

The **GSE** REPORT TM

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- Some bondholders and analysts would like the GSEs to disclose more information on their MBS
- Congressional Research Service (CRS) says Fannie & Freddie’s exemption from SEC requirements saves the GSEs millions of dollars each year and adds to the market perception that their securities have an “implied guarantee” from the federal government ([p. 17](#))
 - Despite Fannie & Freddie’s July 12 agreement that they would voluntarily register their common stock with the SEC, CRS believes the Shays/Markey bill (HR 4071) “remains relevant”
 - HR 4071 would require greater disclosure on securities issuances by Fannie & Freddie and remove an advantage that the GSEs have over their mortgage market competitors
 - CRS notes that HR 4071 would improve disclosures about Fannie & Freddie’s individual debt and MBS
 - “Some improvement in data available to investors in mortgage-backed securities could allow greater efficiency and better investor protection in those markets.”
 - Fannie & Freddie argue that subjecting them to SEC registration would interfere with home buyers’ ability to lock in mortgage interest rates, however, CRS notes that “the GSEs should be able to hedge the interest rate risk using derivatives or other risk management tools, with minimal impact on home buyers”
 - Impact on home buyers of imposing SEC fees on Fannie & Freddie would “be insignificantly and unmeasurably small”
 - “It is not going to do any harm for them to disclose the way other companies do,” says CRS’ Mark Jickling
- Capital Markets Subcommittee Chairman Richard Baker (R-LA) schedules a GSE hearing for July 23 ([p. 19](#))
 - OFHEO will testify on its risk-based capital rule for Fannie & Freddie and the recent voluntary financial disclosure agreement
- *Wall Street Journal* July 15 editorial reviews Fannie & Freddie’s voluntary financial disclosure agreement and calls Fannie & Freddie’s lack of disclosures on their debt and MBS “troubling” ([p. 19](#))
 - “So congratulations to Fan and Fred for seeing the light, and we hope there will be more light to come, in particular a voluntary decision to disclose the same information on their mortgage-backed securities that their competitors do. Perhaps Fan and Fred are as rock-solid financially as they claim, in which case they have nothing to fear from the same disclosure that other public companies make.”
- *Wall Street Journal* July 1 editorial says Fannie & Freddie’s exemption from SEC requirements provides a big market advantage over private companies that are required to register with the SEC ([p. 20](#))
 - Editorial points out the advantages that the GSEs enjoy as a result of their MBS and securities exemption from SEC requirements
 - Editorial notes, “Fan and Fred know more than other investors, so they can cherry-pick higher quality, less risky securities for their own portfolios and leave the dogs for everyone else.”
- *The Economist* calls Fannie & Freddie’s voluntary disclosure agreement “a start, but only a start” since Fannie & Freddie will still be exempt from registering their debt and MBS with the SEC ([p. 22](#))
 - “A test for how well Congress can reorder America’s financial system is whether it tames its own wayward children” (Fannie, Freddie, and the FHLBanks)
- *Christian Science Monitor* editorial says Fannie & Freddie must go further than their voluntary financial disclosure agreement and recommends their MBS be subject to SEC registration requirements as well ([p. 23](#))
- Merrill Lynch report compares private label MBS issuer disclosures and agency (GSE) MBS disclosures and notes that there is less information provided in the GSEs’ disclosures ([p. 23](#))
- Congressman Ron Paul (R-TX) introduces GSE bill (HR 5126) that would remove the GSEs’ line of credit to the Treasury and eliminate the Fed’s purchasing of the GSEs’ debt ([p. 23](#))

Fannie Mae and Freddie Mac

- Government Accounting Office (GAO) recommends OFHEO not include new business assumptions into its stress test used to establish Fannie & Freddie’s risk-based capital requirements ([p. 24](#))
 - GAO notes that Fannie & Freddie’s implicit government guarantee limits market discipline and limits the benefits of the GSEs’ “voluntary initiatives” to increase transparency and market discipline
- Brokers raise concerns about Fannie & Freddie’s “modifiable mortgage” product ([p. 25](#))
- Congressman Barney Frank (D-MA) does not believe Fannie & Freddie pose a risk to taxpayers ([p. 26](#))
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 - (1) Foreign purchases of Fannie & Freddie’s debt have slowed
 - (2) Foreign investors are not dumping Fannie & Freddie’s debt despite a slumping US dollar
 - (3) Fannie doubles the size of its minimum callable debt
 - (4) Freddie’s decision not to issue its Euro-denominated debt as it planned in June surprises the European market
 - (5) Fannie increases debt buybacks
- Fannie & Freddie expand their outreach to credit unions ([p. 28](#))
 - Fannie launches an alliance with the National Association of Federal Credit Unions (NAFCU); Freddie is working on an alliance with the Credit Union National Association (CUNA)

Fannie Mae

- Fannie releases requirements for electronic mortgages ([p. 28](#))
 - Fannie develops its own registry for lenders to sell Fannie their eMortgage notes
- 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. 29](#))
 - 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’s portfolio of Low-Income Housing Tax Credit (LIHTC) investments now exceeds \$2 billion ([p. 30](#))
- Freddie and the National Urban League announce initiative ([p. 30](#))
- Freddie’s Jim Park promoted to Vice President of Industry Relations and Housing Outreach ([p. 30](#))

Federal Home Loan Banks

- Federal Housing Finance Board (FHFB) approves the FHLBanks of Des Moines, Indianapolis, New York and Topeka capital plans ([p. 31](#))
 - FHFB has now approved all 12 FHLBank capital plans
 - America’s Community Bankers expresses concerns about the FHLBank of Chicago’s capital plan
 - The FHFB regulates the FHLBank System
- Regulatory relief bill, which contains a provision that would allow privately insured credit unions to join the FHLBank System, passes the House Judiciary Committee ([p. 32](#))
- Total Mortgage Partnership Finance (MPF) program loans outstanding top \$30 billion ([p. 32](#))
 - The FHLBank System’s MPF program is a competitor to Fannie & Freddie in the secondary mortgage market

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- House Financial Services Committee approves housing omnibus bill containing a provision repealing the 50% increase in the Ginnie Mae guarantee fee ([p. 33](#))
 - Amendment to the omnibus bill establishing a housing trust fund will no longer use surplus FHA and Ginnie Mae money

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- Gotham Partners releases second report raising concerns about Farmer Mac ([p. 34](#))
 - Gotham argues that Farmer Mac is not accomplishing its mission, may be violating its charter and has not reduced lending rates for farmers and ranchers
- Farmer Mac disclosed less financial information in 2001 than in 2000, reports the *New York Times* ([p. 35](#))

Postal Service

- Momentum is building for a Presidential postal reform commission ([p. 35](#))
- *National Journal’s Congress Daily* notes that Postal Service’s problems are igniting a lobbying battle between some of corporate America’s largest businesses ([p. 36](#))
- Postal Service’s June 30 postal rate increase raises revenue but could cause problems in the long run, reports *Knight Ridder* ([p. 36](#))
- Americans for Tax Reform calls the Postal Service’s June 30 postal rate increase a “tax” ([p. 37](#))
 - Believes that the Postal Service’s transformation plan and the recent postal reform legislation are bad ideas
- Heritage Foundation calls the Postal Service’s transformation plan “insufficient” ([p. 37](#))
- *Boston Herald* editorial calls for privatization of the Postal Service ([p. 38](#))
- Postal Service lost \$281 million in the last three months - on track to lose nearly \$2 billion in FY 2002 ([p. 38](#))
- Government watchdog groups and taxpayers raise concerns about the Postal Service’s sponsorship of the Tour de France while the Postal Service is facing financial problems ([p. 38](#))
 - *Indianapolis Star* says the Postal Service spends too much money on activities (such as the Tour de France) that have nothing to do with delivering the mail
 - *Houston Chronicle* and *Slate* question why the Postal Service is spending so much money sponsoring the Tour de France

Major Events

Capital Markets Subcommittee holds July 16 hearing to hear Treasury's views on the GSEs, in general and HR 4071

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Congressmen Baker and Shays do not believe that the agreement solves concerns about GSEs

Congressmen Baker and Shays request that Treasury release the written agreement – Congressman Shays requests that SEC Chairman Harvey Pitt testify on the specifics of the agreement

Treasury calls on all GSEs to comply with the same SEC financial disclosure rules recently agreed to by Fannie & Freddie

Treasury does not support removing the GSEs' exemption from registration of their MBS at this time because it would disrupt the market and will instead conduct a joint study with SEC and OFHEO to promote a more level-playing field between GSEs and non-GSE MBS issuers

Treasury acknowledges that despite the agreement, Fannie & Freddie are not subject to the same SEC requirements as other publicly traded companies

Treasury has no position on removing the GSEs' line of credit to Treasury

Treasury supports removing OFHEO from the appropriations process

Congressman Ron Paul (R-TX) discusses a new GSE bill that he introduced on July 15

Treasury is asked to address concerns about Farmer Mac

Federal Housing Finance Board supports increased financial disclosure requirements for the FHLBanks but acknowledges that complying with the same SEC financial disclosure rules recently agreed to by Fannie & Freddie "may be tricky"

- The House Financial Services Committee's Capital Markets Subcommittee held a hearing on July 16th to hear testimony from the Treasury Department on the GSEs, in general, and HR 4071 – the bill sponsored by Congressmen Chris Shays (R-CT) and Edward Markey (D-MA) that would repeal Fannie and Freddie's

exemption from SEC requirements. Capital Markets Subcommittee Chairman Richard Baker (R-LA) chaired the hearing. Treasury Undersecretary Peter Fisher was the only witness.

- The hearing focused on the July 12th announcement by Fannie and Freddie that they planned to voluntarily register their common stock with the SEC while maintaining the exemption from registering their debt and MBS with the SEC. [Further information on the July 12th announcement is available in this *GSE Report*.] Therefore, Fannie and Freddie will not register their debt or MBS with the SEC as do other publicly traded companies. The announcement reflected an agreement between Fannie and Freddie, the SEC, OFHEO and Treasury. Under the agreement, Fannie and Freddie would be subject to the Securities Exchange Act of 1934 ['34 Act] which requires a publicly traded company to provide periodic disclosure requirements about the financial condition and management of their company but would not subject Fannie and Freddie to the Securities Act of 1933 ['33 Act] which requires a publicly traded company to submit a registration statement and prospectus when bringing new issues to market [such as debt and MBS].
- The Shays-Markey bill would among other things, subject Fannie and Freddie to mandatory registration of their securities, common stock, debt and MBS with the SEC, as well as subject Fannie and Freddie to all SEC laws and requirements governing all other publicly traded companies. The bill repeals Fannie and Freddie's exemption from both the '33 and '34 Acts.
- Despite the voluntary agreement, both Congressmen Baker and Shays said they will continue with their efforts to address concerns about the GSEs. "It's going to take more than that [voluntary agreement] in substantive change for me, in legislative terms, to go away," Congressman Baker told reporters after the hearing (*Dow Jones Newswire*, Dawn Kopecki, 7/16/02). Congressman Baker hopes to bring a new GSE proposal or approach before Congress early in 2003 and said he will continue to press for a single regulator for the GSEs (*Reuters*, Mark Felsenthal, 7/16/02). Both lawmakers were concerned that the GSEs' MBS and debt would still be exempt from the SEC requirements to which all other publicly traded companies are subject.

In summary:

1. **Treasury Department does not support HR 4071** – Treasury said it doesn't support the bill because it focuses only on two GSEs (Fannie and Freddie) and because Treasury is not prepared to support repeal of Fannie and Freddie's exemptions from the '33 Act.
2. **Treasury Department is pleased with Fannie and Freddie's July 12 agreement** to voluntarily register their common stock and be subject to the SEC requirements under the '34 Act.
3. **Congressmen Baker and Shays do not believe Fannie and Freddie's voluntary agreement solves concerns about GSEs** – Congressman Baker noted that the voluntary agreement was a positive change but at the end of the day more study may be required. He asked Fisher whether he was suggesting that subjecting Fannie and Freddie to the '34 Act solves all the concerns about the GSEs. Fisher responded, "No, I'm not," but noted that Treasury was suggesting some significant steps including: (1) subjecting Fannie and Freddie to the '34 Act; (2) encouraging that all GSEs be subject to the '34 Act; and (3) examining the disclosure requirements of all GSE and non-GSE MBS issuers. Congressman Baker noted the voluntary agreement doesn't go far enough to assure that investors completely understand the risks of GSE portfolios.

Congressman Shays called the agreement a "gigantic step in the right direction" but he was still concerned as to why the GSEs are allowed to live under different rules than other publicly traded companies.

4. **Congressmen Baker and Shays request that Treasury release the July 12 written agreement – Congressman Shays requests that SEC Chairman Harvey Pitt testify on the specifics of the agreement** – Congressmen Baker and Shays had very specific questions about the agreement including how it would apply to the GSEs, how it would be enforced, and its comparability to what other publicly traded companies are required to disclose. They wanted to see the written agreement to address these issues.

Fisher testified that he believes that Fannie and Freddie will be subject to all aspects of the '34 Act, subject to the interpretation of the SEC as it applies to these two companies. Congressman Shays suggested that SEC Chairman Pitt testify before the Subcommittee to explain the specifics of the agreement and how they would apply to the GSEs.

In August, publicly traded companies will be asked to sign a pledge giving their personal guarantee that their company's financial statements are correct. Fisher was unsure whether Fannie and Freddie would be subject to this requirement due to the timing of when Fannie and Freddie will actually be in compliance with SEC requirements. He thought it would be up to the SEC. [In an interview with *CNBC*, Fannie's CEO Franklin Raines noted that "technically," Fannie "will become a registrant at the end of this year" and so they "wouldn't be covered by the request by the SEC." He noted, however, that Fannie is "going to make that certification anyway." (*CNBC Business Center News Transcripts*, 7/12/02)]

Congressman Shays asked Fisher whether investors would have the ability to sue Fannie and Freddie in the same manner as other publicly traded companies were subject under current SEC requirements. Fisher was unsure whether this would apply to Fannie and Freddie. Congressman Shays also noted that recent bills to protect investors and improve financial disclosures in light of Enron and WorldCom do not apply to Fannie and Freddie.

5. **Treasury calls on all GSEs to comply with the same SEC financial disclosure rules recently agreed to by Fannie & Freddie under the '34 Act** - Treasury Department believes all GSEs should comply with the same disclosures required of the '34 Act, as interpreted and applied by the SEC. This can be done without legislation, as Fannie and Freddie have accomplished through their July 12 agreement to voluntarily register their common stock with the SEC, which will ensure that they are subject to the same disclosure requirements as other publicly traded companies under the '34 Act. Treasury recommended that other currently exempt GSEs make similar arrangements to voluntarily register with the SEC under the '34 Act. [Farmer Mac is the only GSE that is fully subject to SEC securities laws.]

