

The **GSE** REPORT™

www.gsereport.com

Contents of GSE Report™

Major Events

- Trade associations commend Korsmo, embrace “Shared Funding” ([p. 4](#))
 - Shared Funding will “increase competition in the secondary mortgage market, help drive down costs of mortgage financing, reduce certain risk to taxpayers and the government, and help more Americans realize their dream of homeownership”
- Congressman Richard Baker appeals to OFHEO for uniform disclosure for Fannie, Freddie ([p. 5](#))
 - Letter from Baker reflects growing frustration w/ OFHEO oversight
 - Congressional hearings planned for February on Fannie/Freddie disclosures, with regulatory reform legislation expected in the summer
- OFHEO director responds to Rep. Baker’s October letter on duration gap ([p. 5](#))
- Chairman Korsmo postpones action by Federal Housing Finance board on enhanced bank debt disclosure ([p. 6](#))
- Fannie’s advertising firm pays cash to Hill staff—ethics breach flagged; staff cautioned that payment violates House, Senate ethics rules ([p. 6](#))
- Fannie Mae files motion in U.S. District Court for the District of Columbia to dismiss all counts in class action lawsuit alleging discrimination against African-Americans ([p. 7](#))
- Freddie commissioned study says automatic underwriting doesn’t discriminate; HUD Sec. Martinez cites slip in HUD software bias study ([p. 8](#))
- Shadow Financial Regulatory Committee asks for Christmas gift from the Congress, asks for privatized GSEs; Fannie and Freddie’s voluntary disclosure judged “insufficient” ([p. 8](#))
- Stephen Friedman quits Fannie board; appointment assailed by conservatives, praised by Fannie board’s Fred Malek ([p. 9](#))
- GSE soft money donations explode before Nov. 5 soft \$\$ ban ([p. 10](#))
- FMC analysis warns of “Overheated Mortgage Machine,” including housing-related GSEs ([p. 10](#))
- President Bush signs E.O. launching postal commission, including former Fannie Mae chairman ([p. 11](#))

Fannie Mae and Freddie Mac

- New demands for greater oversight of GSE automatic underwriting (AU) ([p. 11](#))
- Fannie, Freddie say AU speeds mortgage approval ([p. 11](#))
- HUD to raise GSE goals for 2004 as early as next June ([p. 12](#))
- Freddie and Fannie’s stock deemed under-appreciated ([p. 12](#))
- Fannie lowers duration gap ([p. 12](#))
- Flood insurance impasse impacts Fannie, Freddie; legislative fix in the works; Rep. Oxley assures that reauthorization bill will pass by January 8, ’03 ([p. 13](#))
- Mortgage bond prepayments stay near record levels in November ([p. 13](#))

- Jumbo lenders not bothered by conforming limit boost ([p. 13](#))
- Fannie/Freddie limit creation of certain mortgage bonds for 3rd consecutive month ([p. 14](#))
- Fannie and Freddie telling title industry to reduce costs and processing times ([p. 15](#))
- Georgia predatory lending law eyed for revision ([p. 15](#))

Fannie Mae

- Fannie lands former Treasury, Dick Arme staff member for public policy development and advocacy -Michele Davis formerly worked at Treasury, enjoys strong ties to Republican Party ([p. 16](#))
- Fannie vice chair Jamie Gorelick named to terrorism commission ([p. 16](#))
- Fannie announced two-part offering of new 2-year notes ([p. 16](#))
- Fannie chief economist predicts rebound in U.S. economic growth, record home mortgages in '03 ([p. 17](#))
- Chase, Fannie team on Harlem project ([p. 17](#))
- Fannie Mae offers help to minorities with new offerings ([p. 17](#))
- High mortgage rejection rates prompt Fannie program in Waco, Texas ([p. 18](#))
- Fannie Mae forms venture to boost Muslim home ownership in California ([p. 18](#))
- Native Americans to benefit from Fannie's foreclosure prevention program ([p. 19](#))
- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its Partnership Offices in press events ([p. 19](#))
- Fannie has 51 Partnership Offices open across the country
- Fannie "wins the gratitude of politicians by staging local events with them, often to 'announce' its plans to buy local mortgages...It's almost as if Ford or Microsoft could allow politicians to gain some credit with voters for every Escort or Windows package sold in their district." - *Wall Street Journal*, Nicholas Kulish & Jacob M. Schlesinger, 7/25/01

Freddie Mac

- Freddie to raise refinancing fees and tighten underwriting standards ([p. 21](#))
- Freddie loan portfolio grows in November by \$13 billion; duration gap is even ([p. 21](#))
- Freddie pension plan underfunded ([p. 21](#))
- Freddie increasing debt overseas ([p. 22](#))
- 30-year mortgages inch down ([p. 22](#))
- 1-year ARM rate hits record low, per Freddie's Primary Mortgage Market Survey ([p. 22](#))
- Freddie's philanthropic donation expected to streamline costs ([p. 22](#))
- Freddie, BCE Emergis partnership ([p. 23](#))
- Stewart Mortgage integrates with Freddie's loanprospector.com ([p. 23](#))
- Freddie pledges \$10 million in Section 8 federal housing choice in State of Pennsylvania ([p. 23](#))

Federal Home Loan Banks

- Federal Housing Finance Board Chairman prepares plan to address multidistrict issues after legal opinion issued ([p. 24](#))

Farm Credit System/Farmer Mac

- Heritage Foundation analyst describes Farmer Mac as Vegas blackjack, calls for charter revocation. ([p. 24](#))
- Farmer Mac slips out of limelight ([p. 25](#))

Ginnie Mae

- Federal Reserve still mulling buying Ginnie Maes ([p. 26](#))

Sallie Mae

- Judge dismisses part of Sallie Mae lawsuit ([p. 26](#))
- Sallie Mae acquires First Trust Financial in Weymouth, MASS ([p. 27](#))
- Prudential looks at Sallie's future under Republican governance ([p. 27](#))
- Consumer bankers call for reform of Federal student loan program ([p. 28](#))
- Sallie Mae prices \$500 million of short-term floating rate notes ([p. 28](#))

Postal Service

- Bush signs Executive Order to reinvent postal service ([p. 29](#))
- Bush's commission to be co-chaired by two executives; report due July 31 ([p. 29](#))
- Citizens Against Government Waste disappointed with postal commission's first press conference. ([p. 30](#))
- *Christian Science Monitor* editorial sees need for USPS overhaul ([p. 30](#))
- APWU challenges commission's role ([p. 30](#))
- Direct Marketing Association and Mailing Industry CEO Council laud empanelling of postal commission ([p. 31](#))
- Senator Grassley cites 50 complaints about postal inspector Corcoran ([p. 32](#))
- Montana congressman angry over USPS abandonment of airmail service to rural areas; MT editorial takes different tack ([p. 32](#))

Major Events

Trade associations commend Korsmo, embrace “Shared Funding”

- American Financial Services Roundtable, Consumer Bankers Association, Consumer Mortgage Coalition, Financial Services Roundtable, and RESPRO, jointly commend Chairman Korsmo for approval of “Shared Funding” program
- Pledging the support of their memberships, a December 10th trade association letter from the above-mentioned groups to Chairman John Korsmo praised the Shared Funding program as increasing “the safety and soundness of the FHLB system by creating a complementary risk management technique for management of prepayment risks. Shared Funding continues the essential MPF idea, namely that member institutions retain the principal credit risk, rather than credit risk being absorbed by the GSEs.” The text of the letter follows:

On behalf of the members of the above-signed Trade Associations, we are writing to commend the Federal Housing Finance Board for the agency’s recent approval of the Mortgage Partnership Finance (MPF) Shared Funding Program (“Shared Funding”). We believe Shared Funding will increase competition in the secondary mortgage market, help drive down the costs of mortgage financing, reduce certain risk to taxpayers and the government, and help more Americans realize their dream of homeownership.

We understand the first Shared Funding transaction is being developed by the Federal Home Loan Banks of Chicago, Des Moines, and Pittsburgh. Shared Funding essentially allows participating MPF members of the FHLB’s to generate MPF mortgage loans and sell them through a participating member or create a Private Security Instrument rated AA or higher by a national rating agency. This can be made available for purchase by the FHLB’s or to the more than 7,000 members of the FHLB system.

The MPF Shared Funding Program increases the safety and soundness of the FHLB System by creating a complementary risk management technique for management of prepayment risks. Shared Funding continues the essential MPF idea, namely that member institutions retain the principal credit risk, rather than credit risk being absorbed by the GSEs.

FHLB members have produced over \$50 billion of MPF mortgage loans since the Program’s inception in 1997, helping more than 400,000 families buy or refinance their home. MPF loans, with a median size of \$115,639, have been made in every state and every Congressional District in America.

We look forward to the success of the MPF Shared Funding Program, and pledge the support of our Associations and respective memberships to continue the exploration of innovative ideas to help promote competition and make homeownership more affordable in America.

