

The **GSE** REPORT™

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Major Events

Capital Markets Subcommittee Chairman Richard Baker (R-LA) plans summer hearing on Fannie & Freddie, when he expects Treasury Department officials to present the Bush administration's GSE policy

- Congressman Baker would like to hold a hearing on GSE issues this summer, when he expects that Treasury Department officials will present the Bush administration's GSE policy. Congressman Baker told *National Mortgage News' MortgageWire* that he has met with Treasury Secretary Paul O'Neill and Under Secretary Peter Fisher "to get the administration to formulate a GSE policy. I have asked them to do it and prepare it for mid-year."
- Congressman Baker spoke to *MW* after informing the Consumer Federation of America (CFA) that he has not bowed out of the "battle" to improve the regulation of Fannie and Freddie and that although his current priorities involve Enron-related reform and insurance issues, he is still involved in GSE reform. "I can assure you we will return with the same vigor and interest in that subject as I have demonstrated in the past," he said. Congressman Baker said he would like to hold the GSE hearing after the Office of Federal Housing Enterprise Oversight (OFHEO) has announced the results of the risk-based capital (RBC) requirements for Fannie and Freddie. [OFHEO is expected to release the results in June 2002. (*National Mortgage News*, 12/17/01) OFHEO regulates Fannie and Freddie's safety and soundness.] Congressman Baker said he has waited 12 years for OFHEO to run the RBC stress test, and he compared OFHEO to a contractor who takes 12 years to paint a house, which is one reason he takes a "dim view" of OFHEO, he told the CFA. (*National Mortgage News Daily Web site*, 3/15/02)

Senator Chuck Hagel (R-NE) calls for hearings on the accounting practices of Fannie & Freddie – requests that the Senate Banking Housing Subcommittee hold hearings

"Recent press accounts have raised some very serious concerns and questions as to the taxpayer liability and financial soundness" of Fannie & Freddie, notes Senator Hagel

Senate Banking Housing Subcommittee Chairman Jack Reed (D-RI) has no plans to hold a hearing

- Senator Chuck Hagel (R-NE) sent a letter requesting that the Senate Banking Housing Subcommittee consider holding hearings on the accounting practices of Fannie and Freddie. The letter, dated March 1, was sent to Housing Subcommittee Chairman Jack Reed (D-RI) and Ranking Member Wayne Allard (R-CO). (*National Mortgage News Daily Web site*, 3/14/02; *Reuters*, 3/14/02; *Dow Jones Newswire*, Dawn Kopecki, 3/14/02)
- **Senator Hagel asked that hearings be held on the "accounting practices and risk exposure" of Fannie and Freddie.** (*National Mortgage News Daily Web site*, 3/14/02) Senator Hagel wrote, "Recent press accounts have raised some very serious concerns and questions as to the taxpayer liability and financial soundness of these Government Sponsored Enterprises (GSE)." He continued, "Additionally, the President's Budget raised concerns over the GSEs' risk management endeavors. The Budget specifically states that, 'the GSEs' management of counterparty risk is of increasing importance.' Counterparty risk, created through hedging transactions, is only one area of public concern. Others include the amount of debt the GSEs carry on their balance sheet and the implied government backing they possess. Addressing the swing in these companies' stock price, such as occurred after the...editorial in the *Wall Street*

Journal, is another area of concern.” (Senator Chuck Hagel letter to Senator Jack Reed and Senator Wayne Allard, 3/1/02)

- Senator Hagel was concerned at how the prices of the GSEs’ stocks sagged after an editorial was critical of Fannie and Freddie’s accounting practices appeared in *The Wall Street Journal*. Skittish markets have recently reacted to critical headlines about Fannie and Freddie but quickly rebounded to earlier levels. The Administration’s FY 2003 budget document and a comment by Treasury Secretary Paul O’Neill that the size of the GSEs could pose a problem caused short-lived volatility in February. (*Reuters*, 3/14/02) Reports of Senator Hagel’s letter also ruffled an otherwise tranquil agency bond market on March 14, pushing spreads between government and agency bonds wider by 1.5 basis points, an agency bond strategist and an agency debt trader said. (*Reuters*, 3/14/02)

Senator Reed has no plans to hold a hearing

- Senator Reed, who controls the panel’s hearing schedule, said that the subcommittee would not take up the issue. Because of time constraints, Senator Reed has no plans to hold hearings on the issue this year, said Senator Reed’s spokesman Greg McCarthy. (*American Banker*, Tommy Fernandez, 3/18/02)

Fannie & Freddie’s response

- Fannie and Freddie officials defended their accounting and debt management practices as among the most transparent in the U.S. and welcomed Senator Hagel’s request. “Our disclosures on our accounting practices exceed those of any other financial institution on the market and we would be happy to discuss our disclosure practices, our risk management practices with the senators,” said Freddie’s spokeswoman Sharon McHale. (*Dow Jones Newswire*, Dawn Kopecki, 3/14/02)
- Fannie’s Senior Vice President for Communications Chuck Greener said his company enjoys bipartisan congressional support even as its finances and practices have been examined in 11 congressional hearings over the last two years. “We are always willing to meet with policymakers to describe how Fannie Mae lowers mortgage costs and expands homeownership as one of the most open, transparent financial services companies in America,” Greener said. (*Reuters*, 3/14/02)

Investment banker says more disclosure on the GSEs’ derivatives would be beneficial

- An investment banker familiar with Fannie and Freddie’s hedging activities said Senator Hagel is concerned about the GSEs’ use of derivatives. The investment banker added that, based on publicly disclosed information, the GSEs’ use of derivatives is not an issue at this time. However, he added that “more disclosure on derivatives would be better for everyone involved. Just because it’s not an issue now, that doesn’t mean it’s not worth asking the question.” (*National Mortgage News Daily Web site*, 3/14/02)

OFHEO establishes a task force to examine Fannie & Freddie’s increased use of derivatives

GSE critics believe more can be done to track the GSEs

OFHEO – the Office of Federal Housing Enterprise Oversight – is Fannie & Freddie’s safety and soundness regulator

- OFHEO has created a task force to examine Fannie and Freddie’s increased use of derivatives. OFHEO’s Deputy Director Jimmy Barton will head the task force, according to OFHEO spokeswoman Stefanie Mullin. The task force will ultimately include about a dozen OFHEO officers

and examiners, including chief examiner Scott Calhoun, added Mullin. (*Reuters*, 3/11/02; *American Banker*, Robert Julavits, 3/12/02)

- “I want OFHEO to be pro-active to ensure every issue with respect to the enterprises’ use of derivatives is thoroughly analyzed and appropriately supervised,” OFHEO Director Armando Falcon said in a statement. Derivatives are an increasingly important part of Fannie and Freddie’s risk management, he said. “Therefore, it’s essential for OFHEO to carefully assess the enterprises’ use of derivatives from the transactional level to the global level,” he stated. (*Reuters*, 3/11/02) Falcon noted that OFHEO’s review of the GSEs’ derivatives so far has found them to be well managed, and the increased use “doesn’t pose a concern to us right now.” (*Bloomberg News*, Rob Wells, 3/11/02)
- Falcon’s primary concern is whether “the derivatives market is large enough and liquid enough to support the enterprises’ growth.” The total derivatives industry is currently valued at \$119 trillion, according to the Bank for International Settlements, however, the majority of Fannie and Freddie's derivatives dealings are kept within the U.S. market and confined to primarily interest rate instruments. The U.S. interest rate derivatives market is considerably smaller, \$38.3 trillion in the fourth quarter of 2001, according to the Office of the Comptroller of the Currency. With seven institutions controlling nearly all of the interest rate derivatives trading in the U.S., OFHEO is also looking at whether that poses an additional risk to the GSEs. “Beyond the transactional issues we examine, there are also broader issues,” Falcon said. “The issues related to, for instance, consolidation in the financial services industry and what that means in terms of concentration of risk if there are a limited number of counterparties that can enter into a transaction with the enterprises.” (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02)
- OFHEO noted that Fannie and Freddie’s use of derivatives has grown. Fannie and Freddie held \$1.6 trillion in the derivatives in the third quarter, up from \$794 billion in 2000, according to OFHEO. Freddie is the biggest user of derivatives with notional, or contract value, of its derivatives holdings at \$1.1 trillion in the quarter, up from \$474.5 billion in 2000. Mullin added that OFHEO examiners are satisfied with the financial soundness of Fannie and Freddie’s derivatives counterparties. OFHEO has examined the pricing of the GSEs’ derivatives contracts to determine if the market is requiring a higher price because of greater perceived risk, but has found nothing that causes concern about illiquidity, she said. “We have not seen anything that would cause us to be concerned about illiquidity,” stated OFHEO’s Chief Examiner Calhoun. “They’re pretty much plain vanilla.” (*Reuters*, 3/11/02; *Bloomberg News*, Rob Wells, 3/11/02) Calhoun said OFHEO is “very comfortable” with Fannie and Freddie’s derivatives activities. “It is very fair to say that they are using derivatives to manage interest rate risk very prudently,” he said. (*American Banker*, Tommy Fernandez and Robert Julavits, 3/13/02)

GSE critics believe more should be done to track Fannie & Freddie

- GSE critics applauded the move by OFHEO to examine the GSEs’ use of derivatives, though several said more could be done to track Fannie and Freddie’s derivatives activities and that the public should be better informed about those activities. (*American Banker*, Tommy Fernandez and Robert Julavits, 3/13/02)
- American Enterprise Institute Fellow Peter Wallison said OFHEO’s comments were significant because they have access to information that no one else possesses. “I’d have to credit a lot of what they have to say,” he said. Wallison still has questions about the GSEs’ derivatives activities, including why Fannie had 99% of its exposure at the end of 2000 with five counterparties, some of which carried an “A” rating. “An ‘A-rated’ counterparty isn’t that good,” he said. OFHEO’s Calhoun

would not identify the counterparties, but said he was satisfied with their quality. Wallison recommended that Fannie and Freddie disclose more information about their derivatives activities, including the names of their counterparties. "If they are in such good shape, they shouldn't be reluctant to make this information public," he said. (*Bloomberg News*, Rob Wells, 3/11/02)

- Financial consultant Bert Ely said OFHEO has made a "small step" in the right direction. "OFHEO is responding to some legitimate concerns that are being raised about the nature and scope" of the two companies' derivatives positions, he said. Still, "what we need is much more disclosure by Fannie and Freddie so that people outside of OFHEO can make reasoned judgments about them" - especially about their trades and the parties they are trading with, Ely said. (*American Banker*, Tommy Fernandez and Robert Julavits, 3/13/02)

Fannie & Freddie's response

- Freddie spokeswoman Sharon McHale said, "We are happy that they [OFHEO] are doing this. We have a very good story to tell." Freddie uses derivatives solely for interest rate risk management, she said, and only uses the "highest-quality" counterparties. (*American Banker*, Tommy Fernandez and Robert Julavits, 3/13/02) "We think it's appropriate that OFHEO look closely at our use of derivatives," said McHale. "They have indicated to us that they are very comfortable with our use of derivatives and the way we manage them." (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02)
- Fannie spokesman Robert McCarson said, "We think it is fully appropriate that our regulator be thoroughly involved in our use of derivatives to manage our portfolio as they have been through their examination staff for many years." (*American Banker*, Tommy Fernandez and Robert Julavits, 3/13/02)

America's Community Bankers (ACB) asks Treasury Department to stop Fannie & Freddie from selling \$1,000 notes (debt) to consumers

ACB believes the \$1,000 notes are inconsistent with Fannie & Freddie's charters

ACB says dealers are marketing the debt to unsophisticated consumers and representing the securities as fully guaranteed by the U.S. government

- ACB is asking the Treasury Department to stop Fannie and Freddie from selling \$1,000 notes to retail investors that compete for bank deposits. [Fannie's program (launched in May 2001) is called "Investment Notes," while Freddie's program (launched in April 2001) is called "FreddieNOTES."] **"This activity could threaten the deposit base of insured depository institutions across the country and could, over time, weaken the ability of our national financial institutions to respond to the credit needs of their communities, including the need for home mortgage credit,"** ACB President Diane Casey said in a March 8 letter to Treasury Secretary Paul O'Neill. "We are requesting that the Treasury Department address these concerns"
- ACB wants Fannie and Freddie to limit their minimum purchase requirement to \$100,000, with full disclosure of the call options and other risks. (*National Mortgage News Daily Web site*, 3/13/02) "We are committed to working toward limitations which would set the minimum consumer transaction at \$100,000, or the prevailing single account deposit insurance maximum, with safeguards established so that the nature of the risks of these instruments is fully and adequately disclosed to the individuals who purchase them," wrote Casey. (*ACB Letter to Treasury Secretary Paul O'Neill*, 3/8/02)

- Casey said the ACB believes the small denomination debt instruments “are inconsistent” with Fannie and Freddie’s charters and threaten the deposit base of banks and thrifts. The debt instruments appear to many ACB members to be intended to establish the Fannie Mae and Freddie Mac names as retail brand names that would facilitate their entry into other retail markets, including deposit-like instruments and home mortgage loan originations, said Casey. She said that over time, these products could weaken the ability of financial institutions to respond to the credit needs of their communities, including the need for mortgage credit. (*ACB press release, 3/12/02*) “Fannie Mae and Freddie Mac were established for a specific mission and were given special benefits...They were not structured to do business with consumers directly. In light of these statutory purposes, we find it difficult to conclude that the issuance of debt at the retail level is either an efficient means to raise operating funds, or appropriate and in keeping with their mission and charter authority. It appears to many of our members to be intended to establish the Freddie Mac and Fannie Mae names as retail brand names that would facilitate their entry into other retail markets, including that of deposit-like instruments and home mortgage loan originations,” wrote Casey. (*ACB Letter to Treasury Secretary Paul O’Neill, 3/8/02*)
- While, “these smaller denomination debt instruments on average currently account for less than two percent of their long-term funding.” However, “there is no limitation in place and the sales could easily grow to represent a more substantial share of GSE funding,” said Casey. (*ACB Letter to Treasury Secretary Paul O’Neill, 3/8/02*) Neither GSE sells directly to the public. Fannie and Freddie have a group of brokers that independently market the notes. Those brokers have sold more than \$4.3 billion of the Fannie Mae investment notes to date. Freddie officials wouldn’t disclose its sales, saying it represented less than 2% of the company’s total debt. (*Dow Jones Newswire, Dawn Kopecki, 3/13/02*)
- The ACB formally asked Fannie and Freddie to stop issuing small-denominated notes last year, but they refused. (*National Mortgage News Daily Web site, 3/13/02*) Based on previous ACB discussions with Fannie and Freddie, the GSEs modified their prospectuses to delete language that had reserved the right to sell directly to the public. However, Casey said there is now evidence that dealers are marketing the instruments to relatively unsophisticated consumers, and are possibly representing the securities as fully guaranteed by the U.S. government. Casey attached two examples of recent marketing pieces to her letter to Secretary O’Neill. (*ACB press release, 3/12/02*) “Notwithstanding assurances to the contrary from the GSEs, we believe that dealers are marketing these instruments to relatively unsophisticated consumers, and possibly representing the securities as fully ‘guaranteed’ by the U.S. Government. Two examples of recent marketing pieces are enclosed to demonstrate how the nature of the repayment risk and early call provisions can and is being misrepresented, and how these instruments are being marketed to the unsophisticated.” (*ACB Letter to Treasury Secretary Paul O’Neill, 3/8/02*)
- Dawn Kopecki with *Dow Jones Newswire* provides an example of one of the marketing pieces dealers are using to sell Freddie’ \$1,000 notes. The ad, from securities dealer Edward E. Jones, contained an “affable cartoon figure with curly hair, a boyish grin and a broad wave” The ad stated, “Say Hello to Freddie Mac...He may be the new friend your portfolio is looking for.” The Edward Jones’ ad also told clients to track their FreddieNotes holdings in the “Government Securities’ section of your statement.” According to Kopecki, the “unassuming caricature of Freddie, sitting atop a house and ready to win your affection, has drawn the ire of community bankers.” (*Dow Jones Newswire, Dawn Kopecki, 3/13/02*)
- “We question why entities as large as Fannie and Freddie need to do anything at the \$1,000 level, unless you’re trying to do branding at the retail level,” said Casey. “They [Fannie and

