

The **GSE** REPORT™

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Contents of GSE Report™

Major Events

- OMB urges OFHEO to issue new rulemaking to strengthen the corporate governance of Fannie & Freddie and require Fannie & Freddie to make certain public disclosures ([p. 3](#))
 - OFHEO – the Office of Federal Housing Enterprise Oversight – is Fannie & Freddie’s safety and soundness regulator
 - “Even though they are not subject to direct SEC oversight, as publicly traded companies Fannie Mae and Freddie Mac should be subject to no lesser standard than applies to other companies,” says OMB
 - OMB’s letter “is the first signal being sent that the administration is likely to be supportive...of significant new regulatory oversight of the GSEs,” says Congressman Richard Baker (R-LA)
 - Citizens Against Government Waste (CAGW) applauds OMB’s move
- Congressmen Chris Shays (R-CT) and Edward Markey (D-MA) question OFHEO’s authority and ability to regulate Fannie & Freddie’s financial disclosures ([p. 5](#))
 - “...we are concerned that your Office [OFHEO] does not have sufficient legal authority, staffing, or expertise to determine whether additional GSE [financial] disclosures are warranted or what form such disclosures should take”
 - Congressmen Shays and Markey have introduced a bill that would repeal Fannie & Freddie’s exemption from Securities and Exchange Commission (SEC) requirements (HR 4071)
 - Fannie & Freddie are the only two Fortune 500 companies not subject to SEC disclosure and registration rules
- Congressmen Shays and Markey ask the SEC to clarify its position on whether Fannie & Freddie should be exempt from SEC requirements ([p. 6](#))
- Opponents of the Shays-Markey SEC bill claim the bill could make it impossible for consumers to “lock in” their interest rates ([p. 9](#))
 - *Washington Business Journal* noted, “It is not clear...why this would be the case.”
 - Fannie’s spokeswoman concedes that it is unlikely consumers would no longer be able to lock in rates if the bill passes
 - Freddie official claims that increased securities disclosure would be disadvantageous to its business strategy
- Wall Street would like Fannie & Freddie to disclose the percentage of subprime loans in their mortgage-backed securities (MBS) pools, but the GSEs have refused ([p. 10](#))
- American Enterprise Institute (AEI) to hold a June 12 conference on the Shays-Markey bill ([p. 10](#))
 - Congressman Chris Shays (R-CT) to be the keynote speaker
- National Association of Realtors (NAR) plans to oppose Ginnie Mae Choice because they claim it might harm FHA & Fannie & Freddie ([p. 11](#))
 - “Ginnie Mae Choice” supporters say the proposal will lower costs to consumers, increase revenue to the federal government, and create competition for Fannie & Freddie
- *New York Times* reports that dissenters on Farmer Mac’s boards are often removed ([p. 12](#))
 - Gotham Partners claims Farmer Mac is in “precarious financial condition”

All GSEs

- GSE debt news ([p. 13](#))
 - (1) GSE long-term debt increases in first quarter 2002; short-term debt decreases
 - (2) GSE debt may benefit from Freddie’s decline in its retained portfolio
 - (3) FHLBanks issue more callable debt than Fannie & Freddie, but Fannie & Freddie are catching up
 - (4) Freddie issues largest callable debt transaction of 2002; Freddie has grown its callable debt by nearly \$40 billion
 - (5) Freddie refines its callable note offerings by issuing larger securities
 - (6) Freddie modifies the eligible amounts for its periodic repurchase operations

Fannie Mae and Freddie Mac

- Lenders are concerned about Fannie & Freddie's consumer advertising ([p. 17](#))
 - "One of the rules of the road is that you never compete with your customers...Since Fannie and Freddie's customers are lenders, not consumers, they should get off the consumers' radar screen," says Jack Trout of the consulting firm, Trout & Partners
- Alliance Bancorp plans to enter the Alt-A mortgage-backed securities sector to bring the Alt-A market "out of the hands" of Fannie & Freddie ([p. 17](#))
- *New York Times* warns that the government does not back GSEs ([p. 18](#))
 - "Perhaps the only warning label more ignored than the one on cigarette packs is the one stamped on debt offerings issued by Fannie Mae, Freddie Mac and Farmer Mac"
- *Economist* says Fannie & Freddie "have become arguably the two most worrying concentrations of risk in the global financial system" ([p. 19](#))
- *Kiplinger's Magazine* warns about Fannie & Freddie's "growing mountain of debt" and their massive size ([p. 19](#))
- *USA Today* notes that Fannie & Freddie face several critics ([p. 20](#))
- *Fortune Magazine* does not believe criticisms of Fannie & Freddie are likely to stop anytime soon ([p. 21](#))
- OFHEO hires Steve Blumenthal as Counsel to the Director ([p. 21](#))

Fannie Mae

- Fannie further expands its political reach by including Federal and State officeholders in its press conferences and press releases and increasingly using its Partnership Offices in press events ([p. 22](#))
 - Fannie has 51 Partnership Offices open across the country
 - Fannie "wins the gratitude of politicians by staging local events with them, often to 'announce' its plans to buy local mortgages...It's almost as if Ford or Microsoft could allow politicians to gain some credit with voters for every Escort or Windows package sold in their district." - *Wall Street Journal*, Nicholas Kulish & Jacob M. Schlesinger, 7/25/01

Freddie Mac

- Freddie offers a new fixed-to-float option for multi-family mortgages ([p. 23](#))
- Freddie announces cash pricing on its Internet Web site so that lenders may price loans for cash ([p. 24](#))
- Freddie hires a number of employees from its former auditor - Arthur Anderson ([p. 24](#))