Congressman Richard Baker appeals to OFHEO for uniform disclosure standards for Fannie, Freddie

Baker letter reflects growing frustration with OFHEO oversight

Hearings planned for February on Fannie/Freddie disclosures, with regulatory reform legislation expected in the summer

OFHEO director responds to Rep. Baker's October letter on duration gap

- Rep. Richard Baker (R-AL), chair of the Banking Committee's House Financial Services subcommittee overseeing the GSEs, asked OFHEO to review Fannie and Freddie disclosures after Fannie reported the large mismatch between its assets and liabilities in August. The disparity raised questions about how Fannie and Freddie report data. Freddie reports monthly averages while Fannie uses month-end data to calculate its duration gap. OFHEO director Armando Falcon wrote to Baker, "OFHEO is examining how to best reconcile those differences and release a duration gap measure to the public based on uniform methodology." Falcon said the agency was looking at other ways to make interest-rate disclosures more uniform.
- Fannie and Freddie did not immediately respond to OFHEO's letter. Baker spokesman Michael DiResto stated that the Congressman was pleased they are "going to take some of his suggestions and seek uniform duration-gap standards...This doesn't necessarily put a stop to the growing frustration he has had for several years over OFHEO's oversight." Baker plans to hold hearings on Fannie/Freddie disclosures for mortgage-backed securities starting in February, and wants to introduce legislation in the summer to give the companies a new bank-like regulator. (*Dow Jones Newswire*, Dawn Kopecki, 12/13/02)

OFHEO director responds to Rep. Baker's October letter on duration gap

- (OFHEO) Director Armando Falcon answered Congressman Richard Baker's October letter in a December 5 reply, assuring him that OFHEO continues to monitor actively Fannie and Freddie's interest rate risk management as part of the agency's routine examination process. Falcon also indicated that OFHEO was considering developing a uniform duration gap measure for the GSEs, the only real news contained in the director's response. Fannie and Freddie currently report their duration gaps slightly differently. Falcon's letter of response came only days before Fannie released its duration gap, which showed only a small positive 2-month duration mismatch between the cash flows on the GSE's assets and liabilities, a significant change from the large negative 14 months at the end of August, which prompted the Baker inquiry. (*Inside the GSEs*, 12/18/02)

Chairman Korsmo defers discussion on SEC disclosure for Federal Home Loan Banks

- The U.S. Federal Housing Finance Board postponed action, scheduled for Friday on enhanced disclosure regulations for Federal Home Loan Bank debt. The Board had a proposed regulation scheduled for the December 20th meeting that would govern the disclosures concerning obligations and investments sold by Banks, following the standards of the Securities Act of 1933. The Board is also looking to beef up equity disclosures required under the 1934 Securities Exchange Act. The agency delayed the rules to give the 12 regional Home Loan Banks it regulates more time to review the proposal. Finance Board Chairman John Korsmo stated, "Given their concerns about '34 registration, and the fact the two acts 'interlock,' I believe a reasonable delay will permit a more comprehensive discussion about disclosure."
- Korsmo added, "I remain open to the banks' suggestion for drafting a '34 registration requirement, but I have no intention of allowing the status quo to prevail." He affirmed that action is still planned in 2003 on both the debt and equity disclosure front. Korsmo maintained, "The driving reason for enhanced disclosure is to maintain the system's obligation, as a GSE, to the nation's taxpayers." The Federal Home Loan Banks, government-sponsored enterprises, all oppose the Chairman's plan to register their stock with the SEC. The Bush Administration has called for all GSEs to register their stocks, and housing GSEs Fannie and Freddie committed in July to start that process early this coming year. (*Dow Jones Business*, Dawn Kopecki, 12/17/02 and *Dow Jones Newswire*, John Connor, 12/17/02)
- The Bush Administration has been judged as unlikely to force registration on Fannie and Freddie, but the forthcoming disclosure recommendations were expected to level the playing field between the secondary market giants and private-label issuers by detailing what all issuers should disclose, including loan-to-value ratios and unpaid principal balance. Investors have complained that without more data on the mortgages backing the securities, they are unable to gauge prepayment risk. Some experts in industry claim Fannie and Freddie know more about the underlying loans and are therefore able to buy the least-risky securities for their own portfolios- a charge the GSEs deny. A regulator working on the GSE analysis said the government found no evidence of "cherry picking anywhere," not at the GSES, nor at the private-label issuers. OFHEO's General Counsel Alfred Pollard said the rules will be proposed early next year. (*The American Banker*, 12/13/02)

Fannie's advertising firm offers cash to Hill staff; ethics breach flagged; staffers told payment in violation of Senate, House ethics rules

- Fannie is known for the good benefits its employees receive, but recently its payments for participants in focus groups raised eyebrows. Late last month, Fannie's advertising agent, GSD&M, brought in 19 staffers in two groups to assess its latest public relations campaign (Fannie spent as estimated \$45 million in media in 2001 and the ads tested are expected to

break in the D.C. market). An unnamed participant said the Hill aides received \$200 cash and were told they could either accept the payment or donate it to charity. Under House and Senate ethics rules, Congressional staffers are prohibited from taking cash on the theory that such payment constitutes an honorarium, which is banned. Fannie Mae, after contact with a *Washington Post* reporter, subsequently told its ad firm to inform the staff they might want to hand the payment over to a charitable organization. More recently, the ad firm sent a letter to the participants, warning, "It has come to our attention that the honorarium you received may not comply with House and Senate ethics rules."

- An FM Watch spokesperson said Fannie should be "spending its money on putting minorities and low-income people in housing, not on focus groups," and that using and paying Capitol Hill staff was "another way for them (the GSEs) to manage their political risk."
- Fannie spokesman Chuck Greener says Fannie urged its ad agency to "take the most conservative approach" towards remunerating Hill staffers. Fannie has used Capitol Hill staffers in focus groups six times, including the most recent session. Fannie says the staffers were recruited randomly, but declined to identify the staffers or say whether they work on committees that could adopt legislation affecting the agency. House ethics committee rules prohibit staffers paid below the senior-level rate of \$99,096 per year (as focus group participants were) from accepting an honorarium if "the subject matter is directly related to his or her official duties, the payment is made because of the individual's status with the House or the payor has interests before the House that the employee may affect." One source noted that Fannie's status as a quasi-governmental entity makes the focus-group practice "incestuous" at least." (*The Washington Post*, Al Kamen, 12/16/02, *National Mortgage News Daily*, Paul Muolo, 12/14-15/02 and *Adweek*, Wendy Melillo, 12/16, 02)

Fannie Mae files motion in U.S. District Court for the District of Columbia to dismiss all counts in class action lawsuit alleging discrimination against African-Americans

- Fannie Mae moved to dismiss all counts in plaintiff Safiyyah Rahmann's class action lawsuit against the housing GSE, ruling that the plaintiff lacked standing to assert claims that Fannie discriminated against the plaintiff under the Fair Housing Act and the Equal Credit Opportunity Act, and likewise failed to state a claim under either statute in failing to allege that Fannie's actions caused her alleged injury. [see September 27, 2002 edition of *The GSE Report* for additional details]
- Ms. Rahmann alleged that she unsuccessfully sought a mortgage loan from at least one North Carolina lender, and ultimately obtained a mortgage at a higher interest rate than she originally sought. She alleged she separately sought a loan to purchase a multifamily investment property but her application was denied. She attributed her failure to obtain the loans on the fact that she is African-American, and on that basis, sought to represent a nationwide class action of minority mortgage applicants.
- Fannie disagrees, saying Rahmann's own financial history would have qualified her to obtain loans on the terms she sought in the absence of the discrimination she alleged. She failed,

says Fannie, to allege the essence of the impact claim she attempts to assert, and that under the law, her claim that Fannie Mae was required to provide her notices, fails. Fannie's dismissal motion notes that Rahmann did not sue the lenders, but rather Fannie, which cannot originate mortgage loans. The plaintiff, Fannie states, seeks to represent a purported class of borrowers, which has not been certified, and the case could not proceed because as the named class representative, she does not herself state a claim against Fannie Mae and lacks the standing to do so. Fannie is requesting an oral hearing on the motion. (Safiyah Rahmann, Plaintiff, vs. Federal National Mortgage Association, Defendant) Civil Action No. 1:02CV01822 (RWR)

Freddie commissioned study says automatic underwriting doesn't discriminate

- A new study by Freddie Mac economists Susan Gates and Peter Zorn, along with George Washington University's Vanessa Perry, shows its automated underwriting system has less bias than traditional mortgage underwriting. The study could help the GSEs fight class action lawsuits alleging discrimination by Freddie and Fannie. Freddie Mac has now provided unprecedented access to demographic information to researchers examining Loan Prospector. The study released is believed to be the first to reveal borrower demographics about loans processed through Loan Prospector. Both GSEs have claimed their automatic underwriting systems are colorblind, but until now, were not willing to be forthcoming about the workings of their proprietary systems. (*Inside the GSEs*, 12/18/02) The study of automated underwriting systems by the Freddie Mac economists and the GWU professor was published recently in a journal sponsored by the Fannie Mae Foundation. (*Reuters*, Mark Felsenthal, 12/11/02)

Martinez cites delay of HUD software bias study

- HUD Secretary Mel Martinez, unveiling the Spanish-language credit awareness program sponsored by Freddie Mac, said that the release of HUD's study about whether computer credit screening by Fannie and Freddie disqualifies too many minority applicants, was still under review but that the Department wanted to have it out soon. Work on the study began in the previous Administration, and both Fannie and Freddie face lawsuits over their automated underwriting systems, widely used by mortgage lenders. (*Reuters*, Mark Felsenthal, 12/11/02)

Shadow Financial Regulatory Committee (SFRC) asks Congress for Christmas gifts, including a uniform policy on privacy of financial information and privatization of GSEs

- The American Enterprise Institute's SFRC, an independent committee sponsored by AEI, called on Congress and the Federal Reserve to set a uniform national policy on privacy of financial information and to privatize government-sponsored enterprises. In addition, SFRC noted that Fannie Mae and Freddie Mac earlier this year voluntarily agreed to file annual and periodic reports with the SEC, but concluded that this step is "insufficient." "Two of the largest corporations in America— with millions of shareholders and investors in their

mortgage-backed securities- should be subject to the same disclosure requirements as other public companies,” the committee added. (*Dow Jones Newswires*, Phil Mccarty, 12/9/02)

Stephen Friedman quits Fannie Mae board; appointment assailed by conservatives, including for Fannie Mae board membership; praised by Fannie Mae’s Fred Malek