Fisher stated, "Given the size and importance of each of the GSEs' operations in our capital markets and banking system, continued operation outside of the SEC-administered corporate disclosure regime is inconsistent with our objective for investor protection and for a sound and resilient financial system and will only hamper our efforts to bring even more capital to bear on the objective of affordable housing and, more generally, on all the objectives served by GSEs...the GSEs – and particularly the three housing GSEs – are no longer modest experiments on the fringes of our financial system. They are large, rapidly growing and important players in our capital markets and in our banking system. As such, they need to be role models for our system of investor protection, not exceptions to it."

6. **Treasury Department is not ready to support repeal of the GSEs' exemption from the '33 Act – Treasury does not support removing the GSEs' exemption from registration of their MBS at this time because it would disrupt the market and instead will conduct a joint study with the SEC and OFHEO to promote a more level-playing field with respect to initial offering disclosures between GSEs and non-GSE MBS issuers.** "Requiring the GSEs to register their securities under the '33 Act

could have certain benefits, including uniformity and consistency of disclosures for new offerings. But such a change has the potential for disrupting a large and well-functioning market and imposing burdens and added costs.”

Fisher said the study will be completed early in the next session of Congress, however Congressmen Baker and Shays requested that the study be completed by the end of the calendar year.

During the question and answer period, Fisher stated that in his opinion, having Fannie and Freddie register their MBS with the SEC would disrupt the housing market. Congressman Shays said that Fannie and Freddie “play by different rules” and asked Fisher how other companies registered their MBS offerings without disrupting the markets. Fisher responded, “It’s a question of the size and scale of the operations. And I think that even some of the harshest critics of these two enterprises think that it’s a fair question as to whether this would disrupt the mortgage markets. And it’s my opinion that it would,” Fisher replied. If anything, said Congressman Shays, Fannie and Freddie’s volume ought to make people embrace more, not less, disclosures. Fisher said he, too, was usually a proponent of disclosure, but that “liquidity was important,” too. Congressman Baker said that while he understands Fisher’s position, he doesn’t agree with it (*New York Times*, Alison Leigh Cowan, 7/17/02; *Dow Jones Newswire*, Dawn Kopecki, 7/16/02). Congressman Baker further stated that he doesn’t understand why the private MBS market should be treated differently than the GSEs’ MBS. He still thinks there is a significant difference between the disclosure requirements in the private market and the GSEs’ market.

In terms of the volume of GSE MBS - Treasury noted that out of a total MBS market of \$3.9 trillion, over \$2.3 trillion in GSE issued MBS outstanding have come into the market completely outside the requirements of the ’33 Act. There are also, at present, \$916 billion in MBS issued by non-GSEs that are subject to some but not all of the provisions of the ’33 Act, under certain limited exemptions for “mortgage-related securities.”

Fisher noted that there are prepayment and credit risks with regard to the GSEs’ MBS and that both issues would be examined in the joint study.

7. **Fisher acknowledged that despite the voluntary agreement, Fannie and Freddie are not subject to the same SEC requirements as other publicly traded companies** – Congressman Bob Ney (R-OH) questioned Fisher as to whether Fannie and Freddie would be subject to the same SEC requirements as GE Capital. Fisher believes that the level of disclosure by GE Capital’s parent company (General Electric) would be comparable to Fannie and Freddie under the ’34 Act but there is still a distinction between General Electric being held to the same standards under the SEC requirements of the ’33 Act, to which Fannie and Freddie are not subject.
8. **Fisher acknowledged that there may be parts of the ’33 Act requirements that could be applied to Fannie & Freddie** – During the question and answer period, Fisher acknowledged that in his opinion subjecting the GSEs’ MBS to the ’33 Act would disrupt the market but that he was not saying that additional disclosures aren’t needed. The joint study will examine all disclosures by GSEs and private-label issuers to create a level playing field between all issuers. Fisher noted that Treasury has not made up its mind whether there are parts of the ’33 Act that could be applied to Fannie and Freddie.
9. **Treasury has no position on removing the GSEs’ line of credit to Treasury** – Two years ago, Fisher’s predecessor Gary Gensler testified that the Treasury Department supported removing the GSEs’ line of credit to the Treasury. Fisher said that calling it a “line of credit is a misnomer” and that the Treasury Department does not have a position on the issue (*New York Times*, Alison Leigh Cowan, 7/17/02).

10. **Treasury supports removing OFHEO from the appropriations process** – In response to a question by Congressman Ken Bentsen (D-TX), Treasury noted that the Administration supports removing OFHEO from the appropriations process (a recommendation that was included in the President’s budget). Fisher noted that the Administration does not have a position whether OFHEO has the adequate resources and statutory authority to regulate Fannie and Freddie. He noted, however, that some financial disclosures (such as the recent voluntary financial disclosure agreement) might best be regulated by the SEC rather than OFHEO.
11. **Congressman Ron Paul (R-TX) discussed a new GSE bill that he introduced on July 15** – His bill would among other things, remove the GSEs’ line of credit with the Treasury and eliminate the Fed’s purchasing of the GSEs’ debt securities for monetary policy. He believes that Fannie and Freddie have caused a tremendous housing bubble that should be addressed. He does not think that subjecting Fannie and Freddie to SEC regulation would solve his concerns with the GSEs.

Congressman Paul said during the hearing that the “special privileges of Fannie and Freddie have distorted the housing market by allowing Fannie and Freddie and the Home Loan Bank Board to attract capital they would not attract under pure market conditions.” “The way I see it, the GSEs are now our savings and loans of the late-1970s,” he said. “You cannot keep a bubble going on forever” (*CBS Market Watch*, Mike Wilkening, 7/16/02).

12. **Concerns about Farmer Mac should be examined by Treasury** – Congressman Bentsen suggested that the Treasury Department should consider examining concerns that have been reported about Farmer Mac in the press recently and report back to the Subcommittee its findings. Fisher noted that Treasury currently has not taken an initiative on the issue of Farmer Mac but that the issue is certainly worthy of consideration.
13. **Several Members congratulated Fannie & Freddie on their voluntary compliance with SEC requirements.** Congressman Paul Kanjorski (D-PA), the Ranking Member on the Subcommittee, cautioned that moves to increase the GSEs’ disclosures need to be done carefully, deliberately and objectively. Congressman Kanjorski was concerned that subjecting the FHLBanks to the ’34 Act might encourage consolidation within the system and harm certain regions of the country and asked Fisher to keep this in mind when examining the FHLBanks. Fisher noted that currently the FHLBanks are already in compliance with parts of the ’34 Act, although Treasury would like them to be in full compliance with the ’34 Act. He noted that the Department has already had discussions with the FHLBanks on this issue.

(Source: Oral and written testimony from July 16 Capital Markets Subcommittee Hearing on the GSEs, unless otherwise indicated.)

FHFB supports increased financial disclosure requirements for the FHLBanks but acknowledges that complying with the same SEC financial disclosure rules recently agreed to by Fannie & Freddie “may be tricky”

- FHFB Chairman John Korsmo said July 16 that he strongly supports full disclosure requirements for the FHLBank System. Korsmo said he has initiated talks with the SEC and Treasury about expanding financial disclosures for the FHLBank System. “Through their congressional charter, the Federal Home Loan Banks have received real and presumed advantages that allow them to raise funds at low cost to fulfill the System’s public mission,” Korsmo said. “I firmly believe that the public has a right to know at least as much about the Home Loan Banks as they do about the publicly traded companies in their retirement funds.”

- As part of a cooperative system, the FHLBanks are not publicly traded corporations; all the stock is held by the member financial institutions. The Office of Finance prepares combined financial reports for the 12 Banks, which under current FHFB regulations must be consistent with SEC regulations S-K and S-X. “While the Federal Home Loan Bank System already meets many SEC requirements, I want to explore ways to maximize disclosure consistent with the cooperative structure of the System,” Korsmo said. “Each Bank is privately owned, but the value of each franchise is its status and privilege as a publicly endowed enterprise, and the public is therefore entitled to the full range of information about the System and its operations.” (*FHFB press release, 7/16/02*)
- **In an interview with *National Mortgage News*, FHFB Chairman John Korsmo acknowledged that complying with the same SEC financial disclosure rules recently agreed to by Fannie and Freddie “may be tricky” – “We are eager to cooperate to the extent we can be consistent with the fact that this is a different animal [FHLBank System] than Fannie and Freddie.” The article noted that like Fannie and Freddie, the FHLBank System is likely to resist registering its debt with the SEC.** (*National Mortgage News, Brian Collins, 7/22/02*)

<p>Federal Reserve Board Chairman Alan Greenspan says the issue of financial disclosures among GSEs needs to be examined further</p>

- In a July 16 appearance before the Senate Banking Committee, Chairman Greenspan was asked by Senator Jim Bunning (R-KY) whether the Tennessee Valley Authority (TVA) – currently exempt from SEC jurisdiction - should be under SEC jurisdiction. Greenspan stated, “...I am not familiar with the TVA issue, but I do know that Undersecretary Peter Fisher of the Treasury Department is testifying today on the GSE issue of registration and the like. There are several questions here which are emerging. One is not only honor (ph) securities, but also on mortgage-backed securities, which is a much more controversial issue. I think this issue is --- I think requires further examination. It is indeed – I don’t know what the consequences of the testimony is this morning. But I do think that issues such as you raise should be examined to determine what the appropriate role of GSEs and related organizations are with respect to the questions of disclosure.” (*CNNFN Transcript of Federal Reserve Board Chairman Alan Greenspan’s testimony before Senate Banking Committee, 7/16/02; Dow Jones Newswire, Deborah Lagomarsino, 7/16/02*)

Fannie & Freddie announce July 12 they will “voluntarily” register their common stock with the SEC but not their debt and MBS

Unlike other publicly traded companies, Fannie & Freddie will not be required to register their debt or MBS with the SEC

Treasury Department says that as a result of this voluntary disclosure agreement, they do not support HR 4071 - [Shays/Markey bill that would repeal Fannie and Freddie’s exemption from SEC requirements and would require the GSEs to register their debt and MBS with the SEC]

OFHEO abandons its plan to issue a rule-making requiring Fannie & Freddie to register their debt

Congressman Baker calls the announcement a “good start,” but looks forward to discussing with Treasury “the need for even fuller GSE disclosures down the road”

“Fannie Mae and Freddie Mac are to be congratulated for ‘voluntarily’ committing to disclose some of what the rest of the publicly traded Fortune 498 companies are required to disclose,” says Congressman Baker

Congressmen Shays and Markey say they will continue to push to have Fannie & Freddie register their debt and MBS

Mortgage Bankers Association (MBA) calls the voluntary disclosure agreement a “good first step” but believes Fannie & Freddie’s debt, equity and MBS disclosures should meet the SEC standards applied to other companies

Citizens Against Government Waste says “Fannie and Freddie opened their books, but not wide enough”

The voluntary disclosure agreement does not change Fannie & Freddie’s exemption from SEC requirements and has no effect on the status of Fannie & Freddie’s securities as “government securities”

Some bondholders and analysts would like the GSEs to disclose more information on their MBS

- Fannie and Freddie held a press conference with the SEC and OFHEO July 12 to announce that Fannie and Freddie plan to voluntarily register their common stock with the SEC. Fannie and Freddie will not, however, register their debt or MBS with the SEC. (*Reuters*, Mark Felsenthal, 7/12/02) **Not registering their debt and MBS annually saves Fannie and Freddie millions in dollars of fees that competitors in the mortgage finance market must pay and reduces the amount of information publicly available about their debt, sources in the Bush administration acknowledged.** (*Washington Post*, Kathleen Day and Jackie Spinner, 7/13/02)
- The agreement means that Fannie and Freddie have sidestepped for now – their biggest concern: full-scale securities legislation. (*Wall Street Journal*, John D. McKinnon and Patrick Barta, 7/15/02) Lawmakers have introduced a bill that would require Fannie and Freddie’s financial disclosures to go much further. Congressmen Chris Shays (R-CT) and Edward Markey (D-MA) introduced a bill (HR 4071) on March 20 that would repeal Fannie and Freddie’s exemption from SEC requirements and would among other things, require Fannie and Freddie to register their debt and MBS with the SEC.

- Fannie’s Chairman Franklin Raines says that Fannie has not issued stock since the early 1980s, but makes approximately 1,500 debt issuances and more than 40,000 mortgage-backed securities releases annually. (*Reuters*, Mark Felsenthal, 7/12/02)
- The announcement - a consensus agreement by the GSEs, the Treasury Department, OMB, the SEC, and OFHEO - was made at the SEC. (*Freddie press release*, 7/12/02) SEC Chairman Harvey Pitt, OFHEO Director Armando Falcon, Fannie’s Chairman and CEO Franklin Raines, and Freddie’s Chairman and CEO Leland Brendsel participated in the press conference.
- The Treasury, SEC, and OFHEO will also be conducting a joint study on MBS disclosures, with a goal of “ensuring that investors are provided with the information that they should have.” (*Statement of Treasury Secretary Paul O’Neill*, 7/12/02) By relegating it to a study, Fannie and Freddie were able to postpone the resolution of the more controversial question of whether they should be required to comply with SEC-like rules for registering their MBS and debt. (*American Banker*, Rob Garver, 7/15/02) However, the study may be a possible step toward further government regulation in the area where Fannie and Freddie have been most sensitive. The study will include disclosure for all MBS issuers, including private-label issuers that compete with Fannie and Freddie. Further disclosure requirements are still possible, officials said. (*Wall Street Journal*, John McKinnon and Patrick Barta, 7/15/02)
- OFHEO Director Armando Falcon said OFHEO plans to issue a new disclosure rule to “facilitate the implementation of this voluntary action.” (*OFHEO press release*, 7/12/02) “Their voluntary registration [of their stock] does not end the issue of disclosure,” said Falcon. (*Wall Street Journal*, John McKinnon and Patrick Barta, 7/15/02)
- Fannie and Freddie’s 2002 annual report in early 2003 will be the first disclosure made under the new agreement. Although the decision to register their common stock is voluntary, the disclosure requirements will be permanent since the decision isn’t revocable without SEC approval. “Of course we will have our full complement of enforcement authorities over these disclosures,” SEC Chairman Pitt said. “But I’m sure we won’t have to use them.” Pitt added, “This addresses the concern that however complete their disclosures were, it was strictly a matter of choice, not a requirement of law.” The registration of Fannie and Freddie’s common stock will not result in added fees for the companies since it is considered a new issue under SEC guidelines. (*Dow Jones Newswire*, Dawn Kopecki, 7/12/02; *Statement by SEC Chairman Harvey Pitt*, 7/12/02)
- Raines claimed that he proposed the idea of registration to SEC Chairman Harvey Pitt and to Treasury Secretary Paul O’Neill. Both men reacted positively, Raines said, and intensive talks with relevant agencies resulted. (*New York Times*, Daniel Altman, 7/13/02)

The agreement does not change Fannie & Freddie’s exemption from SEC requirements and has no effect on the status of Fannie & Freddie’s securities as “government securities”