Freddie]changed their marketing campaigns...Suddenly you're seeing ads in the local mailers for Freddie Notes.” (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02)

- Bankers argued that the Fannie and Freddie’s retail products are a direct threat to their livelihood. “Retail GSE debt appears to compete favorably with long-term deposit instruments,” Casey wrote, “and likely diverts funds from financial institutions and impedes the ability of depositories to meet their mission and charter obligations.” (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02; *ACB Letter to Treasury Secretary Paul O’Neill*, 3/8/02)

Fannie and Freddie’s responses

- Freddie spokeswoman Sharon McHale claimed the GSE sells debt in smaller denominations “to diversify our investor base and tap new sources of funding,” adding that brokers had been requesting such a product for years. (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02) “We tried to be sensitive to ACB’s position,” Fannie’s spokesman said. He noted that the average order for Fannie’s Investment Notes is \$60,000 and appeals to a “distinct customer base” that is different from “people who are attracted to deposit-based products,” he said. (*National Mortgage News*, Brian Collins, 3/18/02)
- Officials at both GSEs said they have internal auditors that screen marketing materials to be sure there is no implied federal guarantee. While Fannie and Freddie are exempt from most federal securities laws, the brokers that sell their products are not. “We take tremendous care to provide any investor with the education to understand the terms and conditions of FreddieNotes,” McHale said. “That means that every circular and prospectus states very clearly and conspicuously in boldface type that these securities are obligations of Freddie Mac only and are not guaranteed by the federal government.” (*Dow Jones Newswire*, Dawn Kopecki, 3/13/02)

FHFB Chairman John Korsmo is open to the idea of allowing the FHLBanks to securitize mortgages for the first time

FHLBank securitization would increase competition between the FHLBanks and Fannie and Freddie to the benefit of consumers, according to Korsmo

ACB is forming a task force to explore FHLBank securitization

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

- FHFB Chairman John Korsmo said he is open to the idea of allowing the FHLBanks to securitize mortgages for the first time. The ability to issue mortgage-backed securities could “maximize the potential” of the FHLBank mortgage purchase programs, Korsmo told members of America's Community Bankers. “I know this is an ongoing discussion among the Federal Home Loan Bank presidents,” Korsmo said. “And I suspect this is a discussion [the FHFB] will be engaged in sooner rather than later,” he told *National Mortgage News’ MortgageWire*. (*National Mortgage News Daily Web site*, 3/12/02; *National Mortgage News*, 3/18/02)
- Korsmo said that in the interest of competition, which could lead to lower costs for homeowners, he is open to the idea. While no proposal is currently on the table, Korsmo said the issue would likely rise during his tenure. Such a role would be a departure from the FHLBanks’ traditional role and put the FHLBanks in direct competition with Fannie and Freddie. (*Real Estate Finance Today*, Chris De

Reza, 3/18/02) Korsmo stressed that the proposals are coming from the FHLBank presidents, not the FHFB. (*National Mortgage News*, 3/18/02)

- Korsmo noted that the FHLBank of Chicago has pioneered a program called the Mortgage Partnership Finance (MPF) in which nine of the 12 regional FHLBanks now participate, allowing them to purchase mortgages from member financial institutions, and that the three other FHLBanks use another mortgage purchase system [Mortgage Purchase Program]. **Korsmo said a principal purpose of authorizing the FHLBanks to issue mortgage-backed securities would be to maximize the potential of MPF to improve liquidity and lower costs to homebuyers.** “So, in pursuing this new tool, the Banks should improve their cooperation in managing and marketing MPF,” he said. (*Dow Jones Newswire*, John Connor, 3/12/02) “I know there are some within the system who believe that the Mortgage Partnership Finance and the Mortgage Purchase Programs cannot continue to grow at the pace they have been growing without securitization,” Korsmo said. (*National Mortgage News*, 3/18/02)
- **Korsmo noted that securitization would put the FHLBanks in direct competition with Fannie and Freddie.** (*National Mortgage News Daily Web site*, 3/12/02) **Korsmo noted that such a move could increase competition between the FHLBanks and Fannie and Freddie to the benefit of homebuyers.** (*Dow Jones Newswire*, John Connor, 3/12/02)
- Citing Fannie and Freddie, Korsmo said: “I don't speak for the other government-sponsored enterprises in housing finance, or for their regulator. **But who can object to choice and competition if it lowers costs for families buying homes?** That is the common bond of the Bank System, Freddie Mac, and Fannie Mae.” Korsmo noted that he was “pleased to see Freddie Mac’s Leland Brendsel express similar views in a recent *American Banker* story, where he said he is not opposed to another government-chartered corporation competing in the market.” **Korsmo said competition among GSEs “can be good, if each party and their regulators make safety and soundness the guiding star. But someday - and only if Congress devises an orderly, safe process - more competition between the GSEs and the private sector may also lead us to new records of homeownership,”** Korsmo added. **“So, a securitization program for the Federal Home Loan Banks can lead the way by anticipating a more level playing field.”** Korsmo added, **“My philosophy is that competition in a free market always leads to more choice and lower prices – in this case, lower costs of homeownership.”** (*Dow Jones Newswire*, John Connor, 3/12/02; *Prepared remarks of FHFB Chairman John Korsmo before America’s Community Bankers*, 3/12/02)
- The FHLBank of New York is opposed to the idea of securitization. “I have grave concerns about us becoming another Fannie,” said FHLBank of New York Board Member George Engleke (Chief Executive of Astoria Federal Savings and Loan, Lake Success, NY). “There are many other vehicles for secondary market execution. I hope the FHLBank System will not be one of them.” (*National Mortgage News*, 3/18/02)
- The ACB is forming a task force to discuss FHLBank securitization. The MPF program could remain a niche product and continue to serve FHLBank members, ACB regulatory counsel Eric Mondres said. However, it needs securitization and centralization if it is going to become a secondary market program, he said. (*National Mortgage News*, 3/18/02)

Freddie’s comments

- “This is something that has come up periodically, but we don’t know enough about it to really comment,” said Freddie’s spokeswoman Sharon McHale. “It is hard to match the efficiencies and the

expertise we bring to the securitization process,” she added. (*National Mortgage News*, 3/18/02)
Freddie spokesman Doug Robinson said it was too early to comment on something that has not yet taken form or direction. (*Real Estate Finance Today*, Chris De Reza, 3/18/02)

- Fannie’s spokesman Robert McC Carson stated, “We have no problem with competition as long as those competitors have the same mission requirements and capital standards that we do.” (*National Mortgage News*, 3/18/02)

National Council of State Housing Agencies (NCSHA) plans to fight OFHEO’s controversial final amendment to its risk-based capital rule for Fannie & Freddie

NCSHA wants OFHEO to change the rule or it will take its case to Congress

Fannie believes the rule is too tough on mortgage revenue bonds - Freddie believes the haircut provision should be changed at least for AAA bonds

OFHEO says no changes to the rule for the time being

OFHEO’s final rule published in March 15 *Federal Register*

- The NCHSA is “gearing up to fight” OFHEO’s controversial final amendment to its risk-based capital rule for Fannie and Freddie, according to Matthew Vadum at the *Bond Buyer*. Sources said that at a minimum the amendment could hurt future sales of mortgage revenue bonds issued by state housing finance agencies by driving up coupons, or at worst, dry up much of the market for such debt.
- The risk-based capital rule establishes the level of capital Fannie and Freddie must maintain to survive a 10-year “stress test” mandated by Congress in the 1992 Act. OFHEO’s risk-based capital rule was originally due December 1, 1994. The rule became effective once it was published in the *Federal Register* in September 2001, however the rule is not enforceable until one year after publication (September 13, 2002). (*Federal Register*, pages 47730-47875, 9/13/01) On February 20, 2002, OFHEO issued an amendment to its risk-based capital rule, which among other things, reduced the capital differential or “haircut” between AAA-rated and AA-rated bonds, but did not eliminate it. Under OFHEO’s proposed revisions, the “haircut” would be reduced to 3.5% for AAA-rated bonds and 8.75% of AA-rated bonds. OFHEO also extended the phase-in period for this portion of the risk-based capital rule from five to ten years. [See March 1, 2002 *GSE Report* for more details on the amendment to OFHEO’s risk-based capital rule.] On March 15, OFHEO’s final rule was published in the *Federal Register*. (*Federal Register*, pages 11850-11872, 3/15/02)
- The NCSHA is concerned about the “haircut” provisions. “We are very concerned that unless OFHEO changes the rule it could cause Fannie and Freddie to dramatically curtail their mortgage revenue bond purchases from state housing finance agencies,” stated Barbara J. Thompson, Executive Director of the NCSHA. The haircuts will drive up the coupons on new-money bonds and “in the end, it’s the lower-income homeowner who will be hurt by that because it will force up the rates on their mortgages,” she said. Given that no state HFA has ever defaulted on one of its bonds, the haircuts constitute a “huge overreaction” to a perceived problem, she said.
- Thompson would like to meet with OFHEO officials about their concerns and to discuss possible changes to the rule. If that fails, the NCSHA will take its concerns to lawmakers. “If we have to eventually ask Congress to legislate this provision out of the rule, we will,” she said.

OFHEO's response

- OFHEO Spokeswoman Stefanie Mullin said there would be no changes to the rule, for the time being. "No changes will be made before the rule becomes enforceable," she said. OFHEO Chief Economist Patrick Lawler stated, "We don't think this will have a significant effect on Fannie Mae's and Freddie Mac's purchases of HFA bonds."

Fannie & Freddie's response

- Fannie spokesman Robert McCarson said the rule is too tough on mortgage revenue bonds. "It's not supported by historical experience," he said. Freddie spokesman Douglas Robinson said the haircut provision should be changed at least for AAA bonds. "Less capital should be held against them," said Robinson.
- According to NCHSA, Fannie and Freddie purchased more than \$3.3 billion of mortgage revenue bonds issued by state HFAs last year, which is about one-third of all mortgage revenue bonds issued that year, but in the 20-year and 30-year bond segments of the market, the GSEs' purchases probably accounted for about three-quarters of all mortgage revenue bonds sold. (*The Bond Buyer*, 3/6/02)

<p>Citizens Against Government Waste (CAGW) suggests Fannie & Freddie should be subject to SEC disclosure rules</p>
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<p>Fannie & Freddie are the only two Fortune 500 companies not under SEC disclosure and registration rules</p>

- CAGW said it remains skeptical of Fannie's Chairman Franklin Raines' claims that Fannie is the "glass box" of financial services companies."
- "Using slick advertisements, media interviews, and an angry letter to the *Wall Street Journal*, Fannie Mae continues to assert that it 'sets the standards for the global financial market,'" CAGW Vice President Leslie Paige said. "We think Fannie doth protest too much. The Enron debacle has exposed the weakness of corporate accountability and potential coziness between financial bigwigs, accountants, and Wall Street analysts, and Fannie's executives are panicked by the scrutiny they've come under."
- **"Fannie and Freddie are the only two Fortune 500 companies not under Securities and Exchange Commission disclosure rules," Paige continued. "The GSEs are overseen only by a weak and inadequate regulator" at OFHEO. "If Fannie and Freddie really are such 'glass boxes,' why won't they subject themselves to SEC disclosure standards? They claim this will cost too much money, but this congressionally chartered corporation makes huge profits. If they continue to require taxpayer underwriting, they should be at least as accountable and transparent as private corporations."**
- "In the wake of Enron mess, taxpayers and their representatives in Congress should remember that Wall Street analysts were giving Enron the buy sign two weeks before that company went up in smoke," Paige said. "Fannie and Freddie have combined debt of \$1.26 trillion, up from \$518 billion in 1997, which makes for an annualized growth rate of nearly 25 percent. The two combined outborrowed the U.S. Treasury by \$1.1 trillion in 2001. All together, according to the Office of Management and Budget, the GSEs' outstanding obligations total \$3.1 trillion."

- “As President Bush has correctly noted recently, Fannie and Freddie have rapidly expanding liabilities that create ‘a potential problem.’ These liabilities are particularly worrying as Fannie and Freddie have sharply increased their use of derivatives...to hedge risk. The great concern is that taxpayers will be left standing with some or all of these debts when the music stops. Before it’s too late, Fannie and Freddie should come clean,” Paige concluded. (*PR Newswire*, 3/1/02)
- Fannie and Freddie have argued when the issue of SEC requirements has arisen before that they’re highly transparent and that subjecting them to SEC registration fees would be a tax on homeownership. (*Dow Jones Newswire*, John Connor, 3/6/02)

National Association of Home Builders (NAHB) seeks a legislative clarification to Fannie & Freddie’s charters that would give the GSEs the authority to purchase and package production loans

- Kent Conine, first vice president of the NAHB and next to lead the group in 2003, said the NAHB would like to see a delivery system that would facilitate the securitization of acquisition, development and construction loans and the development of securities structures for such loans. “Access to capital market investors could increase market efficiency, lower borrowing costs and help the building industry better navigate future credit crunches,” Conine said. Short of that, the NAHB is seeking a legislation clarification to Fannie and Freddie’s charters that would give the GSEs the authority to purchase and package production loans. (*National Mortgage News*, Lew Sichelman, 3/11/02)

Fannie & Freddie faulted for an oversupply of apartment buildings

Sam Zell, chairman of Equity Residential Properties Trust, the largest US apartment owner, criticized Fannie & Freddie for “very aggressive overlending”

Fannie & Freddie are currently the two biggest providers of financing in the multifamily sector -- much of it for middle- to high-end properties, which is ironic for organizations widely associated with affordable housing

- **Ray Smith with the *Wall Street Journal* asked, “Are the lending programs of Fannie Mae and Freddie Mac driving the nation’s apartment market toward potential trouble?”** Fannie and Freddie have made an aggressive effort to finance buyers of apartment buildings. Construction of apartment buildings has remained relatively strong despite weakening demand, and industry analysts and developers believe an oversupply of apartments is coming.
- **Real-estate magnate Sam Zell, chairman of Equity Residential Properties Trust, one of the nation’s largest apartment landlords, blasted Fannie and Freddie for “very aggressive overlending” in the multi-family market. Zell said Fannie and Freddie were in danger of becoming like the savings-and-loans institutions of the 1980s -- not because of risky loans but because they concentrate so much of the multifamily lending market.**
- While traditional lenders such as banks and insurers have cut back loans to apartment developers and buyers, Fannie and Freddie’s lending programs have kept growing. **Fannie and Freddie are currently the two biggest providers of financing for acquisitions in the multifamily sector -- much of it for middle- to high-end properties, which Smith noted is ironic for organizations widely associated with affordable housing.** Last year, Freddie invested \$12.3 billion in the multifamily sector, while Fannie invested \$22.8 billion.