- President Bush’s choice to replace Lawrence Lindsey as head of the Council of Economic Advisors with investment banker Stephen Friedman, came under attack by conservative economists who cast him as a failed manager out of sync with President Bush’s economic views. The controversy appeared to drag out Friedman’s being formally selected for the directorship of the council. Fred Malek, an investment banker with ties to the Bushes, and who serves on the Fannie Mae board with Friedman, said Friedman’s job in the White House would not be to set economic policy but to meld disparate policy ideas into a coherent package. Malek described Friedman as an “accomplished executive who has risen through the ranks of one of the toughest, savviest investment banks in the world to be elected its chairman...He would be perfect for this job.”
- Conservatives pointed out Friedman’s longtime service on the board of the Concord Coalition, a budget watchdog group and his campaign contributions to Democratic congressional candidates and his service alongside former Clinton-era Treasury Secretary Rubin to argue that he would block the President’s tax-cutting agenda. Others argue that his directorships at Fannie Mae and Wal-Mart stores may prompt the most debate. Friedman is currently a senior principal of MMC Capital, the private equity arm of the insurance, investment management, and consulting firm Marsh & McLennan Cos. Inc. Club for Growth spokesman and President Stephen Moore said the campaign against Friedman may have only angered the candidate, and strengthened Bush’s resolve to bring him on board, adding, “You don’t just want someone who will do the president’s bidding– I have no doubt if he is appointed, Friedman will drink the Kool-Aid...But you need someone who believes this stuff.” (*The American Banker*, Todd Davenport, 12/10/02 and *The Washington Post*, Jonathan Weisman, 12/11/02)
- Fannie Mae announced on December 18th that Friedman had resigned as a member of the Board of Directors. Franklin Raines had strong words of praise for his associate, “Since 1996, Stephen Friedman has been an extraordinary contributor, as a senior member of our Board his insight and thoughtful counsel have been immensely valuable to the company...We at Fannie Mae join in congratulating and wishing Steve well on his appointment.” (*Business Wire*, 12/18/02)
- Friedman’s predecessor, Lawrence Lindsey, by some accounts, played a major role as the moving force behind an Office of Management and Budget’s (OMB) “prompt letter” exercise that held promise that OFHEO would institute new, mandatory debt and equity disclosure regimens for Fannie and Freddie. The OMB/OFHEO drill came on the heels of the corporate scandals and legislation pending in the House to repeal the federal securities law exemptions enjoyed by Fannie and Freddie. (*Dow Jones Newswire*, John Connor, 12/18/02)

- Observers speculate that the new team of Friedman and Snow will have a more pragmatic view about the mortgage system and that the GSEs are not going to be a high priority. Newly named Treasury Secretary Snow, chairman of railroad power CSX Corp., is a former chair of the Business Roundtable, a corporate leadership group in which Fannie Mae's Franklin Raines, is an active member. Kenneth Guenther, head of the Independent Community Bankers of America, noted that, "As usual, Fannie has done superb preparatory work in terms of covering their political bases." (*Reuters*, 12/10/02)

GSEs soft money donations explode in final days before November 5 ban

- The GSEs, particularly Freddie Mac, unloaded large amounts of cash just before the November 5th soft money ban took effect. In the three weeks prior to the imposition of the ban, Freddie dumped \$1,385,000 on Democratic and Republican campaign committees. Freddie began its political spending surge with a \$100K donation to the Democratic Congressional Campaign Committee (DCCC), followed by a \$250K contribution to the NRCCC, the National Republican Congressional Campaign Committee. Freddie then wrote checks totaling \$285,000 to the National Republican Senatorial Committee (NRSC) and checks adding up to \$150,000 to the Democratic Senatorial Campaign Committee (DSCC), wrapping up its soft dollar spending with a \$350,000 check to the RNC, the Republican National Committee and an identical amount to its Democratic counterpart, the Democratic National Committee (DNC). Fannie was less active than Freddie, but it spend \$500K in the final days before the ban, giving \$100,000 to the NRCCC, \$100,000 to the DCCC, \$150,000 to the NRSC, and \$150,000 to the DSCC. Fannie made no last minute contributions to the national political parties. (*Inside the GSEs*, 12/18/02)

FMC analysis, "The Overheated Mortgage Machine" warns of GSE risks
--

- The fast growth in mortgage debt, coupled with the broad distribution of "agency" securities across the financial system has exposed banks and other financial intermediaries, including the GSEs, to considerable risk in the event interest rates rise and/or housing prices decline. In a new analysis, the Financial Markets Center (FMC), an independent, nonprofit research organization, warns that, "The bursting of a mortgage bubble could unleash broader financial disruptions with deeper macroeconomic implications than the shakeout following the S&L crisis of the 1980s." Households, it argues, are "indirectly exposed to the GSEs' fortunes through the holdings of their pension and mutual funds." Rising interest rates could trigger a drop in the value of agency securities, and household net worth would diminish as a result of these holdings. FMC's analysts propound that home equity borrowing is a poor substitute for increased profits, investment, employment and disposable income, and that consumer spending financed by excessive debt accumulation is not a path to sustainable recovery. (*Dow Jones Newswires*, John Connor, 12/19/02)

President Bush signs E.O. launching postal commission, and creating commission to include former Fannie Mae chair

- The President signed an Executive Order December 11th to create a commission to explore the United States Postal Service (USPS) mission and operations at a time when it faces increasing competition from the private sector and new technology, including the Internet. The 9-member commission, to include business community members, will report back to the President by July 31st. Of the postal service's 30,000 offices around the country, about half of them are not profitable. The panel's conclusions could result in an overhaul of USPS, but is not expected to result in privatization. (*Deseret News*, Jeannine Aversa, *AP* writer, 12/12/02) The commission's co-chair is James A. Johnson, a former Fannie Mae chairman (for more details, see "Postal Service," p. 27).

Fannie Mae and Freddie Mac

New demands for heightened oversight of GSE automatic underwriting (AU)

Fannie and Freddie say automated underwriting speeds mortgage approval

- Two groups, the Consumer Federation of America (CFA), a consumer advocacy organization, teamed with the National Credit Reporting Federation of America, a trade group representing firms that resell credit information, announced that they would be lobbying Congress to tighten oversight of Fannie and Freddie's use of AU. Stephen Brobeck, executive director of the CFA, discussed a new study touting the existence of widespread errors on consumer credit reports. The study's major recommendations included a call for federal agencies, in particular HUD, and the Federal Trade Commission, to conduct "regular, comprehensive evaluations of the validity and fairness of all credit scoring systems." Fannie officials said that because its Desktop Underwriter AU system relies on more than just credit scores it can help mitigate the risk that faulty credit information will lead to a mortgage denial. Fannie's officials declined, however, to comment directly on the study's policy recommendations or on reports that the GSE had agreed to meet with representatives from the two groups. (*Inside the GSEs*, 12/18/02)

Fannie and Freddie say automated underwriting speeds mortgage approval

- Before the use of AU software to determine those who qualify for a loan, human underwriters could spend 30 days or more to make that decision. Today, that decision is often made in 30 seconds or less. Patricia Boerger, a Freddie spokesperson, claims automatic underwriting not only has sped up the process but also has made it more accurate. Boerger says "The single-family delinquency rate, i.e. the number of mortgages 90 days or more delinquent, was .64% in 1992, the highest in the past decade." When Freddie introduced the industry's first automatic underwriting software in '95, the rate was .60%. For 2001, it was .41% despite the recession and increasing numbers of people laid off. Industry-wide about 90% of all mortgage applications go through some form of automated underwriting. Borrowers tend to stick with the lender who approved their loan instantly. Automated systems do not reject

loans, which are either approved or referred to a lender. Some lenders over-rule the computer, but when they do, they usually charge higher interest rates or ask for a larger down payment. (*The Orlando Sentinel*, Jim DeBoth, 12/15/02)

HUD looking to raise GSE goals for 2004 as early as next June

- Two years since HUD last raised the affordable housing goals of Fannie and Freddie, the agency is eyeing a new hike for 2004. HUD says the new goals may be higher than the current goals. The last time HUD raised the goals was in the year 2000, with the main change increasing the portion of the GSEs' business that benefits low and moderate-income households from 42 to 50%. The new higher goals were in effect last year, and Freddie easily met them with a 53.2% score, while Fannie passed with a 51.5% score. (*Inside the GSEs*, 12/18/02)

Freddie and Fannie's stock deemed under-appreciated

- In *Newsweek's* recent story on the stock market, "If the water's looking warm," analysts see the market as having bottomed and believes it's time for shopping. One hunter of under-appreciated stocks, David Dreman, looks for stocks with price/equity ratios below the S&P's current 20 and earnings growth that beats the S&P's 8% for the last year. He's buying Freddie Mac, and Fannie Mae, among others. (*Newsweek*, Linda Stern, 12/16/02)

Fannie lowers duration gap

- For the second consecutive month, Fannie narrowed its duration gap to plus two months in November from negative six months in October, keeping within its target of plus or minus six months. (see p. 15 for more on Fannie's duration gap) Outstanding commitment rose to \$123 billion last month versus \$119 billion in October. Retained commitments fell to \$52.8 billion last month from \$67.3 billion, with total business volume in November rising to \$95.6 billion, the highest on record. Mortgage portfolio purchases, meanwhile, increased to nearly \$48 billion from \$33 billion in the previous month. Annualized portfolio growth was over 16% versus flat in October. Fannie does not comment on how it manages its portfolio duration, however, it has in recent months said it has bought mortgages and other instruments to rein in the duration gap. The agency said, "We continued to move commitments forward to take advantage of more attractive pricing for future delivery. (Dow Jones Newswire, Agnes Crane, 12/13/02) On the New York Stock Exchange, Fannie shares gained \$1.2 on Friday to \$66.32 (*Reuters*, Richard Leong, 12/13/02)
- Fannie curbed its portfolio gap from negative 14 months in August to negative six months in October, alleviating fears that earnings would slip. The target range is plus or minus six months. In September, the actively traded 10-year Fannie benchmark notes began trading at yield 6 basis points higher than comparable Freddie bonds after the news of the negative 14-month gap, but the spread has narrowed, though Fannie's bonds still yield 1 basis point more than Freddie's. (*The American Banker*, 12/11/02)

- Fannie offered no new insights on how it managed to lower its gap so dramatically in such a relatively short period of time, but maintains its duration gap narrowed in the normal course of buying a large amount of fixed-rate mortgages with low interest rates and rebalancing its debt. The announcement should silence critics who suggested Fannie had trouble managing its exposure to interest rate risk. (*Inside the GSEs*, 12/18/02)

Flood insurance impasse impacts Fannie, Freddie; legislative fix being readied-- Rep. Oxley sees no reason why reauthorization bill can't be passed by January 8, '03