- The agreement does not change Fannie exempt security status, and there is no effect on the status of Fannie’s securities as “government securities.” (*Fannie press release*, 7/12/02) Freddie announced that “there is no change in the SEC exemption that Congress provided for Freddie Mac’s securities in the company’s charter.” The SEC “confirmed that the actions taken have no impact on the status of Freddie Mac’s securities as exempt from securities offering registration requirements as well as other aspects of the federal securities laws. As a result, Freddie Mac’s access to worldwide capital markets will remain unhindered.” (*Freddie press release*, 7/12/02)

Treasury Department says that as a result of this agreement, they do not support HR 4071

- Congressmen Chris Shays (R-CT) and Edward Markey (D-MA) introduced a bill (HR 4071) on March 20 that would repeal Fannie and Freddie's exemption from SEC requirements.
- Treasury Secretary Paul O'Neill applauded Fannie and Freddie's "self-initiated compliance" with SEC disclosure requirements. "As a result of their actions, the Administration is not prepared to support repeal of the GSEs exemption from the Securities Act of 1933 and the Office of Federal Housing Enterprise Oversight is not pursuing a securities regime for Fannie and Freddie," stated Treasury Secretary Paul O'Neill. (*Statement of Treasury Secretary Paul O'Neill, 7/12/02*)

Fannie opposes the Shays-Markey bill and registering their debt and MBS

- "Some members of Congress have proposed that legislation be passed to require that all of our securities be registered with the SEC. We and virtually every element of the housing industry have opposed that proposal because we believe it would disrupt the flow of capital into the housing market...The SEC registration process was not designed to handle the unique securities market in which Fannie Mae operates," stated Fannie's Chairman Franklin Raines. He added, "The housing sector of the economy benefits by lifting the cloud of potential disruption to the housing finance system that registration of our debt and MBS would cause." (*Statement by Fannie's Chairman and CEO Frank Raines, 7/12/02*)

Announcement of new disclosures will make little difference to Fannie & Freddie

- "It was brilliant. They [Fannie and Freddie] gave nothing up," said Howard Shapiro, an analyst with Goldman Sachs. (*Reuters, Mark Felsenthal, 7/15/02*)
- Fannie and Freddie will have to submit periodic financial reports, proxy statements and reports that other issuers file with the SEC. But they already provide similar information to investors, so the immediate practical effect is relatively small. (*Wall Street Journal, John McKinnon and Patrick Barta, 7/15/02*)
- While the announcement represents a major policy change, it will not provide much more information to investors. (*Washington Post, Kathleen Day and Jackie Spinner, 7/13/02*)
- Michael McMahan, an analyst at Sandler O'Neill & Partners said the agreement cost Fannie and Freddie little but might be politically expedient. "It shouldn't make any difference, provided they disclose the same amount of information," he said. "If the cover says 'Form 10-K' as opposed to 'Investor Analyst Pack,' it doesn't matter to me." (*New York Times, Daniel Altman, 7/13/02*)

SEC Chairman Harvey Pitt's comments

- "Their [Fannie and Freddie's] decision will ensure that the important goals of mandatory disclosures that we have for all publicly traded companies will be accomplished," Pitt said in a letter July 12 to Congressmen Shays and Markey. "It continues to be our position that, because Fannie Mae and Freddie Mac sell securities to the public and have public investors, their disclosures should comply with the disclosure requirements of the federal securities laws and that compliance should be mandatory," Pitt wrote. (*Dow Jones Newswire, Dawn Kopecki, 7/12/02*)

OFHEO Director Armando Falcon's comments

- "I want to compliment Fannie Mae and Freddie Mac for their voluntary compliance with SEC disclosure requirements under provisions of the Securities Exchange Act of 1934...Through their action today, Fannie Mae and Freddie Mac have fulfilled a major part of our disclosure initiative. This step furthers the goals of the President's ten-point plan for corporate responsibility. OFHEO will promulgate a rule on disclosure that will facilitate the implementation of this voluntary action. In addition, together with the SEC, we will review the adequacy of information disclosures related to mortgage backed securities. Also, the review will

consider the appropriate manner for creating a more level playing field and greater comparability of disclosures that will enhance Enterprise safety and soundness. **Accordingly, OFHEO is not pursuing a securities registration regime for Fannie Mae and Freddie Mac.**” (*OFHEO press release, 7/12/02*)

- [Prior to Fannie and Freddie’s July 12 announcement, OFHEO Director Falcon had said that OFHEO would introduce a new rule to strengthen Fannie and Freddie’s financial disclosures, according to a June 28 OFHEO letter to John Graham, Administrator, Office of Information and Regulatory Affairs at the Office of Management and Budget. Falcon noted that OFHEO’s rule would establish mandatory disclosures “that are at, a minimum, comparable to those of other publicly traded companies.” Falcon believed that OFHEO was “uniquely positioned to evaluate” Fannie and Freddie’s financial disclosures and that OFHEO “is best positioned to determine what elements of the enormous amounts of information” developed by Fannie and Freddie “should be disclosed to the public.” Falcon noted that the proposed rule would contain the following: (1) periodic reports similar to what is required of SEC registered companies filing 10-Q, 10-K and 8-K reports; (2) registration of Fannie and Freddie’s stock and debt that “will facilitate registration in a manner that does not impede their ability to meet their financing needs;” and (3) supplemental disclosures beyond what is currently required of the SEC including the possible areas of interest rate risk, derivatives, and mortgage-backed securities. (*OFHEO Letter to OMB’s John Graham, 6/28/02*) OFHEO’s letter to Graham was in response to a May letter by Graham urging OFHEO to issue new rulemaking to strengthen the corporate governance of Fannie and Freddie and require Fannie and Freddie to make certain public disclosures.]

Fannie’s comments

- “This is a win-win situation for all,” said Fannie’s Chairman Frank Raines. “Fannie Mae is pleased to take the bold action President Bush has called for to support investor confidence by assuring that our world-class disclosures will continue in perpetuity.” Fannie said it intends to file a Form 10 with an appended Form 10-K in accordance with the SEC annual report deadline in early 2003. Going forward, Fannie said it will be required to submit to the SEC, Forms 10-K, 10-Q, and 8-K, the periodic financial reports required of SEC registrants. The reports will be available on the SEC’s EDGAR database. With its voluntary action, Fannie said it agreed that all periodic filings by Fannie would be (1) subject to SEC review in the same manner as the SEC reviews the filing of other registered companies; (2) subject to the provisions of Regulation FD (Full Disclosure); and (3) subject to the reporting of beneficial ownership – holders of five percent or more of Fannie’s stock will have to report their ownership to the SEC. (*Fannie press release, 7/12/02*)

Freddie’s comments

- “Freddie Mac already meets or exceeds SEC reporting standards, and today’s announcement leaves no doubt that Freddie Mac is subject to the same standards as every other public company,” Freddie’s Chairman and CEO Leland Brendsel stated. “Today’s announcement reinforces Freddie Mac’s commitment to maintaining the highest standards of disclosure, transparency and financial strength in fulfilling our statutory mission.” Freddie said it will file annual reports to the SEC on Form 10-K, quarterly reports on Form 10-Q and material event disclosures on Form 8-K. In addition, OFHEO will issue a supplemental disclosure regulation that will obligate Freddie to submit proxy statements and insider trading reports to the SEC. “As a result of these combined actions, the oversight of Freddie Mac’s disclosure will be identical to that of other public companies, while maintaining Freddie Mac’s uninterrupted access to worldwide capital markets.” (*Freddie press release, 7/12/02*)

Some bondholders and analysts would like the GSEs to disclose more information on their MBS

- **Some bondholders criticized Treasury Undersecretary Peter Fisher for not requiring the GSEs to register more than their stock. “I’m a bondholder and the more transparency the better,” said James Cusser, who manages \$13 billion of bonds for Waddell & Reed Investment Co. in Overland Park, KS, and owns debt sold by both Fannie and Freddie. “It puts others at a disadvantage as they get cheaper**

capital and the difference is borne by the taxpayer.” (*Bloomberg News*, Simon Kennedy and Alex Canizares, 7/16/02)

- Private label MBS issuers disclose information in their offering documents that is not available in Fannie and Freddie’s prospectuses, but analysts are not too worried about the missing information in GSE offering documents. **“Though it’s not default risk that the investor has in agency MBS, it is in terms of prepayment risk where information about characteristics such as loan-to-value becomes helpful,”** said a senior mortgage analyst. **“I believe it would be a benefit if this type of data was accessible to the market.”** The analyst added that information on limited documentation loans would also help in estimating the percentage of Alt-A mortgages in given pools. **Currently, analysts can only get this information through the originator of the loans.** (*Asset Securitization Report*, Karen Sibayan, 7/22/02)

Capital Markets Subcommittee Chairman Richard Baker’s (R-LA) comments

- **Congressman Baker stated, “Fannie Mae and Freddie Mac are to be congratulated for ‘voluntarily’ committing to disclose some of what the rest of the publicly traded Fortune 498 companies are required to disclose.”** Fannie and Freddie have made **“a good start,”** Congressman Baker said. **“I look forward to discussing with Treasury on Tuesday the need for even fuller GSE disclosures down the road. And I particularly look forward to discussing Treasury’s ideas for additional, more comprehensive GSE reforms.”** (*Dow Jones Newswire*, John Connor, 7/12/02)

Congressman Chris Shays’ (R-CT) comments

- **Congressman Shays called the announcement a “turning point in the debate” over Fannie and Freddie’s disclosure practices.** Shays also said, **“Despite these positive developments, there remains a number of important questions of how these new requirements will be enforced. It’s vital that investors have a legal course of action under the securities laws. I also want to ensure that Fannie Mae and Freddie Mac disclose what is in their mortgage-backed securities, not just their common stock.”** (*Washington Post*, Kathleen Day and Jackie Spinner, 7/13/02; *Dow Jones Newswire*, Dawn Kopecki, 7/12/02, John Connor, 7/15/02)

Congressman Ed Markey’s (D-MA) comments

- **“This is a welcome and long-overdue step by the SEC, Fannie Mae and Freddie Mac. I have long felt that there is no justification for these two huge companies being exempted from the financial disclosure requirements of the securities laws,”** Congressman Markey stated. **“The SEC announcement means that investors will now be able to obtain better disclosures about Fannie Mae and Freddie Mac stock, and that those disclosures will be subject to SEC requirements,”** he added. **“However, I note that Fannie and Freddie mortgage-backed securities would not be subject to those disclosure requirements.”** (*Dow Jones Newswire*, Dawn Kopecki, 7/12/02) **Congressman Markey said it was disappointing that Fannie and Freddie’s MBS will not be subject to the disclosure requirements under the new agreement.** (*Associated Press*, Marcy Gordon, 7/12/02)
- **Congressmen Shays and Markey said they will continue pushing Fannie and Freddie, the SEC, and OFHEO for better disclosures of Fannie and Freddie’s debt issues. “I continue to believe that it should be possible to work out an appropriate disclosure regime for those securities as well,”** Congressman Markey said. (*Dow Jones Newswire*, Dawn Kopecki, 7/12/02)

House Financial Services Committee Chairman Michael Oxley’s (R-OH) comments

- **“Fannie and Freddie’s move today to report to the SEC will increase transparency, reassure investors, and strengthen the housing market,”** said Congressman Oxley. **“This is a great example of the marketplace responding to the need for greater clarity in financial transactions.”** (*House Financial Services Committee press release*, 7/12/02)

Senator Michael Enzi's (R-WY) comments

- “As the ranking member of the Securities Subcommittee, “I want to commend the SEC, Fannie Mae and Freddie Mac for taking this step,” stated Senator Enzi. He added, “under SEC regulation, Fannie Mae and Freddie Mac will be subjected to the same restrictions and requirements as other publicly traded companies. Bringing two of the largest financial companies in the country under the jurisdiction of the SEC is a positive step.” (*Senator Enzi press release, 7/12/02*)

Senator Jon Corzine's (D-NJ) comments

- “This is appropriate, and I think it's smart politically. They have nothing to hide, said Senator Corzine. (*Washington Post, Kathleen Day and Jackie Spinner, 7/13/02*)

Congresswoman Stephanie Tubbs Jones's (D-OH) comments

- “I applaud Fannie Mae and Freddie Mac for taking this extraordinary step. This action is consistent with their announcement in October of 2000 to set in place financial reports and securities offering disclosures that meet or exceed SEC requirements. (*PR Newswire, 7/12/02*)

MBA's comments

- **The MBA called Fannie and Freddie's announcement “an important first step toward full and complete disclosure.” Jim Murphy, MBA Chairman, stated, “We believe this is a good first step toward full disclosure by the GSEs, however, MBA members believe that their debt, equity, and mortgage-backed securities disclosure should at least meet the standards applied by the SEC to private companies that issue securities.” He added, “We look forward to future steps that will meet that objective.” (*MBA press release, 7/12/02*)**

Citizens Against Government Waste's comments

- **In a press release entitled, “*Fannie and Freddie open their books, but not wide enough*,” CAGW “applauded with caution” Fannie and Freddie's agreement to register their common stock with the SEC. “This is definitely a move in the right direction,” CAGW Vice President Leslie K. Paige said. “However, it is only a small step. Until Fannie and Freddie agree to full disclosure with the SEC, there are still great risks involved. The collapse of Enron is teaching us new lessons about the critical importance of transparency and full disclosure; Fannie and Freddie must be brought under that same umbrella of accountability.”**
- **CAGW noted that “despite the recent agreement, Fannie and Freddie still do not have to register their debt and mortgage-backed securities with the SEC, as do all other publicly traded companies. The two GSEs have a combined debt worth \$1.26 trillion, up from \$518 million in 1997, and an annualized growth rate of nearly 25 percent. Fannie's balance sheet is bigger than the Federal Reserve, and the two GSEs combined out-borrowed the U.S. Treasury by \$1.1 trillion in 2001. In addition, according to the Office of Management and Budget, the GSEs' outstanding obligations total \$3.1 trillion. They also enjoy a \$10 billion financial windfall each year as a result of tax breaks, SEC exemptions, and the implied backing of taxpayers in case of failure.”**
- **“In order to have full competition in the industry, it is only fair Fannie and Freddie provide total disclosure to the SEC,” Paige continued. “Such information is even more important for the GSEs because if there is a catastrophe, similar to that of Enron, it will be the taxpayers left holding the bag. The public has a right to know the financial dealings of Fannie Mae and Freddie Mac, as it is their money that is at stake. I urge the SEC, Congress, and the Administration to ensure that this full oversight takes place immediately.” (*CAGW press release, 7/17/02*)**

Free Congress Foundation's comments

- **J. Bradley Jansen, Deputy Director of the Center for Technology Policy at the Free Congress Foundation, called the agreement by Fannie and Freddie “a necessary first step,” but called for “a repeal of Fannie and Freddie’s exemptions from the privacy disclosure requirements that their private sector competitors must obey.” He noted, “Since companies and courts have violated customers’ privacy preferences in bankruptcy and takeover proceedings, it is more important now than ever that Congress revoke the GSE exemption from Title V of the Gramm-Leach-Bliley Act.” He added, “There is good reason for public concern about the GSEs...If GSEs find themselves in dire financial straits, it is very easy to imagine their executives to succumb to temptation to sell the private financial data of their customers. Removing their exemption from Title V would protect the privacy of their customers.”** (*Free Congress Foundation press release, 7/16/02*)

Consumer Federation of America's comments

- **Barbara Roper, director of investor protection for the Consumer Federation of America, said that in light of the recent corporate accounting scandals, “it was a losing argument for them [Fannie and Freddie] to make that there was no need for them to be subject to any regulatory scrutiny.”** (*Washington Post, Kathleen Day and Jackie Spinner, 7/13/02*)

FM Watch's comments

- **“Clearly Fannie Mae and Freddie Mac were boxed into a corner...Today’s announcement still falls short of the disclosure requirements for every other publicly traded Fortune 500 company,” said FM Watch executive director Mike House.** (*American Banker, Rob Garver, 7/15/02*)

Financial consultant Bert Ely's comments

- Ely called the announcement “a step in the right direction,” adding, “the question is enforcement.” **He did not believe that the announcement would satisfy Congressman Baker. “Believe me, it’s not going to be the solution,” Ely said. “There is still the question of the competitive threat they [Fannie and Freddie] pose [to other companies], mission creep, and so forth.”** (*BNA Daily Report for Executives, Richard Cowden, 7/15/02*)

Congressional Research Service (CRS) says Fannie & Freddie's exemption from SEC requirements saves the GSEs millions of dollars each year and adds to the market perception that their securities have an "implied guarantee" from the federal government

Despite Fannie & Freddie's July 12 agreement that they would voluntarily register their common stock with the SEC, CRS believes the Shays/Markey bill (HR 4071) "remains relevant"

HR 4071 would require greater disclosure on securities issuances by Fannie & Freddie and remove an advantage that the GSEs have over their mortgage market competitors

CRS notes that HR 4071 would improve disclosures about Fannie & Freddie's individual debt and MBS

"Some improvement in data available to investors in mortgage-backed securities could allow greater efficiency and better investor protection in those markets."