Federal Home Loan Banks

- Federal Housing Finance Board (FHFB) to review the FHLBanks of Cincinnati and Chicago capital plans at its June 5 meeting ([p. 24](#))
 - FHFB expects to approve all 12 FHLBank capital plans by the summer; FHFB has approved 4 of the 12 FHLBank capital plans so far
 - FHFB regulates the FHLBank System
- President Bush intends to nominate Diana Furchtgott-Roth to be a director of the FHFB ([p. 25](#))
- FHFB is considering expanding the System's Office of Finance to include all 12 FHLBanks ([p. 25](#))
 - FHFB to hire a new Office of Finance Chairman (making at least \$700,000 in compensation)
- FHFB is conducting a review of the agency and possibly reorganizing its supervisory staff, compensation packages and budget processes ([p. 26](#))

Postal Service

- Government Accounting Office (GAO) to investigate whether postal rates subsidize big mailers ([p. 26](#))
- Mark-up on postal reform bill postponed indefinitely ([p. 26](#))
- APWU President William Burrus opposes a Presidential postal reform commission ([p. 27](#))
- *Houston Chronicle* editorial says Congress should say "no" to the Postal Service's transformation plan that would transform the Postal Service into a commercial government enterprise ([p. 27](#))
- *Deseret News* calls for careful review of postal reform ([p. 27](#))
- *Providence Journal-Bulletin* editorial calls for postal subsidies and profit incentives ([p. 28](#))
- Heritage Foundation Research Fellow says the reforms outlined in the Postal Services' transformation plan are not enough ([p. 28](#))
- Postal Service/Postal Rate Commission hold May 28 Ratemaking Summit ([p. 29](#))
 - Follow-up meeting to be held in June

Major Events

OMB urges OFHEO to issue new rulemaking to strengthen the corporate governance of Fannie & Freddie and require Fannie & Freddie to make certain public disclosures

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

“Even though they are not subject to direct SEC oversight, as publicly traded companies Fannie Mae and Freddie Mac should be subject to no lesser standard than applies to other companies,” says OMB

OMB’s letter “is the first signal being sent that the administration is likely to be supportive...of significant new regulatory oversight of the GSEs,” says Congressman Richard Baker (R-LA)

Citizens Against Government Waste (CAGW) applauds OMB’s move

- The Office of Management and Budget (OMB) urged OFHEO to consider a rulemaking to strengthen the corporate governance of Fannie and Freddie and require the GSEs to make certain public disclosures. The OMB noted that unlike other publicly traded companies, Fannie and Freddie are not required to make periodic reports about their financial condition and special reports when material changes occur that affect their financial situation. In addition, Fannie and Freddie are not required to publish related disclosure materials required of other publicly traded companies. Fannie and Freddie currently disclose voluntarily information that is similar to that required of publicly-traded companies by the SEC. **“Even though they are not subject to direct SEC oversight, as publicly traded companies Fannie Mae and Freddie Mac should be subject to no lesser standard than applies to other companies.”** said John Graham, Administrator of OMB’s Office of Information and Regulatory Affairs. **“While the Enterprises now voluntarily comply with many of these disclosures, they are not required to do so. Such voluntary compliance might be abandoned at a time when it is most needed,”** said Graham. (*OMB press release, 5/29/02*)
- The OMB believes that OFHEO’s issuing of a rule would advance the goals outlined by the President in his 10-point plan to improve corporate responsibility and help protect America’s shareholders. While OMB’s request does not necessarily force OFHEO to issue a rule, it alerts OFHEO of issues that OMB considers a priority. (*OMB press release, 5/29/02; OMB letter to OFHEO Director Armando Falcon, 5/29/02*)
- In September 2001, OFHEO published a proposed corporate governance rule for Fannie and Freddie. Graham’s letter indicated OMB doubts the earlier rulemaking goes far enough. **“We request a further rulemaking that would include additional requirements to strengthen corporate governance”** of Fannie and Freddie, wrote Graham. OMB suggested OFHEO work closely with the SEC on this issue. (*OMB letter to OFHEO Director Armando Falcon, 5/29/02; BNA Daily Report for Executives, Richard Cowden, 5/31/02*)
- In April 2002, OFHEO also announced a review of Fannie and Freddie’s public disclosures to determine whether their current disclosures meet SEC criteria, and also to consult with analysts about additional disclosures that would enhance market transparency. Graham’s letter also indicated OMB considers OFHEO’s April announcement to be inadequate. OMB noted that OFHEO’s public announcement does not commit to a rulemaking on disclosures. The OMB requested that OFHEO

consider a rulemaking to require Fannie and Freddie to disclose publicly the information that is required of publicly traded companies by the SEC, including any additional disclosures SEC requires in the future. “While the Enterprises now voluntarily comply with many of these disclosures, they are not required to do so. Such voluntary compliance might be abandoned at a time when it is most needed.” (*OMB letter to OFHEO Director Armando Falcon, 5/29/02; BNA Daily Report for Executives, Richard Cowden, 5/31/02*)

- The OMB suggested that OFHEO also “consider disclosures to enhance market transparency related to the unique issues involved in the operation of government-sponsored enterprises. OFHEO should study the disclosures favored by the Multidisciplinary Working Group on Enhanced Disclosures.” *OMB letter to OFHEO Director Armando Falcon, 5/29/02*

Implications of OMB’s move

- **The *Wall Street Journal* reported that OMB’s “move increases the likelihood the Bush administration will formally require disclosure, at a time when corporate-governance issues are hot in Washington. More broadly, it encourages critics of the two financial companies to push harder in Congress for still-tougher disclosure requirements, as well as other measures to limit Fannie Mae’s and Freddie Mac’s activities. It could even lay the groundwork for an administration endorsement of those steps, although Wednesday’s action stopped well short of that.”** (*Wall Street Journal, John D. McKinnon and Patrick Barta, 5/29/02*)

Fannie & Freddie’s comments

- “We wholeheartedly embrace the goals outlined in the president’s 10-point plan,” said Freddie’s spokeswoman Sharon McHale. “We’re already working with OFHEO on its disclosure project. We welcome the opportunity to continue working with OFHEO and OMB because we are confident that both OFHEO and OMB will recognize that our disclosures already meet or exceed those required by the SEC.” (*Dow Jones Newswire, Dawn Kopecki, 5/30/02*)
- Fannie officials said they support the President’s corporate governance plan and claimed their company is a leader in corporate transparency and disclosure. (*Dow Jones Newswire, Dawn Kopecki, 5/30/02*) “Fannie Mae currently discloses more information to investors than any large financial institution,” said Chuck Greener, Fannie’s Senior Vice President for Communications. Fannie “looks forward to working with [government regulators] on continuing our leadership in this matter.” (*Wall Street Journal, John D. McKinnon and Patrick Barta, 5/29/02*)