- By financing loans for buyers, Fannie and Freddie “have made it more advantageous for builders to go out there and develop,” said Robert Stevenson, an apartment analyst at Morgan Stanley. In a worst-case scenario, “what you could eventually see if the supply problem got bad enough, is that some of these properties would be given back to lenders in foreclosures, like in the '90s,” he said.
- Officials at Fannie and Freddie argue that while their lending programs have expanded, their standards haven't. Officials at Freddie do not see any connection between its financing initiatives and continued apartment construction. “I don't think that's true,” said Adrian Corbiere, senior vice president of multifamily at Freddie. **“Our overall volume of lending has increased because we have taken significant market share from other lenders.** But the overall volume of lending for multifamily financing hasn't increased dramatically.”
- **Smith reported that while much of Fannie and Freddie's financing goes toward middle- and high-income properties, the GSEs argue that most of their programs help fund so-called affordable housing. However, national data show an increasing shortage of lower-income multifamily housing but a growing oversupply at the higher levels, which “makes it hard for the organizations to reconcile their do-gooder images with their existence as numbers-driven, publicly traded corporations seeking to please shareholders.”** (*Wall Street Journal*, Ray A. Smith, 3/1/02)

Mortgage Bankers Association (MBA) would like Fannie & Freddie to disclose their non-mortgage investments and the identities of their derivative counterparties

MBA supports stronger regulation of the GSEs and removing OFHEO from the appropriations process

“Currently, the financial, political, and strategic means of the companies dwarf the capacity of their regulators,” says MBA President Jonathan Kempner

- In a March 8 letter-to-the-editor of the *Wall Street Journal*, MBA President and CEO Jonathan Kempner took exception to the *Wall Street Journal's* editorial comparing Fannie and Freddie to Enron, yet noted that the editorial raised “important points worthy of discussion.”
- **Kempner noted that Fannie and Freddie had “grown dramatically in size and market share” in the past twenty years. “While they [Fannie and Freddie] are exceedingly well run, no business is immune to unexpected difficulties. Indeed, any diminution in their financial condition would be troubling for the entire housing finance system, and their failure would be catastrophic.” Therefore, the MBA supports the need for strong and effective regulators of the GSEs.**
- “We agree in concept with more regulatory oversight of their financial condition, along with continued assurances that they operate within the statutory bounds of their congressional charters,” wrote Kempner. The MBA supports removing OFHEO from the appropriations process and providing HUD with the necessary resources to fulfill its regulatory duties. The MBA also supports having Fannie and Freddie include non-mortgage investments and identify their derivatives counterparties in their financial disclosures. **“Currently, the financial, political, and strategic means of the companies dwarf the capacity of their regulators.”** (*Wall Street Journal Letter-to-the-Editor by Jonathan Kempner*, 3/8/02)

MBA supports “Ginnie Mae Choice” but does not support specific Ginnie Mae Choice legislation

MBA plans to explore ways to increase competition in the secondary mortgage market

Consumer Mortgage Coalition (CMC) praises the MBA for adopting a task force position paper that supports the concepts contained in the Ginnie Mae Choice proposal

“Ginnie Mae Choice” supporters say the proposal will lower costs to consumers, increase revenue to the federal government, and create competition for Fannie & Freddie

- The MBA approved its task force review of Ginnie Mae Choice - a program that would allow Ginnie Mae to securitize privately insured high loan-to-value conventional mortgages - at a March 11 forum. The MBA’s position paper noted the following:
 - “MBA believes that Ginnie Mae has performed a critical role historically as the secondary market agency responsible for the securitization of government loans and we believe that Ginnie Mae also has the potential to benefit additional American homebuyers by providing an alternative mechanism for the securitization of certain conventional loans through its guaranty function.”
 - “Therefore, MBA supports broad authorization that would allow Ginnie Mae to guarantee MBS [mortgage backed securities] pools, which include, in whole or in part, conventional mortgages.”
 - “MBA believes authorization to permit Ginnie Mae to guarantee MBS backed by conventional loans must be broad and not program specific. Broad authority will provide the discretion Ginnie Mae needs to create and alter successful programs to serve the changing needs of the American homebuyer and the housing finance system.” (*MBA Position Paper – Ginnie Mae and 2002 Action Plan; MBA press release, 3/13/02*)
- **The MBA said it would not back pending Ginnie Mae Choice legislation – as currently written – but is in favor of the concept of Ginnie Mae Choice. While the MBA agreed to support broad authorization that would allow Ginnie Mae to guarantee MBS pools backed by conventional loans, the MBA “determined that it would not support the current versions of legislation that would permit Ginnie Mae to include conventional mortgage loans in their mortgage-backed securities pools.”** A spokeswoman for the MBA said, “The way the bill[s] is [are] now written, we are not supporting it.” (*MBA Position Paper – Ginnie Mae and 2002 Action Plan; MBA press release, 3/13/02; National Mortgage News Daily Web site, 3/13/02; National Mortgage News, Paul Muolo, 3/18/02*)
- **The MBA said it will, however, “continue to work closely with all interested parties to explore ways to bring more competition into the secondary market.”** The MBA said its task force “reaffirmed MBA’s long-standing support for free, fair and expanded competition in the secondary markets.” “Increased competition in the secondary market creates a more rigorous and responsive industry and increases homeownership opportunities for more Americans,” said MBA Chairman, Jim Murphy. “This is true whether the increased competition comes from expanding the role of Ginnie Mae, opening up access to the Federal Home Loan Banks, or ensuring the mission fulfillment of the Government-Sponsored Enterprises.” (*MBA Position*

Paper – Ginnie Mae and 2002 Action Plan; MBA press release, 3/13/02; National Mortgage News Daily Web site, 3/13/02)

- There are currently two versions of “Ginnie Mae Choice” bills. The bills were introduced by Senator Wayne Allard (R-CO) and Congresswoman Marge Roukema (R-NJ) on November 1, 2001 and would allow Ginnie Mae to securitize privately insured mortgage loans for the first time and allow Ginnie Mae to compete with Fannie and Freddie in the secondary mortgage market. (*Reuters*, Mark Felsenthal, 12/3/01) MBA Vice President of Government Affairs Steve O’Connor said, “The two bills are markedly different. There is not enough in the language that gives GNMA [Ginnie Mae] good control over designing the program.” **O’Connor and other MBA officials made it clear that they like the Ginnie Mae Choice program in concept and that the MBA would like more competition in general. The MBA is forming a special “new markets” task force to further study the issue of competition in the secondary market.** (*National Mortgage News*, Paul Muolo, 3/18/02)
- **Industry and political observers said Ginnie Mae Choice could pose a major competitive threat to Fannie and Freddie. Several analysts have said that a larger role for Ginnie Mae would stimulate competition through lower guarantee rates and better execution for mortgage banks. That would in turn check the growth of Fannie and Freddie, observers said.** (*American Banker*, Tommy Fernandez, 2/11/02)

CMC praises the MBA

- **In a March 14 letter to MBA President Jonathan Kempner, the CMC congratulated the MBA board members and Kempner “for the adoption of the task force position paper that supports the concepts contained in the ‘Ginnie Mae Choice’ proposal.” The letter, signed by CMC Executive Director Anne Canfield, said the CMC looks forward “to working actively with the MBA to advance legislation that creates competition in the secondary market, expands homeownership opportunities, and provide consumers with more choices in the mortgage marketplace.”** (*CMC Executive Director Anne Canfield letter to MBA President Jonathan Kempner*, 3/14/02)
- In related news, the National Community Reinvestment Coalition (NCRC) held an “off-the-record” debate on Ginnie Mae Choice. “We are being lobbied by both sides,” said NCRC President John Taylor. The NCRC is primarily concerned about what will increase the availability of mortgage credit for low-income and underserved borrowers. “I have no interest in trying to have Fannie and Freddie’s multibillion profit go to GE or any of the mortgage insurers,” said Taylor. “Our interest at the end of the day, is whether it is going to benefit traditionally underserved people.” (*National Mortgage News*, Brian Collins and Paul Muolo, 3/4/02) “The question is whether Ginnie Mae Choice begins the opportunity for a third securitizer to do more,” Taylor said, “or for Fannie and Freddie to do more and to show that we do not need a third securitizer.” (*National Mortgage News Daily Web site*, 2/26/02)
- Representatives of private mortgage insurance companies argued to the NCRC that Ginnie Choice would help A-minus borrowers get prime conventional financing. Fannie and Freddie representatives argued that it only duplicates their efforts and that Ginnie Choice will hurt the FHA program. However, the community activists complained that Fannie and Freddie need to provide more affordable housing loans in urban neighborhoods, which have been taken over by subprime lenders. NCRC members support risk sharing if it could improve the FHA’s performance. They said the FHA’s high foreclosure rate is “destroying” neighborhoods, and insisted that legislation creating a

risk-sharing program should have explicit affordable housing goals. (*National Mortgage News Daily Web site, 3/1/02*)

National Taxpayers Union (NTU) praises the Bush Administration's budget plan for better scrutiny of Fannie & Freddie

NTU says the taxpayer cost of bailing out the GSEs would dwarf Enron and the S&L crisis

- The Bush Administration's FY 2003 budget proposal calling for Fannie and Freddie's safety and soundness regulator, OFHEO, to be removed from the appropriations process was praised by the NTU. The proposal would provide a more independent, assessment-based structure for OFHEO, similar to that which exists for other financial regulatory agencies.
- **"Trillions of dollars in potential taxpayer liabilities add up to one big reason for better oversight of Government-Sponsored Enterprises like Fannie Mae and Freddie Mac,"** said NTU Vice President for Communications Pete Sepp. **"Current headlines about the Enron debacle, not to mention past headlines about the S&L crisis, ought to convince policymakers of the need for more fiscal stewardship now."**
- According to the Congressional Budget Office (CBO), Fannie and Freddie receive an annual taxpayer subsidy of \$10.7 billion. As of September 2001, Fannie and Freddie's outstanding debt had more than doubled over the previous 4 years to \$1.26 trillion, which CBO said is implicitly backed by taxpayers.
- **"By subjecting Fannie Mae and Freddie Mac to a more robust oversight system that other regulators already require, the Bush Administration is doing an important service for the safety of the nation's balance sheet,"** Sepp concluded. (*NTU press release, 3/1/02*)

Fannie Mae and Freddie Mac

OFHEO releases the first in its series of research papers on Fannie & Freddie

Paper finds defaults are far more likely for subprime than prime mortgages

- OFHEO released the first in a series of research papers ("working papers") on Fannie and Freddie. Views expressed in these papers are those of the researchers and authors and do not necessarily represent the policies or positions of OFHEO or other officers, agencies, or instrumentalities of the US Government. OFHEO's papers are designed to enhance public understanding of the nation's housing finance system, particularly the mortgage industry.
- The first paper, *"Patterns of Default and Prepayment for Prime and Nonprime Mortgages,"* by OFHEO staffer Anthony Pennington-Cross, found that the probability of a subprime loan default in the first 28 months is eight times as high as that of a prime loan default and that subprime [nonprime] borrowers are generally more likely to prepay and default than prime borrowers. The paper noted, "However, the econometric findings indicate that the extent of those relative tendencies vary substantially and (with respect to prepayments) may be reversed depending on loan age, credit scores, down payments, interest rates, house prices, and labor market conditions."

- The paper found that “For example, model results indicate that in the 28th month of the loan the conditional monthly probability of defaulting is 0.98% for typical nonprime borrower and 0.12% for the typical prime borrower,” the OFHEO paper said. “The typical conditional monthly probability of prepaying is also estimated as 3.12% for nonprime and 2.44% for prime borrowers.” The paper, available on OFHEO’s Web site (www.ofheo.gov) used data from Fannie and Freddie. (*OFHEO press release, 3/6/02; National Mortgage News Daily Web site, 3/8/02; Dow Jones Newswire, John Connor, 3/6/02*)

Fannie & Freddie are the top purchasers of subprime loans, according to *National Mortgage News*

FM Watch says Fannie & Freddie deny purchasing subprime loans, while having a 30% subprime market share

Fannie says it plans to purchase half of today’s subprime loans

Freddie will no longer invest in subprime mortgages with prepayment penalty terms greater than three years

National Mortgage News reports that Fannie & Freddie are the top purchasers of subprime loans

- Fannie and Freddie securitized \$22.3 billion in subprime loans in 2001, increasing their combined market share by 74%. According to figures released by the GSEs, Fannie securitized \$13.3 billion in subprime loans, Freddie \$9.03 billion.
- In 2001, all subprime lenders produced \$180 billion in loans, which means Fannie and Freddie securitized or guaranteed 12.04% of all credit-impaired loans produced by the residential finance industry. In 2000, Fannie and Freddie securitized or guaranteed 6.9% of the \$134 billion in subprime loans originated, according to figures by *National Mortgage News* and its affiliate *Quarterly Data Report*. Fannie’s spokeswoman said that about 22% of the subprime loans it securitized were held in the GSEs’ portfolio. Freddie would not provide a number. (*National Mortgage News, 3/11/02*)

FM Watch says Fannie & Freddie deny purchasing subprime loans, while having a 30% subprime market share

- **Fannie and Freddie are both denying and leading the subprime market, according to FM Watch.** According to data from last year compiled by *National Mortgage News*, Fannie bought \$13.3 billion in subprime loans last year, more than any other lender, while Freddie purchased approximately \$7.5 billion, making it second only to Fannie. (*FM Watch press release, 3/5/02*)
- [FM Watch based its press release on *National Mortgage News’ Daily Web site* on March 1. The Web site reported that Fannie purchased \$13.3 billion in subprime loans last year, making it the largest buyer of these nonconforming loans, according to figures compiled by *National Mortgage News* and its *Quarterly Data Report* affiliate. In four years, Fannie has gone from having little or no presence in the market to amassing a correspondent market share of 19.56%. At *MortgageWire’s* deadline, figures were not available for Freddie, but its subprime purchases or guarantees were estimated to be in the range of \$7.5 billion, which would make Freddie the No. 2-ranked buyer (approximately 11.03% market share). According to *QDR*, about \$180 billion in subprime mortgages were produced last year. (*National Mortgage News Daily Web site, 3/1/02*)]

- FM Watch’s recent report, “Fannie Mae and Freddie Mac: Failing the American Dream in the Nation’s Cities,” showed that Fannie and Freddie are lagging private institutions in serving minority homebuyers in 97 of the 100 top African-American markets, and 87 of the 100 top Hispanic markets. The only loans included in the survey were conventional, conforming home purchase loans. Typically, 11% of such loans can be considered subprime.
- By way of rebuttal, FM Watch noted that Fannie and Freddie offered the following:
 - “The FM Watch report is a distortion of our records because they're comparing us to a market we don't compete in - the sub-prime market.”
(Wynn Yerby, director, Fannie Mae Alabama Partnership Office, Birmingham, AL, “Minority homebuyers untallied,” *Montgomery Advisor*, 3/4/02)
 - “Fannie Mae spokesman [Bob] McCarson took exception to the group's numbers, saying that they include the private sector's subprime and manufactured housing lending statistics, two areas in which his organization does not lend. He also refuted FM Watch's claim that the GSEs receive a governmental subsidy.”
(“Freddie and Fannie take heat from lobby group,” *Indian Country Today*, 2/26/02)
 - Spokesmen for Fannie Mae and Freddie Mac . . . say FM Watch's figures -- based on U.S. Home Mortgage Disclosure Act data -- exclude small lenders, a substantial amount of their business, and include subprime loans, which the two agencies avoid.
(“Mortgage firms boost minority service; But competitors criticize Fannie Mae, Freddie Mac,” *Milwaukee Journal Sentinel*, 2/24/02)
 - Fannie and Freddie both said the FM Watch study relies on statistics that don’t apply to their operations. “To make it appear that Fannie Mae doesn't lead (the industry) in lending, FM Watch throws in high-cost subprime loans and lenders we don't do business with,” Fannie’s spokeswoman Daue said. “They're judging us against loans we're not even buying.”
(“FM Watch Blasts Fannie, Freddie In Lobby, Media Campaign,” *Dow Jones Newswire*, 2/11/02)
- **“This is a classic example of Fannie and Freddie's habit of speaking out of both sides of their mouths,”** said FM Watch Executive Director Mike House. **“When they can't justify their failure to lead the market in serving minority and low income families, they resort to distorting their facts. It's time for Congress to strengthen oversight of the GSEs - someone should be holding them accountable.”** (*FM Watch press release*, 3/5/02)

Fannie says it plans to purchase half of today’s subprime loans

- In an interview with the *American Banker*, Fannie’s Vice Chairman Jamie Gorelick said Fannie is planning to purchase as much as half of today’s subprime loans. Gorelick said Fannie would be enlisting the help of conventional lenders to reach this goal by coaxing them to lend to borrowers considered subprime and to do so with Fannie’s products. Fannie has also modified the loan acceptance parameters of its automated underwriting system, Desktop Underwriter, to accept these new subprime borrowers. “We’ve moved cautiously and gradually by expanding our underwriting criteria a little bit at a time to make sure that we understood how the loans perform,” Gorelick said.
- Though Fannie says it does not have a timetable or volume target, Gorelick said that Fannie could eventually absorb half of what is now considered subprime into the conventional market. “I doubt that we would ever reach the full subprime market,” she said, “but a very significant portion of those currently in the A-minus market could qualify for one of our products and could be served by conventional lenders.”