Fannie & Freddie argue that subjecting them to SEC registration would interfere with home buyers' ability to lock in mortgage interest rates, however, CRS notes that "the GSEs should be able to hedge the interest rate risk using derivatives or other risk management tools, with minimal impact on home buyers"

Impact on home buyers of imposing SEC fees on Fannie & Freddie would "be insignificantly and unmeasurably small"

"It is not going to do any harm for them to disclose the way other companies do," says CRS' Mark Jickling

- A CRS report, entitled "*Fannie Mae, Freddie Mac and SEC Registration and Disclosure*," focuses on the Shays-Markey bill that removes Fannie and Freddie's exemption from SEC requirements. The report was written by CRS' Mark Jickling, Specialist in Public Finance and Barbara Miles, Specialist in Financial Institutions-Government and Finance Division. **The report noted that Fannie and Freddie's exemption from SEC requirements is a "privilege that saves them millions of dollars each year and adds to the market perception that their securities have an 'implied guarantee' from the federal government."** The report noted that Fannie and Freddie announced July 12 that they would begin voluntarily filing their financial statements with the SEC, however both GSEs would maintain the exemption from registering their securities. **"Thus the legislation [HR 4071] remains relevant."** The legislation would **"have the effect of requiring greater disclosure on securities issuances by the GSEs, and removing one advantage – in this case a benefit that confers direct monetary savings – that the GSEs have over their mortgage market competitors."**
- The report stated that HR 4071 "would make Fannie Mae and Freddie Mac subject to the same disclosure and registration requirements that apply to other firms that sell securities to public investors. The immediate effects are two: that the GSEs would, as a matter of law and not voluntary submissions, have to disclose routinely information on themselves, their operations and their securities, some of which presumably is not now disclosed; and that the GSEs would have to pay a fee to the SEC."

HR 4071 would improve disclosures about individual debt and MBS

- **Supporters of HR 4071 claim the bill would among other things, improve disclosures about individual debt and, especially, MBS issues, beyond codifying the voluntary disclosures on the financial condition of the issuing GSE. According to CRS, "this appears to be the case." CRS stated, "Investors**

in MBS could use better information about the pooled mortgages that support the bonds to accurately price them: initial and average time to maturity, the interest rate paid by homeowners on individual loans, initial size of loans, geographic location of mortgaged properties, and so on. Such information is routinely available at individual loan level for non-GSE MBS issues. By contrast, the GSEs disclose this information on an aggregated basis about pools of mortgages underlying groups of similar MBS issues. **Under SEC regulation, a prospectus would have to be published describing the risks of each issue, which would require disclosures about the mortgages related to particular MBS. With this information, investors might be able to price risk more efficiently.** Supporters of H.R. 4071 argue that only their protected monopoly status allows the GSEs to withhold these data from the market, and that they are able to profit from their information advantage by retaining the MBS pools with the most attractive characteristics while selling those with less attractive characteristics.”

- According to CRS, Ginnie Mae securities issues deliberately suppress some information in order to get their MBS treated in a generic fashion with trading based on the coupon rate of issues rather than characteristics of mortgages in the pool (all of which are themselves government-guaranteed). CRS noted, **“Fannie Mae and Freddie Mac are attempting to do the same thing by not revealing much of the relevant information on mortgages underlying their MBS issues.”** According to CRS, **“This strategy, while increasing liquidity (because more issues appear interchangeable with each other), has limits. When mortgages prepay faster than expected because of undisclosed data, investors may reprice all MBS in a more generic way than is warranted. It is one thing if ‘standardized’ mortgage pools are actually standard; it is something else if they are not. The greater the pre-payment discrepancies within the mortgage pools backing securities, the more valuable the information is, and the greater the possibility that investors, who cannot distinguish issues, will penalize the broader market, raising mortgage interest rates across the board.”** CRS stated, **“There is some evidence this is already happening,”** pointing to a Bear-Stearns report which noted that the prepayment problems of undisclosed GSE MBS were making the better disclosed non-GSE securities more attractive.”

Subjecting GSEs to SEC registration should have minimal impact on home buyers’ ability to lock in mortgage interest rates

- Fannie and Freddie argue that SEC registration would interfere with current arrangements that allow home buyers to lock in a mortgage rate at the beginning of negotiations with lenders, even though market interest rates may rise before final settlement. However, CRS noted that “the GSEs should be able to hedge the interest rate risk using derivatives or other risk management tools, with minimal impact on home buyers.”

Impact on home buyers of imposing SEC fees on Fannie & Freddie would “be insignificantly and unmeasurably small”

- **“The GSEs argue that SEC registration and reporting will impose costs that will ultimately be borne by home buyers...There are costs associated with SEC registration that the GSEs do not now bear: an added paperwork burden and a registration fee collected by the SEC. However, the GSEs already bear the major costs associated with issuing securities: the compensation of Wall Street underwriters who find investors willing to buy, and the voluntarily or market-mandated disclosure of information as noted above. There is no obvious reason to assume that SEC registration will have any significant impact on transaction volume or prices in the robust secondary mortgage market. Supporters of H.R. 4017 point out that many other issuers of securities find the U.S. markets attractive places to sell debt and equity, regardless of registration costs. The possible impact on mortgage borrowers should also be insignificantly and unmeasurably small. At less than one cent per \$100 of securities issuance, the fee is easily absorbed by the GSEs whose funding advantage is about 40 times larger.”**

CRS' conclusion

- **CRS concluded, “Given that Fannie Mae and Freddie Mac already disclose information - voluntarily and because the market demands it - it is not clear that ending the SEC exemption would dramatically affect the quality or quantity of most information they provide. Some improvement in data available to investors in mortgage-backed securities could allow greater efficiency and better investor protection in those markets. Even if the improvement is only modest, however, there may be benefits in standardization. Essentially all other issuers in mortgage markets (save Ginnie Mae which is the government) must meet SEC registration and disclosure requirements. In a 1992 report, the SEC and federal banking regulators concluded that investors in GSE securities need the same basic information as investors in any other companies, and that the exemption should be repealed. ‘All this information should be provided in the same form, and under the same time frames, as for similar securities of other issuers.’ The underlying basis for that conclusion appears not to have changed in the intervening years.”** (*“Fannie Mae, Freddie Mac and SEC Registration and Disclosure,” Congressional Research Service, Mark Jickling, Specialist in Public Finance and Barbara Miles, Specialist in Financial Institutions-Government and Finance Division, 7/15/02*)
- **“It is not going to do any harm for them [Fannie & Freddie] to disclose the way other companies do,” CRS research Mark Jickling told *National Mortgage News*. “They may have to change their business practices. But private MBS sellers and issuers manage to deal with it, so I don’t see why they couldn’t,” Jickling said. (*National Mortgage News, Brian Collins 7/22/02*)**

Capital Markets Subcommittee Chairman Richard Baker (R-LA) schedules a GSE hearing for July 23

OFHEO will testify on its risk-based capital rule for Fannie & Freddie and the recent voluntary financial disclosure agreement

- Congressman Baker scheduled a July 23 Capital Markets Subcommittee hearing regarding OFHEO’s risk-based capital test for Fannie and Freddie as well as the recent voluntary financial disclosure agreement by Fannie and Freddie to register their common stock with the SEC. OFHEO Director Armando Falcon is the only witness. (*House Financial Services Committee press release, 7/19/02*)

***Wall Street Journal* July 15 editorial reviews Fannie & Freddie’s voluntary financial disclosure agreement and calls Fannie & Freddie’s lack of disclosures on their debt and MBS “troubling”**

“So congratulations to Fan and Fred for seeing the light, and we hope there will be more light to come, in particular a voluntary decision to disclose the same information on their mortgage-backed securities that their competitors do. Perhaps Fan and Fred are as rock-solid financially as they claim, in which case they have nothing to fear from the same disclosure that other public companies make.”

- Fannie and Freddie “ended months of resistance, stonewalling and downright crankiness” and agreed to register their common stock with the SEC, reported the *Wall Street Journal’s* editorial. “Fannie’s executives even took credit for their surrender...They sounded like it was their idea all along.” The editorial noted, “In any event, it is a major victory for investors and taxpayers, who will now be better able to assess the two companies that dominate American mortgage finance. It’s also a victory for the Bush Administration, which took some risks to challenge the political powerhouses.”
- **“This is not to say that their capitulation is total. Fan and Fred are still declining to comply with another law, the securities act of 1933, that would require them to register their trillions of dollars in debt-and-mortgage-backed securities with the SEC. Fan and Fred have also been fighting this kind of disclosure, which would be required by Shays-Markey. As part of the political compromise...the**

Treasury, the SEC and Fan and Fred's hapless regulator, the Office of Federal Housing Enterprise Oversight, have agreed to 'study' this issue."

- **"This is troubling, because the lack of disclosure has helped Fan and Fred dominate the huge mortgage-backed securities market. Their competitors, who issue private-label mortgage-backed securities, offer investors very detailed information on their mortgage pools. But Fan and Fred offer only generic information. This information asymmetry can hide from investors the major risk in this market (prepayment of mortgages) and give Fan and Fred the opportunity to cherry-pick the best mortgages for themselves. Worse, investors are beginning to respond to Fan and Fred's disclosure gap by building a risk premium in their pricing, which in turn makes the market less efficient and interest rates higher for home buyers."**
- **"Having Fan and Fred provide the same information as their competitors levels the playing field in an enormous and crucial industry. Increased disclosure will also help investors understand the risks undertaken by Fan and Fred, which have grown at Mach speed with heavy leverage. The more investors understand the risks, the more efficient pricing becomes."**
- **"More important still is disclosure's role in protecting taxpayers. Fan and Fred have a special relationship with government that includes an implicit call on taxpayers if they get into trouble. Because of this subsidy and the companies' rapid growth and size, more and more of America's housing market risk is being piled onto these two companies. (The size of a taxpayer bailout is too large to contemplate, since we prefer to sleep at night.)"**
- **"So congratulations to Fan and Fred for seeing the light, and we hope there will be more light to come, in particular a voluntary decision to disclose the same information on their mortgage-backed securities that their competitors do. Perhaps Fan and Fred are as rock-solid financially as they claim, in which case they have nothing to fear from the same disclosure that other public companies make."**
(*Wall Street Journal*, editorial, 7/15/02)

***Wall Street Journal* July 1 editorial says Fannie & Freddie's exemption from SEC requirements provides a big market advantage over private companies that are required to register with the SEC**

Editorial points out the advantages that the GSEs enjoy as a result of their MBS and securities exemption from SEC requirements

Editorial notes, "Fan and Fred know more than other investors, so they can cherry-pick higher quality, less risky securities for their own portfolios and leave the dogs for everyone else."

- A July 1 editorial in the *Wall Street Journal* asked, "Would you buy a pig in the poke? Probably not if you knew what you were buying. Yet every day Fannie and Freddie "expect investors to do just that." **The editorial noted that Fannie and Freddie do not provide the same amount of disclosure on their securities as other private mortgage companies that are required by law to register their securities with the SEC.** The GSEs are now facing, and fighting, proposed legislation from Congressmen Christopher Shays (R-CT) and Edward Markey (D-MA), which would force the GSEs to be subject to SEC disclosure requirements. According to the editorial, **"this intransigence is troubling, not least because it gives Fan and Fred a big market advantage. Fan and Fred know more than other investors, so they can cherry-pick higher quality, less risky securities for their own portfolios and leave the dogs for everyone else."** It is hard to quantify the GSEs' cherry-picking without their disclosure, added the *Journal*. However, the editorial noted "market players, who look at what's available to institutional and individual investors, say that there is absolutely no debate that Fan and Fred are keeping the higher quality securities for themselves."