OFHEO’s comments

- OFHEO Director Armando Falcon said he is seriously considering issuing disclosure rules. “We will soon have the first comprehensive rule on corporate governance in place. We also have a review underway on the disclosure practices of the Enterprises and a rulemaking on the issue of disclosure is certainly an option under serious consideration,” Falcon said in a statement. (*Dow Jones Newswire, Dawn Kopecki, 5/30/02; OFHEO press release, 5/29/02*)

Congressman Baker’s comments

- **Chairman of the House Capital Markets Subcommittee Richard Baker (R-LA) stated that OMB’s letter “is the first signal being sent that the administration is likely to be supportive...of significant new regulatory oversight of the GSEs.”** He predicted that Fannie and Freddie’s response would be to say that they already make more disclosures than they are required. “My observation is that everything they do today is voluntary, and if conditions were to deteriorate one of the first things they would likely do, if [disclosure is] not mandated by law, would be to withhold

information that might be troubling to the market,” he said. However, a Fannie spokeswoman said the company would support any efforts to make its current voluntary disclosures mandatory. (*American Banker*, Rob Garver, 5/31/02)

FM Watch’s comments

- FM Watch Executive Director Michael House applauded OMB’s move. “The fact that OMB made this statement today is very heartening to us... We hope that OFHEO will move.” (*Dow Jones Newswire*, Dawn Kopecki, 5/30/02)

CAGW applauds the OMB

- CAGW applauded the OMB for calling for enhanced corporate governance of Fannie and Freddie. **“By taking this action, the OMB is trying to safeguard the interest of both GSE stockholders and the taxpayers,”** CAGW Vice President Leslie K. Paige said. **“The GSEs must be held to the same standards as other publicly traded companies. It is patently absurd that we permit these two companies, and only these two companies, to decide which information they deem important enough to disclose, and the manner and timing of that disclosure. The collapse of Enron is teaching us new lessons about the critical importance of transparency and full disclosure; Fannie and Freddie must be brought under that umbrella of accountability.”**
- “The two GSEs have a combined debt worth \$1.26 trillion, up from \$518 million in 1997, an annualized growth rate of nearly 25 percent,” Paige also said. “Fannie's balance sheet is bigger than the Federal Reserve, and the two combined out-borrowed the U.S. Treasury by \$1.1 trillion in 2001. In addition, according to the OMB, the GSEs' outstanding obligations total \$3.1 trillion, yet they enjoy a \$10 billion financial windfall each year as a result of tax breaks, SEC exemptions, and the implied backing of taxpayers in case of failure.”
- **“Fannie and Freddie claim to already be providing ample financial information, so it is difficult to understand why they would oppose these measures,”** Paige concluded. **“Registration and regular reporting will provide investors, Congress, and taxpayers with better information on how these companies do business, what financial risks they face, and how they manage those risks.”** (*US Newswire*, 5/31/02)

Congressmen Chris Shays (R-CT) and Edward Markey (D-MA) question OFHEO’s authority and ability to regulate Fannie & Freddie’s financial disclosures

“...we are concerned that your Office [OFHEO] does not have sufficient legal authority, staffing, or expertise to determine whether additional GSE [financial] disclosures are warranted or what form such disclosures should take”

Congressmen Shays and Markey have introduced a bill that would repeal Fannie & Freddie’s exemption from Securities and Exchange Commission (SEC) requirements (HR 4071)

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

- In a May 24 letter to OFHEO Director Armando Falcon, Congressmen Shays and Markey questioned OFHEO’s authority and ability to regulate Fannie & Freddie’s financial disclosures, in response to OFHEO’s announcement in April that it would conduct a comprehensive review of the financial

disclosure policies and practices of Fannie and Freddie, with the assistance of the SEC.
(*Shays/Markey Letter to OFHEO Director Armando Falcon, 5/24/02; OFHEO press release, 4/8/02*)

- Congressmen Shays and Markey noted that they introduced a bill (HR 4071) on March 20 that would repeal Fannie and Freddie’s exemption from SEC requirements. It was the Congressmen’s understanding that OFHEO announced its review of the GSEs’ financial disclosures in response to their legislation and they believed OFHEO may not be qualified to conduct this review. “While we support any effort to improve the financial disclosures provided by Fannie Mae and Freddie Mac, we are concerned that your Office does not have sufficient legal authority, staffing, or expertise to determine whether additional GSE disclosures are warranted or what form such disclosures should take.” The Congressmen continued, “Congress has made the SEC the nation’s financial disclosure regulator, and we are concerned that any OFHEO investor disclosure standards for the GSEs will not fully promote market transparency and investor protection.” The Congressmen were also concerned that OFHEO’s proposal to take on a public disclosure mission would conflict with OFHEO’s duties as Fannie and Freddie’s safety and soundness regulator. (*Shays/Markey Letter to OFHEO Director Armando Falcon, 5/24/02*)
- In addition, the Congressmen asked OFHEO to provide them additional information, within 15 business days, including,
 - (1) The names of the staffers OFHEO assigned to the project and their professional background;
 - (2) The specific statutory authority that would permit OFHEO to issue any rules, guidance, or other binding requirements regarding GSE investor disclosures and to “describe how OFHEO will manage any situation in which a public disclosure arguably could increase GSE debt or equity price volatility, thereby presenting a potential conflict with the agency’s safety and soundness;”
 - (3) How OFHEO plans to manage any conflict between investor protection and safety and soundness with particular regard to loan loss reserves and mark-to-market accounting;
 - (4) And finally, if OFHEO were to adopt financial disclosure rules, would OFHEO or the SEC enforce compliance with them? (*Shays/Markey Letter to OFHEO Director Armando Falcon, 5/24/02*)
- The Congressmen also requested that OFHEO provide them with a specific action plan for any OFHEO corporate disclosure rules for the GSEs. (*Shays/Markey Letter to OFHEO Director Armando Falcon, 5/24/02*)