- Gorelick claimed that conventional lenders have not done enough to serve minority and urban populations, which has contributed to conventional lenders' giving up large areas of urban America to subprime lenders and causing predatory lending to proliferate. She claimed that Fannie's presence in the subprime market would mitigate abusive lending and end predatory lending practices. She dismissed subprime lenders' contention that the GSEs' hold a competitive advantage from their implicit government guarantee and that they do not have enough experience with the subprime market.
- Financial consultant, Bert Ely, was not surprised by Fannie's plan. "This just reflects the fact that they are running out of room in their normal A-minus paper market," he said. "They are having to dip further and further into the credit pool." Ely said that Fannie and its regulators would have to be careful over the next few years to determine whether the company's underwriting practices can keep pace with the new level of credit risk. "Are their scoring models and their underwriting models geared sufficiently to deal with this higher-risk lending?" he said. "You can't extrapolate painlessly from writing A-minus-grade mortgages to going down the market."
- Gary Gordon, managing director of specialty finance at UBS Warburg, expressed confidence that Fannie would be "very careful" about risk sharing with its lenders and about the quality of servicing for the loans. Subprime mortgages "are obviously loans that are very servicing-sensitive," he noted. (*American Banker*, 3/1/02)

Freddie will no longer invest in subprime mortgages with prepayment penalty terms greater than three years

- Freddie said it will no longer invest in subprime mortgages with prepayment penalty terms that exceed three years, effective for all subprime mortgages originated on or after October 1, 2002. The announcement was made at the annual conference of the National Community Reinvestment Coalition in Washington, D.C. on February 28. Freddie currently has a five-year limit on prepayment penalties.
- Freddie is timing its subprime investment changes to coincide with the October 1 effective date of the lower interest rate "triggers" for disclosures on high cost loans covered by the Home Ownership and Equity Protection Act (HOEPA) announced last year by the Federal Reserve Board. (*Freddie press release*, 3/1/02; *National Mortgage News Daily Web site*, 3/4/02))
- Prepayment penalties are standard in the subprime market and are not inherently predatory, according to Faith Schwartz, Freddie's Director of Sales and National Lending. "But we felt that it could be more predatory as the duration got longer," she said. After three years a borrower should be able to refinance without a significant penalty, she stated, particularly if their credit rating has improved. (*National Mortgage News Daily Web site*, 3/4/02; *National Mortgage News*, Brian Collins, 3/11/02)
- Fannie said it does not plan to impose any limit on the duration of prepayment penalties at this time, according to Fannie spokesman Alfred King. "So right now we aren't planning to do anything more. But we continue to review it to see if there is a need for clarification," he said. (*National Mortgage News*, Brian Collins, 3/11/02)

OFHEO says Fannie & Freddie are adequately capitalized for this quarter under their minimum capital requirements

OFHEO does not yet report whether Fannie & Freddie are adequately capitalized under their risk-based capital requirements

- OFHEO Director Armando Falcon, Jr. announced that Fannie and Freddie were adequately capitalized at December 31, 2001. The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the OFHEO Director to determine the capital level and classification of the Enterprises not less than quarterly. OFHEO determines whether the Enterprises are adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized.
- OFHEO determined that Fannie's minimum capital requirement was \$24.182 billion and critical capital level was \$12.324 billion at December 31, 2001. Thus, Fannie's core capital of \$25.182 billion on that date exceeded the minimum capital requirement by \$1.000 billion and exceeded the critical capital level by \$12.859 billion.* Freddie's minimum capital requirement was \$18.515 billion and critical capital level was \$9.429 billion at December 31, 2001. Thus, Freddie's core capital of \$19.336 billion on that date exceeded the minimum capital requirement by \$821 million and exceeded the critical capital level by \$9.907 billion.*

*Although OFHEO's risk-based capital rule is final, the '92 Act provides a one-year period between its effective date (September 13, 2001) and the time OFHEO may classify an Enterprise based on its risk-based capital requirement. Therefore, during this period, OFHEO will continue to classify the Enterprises based on their minimum capital requirement. (*OFHEO press release, 3/11/02*) OFHEO's risk-based capital rule is not enforceable until September 13, 2002.

OFHEO announces new associate director for external relations

- Peter Brereton has joined OFHEO as Association Director for External Relations. Brereton will work with Congress, the Administration and trade associations on behalf of OFHEO. Brereton served as Senior Vice President and Director of Government Relations for KeyCorp for nearly a decade, served as Senior Vice President and Legislative Counsel for the Savings and Community Bankers of America, was Vice President and Legislative Counsel for Ameritrust Company and worked for the Mortgage Bankers Association of America. Brereton has also served as Chairman of the Government Affairs Council for the Financial Services Roundtable and belonged to the Legislative Liaison Advisory Group of the American Bankers Association. He received his law degree from the Cleveland-Marshall College of Law, a master's degree from the George Washington University and undergraduate degree from Le Moyne College. (*OFHEO press release, 2/22/02*)

Fannie & Freddie are rated "A-" by Moody's Investors Services

Fannie & Freddie's senior debt rated "AAA," primarily based on the GSEs' implied government guarantee

- Moody's Investors Service assigned Fannie and Freddie financial strength ratings of "A-." Fannie said Moody's attributed the rating to the "critically important role Fannie Mae plays in housing finance in the United States, together with its stable earnings performance and its comprehensive and conservative risk management capabilities." The Bank Financial Strength Rating measured the

company's independent financial strength, and “does not assume government support,” Fannie said. Freddie said Moody’s lauded its “strong risk management disciplines, and a very sound and conservative credit culture” and characterized Freddie as “among the best financial firms worldwide on these factors.” Moody’s also said the rating reflected Freddie’s “deeply ingrained risk conservatism, excellent business franchise, and sophisticated, multi-level reporting and governance procedures,” Freddie said. (*National Mortgage News Daily Web site, 2/28/02*)

- Moody’s assigned Fannie’s senior long-term debt as “AAA,” accounting for the GSEs’ implied government guarantee. (*Dow Jones Capital Markets Report, Tyler Lifton, 2/28/02*) Freddie’s long term debt received a similar rating from Moody’s. (*Freddie press release, 2/28/02*) Standard & Poor’s also rated Fannie and Freddie’s senior unsecured debt “AAA,” primarily reflecting Standard & Poor’s opinion that the US government implicitly supports the senior debt of both GSEs. (*Standard & Poor’s press release, 2/28/02*)

GSE debt news:

- (1) GSEs’ long-term debt issuance surges in 2001**
- (2) Foreign investors are purchasing a record amount of Fannie & Freddie’s debt and are “happy to ignore the precarious leverage underpinning these two enormous institutions,” reports *breakingnews.com***
- (3) Fannie may issue euro-denominated debt in the future but has no current plans**

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 are being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark are: (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 that there is expected to be budget deficits in the next few years, the search for alternative investments may be lessened.

GSEs’ long-term debt issuance surges in 2001

- Long-term federal agency debt issuance reached a record \$921.5 billion in 2001, more than double the \$428.1 billion issued in 2000. Long-term issuance by all federal agencies increased in 2001. Federal agencies include Fannie, Freddie, the FHLBanks, Sallie Mae, Farm Credit System, and the Tennessee Valley Authority. (*Bond Market Association press release, 2/28/02; Dow Jones Newswire, John Connor, 2/28/02*)
- Fannie, Freddie and the FHLBanks accounted for the lion’s share of the long-term agency debt issuance last year. The biggest agency issuer of long-term debt in 2001 was the FHLBank System with \$383 billion, up more than 100% from the \$190.8 billion total in 2000. Next was Fannie, which issued \$249.4 billion in 2001, up 126% from the \$110.2 billion issued in 2000. Freddie was third with long-term debt issuance of \$235.2 billion in 2001, up 147% from the \$95.2 billion total in 2000. Fannie and Freddie each increased issuance, partly to finance the growth of their retained mortgage portfolios during 2001. (*Bond Market Association press release, 2/28/02; Dow Jones Newswire, John Connor, 2/28/02*)

- Short-term federal agency debt outstanding increased to \$718.3 billion as of December 31, 2001, up 23.1 percent from the \$583.5 billion outstanding at the end of 2000. Short-term debt outstanding of Fannie and Freddie increased. Fannie issued \$288.5 billion in short term debt in 2001, up 29.2% from 2000; while Freddie issued \$222.8 billion in short term debt, up 65.8% from 2000. Short-term debt outstanding of FHLBanks decreased 13.3 percent to \$139.8 billion as of December 31, 2001. (*Bond Market Association press release, 2/28/02; Dow Jones Newswire, John Connor, 2/28/02*)

Foreign investors are purchasing a record amount of Fannie & Freddie's debt

- Foreign investors purchased a record \$165 billion in US government agency bonds in 2001. **“Needless to say, foreigners are buying Fannie Mae and Freddie Mac bonds because of the sanguine view that these are higher yielding quasi Treasury bonds. In so doing, foreigners are happy to ignore the precarious leverage underpinning these two enormous institutions,” reported Christopher Wood with *breakingnews.com*. (*breakingnews.com*, Christopher Wood, 3/8/02)**

Fannie may issue euro-denominated debt in the future but has no current plans

- Fannie may issue euro-denominated bonds in the future but has no current plans for a program like Freddie's euro-denominated bond program, Fannie's Vice President and Treasurer Linda Knight said on March 14. Knight said that Fannie would continue to be opportunistic when examining non-dollar funding opportunities. “We look at it all the time, but we have not yet executed in the euro market.” She noted that Fannie's responsibility on the funding side “is to deliver to a mortgage portfolio the most attractively priced debt in the best structure at any point in time...So far we continue to see that execution in dollars as opposed to other currencies. But we constantly monitor these markets and if we see some opportunities we would be happy to take advantage of them.” (*Reuters*, Alex Clelland, 3/14/02)

<h3>Freddie has outpaced Fannie in collateralized mortgage obligation (CMO) issuance in 2002</h3>
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- Freddie has been garnering an ever larger share of the market for structured mortgage products, according to Joy C. Shaw with *Dow Jones Newswire*. The market share of structured mortgage products – mostly CMOs – shifts frequently between Fannie and Freddie, but generally their shares are fairly comparable. However, this year, Freddie's CMO issuance has far outpaced Fannie, which caught the attention of the market.
- Lehman Brothers noted that preliminary data shows that Freddie issued \$26 billion of CMOs in February while Fannie issued \$9.5 billion. In January, Freddie issued approximately \$20 billion of CMOs, while Fannie issued \$3.5 billion. If Freddie's total structured mortgage product issuance is added up for February, which includes CMOs, interest-only strips (IOs) and principal-only strip securities (POs), it totaled \$31.5 billion. February is the best one-month showing for Freddie since the GSE began issuing CMOs in 1988, said Tom Flynn, transaction executive at Freddie. By comparison, Fannie in February issued \$10.8 billion in structured mortgage products, according to Sharon Stieber, vice president of structured products at Fannie. In its quarterly newsletter *Gold Perspective*, Freddie said it plans to “broaden and deepen the market for structured mortgage securities” over the next several years. (*Dow Jones Newswire*, Joy C. Shaw, 2/22/02)

Fannie Mae

Fannie announces new agreements with the American Bankers Association (ABA) and the Independent Community Bankers (ICBA) for community banks

Fannie is increasing its small-lender efforts

Fannie catches up to Freddie in serving the small and mid-size thrift industry

ABA partnership

- Fannie and the ABA announced a nationwide partnership to increase small and mid-size banks' access to the secondary market and expand homeownership opportunities for low- and moderate-income homebuyers. The partnership was announced at the ABA National Conference for Community Bankers in Las Vegas.
- Under the agreement, ABA members will benefit from better pricing and easier access to Fannie's products and services, including: Fannie's automated underwriting system, Desktop Underwriter; mortgage products such as Fannie's MyCommunityMortgage that help banks meet Community Reinvestment Act requirements; educational and training support on accessing the secondary market; and a package of nontraditional mortgage products to help ABA members meet the diverse needs of their customer base.
- ABA members that participate in the partnership can choose from a variety of products to meet customer needs, including:
 - Biweekly mortgages;
 - Mortgage loans up to 100 percent loan-to-value for borrowers qualified through Fannie's automated underwriting system, Desktop Underwriter;
 - Adjustable-rate mortgages (ARMs), including those with fixed periods of three, five, seven and 10 years;
 - Construction to permanent loans, which combine financing for the purchase of land, the construction of a home, and a permanent mortgage into one loan with one closing; and
 - Fannie's HomeStyle renovation mortgages, which combines home purchase or refinance with home improvement financing, allowing up to 50 percent of the after-improvement value of the home to be used for renovation costs.
- "This deal [with Fannie] allows banks like ours to be more competitive and take full advantage of the secondary market. Now we can benefit from the kind of discounts that were only available previously to high-volume sellers," said Kenneth A. Heiser, president and CEO of First National Bank of Hudson in Hudson, WI., and a former member of ABA's Community Bankers Council who helped craft the agreement with Fannie. Each bank that participates in this partnership will receive custom pricing based on the package of products it selects. (*ABA press release, 3/4/02*)
- The ABA partnership "is going to help a small bank compete in a marketplace that has been dominated by large companies like Countrywide and brokers," said Joseph Pigg, senior counsel for the ABA. "The secondary market has been a challenge for community banks, because the secondary market has generally looked to high-volume producers," he added. One of the ABA partnership's most important benefits will be the expertise Fannie will bring to banks with no secondary-market experience, Pigg said. (*American Banker, Tommy Fernandez, 3/15/02*)

- Jeffrey Hayward, Fannie’s senior vice president in charge of single-family lending, said the GSE hopes to remove the “inhibitions” of banks that have never done business with the secondary market and “were afraid to broach the subject.” The ABA worked for nine months with Fannie to help it figure out how to best work with ABA members, he said. (*American Banker*, Tommy Fernandez, 3/15/02)
- Kenneth A. Heiser, the president and chief executive of First National Bank of Hudson in Wisconsin, helped negotiate the ABA's partnership with Fannie. Heiser and Pigg said better pricing would help the smaller banks offer rates comparable to the larger lenders. (*American Banker*, Tommy Fernandez, 3/15/02)

ICBA partnership

- The ICBA and Fannie announced a nationwide partnership on March 13 for community banks. The partnership provides ICBA member institutions that enter the secondary mortgage market directly through Fannie with a comprehensive package of secondary mortgage market services, including special pricing and easier access to Fannie’s products and services tailored to members’ needs.
- Lenders participating in the ICBA partnership will have the benefit of a variety of mortgage products and services. These include special pricing; biweekly and reverse mortgages; Fannie’s automated underwriting system, Desktop Underwriter; support for lenders' Community Reinvestment Act requirements and affordable housing initiatives; and access to a dedicated team to ensure that lenders receive the most value from their participation in the partnership.
- ICBA members that participate in the partnership can choose from the following products:
 - A faster and easier approval process to become approved Fannie lenders;
 - Mortgages with low, very low or even zero down payments for borrowers qualified through Fannie’s Desktop Underwriter;
 - Adjustable-rate mortgages;
 - Biweekly mortgages;
 - Construction to permanent loans, which combine financing for the purchase of land, the construction of a home and a permanent mortgage into one loan with one closing; and
 - Fannie’s HomeStyle renovation mortgages, which combine home purchase or refinance with home improvement financing, allowing up to 50 percent of the after-improvement value of the home to be used for renovation costs.
- In addition, Fannie will provide ICBA members with a broad range of training opportunities, including discounts for industry-recognized courses at Fannie's Housing Finance Institute. (*ICBA press release*, 3/13/02)

Fannie is increasing its small-lender efforts

- After years of focusing on large mortgage lenders, Fannie is targeting smaller lenders, according to Tommy Fernandez with the *American Banker*. Fannie recently announced deals with the ABA and the ICBA . Fannie and Freddie also have similar arrangements with the America's Community Bankers. Fannie announced a partnership with the ACB in February of last year, while Freddie announced its partnership with the ACB in February of this year. Fannie's first trade-group partnership, signed in August 2000, was with America’s Mortgage Cooperative, an alliance of small and midsize home lenders.

