 2001. (*Fannie pres release*, 4/15/02)
- FAS 133, which changes the way Fannie accounts for its derivatives, resulted in a 6.5% drop in net income. Net income and EPS for the first quarter of 2002 including FAS 133 items were \$1.209 billion and \$1.17, respectively, compared with \$1.293 billion, or \$1.25 per share, in the first quarter of 2001 – a 6.5% decline. The decline, Fannie’s first in more than a decade, occurred because of an unrealized loss of \$787.2 million in the market value of some of the company’s derivatives. The unrealized loss was captured as a result of FAS 133, which requires companies to record changes in the value of their derivatives each quarter. The company attributed this quarter’s decline in derivative values to “interest rate volatility.” (*Fannie pres release*, 4/15/02; *Wall Street Journal*, Patrick Barta, 4/16/02)

#### Freddie

- Freddie announced operating earnings for first quarter 2002 were \$893 million, compared to \$729 million for the same period a year ago and \$853 million for fourth quarter 2001. Diluted operating earnings per common share were \$1.19 for first quarter 2002, a 24% increase over first quarter 2001 diluted operating earnings per common share of \$0.96. (*Freddie press release*, 4/23/02) Freddie’s reported net income rose 69% in the first quarter, due mainly to effects of FAS 133, and also strong growth in its underlying mortgage business. Freddie reported net income totaling \$1.41 billion in the first quarter of 2002, or \$1.94 a share, compared with \$837 million, or \$1.13 a share, a year earlier. Analysts attribute the differences between Fannie and Freddie’s results from FAS 133 to differences in the way the GSEs use derivatives to hedge their interest-rate risk, and they have predicted that

Freddie could have a similar swing like Fannie's in the future. (*Wall Street Journal*, Patrick Barta, 4/24/02)

#### Fannie & Freddie purchased 68% of all mortgages originated in the first quarter

- Fannie and Freddie grabbed significant market share in the first quarter, purchasing a stunning 68% of all mortgages originated, according to Sanford C. Bernstein analyst Jonathan Gray. That's up from the previous record of 57% reached in the third quarter of 2001, Gray said. (*Dow Jones Newswire*, Janet Morrissey, 4/4/02)

#### Sanford C. Bernstein analyst concerned about Fannie's slow growth in its retained portfolio

- Sanford C. Bernstein & Co. analyst Jonathan Gray said he felt the relatively slow growth in Fannie's retained portfolio was a greater concern than the FAS 133-related loss. "The most noteworthy development, was the disappointing rate of growth in the retained loan portfolio in the quarter, and indeed for the past five quarters," he said. "The GSEs have the greatest opportunity for rapid volume growth - and at elevated spreads - during refi booms, when the preponderance of originations are fixed-rate ... However, despite the surge in new mortgage spreads to an average of 112 basis points in 2001, there was no acceleration in retained loan growth, which remained at 16%." (*National Mortgage News*, Kyriaki Venetis, 4/22/02) Freddie reported a retained portfolio growth of \$34 billion, representing a 28% annualized growth. (*Freddie press release*, 4/23/02)

#### **Fannie & Freddie's executive salaries continue to increase**

**Fannie's Chairman earned \$10.8 million in compensation last year; Freddie's Chairman earned \$8.28 million**

#### Fannie

- Fannie's Chairman Franklin Raines had total compensation -- including deferred stock awards -- of \$10.8 million in 2001, according to Fannie's just-released proxy statement, as reported by *National Mortgage News*. Overall, his total compensation increased 34% from 2000. (*National Mortgage News Daily Web site*, 5/1/02)
- Raines's 2001 compensation package includes a base salary of \$992,250, a \$3,125,650 bonus, long-term compensation of \$2,779,934, "other" compensation of \$28,501, and deferred stock (based on a value of \$78 a share) worth \$3,876,522. The package excludes the value of 277,335 options whose strike price is \$80.95. (The options are under water until Fannie's stock rises above the strike price.) A Fannie spokeswoman noted that the 49,669 shares Raines received in 2001 were awarded in that year but he chose to defer them. In 2001 Fannie saw its net earnings increase by 21% to \$5.36 billion. (*National Mortgage News Daily Web site*, 5/1/02)
- Raines earned \$6.09 million in total compensation in 2000, a 45% increase from 1999 and a 148% increase from 1998. Total compensation includes salary, bonus, stock awards, and other payouts. Raines earned \$3.47 million in salary and bonuses in 2000. The balance of his compensation came from stock options. Fannie granted Raines 207,810 options in 2000. Fannie's Chief Operating Officer Daniel Mudd, Vice Chairman Jamie Gorelick, and Chief Financial Officer Timothy Howard earned \$3 million or more last year. (*National Mortgage News Daily*, 4/26/01; *National Mortgage News*, 4/30/01)