OFHEO’s reaction

- OFHEO Spokeswoman Stefanie Mullin said the regulator does not comment on its correspondence with members of Congress. (*Dow Jones Newswire, Dawn Kopecki, 5/27/02*)

<p align="center">Congressmen Shays and Markey ask the SEC to clarify its position on whether Fannie & Freddie should be exempt from SEC requirements</p>
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- In a May 22 letter to SEC Chairman Harvey Pitt, Congressmen Shays and Markey asked the SEC to clarify its position on whether Fannie and Freddie should be exempt from SEC requirements and questioned Pitt’s March 2002 comments that seemed to put the SEC’s position on Fannie and Freddie’s SEC exemption “in question.” (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)

- Congressmen Shays and Markey noted that they introduced a bill (HR 4071) on March 20 that would repeal Fannie and Freddie's exemption from SEC requirements. The Congressmen asked the SEC to advise them whether it supports the Congressmen's position that the exemptions for Fannie and Freddie should be eliminated, thereby giving the SEC authority to apply the securities laws fully to these GSEs and their insiders. If the Commission does not support the Congressmen's position, the Congressmen would like an explanation of the reasons why the SEC believes the exemptions provided to Fannie and Freddie continue to be necessary or appropriate, and to indicate why its position has changed from the 1992 joint report by the SEC, Treasury, and the Federal Reserve which recommended repealing the GSEs' exemption from SEC requirements. (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)
- The Congressmen noted that in the decades since Fannie and Freddie were first provided an SEC exemption, the two GSEs and the markets in which they operate "have changed dramatically" and there is no longer a need for the SEC exemption. In fact, the SEC, Treasury Department, and the Federal Reserve issued a joint report in January 1992 reaching the same conclusion, and the Congressmen "are not aware of any events in the intervening decade that would warrant a different conclusion." (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)
- The Congressmen said they were concerned about Chairman Pitt's statements on March 20 that put the SEC position on Fannie and Freddie's SEC exemption "in question." During a March 20 hearing, Chairman Pitt was asked about the SEC's position in the 1992 joint SEC, Treasury, Federal Reserve study, which recommended repealing the GSEs' exemption from SEC requirements. Chairman Pitt stated that the SEC had "not changed" its "general position" and believed that "disclosure is critical for the GSEs as well as for other public companies." However, later that day, the SEC issued a "clarifying" statement that seemed to confuse the issue more than it cleared up. The SEC later stated, "In response to a question regarding the obligations of GSEs, Chairman Pitt told the House Financial Services Committee today that, as a matter of principle, all publicly traded companies, including GSEs, should meet the highest standards of disclosure and transparency. Neither Chairman Pitt nor the Commission are advocating any change in the legal status of GSEs." The SEC said they decided to issue the statement after receiving several calls from Fannie staff and reporters noting that Chairman Pitt's original markets roiled the markets, reported *Dow Jones Newswire*. The Congressmen pointed out to Chairman Pitt that "Because the 1992 recommendations were the product of formal action by the Commission, we would be interested in learning whether the Commission had met to reconsider its 1992 position prior to March 20 and whether it has done so since that date." The Congressmen asked for a response from the SEC within 15 business days. (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02; Dow Jones Newswire, Dawn Kopecki, 5/22/02*)
- The Congressmen noted that banks, insurance companies and others that compete with Fannie and Freddie in the secondary market do not have the exemptions from SEC laws that are provided to Fannie and Freddie, yet "the burdens of complying with those laws have not prevented these entities from being competitive. This confirms that subjecting Fannie Mae and Freddie Mac to these requirements would neither impair unduly their ability to promote the market on a continuing basis, nor impact adversely the smooth functioning of the market." The Congressmen further noted, "Although Fannie Mae and Freddie Mac contend that the extremely high volume of mortgage-backed and other securities offerings issued or sponsored by them would result in delays and in processing their filings, we know of no basis for this assertion." (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)

- The Congressmen noted that Fannie and Freddie argue that they voluntarily disclose more information than would be required if they were to register with the SEC, so there is no need to subject them formally to SEC requirements. “But even if this is true (and we are not sure it is), there is no regulatory presence to assure that they abide by their stated policy.” Fannie and Freddie’s current safety and soundness regulator – OFHEO – “has no experience in administering the complex disclosure and other requirements of the securities laws. If OFHEO...were to attempt to impose SEC-type disclosure requirements on Fannie Mae or Freddie Mac, it clearly would lack sufficient staff to deal with the large volume of securities offerings that Fannie Mae and Freddie Mac contend would overwhelm the vastly superior resources of the SEC.” (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)
- Finally, Farmer Mac – another publicly-traded GSE – does not receive an exemption from SEC requirements – “yet it has not found the absence of such an exemption to be a significant hindrance to furthering its mission or to conducting its daily operations.” (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)
- The Congressmen asked the SEC to consider the following issues regarding GSE exemption from SEC requirements:
 - “The substantial amount of public investor funds (over \$3 trillion) at risk and the exposure of public investors that presently results from a less-than-full application of the federal securities laws to Fannie Mae and Freddie Mac”;
 - The freedom of Fannie and Freddie to establish their own disclosure requirements, rather than conform to requirements established and administered by the SEC, “with the result that, as of any point in time, the levels of disclosure may well depend on the identities and predispositions of their incumbent managers”;
 - The need for uniform disclosures to enable investors to compare investments in these GSEs with potential investments in the equity securities of other issuers;
 - “The absence of oversight of the securities activities of Fannie Mae and Freddie Mac by a regulator experienced in securities law disclosures”;
 - “The absence of the protections against overreaching by insiders of Fannie Mae and Freddie Mac”;
 - “The absence of ready access by the public to disclosure documents issued by Fannie Mae and Freddie Mac of the type available on EDGAR for all other public companies”;
 - The competitive advantage provided to Fannie and Freddie by not having to comply with the disclosure, fee and other SEC requirements. (*Shays/Markey Letter to SEC Chairman Harvey Pitt, 5/22/02*)