- Fannie and Freddie are hoping that the partnerships will allow the GSEs to gather loans from smaller banks more quickly without having to create individual deals, as they currently do with larger mortgage banks. Fernandez noted that smaller lenders have generally shied away from the secondary mortgage market because of its complexity.
- Under the partnerships with Fannie, small lenders will be able to sell some kinds of loans they had not been able to unload, even to aggregators who resell to the GSEs. For example, Fannie buys “construction to permanent loans” that combine a permanent mortgage with the financing for buying land and building a house on it. (*American Banker*, Tommy Fernandez, 3/15/02)

Fannie catches up to Freddie in serving the small and mid-size thrift industry

- Fannie has closed the gap with Freddie in serving small and midsize thrifts, according to the ACB. Fannie easily beat Freddie in terms of the dollar volume of loan purchases from participating thrifts. The ACB annual real estate lending survey found that 23% of the 113 thrifts that participated sold loans to Freddie in 2001 and 19% sold loans to Fannie. (In the last refinancing boom, Freddie led Fannie by 31% to 20%.) The ACB survey respondents sold \$1.38 billion of their loans to Fannie and \$564.9 million to Freddie. Fannie reaped most of its loan purchases (\$1.15 billion) from thrifts with more than \$1 billion in assets. Fannie also led Freddie in the smallest asset category (less than \$50 million) mainly due a partnership alliance between Fannie and the ACB announced in early 2001, which allows thrifts to sell individual loans with no minimum volume threshold. Freddie entered into a similar alliance with ACB last month. (*National Mortgage News Daily Web site*, 2/26/02)
- The ACB survey also found that 20% of thrift respondents sold loans to the FHLBanks and 41% intend to participate in the FHLBank System’s Mortgage Partnership Finance (MPF) program. (*National Mortgage News*, 3/4/02)

<p>Fannie commissions paper finding that the probability of a shock as severe as embodied in OFHEO’s risk-based capital rule for Fannie & Freddie is very low</p>
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- Fannie commissioned a paper, the “*Implications of the New Fannie Mae and Freddie Mac Risk-Based Capital Standard*,” which analyzed the probability of the economic 10-year “stress test” scenario in OFHEO’s risk-based capital standard for Fannie and Freddie. OFHEO’s capital standard determines the level of capital Fannie and Freddie must maintain to survive the stress test. The paper concluded that “based on historical data, the probability of a shock as severe as embodied in the risk-based capital standard is substantially less than one in 500,000 – and may be smaller than one in three million. Given the low probability of the stress test shock occurring, and assuming that Fannie Mae and Freddie Mac hold sufficient capital to withstand that shock, the exposure of the government to the risk that the GSEs will become insolvent appears quite low.” (*Fannie press release*, 3/7/02)
- The paper was written by Joseph Stiglitz, a professor of economics at Columbia University and Chairman of the Advisory Committee at economic policy firm Sebago Associates, and recipient of the Nobel Prize for Economics in 2001; Jonathan Orszag, the Managing Director of Sebago Associates; and Peter Orsza, President of Sebago Associates, and the Joseph A. Pechman Senior Fellow in Economic Studies at the Brookings Institution. (*Fannie press release*, 3/7/02; “*Implications of the New Fannie Mae and Freddie Mac Risk-Based Capital Standard*,” Joseph E. Stiglitz, Jonathan M. Orszag and Peter R. Orszag, 2002)

CitiMortgage Inc., Fannie, and E-Loan Inc. are working on a “transparent mortgage” concept called the “eMortgage Axis” - an online platform that can be accessed by all the key parties in a mortgage loan transaction, including the borrower

eMortgage Axis platform by BridgeSpan ties the mortgage process, from origination to closing and delivery to Fannie

BridgeSpan hopes to add other secondary market participants

- CitiMortgage Inc., Fannie, and E-Loan Inc. are working on a “transparent mortgage” concept called the eMortgage Axis.” It is the product of a high-tech company called BridgeSpan. Lenders who sign up for the product agree to put all their loan files on an electronic “platform” created and run by BridgeSpan. The online platform can be accessed by all the key parties in a mortgage loan transaction, including the borrower. (*Washington Post*, Kenneth R. Harney, 3/2/02)
- Borrowers are supposed to receive a “good faith estimate” of their closing cost within three days of application, however the estimates by the lender sometimes are not the same as the final charges the borrower sees on the “HUD-1” settlement sheet a few days later. To address this concern, borrowers applying for a transparent mortgage are able to pull up their entire loan file – including final settlements – weeks in advance by using a password protected access to a secure Web site. Borrowers may view their file anytime. CitiMortgage has been experimenting with the product, customizing it for the company’s needs. For example, CitiMortgage borrowers are able to review loan documents online and request changes in rates, fees and other terms. Ram Lakshmanan, CitiMortgage’s senior vice president, said borrowers can opt for loan modifications after reviewing their settlement fees. CitiMortgage’s program also notifies borrowers by e-mail every time a document is added to their file or changed in any way. (*Washington Post*, Kenneth R. Harney, 3/2/02)
- “BridgeSpan could send the mortgage banking industry spinning on its e-mortgage axis with its loan purchase agreement with Fannie Mae,” wrote Michael Murray with *Real Estate Finance Today*. The e-Mortgage Axis platform ties the mortgage process, from origination to closing and delivery, to Fannie, completely online and integrating e-signatures as well. Lenders using the system can either hold the loans in portfolio or deliver them to Fannie using eMortgage Axis. BridgeSpan hopes to add other secondary market participants to the system, possibly Freddie. The agreement between BridgeSpan and Fannie does not force the company to exclude Freddie from the system.
- The system integrates with the lender’s loan origination system (LOS) to provide collaboration with the title company and investors, but origination is not part of e-Mortgage Access. CitiMortgage has been in a six-month pilot testing program, using e-Mortgage Access with CitiMortgage’s current mode of underwriting and its own LOS. (*Real Estate Finance Today*, Michael Murray, 3/4/02) The eMortgage Axis brings together all the diverse elements of the mortgage process. The eMortgage Axis integrates with existing lender systems – such as their loan origination software – to automate the loan process from origination through processing to closing, to investor delivery. (*Business Wire*, 3/4/02)

Freddie Mac

Freddie introduces new product – the “modifiable mortgage”

Product sounds promising to servicers and lenders, however, mortgage brokers, Wall Street and investors are wary

- Freddie introduced the “modifiable mortgage” product, a fixed-rate home mortgage that can be modified after being sold to Freddie. The product will be pooled under one of two new prefixes. The modification option, available for newly originated and seasoned loans, will be available on a negotiated basis, and will allow only downward modifications in the note rate and monthly payment. The new prefixes are MM (30-year mortgages) and MN (15-year mortgages). (*Freddie press release, 2/22/02; National Mortgage News Daily Web site, 2/20/02*)
- The MM and MN designations are simply prefixes, and do not signify any other meaning. The loans will be available to borrowers on a basis negotiated with the lender. (*Real Estate Finance Today, Chris De Reza, 3/4/02*) Freddie said it developed the product in response to customers’ concerns about portfolio runoff, paperwork backlogs and operations inefficiencies during heavy refinancing periods. (*Freddie press release, 2/22/02; National Mortgage News Daily Web site, 2/20/02*)
- “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; National Mortgage News Daily Web site, 2/20/02*) The option is available to fixed-rate conforming traditional loans that Freddie handles. The option is not available for balloon loans or adjustable-rate loans, according to Douglas Robinson, a spokesman for Freddie. (*Real Estate Finance Today, Chris De Reza, 3/4/02*)
- “MM and MN pools will be clearly identified to the mortgage market community, and will not be TBA-eligible. As a result, we do not expect prepayment rates in these prefixes to affect the market calculation of overall prepayment rates in any other Freddie Mac PCs [participation certificates].” (*Freddie press release, 2/22/02; National Mortgage News Daily Web site, 2/20/02*) TBA refers to the to-be-announced agency securities that dominate the securitized mortgage market. Instead the modified mortgages must trade in the smaller specified pool market, where they will be clearly identified by the agency’s “MM” and “MN” prefixes. This makes it likely that these new bonds, like others identified as specified pools, are likely to trade at disparate price levels. (*National Mortgage News, Bonnie Sinnock, 3/4/02*)
- Upon the exercise of the option to modify a loan, that loan will be purchased (removed) from the applicable MM or MN pool. Subsequently, the same mortgage must be resold to Freddie as either a non-modifiable mortgage (pooled into a TBA-eligible prefix) or as a modifiable mortgage (pooled into either the MM or MN prefix). (*Freddie press release, 2/22/02; National Mortgage News Daily Web site, 2/20/02*)
- The product is established between the lender and the borrower. The lender then pools the loans into the Freddie prefixes. No matter how the lender administers the product, the chances are that the product will have a different triggering effect for prepayments than the typical mortgage, Robinson said. These loans will therefore be pooled separately in order to maintain the integrity of analysis on other mortgages in the marketplace, Robinson added. As for triggers for the modifications, the lender

has some discretion as to when to modify it, which can be done more proactively or on a less flexible timetable, Robinson said. (*Real Estate Finance Today*, Chris De Reza, 3/4/02)

Bond Market response

- According to officials from the Bond Market Association (BMA) - which worked with Freddie to make sure that the proper distinctions were made between the TBA-eligible market and the MM and MN pools - the prefixes protect investors because the disclosure helps them anticipate the level of prepayments in pools with modifiable mortgages. Not only does the increased disclosure help investors but it “also gives our dealers the ability to properly analyze the securities before they sell them,” said Robert Fry, director of fixed income operations at the BMA. “The dealers’ reaction was positive to the new product and to the kind of notice that Freddie Mac provided to us. They are happy with having the ability to work with the new product and with having the notice necessary to work it into their systems and their analysis tools.” However, Fry said that until there is volume in this product, it’s difficult for them to answer the question of how popular the product will be. (*Asset Securitization Report*, Karen Sibayan, 3/4/02)

Product sounds promising to servicers and lenders, however, mortgage brokers, Wall Street and investors are wary

- The modifiable mortgage product sounds promising to servicers, lenders/originators and consumers. However, mortgage brokers, Wall Street and investors are somewhat wary of it. After seeing their customer relationships decimated by refinancings over the past year, mortgage bankers have desperately sought Freddie’s help in their portfolio retention efforts. Funding originators and lenders with portfolio retention have been offering customers who might otherwise be tempted to refinance the loans elsewhere, the opportunity of modifying their existing loan’s terms to a lower rate to avoid the complications for a full refinance. (*National Mortgage News*, Bonnie Sinnock, 3/4/02)
- Freddie is now offering this modifiable mortgage product as a means of helping mortgage bankers retain customers during refinancings. (*National Mortgage News*, Bonnie Sinnock, 3/4/02) The modifiable mortgage is a “very significant” development in the mortgage industry, said James Cameron, partner with The STRATMOR Group, a mortgage banking consulting firm. “Modifiable mortgages should improve retention rates for servicers significantly,” he said. “If a loan is refinanced, the lender/servicer and the GSE [Fannie and Freddie] may or may not get the loan back,” Cameron said. “If a loan is modified, it never leaves the fold.” (*Dow Jones Newswire*, Joy C. Shaw, 2/28/02)
- 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’ new product appears relatively limited in scope. (*National Mortgage News*, Bonnie Sinnock, 3/4/02)
- Analysts said that this new product, which carries more prepayment risk, would significantly trade behind TBA securities, and would never achieve the liquidity of the TBAs. Modifiable loans would be seen as a prepayment by investors. MBS analysts said that for this product to work, homeowners would have to be charged a higher interest rate than the going rate, which is totally different from how conventional loans are priced. (*Asset Securitization Report*, Karen Sibayan, 3/4/02) Lenders and analysts agreed that modified mortgages will likely carry higher interest rates than a typical conventional mortgage, for the convenience borrowers would enjoy during a refinancing wave. This may deter some shrewd borrowers. (*Dow Jones Newswire*, Joy C. Shaw, 2/28/02)

- Originators are able to turn around and sell conventional products into the TBA market at par and also collect servicing and origination fees. However, if lenders offer modifiable mortgages they would have to sell the bonds at a discount in the secondary market. Lenders will make less money with these modifiable mortgages relative to what they would have gotten on a regular conventional loan. “How much more homeowners will be charged depends on where these things would trade in the secondary market,” said an MBS analyst. “So that’s why it’s really a trade-off between investors’ estimate of the prepayment risk versus homeowners’ estimate of how much they are going to save when they opt to modify their mortgage.” He added that there would be a huge amount of uncertainty among investors about the amount of prepayment risk involved, so they will probably prefer to err on the conservative side, and price for the worst case. In a UBS Warburg report, analysts stated that, “it remains to be seen whether homeowners will be willing to pay up (in the form of higher rates) to avoid the hassle and cost of a refi.” Some mortgage strategists said that investors would mostly likely feel that they would have to be paid a whole lot more than the homeowner is willing to pay. (*Asset Securitization Report*, Karen Sibayan, 3/4/02)

How popular will the product become?