- **The *Journal* claimed that the GSEs withhold crucial data about the prepayment risks of the loans in their securities.** The *Journal*, with the help of Peter Wallison of the American Enterprise Institute, compared Fannie’s disclosures with those of Chase Mortgage Finance Trust. “While Fan offers only generic disclosure, Chase provides specific information in 12 key categories.” Among the information omitted from Fannie’s disclosures, the geographical description of properties in the security, as some areas have faster prepayment rates. In addition, a high original principal balance is indicative of early prepayment. While Chase provides this information, Fannie does not. Fannie also fails to disclose the purpose of the loans, type of property and loan documentation, all of which Chase provides to shareholders as well as the SEC.
- **The editors noted that mortgage prepayment rates have become increasingly important as Fannie and Freddie expand into “riskier lending.”** Subprime mortgages are likely to prepay faster, and the editorial notes that **Fannie and Freddie are “sticking investors with securities containing as much as 10% in subprime. Further, Fan and Fred’s automated underwriting programs allow for greater variance in loan characteristics, so detail becomes crucial. By refusing to share their information, Fan and Fred are exposing investors to an unknown amount of prepayment risk.”** The *Journal* believes that the risk of mortgage-backed securities may not be an issue if the price of the securities reflects the risk. However, that is not the case with the GSEs. **Since their portfolios contain “mystery” securities, pricing cannot be accurate. “If investors are asked to pay an average price that underestimates the risk, then they are overpaying. At the same time, if Fan and Fred are paying an average price for securities that overestimate risk, then they are getting a windfall.”**
- Investors have begun to factor in the risk associated with GSE securities by adding a risk premium into their pricing. However, this causes the market to become less efficient and causes interest rates to rise higher than they might be with full disclosure. **“The government-sponsored duopoly known as Fan and Fred are fighting the Shays-Markey bill because it would end their profiting from market inefficiencies they have created. This makes sense for them, but not for investors or for taxpayers, who already subsidize the pair in other ways. By lifting the exemption from SEC registration that allows Fan and Fred to issue mystery securities, Shays-Markey would permit more accurate pricing of mortgage-backed securities. No more pigs in a poke.”** (*The Wall Street Journal*, Editorial, 7/1/02)

Fannie & Freddie’s response- Freddie acknowledges that the information it provides to investors is different from that of private-label issuers

- Fannie claimed the editorial was “riddled with factual errors.” Fannie distributed a letter by Fannie’s Treasurer Linda Knight to some investment banks claiming that the editorial was “flatly wrong” in saying Fannie and Freddie can “cherry pick higher quality, less risky securities for their own portfolios and leave the dogs for everyone else” because they don’t disclose enough information to investors. Fannie claimed that the company’s mortgage buyers don’t have any information that isn’t available to the public, because a firewall separates them from the employees who create the securities. Knight also claimed that the editorial’s assertions that the company withholds geographical, maturity, and size descriptions of loans backing its securities were also wrong.” (*Bloomberg*, Al Yoon, 7/1/02) Fannie said it provides as much information as possible, given the fact that it often creates securities before it receives the actual loans it places in the pools. (*Wall Street Journal*, Patrick Barta, 7/2/02)
- **Freddie said that while it is true it doesn’t supply some information provided by other issuers of MBS, it does disclose all information it considers to be material to investors.** (*Wall Street Journal*, Patrick Barta, 7/2/02) **Representatives from Fannie and Freddie say that information on some of the items listed in the *Wall Street Journal* article is actually available, and the data that is not disclosed is usually credit-related.** Freddie’s spokesperson Sharon McHale explained that there are significant

differences between the characteristics of private label and agency mortgage pools. Since the agencies hold the credit risk on their securities, disclosure on credit-related items is really not material unlike in private-label MBS. She claimed that mortgages in private label deals have varying credit risk, underwriting, and collateral characteristics, so credit-related disclosure items are more important for investors in private-label MBS, but not as relevant for homogenous agency mortgage pools. While the GSEs do not indicate some types of data in offering documents, they do release tapes with pool performance data, which is then processed by information providers such as Bloomberg. While missing from the prospectuses, statistics such as average note rate on the underlying loan, seasoning, year of origination and geographic concentration are available through other channels. (*Asset Securitization Report*, Karen Sibayan, 7/22/02)

***The Economist* calls Fannie & Freddie’s voluntary disclosure agreement “a start, but only a start” since Fannie & Freddie will still be exempt from registering their debt and MBS with the SEC**

“A test for how well Congress can reorder America’s financial system is whether it tames its own wayward children” (Fannie, Freddie, and the FHLBanks)

- ***The Economist* noted, “A test for how well Congress can reorder America’s financial system is whether it tames its own wayward children.” The article added, “Fannie Mae, Freddie Mac, the Federal Home Loan Bank System and other financial institutions were created by the government years ago to provide liquidity in markets that have long since grown beyond the need for government support.”**
- All of these GSEs enjoy special benefits that “provide advantages over their private-sector competitors” and has allowed these GSEs to “become huge participants in some of the world’s biggest financial markets.” The article noted that the GSEs have issued three-fifths of the \$4 trillion in outstanding MBS in America and their annual rate of growth in assets is over 15%, double the overall growth in mortgages.
- **Fannie and Freddie’s voluntary agreement to register their common stock with the SEC, while retaining their exemption for registering their MBS and debt with the SEC, “is a start, but only a start,” reported *The Economist*. “After all, the agreement lets both Fannie Mae and Freddie Mac remain exempt from the Securities Act of 1933, the bedrock legislation for America’s public markets that covers disclosures for securities offerings. Yet few companies are more active offerers, rebundling mortgages into issues of mortgage-backed bonds.”**
- **The article noted that Fannie and Freddie’s exemption from registering their MBS and debt “breeds two suspicions on Wall Street, although they are admittedly contradictory.” *The Economist* explained, “The first is that they [Fannie and Freddie] retain the better mortgage-backed securities on their books, that is, the ones with less risk of being repaid early; they then flog off the rest. Over time, this would push up mortgage rates and undermine the rationale for Congress creating these agencies in the first place. Of equal concern in other parts of the market is that Fannie Mae and Freddie Mac are in fact keeping the poorer quality of mortgages on their books, and so concealing possible problems in their fast-growing balance sheets. Together, the two agencies hold well over \$1 trillion in mortgage-backed securities.”**
- ***The Economist* concluded, “Any crisis at Fannie Mae and Freddie Mac would have consequences for the financial system. Mutual funds are large holders of their debt. So, too, are banks and thrifts, because the debt of government agencies is exempt from normal rules limiting exposure to any one borrower. In the event of a crisis, it is hard to imagine any institution apart from the Treasury Department with the financial clout to arrange a rescue.” (*The Economist*, 7/20/02)**

Christian Science Monitor editorial says Fannie & Freddie must go further than their voluntary financial disclosure agreement and recommends their MBS be subject to SEC registration requirements as well

- Referring to Fannie and Freddie's voluntary financial disclosure agreement to register their common stock with the SEC, a *Christian Science Monitor* editorial noted that Fannie and Freddie "deserve some sort of slap on the back for finally, in these post-Enron days, acting like other public companies." The editorial noted that "Indeed, and almost unbelievably, Fannie and Freddie were the only members of the Fortune 500 with such an exemption." **However, Fannie and Freddie "have further to go to meet the market's demands for greater transparency in accounting. They have not relinquished another exemption – more disclosure of information on their own mortgage-backed securities...Fannie and Freddie have trillions in such securities. They should be SEC-registered as well."**
- **"Insufficient regulatory oversight and more disclosure by Fannie and Freddie must be part of current economic reform efforts in Congress. A burst in the nation's housing bubble could fell these two giants, and leave taxpayers with billions, if not trillions, in debt."** (*Christian Science Monitor*, 7/22/02)

Merrill Lynch report compares private label MBS issuer disclosures and agency (GSE) MBS disclosures and notes that there is less information provided in the GSEs' disclosures

- According to Karen Sibayan with *Asset Securitization Report*, a report by Merrill Lynch analyzed the data that is available on agency (GSE) pools and private label MBS issuer disclosures, using Wells Fargo MBS 2002-8 as a standard non-agency pool to compare information availability. Merrill found that both agency and non-agency MBS issuers disclose information on weighted-average-coupon, weighted-average-life, weighted-average-maturity, origination year, geographic distribution, and average loan size. However, there was less information on loan size distribution and weighted-average-coupon distribution in the agency MBS and there were no details available on the loan purpose, documentation levels, loan-to-value ratios, FICOs and delinquency history for agency securities. Merrill added that though information on loan size, weighted-average-coupon distribution, FICO scores and documentation levels would be helpful in building prepayment models, it is not crucial in developing reasonable valuation tools. Merrill noted that the bulk of agency mortgages are traded through the TBA market "where pool characteristics are not disclosed at the time of the trade." (*Asset Securitization Report*, Karen Sibayan, 7/22/02)

Congressman Ron Paul (R-TX) introduces GSE bill (HR 5126) that would remove the GSEs' line of credit to the Treasury and eliminate the Fed's purchasing of the GSEs' debt

- Congressman Paul introduced July 15 a GSE bill that among other things would remove the GSEs' line of credit with the Treasury and eliminate the Fed's purchasing of the GSEs' debt securities for monetary policy. The bill is HR 5126 – the Free Housing Market Enhancement Act.
- Congressman Paul noted when introducing his bill, "One of the major government privileges granted the GSEs is a line of credit to the United States Treasury. According to some estimates, the line of credit may be worth over \$2 billion dollars. This explicit promise by the Treasury to bail out the GSEs in times of economic difficulty helps the GSEs attract investors who are willing to settle for lower yields than they would demand in the absence of the subsidy. Thus, the line of credit distorts the allocation of capital. More importantly, the line of credit is a promise on behalf of the government to engage in a massive unconstitutional and immoral income transfer from working Americans to holders of GSE debt."
- Congressman Paul's bill repeals the explicit grant of legal authority given to the Federal Reserve to purchase GSE debt. "GSEs are the only institutions besides the United States Treasury granted explicit

statutory authority to monetarize their debt through the Federal Reserve,” he noted. “This provision gives the GSEs a source of liquidity unavailable to their competitors.”

- Congressman Paul believes that Fannie and Freddie have caused a tremendous housing bubble that should be addressed. He stated, **“It is time for Congress to act to remove taxpayer support from the housing GSEs before the bubble bursts and taxpayers are once again forced to bail out investors who were misled by foolish government interference in the market.”** (*Congressional Record*, pages E1258-E1259, 7/15/02)

Fannie Mae and Freddie Mac

Government Accounting Office (GAO) recommends OFHEO not include new business assumptions into its stress test used to establish Fannie & Freddie’s risk-based capital requirements

GAO notes that Fannie & Freddie’s implicit government guarantee limits market discipline and limits the benefits of the GSEs’ “voluntary initiatives” to increase transparency and market discipline

- The GAO released a report recommending that OFHEO not include new business assumptions into its stress test used to establish Fannie and Freddie’s risk-based capital requirements. The GAO said it was mandated by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 to study whether OFHEO should incorporate new business assumptions into the stress test. OFHEO’s risk-based capital rule includes a stress test, which determines whether Fannie and Freddie have sufficient capital on hand to survive during a 10-year economic downturn. Incorporating new business assumptions into the stress test, according to the GAO, would mean specifying details about the types and quality of new mortgages that would be acquired during the 10-year stress period, the types of funding that would be used to acquire such mortgages, and other operating and financial strategies that would be implemented by Fannie and Freddie’s management. After taking more than nine years to complete, OFHEO issued its risk-based capital requirement on September 13, 2001 [though not enforceable until September 13, 2002]. Four years after OFHEO issues its risk-based capital rule, OFHEO has the option to incorporate new business assumptions into the stress test. GAO’s mandate is to provide, within the first year after the rule is issued, an opinion on the advisability of including new business after the initial 4-year period. (*GAO, “OFHEO’s Risk-Based Capital Stress Test: Incorporating New Business Is Not Advisable,”* GAO-02-521, June 2002)
- According to the GAO, Fannie and Freddie’s data “show that new business conducted over a 10-year period generally accounts for a large share of their on- and off-balance sheet holdings of assets and liabilities at the end of each 10-year period. Because new business represents such a large share of enterprise holdings over time, it would have a major impact on the enterprises’ financial condition, risks, and capital adequacy in the face of stressful events.” However, GAO noted that “determining the appropriate new business assumptions to include in OFHEO’s model would be difficult and inherently speculative.” Further, “incorporating new business assumptions would increase the complexity of OFHEO’s already complex stress test, making it more difficult to understand and replicate.” GAO believes that OFHEO can use its supervisory review power to limit risk-taking by Fannie and Freddie, which includes examination of Fannie and Freddie’s ongoing business activities and enforcement actions. The GAO recommended that OFHEO “not incorporate new business assumptions into its stress test, because determining the assumptions is inherently speculative and including them would introduce more complexity to an already complex model.” (*GAO, “OFHEO’s Risk-Based Capital Stress Test: Incorporating New Business Is Not Advisable,”* GAO-02-521, June 2002)

Fannie & Freddie's implicit government guarantee limits market discipline

- **The GAO noted that the market's perception that Fannie and Freddie are implicitly guaranteed by the federal government limits the benefits of the GSEs' "voluntary initiatives" to increase transparency and market discipline,** reported John Connor with *Dow Jones Newswire*.
- The GAO noted that the "federal government's creation of and continued relationship with Fannie Mae and Freddie Mac have created the perception in financial markets that the government will not allow the enterprises to default on their debts and MBS obligations, although no such legal requirement exists. As a result, Fannie Mae and Freddie Mac can borrow money in the capital markets at lower interest rates that comparably creditworthy private corporations that do not enjoy federal sponsorship."
- **In October 2000, Fannie and Freddie released voluntary risk management initiatives to improve transparency and market discipline, including the periodic issuance of subordinated debt and increased disclosures.** GAO discussed the voluntary commitments in its report and said market discipline can curb risky behavior by Fannie and Freddie to the extent that the firms' creditors and customers will demand that they stay fiscally strong to fulfill their obligations, and **acknowledged that the financial disclosures mandated by the October 2000 voluntary accord may improve transparency.** "However, its impact on the enterprises and their customers is limited if the enterprises are perceived to have implicit government backing," GAO said. "That is, other economic parties may believe that the federal government will ensure that the enterprises continue to operate and perform satisfactorily on financial contracts such as loans and mortgage purchases," GAO noted. "For this reason, while market discipline can play a role in curbing risky behavior by the enterprises, it also has its limitations," GAO said. "Supervisory review thus takes on more importance as a means for limiting inappropriate risk-taking behavior by the enterprises," the GAO added. (Dow Jones Newswire, John Connor, 7/1/02; GAO, "OFHEO's Risk-Based Capital Stress Test: Incorporating New Business Is Not Advisable," GAO-02-521, June 2002)

Brokers raise concerns about Fannie & Freddie's "modifiable mortgage" product

- **Fannie and Freddie's modifiable mortgage product "could be one of the biggest threats to the survival of the mortgage broker industry, or it could be just a minor nuisance, costing the broker some market share,"** reported Brad Finkelstein with *Broker Magazine*. (*Broker Magazine*, 6/02-7/02)
- As noted in the March 15, 2002 *GSE Report*, Freddie introduced the "modifiable mortgage" product, a fixed-rate home mortgage that can be modified after being sold to Freddie and pooled. The product will be pooled under one of two new prefixes (MM or MN). The modification option, available for newly originated and seasoned loans, will be available on a negotiated basis, and will allow only downward modifications to the borrower's note rate and monthly payment. If the loan is modified, that loan will be purchased (removed) from the applicable MM or MN pool, and then resold to Freddie as either a non-modifiable mortgage or as a modifiable mortgage. "Our modifiable mortgage offers all Freddie Mac customers the option to modify mortgages instead of refinancing them, while maintaining the integrity of Freddie Mac's Gold PC securities," said Mark Hanson, Freddie's Vice President, Mortgage Funding. (*Freddie press release*, 2/22/02)
- Fannie's product – the Fixed Rate Convertible – has a conversion option that can be exercised whenever the borrower wishes over the life of the loan, said a Fannie spokeswoman. Borrowers are able to lower their interest rate as often as every 30 days, without having to reapply or requalify for a mortgage, as they would if they were to refinance. (*Broker Magazine*, 6/02-7/02)