SEC’s comments

- SEC spokesman John Heine declined to comment on the letter. “As a matter of protocol we don’t comment on congressional correspondence,” he said. (*Dow Jones Newswire, Dawn Kopecki, 5/22/02*)

Fannie's comments

- Fannie officials said the Shays/Markey letter contained several errors they will correct in a response they are preparing to lawmakers and the SEC. For example, Fannie's spokeswoman Janice Daue claimed that the 1992 joint SEC, Treasury, Federal Reserve Board study did not recommend that Fannie and Freddie register their mortgage-backed securities. (*Dow Jones Newswire*, Dawn Kopecki, 5/22/02)

Opponents of the Shays-Markey SEC bill claim the bill could make it impossible for consumers to "lock in" their interest rates

Washington Business Journal noted, "It is not clear...why this would be the case."

Fannie's spokeswoman concedes that it is unlikely consumers would no longer be able to lock in rates if the bill passes

Freddie official claims that increased securities disclosure would be disadvantageous to its business strategy

- As noted in the April 5, 2002 *GSE Report*, Fannie's spokesman Robert McCarson said it would "disrupt the housing finance market" if Fannie had to register each security. "For example, homebuyers will no longer be able to lock in their mortgage, or they will have to pay a handsome price," he claimed. (*National Mortgage News Daily Web site*, 3/21/02) As noted in May 3, 2002 *GSE Report*, an April 23 "Dear Colleague" letter signed by 12 Congressional Members opposed the Shays/Markey bill, arguing among other things that the bill would "make it more difficult, costly or even impossible for consumers to 'lock-in' their interest rate when getting a mortgage." The letter was signed by Congressman Bob Ney (R-OH); Congressman Peter King (R-NY); Congressman Bob Barr (R-GA); Congresswoman Judy Biggert (R-IL); Congressman Mark Green (R-WI); Congressman William Lacy Clay (D-MO); Congressman Harold Ford, Jr. (D-TN); Congresswoman Julia Carson (D-IN); Congressman Max Sandlin (D-TX); Congressman Rubin Hinojosa (D-TX); Congressman Joseph Crowley (D-NY); and Congressman Steve Israel (D-NY). (*Dear Colleague Letter on HR 4071*, 4/23/02)
- **The *Washington Business Journal* noted, "It is not clear, however, why this would be the case." The publication noted, "Consumers in the jumbo mortgage market for loans of more than \$300,700 already are able to lock in interest rates, despite the fact that Fannie and Freddie do not participate in this market. In addition, banks and other financial institutions hedge interest rate risk every day through the multitrillion-dollar swaps and options market."** (*Washington Business Journal*, 5/3/02)
- Fannie's spokeswoman Janice Daue conceded to the *Washington Business Journal* that it's unlikely consumers would no longer be able to lock in rates, but says that if the bill passes, it would cost more for them to do so. (*Washington Business Journal*, 5/3/02)

Freddie claims that increased securities disclosure would be disadvantageous to its business strategy

- A Freddie official claimed increased securities disclosure would be disadvantageous to its business strategy, reported Bonnie Sinnock with *National Mortgage News*. When asked to explain, a Freddie spokeswoman claimed that it might hurt Freddie's strategic position in forming business relationships with different counterparties if they [investors] could see how much business the agency was doing with them. (*National Mortgage News*, Bonnie Sinnock, 5/20/02)

Wall Street would like Fannie & Freddie to disclose the percentage of subprime loans in their mortgage-backed securities (MBS) pools, but the GSEs have refused

- According to *National Mortgage News*, the way Fannie securitizes the bulk of its subprime loans by placing its Expanded Approval loans (mostly A-minus) into regular pools of prime loans that are securitized in the to be announced [TBA] market has been a “bone of contention” between Fannie and Wall Street market participants for some time. Due to a lack of disclosure, many mortgage-backed securities investors do not know whether Fannie includes subprime (Alt-A and A-minus loans) in its standard MBS and have difficulty determining the terms of the loans and who originates the loans the GSEs securitize. Some Wall Street market participants have asked the GSEs to at least identify the percentage of Alt-A credit loans in its pools, but the GSEs have refused, with Fannie’s spokeswoman Janice Daue claiming that for competitive reasons Fannie does not disclose the names of its Expanded Approval lenders. (*National Mortgage News*, Brian Collins and Bonnie Sinnock, 5/20/02)

American Enterprise Institute (AEI) to hold a June 12 conference on the Shays-Markey bill

Congressman Chris Shays (R-CT) to be the keynote speaker

- AEI announced that it would be holding a conference on the Shays-Markey bill on June 12 from 9:15 a.m. – 12:45 p.m. at the AEI’s offices. According to an announcement by AEI: “Since the collapse of Enron, there has been an increasing focus on the adequacy of disclosure by public companies. Because they are exempt from registration with or reporting to the Securities and Exchange Commission, Fannie Mae and Freddie Mac are able to determine for themselves what and how they disclose information to investors. Fannie and Freddie contend that they meet or exceed all applicable SEC requirements, but legislation (the Shays-Markey bill) has been introduced that would eliminate their SEC exemption. This conference will explore whether Fannie and Freddie are adequately informing investors and others who may be relying on their public disclosure.”
- The following is the schedule for the June 12 AEI conference:

9:00 a.m. Registration

9:15 a.m. Introduction, Peter Wallison, AEI

Keynote address, Congressman Christopher Shays (R-CT)

10:15 a.m. Panel 1: Comparing Fannie and Freddie to Banks

Speakers: Bert Ely, Ely & Co.
W. Scott Frame, Federal Reserve Bank of Atlanta
Larry D. Wall, Federal Reserve Bank of Atlanta