## Freddie

- Freddie’s Chairman Leland Brendsel earned total compensation -- including restricted stock awards -- of \$8.28 million last year, according to Freddie’s recent proxy statement, as reported by *National Mortgage News*. Brendsel earned a base salary of \$1.13 million and a bonus of \$2.12 million in 2001, compared to a salary and bonus, respectively, of \$1.09 million and \$1.71 million in 2000. His total compensation package rose just 3.5% in 2001. The majority of his compensation in 2001 came in the form of restricted stock -- \$4.7 million.
- The three other top executives at Freddie – President David Glenn, Senior Vice President in charge of funding and investments Greg Parseghian and Executive Vice President Paul Peterson – had compensation packages of \$5.3 million, \$1.8 million, and \$1.5 million, respectively. Glenn’s total compensation increased by 22% in 2001. The total compensation for Parseghian and Peterson actually decreased in 2001, but only because their restricted stock awards fell. Parseghian’s base salary and bonus more than doubled in 2001, while Peterson’s increased by 45%.
- In 2000, Parseghian, was granted \$12.1 million in restricted stock which vests in 2002 and 2005, but in 2001 Parseghian was not granted any restricted stock. According to proxy materials, it appears that Parseghian's restricted stock awards are lumped together as opposed to being spread out over consecutive years. (*National Mortgage News Daily Web site*, 4/17/02; *National Mortgage News*, Paul Muolo, 4/22/02)

Name	Title	2001 Salary and Bonus	Restricted Stock	Total Compensation Package
Leland Brendsel	Chairman/CEO	\$3,255,938	\$4,711,404	\$8,280,817
David Glenn	Vice Chair/Pres	\$2,125,000	\$3,020,028	\$5,293,016
Greg Parseghian	SVP	\$1,750,000	\$0	\$1,841,644
Paul Peterson	EVP	\$1,145,834	\$269,872	\$1,483,785
	Totals:	\$8,276,772	\$8,001,304	\$16,872,262

Source: Freddie Mac proxy statement; as reported by *National Mortgage News*, Paul Muolo, 4/22/02

### **American Securitization Forum opens its membership for the first time to Fannie & Freddie**

- The American Securitization Forum opened its membership to GSEs for the first time, George P. Miller, vice president and deputy general counsel of The Bond Market Association, told attendees at the association's annual meeting. The forum is one of two relatively new groups the association coordinates with in order to reach a broader range of market participants outside its core membership of broker-dealers and underwriters. Miller said both the American Securitization Forum and the new European Securitization Forum “go beyond dealers” and represent issuers, investors, legal and accounting professionals, rating agencies, guarantors, servicers, trustees, data vendors, and utilities. (*National Mortgage News Daily Web site*, 4/25/02)

## **President Bush nominates 10 people to serve on Fannie & Freddie's boards**

**Fannie & Freddie have 13 board members elected by shareholders and five appointed by the President**

**“Supposedly the presidential appointees give the public a voice in how the companies are run. In reality they give the companies the political advantage of having board members wired into the Washington power elite,” reports Jerry Knight with the *Washington Post***

- President Bush has nominated ten people to serve on the board of directors of Fannie and Freddie the White House announced April 16.

### Fannie

- President Bush nominated five people to serve on Fannie's board whose terms will end at the next annual shareholders meeting. Victor Henderson Ashe of Tennessee will be the community representative, Molly Hering Bordonaro of Oregon will be the real estate representative, William Robert Harvey of Alabama will be the mortgage lending representative, Manuel J. Justiz of Texas will be the public representative and Taylor C. Segue III of Michigan will be the home building representative. (*Dow Jones Newswire*, 4/17/02)
- In related news, Fannie announced that Frederic Malek has been nominated for election as a member of Fannie's Board of Directors at the company's annual 2002 shareholders meeting on May 21. Malek would fill the board seat vacated by Vincent Mai, who will be retiring at the end of his term. Malek is Chairman of Thayer Capital Partners, a Washington, DC based merchant bank. He is also Chairman and CEO of Thayer Hotel Investors. Malek was President of Marriott Hotels from 1981 through mid-1988. He also served as President of Northwest Airlines from 1989 to 1990, Vice Chairman from 1990 to 1992, and continues to serve on its Board of Directors. Malek has also served as an advisor to four US Presidents include Presidents Nixon, Ford, Reagan and Bush. (*Fannie press release*, 5/1/02)
- Jerry Knight with the *Washington Post* noted, “Supposedly the presidential appointees give the public a voice in how the companies are run. In reality they give the companies the political advantage of having board members wired into the Washington power elite. The newest Fannie Mae appointee is a good example...Malek is one of those people who know how Washington works. He has been making things happen for three decades, since he was a White House staff member in the Nixon administration. Once a top executive at Marriott, Malek has a Rolodex -- or a Palm Pilot -- with every phone number you'd need to prosper in Washington when a Republican is in the White House. And he's an extremely successful business executive, savvy enough to understand the complex workings of Fannie Mae.” (*Washington Post*, Jerry Knight, 5/6/02) Malek is a member of the Bush family “kitchen cabinet.” (*Washington Post*, 5/5/02)