- Congress' failure to reauthorize the National Flood Insurance Program, which affects 4.4 million property owners with \$623 billion in insurance coverage, will make new mortgages and refinancings difficult or impossible to close in designated flood hazard areas. Mortgage lenders and investors, including Fannie and Freddie, are prohibited under federal law from making or buying loans on properties located within flood hazard zones unless valid insurance policies are in force. The impasse is related to the gridlock over the entire federal budget this past year, with the Senate failing to enact a budget resolution. A continuing resolution authorized operations for major federal agencies, but to keep the resolution streamlined, a variety of federal activities that required reauthorization before the year's end were eliminated.
- House Financial Services Committee chair Michael Oxley (R-OH) says everything is lined up to pass a flood insurance reauthorization bill by January 8th, reauthorizing the NFIP retroactively to January 1, with Senators Shelby (R-AL) and Sarbanes (D-MD), sponsoring a similar Senate bill. Some 400,000 policies are expected to be impacted by an authorization lapse during January, and inevitably, some mortgage and real estate transactions could suffer disruption. (*National Mortgage News Daily*, 12/19/02 and (*The Washington Post*, Kenneth Harney, 12/14/02)
- Key legislators on the House Financial Services Committee are planning to introduce a reauthorization bill that addresses any "lapses in coverage," and a coalition of housing trade groups is working to assure quick passage. Fannie intends to offer flood insurance guidelines for its seller/servicers this week. (*National Mortgage News*, 12/16/02)

Mortgage bond prepayments stay near record levels in November

- So-called prepayments on the mortgage bonds sold by Fannie Mae and Freddie Mac were little changed from October's record pace as the average 30-year mortgage rate reached the month at 6.13 percent, above the 5.94 percent low reached the week of November 15th. The constant prepayment rate on Fannie Mae's 30-year 6.5% issues, the biggest portion of outstanding mortgages, was unchanged at 53.4 percent in November, according to the company. At that speed, 53.4% of the \$350 billion outstanding would be prepaid within a year. The rate of prepayment on the \$264 billion in Freddie Mac 30-year 6.5% issues was 56.2% in November, compared with 56.1% in October. The company's 7% mortgages prepaid at a 61.4% rate, down from October's 62.8%. Fannie and Freddie are the biggest

buyers of U.S. home mortgages, most of which they package into bonds that are sold to investors. They issue their own corporate debt, known as agency debt, to raise cash for their purchases. The current Fannie Mae 30-year mortgage bond yields 5.34%, 1.35 % points more than the 10-year Treasury note. (*Bloomberg News*, Al Yoon, 12/6/02)

Jumbo lenders not bothered by conforming limit boost

- With Fannie Mae and Freddie Mac being allowed to buy bigger loans next year, jumbo lenders say they are not troubled about losing borrowers to the conforming market. Some mortgage analysts believe the planned increase could have the effect of spurring consumers already considering jumbo loans to take out even larger mortgages. With the 7.3% increased limit beginning January 1, Fannie calculates that 210,000 jumbo loans or 20% of all outstanding jumbos, will become eligible for refinancing once the new limits are in place. Jumbo lenders said they are not worried that higher conforming limits would increase the prepayment risk of existing jumbo loans by spurring borrowers to refinance out of formerly jumbo loans of between \$300,700 and \$322,700. (The 12/6/02 edition of *The GSE Report* referenced Fannie/Freddie conforming loan limit increases to \$322,700 effective January 1, 2003, a 7.3% increase) (*The American Banker*, Erick Bergquist, 12/10/02)
- Seniors can qualify for larger reverse mortgages beginning January 1 because of new, higher limits on the size of mortgages. The new limits impact two reverse mortgage products, the federally insured Home Equity Conversion Mortgage and the Fannie Mae Home Keeper loan. The new ceiling for Home Keeper borrowers is to be \$322,700, up from \$300,700 in 2002. The new limit for a Home Equity Conversion Mortgage varies by geographic areas, with the highest amounts available in metropolitan areas, and the top loan amount set at \$280,749, up from \$261, 609, with the lowest loan amount \$154,896, up from \$144,336. Loans are available to borrowers 62 and older. Reverse mortgage applications have doubled this year, according to the National Reverse Mortgage Lenders Association. (*The Washington Post*, 12/7/02, and *AP*, 12/12/02)

Fannie/Freddie limit creation of certain mortgage bonds for 3rd consecutive month

- For the third consecutive month, Fannie and Freddie set limits on creation of certain mortgage bonds to alleviate shortages in some securities. The shortage in mortgage debt has become severe because mortgage banks are having difficulty processing the tide of loan refinancing applications spawned by low interest rates. Fannie and Freddie told Wall Street dealer firms they are limiting the production of structured mortgage bonds known as collateralized mortgage obligations (CMOs) or real estate mortgage investment conduits (REMICS). Limits have been imposed by Fannie on creation of CMOs backed by 30-year 5 ½% mortgage bonds, while Freddie has limited production of CMOs backed by 30-year 5 1/2% mortgage bonds and 15 year 5% mortgage bonds. Investors sell mortgage debt for delivery in a particular month and buy similar debt for delivery in the following month in the dollar roll market.
- Demand for Fannie Mae 5 1/2% and 6% was so heated in the dollar roll market that this

mortgage debt traded “at fail, “ which means the financing rate for the debt effectively was 0%. Dealers were scrambling to meet request by investors taking delivery of mortgage debt in the dollar roll area, a demand which helped “nudge” in mortgage bond spreads relative to Treasuries. A Freddie spokesperson said the move was an effort to ensure liquidity of mortgage-backed securities and that Freddie extended its limit because their mission is to provide liquidity and tradeable supply to the market. Fannie’s spokesman said “We need to be certain there is sufficient loan volume there to collateralize the Remic issues for January delivery.” (*Reuters*, Aleksandrs Rozens, 12/12/02)

Fannie, Freddie tell title industry to reduce costs, processing times

- After a surging housing market and unprecedented refinancing boom, the title-insurance industry is being told to lower costs and processing times. Joe Biegel, Fannie’s Vice-President for credit policy, commented, “It’s safe to say that prices, in many respects are higher than they ought to be.” Americans will pay a record \$11 billion for title insurance and related services this year, the bulk coming from residential transactions, up from \$7.8 billion two years ago. Title insurers may charge hundreds or thousands of dollars, paying out just 47 cents in claims for every \$10 in premiums, in contrast with the property and casualty insurance business, which pays out \$8.70 for every \$10 collected. One reason that title insurance is not quick or cheap is because some localities have been slow to automate their records, and in other cases, the industry is waging legal challenges to block competition. Lenders claim title insurance is the biggest opportunity to whittle away costs, and some title insurers are already responding to the pressure, charging as little as \$275 for title policies bought by those refinancing and issued using computer databases and automated underwriting. (*Wall Street Journal*, Ruth Simon, 12/18/02)

Georgia predatory lending law eyed for revision

- Lenders in Georgia anticipate that with the defeat of Governor Roy Barnes, a Democrat and former trial lawyer who had pushed hard to enact the state’s tough predatory lending law, that amendment of it is in the works. The law, which went into effect in October, prompted several large mortgage companies, including J.P. Morgan Chase & Co., to stop making many subprime loans in the state. Others pulled out completely. For some of those that pulled out, the clincher in the law was a provision making secondary-market investors, including Freddie Mac, Fannie Mae and Wall Street firms, liable for any violations by originators, leaving them vulnerable to the law’s monetary and criminal provisions. The provision prompted Freddie to stop buying loans governed by Georgia’s restrictions in November; Fannie said it will also stop purchasing any loans that qualify as high-cost, effective January 1, 2003. The law put restrictions on “high-cost” loans or those with an annual percentage rate of at least 8 percentage points above comparable Treasuries or discount points and fees equaling 5% or more of the loan amount. (*The American Banker*, 12/20/02 and *National Mortgage News*, 12/16/02)

Fannie Mae

Fannie lands former Treasury and Rep. Dick Arme y staffer for public policy development and advocacy

Fannie vice chair named to terrorism investigatory commission

- Fannie Mae announced the hire of Michele Davis, who most recently worked for outgoing Treasury Secretary Paul O'Neill as the agency's assistant secretary for public affairs, and prior to that as communications director for retiring House Majority Leader, Dick Arme y (R-TX). Davis, who enjoys strong ties to the Republican party, will become the senior executive responsible for the company's public policy development and advocacy on a full range of issues related to housing mortgage finance and capital markets. (*Dow Jones Newswire*, Dawn Kopecki, 12/13/02)

Gorelick named to terrorism commission

- Jamie Gorelick, vice chairman of Fannie Mae and a former Clinton Administration official who served as deputy attorney general at the Department of Justice, was one of four Democrats appointed December 11th to serve on the bipartisan, 10-person National Commission on Terrorist Attacks, to investigate failures in areas such as aviation security and immigration. The commission, created under the broad intelligence authorization bill enacted in November, was established last month, and will be co-chaired by former Democratic Congressman Lee Hamilton and by former New Jersey Governor Tom Kean, a Republican.