Discussants: Ed Golding, Freddie Mac
Ray Soifer, Soifer Consulting, LLC

11:40 a.m. Panel 2: Disclosure for Derivatives and Mortgage Back Securities

Speaker: Dwight M. Jaffee, University of California at Berkeley

Discussants: Steven D. Thomas, Financial Security Assurance Inc.
Susan E. Woodward, Sand Hill Econometrics

12:45 p.m. Adjournment (*AEI Web site*)

National Association of Realtors (NAR) plans to oppose Ginnie Mae Choice because they claim it might harm FHA & Fannie & Freddie

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

- NAR plans to oppose Ginnie Mae Choice legislation, according to Dawn Kopecki with *Dow Jones Newswire*. There are currently two versions of “Ginnie Mae Choice” bills. (*Dow Jones Newswire*, Dawn Kopecki, 5/22/02) The bills were introduced by Senator Wayne Allard (R-CO) and Congresswoman Marge Roukema (R-NJ) on November 1, 2001. Both 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)
- Realtors claim Ginnie Mae Choice would weaken the FHA and VA mortgage programs, according to Kopecki. “Federal mortgage programs should not be exposed to an unreasonable proportion of risk-sharing responsibilities nor should the stability and liquidity of the residential secondary market be exposed to risk elements that are detrimental to their public policy missions and the interest of the taxpaying public,” according to a NAR statement adopted at their recent legislative meeting. (*Dow Jones Newswire*, Dawn Kopecki, 5/22/02) *National Mortgage News* reported that NAR is concerned about Ginnie Mae Choice because it might weaken FHA and take business away from Fannie and Freddie. While the NAR’s board of directors did not vote specifically to reject Ginnie Mae Choice they decided not to support any risk-sharing program if it could cause the FHA to become dependent on congressional appropriations or result in losses to the US Treasury – and under that test - “Ginnie Mae Choice would have a hard time passing muster,” said Gary Weaver, NAR’s Managing Director for public policy. (*National Mortgage News Daily web site*, 5/20/02)
- MICA Executive Vice President Suzanne Hutchinson was disappointed in NAR’s decision. “Ginnie Mae Choice would generate significant revenues to HUD, help underserved borrowers and reduce taxpayers’ risk...We hope to continue to work with NAR to help them better understand the program.” (*National Mortgage News*, 5/27/02)
- Supporters of Ginnie Mae Choice argue that Fannie and Freddie have a duopoly on the secondary mortgage market, limiting competition, and harming the ability of low-income or credit-impaired borrowers from obtaining credit. In a letter to Congresswoman Roukema earlier this year, mortgage bankers and private insurance companies wrote, “Studies have shown that (Fannie and Freddie's) automated underwriting systems are more restrictive than competing systems offered by (private mortgage insurers). The disparity is particularly great for consumers with lower incomes or lower (credit) scores.” (*Dow Jones Newswire*, Dawn Kopecki, 5/22/02)
- However, Fannie and Freddie and the Realtors claim Ginnie Mae Choice would attract the most creditworthy FHA and VA borrowers, leaving the two programs exposed to a much riskier pool of mortgages. “It would be skimming, if you will, the cream of the loans, the most creditworthy loans of this program. It would drive the riskier loans into the government program,” said Freddie’s

spokeswoman Sharon McHale. She also claimed that Ginnie Mae lacks the expertise and tools necessary to launch such a program. (*Dow Jones Newswire*, Dawn Kopecki, 5/22/02)

***New York Times* reports that dissenters on Farmer Mac's boards are often removed**

Gotham Partners claims Farmer Mac is in "precarious financial condition"

***New York Times* reports that dissenters on Farmer Mac's boards are often removed**

- *New York Times'* Alison Leigh Cowan wrote an extensive article reporting that dissenters on Farmer Mac's board are often removed. Cowan details how in March 1996, a coup to unseat Farmer Mac's Chairman Henry D. Edelman was thwarted, even though a bare majority of directors had concluded that Edelman should leave. Edelman was able to stop the plans with help from the White House, according to accounts provided by ousted former director Edward C. Williamson, Jr. and other former directors.
- Just a day prior to the board meeting, Williamson had a letter awaiting him at the hotel from the White House informing him that his service on the board was terminated immediately. Williamson was considered vulnerable because he was one of five Farmer Mac board members that are appointed by the President. Former directors said the others were purged one by one, as Edelman "systematically cleared the board of those who stood up to him, questioned his figures or threatened his hold on Farmer Mac," which he helped start in 1988. Along with thwarting Williamson, Edelman changed the board's nominating process in February 1996 and was able to therefore control the nominating process for the remaining 10 directors, according to former directors. "After the change, at least five directors, four of whom spoke for the record, had serious disagreements with Mr. Edelman over the company's stewardship and said they had little choice but to resign or agree not to stand for re-election."
- Asked about issues facing the board, Charles Eugene Branstool, Farmer Mac's chairman since 1995, released a statement through the company on May 24 noting: "Our board today is made up of responsible and conscientious individuals who work constructively together to fulfill their fiduciary duties. In that regard, we are confident that Mr. Edelman and his management team have created substantial value for shareholders while fulfilling the Congressionally chartered mission of Farmer Mac." He declined to comment further on internal workings of the board, "particularly where the questions are highly speculative and refer to events that are claimed to have occurred more than six years ago." The statement said Edelman shared that view and would "decline further comment." (*New York Times*, Alison Leigh Cowan, 5/28/02)

Gotham Partners claims Farmer Mac is in "precarious financial condition"

- Gotham Partners Management Co., LLC claimed Farmer Mac is "in a precarious financial condition and could face severe financial distress." Gotham believes "Farmer Mac's earnings are overstated and may in net economic effect, be illusory as a result of the company's inadequate levels of loan-loss reserves." Gotham claimed Farmer Mac has inadequate reserves, growing delinquencies, and misleading delinquency disclosures; increased funding risk; mismatched assets and liabilities; increased risk in program assets (farm mortgages) and non-program assets; high leverage; inadequate board oversight, conflicts of interest and excessive compensation; overvaluation of the company; and a risk to the US taxpayer. ("*Buying the Farm: A Detailed Examination of Accounting, Investment, and Reserving Practices at the Federal Agricultural Mortgage Corporation*," Gotham Partners Management Co., LLC, 5/23/02)