### Freddie

- President Bush nominated five people to serve on Freddie's board until the next annual meeting of shareholders in 2003. Cesar Benito Cabrera of Puerto Rico will serve as Freddie's real estate representative. David James Gribben III of Maryland will serve as the public representative, William Dodd powers of New York will be the mortgage lending representative, Michelle Engler of Michigan will be the community interests representative and Catherine Lynne Stepp of Wisconsin will be the home building representative. (*Dow Jones Newswire*, 4/17/02)

- In related news, at its annual shareholders' meeting on May 2, Freddie's shareholders elected 13 directors to the board, including Chairman and Chief Executive Officer Leland C. Brendsel and Vice Chairman and President David W. Glenn.
- The other directors elected were:
  - George D. Gould, Vice Chairman of Klingenstein, Fields & Company
  - Thomas W. Jones, Chairman and CEO, Global Investment Management and Private Banking Group (a division of Citigroup, Inc.)
  - Henry Kaufman, President of Henry Kaufman & Company, Inc.
  - John B. McCoy, Retired Chairman of BANK ONE CORPORATION
  - James F. Montgomery, Chairman and CEO of Frontier Bank
  - Shaun F. O'Malley, Retired Chairman of Price Waterhouse LLP
  - Ronald F. Poe, President of Ronald F. Poe & Associates
  - Stephen A. Ross, Professor of Finance and Economics at the Massachusetts Institute of Technology
  - Donald J. Schuenke, Non-Executive Chairman of Allen-Edmonds Shoe Company
  - Christina Seix, Chairman, CEO and Chief Investment Officer of Seix Investment Advisors, Inc.
  - William J. Turner, Co-Manager of Signature Capital, Inc. (*Freddie press release, 5/2/02*)

## ***Fannie Mae***

<b>Fannie expects to purchase \$2 billion of interest-only loans</b>
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- Fannie expects to purchase \$2 billion of interest-only mortgages this year, up from \$1.2 billion in 2001. Fannie didn't offer these mortgages before last spring, reported Ruth Simon with the *Wall Street Journal*. Interest-only mortgages allow borrowers to pay interest, but no principal, on a loan in its early years. The result: lower monthly payments. Interest-only loans are currently a small part of the mortgage market, but they are growing rapidly.
- Simon noted, however, that interest-only loans have some catches. Homeowners don't build up any equity during the interest-only period, which can last anywhere from five to 15 years. If housing prices drop sharply, borrowers could wind up owing more than their homes are worth. In addition, many interest-only loans have adjustable rates for at least a portion of their life, meaning borrowers could see their monthly payments jump if interest rates climb. "There may be some selective instances, where [interest-only] loans could be valuable," said Keith Gumbinger, a mortgage analyst with HSH Associates, a financial publisher in Butler, N.J. "But I haven't found them."
- Interest-only borrowers could be hit with sticker shock if they don't pay off or refinance their loans before the interest-only period ends. For example, someone with a 30-year 7 1/8%, \$150,000 mortgage that is interest-only for the first 15 years would see payments jump to \$1,359 from \$891 once the interest-only period ends, even if rates don't budge, according to Fannie. That is because the interest-only loan is really two loans in one: a \$200,000 15-year interest-only mortgage and a \$200,000 15-year conventional loan. (*Wall Street Journal*, Ruth Simon, 4/16/02)

**Fannie has new top lobbyist - Fannie's Senior Vice President of Government and Industry Relations William Maloni to become a Senior Advisor; Fannie Vice President Duane Duncan promoted to Maloni's position**