- Mortgage brokers, who often count on their ability to control the customer relationship and refinance loans, have mixed feelings about loan modifications and the fact that Freddie is for the first time making it possible to include them in select GSE securitizations. A secondary market move that resulted in a large-scale increase in loan modifications might hypothetically increase the use of the product and potentially pose a huge threat to mortgage broker's incomes, but the impact of Freddie's new product appears relatively limited in scope. (*National Mortgage News*, Bonnie Sinnock, 3/4/02)
- Todd White, senior vice president, loan production manager, Arvest Mortgage, expressed the possibility at a Broker roundtable that "widespread adoption of note modifications could create the possibility in the future of never again having a broker-driven refi boom," reported Finkelstein. White added that the statement is an exaggeration, but modifications can have an impact on the broker/servicer relationship and goes to the heart of one of the most contentious issues between brokers and servicers – who owns the borrower. Modifications raise the issue of who has the right to contact the customer for a refinance – the mortgage broker or the servicer. There is going to be a challenge for the modifiable products to be widespread, said White, but assuming it gains popularity, it becomes a competitive issue for the small mortgage broker who sells loans servicing released. (*Broker Magazine*, 6/02-7/02)

Congressman Barney Frank (D-MA) does not believe Fannie & Freddie pose a risk to taxpayers

- In an interview with *Dow Jones Newswire*, Congressman Frank said he does not believe Fannie and Freddie pose a risk to taxpayers. "I don't see them [Fannie and Freddie] as a problem. I think they've been very helpful," he said. "There is no federal risk here," he added. "This notion that there's an implicit federal guarantee doesn't make any sense to me." Congressman Frank is in line to be the next top Democrat on the House Financial Services Committee, since Congressman John LaFalce (D-NY) has decided not to run for re-election. (*Dow Jones Newswire*, Rob Wells, 6/27/02)

GSE debt news:

- (1) Foreign purchases of Fannie & Freddie's debt have slowed**
- (2) Foreign investors are not dumping Fannie & Freddie's debt despite a slumping US dollar**
- (3) Fannie doubles the size of its minimum callable debt**
- (4) Freddie's decision not to issue its Euro-denominated debt as it planned in June surprises the European market**
- (5) Fannie increases debt buybacks**

Background on GSE debt and the supply of Treasurys

- Over the past few years, as the US was running budget surpluses, and the national debt was being paid down, the supply of Treasury securities shrunk. Investors, traders, borrowers, and even the US Federal Reserve were being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark were: (1) the debt securities of Fannie and Freddie; (2) derivatives tied to the swaps market; or (3) high-grade corporate bonds. Investors view the debt securities of Fannie and Freddie as "almost" as good as US Treasurys because of the implicit government guarantee of Fannie and Freddie's securities. Fannie and Freddie began bond issuance programs (Fannie – Benchmark bond program; Freddie- Reference bond program) to mirror traditional Treasury operations in size and regularity as an alternative benchmark. Given the expected budget deficits in the next few years, the search for alternative benchmark investments may be lessened.

Foreign purchases of Fannie & Freddie's debt have slowed

- Analysts at Credit Suisse First Boston say foreign purchases of securities issued by agencies such as Fannie and Freddie – which peaked at more than \$170 billion last year – have slowed sharply in recent months. (*International Herald Tribune*, 6/5/02)

Foreign investors are not dumping Fannie & Freddie's debt despite a slumping US dollar

- Overseas investors are holding on to US agency debt despite a slumping US dollar, according to Lynn Adler with *Reuters*. The US currency's steep decline is forcing some foreign investors to dump dollar-denominated debt, but agency debt remains popular for its high quality and returns. Astrid Adolfson, economist at MCM Money Watch stated, "there's more of a slowing of buying than necessarily a real selling of US agency securities." More foreign central banks have been approved to purchase US agency debt. The Bank of Japan has been selling yen and buying dollars, investing that US currency in agencies and Treasuries, according to analysts. The Fed held \$154 billion of agency debt in custody for foreign accounts ended June 19, up from about \$21 billion from the end of 2001. Treasury holdings rose to \$619 billion most recently, up \$19 billion this year. Last year, agencies holdings in those accounts jumped nearly \$31 billion as Treasuries holdings gained \$10 billion. "You probably are reaching a maturation point," said Shrikant Ramamurthy, agency strategist at Greenwich Capital. (*Reuters*, Lynn Adler, 6/24/02)

Fannie doubles the size of its minimum callable debt

- Fannie announced enhancements to its Callable Benchmark Notes ® debt issuance format. Minimum new issue sizes for Callable Benchmark Notes offerings will be increased to \$2 billion from \$1 billion, while minimum reopening sizes will continue to be \$500 million. Beginning in July, Fannie will issue one or two Callable Benchmark Notes structures each month with maturities and call lockouts to be determined through market feedback. The core structures will continue to be five-year notes that are noncallable during the first two years and ten-year notes that are noncallable during the first three years. All Callable Benchmark Notes will continue to have one time (European) calls. The newly enhanced format may now also include other maturities and call lockouts with one-time calls. (*Fannie press release*, 7/2/02)

Freddie's decision not to issue its Euro-denominated debt as it planned in June surprises the European market

- Freddie, which had a space open in its calendar to issue a reopening of one of its six outstanding euro deals in the week starting June 24, instead surprised the market by announcing that it had bought back some of its euro debt. Fannie and Freddie had been scaling back their calendar issuance in dollars to match slow growth in their mortgage portfolios. So while Freddie's decision not to issue in euros in June had been expected, the announcement of its repurchase came as a shock. Even the dealers who made the purchases did not know who the buyer was. "There were some traders that were upset because they did not know about the trade," said Louise Herrle, Freddie's Treasurer, "and it was certainly not transparent." It would not be appropriate to compare the dollar market, where Freddie has an established buyback program, with the euro market, she argued. Freddie has 25 Reference Note issues in dollars. In euros, it has six issues totaling Eu35bn. Given the relative lack of liquidity, Freddie said it was concerned that announcing the buyback would affect spreads on its euro debt. "It was a beneficial opportunity for us to provide support for our securities," Herrle said. "We looked at where they were trading vis a vis other assets. We were concerned that if certain trading relationships are around for a long time they become established as valid." (*Euroweek*, 6/14/02)
- The reopening planned in June was always optional, said Freddie. Mortgage growth has been slow recently, said a Freddie spokesman. In this climate, it makes no sense to solicit a euro borrowing, which is always considerably more costly than dollar borrowing. In addition, Freddie has also purchased and retired a number of outstanding EuroReference Note issues. Freddie stressed that its commitment to the euro market remains unwavering, and its buyback program was to preserve the value of outstanding debt for investors. Its scheduled offering in September will go ahead as planned. (*Euroweek*, 6/14/02)

Fannie increases debt buybacks

- Fannie is buying back more of its debt as increased competition from banks for mortgages pushes down returns, according to *Bloomberg*. Fannie repurchased \$3.5 billion of debt in the second quarter, up from \$2.5 billion in the first quarter. The loss from buying back debt rose to \$224.7 million from \$150 million. Fannie's Chairman Frank Raines expects the buybacks will cut interest expense and help meet the company's goal of "double digit" growth in operating earnings. (*Bloomberg News*, Al Yoon, 7/15/02)

Fannie & Freddie expand their outreach to credit unions

Fannie launches an alliance with the National Association of Federal Credit Unions (NAFCU); Freddie is working on an alliance with the Credit Union National Association (CUNA)

- Fannie and NAFCU announced an alliance on July 18, the first deal signed by Fannie with a credit union group. According to NAFCU, nine out of every ten NAFCU-member credit unions already use Fannie's automated underwriting system, Desktop Underwriter. The alliance provides NAFCU members benefits such as special pricing in the secondary market for fixed-rate mortgages, access to Fannie's automated underwriting system, educational training support on how to expand access to the secondary market, and the ability to offer numerous mortgage products. (*NAFCU press release*, 7/18/02; *Credit Union Journal*, 7/22/02) Freddie is negotiating an affinity relationship with CUNA, in which Freddie is expected to offer CUNA members access to technology, products, services, and training and it is expected to be "significantly larger than" than Freddie's affinity deal struck earlier this year with America's Community Bankers. (*National Mortgage News Daily Website*, 7/8/02)

Fannie Mae

Fannie releases requirements for electronic mortgages

Fannie develops its own registry for lenders to sell Fannie their eMortgage notes

- Fannie released its formal requirements to help lenders create, sell, and deliver paperless mortgages to Fannie. (*Fannie press release*, 7/3/02) According to eFannieMae.com, Fannie's announcement details the requirements lenders must follow to create and sell eNotes to Fannie. These requirements: (1) include a special electronic document format that is based on the MISMO [Mortgage Industry Standards Maintenance Organization] SMARTDOC specifications; (2) include special language in the eNote to recognize the creation of an electronic asset; (3) describe e-signature methodologies for e-signing and tamper-sealing the electronic documents; (4) introduce a new application, eMortgage Delivery, to facilitate the delivery of an eMortgage loan to Fannie; and (5) describe servicing requirements for eMortgage loans. Fannie noted that it is working with the MBA and its members to develop an industry-wide registry to track ownership of eMortgage notes. Until the industry implements the centralized registry, Fannie will operate an interim registry to enable lenders to sell Fannie their eNotes. (*eFannieMae.com*, 7/9/02)

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) 7/9/02).

Senator Kent Conrad (D-ND), Senator Byron Dorgan (D-ND), Congressman Earl Pomeroy (D-ND) and Lieutenant Governor Jack Dalrymple

- Fannie and the USDA Rural Development announced two grants totaling \$115,454 for Lewis and Clark CommunityWorks, a non-profit organization. The group will use the grants to hire a reservation mortgage lending coordinator, who will help Native American borrowers access mortgage financing. The officials were included in the presentation held at United Tribes Technical College. (*Fannie press release, 7/2/02*)

Senator Mary Landrieu (D-LA), Congressman William Jefferson (D-LA), and State Treasurer John Kennedy

- Fannie joined with the above named officials to announce a new \$1.25 billion lending partnership between Standard Mortgage Corporation and Fannie. (*Fannie press release, 7/15/02*)

Congressman Lamar Smith (R-TX) and Ciro Rodriguez (D-TX)

- Fannie announced mortgage relief provisions for flood-damaged homes in TX. Statements of support by the above named officials were included in Fannie’s press release. (*Fannie press release, 7/10/02*)

Congressman Michael Ferguson (R-NJ) and Donald Payne (D-NJ)

- Fannie joined with the above named officials to announce the availability of Community Solutions, a mortgage product for New Jersey’s firefighters, police officers, and teachers. (*Fannie press release, 7/2/02*)

Congressman Tim Johnson (R-IL) and Savoy Village President Robert McCleary

- Fannie joined with the above named officials to announce the opening of a new affordable rental complex for seniors. (*Fannie press release, 7/2/02*)

Congressman Ron Lewis (R-KY) and Bowling Green, KY Mayor Sandy Jones

- Fannie joined with the above named officials to announce a program which allows eligible families to use their Section 8 rental assistance vouchers toward homeownership. (*Fannie press release, 7/1/02*)

Congresswoman Darlene Hooley (D-OR) and Newport, OR Mayor Mark Jones

- Fannie joined with the above named officials to announce a new affordable rental development for seniors. (*Fannie press release, 7/1/02*)

Congressman Robert Matsui (D-CA)

- Fannie, the Sacramento Realist Association, and Countrywide Home Loans sponsored a training seminar for brokers and real estate professionals on new mortgage and technology products. A statement of support by Congressman Matsui was included in Fannie’s press release. (*Fannie press release, 7/18/02*)

Congressman Ruben Hinojosa (D-TX)

- Fannie joined Congressman Hinojosa for the third annual regional leaders conference to discuss housing issues in Texas' 15th Congressional district. (*Fannie press release, 7/1/02*)

Congressman Sam Johnson (R-TX)

- Fannie announced that it purchased a \$12 million mortgage revenue bond issued by the Garland Housing Finance Corporation. A statement of support by Congressman Johnson was included in Fannie's press release. (*Fannie press release, 7/2/02*)

Congressman Harold Ford (D-TN)

- Fannie joined Congressman Ford to announce HomeSAFE Memphis, an initiative to help predatory lending victims in Memphis. (*Fannie press release, 7/1/02*)

Other local officials with whom Fannie held press opportunities:

- (1) Cameron County, TX Judge Gilberto Hinojosa and Brownsville, TX Mayor Blanca Vela (*Fannie press release, 6/28/02*)
- (2) Henderson, NV Mayor Jim Gibson (*Fannie press release, 7/18/02*)

Freddie Mac

Freddie's portfolio of Low-Income Housing Tax Credit (LIHTC) investments now exceeds \$2 billion

- Freddie announced that its portfolio of LIHTC investments now exceeds \$2 billion. This was accomplished through 153 separate limited partnerships covering 2,300 housing developments. Family housing makes up 70% of the portfolio while 15% is for seniors housing and 15% is special needs supportive housing. "Freddie Mac's commitment to the LIHTC program is evidenced by the fact that its multifamily LIHTC portfolio has doubled every three years, from \$500 million in 1996 to over \$2 billion in 2002," said Christine Hobbs, director of community development investments in Freddie's Multifamily Division. "Additionally, in 2002 we plan on increasing our LIHTC portfolio by at least \$500 million." (*Freddie press release, 6/28/02*)

Freddie and the National Urban League announce initiative

- Freddie and the National Urban League announced the CreditSmart(SM)/Homeownership Development Initiative that combines borrower education and flexible mortgage products in an effort to increase minority homeownership. The effort will launch with seven Urban League affiliates located in Birmingham, AL; Charlotte, NC; Louisville, KY; Greenville, SC; Oklahoma City, OK; Springfield, IL; and Washington, DC. Free financial literacy workshops will be offered at the affiliates using Freddie's CreditSmart curriculum. (*Freddie press release, 7/12/02*)

Freddie's Jim Park promoted to Vice President of Industry Relations and Housing Outreach

- Freddie announced that Jim Park has been promoted to VP of Industry Relations and Housing Outreach. Park joined Freddie in 1997 as the Director of Industry Relations and was named Director of Housing and Industry Outreach in May 2000. Prior to joining Freddie, Park served as the Executive Assistant to the Federal Housing Commissioner/Assistant Secretary for Housing at HUD. Prior to joining HUD, Park served as the Legislative Counsel at the National Community Development Association. (*Freddie press release, 7/15/02*)