Fannie announced two-part offering of new 2-year notes

Fannie chief economist predicts rebound in U.S. economic growth, record home mortgages in '03

- Fannie announced it would sell a two-part offering of new 2-year notes and reopened 10-year notes on Thursday, December 12, in what is to be the year's last scheduled long-term noncallable debt. The \$4 billion in new 2-year notes due December 2004 were expected to be priced at a yield 13 basis points above Fannie Mae's existing notes due September 2004. That would translate to a yield 22 basis points over 2-year Treasuries, which late Monday yielded 1.91%, according to agency traders. GSE debt has grown at an annual 17.5% pace during the past 5 years, according to UBS Paine Webber. The pace has been slowing, with an 11% growth rate in the third quarter of this year. A UBS Paine Webber strategy report said, "We feel it is reasonable to expect the rate of debt growth to return to a level closer to its longer-term average, say about 15%." UBS Paine Webber adds that GSE debt growth in the 10-15% range and a federal deficit of about \$275 billion would put 10-year agency yields 58 to 71 basis points over Treasuries, with an average of 65 basis points, which is wider than current spreads. (*iWon Money & Investing*, Lynn Adler, 12/16/02)

Fannie chief economist predicts rebound in U.S. economic growth, record home mortgages in '03

- Fannie's chief economist, David Berson, projects that the U.S. economy will rebound in 2003, with mortgages for home purchases hitting a new record. Berson expects that the rebound will be fueled by low short-term interest rates, tax cuts and consumer spending, aided by mortgage refinancing. He believes the economy could get a further boost when uncertainty about war with Iraq is resolved. He also sees ebb in refinancings, with outstanding mortgage debt to increase to \$6.95 trillion in '03, an increase of 8.5% from \$6.4 trillion. (*Reuters*, Mark Felsenthal, 12/18/02)

Chase, Fannie team on Harlem project

Fannie Mae offers help to minorities with new offerings

High mortgage rejection rates prompt Fannie outreach in Waco, Texas

Fannie Mae forms venture to boost Muslim home ownership in California

Native Americans to benefit from Fannie's foreclosure prevention program

- J.P. Morgan Chase and Company and Fannie Mae say they will guarantee \$44 million of debt on a 231 unit middle-income apartment house to be constructed in Harlem. The New York City Housing Development Corporation will fund the project by floating tax-exempt bonds, with Morgan Chase guaranteeing the bonds during construction. Fannie will take over as guarantor once the building is completed. American Property Financing, Inc., a New York mortgage bank, arranged the credit enhancement from Fannie. The project is part of the city's Cornerstone program, which plans to create 3,000 middle-income and market-rate apartments. Forty-seven of the units will be available only to families earning \$31,400 or less per year; 63 units will be for families with income below 7 or 8 times the annual rents set by the Housing Development Corporation, or under \$157,000, whichever is lower. The other apartments will rent at market rates. (*The American Banker*, 12/13/02)

Fannie Mae offers help to minorities with new offerings

- According to a top Fannie Mae official, many real estate agents and conventional lenders don't get as much of their business as they should because they don't understand what motivates black and Hispanic home buyers expected to make up 60% of first-time home buyers (including other minorities and immigrants) over the next decade. A Fannie Mae survey 3 years ago of more than 9000 households, all headed by someone at least 25 years old and with annual income of \$30,000 or more, showed big differences between racial and ethnic groups. Blacks were more likely to use government-backed mortgages for first homes and seven times as likely as whites to refinance with high-interest, "subprime" loans. Fannie Mae mortgage products are designed to promote minority home ownership, with several new offering being tested. They include a mortgage that lets homeowners stop payments for 6 months if they lose their job, become disabled or a spouse dies. Another provides a safety net in case of a major, unexpected home repair, a big reason low-income homeowners default on

mortgages. The product lets them pay just \$50 and select from a list of contractors to do the job. (*St. Petersburg Times*, Steve Huettel, 12/10/02)

High mortgage rejection rates prompt Fannie outreach in Waco, Texas

- Half of those applying for home loans in Waco get rejected, and only 46% of the homes in Waco are owner-occupied, while that statistic stands at 64% nation-wide. Those numbers spurred Fannie Mae to host a program in Waco where lenders and elected officials could hear about products offered by Fannie and others to help people buy homes. Fannie's senior business manager for housing and community development in Dallas blamed the high rejection figure on conservative lending practices and would-be borrowers with "serious credit issues." But she added that Fannie can assume risks that other lenders may avoid, and can do so in conjunction with the cooperation of local lenders.
- Waco Mayor Linda Ethridge said she hoped this would be the first of several seminars to be held in the city, and U.S. Congressman Chet Edwards (D-TX) commended local leaders for having the seminar, calling home ownership a stabilizing factor. Some 50 people attended the seminar, but Waco's Housing Authority's Gary Moore, asked for a show of hands from those who actually make loans and only two in attendance raised their hands. Bert King of Synergy Mortgage did not attend the meeting, but took issue with Fannie's claim that conservative lending practices by banks and mortgage companies led to Waco's high rejection rates for mortgage applicants. King said the problem is poor credit histories. Fannie has programs requiring only a \$500 down payment, and another, Expanded Approval, which helps borrowers with past credit difficulties, to receive an interest rate reduction of up to 1% after 24 months of timely payments. (*Waco Tribune Herald*, Mike Copeland, 12/14/02)

Fannie Mae forms venture to boost Muslim home ownership in California

- Fannie Mae is developing as part of its \$2 trillion "American Dream" commitment of affordable mortgages by the end of the decade, a \$10 million relationship with an Islamic financial institution, Pasadena-based American Finance House LaRiba, to open up southern California's housing market to more Muslims. The deal will allow Muslims to purchase a home while recognizing the prohibition of Islamic law on paying or collecting interest on mortgages and other types of debt. LaRiba will make the loans to qualified buyers and the loans will be purchased by Fannie Mae, similar to a partnership LaRiba entered into 15 months ago with Freddie Mac.
- LaRiba founder Yahia Abdul-Rahman said because of the partnership with Freddie Mac, "we are really skyrocketing." The transactions use standard real estate financing documents and are serviced like conventional Fannie Mae mortgages, which make them compliant with US real estate laws, and borrowers also get tax breaks associated with homeownership. However, the language of the transaction is different, with the agreement made between LaRiba and the prospective homeowner establishing jointly negotiated maximum monthly payments based on the property's sale price and fair rental value. Using that payment, LaRiba calculates the "implied interest rate" which represents the rate of return on the

transaction. The average LaRiba loan is about \$200,00 and the agreement with Fannie Mae will fund about 50 loans, an amount expected to grow over time. Colette Porter, a manager in Fannie Mae's Pasadena office, stated that she expects this to be the beginning of thousands of loans. (*Daily News* (Los Angeles), Gregory J. Wilcox, 12/9/02)

Native Americans to benefit from Fannie's foreclosure prevention program

- The National Congress of American Indians, the National American Indian Housing Council and other groups are developing a homebuyer education program for Indian Country, which will use a financial literacy course designed by First Nations Development Institute and Fannie Mae, titled, "Building Native Communities: Financial Skills for Families." The program includes a workbook, instructor toolkit, training curriculum and promotional brochures, with 18,000 copies created, 500 trainers and 33 workshops around the country. At a Federal Reserve Board's recent "Banking Opportunities in Indian Country" symposium in Scottsdale, AZ, consultant Joanna Donohoe quoted a Freddie Mac study to the effect that borrowers with homebuyer education are 13% less likely ever to become 60 days delinquent on a mortgage. Some communities are still in need of being taught the basics of credit, checking and savings, including rural communities that remain cash economies, or inner-city areas where redlining limits access to banking services. (*National Mortgage News* editorial, 12/9/02)

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

Fannie has 51 Partnership Offices open across the country

Fannie "wins the gratitude of politicians by staging local events with them, often to 'announce' its plans to buy local mortgages...It's almost as if Ford or Microsoft could allow politicians to gain some credit with voters for every Escort or Windows package sold in their district." – *Wall Street Journal*, Nicholas Kulish & Jacob M. Schlesinger, 7/5/01

Fannie has 51 partnership offices

- According to Fannie's Web site, the company has 51 partnership offices open across the country. (http://www.fanniemae.com/contact/partnership_offices.html) 10/22/02)

Rep. Collin Peterson (D-MN) and White Earth Reservation representative join Fannie on housing venture

- Fannie has made a \$100,000 equity investment in the Community Development Bank, to enhance the bank's ability to address the lending and financial service interests of tribal members on the White Earth Reservation in northwestern Minnesota. U.S. Congressman Collin Peterson (D-MN) and White Earth Reservation Tribal Council Chairman Doyle Turner joined Fannie in announcing this initiative and Fannie's award of \$5,000 in grant monies to the White Earth tribe to expand homeownership opportunities. (*Fannie Mae press release*, 12/16/02)

Rep. John Dingell (D-MI) joins Fannie, Ann Arbor Housing Commission to welcome homeowners with disabilities

- Thanks to a community partnership with the Ann Arbor Housing Commission, the Northern Ohio Investment Company (NOIC), Community Housing Alternatives and Fannie Mae, two people with disabilities celebrated achieving first-time home ownership during a Home for the Holidays celebration in Ypsilanti, Michigan on December 16th. Ypsilanti's pro tem Mayor was present for the ceremony, along with Ann Arbor's Mayor John Hieftje. The new homeowners were able to purchase their homes through mortgage financing from NOIC that uses Fannie's HomeChoice mortgage product, which provides flexible mortgage financing for low to moderate income people with disabilities or who have family members with disabilities.
- HomeChoice offers down payments as low as \$500 from the borrower's own funds; more flexible use of second mortgage financing for down payment and closing cost assistance, rehabilitation and access modifications; and special qualifying and underwriting guidelines for borrowers whose income is at or below 100% of the median income. Since September 2000, public housing agencies have had authority to develop single-family homeownership programs for Section 8 recipients and Ann Arbor's Housing Commission has created its own program that allows Section 8 recipients to use their vouchers as qualifying income for a mortgage. Fannie's participation in the Section 8 to Homeownership and HomeChoice initiatives are part of the company's 7-year plan to invest \$50 billion in Michigan to help finance affordable housing for 500,000 families statewide. (*Fannie Mae press release, 12/16/02*)

Selma, Alabama's Mayor James Perkins joined Fannie, HUD, to announce a \$2 million homeownership initiative

- Selma's Mayor joined Fannie, HUD, the Alabama Housing Finance Authority, the Selma Housing Authority and Peoples Bank & Trust in announcing a \$2 million initiative to expand home ownership in a new 5-unit housing conversion of existing rental units. In an effort to assist more families, Fannie approved a \$2 million underwriting experiment, requiring borrowers to contribute only 1% of the purchase price toward down payment or closing costs. Fannie has committed to purchase eligible mortgage loans originated by Peoples Bank & Trust. The Selma program is part of Fannie's \$2 trillion American Dream commitment to increase homeownership rates and serve 18 million targeted families by the end of the decades. (*Fannie Mae press release, 12/10/02*)

Missouri Mayors, Kay Barnes of Kansas City and Independence's Ron Stewart, and Fannie Mae representatives announce launch of socialserve.com, a comprehensive rental-housing database

- The Missouri mayors joined Fannie Mae in announcing socialserve.com, a nonprofit, web-based service offering one-stop rental property listings from throughout Kansas City and the surrounding areas. People seeking rental housing and property providers wishing to advertise their properties freely may access the service through any Internet-enabled computer. Some properties accept HUD Section 8 vouchers. The site is the first of its kind in the country to include affordable rental housing listings in both English and Spanish. Socialserve.com was

developed in 1999 as a program of NonProfit Industries in Charlotte, N.C., a nonprofit dedicated to the creation of affordable software solutions to address community needs.