- Fannie announced that William Maloni will become senior advisor to the company and also announced its intention to promote Duane Duncan to senior vice president for government and industry relations. (*Business Wire*, 5/1/02)
- As senior vice president, Duncan will have overall responsibility for the company's legislative, as well as industry, and government relations, and will serve on the Company's Operating Committee. This promotion is subject to approval by the Board of Directors. (*Business Wire*, 5/1/02)
- Duncan joined Fannie in 1995 as director of government and industry relations and was promoted to vice president in 1996 with responsibility for the development of relationships with key members of the House of Representatives, the Senate and their staff. Prior to joining Fannie, he was chief of staff for Congressman Richard Baker (R-LA). Duncan received a juris doctorate from George Mason University School of Law and a bachelor of arts degree from Randolph-Macon College. (*Business Wire*, 5/1/02)
- Maloni joined Fannie in 1983 as director of congressional relations. He was elected vice president in 1984 and subsequently became senior vice president for government relations in 1987. In March of 1989, Maloni assumed his current position of senior vice president of government and industry relations. Prior to joining Fannie, Maloni was special assistant to the Board of Governors of the Federal Reserve Board, where he was the senior congressional liaison for the nation's central bank. In 1980 and 1981, he was director of congressional relations for the Federal Home Loan Bank Board. He also served for 12 years as special assistant to Congressman William S. Moorhead (D-PA), a member of the House Banking Committee. Maloni completed a Graduate Fellowship at the Washington Journalism Center and received a bachelor of arts degree from Duquesne University. (*Business Wire*, 5/1/02) As a Senior Advisor, Maloni will move out of day-to-day operations but will continue to work on several projects Fannie's leadership have asked him to undertake. (*Dow Jones Newswire*, John Connor, 5/1/02)

**Staff director of Senate Banking economic policy subcommittee hired by Fannie**

- Kate Scheeler, the staff director of the Senate Banking economic policy subcommittee was hired by Fannie, where she will start in early May to work on policy issues in Fannie's government and industry relations division. Scheeler worked for Senator Charles Schumer (D-NY). (*American Banker*, Rob Blackwell and Michele Heller, 4/22/02)

***Freddie Mac***

**Freddie and Cenlar announce new private label servicing option for members of America's Community Bankers**

- Freddie and Cenlar announced a new private-label servicing option for members of the ACB that enables them to originate mortgages without the expense of a costly servicing infrastructure. The initiative is the latest step in an alliance announced in February designed to bring more new choices

and exclusive secondary market benefits to ACB members. Under the agreement, members of the ACB are able to originate a wide range of mortgages and manage the servicing through two options offered by Cenlar. In the first option, Cenlar operates as a subservicer, and under the second, Cenlar purchases mortgage servicing rights and services the loan in the originating lender's name. In both cases ACB members have access to a private label servicing arrangement, which allows them to also retain all cross-selling opportunities. Freddie and the ACB announced their strategic alliance in February. Nearly 40 institutions are close to deploying new state-of-the-art Web sites developed by Mortgagebot as part of the alliance. The Web sites are fully branded in the institution's name and trademarks, and enables fast underwriting decisions through Freddie's automated underwriting system, Loan Prospector. (*Freddie press release, 4/24/02*)

### **Freddie's Senior Vice President in charge of national sales is leaving the company**

- Pat Sheehy, a senior vice president in charge of national sales at Freddie, is leaving the company, sources have told *National Mortgage News' MortgageWire*. A spokesman for Freddie confirmed his departure, noting that May 2 was scheduled to be Sheehy's last day. Sheehy is leaving the company after three years to join Molton, Allen & Williams Corp., a commercial mortgage banking firm based in Birmingham, AL. (*National Mortgage News Daily Web site, 5/2/02*)

## ***Federal Home Loan Banks***

**American Bankers Association (ABA), America's Community Bankers (ACB), and Independent Community Bankers Association (ICBA), oppose a provision in a regulatory relief bill that would allow privately insured credit unions to join the FHLBank System**

**Credit Union National Association (CUNA) strongly supports the provision; National Association of Federal Credit Unions (NAFCU) has reservations about the provision**

- Representatives from the ABA, ICBA, and ACB testified April 25 before the House Financial Services Subcommittee on Financial Institutions that they opposed a provision in a regulatory relief bill (HR 3951) that would allow privately insured credit unions to join the FHLBank System. (*Credit Union Journal*, Ed Roberts, 4/29/02) Currently, such credit unions are excluded from FHLBank membership.