- Freddie officials were unclear how popular the product might be, based on market conditions. If interest rates remain low (e.g., below 7%) the use of the number of loans put in the MM or MN pools will be less than if they go up 8% or 9%, Robinson said. Robinson would not comment on the effect the product would have on the values of servicing rights. (*Real Estate Finance Today*, Chris De Reza, 3/4/02) Ultimately, the success of the product is likely to depend on investor acceptance and pricing. “I think it all comes down to how it gets priced,” said Bob Husted, a principal at the Mortgage Industry Advisory Corp., a NY-based servicing hedging consultant and technology provider. (*National Mortgage News*, Bonnie Sinnock, 3/4/02)
- Participants in the mortgage market are taking a wait and see approach to the new product. “It’s not clear at this stage how significant a role it’s going to play because the secondary market is ultimately going to determine the success or the failure of the product,” said Glenn Boyd, a prepayment analyst at UBS Warburg, referring to the MBS market. (*Dow Jones Newswire*, Joy C. Shaw, 2/28/02)
- Many doubt that this program will emerge as the next big product, comparable to the 30-year fixed-rate mortgage. “I think it would be an interesting product to see, assuming that they could generate enough origination to have some meaningful prepayment history and to see how these things prepay; that will give you a real read on how prepayment speeds depend on refi efficiency,” said an MBS observer. “Though that would be interesting to see, I don’t think anyone expects this product to take off and be the next 30-year mortgage. It’s probably going to be a non-issue for the secondary market.” (*Asset Securitization Report*, Karen Sibayan, 3/4/02)

Freddie drops Arthur Anderson as its auditor

- Freddie announced that its Board of Directors has appointed PriceWaterhouseCoopers as Freddie’s independent auditor, replacing Arthur Anderson (which Freddie has retained for 32 years), for the year ending December 31, 2002. (*Freddie press release*, 3/6/02) Until six months ago, Freddie was one of Arthur Anderson’s six largest clients nationwide in terms of company revenue. (*Washington Post*, Kirsten Downey Grimsley, 3/7/02) Freddie is one of the latest companies that have replaced Arthur Anderson as their auditor since the Enron collapse. Freddie used Arthur Anderson for both auditing and consulting. Freddie’s auditing committee said it will continue to engage Anderson for consulting services. Recent attention has focused on conflicts of interest for auditors who are paid more in

consulting fees than they are for auditing. Freddie's spokesperson Sharon McHale said the move was "obviously consistent with the best practices right now of the relationships between auditing and consulting services." (*Wall Street Journal*, Cassell Bryan-Low and Jon E. Hilsenrath, 3/7/02)

- In 2000, Freddie paid Arthur Anderson a total of \$6.9 million - \$1.3 million for its audit and \$5.6 million for consulting. Freddie officials said the amount spent on consulting services was likely inflated that year by expenses related to Y2K. (*Washington Post*, Kirsten Downey Grimsley, 3/7/02)
- Fannie spokeswoman Janice Daue said Fannie plans to stay with its current auditor, KPMG LLP. Fannie does not use KPMG for consulting services, she said. (*American Banker*, Tommy Fernandez and Robert Julavits, 3/7/02)

Freddie launches its own mortgage insurance claims automation product, MI Access

- Freddie announced a new mortgage insurance claims automation product - MI Access – which enables mortgage insurance companies to view summary and detailed views of relevant Freddie Mac primary and pool claim information through GoldWorks[®], Freddie's network for the mortgage industry. "MI Access has the power to become the communication tool by which Freddie Mac and mortgage insurance companies interact," said Phillip E. Comeau, vice president of single-family services at Freddie. "MI Access will be used to automatically file claims, provide mortgage insurers with the pertinent information they need to process a claim, and then transmit payment data back to Freddie for auditing purposes." By reducing the effort and resources needed to process claims, Freddie claims MI Access will help reduce servicing costs and streamline the mortgage insurance claims process. (*Freddie press release*, 2/14/02)

Wells Fargo is first servicer to implement Freddie's Web-based version of Freddie's EarlyResolution (tool for counseling delinquent borrowers)

- Freddie announced that Wells Fargo Home Mortgage Inc. is the nation's first mortgage servicer to implement EarlyResolutionSM, Freddie's Web-based tool for counseling delinquent borrowers. Several other major servicers, including Bank of America and National City Mortgage, are expected to implement EarlyResolution in 2002. Together with Wells Fargo, lenders planning to use EarlyResolution this year service about 20 percent of the nation's residential mortgages.
- First announced in 2000, Freddie's EarlyResolution is designed to help counselors obtain better information from delinquent borrowers over the telephone and use that information to determine workout strategies that will help those borrowers avoid foreclosure. EarlyResolution provides counselors with consistent direction for a wide range of reinstatement and workout options including promises to pay, repayment plans, forbearance plans, loan modifications, short payoffs and deeds in lieu of foreclosure. EarlyResolution is an enhanced version of a system pioneered by Wells Fargo Home Mortgage.
- EarlyResolution can be used as a stand-alone product or as part of Freddie's loss mitigation suite of technology tools, which include EarlyIndicator[®], for quick identification of likely loss producing loans, and Workout Prospector[®], which is used to analyze and structure foreclosure alternatives on Freddie's private GoldWorks[®] network.
- Today, Wells Fargo delinquency counselors access EarlyResolution through a dedicated program Web site maintained by Computer Sciences Corporation. As EarlyResolution records alternatives

during calls, they are transmitted to ALLTEL Information Services through an XML-based transaction that automatically updates Wells servicing system of record with key data. In the case of Wells Fargo, borrower data is seamlessly retrieved through a link between EarlyResolution and ALLTEL. Freddie and ALLTEL are also working together to integrate EarlyResolution with ALLTEL's suite of lender tools. Freddie is discussing similar links to EarlyResolution with other data service providers. (*Freddie press release, 1/31/02*)

- The tool is used primarily for borrowers that are 16 to 60 days delinquent, “though you could certainly use this tool anywhere through the process,” said Phillip Comeau, Freddie’s vice president of servicing and cash management. Comeau described the system as a “scripting system that assists the collector to walk through (the counseling process with the borrower) and determine what the issues are, and what opportunities are available to help the borrower given the situation.” (*Mortgage Servicing News, 3/02*)

Freddie announces a “Home Value Calibrator” to address home appraisal fraud

- Freddie announced the forthcoming release of a Home Value CalibratorSM, a new automated quality control and credit risk management tool for mortgage loans to identify inflated property valuations that may be the result of fraud or misrepresentation. It can provide quick pre- or post-funding validations prior to closing or purchasing a loan, identify potential predatory loans, evaluate a batch of mortgages originated by third parties and review large pools of mortgages. GreenPointFinancial participated in a pilot test of Home Value Calibrator for six months.
- Home Value Calibrator, available in the second quarter of 2002, will automatically analyze home valuation data and provide a score to indicate if there are valuation inconsistencies. Users input an address and loan details, and Home Value Calibrator generates a report that can be used to predict whether a loan is at high risk, moderate risk, or low risk of a faulty assessment. It is available for use by lenders and their quality control professionals, underwriters, analysts and portfolio managers.
- “Inflated appraisals are a key component of many abusive lending practices,” said Michael Bradley, vice president of Strategic Information Services for Freddie. “Home Value Calibrator will help honest lenders protect themselves from abuse. Home Value Calibrator helps provide fraud and risk protection to the consumer, as well as the lender. The borrower who buys an overpriced home may lose money when they try to sell.”
- Home Value Calibrator will examine the property valuation, generated by Freddie’s automated valuation model, along with borrower and loan data and then identify the loans that look questionable. Home Value Calibrator provides a score rather than volumes of data that require interpretation. If a high Home Value Calibrator score is returned, the lender may be able to close that loan faster. Or, if a low score is returned, it indicates increased probability that the market value is significantly less than the appraised value, borrower's estimate, or purchase price. The lender may want to further review the loan and the valuation. Home Value Calibrator can also be used after running a loan through Freddie’s automated underwriting system, Loan Prospector. For example, if Loan Prospector requires an appraisal on a loan, a lender can run the appraised value through Home Value Calibrator for quality control and credit risk management purposes. (*Freddie press release, 3/12/02*)

Federal Home Loan Banks

Industry is cautiously supportive of multi-district FHLBank membership

Banks, thrifts, credit unions, and community groups almost unanimously support allowing banks and thrifts to belong to multiple FHLBanks

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

- Responses that the FHFB has received on the issue of multi-district FHLBank memberships (allowing a bank or thrift in one FHLBank to gain membership and borrowing rights in other FHLBanks) reflect the industry's cautious support, according to Richard Cowden with the *BNA*. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) Banks, thrifts, credit unions, and community groups almost unanimously support allowing banks and thrifts to belong to multiple FHLBanks, according to Nicole Duran with the *American Banker*. There were some critics of the multi-district plan and at least one FHLBank offered an alternative. The FHFB received more than 150 comment letters. (*American Banker*, Nicole Duran, 3/13/02) The FHFB requested comments on October 3, 2001, with a January 2, 2002 deadline, which was extended to March 4, 2002. (*Federal Register*, page 63007, 12/4/01; *FHFB press release*, 9/26/01; *Federal Register*, pages 50366-50375, 10/3/01)
- Washington Mutual, Fleet National Bank, and Charter One Bank have all petitioned the FHFB to become members of more than one FHLBank. Washington Mutual acquired a Houston bank and wanted to become a member of the Dallas FHLBank, while retaining its membership in the FHLBank of San Francisco. Washington Mutual is also seeking membership in the FHLBank of New York due to its acquisition of Dime Savings Bank of New York. Fleet National Bank, Boston would like to become a member of the FHLBank of New York and Charter One Bank, Cleveland, would like to become a member of the Chicago FHLBank. (*National Mortgage News*, 3/11/02)
- Although the FHFB has never approved a bank for multi-district FHLBank membership, more than 100 bank holding companies have financial institutions in more than one of the 12 FHLBank System districts, and nearly 200 members of the FHLBank System have branches extending beyond district lines, according to Scott Smith, acting director of the FHFB's Office of Policy Research and Analysis. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) **FHFB Chairman John Korsmo said his intention is that FHFB board members vote before the end of this year on the question of multi-district memberships within the FHLBank System.** (*Dow Jones Newswire*, John Connor, 3/12/02) He told members of the ACB that his reading of the statute that created the FHLBank System does not give the FHFB clear authority to allow a single thrift or bank to become a member of two or more FHLBanks. He does not, however, have a closed mind. He said the FHFB may hold public hearings on multi-district memberships and may hire its own attorney to advise the FHFB on the issue. (*National Mortgage News*, 3/18/02)
- The commenters' main concerns were not whether a bank or thrift should be allowed membership in more than one FHLBank, but whether approving multi-district memberships will lead to a concentration of power by a small number of institutions. Many of the comment letters noted that concerns inherent in the ongoing process that has resulted in fewer but larger banks. A number of the commenters suggested the FHLBank System could tolerate the consequences of permitting multi-district membership, provided it adheres to its "core principles." (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02)

FHLBanks' response

- Not all of the 12 FHLBanks submitted comment letters. The FHLBank of Cincinnati chose not to comment on the issue of multi-district membership because its board of directors was divided on the issue, but instead expressed support for the FHLBank of Cincinnati's statement of principles. The Council of Federal Home Loan Banks (representing 10 of the 12 FHLBanks) submitted a comment letter but did not take a position on whether the FHFBS should approve multi-district membership. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) The New York FHLBank recommended the FHFBS adopt a "limited" approach to the issue that would treat a FHLBank membership as an asset of an acquired institution – which would allow Fleet and Washington Mutual to become members of the New York FHLBank. (*National Mortgage News*, 3/11/02) The FHLBank of New York letter also said that unless the FHLBanks can resolve issues relating to multi-district membership, the FHFBS should consider consolidating the 12 FHLBanks. It further advocated congressional review of the structure of the FHLBank System as established in the 1932 Federal Home Loan Bank Act. The FHLBank of San Francisco urged the FHFBS to adopt a rule applicable to all members, rather than procedural solutions applicable only to specific members. The San Francisco letter took issue with supporters of the multi-district membership on two grounds: That the absence of permission to join more than one FHLBank results in a concentration of advances to member institutions and that such permission is needed to assure that the FHLBanks must respond to the competitive forces. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) The Dallas FHLBank "believes that some form of multidistrict membership will be critical to preservation of a system of strong regional Federal Home Loan Banks in the face of the industry consolidation that is likely to continue through the next decade and beyond," wrote Terry Smith, the President of the Dallas FHLBank. (*American Banker*, Nicole Duran, 3/13/02)
- The Des Moines FHLBank stopped short of endorsing or criticizing the issue. Apart from its merits, the FHLBank of Des Moines noted that multi-district membership may not be necessary, even within the legal framework of the FHLBank System. (*BNA Daily Report for Executives*, Richard Cowden, 3/7/02) The Des Moines FHLBank, which along with a few other FHLBanks had raised objections to pending applications, suggested an alternative intended to lessen the economic impact on banks that lose members because of industry mergers. It proposed a system that would basically allow FHLBanks to buy and sell parts of advances made to member institutions. For example, if a thrift belonged to the San Francisco FHLBank but did business in the Boston region, the two banks could divvy up interests in the advances similar to a loan syndication. (*American Banker*, Nicole Duran, 3/13/02)

ACB's response

- America's Community Bankers (ACB) offered conditional support for multi-district membership, if the FHFBS has statutory authority. In a comment letter to the FHFBS, the ACB said that, if it is determined that the law will allow it, members of the FHLBanks should be permitted to be concurrent members of more than one FHLBank where it has deposit-taking branches. ACB supplied a legal opinion from the law firm of Venable, Baetjer, Howard & Civiletti, LLP, that the FHFBS has the authority to grant concurrent memberships in contiguous or adjoining FHLBank districts, but its legal authority to interpret the statute to permit concurrent memberships in non-adjointing districts is unclear. (*ACB press release*, 3/1/02) "Ultimately, it is the job of the Finance Board to interpret the law, and if people have differences with respect to their interpretation, it is up to the courts to make the determination," said ACB Managing Director of Government Affairs Robert Davis. ACB, whose members own more than half of all FHLBank stock, maintains it will not support legislative changes to clear the way for multi-district memberships. Davis believes it is too risky to approach Congress to

make changes that could inadvertently damage the FHLBank System. “This isn’t a big enough issue to run all the risks of changing the law,” Davis said. (*National Mortgage News*, 3/11/02)

ICBA’s response

- The Independent Community Bankers (ICBA) submitted a comment letter to the FHFBS outlining its principles in considering FHLBank multi-district membership, but declined to take a position on multi-district membership until after its annual convention (March 10-13, 2002). The ICBA urged the FHFBS to establish loan-to-one borrower limits on an individual FHLBank basis and on a system wide basis. ICBA is concerned about the large concentration of borrowing by some of the largest FHLBank members. “This is something the Finance Board ought to address now before it becomes a problem,” said ICBA’s Director of Bank Operations Ann Grochala. (*National Mortgage News*, 3/11/02)

Fleet’s response

- Merrily S. Gerrish, Fleet's senior counsel, argued that banking companies no longer do business solely within one FHLBank’s jurisdiction. “We believe this is especially true for Fleet National Bank, since it does approximately 50% of its deposit taking outside of the Boston district,” he wrote. “The current structure simply does not make sense in light of the current banking/thrift environment. The current regulations were designed for institutions that lend in their local community and are dated in the face of interstate banking and the consolidation in the banking/thrift industries.” (*American Banker*, Nicole Duran, 3/13/02)

Washington Mutual’s response

- “As depository institutions continue to consolidate and streamline their operations, Federal Home Loan banks will continue to face more and more membership, asset, capital, and affordable housing disruptions,” wrote William A. Longbrake, the vice chairman of enterprise risk management for Washington Mutual Inc. “The Finance Board should allow multiple memberships before the impacts of marketplace trends become irreversible.” (*American Banker*, Nicole Duran, 3/13/02)