Federal Home Loan Banks

Federal Housing Finance Board (FHFB) approves the FHLBanks of Des Moines, Indianapolis, New York and Topeka capital plans

FHFB has now approved all 12 FHLBank capital plans

America's Community Bankers expresses concerns about the FHLBank of Chicago's capital plan

The FHFB regulates the FHLBank System

- The FHFB July 10 unanimously approved the capital structure plans of the FHLBanks of Des Moines, Indianapolis, and Topeka. (*FHFB press release, 7/10/02; BNA Daily Report for Executives, 7/11/02*) The FHFB unanimously approved July 18 the capital plan of the FHLBank of New York, completing the approval process for all 12 FHLBanks' capital plans. (*FHFB press release, 7/18/02*)
- The FHFB also approved July 18 a resolution in support of the FHLBank's efforts to back a \$1 billion bond issue for disaster recovery relating to the World Trade Center destruction. The FHLBank of New York is slated to enter into a standby purchase agreement with the Transitional Finance Authority to act as a backup source of liquidity for \$520 million of the Recovery Bonds. The FHFB also marked the 70th anniversary of the FHLBank System by re-issuing a new charter to the FHLBank of New York. The original FHLBank of New York charter was lost when its offices at 7 World Trade Center were destroyed in the September 11th terrorist attack. (*FHFB press release, 7/18/02*) Since September 12, the FHLBank of New York has been operating out of an office in Jersey City. FHLBank President Alfred DelliBovi said the FHLBank of New York had signed a lease in July on a new headquarters in midtown Manhattan and expects to move in by the end of the year. (*American Banker, John Reosti, 7/19/02*)
- All of the FHLBanks whose capital plans have been approved must still obtain FHFB approval of their internal market risk model and risk assessment procedures and controls prior to implementing their plans. The FHLBank of Seattle has obtained this approval and began implementation of its capital plan on June 30. (*FHFB press release, 7/10/02*)
- The Gramm-Leach-Bliley Act, signed into law on November 12, 1999, amended the provisions of the FHLBank Act that relate to the capital structure of the FHLBanks. The law mandated the replacement of the existing subscription capital structure with a modern capital structure, with risk-based and leverage capital requirements that are similar to those of depository institutions. (*FHFB press release, 7/10/02*)

America's Community Bankers expresses concerns about the FHLBank of Chicago's capital plan

- ACB's Director of Government Relations Eric Mondres expressed concern that the FHLBank of Chicago's plan does not require member banks to purchase additional shares to participate in the Mortgage Partnership Finance (MPF) program. Members must buy additional stock as they do more business with a FHLBank – whether borrowing or selling mortgage assets to it. Mondres said the FHLBank of Chicago's plan “warps the system” because it could lead to a member playing one FHLBank off another. Mondres wondered if a holding company belonging to more than one FHLBank would be inclined to sell its mortgage assets to the FHLBank that does not make additional stock purchases mandatory. “We think that having healthy competition based on the value of their programs is appropriate,” said Mondres. “But the capital requirements themselves should not create the competition. This encourages greater risk-taking, or stretching the limits.” (*American Banker, E. Christopher Brown, IV and Alan Kline, 7/2/02*)

- FHLBank of Chicago President Alex Pollock defended the FHLBank of Chicago's capital plan. He argued that the FHLBank of Chicago has never stipulated that members buy additional stock to participate in the MPF program and if they did so, members may simply decide to sell their mortgage loans to Fannie or Freddie. Pollock noted at a FHFB hearing in April on the FHLBank of Chicago's capital plan that a "mandatory stock purchase makes dealing with the Mortgage Partnership Finance program much more complex and uncertain...which will make it a more costly and less attractive financial opportunity" for members. (*American Banker*, E. Christopher Brown, IV and Alan Kline, 7/2/02)

Regulatory relief bill, which contains a provision that would allow privately insured credit unions to join the FHLBank System, passes the House Judiciary Committee

- The House Judiciary Committee July 17 passed a regulatory relief bill (HR 3951), which among other things would allow privately insured credit unions to join the FHLBank System if they meet certain eligibility requirements. The Financial Services Regulatory Relief Act of 2002 would make privately insured credit unions eligible to join the FHLBank System if state regulators of a privately insured credit union certify that the credit union meets eligibility standards for federal deposit insurance. The bill also passed the House Financial Services Committee June 6. A spokesman for co-sponsor Congressman Spencer Bachus (R-AL) told *BNA* July 17 that the bill is expected to reach the House floor the week of July 22. (*House Financial Services Committee press release*, 6/6/02; *American Banker*, Michele Heller, 6/6/02, 6/7/02; *BNA Daily Report for Executives*, Karen L. Werner, 6/7/02, 7/18/02)
- Currently, privately insured credit unions are excluded from FHLBank membership. The National Credit Union Administration insures nearly 97% of the country's 10,079 credit unions. Private insurers cover most of the other 240, primarily American Share Insurance in Dublin, OH. Less than 10% of federally insured credit unions have actually joined a FHLBank. (*American Banker*, Laura Thompson, 5/8/02)

Total Mortgage Partnership Finance (MPF) program loans outstanding top \$30 billion

The FHLBank System's MPF program is a competitor to Fannie & Freddie in the secondary mortgage market

- **According to the FHLBank of Chicago, five years after the FHLBank of Chicago funded its first mortgage in partnership with LaSalle Bank, the MPF program "continues to offer FHLB member lenders a better alternative" than selling their fixed-rate loans to Fannie and Freddie.** Since 1997, ten of the twelve FHLBanks have used the MPF program.
- As of June 30, total MPF outstanding loans were \$30.6 billion, up \$5.8 billion from year-end, producing an annualized growth rate of 47%. Most of the increase is attributable to growth in the portfolio of outstanding conventional loans, which grew at an annualized rate of 83% during the same period. About two-thirds of the MPF loans funded in 2000 have been conventional mortgages, while one-third have been FHA/VA loans. The nationwide total of approved participating financial institutions increased to 345 members at the end of June, up from 282 at the beginning of the year. Most are small and mid-size lenders.
- "We are gratified by the response from mortgage lenders to the MPF program," said Alex J. Pollock, President and CEO of the FHLBank of Chicago. "It was obvious from the beginning that more competition in the secondary market is a good thing. That is what the MPF Program is all about. Both mortgage lenders and homebuyers benefit from increased competition."
- Created by the FHLBank of Chicago five years ago, the MPF Program provides FHLBank members an alternative to holding fixed rate, conventional conforming and government residential mortgage loans in

portfolio or selling loans servicing released as a means of offering competitive loan origination rates. Under the MPF Program, the local lender manages the credit risk and customer relationship, while the FHLBank manages the funding, interest rate, and prepayment risks. "This structure allows lenders to keep their valuable customer relationships without paying costly guarantee fees charged by secondary market agencies to manage the credit risks of the loans they buy...Instead of paying guarantee fees, participating MPF lenders have collectively received over \$20 million in fees from the FHLBs since the program began for managing the credit risk of their own customers," said the FHLBank of Chicago. (*FHLBank of Chicago's MPF press release, 7/3/02*)

Ginnie Mae

House Financial Services Committee approves housing omnibus bill containing a provision repealing the 50% increase in the Ginnie Mae guarantee fee

Amendment to the omnibus bill establishing a housing trust fund will no longer use surplus FHA and Ginnie Mae money

- The House Financial Services Committee approved by voice vote July 10 an omnibus housing bill (HR 3995), which includes a provision repealing the proposed increase in the Ginnie Mae guarantee fee, scheduled to go into effect in FY 2004. Congresswoman Marge Roukema (R-NJ) introduced the bill - (Housing Affordability for America Act) - March 19. The Financial Services Committee began marking up the bill on June 20 and then recessed and continued on July 10. (*House Financial Services Committee press release, 7/10/02*)
- The MBA supports the provision repealing the Ginnie Mae guarantee fee increase. (*MBA press release, 6/18/02*) The increase in the Ginnie Mae guarantee fee - included in the 1998 Higher Education Act - raises the annual fee that Ginnie Mae charges on mortgage loans from 6 basis points to 9 basis points, for loans made after October 1, 2004. The revenue from that increase will be used to increase the level of Federal receipts produced by Ginnie Mae. The MBA estimated this increase would cost \$30 million or more a year and would penalize families that are in need of government programs to buy a home. In addition, the MBA noted there is no financial basis for a guarantee fee increase because Ginnie Mae is currently operating at a profit. (*MBA press release, 3/18/02*)

Amendment establishing national trust fund will no longer use surplus money from FHA and Ginnie Mae

- During the June 20 mark-up, the Financial Services Committee agreed by a vote of 33-28 to an amendment by Congressman Bernard Sanders (I-VT) to establish a national trust fund to be funded by surplus money from FHA and Ginnie Mae. The fund would be used to construct and preserve affordable rental housing. (*BNA Daily Report for Executives, Karen L. Werner, 6/21/02*) The MBA opposed the amendment, claiming it could harm the FHA and Ginnie Mae programs, and stated at the time that they were optimistic that the amendment would be defeated on a second vote. (*National Mortgage News Daily Web site, 6/21/02*)
- During the July 10 mark-up, the Committee approved a joint amendment by Congresswoman Sue Kelley (R-NY) and Congressman Sanders that creates a federal matching grant program to support state and local affordable housing trust funds. The amendment calls for Congress to appropriate federal funds for the matching grants and does not touch FHA or Ginnie Mae surpluses, as Congressman Sanders had originally proposed. (*National Mortgage News Daily Web site, 7/10/02*)

Farm Credit System/Farmer Mac

Gotham Partners releases second report raising concerns about Farmer Mac

Gotham argues that Farmer Mac is not accomplishing its mission, may be violating its charter and has not reduced lending rates for farmers and ranchers

- Gotham Partners Management Co., LLC, a New York-based investment manager, released a second report critical of Farmer Mac. The new report specifically addresses issues raised on Farmer Mac's conference call of May 31, 2002 and in the June 5, 2002 Robertson Stephens research report. [Details of Gotham's first report, "*Buying the Farm*," is available in the May 31, 2002 *GSE Report*.]
- Entitled "*Buying the Farm Part Two -- A Response to Issues Raised by Farmer Mac on May 31, 2002 Investor Conference Call*," Gotham's report raised additional questions about the health of Farmer Mac and points out factual misstatements made by Farmer Mac's management on the conference call. Gotham argued that Farmer Mac is not accomplishing its mission, may be violating its charter and has not reduced lending rates for farmers and ranchers.
- Gotham also criticized Farmer Mac for its aggressive financial practices; the inadequacy of its reserves; its ballooning delinquencies; the inadequate pricing of its products; its asset-liability mismatch; its funding problems; its conflicts of interest; and its governance issues.
- In "*Buying the Farm Part Two*," Gotham concluded:
 - "Farmer Mac is the Largest Unrated Issuer of Debt in America. Despite Gotham's offer on the conference call to pay for a rating, Farmer Mac continues to refuse to be rated. Farmer Mac appears to be arguing that credit analysis of GSEs should begin and end with their quasi-governmental status. Clearly, this was not the intention of Congress in creating GSEs. Congress, Farmer Mac's regulators, shareholders and taxpayers should find Farmer Mac's attitude toward its GSE status concerning."
 - "Misleading Disclosure of Delinquencies. Farmer Mac's disclosure of delinquencies materially understates actual loan performance. When adjusted to reflect Farmer Mac's rapid growth, Farmer Mac's delinquencies are as much as five times greater than its peers' delinquencies and are rising. In addition, Gotham demonstrates that loans purchased by the company in 1996 have a delinquency rate in excess of 14.6%."
 - "Reduced Disclosure. On the conference call, the company stated that: 'Transparency in disclosure is, of course, paramount to Farmer Mac.' In fact, as the company's interest-rate, credit, and investment risks have increased, the company has substantially decreased the amount of disclosure it provides to shareholders about these risks. These omissions include nearly all disclosure about Farmer Mac's interest-rate derivative exposure with a notional amount that totaled more than \$1.1 billion the last time this information was disclosed on December 31, 2000."
 - "Match Funding. The company claims that it has matched the duration of its assets and liabilities. It also claims to optimize its hedging in anticipation of the Fed's interest-rate actions. Gotham believes that a company cannot be match funded and, simultaneously, be speculating on interest-rate movements."

- “Farmer Mac May Be in Violation of its Charter. Gotham’s analysis of Farmer Mac’s charter indicates that the company does not have the authority to issue LTSPCs [Long Term Standby Purchase Commitments], which have accounted for over 60% of Farmer Mac’s guarantee volume since their introduction three years ago and approximately 80% of its guarantee volume in 2001.”
- “Farmer Mac Does Not Play a Necessary or Important Role in the Farm Mortgage Market. The company claims to be fulfilling its mission of bringing liquidity to the agricultural mortgage market. In fact, Farmer Mac has not achieved this goal. Despite a guarantee portfolio of over \$4.4 billion at March 31, 2002, less than \$400 million of Farmer Mac-issued Agricultural Mortgage Backed Securities are owned by investors other than Farmer Mac. Farmer Mac’s LTSPC has primarily served to transfer risk from one GSE (the Farm Credit System) to another (Farmer Mac), while increasing risk to the U.S. Government and to taxpayers.”
- “Farmer Mac has Not Reduced Interest Rates for Farmers. In fact, despite significant growth in the company’s guarantee portfolio over the last six years, farm mortgage spreads over Treasury securities have increased over the same period.”
- “The Largest and Perhaps Only Beneficiary of Farmer Mac’s Existence has been Management and the Board. On the conference call Mr. [Henry] Edelman [President of Farmer Mac] pointed to management’s large stock ‘holdings’ of 22% of the company (excluding Zions Bancorp) as evidence of insiders’ stake in the continued success of the company. If Mr. Edelman’s numbers are correct, then restricted stock or options on approximately 960,000 shares representing 8.3% of the company have been granted to insiders since the filing of the 2002 proxy.”
- “*Buying the Farm (Part I)*” and “*Buying the Farm Part II*” and an unofficial transcript of Farmer Mac’s May 31, 2001 conference call are available on Gotham’s Web site at <http://www.gothampartners.com>. (PR Newswire, 7/2/02)

Farmer Mac disclosed less financial information in 2001 than in 2000, reports the *New York Times*

- Although Farmer Mac is subject to SEC requirements, their financial disclosures in 2001 were less than in 2000 in at least three instances, reported Alison Leigh Cowan with the *New York Times*. In 2001, Farmer Mac ceased publishing a table in its annual report on its use of interest rate swaps and replaced it with a few paragraphs with little numbers. As a result, Farmer Mac no longer discloses the notional amount of its derivative position, which was \$1.1 billion in 2000. Farmer Mac also ceased disclosing in 2001 how much of its guarantee fees came from securities retained in its portfolio. Farmer Mac also reported less information on details it once disclosed about the kinds of farm loans it guarantees and their geographic concentration. Farmer Mac noted, “Farmer Mac completely and accurately discloses all information required of it by the securities laws and regulations.” (*New York Times*, Alison Leigh Cowan, 7/12/02)

Postal Service

Momentum is building for a Presidential postal reform commission

- After the recent defeat of a postal reform bill in the House Government Reform Committee, members of the mailing community say momentum is building for the creation of a Presidential postal reform commission, reported Melissa Campanelli with *DM News*. “We’ve heard that it is likely that a commission will be formed within a month or two,” said Jerry Cerasale, senior vice president of government affairs at the Direct Marketing Association (DMA). DMA only recently started supporting the idea. Previously, they felt it

would only slow down the reform process. “When postal reform basically went down in the House, that pretty much dictated to us that something else had to be done,” Cerasale said. “Now, it looks to me like a presidential commission is the fastest way to get some type of reform.”