### **ACB**

- ACB opposes the provision that would permit privately insured credit unions to become members of the FHLBank System. The ACB noted, "Every other depository institution that is a member of a FHLBank must be and is federally insured and federally regulated. This helps ensure that these institutions are operated in a safe and sound manner, providing a substantial layer of security for the FHLBank System. In the recently enacted Gramm- Leach-Bliley Act the Congress struck a careful balance for the System by equalizing membership requirements for all federally insured depository institutions and reforming the System's capital system to reflect these changes. Permitting privately insured credit unions that undergo no federal regulatory scrutiny to borrow from the FHLBank System undermines the carefully balanced decisions made in GLB." (*Written Testimony of Curtis Hage, Chairman and CEO, Home Federal Bank, on behalf of the ACB, 4/25/02*)

### ICBA

- ICBA opposes the provision that allows privately insured credit unions to become members of the FHLBank System. “Under current law, only federally insured credit unions may become members of the FHLB. Allowing privately insured credit unions to become members of FHLB could pose a significant risk to the FHLB system, a system that many community banks rely on as an important source of alternative funding. Privately insured credit unions do not operate under the federal regulatory oversight that current FHLB members do (including state chartered institutions). Members of the FHLB system are federally insured depository institutions. The strong link to federal insurance should not be diluted by opening the door to non-federally insured entities. In addition, when the FHLBs are reviewing institutions for membership (and monitoring their performance) they have easy access to the regulator's exam reports. There is a question as to whether the information available for privately insured credit unions would be of a similar quality.” Finally, the ICBA noted that the NAFCU opposes this provision. (*Written Testimony of Pierce Stone, President and CEO of Virginia Community Bank, on behalf of the ICBA, 4/25/02*)

### CUNA

- CUNA said it strongly supports the provision allowing privately insured credit unions to join the FHLBank System. CUNA believes that this provision would “provide a needed funding source for home ownership for many credit union members, as well as strengthen the dual chartering system of credit unions.” CUNA noted that the FHLBanks offer a number of products and services to financial institutions that should be available to privately insured credit unions. “There is no compelling public policy reason to exclude them.” Currently there are only 216 privately insured credit unions in 7 states. These institutions are regulated by the states in which they were chartered and are subject to safety and soundness requirements from the state regulator, as well as the private insurer. These requirements are similar in scope and nature to those faced by other financial institutions.
- “Membership in a FHLBank would benefit privately insured credit unions and their members and could enhance the ability of such credit unions to broaden key programs, such as reaching out to low-income groups. Contrary to some assertions, the beneficiary of this provision would not be a specific company, rather it would be the 1.3 million credit union members belonging to privately insured credit unions. The membership of these credit unions comprises people from all walks of life, such as fire fighters, postal workers, teachers, healthcare and agriculture workers. Under current law, these credit unions cannot access the Federal Home Loan Bank System in order to provide mortgage funding for their members. This provision would do nothing more than permit these institutions to apply to join the FHLB System and provide a new source of housing funds for these credit unions and their members. It is critical to include this provision in H.R.3951 in order to advance home ownership options for these credit union members. It also is important to remember that this bill provides no special treatment for these institutions. Before joining the FHLB System, any institution covered by this provision would have to be subject to approval by the appropriate Federal Home Loan Bank. Advances from the Bank System would be on the same terms as any other similar institution. This would ensure that there would be no safety and soundness concerns.” (*Written Testimony of Charlene R. Gaither, Manager, Eastern Panhandle Community Federal Credit Union on behalf of CUNA, 4/25/02*)

### National Association of Federal Credit Unions (NAFCU)

- NAFCU believes that the provision allowing privately insured credit unions to join the FHLBank System “needs further examination and scrutiny by the Subcommittee before moving forward.” NAFCU said it has “reservations” regarding the provision. NAFCU noted that as of December 2001, there were 678 credit union members of various FHLBanks. Of that amount, about half are state-

chartered but *all have federal insurance*. “In fact, federal insurance is a pre-condition for all regulated depository institutions --banks, thrifts and credit unions - seeking membership in the Federal Home Loan Banks. (The sole exception to this requirement under existing law applies to insurance companies for whom there is no federal insurance option.)” NAFCU said they have heard from a number of their members with concerns about this provision “in light of past failures of some private and/or state insurance funds in the late 1980’s and early 1990’s.” (*Written Testimony of William Cheney, President/CEO of Xerox Federal Credit Union, on behalf of NAFCU, 4/25/02*)

**FHFB Chairman John Korsmo believes the FHLBank System will eventually become a major competitor to Fannie & Freddie**

**FHLBank of Chicago President Alex Pollock claims the FHLBank System’s Mortgage Partnership Finance (MPF) program is a more efficient use of GSE advantages than Fannie & Freddie**

**MPF volume grows to \$27 billion during the first quarter of 2002**

**MPF is a competitor to Fannie & Freddie in the secondary mortgage market**

#### FHLBank System will become a major competitor to Fannie & Freddie

- FHFB Chairman John Korsmo stressed that while the 12 FHLBanks are “different animals” from Fannie and Freddie, the system could eventually become a major competitor. He acknowledged that the MPF program remains small in comparison to Fannie and Freddie; the \$24 billion it generated in sales last year represented less than 1% of Fannie’s and Freddie’s outstanding assets. However, he said that industry interest in the program is growing as more mortgage companies view it as a “counterweight” to Fannie and Freddie, “especially as the pressures build on the GSEs to continue to generate the kinds of returns that they have generated without ‘mission creep.’” (*American Banker, Tommy Fernandez, 4/22/02*)