Freddie Mac

Freddie to raise refinancing fees, tighten underwriting standards

Freddie loan portfolio grows in November by \$13 billion; duration gap is even

- Freddie Mac, tracking changes Fannie made a few months ago, is set to boost fees for some cash-out refinancings next year and strengthen underwriting standards. Freddie will raise its service fee on April 1 to 50 basis points for refi mortgages for more than 70% of home value but less than 80%, according to a memo for sellers and servicers. The fee will be 75 basis points for ratios of 80% to 85%. Standards for manually underwritten mortgages will be tightened, with a credit rating of at least 720, now required on loans for more than 75% of value, needed for those for as little as 70%. Analysts claim the changes are because of the surge in home prices in some regions in the last few years, exacerbated by homeowners trying to maximize the equity they can withdraw, and a sign that there are problems with high appraisals in cash-out refinancings. (*The American Banker*, 12/18/02)

Freddie loan portfolio grows in November by \$13 billion; duration gap is even

- Freddie Mac announced its loan portfolio grew at an annualized rate of 29.1% in November, the fastest rate in nine months, increasing \$13 billion to \$594.4 billion, as some of the \$62 billion in mortgages it committed to buy over the previous 2 months were completed. The annualized growth rate of the portfolio is up from a 12.9% rise in October. The company also said its duration gap, a measure of interest rate risk, was even last month, indicating mortgages will be repaid by homeowners and replaced at a lower interest rate at the same speed as the company can refinance its own debt. (*Bloomberg.com*, Al Yoon, 12/19/02)

Freddie pension plan underfunded

- Freddie's pension plan is considered underfunded according to an article in the recent issue of *Money* magazine, which generally describes an underfunded pension plan as one without enough money on hand to make pension payments to current and future retirees, explaining that companies whose plan assets are less than 85% of its projected benefit obligation will likely have to add cash or stock to the plan over the next 3-5 years. Freddie Mac, it says, is at 77.7% of full funding, a shortfall of \$219 million. Other examples with data from December 31, '01, are Phillips Petroleum at 60.2% of full funding, with a shortfall of more than \$2.5 billion, and United Airlines with a shortfall of more than \$12 billion. (*Money*, Lisa Gibbs, January 2003)

Freddie increasing debt overseas

- Freddie Mac's chairman Leland Brendsel, addressing a media luncheon, announced he would like to see Freddie make greater inroads with foreign investors in 2003. Currently, about 1/3 of the firm's debt is sold outside the United States. Freddie has several different types of debt instruments at its disposal, including reference notes and discount notes. At the end of September, it had outstanding debt totaling \$623 billion (all types of instruments). About 28% of its reference notes had been issued to foreign investors, with Asian countries (excluding Japan) buying the most at 13%. European investors ranked second with 11%. Japanese investors have 3%. Freddie sells debt overseas to diversity its investor base and hopes to see its foreign debt issuance rise to 40% next year. Roughly 75% of Fannie's callable benchmark securities are held by U.S. investors, the remainder by foreign investors. (*National Mortgage News*, 12/16/02)

Freddie cites 30-year mortgage rates drop for first time since November

Freddie Mac's Primary Mortgage Market Survey cites average 1-year ARM hitting record low for week ending December 20th

- Mortgage rates nationwide had inched up for the 3rd week in a row, with rates on 30-year mortgages climbing to their highest level since late October, then fell for the week ending December 13th for the first time since the middle of November, with the average interest rate on 30-year fixed mortgages dropping to 6.14% for the week, according to Freddie Mac in its weekly nation-wide survey. Freddie Mac's weekly survey showed average interest rates on 30-year mortgages was 6.19% for the week ending December 6, up from 6.13%. It also marked the 7th time this year that rates on this benchmark mortgage hit a new low.

Freddie Mac's Primary Mortgage Market Survey cites average 1-year ARM hitting record low for week ending December 20th

- The average 1-year ARM was 4.07%, while the average 15-year fixed rate mortgage fell from 5.46% to 5.42%, while the average rate for one-year Treasury-indexed ARMs dropped from 4.18% to 4.07%, its lowest level since Freddie began tracking it in 1984. Freddie's chief economist, Frank Nothaft, said, "Since mortgage rates are not expected to increase significantly, we remain confident that the housing industry will continue to be alive and well into 2003." A year ago, the average 30-year and 15-year fixed rates were 7.17% and 6.65% respectively, and the average one-year ARM rate was 5.27%, according to Freddie. (*National Mortgage News*, 12/19/02) Nothaft also predicted interest rates continuing to decline a little more in the coming weeks as investors flee stock markets fearing concern over military action in Iraq. (*Reuters*, 12/19/02)

Freddie's philanthropic contribution to streamline costs in expectation of narrowing net interest margins

- Freddie Mac's recently announced \$225 million contribution to its philanthropic program was meant to streamline costs in anticipation of narrowing net interest margins, an analyst said Monday. The donation to the Freddie Mac Foundation was announced last week, with Freddie recognizing the gift would reduce its 4th-quarter earnings by \$156 billion but would also trim administrative costs, since Freddie would be donating less to the charity over the next six to eight years. An industry analyst cautioned, "Interest margin compression is something that both companies have continuously warned investors about the past year," and said "the gift was like Fannie Mae's \$300 million contribution to its own foundation in last year's 4th quarter." (*The American Banker*, Tommy Fernandez, 12/10/02)

Freddie, BCE Emergis partnership

Stewart Mortgage integrates with Freddie's loanprospector.com

- Freddie's vice president of origination services, Patricia McClung appeared on stage with BCE senior vice president Gunnar Bergstrom, with the company's new electronic mortgage services division, to explain how BCE's broker origination tools would soon become part of loanprospector.com (see previous GSE report of December 16th), making it easier for lenders to interface with mortgage service providers and save money. Some had speculated as to whether Freddie was getting out of the technology business when it sold off the production of its web-based mortgage origination tools to Canadian firm BCE Emergis. Bergstrom was formerly with Freddie, but moved along with "a bunch of folks" over to BCE after the sell-off last fall.
- Bergstrom said the pilot for some of these vendor and other services through loanprospector.com would begin in the first quarter of next year and BCE hoped to begin rolling out these services commercially by the third quarter, 2003. He pointed to numbers indicating lenders are currently paying in the neighborhood of \$748 to close a loan that Freddie will buy. When all of the new tools are available at loanprospector.com, lenders will pay between \$400 and \$500 to close the same loan, with the difference gleaned from infrastructure savings. McClung said that initially there will be no fees charged to lenders. Fannie spokesperson Tonya Baltimore said Fannie would also be working to overhaul its legacy technology systems in 2003. (*National Mortgage News*, 12/16/02)

Stewart Mortgage integrates with Freddie's loanprospector.com

- Stewart Mortgage Information (SMI), a wholly owned subsidiary of Stewart Information Services Corp. (NYSE: STC) announced that its products and services are available through the new Freddie Mac web site, loanprospector.com. Stewart's chief operating officer, Kevin Gugenheim, said, "Integration with Loan Prospector seamlessly connects lenders to SMI services, further automating the steps from application to closing." Stewart was one of the first service providers on loanprospector.com. Stewart is a global real estate information company, providing title insurance and related information services through more than 6,300 issuing locations in the U.S. and several international markets, meeting the needs of the real estate and mortgage industries through delivery of information services required for

settlement using e-commerce. (*PR Newswire*, 12/16/02)

Freddie pledges \$10 million in Section 8 federal housing choice in State of Pennsylvania

- Freddie pledged to finance up to \$10 million in Section 8 mortgage vouchers to assist low-income renters from Dauphine County, PA., to become homeowners in the coming year. The Dauphine initiative is a joint effort between Freddie and community groups and banks. Freddie will purchase the Section 8 voucher subsidized 30-year fixed rate mortgages originated by Waypoint Bank. (*National Mortgage News*, 12/9/02)

Federal Home Loan Banks

FHFB Chairman prepares plan to address multidistrict issues after legal opinion issued

- Chairman John Korsmo said an independent legal analysis affirms the Federal Housing Finance Board's authority to regulate terms of membership in the Federal Home Loan Bank System as part of its mandate to supervise the safety and soundness and housing-finance mission of the system. Korsmo said he will ask the Finance Board soon to adopt a resolution posing specific questions to the 12 Federal Home Loan banks, gathering information needed to permit the board, if it so decides, to design a modern membership structure. Questions will center on how a new membership structure can preserve each bank's capital structure and cooperative nature. Once that information is collected and processed, Finance Board staff will develop a regulatory plan for broadening the capital base of each bank in the interests of meeting those regulatory goals. The Chairman would then begin a formal rule-making process, asking the Board to consider a proposed regulation by June. (Federal Housing Finance Board press release, 12/11/02)

Farm Credit System/Farmer Mac

Heritage Foundation analyst describes Farmer Mac as Las Vegas blackjack, calls for charter revocation

Farmer Mac slips out of limelight

- Daniel Mitchell, McKenna fellow in political economy at the Heritage Foundation, a conservative think tank, describes the GSEs as follows: "Imagine you go to Las Vegas to play blackjack. You have the money you've saved all year, and you hope to make it home with at least some of your savings. Then Uncle Sam shows up and says he'll bankroll your losses. Needless to say, with the risk of losing your savings eliminated, you'd be more bold, more likely to take chances. Even foolish ones. That's what happened now with the three principal government-sponsored enterprises (GSEs) designed to create a secondary market in mortgages—Freddie Mac, Fannie Mae and, for farmers, Farmer Mac." Mitchell contends the

GSEs, with huge implicit subsidies in the form of guarantees on the loans they make, are at risk because the government can play with an endless supply of other people's money. The government created the GSEs on the theory, he says, that it would be cheaper if GSEs could buy mortgages, bundle them together and sell them to investors, which could work unless the housing market falters. If mortgage delinquencies climb, the government is required to bail them out. GSEs' defenders say this isn't likely to happen, but forget the savings and loan crisis in 1990, when taxpayers got stuck with a bill for several hundred billion dollars.