- There is currently no word on how many members a postal reform commission would have. There have been reports that President Bush has already signed off on a concept paper for the creation of a commission and is identifying those who would serve. However, Bob McLean, executive director of the Mailers Council, and a major supporter of a Presidential commission, said he has not heard anything definitive. He noted that Treasury Department has also “become increasingly interested in this issue.” (*DM News*, Melissa Campanelli, 7/15/02)

***National Journal's Congress Daily* notes that Postal Service's problems are igniting a lobbying battle between some of corporate America's largest businesses**

- The Postal Service “is careening toward a financial train wreck,” reported *National Journal's Congress Daily*. Reforming the Postal Service has ignited a lobbying battle between some of corporate America's largest businesses. On one side is the mailing industry – from monthly billers like American Express to sorters and packagers like R.R. Donnelly & Sons and paper producers, such as International Paper. The mailing industry would profit from a generous Postal Service bailout that could stem a rapid increase in postage costs, reported *Congress Daily*. On the other side, are the Postal Service's two biggest competitors – United Parcel Service and Federal Express. These companies along with the Teamsters Union believe the Postal Service is losing money because it is trying to expand from its traditional mission of delivering first-class mail and that the Postal Service is improperly using revenue from its monopoly in first-class mail to compete with UPS and FedEx in the more lucrative overnight, second-day and bulk mail.
- *Congress Daily* noted, “So far, UPS and FedEx have prevailed in Washington, blocking reform legislation for nearly a decade.” The publication also credited the companies to helping to defeat postal reform legislation in the House Government Reform Committee recently. Even the bill's supporters acknowledge that Congress is unlikely to enact comprehensive postal reform this year. “I think that postal legislative reform is dead,” said Robert McLean, the head of the Mailers Council.
- As a result, a smaller group of mailers are urging limited changes to the Postal Service, such as allowing the Postal Service to make deals (negotiated service agreements) with bulk mailers so that large mailers could perform much of the sorting, bundling, and packaging on their own. UPS opposes the special deals, arguing that they would undercut the company's own package deals while making the Postal Service more competitive. The mailers successfully had language added into an appropriations bill last year requiring the Postal Service to accept the agreements, but the Postal Service has been delaying these arrangements. As a result, mailers may try to add legislation to this year's FY03 Treasury-Postal spending bill to encourage the Postal Service. *Congress Daily* noted, however, that “even if the Postal Service begins entertaining negotiated service agreements, a significant reform of the service may be necessary to avert a financial meltdown.” (*Congress Daily*, Brody Mullins, 7/8/02)

Postal Service's June 30 postal rate increase raises revenue but could cause problems in the long run, reports *Knight Ridder*

- The Postal Service's June 30 postal rate increase, which raises the cost of a first-class stamp from 34 to 37 cents, “will address one problem and aggravate another,” reported Tony Pugh with *Knight Ridder*. The increase will provide the Postal Service with more than \$4 billion a year in new revenue. “But it could also cost millions of customers,” reported Pugh. “That's because every time the cost of mailing a letter goes up, more consumers and businesses turn to the Internet to electronically present and pay monthly bills – often

more cheaply and conveniently than by mail.” Since bills mailed to customers and the return payments generate \$17 billion a year in postal fees, postal officials fear that further postage rate increases could erode those profits and one day price them out of the billing market altogether.

- “When it will reach that point, no one really knows, but we don’t want to get to that position,” said Postal Service spokesman Gerry Kreinkamp. “We know it’s going to happen. We just don’t know when and how fast,” said Robert McLean, president of the Mailers Council. (*Knight Ridder Washington Bureau*, Tony Pugh, 6/29/02)

Americans for Tax Reform calls the Postal Service’s June 30 postal rate increase a “tax”

Believes that the Postal Service’s transformation plan and the recent postal reform legislation are bad ideas

- Grover Norquist with Americans for Tax Reform noted that the Postal Service’s postal rate increase, which raises the cost of a first-class stamp from 34 to 37 cents, is an 8.8% tax increase. “Since we’re all held captive by the USPS monopoly on first-class mail, we’ll have no choice but to cough up additional money to fund a government agency. I’d call that a tax increase, even though the USPS claims on its website that ‘The Postal Service receives no tax dollars for operations.’ Apparently, they think we’re voluntarily paying for their lousy, inefficient services. And they’d have us believe that the \$1.7 billion it received to cover its deficit in 2001 came from some other source than the federal government (i.e. you and me).”
- Norquist noted that the Postal Service’s recent “Transformation Plan” requested that “The Postal Service should be free to make use of its assets and explore service offerings in related markets in order to help fund continuing service responsibilities.” Norquist responded, “Or, in plain English, ‘We should be allowed to abuse our monopoly and screw around in competitive sectors already occupied by companies offering express mail deliveries and e-commerce ventures. We’ll undercut them with taxpayer subsidies, take their market share, drive them out of business, maybe plug our leaks with the money, but definitely give ourselves executive performance bonuses.” As Norquist noted, “That’s privatization in reverse, and it’s as bad as it sounds...The House Government Reform Committee recently considered (and mercifully rejected) postal legislation that would have fed the very same beast it sought to slay by essentially making the ‘Transformation Plan’ law.” The legislation “should stay buried,” said Norquist. “Rather than bestow upon the USPS new abilities to get its hands on our money. Congress should instead encourage and, as necessary, require the USPS to rein in its costs and bring them in line with the already plentiful revenue generated by the sale of 34-cent first-class stamps.” (*National Review Online, Guest Commentary*, Grover Norquist (Americans for Tax Reform), *National Review*, 7/1/02)

Heritage Foundation calls the Postal Service’s transformation plan “insufficient”

- In a *Milwaukee Journal Sentinel* commentary, Heritage Foundation’s Research Fellow James Gattuso argued that the Postal Service’s transformation plan “falls short of the needed transformation.” He added, “It should be stamped ‘insufficient’ and returned.”
- Gattuso noted that the plan “falls short of the mark.” He added, “It rejected the option of going private, although Great Britain and other nations have taken this sensible step. Instead, it chose to remain a government-owned enterprise but with increased flexibility – including the ability to set rates and enter related businesses, such as e-commerce, transportation and printing.”
- Gattuso concluded that the “Postal Service is trying to have its package and mail it, too. It wants the benefit of its present status without the downside. While asking for the freedom that comes with being a private

company, it wants the perks it gets from government – ranging from tax-free status to implied financial backing from the US Treasury. The foremost perk...is its legal monopoly on first-class mail; the privilege of sending competitors to jail is one that few private firms enjoy.” Gattuso added, “Letting the service enter new markets without eliminating its special protections is a recipe for economic distortion. What’s more important, this kind of protection is exactly what fostered the Postal Service’s famous inefficiency in the first place. The culture needs to change, and more competition, not less, is the way to do it.” (*Milwaukee Journal Sentinel*, Commentary by James Gattuso (Heritage Foundation), 7/8/02)

***Boston Herald* editorial calls for privatization of the Postal Service**

- A *Boston Herald* editorial noted, “A new approach is needed before the US Postal Service winds up like Amtrak. Congress should require a privatization plan on a reasonably early deadline. The Postal Service is in the early stages of a death spiral.”
- “Other countries have turned their postal organizations into competitive enterprises, and Americans should not be afraid to learn from them,” added the editorial. “Competition should be the aim of any postal reform in the United States...There is no reason the Postal Service shouldn’t become a profitable, tax-paying, service-oriented enterprise.” (*Boston Herald editorial*, 6/30/02)

Postal Service lost \$281 million in the last three months - on track to lose nearly \$2 billion in FY 2002

- The Postal Service July 2 announced that it lost \$281 million in the last three months, which was a smaller loss than had been expected, largely due to cost cutting. The revenue figures were presented by Chief Financial Officer Richard Strasser at the monthly meeting of the postal governing board. Strasser told the board the loss in the quarter – the three months ending May 17 – was \$80 million less than expected. Overall mail volume was down 1.2 billion pieces below the same period last year – a 2.5% drop. So far this fiscal year, the Postal Service has cut 13,750 workers from the rolls and reduced other expenses. (*Associated Press*, 7/2/02) The Postal Service remains on track to lose nearly \$2 billion for FY 2002. (*BNA Daily Report for Executives*, Derrick Cain, 7/5/02)

Government watchdog groups raise concerns about the Postal Service’s sponsorship of the Tour de France while the Postal Service is facing financial problems

***Indianapolis Star* says the Postal Service spends too much money on activities (such as the Tour de France) that have nothing to do with delivering the mail**

***Houston Chronicle* and *Slate* question why the Postal Service is spending so much money sponsoring the Tour de France**

- **Government watchdog groups raised concerns about the Postal Service’s sponsorship of the Tour de France**, reported the *Indianapolis Star*. The Postal Service spent an estimated \$25 million to sponsor Lance Armstrong’s team at a time when the Postal Service “has bled money, begged for annual bailouts and...raised the price of a first-class stamp to 37 cents.” The article added, “Worse, a number of groups complain, is that the Postal Service carries on its spending largely outside of the public’s view and, in fact, has refused to confirm how much was spent to sponsor the Tour de France effort or whether the expense has translated into any new business.”
- **“I think that any organization that is hemorrhaging money should not spend it on frivolous activities,”** said David Williams, a policy expert with Citizens Against Government Waste (CAGW). **“Ask people at Enron and WorldCom if they’re going to sponsor anything right now.”**

- Some, including Williams, argue that given the Postal Service's financial problems, the Postal Service should not sponsor a sports team. Others argue that the Postal Service must market its name to compete with UPS, FedEx, and DHL Worldwide.
- The Postal Service declined to comment on its sponsorship of the team, whether business had increased because of it or exactly how much money is being spent. Postal Service spokeswoman Monica Hand said the agency would not comment because the *Indianapolis Star* had filed a related Freedom of Information Act request for budget documents. (*Indianapolis Star*, John Fritze, 7/7/02)

Other comments by CAGW

- "I don't know how this deal [cycling sponsorship] will help them climb out from nearly \$13 billion in debt, and they won't tell us what they are getting back from this," said Tom Schatz, President of CAGW. "This has nothing to do with their mission of delivering first-class mail." He added, "This isn't the time for the Postal Service to be throwing money around, not when so many people in this country have opted for other services, including electronic mail, and created losses the Postal Service cannot recover... This is when you need to look at reducing expenditures, and a lot of other businesses have cut back on marketing and promotion. This is not an event that's widely popular in the US. Plus, who doesn't know the post office?" (*Los Angeles Times*, 7/17/02)

Indianapolis Star

- In a July 11 editorial, the *Indianapolis Star* claimed the "Postal Service spends too much on activities that have nothing to do with delivering the mail." The editorial noted that just days after the latest postage rate price increase went into effect, the Postal Service spent \$25 million, maybe more, to sponsor Lance Armstrong's cycling team in this year's Tour de France.
- The editorial noted that Lance Armstrong deserves generous backing, however, "What rankles is the fact that a quasi-independent government service, whose first duty is to the public, feels free to engage in ventures that have nothing to do with delivering the mail, all the while poor-mouthing about the need for more rate increases." The editorial further noted that the Postal Service "spends millions on slick marketing campaigns and product gimmickry" and "has wasted additional millions on failed e-commerce boondoggles and invested billions in equipment modernization without increasing efficiency or reliability."
- The Postal Service's claim that it doesn't receive not tax funding "is hypocritical at best." The editorial noted, "The Postal Service has a monopoly on first-class mail and is exempt from most national, state and local taxes, fees, zoning laws, vehicle license requirements and even parking tickets. Moreover, it has guaranteed access to low-cost government loans. By spring of 2001, the agency had borrowed more than \$12 billion on its \$15 billion line of credit with the U.S. Treasury. For the agency to say it is not beholden to taxpayers is sheer nonsense." The editorial concluded, "The only thing that will stanch the flow of red ink is a complete overhaul of postal operations by Congress. Until elected officials summon the courage, nothing will change -- only the price of first-class stamps." (*Indianapolis Star*, editorial, 7/11/02)

Houston Chronicle

- In a July 13 article, Dale Robertson questioned why the Postal Service sponsors a Tour de France cycling team. Robertson does not believe the Postal Service's sponsorship of Lance Armstrong sell stamps for the US Postal Service and convinces the public that the USPS' mail moves quickly and efficiently. The Postal Service's affiliation with Armstrong is not free publicity – the USPS' cycling budget is almost \$7 million, or more than twice as much as many Tour rivals. The article noted, "When compared with the Postal Service's revenues for the 2001 fiscal year - \$65.9 billion – its commitment would appear inconsequential. But, considering its net 'income' is expected to be a negative \$1.7 billion, increasing its debt load to \$11.3

billion, one has to wonder why the cycling business, no matter how piddling it might be in the grand scheme of things, is deemed to be a good business for a business whose troubles have worsened during Armstrong's reign." The article noted that the Postal Service's recent three-cent increase in the price of a first-class stamp "can easily be construed as a tax on the American Everyman that underwrites Armstrong's goal of winning an unprecedented six consecutive Tours." The article concluded that the US Postal Service "has nothing to gain by having its logo flashed to the French, Danes, Italians, Belgians, and Germans. None are likely to hightail it to the States so they can mail a letter to the family back home." (*Houston Chronicle*, Dale Robertson, 7/13/02)

Slate

- *Slate's* Washington editor, David Plotz, questioned why the Postal Service is spending an estimated \$25 million a year for a three-year contract for its cycling team, when it lost \$281 million last quarter and just raised stamp rates again. The Postal Service's spokeswoman Monica Hand said the cycling deal benefits the post office because it "associates us with a winning team," raises employee morale, and helps promote USPS's international delivery services. She added, "Multinationals in Europe do a lot of mailing, and we are interested in them using our products and services." Plotz noted, "The Postal Service's total international business is only \$1.7 billion annually, less than 3 percent of its revenues. Yet, it's spending more than 6 percent of its entire ad budget on this indirect European product placement." Plotz concluded, "It's worth noting that the millions of Europeans who root for Armstrong and his team can't even use USPS. The post office ships mail from the United States to Europe, but – unlike FedEx – not from Europe to the United States." (*Slate*, David Plotz, 7/10/02)

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