#### MPF a more efficient use of GSE advantages

- President of the FHLBank of Chicago Alex Pollock referred to MPF program, pioneered by his institution, as “an unqualified success.” Pollock said the MPF program offers “significant advantages” from a public policy perspective over the programs offered by Fannie and Freddie – “since it allocates most of the credit risk associated with MPF assets to private sector entities.” He added, “Moreover, the cooperative nature of the Federal Home Loan Bank System, as compared to the public shareholder orientation of the other housing GSEs, provides for a more efficient use of GSE advantages, keeping more of the value added of the mortgage transactions within the FHLBank members both as customers and stockholders.” (*Dow Jones Newswire, John Connor, 4/22/02*)

#### MPF volume grows to \$27 billion during the first quarter of 2002

- The FHLBank of Chicago reported that total outstanding loans in the MPF program were \$27.1 billion at the end of the first quarter, up from \$24.8 billion at year-end. About 70% of all loans funded through the program during the quarter were conventional single-family mortgages, while 30% were FHA/VA loans. The portfolio of conventional loans grew 19% during the quarter, an annualized growth rate of 75%. Total loan volume for the quarter was \$4.5 billion. During the first quarter, 40 additional member institutions were approved to fund MPF loans, bringing the nationwide total to 322, a 57% annualized growth rate. Most are small and mid-sized lenders, 73% are Community Financial Institutions with assets of less than \$527 million. An additional 108 members are actively in the process of joining the program while more than 425 members are in discussions to join.

- Since beginning in 1997, the program has funded over \$37.3 billion of mortgages to help more than 310,000 families and individuals purchase a new house or lower the cost of their existing home. Most MPF funded loans have been made to low and moderate-income borrowers. The median size of a loan is \$112,702. (MPF press release, 4/19/02)

**FHFB profiles the FHLBank System in a new report**

- The FHLBank System's \$700 billion of assets at the end of 2001, would make the System the third largest domestic banking organization in the US if it were a holding company, ranking behind Citigroup and J.P. Morgan Chase & Co. but ahead of Bank of America, according to a new FHFB report as reported by John Connor with *Dow Jones Newswire*.
- The report – “Profile of the Federal Home Loan Bank System, Dec. 31, 2001” - said the four largest FHLBanks were San Francisco, Atlanta, New York, and Cincinnati. It said the Chicago FHLBank jumped from 10th to fifth place on the strength of double-digit increases in advances and investments and a near doubling of mortgage loans.
- The report said gross mortgage originations by the FHLBanks were \$19.5 billion by last year. In comparison, Fannie and Freddie's mortgage originations in 2001 were \$615 billion and \$475 billion, respectively.
- As of December 31, the FHLBanks had unsecured credit exposure of \$90.2 billion, \$48.4 billion of which was federal funds sold, the report said. “The FHLBanks had \$15.9 billion of unsecured credit to the Treasury, GSEs and supranationals (e.g., World Bank), including \$7 billion to Freddie Mac and \$5 billion to Fannie Mae,” it said.
- The FHLBanks held investments of \$193 billion at the end of last year, including \$86.7 billion of mortgage-backed securities, the report said. “The FHLBanks hold an estimated 12% of all private-label MBS,” according to the report. “These holdings raise mission issues because only a small proportion of the mortgages underlying these MBS are below the conforming loan limit,” said the report. (*Dow Jones Newswire*, John Connor, 4/25/02)

**FHFB will likely allow the FHLBank of Chicago to continue operating its MPF program without a stock purchase requirement in its capital plan**

**FHLBank of Chicago believes a stock purchase requirement would hurt the MPF program**

**FHFB is considering the FHLBanks of Boston and Pittsburgh's capital plans at its May 8 open meeting**

- It appears that the FHFB will allow the FHLBank of Chicago to continue operating its MPF program without imposing a stock purchase requirement on participating members. FHFB Chairman John Korsmo instructed agency staff that all FHLBanks should include stock purchase requirements for advances and mortgage purchases in their capital plans. “Do not, however, reject requests to initially set the activity charges at 0%, if the plan is otherwise sound and complies with our regulations,” Korsmo says in an April 23 memo. The Chicago FHLBank is “very pleased” with this conclusion, according to spokesman David Feldhaus. “This outcome will allow the MPF to continue its rapid growth and improve the American mortgage market,” he said. Chicago FHLBank President Alex Pollock recently warned the FHFB that a stock purchase requirement would cripple the MPF program,

and participating FHLBank members would go back to selling their loans to Fannie and Freddie. The FHFB is scheduled to vote on the FHLBank of Chicago's capital plan on June 12. (*National Mortgage News Daily Web site*, 4/26/02)