All GSEs

GSE debt news:

- (1) GSE long-term debt increases in first quarter 2002; short-term debt decreases**
- (2) GSE debt may benefit from Freddie's decline in its retained portfolio**
- (3) FHLBanks issue more callable debt than Fannie & Freddie, but Fannie & Freddie are catching up**
- (4) Freddie issues largest callable debt transaction of 2002; Freddie has grown its callable debt by nearly \$40 billion**
- (5) Freddie refines its callable note offerings by issuing larger securities**
- (6) Freddie modifies the eligible amounts for its periodic repurchase operations**

Background on GSE debt and the supply of Treasurys

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

GSE long-term debt increases in first quarter 2002; short-term debt decreases

- Federal agencies increased long-term new issue volume to \$240.1 billion in the first quarter of 2002, according to a report by the Bond Market Association, up 23.0 percent from the \$195.2 billion issued during the same period last year. The housing-related agencies—Fannie, Freddie and the FHLBank System—together accounted for most of the increase of long-term agency debt issuance.

Long-term federal agency debt issuance:

\$ billions	2001	2001: Q1	2002: Q1	YTD-to-YTD %Change	YTD-to-YTD \$Change
FHLB	383.0	77.6	90.6	16.8%	13.0
Freddie Mac	235.2	50.4	75.5	49.8%	25.1
Fannie Mae	249.4	57.8	61.9	7.1%	4.1
Sallie Mae	19.5	2.2	4.7	113.6%	2.5
Farm Credit System	31.0	6.2	7.2	16.1%	1.0
Tennessee Valley Authority	3.4	1.0	0.2	-80.0%	(0.8)
Totals	921.5	195.2	240.1	23.0%	44.9

Source: *Research Quarterly, Bond Market Association, May 2002*

- Short-term federal agency debt outstanding decreased 5.5 percent, to \$678.8 billion as of March 31, 2002, down from \$718.3 billion outstanding at the end of 2001. Short-term debt outstanding decreased across all agencies, with the exception of the Farm Credit System, whose short-term debt increased 3.6 percent, to \$34.8 billion outstanding. The largest dollar volume decreases were by Fannie and the FHLBank System.

Short-term federal agency debt issuance:

\$ billions	3/31/01	12/31/01	3/31/02	% Change *	\$Change *
FHLB	186.2	139.8	128.3	-8.2%	(11.5)
Freddie Mac	183.8	222.8	212.5	-4.6%	(10.3)
Fannie Mae	282.6	288.5	270.7	-6.2%	(17.8)
Sallie Mae	37.5	31.1	30.7	-1.3%	(0.4)
Farm Credit System	32.8	33.6	34.8	3.6%	1.2
Tennessee Valley Authority	1.7	2.5	1.8	-28.0%	(0.7)
Totals	724.6	718.3	678.8	-5.5%	(39.5)
* Percentage and amount change between 3/31/02 and 12/31/01					
Source: <i>Research Quarterly, Bond Market Association, May 2002</i>					

- New issue activity of agency MBS totaled \$360.2 billion in the first quarter of 2002, more than double the \$167.7 billion issued during the same period last year. Fannie, Freddie, and Ginnie Mae increased new issuance during the first quarter of the year. The high rate of mortgage originations toward the end of 2001 and beginning of this year continued to boost issuance in the agency MBS market. Fannie's issuance increased more than two-fold, to \$176.0 billion in the first quarter of 2002, up from the \$83.3 billion issued in the first quarter of 2001. New issue volume by Freddie totaled \$139.0 billion in the first quarter of 2002, up more than 150 percent from the \$54.3 billion issued in the same period last year. Ginnie Mae's issuance increased 50.2 percent, to \$45.2 billion in the first quarter of the year, up from the \$30.1 billion issued during the first quarter of 2001. All federal agencies, with the exception of Ginnie Mae, increased issuance when compared to the fourth quarter of 2001.
- Issuance of agency collateralized mortgage obligations (CMO) increased sharply, to \$127.9 billion in the first quarter of 2002, up from \$39.5 billion issued during the first quarter of 2001. Freddie led the way with total CMO issuance of \$77.2 billion in the first quarter of 2002, more than triple the \$23.6 billion issued during the same period last year. Fannie's CMO issuance increased sharply, to \$36.8 billion in the first quarter of the year, up from the \$8.7 billion issued during first-quarter 2001. Issuance of Ginnie Mae CMOs was also up, totaling \$13.9 billion in the first quarter of 2002, almost double the \$7.2 billion issued one year ago. However, both Fannie and Ginnie Mae's issuance decreased when compared to the \$36.8 billion and \$13.9 billion issued in the fourth quarter of 2001. Freddie's CMO issuance increased 10.1 percent from the \$70.1 billion issued in the fourth quarter of 2001. (*Research Quarterly, Bond Market Association, May 2002*)

GSE debt may benefit from Freddie's decline in its retained portfolio

- Analysts believe Freddie's first-ever decline in its retained mortgage portfolio should benefit agency debt but not mortgage-backed securities, reported *Dow Jones Newswire*. Freddie said that its retained mortgage portfolio declined in April by an annualized rate of 10.3% to \$521.6 billion from \$526.1 billion in March. "We have been negative on mortgages for the past two weeks or so, but this news is

more fuel to that fire,” said Alec Crawford, director and head of agency and mortgage-backed securities strategy at Deutsche Bank Securities Inc. “Our concern is that the arbitrage that Fannie Mae and Freddie Mac get by buying mortgages and selling their own debt appears to be close to zero right now,” Crawford said. Others like Jim Vogel, a senior vice president at FTN Financial Capital Markets believe it is too early to determine if the current portfolio decline is a trend. Fannie and Freddie have the lowest monthly net total of MBS portfolio growth combined since April of 2000, said Vogel. Total portfolio growth in March and April was only \$7 billion, compared with a more typical volume during a two-month time period of \$30 billion to \$50 billion, added Vogel. “Against the backdrop of the last two years, however, we need a little more than a two-month downturn to call a turn in the trend,” he added. (*Dow Jones Newswire*, Julie Haviv, 5/22/02)