- Farmer Mac, the smallest of the GSEs, has guaranteed more than \$5 billion of agricultural mortgages since the mid-1990s when politicians loosened restrictions requiring Farmer Mac to retain the first 10% of credit risk if loans go bad. Despite the subsidies, Farmer Mac still has sold only 15% of its outstanding loans, and to mask this problem, it created the Long-Term Standby Purchase Commitment, which allows farm lenders to retain their loans but pass credit and liquidity risks onto Farmer Mac. According to Mitchell, this "heads-I-win, tails-you-lose arrangement is a disaster waiting to happen, and probably violates the law since the product is not authorized under Farmer Mac's charter." Performance doesn't seem to impact Farmer Mac executives' benefits, with management and directors granted 13% of the company in the form of stock options and restricted stock. An additional 8% may have been granted since the proxy statement was issued, and the option program equals 35% of total shares outstanding. Mitchell concludes that GSE shouldn't stand for "Government-sponsored Enron" and urges lawmakers to "yank" the company's charter. (*The Washington Times*, editorial by Daniel Mitchell, 12/15/02)

Farmer Mac slips out of the limelight

- Three months after Gotham Partners published a report that placed Farmer Mac under media and Congressional scrutiny, the GSE's share price has rebounded somewhat, while trading in its bonds and derivatives that provide credit on those debt securities—has dried up. Shares of Farmer Mac, recently traded at \$30.07, were up from a low close this year of \$20.80 on July 18. Some concerns still resonate with analysts, however, such as Deutsche Bank's Alec Crawford: "From my perspective, the books on Farmer Mac are relatively opaque," with the company failing to provide, "...information on individual loans in their portfolio, or about third party guarantees which Farmer Mac provides." In late June, the Senate Agricultural Committee asked the GAO to examine safety and soundness issues with Farmer Mac, and GAO is currently working on a plan to gather this information, but has no date for the completion of its audit. In September, the House Subcommittee on Capital Markets, Insurance and GSEs, asked for information on short-selling in Farmer Mac stock, which Farmer Mac officials conceded might have occurred in violation of federal securities laws. A spokesman for Rep. Richard Baker, the subcommittee's chair, was not able to provide information on the SEC's response to the inquiry. (*Dow Jones Newswire*, 12/20/02)

Ginnie Mae

Federal Reserve still mulling buying Ginnie Maes

- The Federal Reserve is still weighing whether to buy Ginnie Mae mortgage-backed securities for its permanent account to supplement the supply of U.S. government debt, based on minutes from the central bank's policy makers from a November 6th meeting. The Fed already buys Treasury, federal agency and mortgage-backed securities in its temporary repurchase agreements that are used to make adjustments in the amount of money in the banking system and keep federal funds, the level for overnight loans between banks, in line with the Fed's target rate. Members expressed a consensus in favor of continuing to study the alternatives to Treasury obligations for potential future use, according to the minutes but recognized that outright purchases of Ginnie Maes for permanent additions to the system's portfolio would present a number of difficulties and would require extensive preparations for their effective integration.
- Purchases of Ginnie Mae debt, rated the same as government debt and backed by the government, could broaden the Fed's options if it wants to fight deflation by increasing money in the banking system, according to a strategy director at Barclays Capital, thereby reducing unwanted side effects on the bond market. Federal Reserve Governor Ben Bernanke acknowledged that with the U.S. budget in deficit and the Treasury increasing its borrowings, finding alternatives to Treasuries is less urgent than two years ago. Two years ago, when the U.S. was still projecting surpluses, the government said it might be able to retire all eligible outstanding Treasury debt within a decade, but with the return of budget deficits, Treasury is once again boosting the amount of debt it issues. (*Bloomberg News*, Simon Kennedy and Al Yoon, 12/12/02)

Sallie Mae

Judge dismisses part of Sallie Mae lawsuit

Sallie Mae acquires First Trust Financial in Weymouth, MASS

Prudential looks at Sallie's future under Republican governance

Consumer bankers call for reform of Federal student loan program

Sallie Mae prices \$500 million of short-term floating rate notes

Judge dismisses part of Sallie Mae lawsuit

- Sallie Mae prevails partially in a court battle against SLM by a third party loan broker, San Diego-based College Loan Corporation (CLC). The federal district court in the State of Virginia refused to issue an interpretation of the 1998-legislated "single holder" rule, which

has inhibited CLC and other non-traditional lenders from exploiting terms applicable to federally guaranteed consolidation loans in order to call away assets from Sallie and other participants in the Federal Family Education Loan Program. SLM has interpreted the “single holder” rule in such a way as to limit competition unfairly, the court also rejected allegations that Sallie has offered unfair enticements such as free software to colleges and universities to steer students to lenders that sell their loans to Sallie Mae, to lock up preferred lender status at schools (thereby denying its competitors business).

- CLC’s allegations that SLM has engaged in antitrust violation were also thrown out. Although the plaintiff will be allowed to re-plead its case in this regard. A top banking lobbyist described the verdict as a very positive outcome for Sallie Mae, removing a negative estimated \$50 million potential liability for SLM. College Loan was seeking an injunction against Sallie Mae and at least \$200 million in damages. The court refused to dismiss allegations that Sallie mishandled applications and loan verification certificates, allowing the case to continue on those narrower grounds. Sallie’s spokesperson said that Sallie had processed all consolidation loans in the letter and spirit of the law. (*Associated Press Online*, 12/12/02)

Sallie Mae acquires First Trust Financial in Weymouth, Massachusetts

- Sallie Mae announced it has completed purchase, for an undisclosed amount, of First Trust Financial (FTF), a mortgage banking company with headquarters in Weymouth, MASS. The acquisition, which closed last week, is meant to supplement in-house, fee-based mortgage origination activities that have been done by Sallie’s own SLM Financial Corporation subsidiary since 1999. First Trust, founded in 1991 and a \$300 million per year producer, will continue its 18-person operation as a wholly owned unit of SLM Financial. Sallie launched SLM Financial subsidiary in 1999 to meet the changing needs of the company’s growing customer base, providing career training loans to students participating in a technical or specialized training program and originating mortgage and consumer loans to help individual finance home purchases and other major expenditures. Sallie Mae’s senior vice president, Joseph Corvaia commented, “First Trust Financial will help us to continue to meet our core customers’ financial services needs after they have left school.” FTF President Peter Thorbahn currently sells its production, a mix of conventional, jumbo and government—into the secondary market, servicing released, but while Thorbahn said it has no immediate plans to begin servicing home mortgages, he does not rule it out for the future. (*PR Newswire*, 12/11/01 and *National Mortgage News*, Paul Muolo, 12/16/02)

Prudential looks at Sallie’s future under Republican governance

- When direct lending emerged under the Clinton Administration as a real threat to Sallie Mae and other private lenders, the birth of the GDSLPL also witnessed three uplifting forces: 1) a dissident shareholders’ movement, 2) the 1994 election of a lender-friendly GOP Congress, and 3) 1996 enactment of privatization legislation. The late ‘90s brought about a second battle over direct lending, and a full-circle return to bipartisan FFELP support. Three other positives have emerged since then for Sallie Mae: The Bush Administration, the FY02 budget resolution (which contained a free and permanent fix to the constant threat of a shift in lender yields) and the return to a more lender-friendly Republican-controlled Senate after

last month's mid-term elections. President Bush came into office after having held a campaign event at Sallie Mae headquarters in summer 2000, tapping Education Secretary Rodney Paige, who'd served as president of a FFELP college, and appointing to key administrations at DoEd a number of talented individuals with previous ties to the student loan industry.

- When the Republicans defied the historical pattern of mid-term congressional losses by the party controlling the White House, Sallie Mae and the lenders gained again. While Senator Kennedy enjoys positive relations with the FFELP lender community, the shift of the HELP Committee to incoming Chairman Judd Gregg (R-NH) might provide an additional measure of lender-friendly support during the upcoming HEA authorization cycle. However, Senator John Edwards (D- NC), a possible Democratic presidential contender in '04, recently proposed an expensive new set of college scholarships, including calling for full "direct" lending to help pay for it, investors were caught by surprise. On November 21, the day of Edwards' announcement, shares of student loan industry SLM Holding Company traded down from an intraday high of \$106.23 to close at \$103.95, and bottomed six days later at \$97.52, and since rebounded.
- Although the new Congressional and White House alignment bode well for the FFELP program and its stakeholders, there are no guarantees given the politics of student loans. (SLM Holding Corp. is rated a "hold" by Prudential Securities' Specialty Finance analyst Brad Ball.) Prudential Financial's *Washington Research Financial Services*, Charles Gabriel, 12/13/02.