#### FHFB is evaluating the capital plans for the 12 FHLBanks

- The Gramm-Leach-Bliley Act (GLB), signed into law on November 12, 1999, amended the provisions of the FHLBank Act that relate to the capital structure of the FHLBanks. The law mandated the replacement of the existing subscription capital structure with a modern capital structure, with risk-based and leverage capital requirements that are similar to those of depository institutions. (*FHFB press release*, 3/13/02) As required by GLB, all of the FHLBanks submitted proposed capital structure plans to the FHFB by October 29, 2001. Each FHLBank must obtain FHFB approval of its internal risk model and risk assessment procedures and controls prior to implementing its capital plan. (*FHFB press release*, 2/13/02)
- The FHFB has approved capital plans for the FHLBanks of Seattle and Atlanta - both of which have stock requirements for secondary market programs. (*National Mortgage News*, 4/15/02) The FHFB is considering the FHLBanks of Boston and Pittsburgh's capital plans at its May 8 open meeting. (*Federal Register*, page 22084, 5/2/02)

#### **FHFB hires new director for its Office of Supervision**

- FHFB Chairman John Korsmo announced the hiring of Stephen M. Cross as the new director of the Finance Board's Office of Supervision. Cross has been director of the Division of Compliance and Consumer Affairs at the Federal Deposit Insurance Corporation since June 1999, and brings a strong background in economics and financial regulation to the supervision position.
- As Director of Supervision, Cross will head the FHFB's lead office for overseeing the safety and soundness of the 12 FHLBanks and the Office of Finance. He will manage about 20 employees within the office. "This is an exciting opportunity to restore the importance of the Office of Supervision at the Federal Housing Finance Board," said Cross. "I look forward to this new challenge."
- At the FDIC, Cross supervised a staff of approximately 550 employees, including compliance examiners, complaint specialists, community affairs officers and policy analysts. He previously worked at the Office of the Comptroller of Currency as a deputy comptroller.
- The Office of Supervision at the FHFB is not only responsible for ensuring that the FHLBanks operate in a safe and sound manner, but also for ensuring that they are carrying out their housing finance mission. These functions are performed through annual on-site examinations of each of the 12 FHLBanks and the Office of Finance, as well as off-site monitoring. Cross begins his duties at the FHFB on May 20. (*FHFB press release*, 4/30/02)

## ***Farm Credit System***

### **Farmer Mac sets earning record in the first quarter**

- Farmer Mac earned net income of \$7.2 million in the first quarter, a new record. Farmer Mac announced that diluted operating earnings per share were \$.44 for the first quarter, an increase of 63% from the first quarter of last year. Farmer Mac also announced that it purchased a \$490 million portfolio of agricultural loans from an insurance company in mid-April. (*National Mortgage News Daily Website*, 4/19/02)

## ***Postal Service***

### **Senate Subcommittee to hold May 13 hearing on the Postal Service's transformation plan**

- International Security, Proliferation and Federal Services Subcommittee of the Senate Governmental Affairs Committee will hold a hearing on the Postal Service's transformation plan at 10 a.m. on May 13. Postmaster General John Potter and GAO Comptroller General David Walker will testify. The hearing was originally scheduled for May 3. (*CQ Daily Monitor*, 5/2/02)

#### Background on Transformation Plan:

- The USPS announced details of a "transformation plan" on April 5. The "transformation plan" is a proposed new business model that would preserve universal mail delivery and strengthen the mail system. (*USPS press release, Postal Service Vows to Save Universal Mail Delivery – Proposes New Business Model*, 3/5/02) The transformation plan outlines three alternative business models: (1) restructuring the USPS as a traditional government agency; (2) transforming the USPS into a commercial government enterprise; (3) creating a privatized corporation. Each would require structural legislative reform. (*USPS press release, PMG Unveils USPS Transformation Plan today at the National Press Club*, 4/5/02) The transformation plan recommends a "middle ground" approach, modeled on Fannie and Freddie, as the most appropriate. (*White House Bulletin*, 4/5/02) The new model, called a Commercial Government Enterprise (CGE), would create a government owned entity, but one that enjoys some of the operational and financial flexibility found in the private sector. Under the CGE, USPS claims it would set rates more predictably, be able to retain earnings, work under private sector labor laws and, depending on future legislation, could even pay taxes or dividends to the government. (*USPS press release, Postal Service Vows to Save Universal Mail Delivery – Proposes New Business Model*, 3/5/02)