World Savings’ response

- World Savings Bank pointed out that the FHLBank Act and regulations explicitly prohibit multi-district memberships. “Thus we do not believe the Finance Board has the authority to approve multiple memberships...” said Herbert Sandler, the chairman and chief executive of World Savings. He noted that approving multi-district memberships would force the FHFBS to write complex rules preventing large multi-district members from “gaming” the system. In addition, “there will be a very high temptation for all FHLBanks to compete on some basis for business of large multiple members and that competition will be cutthroat,” he warned. (*National Mortgage News*, 3/11/02) “World has repeatedly expressed its legal and policy concerns about the concept of a single-chartered entity being a member of several Federal Home Loan banks,” wrote Sandler. “Let us state the obvious once again: The applicants can leave in place their newly acquired charters, and even transfer most of the acquired assets and liabilities to their existing depository subsidiaries, thereby achieving the operating efficiencies they desire, while at the same time maintaining membership in the relevant Federal Home Loan banks.” (*American Banker*, Nicole Duran, 3/13/02)

Consumer groups’ response

- “Currently, bank mergers present a zero-sum scenario from a community group perspective,” wrote John Taylor, the president of the National Community Reinvestment Coalition. “Suppose, for example, an East Coast bank merges with a Southern bank and then must choose whether to continue affiliation with the New York Federal Home Loan Bank or affiliate with the Dallas Bank. If the bank

selects the Dallas Federal Home Loan Bank, then the bank will no longer have access to the affordable housing program dollars in the New York region. While housing and community development projects in the South will enjoy a new infusion of affordable-housing program dollars, development projects on the East Coast will have less ... financing.” (*American Banker*, Nicole Duran, 3/13/02)

FHFB approves first FHLBank capital plan (FHLBank of Seattle) – the first of 12 FHLBank capital plans

America’s Community Bankers (ACB) and 17 state banking trade groups urge FHFB to require all FHLBank capital plans to include an activity-based stock purchase requirement

Most of the proposed capital plans include this requirement

- The FHFB approved the capital structure plan of the FHLBank of Seattle at a March 12 FHFB meeting, the first of 12 capital plans that the FHFB is considering for approval. “This is a notable occasion because the plan approved today will establish a permanent capital structure for the Federal Home Loan Bank of Seattle. It addresses the fundamental issues of safety and soundness and gives the Seattle FHLBank greater flexibility to provide liquidity for mortgage lending by its members,” said FHFB Chairman John Korsmo.
- The FHFB determined that the FHLBank of Seattle’s capital plan meets all statutory and regulatory requirements regarding capital structure and does not compromise that FHLBank’s safety and soundness or that of the FHLBank System.
- The FHLBank of Seattle’s capital plan authorizes Class B stock (redeemable on five years’ written notice), with two subclasses. Class B(1) stock includes stock issued to a member to comply with its minimum investment requirement, plus a limited amount of excess stock. Any excess stock above the set limit either will be repurchased by the FHLBank or will be converted to Class B(2) stock, which will pay a lesser dividend rate than the dividend rate on Class B(1) stock.
- Under the Seattle FHLBank’s plan, a member’s minimum investment requirement is the sum of three Stock Purchase Requirements: the Membership Requirement (.75% of a member’s home mortgage loans), the Advance Requirement (3.5% of a member’s outstanding advances), and the MPP Requirement (5% of a member’s outstanding balance of Mortgage Purchase Program loans minus the amount of stock purchased under the Membership Stock Purchase Requirement).
- Prior to implementing its capital plan, the FHLBank of Seattle must obtain FHFB approval of its internal market risk model and risk assessment procedures and controls, as is the case for all the FHLBanks. The Seattle FHLBank intends to implement its capital plan on June 30, 2002. (*FHFB press release*, 3/13/02)
- The Gramm-Leach-Bliley Act (GLB), signed into law on November 12, 1999, amended the provisions of the FHLBank Act that relate to the capital structure of the FHLBanks. The law mandated the replacement of the existing subscription capital structure with a modern capital structure, with risk-based and leverage capital requirements that are similar to those of depository institutions. (*FHFB press release*, 3/13/02) The FHFB is currently reviewing the other 11 FHLBank capital plans and plans to consider them individually at its May 8, June 12, and July 10 meetings. As required by GLB, all of the FHLBanks submitted proposed capital structure plans to the FHFB by

October 29, 2001. Each FHLBank must obtain FHFB approval of its internal risk model and risk assessment procedures and controls prior to implementing its capital plan. (*FHFB press release, 2/13/02*)

- The FHFB expected that the FHLBanks will be able to implement their new capital plans individually, rather than all at once, without affecting the FHLBanks' access to the capital markets. The FHFB estimated that implementation of the plans will be completed in less than the three-year time frame mandated by GLB. (*FHFB press release, 2/13/02*) In a January 30, 2002 letter to Cong. Richard Baker (R-LA), Korsmo anticipated that all the capital plans would be voted upon "no later than mid-August." Korsmo also wants the transition period of up to three years mandated by GLB to be cut in half. "Implementation of the plans will be managed by each FHLBank, but should follow within 18 months of approval," wrote Korsmo. (*National Mortgage News Daily Web site, 2/11/02*)
- Korsmo said he did not believe that the 12 FHLBanks would have identical capital plans, "but the board will move to limit unhealthy and unnecessary competition among the [Federal Home Loan] banks – what we might call bank shopping." He said that the FHFB would encourage the FHLBanks to establish stock purchase requirements for their mortgage purchase programs. "This is not a closed issue, however, as I expect at least two Federal Home Loan Banks will use their best efforts to persuade the board to approve a different means of capitalizing mortgage purchase activities. I am open to their arguments, as I believe are my colleagues," Korsmo said. (*National Mortgage News, 3/18/02*)

ACB and 17 state banking trade groups urge FHFB to require all FHLBank capital plans to include an activity-based stock purchase requirement

- The ACB and 17 state banking trade groups have strongly renewed their request that the FHFB require all FHLBank capital plans to include an activity-based stock purchase requirement. In a letter to the FHFB, the trade groups said: "Requiring each FHLBank member to capitalize its own activities will mean that the FHLBank's programs in which members engage generally would not require additional capitalization by non-participating FHLBank members."
- The groups further said that a combination of minimum capital requirements for membership coupled with activity-based requirements "can prevent creation of separate classes of membership with the potential of some members gaming the FHLBank for lower interest rates on advances, while others game the FHLBank for higher dividends. We strongly urge the Finance Board to adopt such a requirement."
- The ACB noted that most of the proposed capital plans contain an activity-based stock purchase requirement.
- The letter was signed by the America's Community Bankers; Arkansas Community Bankers Association; California Bankers Association; Connecticut Bankers Association; Community Bankers Association of New York; Hawaii Bankers Association; Heartland Community Bankers Association; Illinois League of Financial Institutions; Iowa's Community Bankers; Massachusetts Bankers Association; Michigan League of Community Banks; Minnesota League of Savings & Community Bankers; New Jersey League of Community & Savings Bankers; North Carolina Bankers Association; South Dakota Bankers Association; Texas Savings & Community Bankers Association; Tennessee Bankers Association; and Virginia Bankers Association. (*ACB press release, 3/8/02; ACB and state banking trade groups letter to the FHFB Chairman John T. Korsmo, 3/8/02*)

FHFB's final rule establishing practices and procedures for implementing its new enforcement authorities is published in the *Federal Register*

- As noted in the March 1, 2002 *GSE Report*, at a March 13 meeting, the FHFB approved a final rule that establishes explicit procedures for implementing enhanced administrative enforcement powers granted by GLB, giving the FHFB enforcement authorities similar to other federal banking agencies and OFHEO. The rule was published in the *Federal Register* on March 5, 2002. The FHFB noted that when the final rule is published, the FHFB will have implemented all of the FHLBank System provisions of GLB, aside from the ongoing capital restructuring process. The rule establishes practices and procedures for implementing its new enforcement authorities, including the authority to issue cease and desist orders and to impose civil money penalties. The rule is effective on April 4, 2002. (*Federal Register*, pages 9897-9919, 3/5/02; *FHFB press release*, 2/13/02; *Dow Jones Newswire*, John Connor, 2/13/02)
- GLB augmented the FHFB's broad authority to supervise the FHLBanks and issue and enforce regulations and orders under the FHLBank Act by adding specific powers, procedures and authorities. These added enforcement powers include: explicit authority to issue cease and desist orders, issue temporary cease and desist orders, assess civil money penalties and subpoena power. (*FHFB press release*, 2/13/02)
- In approving the rule, the FHFB dropped a proposed provision dealing with the removal of officers, directors, employees and agents of the FHLBanks. The FHFB agreed to consider this matter at a later date. The FHFB said it received numerous comments on the removal provision arguing that the FHFB lacked the authority to adopt such a measure and challenging whether the provision met with constitutional requirements of due process. (*Dow Jones Newswire*, John Connor, 2/13/02)

Senior Vice President of Strategy Development John Gibbons has left the FHLBank of Chicago

- John Gibbons, a senior advisor to the FHLBank of Chicago on its Mortgage Partnership Finance (MPF) program has left the FHLBank of Chicago. Gibbons is a former top official at Freddie. A FHLBank of Chicago spokesman said Gibbons left in late January "to pursue other opportunities." (*National Mortgage News Weekend Edition*, 3/9-3/10-02; *National Mortgage News*, 3/11/02)

Farm Credit System

Farm Credit Administration's (FCA) safety and soundness oversight of the Farm Credit System receives a positive evaluation from the Government Accounting Office (GAO)

However, GAO finds that the FCA's oversight of the Farm Credit System's mission needs to be improved

GAO gives FCA a positive evaluation on its safety and soundness oversight of the FCS

- The Farm Credit Administration's safety and soundness oversight of the Farm Credit System received a positive evaluation from the GAO. In a new report, the GAO advised Senate Agriculture Committee Ranking Member Richard Lugar (R-IN) that a comprehensive review of the FCA's oversight isn't warranted at this time. Senator Lugar had requested that the GAO determine if such a review was needed.
- GAO said that on the basis of its limited review, it found that a comprehensive review was not needed at this time. The GAO's limited review showed that the FCA's safety and soundness oversight "appeared to be timely, comprehensive, and effective." The GAO report noted, "For example, FCA's examinations were timely and covered key areas of risk, such as capital adequacy and internal controls," GAO said. "We observed that FCA required FCS institutions to take appropriate and timely corrective actions to address any identified weaknesses and closely monitored the institutions' compliance." The FCA also had special supervisory and enforcement procedures in place and "used them when it found more serious weaknesses at FCS institutions," GAO continued.
- "In addition, FCA's offsite monitoring efforts included timely analyses of relevant qualitative and quantitative information that allowed FCA to identify, monitor, evaluate, and proactively address risks faced by FCS institutions," the GAO said. "Examples of these efforts include analyses of internal and external audit reports and quarterly stress tests of institutions' loan portfolios," GAO added. "FCA follows processes designed to ensure the quality and reliability of its safety and soundness examination process through periodic quality assurance reviews and the Inspector General's audits and inspection reports." (*Dow Jones Newswire*, John Connor, 3/1/02; GAO, GAO-02-324R FCA Safety and Soundness Oversight)

GAO finds that the FCA's oversight of the Farm Credit System's mission needs to be improved

- In a separate report, requested by Senator Lugar, the GAO found that the FCA has issued policies and guidance to serve young, beginning, and small farmers (YBS) and it has developed and relied on examination procedures to assess compliance with the mission requirement to serve YBS. However, the FCA has not promulgated a regulation with specific YBS program activities and standards it expects of System institutions. GAO, GAO-02-304, "Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to be Improved," March 2002)
- Congress specified that FCA's lenders serve farmers who are under 35; those with less than 10 years' farming experience; and small farms, defined as those with less than \$250,000 in gross yearly income. (*American Banker*, Ben Jackson, 3/13/02)
- "FCA's regulation restates the broad statutory requirement, which is open to interpretation and results in some System institutions taking no specific actions towards YBS," stated the report. The GAO identified weaknesses in FCA's 2001 examinations "that limited the agency's ability to effectively oversee YBS mission compliance. Generally, these weaknesses were incomplete execution of

examination procedures and incomplete documentation to support examination conclusions.” The GAO found that the FCA examination reports indicated that just over half of the institutions’ YBS programs had features designed to target services specifically to YBS farmers. (GAO, GAO-02-304, “Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to be Improved,” March 2002)

- The GAO recommended that the FCA Board: (1) “promulgate a regulation that outlines specific activities and standards that constitute an acceptable program to implement the YBS statutory requirement;” (2) “ensure that examiners fully execute and document examinations,” and; (3) “publicly disclose the results of individual YBS compliance examinations.” (GAO, GAO-02-304, “Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to be Improved,” March 2002)

Bankers say report supports their charges that Farm Credit System lenders do not do enough to fulfill their mission

- Bankers say the report backs their contention that Farm Credit System lenders cherry-pick banks' best customers and ignore the borrowers they are supposed to serve under the Farm Credit Act, according to Ben Jackson with the *American Banker*. John M. Blanchfield, the director of the American Bankers Association’s center for agricultural and rural banking, said he felt “vindicated to have a third party say the same thing” that the rural bankers have been saying for so long. (*American Banker*, Ben Jackson, 3/13/02)
- Bankers supported the GAO’s recommendations and called for the FCA to act on them right away. The ABA wrote, “These will ensure that the Farm Credit System, which has been lavishing taxpayer subsidies on the richest in agriculture for years, returns its attention and funding to the farmers, ranchers, and rural homeowners it was created to serve.” (*American Banker*, Ben Jackson, 3/13/02)

Farm Credit System lenders claim the GAO report criticized the FCA not the Farm Credit System lenders

- The Farm Credit Council (the trade group for the Farm Credit System's lenders) claim the GAO report criticizes the FCA’s examination processes, not the Farm Credit System lenders themselves. “Our view is we’re doing a good job, thank you,” said Kenneth E. Auer, the Farm Credit Council's president. The FCA has not commented on the report. But in response to an earlier draft of the report, FCA Chairman Michael M. Reyna said the FCA did not dispute its findings. “We find the report to be factually correct and believe it accurately reflects Farm Credit Administration's current policies and practices,” he wrote. (*American Banker*, Ben Jackson, 3/13/02)
- Farm Credit System lenders claimed that they do lend to small farms and beginning farmers and said the report only reflected the amount of documentation that the FCA collects in its examinations. Doug Hofbauer, the president and CEO of \$610 million-asset Frontier Farm Credit ACA in Manhattan, Kan., said 75% to 80% of its loans are to small farms and that his association set aside \$2.5 million for beginning farmers. (*American Banker*, Ben Jackson, 3/13/02)

Farm Credit System reports that net income jumped 26% in 2001
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- The Farm Credit System reported on February 26, 2002 that net income rose nearly 26% last year, to \$1.79 billion. The FCS attributed the gain to a 27-basis-point increase in net interest spread, to 2.06%, and a 10% jump in loan volume. At yearend it had \$82.64 billion of outstanding loans, less than 1% of which were nonaccruing. Farm Credit lenders increased their loan-loss reserves by 35%, to

\$190 million. Only 1.2% of the system's loans were nonperforming, the same percentage as 2000. (*American Banker*, Alan Kline, 2/27/02)

FCA announces March 4 as the effective date for its final rule amending its loan participation regulations