Consumer bankers call for reform of federal student loan program

- Consumer banker representatives urged reform of the federal student loan consolidation program because it has become costly and not a necessity for the needy. Reform of the program is expected to come under discussion as part of a reauthorization of the Higher Education Act expected during the upcoming Congress. John Dean, counsel to the Consumer Bankers Association, said at CBA's Student Lending conference that consolidation loans are being locked in at 4% rates for borrowers for up to 30 years and could become a substantial drain on the government, and that many persons receiving federal subsidies are not in need of them. He suggested that a key question should be whether borrowers who are out of school should continue to be subsidized.
- One program change could be to make funds available to students who need them but without draining the treasury, such as extending repayment periods on loans before they are consolidated, to lessen the need to consolidate at all. A DoEd spokesperson noted that the upcoming reauthorization is not likely to be as extensive as the one in '98 on the financial side but could be bigger than higher education institutions would like on the "accountability" issue. (*BNA*, Karen Werner, 12/10/02)

Sallie Mae prices \$500 million of short-term floating notes

- Sallie Mae announced an offering of \$500 million of short-term floating rate notes, priced at par to yield a variable rate equal to 5 basis points above the bond equivalent yield of the 91-

day U.S. Treasury bill auction rate and are due June 19, 2003. Sallie generally issues such notes on a monthly basis. (*PR Newswire*, 12/16/02)

Postal Service

President Bush signs Executive Order to re-invent postal service, commission to be co-chaired by former Fannie chairman

Various interest groups comment on new commission

President's Executive Order to re-invent postal service, headed by two corporate executives

- The bipartisan commission will be headed by two corporate executives, James A. Johnson, the vice chairman of Perseus, a financial services company, and Harry J. Pearce, the chairman of the Hughes Electronic Corporation, the satellite-t.v. company controlled by General Motors, who will serve as co-chair. The commission will be charged with identifying problems and proposing solutions for the postal service, which at last fiscal year's end, reported \$11 billion in losses and outstanding loans. The panel's findings are expected to pave the way for the first major reorganization of the postal service since 1971. The service is the foundation of a \$900 billion domestic mailing industry, which represents about 8% of the nation's GDP and has 9 million workers. In recent years, the USPS has been shaken by competition from the private sector, including overnight delivery, and growing use of the Internet to send mail and pay bills.
- Mr. Johnson, is a former chairman of Fannie Mae, and chairman of the board of the Brookings Institution. Mr. Pearce, an engineer and lawyer, is former vice chair of General Motors. Other commissioners include, Dionel Aviles, president of the Aviles Engineering Corporation in Texas; Don Cogman, chairman of CC Investments in Scottsdale, AZ; Carolyn Gallagher, the former chief executive of Texwood Furniture in Taylor, TX; Richard Levin, President of Yale; Norman Seabrook, president of the New York City Correction Officers Benevolent Association; Robert Walker, chief executive of the Wexler Group in Washington; Joseph Wright, chief executive of PanAmSat in Wilton, CT. (*The New York Times*, Christopher Marquis, 12/11/02)
- The postal commission is part of President Bush's plan to allow private contractors to compete for nearly half of the government's civilian job in coming years. Postmaster General John Potter plans to fight to maintain the government commitment to provide affordable mail service to the nation's residents. The USPS announced December 10th that it had delivered fewer pieces of mail to more addresses during the last fiscal year, but lost less money doing it than officials had anticipated. The postal service has not turned a profit since 1999. Mail volume declined by 4.6 billion pieces in the fiscal year that ended September 30th. USPS finances were improved, however, by the postage rate increase that took effect in June when first-class stamps by 3 cents rose to 37 cents. (*The Washington Post*, Mike Allen and Christopher Lee, 12/11/02)

Citizens Against Government Waste disappointed with postal commission's first press conference.

- CAGW, a nonprofit organization dedicated to eliminating waste, fraud, mismanagement and abuse in government, applauded President Bush for establishing a reform commission, but expressed dissatisfaction with the commission not getting to the root of the problem, which is competition. "This is no time to be tinkering around the edges at USPS when invasive surgery is needed," said CAGW Vice President Leslie Paige. Paige questioned why privatization appeared to be taken off the table, noting that privatization is not an ideological position, but rather a pragmatic approach that other countries successfully have pursued, and consistent with the Bush Administration's support for outsourcing throughout government to reduce costs and increase efficiency. USPS does not operate free of taxpayer subsidy, touts CAGW, since postal ratepayers are captives due to a first class mail monopoly which in essence forces the public to pay up, in essence, a tax. USPS has been allowed to borrow \$11 billion at lower-than-market rates from the Treasury, i.e. from taxpayers, an expense within the government's budget, and finally, USPS operates largely tax free, in effect, a transfer payment from private enterprises and individual taxpayers to the postal service. CAGW commended the appointment of Joseph Wright, a former OMB Director and long-time supporter of the Grace Commission and CAGW, who was named to the commission. (*PR Newswire*, 12/11/02)

Christian Science Monitor editorial sees need for USPS overhaul

- The USPS is threatened by instant, worldwide electronic communication, stronger direct competition and its own cumbersome, union-clad bureaucracy. With a loss of some \$6 billion since 1971, the need for overhaul is clear, but the commission should proceed carefully on privatization. The essence of the postal service, universal service at universal rates, runs counter to privatization. Would a native American on a Navajo reservation end up paying more than a downtown Washington DC resident, and would a MacDonald's in every post office be far behind? What of the hometown feel the federal post office brings to smaller communities. The post office needs to generate reasonable returns, and the commission should include a mandate for lower prices achieved through cost cutting, and reducing delivery days where practical. (*Christian Science Monitor*, editorial, 12/11/02)

APWU challenges commission's role

- William Burrus, the head of the largest postal union, labeled the White House appointment of a Commission on the U.S. Postal Service "a thinly-veiled attempt to dismantle the Postal Service as we know it. The Bush Administration is responding to the requests of the right wing of the Republican Party and the large mailers." Burrus said, "This act of the president puts in motion the most serious effort in more than 200 years to modify the underpinnings of the U.S. Postal Service, including universal service, uniform rates and six-day delivery." Burrus mentioned the threat of a substantial degradation of mail service to rural areas and the inner cities, or any areas not deemed profitable by large volume mailers and presort companies. Burrus faulted the time allotment of six months for the report, arguing that the commission members, who have no prior postal experience, can't capture the essence of an institution with 230 years of history, 750,000 employees and 38,000 facilities, in such a short

period of time. The APWU President said, “It will require all of the resources at our disposal to turn back this tide of privatization.” Burrus, however, also said APWU “...looks forward to working with the commission to compile a report recommending changes to the Postal Service that will protect universal service at universal rates.” (*APWU Press Release*, 12/11/02)

Direct Marketing Association and Mailing Industry CEO Council laud empanelling of postal commission

- The DMA’s President and CEO, Robert Wientzen, applauded the inauguration of the postal commission, saying he had written the President earlier this year requesting the creation of such a commission to examine the financial and structural underpinnings of the USPS after legislative reform efforts reached an impasse. Wientzen described the USPS as a “vital cog” and said the commission should focus on constructive recommendations to guarantee the continued viability of the postal service. The DMA is the leading and largest trade association for businesses interested in interactive and database marketing, with almost 4,700 member companies from the U.S. and 53 other nations. DMA said it would be working with Congress to correct an error in the current formula for funding employee retirement as well as addressing the need to modernize the service’s 30-year plus old business plan. (*PR Newswire*, 12/11/02)
- Pitney Bowes Chairman and CEO Michael Critelli, president of the CEO Council, described the commission’s forming as a critical first step toward essential reforms in the system. The CEO Council emerged earlier this year from the Mailing Industry Task Force, and had called upon the President October 30th to establish a postal commission. The Council is made up of corporate leaders of 17 major companies, including Hearst magazines, Readers Digest Association, Lockheed Martin, FedEx, Lands’ End, and Time, involved in different aspects of the mailing industry, and has been focused on Task Force recommendations contained in the postal service’s transformation plan, and is working to promote legislative reforms. Its members are leaders of companies that depend on the postal system for much of their business (the \$900 billion mailing industry employs approximately 9 million people). (*PR Newswire*, 12/11/02)
- Neal Denton, executive director of the Alliance for Nonprofit Mailers, a Washington-D.C.-based advocacy group, along with other postal management groups and large mailers, welcomed the new presidential commission. Denton praised the commission as “...our best hope for keeping rates down during these competitive times,” and said the commission did not appear to be an attempt at privatization but instead, was in keeping with Postmaster General John Potter’s transformation plan. The commission is expected to examine more flexibility over prices, more freedom to introduce new services and more cost control, especially over labor costs. Treasury Undersecretary Peter Fisher, who announced the commission, claims everything is on the table for discussion, but that two things are out of bounds: 1) leaving the existing business model in place and the costs rolled up on the taxpayer and 2) existing costs rolled up on the rate payer. Treasury will fund the commission and provide administrative support.

- The National Association of Postal Supervisors (NAPS) also welcomed the commission, and NAPS President Vincent Palladino acknowledged that a commission was the only way to get any reforms accomplished. He added that he expects flexible pricing and containing costs to be at the top of the commission’s agenda. The National League of Postmasters President, Steve LeNoir, said there were some serious concerns, particularly with regard to rural post offices and universal service (identified by the Postal Service as 6-day service to every address at a uniform rate), but recognized that his organization wanted to do “what’s good for the whole organization.”
(*federaltimes.com*, Dan Davidson, 12/16/02)

Senator Grassley cites 50 complaints about postal inspector Corcoran

Montana congressman angry over USPS abandonment of airmail service to rural areas; editorial takes different tack

- Senator Chuck Grassley (R-IA), faulted the inspector general of the post office for wasting money on “team building” retreats and for intimidating staffers who do not embrace her management style. Grassley said his office has received some 50 complaints from current and former auditors and investigators about Postal Inspector General (IG) Karla W. Corcoran. Grassley, who is preparing to take the helm of the Senate Finance Committee in January, is investigating the complaints, and plans to send Mrs. Corcoran a letter with detailed questions about the charges. A deputy auditor said that the “values” training takes up “maybe five percent” of staff time, and Mrs. Corcoran disputed the allegations of intimidation. Yet former staffers claim “public floggings” are common and that the staff spends time building “gingerbread houses and going on leadership retreats” to learn teamwork values, costing tens of thousands of dollars. Mrs. Corcoran has been in the position since 1997 when the post was created (IGs serve 7-year terms), and before then, she served on then-Vice President Gore’s National Partnership for Reinventing Government. (*The Washington Times*, James Lakely, 12/16/02)

Montana congressman angry over USPS abandonment of airmail service to rural areas; editorial takes different tack

- Congressman Denny Rehberg (R-MT?) Is upset over the postal service’s decision to abandon airmail service to rural areas, including parts of Montana, in favor of more economical deliveries by truck. In a press statement, the Montana representative said, “...we’re just going to fight it every step of the way so that Montanans get the same quality, speedy service that everyone else gets from their postal carriers.” The editorial argues that “...we’ll be darned if we want to pay the \$25 million it costs the Postal Service to subsidize rural airmail, and we can’t in good conscience demand that others pay the cost, either.” Airmail is a convenience, not a necessity, and the postal service is supposed to be self-sustaining sine 1982, yet it’s lost \$676 million in the last year. Airmail subsidies have a second benefit of subsidizing commercial airline services to some communities, but that’s another costly service that only makes sense if someone else pays the bill. (*Montana forum.com*, editorial: Airmail’s value

depends on who pays, 12/11/02)

December 20, 2002

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