### **Direct Marketing Association President says there is a "slim" chance of postal reform soon**

- Direct Marketing Association president/CEO H. Robert Wientzen is less than sanguine about the future of the Postal Service. "Frankly I think our chances of doing anything to have a material effect soon are slim," he told *Catalog Age*. He noted that the DMA has been doing several things to help stop the Postal Service's "death spiral." Wientzen noted that he had attended "over 150 meetings...with all the constituencies that make up the mailing community" to do the following (1) influence the transformation plan that the USPS recently introduced to Congress; (2) broker the recent USPS agreement in which the next rate hike was moved up to go into effect on June 30 rather than in the fall, in exchange for a promise that there would not be another increase until 2004; and (3) to help draft the latest postal reform bill introduced by Congressman John McHugh (R-NY). (*Catalog Age*, Sherry Chiger, 4/29/02)

## **European Union may recommend that foreign companies be allowed to compete with the US Postal Service**

- The European Union is demanding that foreign companies be allowed to compete with the US Postal Service as part of World Trade Organizations talks that began last year, according to draft document demands obtained by the *Washington Times*. The final demands will be formally presented to the US government by the end of June. The suggestion that foreign companies be allowed to deliver US letters is certain to face opposition. “We oppose this idea, as does the Postal Service and the other unions,” said Sally Davidow, spokeswoman for the American Postal Workers Union. (*Washington Times*, Carter Dougherty, 4/26/02)

## **Given the Postal Service’s deficit, observers wonder how the Postal Service can keep its promise not to increase postage rates until 2004**

- Postal Service observers wonder how postal management can hold their promise to wait at least until 2004 before another rate increase, given that the Postal Service is confronting mounting financial losses, rising fuel prices, a lackluster economy and uncertainty over whether the mail volume lost following last year’s terrorist attacks will return. “I have no idea how that can be done,” Gene Del Polito, president of the Association for Postal Commerce, said of the agency’s proposed rate freeze. Rising fuel prices alone will cause “a gaping cost increase that will probably accelerate.”
- The Postal Service is counting on two developments to carry it through 2003 without a rate hike, Postal Service Chief Financial Officer Richard Strasser said. One is the postage rate hike that takes effect June 30 and will generate about \$5 billion in new revenues each year. The second reason is productivity gains that will cut operating expenses by \$5 billion over five years. However much depends on the economy and how quickly advertising mailers, who provide a large piece of Postal Service revenues, crank up their budgets, said economist Alan Robinson. “The Postal Service is hoping for a robust economic recovery,” said Robinson, president of Direct Communications Group. “But an economic turnaround is hardly a sure thing.”
- Postmaster General John Potter’s promise not to raise rates is not as momentous as it appears, Robinson said. The mailing industry had expected the Postal Service would file for another rate increase in October — meaning the next rate increase would take effect in mid- to late 2003. Because of the promise not to raise rates until 2004, the Postal Service’s anticipated application for a rate hike may be put off to January 2003 so any increase would start in January 2004. “So we’re really looking at only a three-month delay,” Robinson said. (*Federal Times.com*, Dan Davidson, 4/15/02)

## **National Taxpayers Union says Microsoft isn’t a monopoly – the Postal Service is**

- In a *National Review* guest comment, NTU President John Berthoud stated, “Microsoft’s not the monopoly. The Postal Service is.” What is a monopoly? The attorneys general of the states that are launching legal attacks against Microsoft should focus on the Postal Service. “The Postal Service, by every possible meaning of the word, is a monopoly — and these attorneys general are going after the wrong entity.”
- Berthoud noted, “While Microsoft faces the white heat of competition every day, the Postal Service has special protections frozen into law that it jealously guards. The Postal Service is exempt from zoning, customs, and tax laws (unlike private delivery companies). Federal law prohibits private companies such as UPS or FedEx from providing first-class mail delivery.”

- He asked, “what then ultimately explains why these attorneys general are pursuing Microsoft and leaving the Postal Service's special protections untouched?” He answered, “Politics.” Microsoft's competitors have driven this suit from the start and the rewards have been rich for the attorneys general doing the bidding of Microsoft's competitors. “The Postal Service, on the other hand, has a guardian angel in the form of powerful labor unions.” As NTU's Jerry W. Terry has observed, “political pressure from powerful labor unions ensures that Congress will not allow free-market competition to threaten the Postal Service's grip on mail delivery.” Berthoud concluded, “So ultimately, to many of America's elected officials, no matter what the economics textbooks say about what is or isn't a monopoly, the only definition that matters comes from a political playbook.”  
*(National Review, guest commentary by NTU President John Berthoud, 4/23/02)*

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