Banking trade groups were opposed to the rule

- The FCA issued a final rule on January 10, 2002 to amend its loan participation regulations. The final rule enables Farm Credit System institutions to better use existing statutory authority for loan participations by eliminating unnecessary regulatory restrictions that may have impeded effective participation relationships between System institutions and non-System lenders. The FCA announced that the effective date of the final rule is 30 days from the date of publication in the *Federal Register* during which either or both Houses of Congress are in session. Based on the records of the sessions of Congress, the effective date of the regulations is March 4, 2002. On July 26, 2000, the FCA published the proposed rule in the *Federal Register*. (*Federal Register*, page 9581, 3/4/02; *Federal Register*, pages 1281-1286, 1/10/02)
- The FCA received 61 comment letters in response to the proposal. The majority of the responses were from boards of directors, management, or customers of System associations. The FCA also received responses from five Farm Credit banks, two banking trade groups, and one community bank. All but four of the comment letters supported the proposed rule. The four comment letters expressing concerns were from the banking trade groups, the community bank, and one Farm Credit bank. Comments opposing the proposed rule ranged from questioning the FCA's authority to adopt the rule to expressing concerns that the proposed rule moves the System away from its cooperative principles. (*Federal Register*, pages 1281-1286, 1/10/02)

Postal Service

Critical report by the Postal Rate Commission consumer advocate threatens the Postal Service's efforts to increase stamp prices

The report criticizes the Postal Service's performance and marketing

- According to *PostalWatch*, Shelley S. Dreifuss, acting director for the Office of Consumer Advocate for the Postal Rate Commission released a highly critical report on Postal Service operations on March 6. The report stated, among other significant deficiencies, "It is evident that by all measures, regardless of data collection system, First Class far outperforms Priority Mail. Priority Mail's inferior delivery times (compared to First Class) and serious failure to meet delivery standards overall leads to posing again in this proceeding the two major questions posed by the Commission in the last rate case: (1) Is the Postal Service giving consumers the information necessary to make a complete and accurate comparison of First-Class delivery performance with Priority Mail, and (2) Are advertisements of Priority Mail misleading consumers? Characterizing Priority Mail as a 2-3 day service clearly deceives the public and may cause severe hardship. At the end of 3 days, the Postal Service has delivered only 88.6% of total Priority Mail." (*PostalWatch.org Web site*, 3/15/02)
- Rick Brooks with the *Wall Street Journal* reported that the Postal Service is trying to keep the critical report from derailing its efforts to increase the price of a first-class stamp from 34 cents to 37 cents as

early as June. The report criticized the Postal Service of “unacceptable” customer-service deficiencies ranging from long lines at post offices to delays in delivery of Priority Mail, which the report claimed moves more slowly than much-cheaper first-class mail. The report claimed that postal employees make it hard for customers to compare Priority Mail (service that offers delivery in as little as two or three days, and competes against private-sector companies like United Parcel Service), which costs at least \$3.50, with first-class mail. First-class mail is faster than Priority Mail in every category, the report found, concluding that the Postal Service “is misleading the public about the quality of service it is likely to receive upon purchase of Priority Mail.” (*Wall Street Journal*, Rick Brooks, 3/15/02)

- The report recommended increasing the number of postal clerks to reverse a surge in customer complaints, and softening the advertising pitch of Priority Mail so customers don't have unrealistic expectations about its delivery speed. (*Wall Street Journal*, Rick Brooks, 3/15/02)

Postal Service response

- The Postal Service said it is too soon to comment on the contents of the report. The Postal Service requested that the Postal Rate Commission, which is considering the rate-increase request, to eliminate the report from the official record of the pending rate-increase case, so that it could have no bearing on the panel's rate decision. On March 14, the Postal Service initially said it also wanted to remove the report from the Postal Rate Commission's Web site, which includes filings made by the post office and mailers as part of the rate-setting process. However, a Postal Service spokesman said later that the agency doesn't oppose public access to the report and is “not trying to obliterate it from the Web site.”
- Gerry Kreienkamp, a Postal Service spokesman, said the Postal Service wants to exclude the report from the rate-setting process because “the record is closed.” In a filing, the Postal Service said including the findings “would be inappropriate and would not serve a practical purpose” now that the rate-increase case is almost over. (*Wall Street Journal*, Rick Brooks, 3/15/02)
- The Postal Rate Commission is likely to issue a ruling on the higher rates in approximately two weeks. The decision must then be accepted, rejected or appealed by the Postal Service's board of governors. It is not clear what impact the report will have on the rate case process at this time. All but one of the 58 parties in the pending case already agreed to a compromise that would boost rates at least three months earlier than the October implementation originally projected by the Postal Service, including boosting the price of a first-class stamp to 37 cents from 34 cents. “The ultimate goal is to improve the quality of service to the public,” Dreifuss said, adding that the report could carry more weight the next time the Postal Service requests an increase. (*Wall Street Journal*, Rick Brooks, 3/15/02)

Postal Service says that the \$675 million in appropriations that the Postal Service has received from Congress is not enough

Postmaster General Potter tells Congress the agency needs \$762 million this year and \$1.7 billion over two years for greater levels of mail security

Congressional Members question the credibility of the Postal Service

- The Postal Service was provided \$500 million for mail sanitization as part of a \$318 billion defense department appropriations bill signed by President Bush in January. The Postal Service also received \$175 million from President Bush last year to immediately improve Postal Service safety shortly after the September 11 terrorist attacks and anthrax scare. (*DM News*, Melissa Campanelli, 2/6/02)
- Postmaster General John Potter told the House Appropriations Subcommittee on the Treasury, Postal Service on March 13 that he will need \$762 million this year (an additional \$87 million over what the Postal Service has already been appropriated) and \$1.7 billion over the next two years for greater mail security. (*DMNews*, 3/14/02; *Associated Press Online*, 3/13/02) Potter noted that the Postal Service has created and presented to Congress its emergency preparedness plan to guide the Postal Service in using the funds. (*Statement of Postmaster General/CEO John Potter before the Subcommittee on Treasury, Postal Service, and General Government, Committee on Appropriations*, 3/13/02)
- Potter noted that the Postal Service's projected deficit for this year is "somewhere above \$2 billion." He hopes that the Postal Rate Commission will accelerate consideration of a rate increase so that higher prices can take effect this summer rather than in the fall as planned. Otherwise, losses could rise to \$3 billion or possibly \$4 billion, warned Potter. (*Associated Press Online*, 3/13/02; *Reuters*, Christopher Doering, 3/13/02)

Congressional Members question the credibility of the Postal Service

- During its March 13 hearing, Members of the House Appropriations Subcommittee on the Postal Service questioned the agency's credibility because it distributed executive bonuses while facing a possible deficit of \$4 billion this year. "I need to bring up directly the major challenge that this subcommittee has in deciding Postal Service requests, and frankly it's a credibility issue," said Subcommittee Chairman Ernest Istook (R-OK).
- The Postal Service paid out \$170 million in executive bonuses last year as part of a "pay for performance" program that rewards employees for boosting performance and safety regardless of the agency's financial performance. Some members of the subcommittee expressed concern that the Postal Service may be holding back some mail or double counting other pieces to improve productivity. "It is that type of management approach that causes a great measure of trepidation with me and other members of Congress," said Istook.
- "I don't disagree that there are a lot of questions out there (regarding the performance plan)," Potter responded. "We are attempting to address that in consultation as we speak." Potter said he stood by the controversial employee bonus program. He claimed the Postal Service has saved about \$1 billion during the last three years than it would have under its old bonus system. (*Reuters*, Christopher Doering, 3/13/02)

- In related news, Citizens Against Government Waste (CAGW) had urged House Members to vigorously question Postmaster General John Potter at the March 13 hearing on the financial state of the Postal Service. (*US Newswire*, 3/12/02)

<p>Significant differences between Republican and Democratic draft versions of postal reform legislation may delay postal reform</p>

- A discussion draft on postal reform circulated by House Democrats in February differs significantly from a Republican version submitted last year. The Democratic version was submitted after Government Reform Committee Chairman Dan Burton (R-IN) was unable to broker an agreement between the two parties. Postal observers wonder whether the drafts could add more delays to postal reform legislation because lawmakers cannot reach agreement. (*DMNews*, Melissa Campanelli, 3/8/02; *Direct Newslines*, Paul M. Alberta, 3/1/02)
- In the Democratic version, Ranking Democrat on the House Government Reform Committee Cong. Henry Waxman (D-CA) and other committee Democrats call for a “Super Regulatory Agency” that would delegate almost all authority over postal matters to the Postal Rate Commission. The Postal Rate Commission would also be able to redefine mail categories and services, and transfer various products and service to and from the monopolized and competitive categories. The Postal Service would be prohibited from subsidizing competitive and non-competitive products and services while ensuring that competitive products and services “cover their costs and make a reasonable contribution” to its institutional costs. The Postal Service would also be permitted to develop incentive and bonus programs to reward high-performing officers and employees. The Republican version, introduced by Congressman John McHugh (R-NY) also contains an enhanced Postal Rate Committee, but unlike the Democrat’s version, it outlines reform steps and requires the Postal Rate Committee follow those measures. (*DMNews*, Melissa Campanelli, 3/8/02; *Direct Newslines*, Paul M. Alberta, 3/1/02)
- “I think the [Democratic] discussion draft is a serious attempt by Congressman Waxman to try to look at postal reform from a different point of view,” said Jerry Cerasale, senior vice president of government affairs at the Direct Marketing Association. “But I think it’s difficult at this late stage in a political year to now have, in a sense, two competing [drafts] – the McHugh discussion draft and the Waxman discussion draft. I think that is going to dramatically slow down the process of postal reform.” (*DMNews*, Melissa Campanelli, 3/8/02)
- Neal Denton, executive director at the Alliance of Nonprofit Mailers, believes a compromise is still possible. “Over the last several weeks, members of the House Committee on Government Reform have been working to find common ground in the hopes of introducing a bipartisan approach to postal reform,” Denton said. “I remain hopeful that such a bipartisan bill will emerge. We still have a little bit of time in the 107th session, and there is a lot that can be done. There is a very great possibility of another rate case filing at the close of the current postal fiscal year, and it’s going to be gross. Something has to be done to mitigate that damage.” (*DMNews*, Melissa Campanelli, 3/8/02)
- Gene A. DePolito, President of the Association for Postal Commerce, does not believe that the Democratic version will go very far. He described the Democratic version as “stillborn,” and said “it doesn’t have a snowball’s chance in Hell of surviving.” He continued, “I can’t see a single [postal] employee, the USPS, or anyone in the industry supporting it.” (*Direct Newslines*, Paul M. Alberta, 3/1/02)

Postal Service announces that its transformation plan will be submitted to Congress on April 4

- A blueprint document detailing the future vision of the Postal Service, known as the “transformation plan,” will be submitted to Congress on April 4, 2002, announced Chairman of the Postal Service’s Board of Governors, Robert F. Rider. Rider said that the plan “will provide the framework for how the Postal Service of the future will be reformed and revitalized to meet the changing needs of our customers, the American people, over the next 10 to 20 years. It is clear to all of us that the time for debating the need for reform is past.” (*Postal Service press release, 3/5/02*)
- Congress and the General Accounting Office have requested that the Postal Service create a Comprehensive Transformation Plan outlining how the Postal Service intends to manage in the wake of changing global markets, new technologies and the need to deliver mail to an ever-increasing number of addresses. (*Postal Service press release, 3/5/02*)
- Rider said the Postal Service is seeking increased flexibility in setting rates, but he did not detail other aspects of the transformation plan. It currently takes nearly a year to change rates. (*Associated Press, 3/5/02*)

Former Director of the Office of Economics, Strategic Planning for the Postal Service calls for postal reform and advocates for the creation of a Postal Regulatory Commission

- In a commentary in the *Charleston Gazette*, Charles Guy, former director of the Office of Economics and Strategic Planning for the Postal Service called for postal reform. According to Guy, the Postal Reorganization Act of 1970, which currently guides the Postal Service, offers little incentive to improve productivity or modernization. All the Postal Service has to do is “break even financially while managing itself in an economical and business like manner.” Guy noted that until recently, Congress thought the Postal Service was doing just that. However, after the Postal Service’s Board of Governors announced multibillion-dollar losses in early 2001, and after the anthrax scare of late 2001, Congress is now aware of the Postal Service’s financial woes.
- **Guy warned, “Even if Congress offers the Postal Service a post-Sept. 11 bailout, the service’s management practices remains the fundamental cause of its worsening financial condition. This deterioration is a direct result of spending excesses of the past few years...and a general failure to plan for sustainable productivity increases.”** The Postal Service management has maintained a pricing strategy that keeps postal rates below inflation, keeping profits at a minimum. Guy added that a 1997 “pay-for-performance” program that awarded bonuses to management if postage rates rose less than inflation is partially to blame.
- To solve the current crisis facing the Postal Service, Guy advocated the creation of a Postal Regulatory Commission, as proposed by the Progressive Policy Institute. The commission would regulate the entire postal market, not just the Postal Service and would work to ensure the overall efficiency of the postal system. Guy concluded, “the Postal Service expects to lose \$2 billion or more this year, after losing \$1.7 billion last year. Short of privatizing outright, a primary focus...must be to bring labor costs – the bulk of its cost base – back into line. Without that, the billion-dollar bailout the service is seeking from Congress will only continue to subsidize more failure.” (*Charleston Gazette, Commentary by Charles Guy, 3/10/02*)

Economist at the Fiscal Policy Institute opposes Postal Service privatization

- In an op-ed in the *San Diego Tribune*, Moshe Adler, economist at the Fiscal Policy Institute, noted that a strong case can be made for abolishing the Postal Service. “Not only is the Postal Service inefficient, it is inefficient by design. It charges the same price for deliveries regardless of distance or how remote a destination is. It delivers to and picks up from practically all locations daily, regardless of the volume of mail involved. It keeps offices open even in small towns. For the post office, universal service comes before minimizing cost.”
- However, Adler is not in favor of proposals to privatize the Postal Service, and predicted that any attempt to do so would fail, brought on by a “dramatic deterioration in the quality of service.” Adler claimed that a private postal service would force the government to create a “new army of inspectors” to make sure the mail is delivered promptly and correctly. According to Adler, a private postal service would become one of the largest employers in the US, with annual revenues over \$65 billion and 780,000 employees. A private postal service would also be a “formidable political contributor and player.”
- Adler compared the prospect of a private postal service to that of the private firms that handles airport security before September 11th, and warned “a well-kept secret in the debate about privatization is its long history of failure. In fact, the only reason that government at all levels began using its own employees was that privatization failed consistently and repeatedly.” Adler concluded by noting that 90 percent of Americans approve of the current system and that it should not be changed. (*Op-Ed, San Diego Tribune*, Moshe Adler, 2/26/02)

President intends to nominate Albert Casey to serve on the Board of Governors of the Postal Service

- The President intends to nominate Albert Casey to be a Governor on the Board of Governors of the Postal Service for the remainder of a nine-year term expiring December 8, 2009. Casey is presently a Distinguished Executive in Residence at the Edwin L. Cox School of Business at Southern Methodist University. Prior to joining the Cox School of Business, Casey was the President and CEO of the Resolution Trust Corporation. From 1968 to 1988, he was the Ann Cox Distinguished Professor of Business Policy at Cox School of Business after serving as the Postmaster General of the US in 1986. Casey was the chief executive of AMR Corp., from 1974 to 1985, and remained on the board of directors until 1991. He joined AMR Corp. after eight years as the President of the Times Mirror Company. (*White House press release*, 3/1/02)

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