- Freddie officials claimed that the first-ever decline in its mortgage portfolio is a “sign of sound business practices, not of any problems,” reported Tommy Fernandez with the *American Banker*. Freddie’s investment strategy is guided by market conditions - it does not have a fixed monthly investment, said Freddie’s spokeswoman Gisela Vallandigham. Retained portfolio growth can vary considerably month to month, she said, and it has done just that in the first four months of this year. “We will continue to grow our retained portfolio only when returns meet our thresholds and when we can prudently manage risk,” Vallandigham said. “It’s important to note that we grow our retained portfolio opportunistically, buying in size when spreads are wider and when purchases meet our established thresholds.” In the near term, Freddie expects “slow to negative” retained portfolio growth, but for all of 2002 gains should be in the “mid-teens,” she said. (*American Banker*, Tommy Fernandez, 5/23/02)

FHLBanks issue more callable debt than Fannie & Freddie, but Fannie & Freddie are catching up

- At \$230 billion, the FHLBanks have about 50% more callable debt outstanding than either Fannie or Freddie, but that \$230 billion represents only \$16 billion more than the FHLBanks had outstanding at the end of 2001, according to Julie Haviv with *Dow Jones Newswire*. While callable debt issuance by the FHLBanks has slowed, Fannie and Freddie have increased their callable debt issuance. Freddie has grown its outstanding callable debt by nearly \$40 billion this year, while Fannie has issued \$41.5 billion during the same time frame. (*Dow Jones Newswire*, Julie Haviv, 5/29/02)

Freddie issues largest callable debt transaction of 2002; Freddie has grown its callable debt by nearly \$40 billion

- Freddie priced \$2 billion of its 10-year callable note due on May 25, 2002. The issue was priced at 99.685 to yield 6.043%, or 94 basis points over the on-the-run 10-year Treasury security due on February 15, 2002. The issue, with a one-time call option on May 25, 2004, settled on May 29, 2002. Including this pricing of \$2 billion, Freddie has grown its outstanding callable debt by nearly \$40 billion this year and now has approximately \$160 billion outstanding. This transaction is the fourth in a series of syndicated callable transactions this year. Heading the transaction were joint-leads Credit Suisse First Boston, UBS Warburg and Salomon Smith Barney with First Tennessee as co-manager. (*Freddie press release*, 5/2/02) The issue was oversubscribed by 10%. “There was solid crossover buying from mortgage accounts and excellent insurance company interest,” said Jim Vogel, a senior vice-president at FTN Financial Capital Markets. (*Dow Jones International News*, 5/22/02)

Freddie refines its callable note offerings by issuing larger securities

- Freddie announced that it has refined its callable note offerings by issuing larger, more liquid securities on an investor-demand basis. Issues will have a minimum size of \$1 billion and a target size of \$2 billion, and be offered no more than twice each month. These refined callables do not replace existing callable medium-term notes, but are an addition to Freddie’s suite of offerings.

- “Our four syndicated callables this year have been successful because we responded to investor demand. The program features we are announcing today will increase the predictability and transparency of our activity in the callable market,” said Jerome Lienhard, senior vice president of global funding.
- For these callable offerings, Freddie will form a syndicate of dealers to distribute the securities under a book building process. Transactions will generally be announced three days prior to pricing. Freddie will refrain from issuing the same structure through other distribution mechanisms a minimum of two days prior to the announcement through three days after pricing. Securities will be priced on a spread to treasuries with coupons set in increments of 1/8th. Participating dealers will make active secondary markets monitored by Freddie, and will post daily closing prices on Freddie’s “FREI” Bloomberg page. (*Freddie press release, 5/28/02*)

Freddie modifies the eligible amounts for its periodic repurchase operations

- Freddie announced May 29 that effective immediately, it will modify eligible amounts for its periodic repurchase operations. Minimum issue sizes following repurchase operations have been reduced. For Freddie’s Reference Notes®, the minimum has been reduced from the greater of 80% of the issue size (prior to any repurchase activity) or \$5 billion to the greater of 70% of the issue size or \$4 billion. For Freddie’s Reference Bonds, the minimum remains \$1 billion. The periodic repurchase operations, which are Internet-based, focus exclusively on older, off-the-run issues while preserving the supply of active, on-the-run Reference Notes and Bonds. Freddie said it conducts repurchases at least once every calendar quarter, provides overnight advance public notice of each repurchase operation, and posts results - including the amounts of each security the company has repurchased - within 15 minutes after completing the repurchase operations. (*Freddie press release, 5/29/02*)
- Freddie’s announcement “sent a message to the mortgage community” that Freddie “is changing its business strategy,” reported Karen Sibayan with *Asset Securitization Report*. By reducing the minimum that has to be outstanding after the buyback process, Freddie would have more leeway to “use their cash to buy down debt rather than add assets,” said an MBS analyst. “If mortgages are rich in Freddie’s view relative to their debentures, they could buy back their debentures to a greater extent than they could without this change in policy instead of adding to their mortgage portfolio,” explained the analyst. “But if mortgages are cheap than they could buy mortgages. This just gives them more flexibility.” (*Asset Securitization Report, Karen Sibayan, 6/3/02*)

Fannie Mae and Freddie Mac

Lenders are concerned about Fannie & Freddie's consumer advertising

“One of the rules of the road is that you never compete with your customers...Since Fannie and Freddie's customers are lenders, not consumers, they should get off consumers' radar screen, says Jack Trout of the consulting firm, Trout & Partners

- *American Banker's* Tommy Fernandez reported that Fannie and Freddie “may not do business directly with consumers, but they have been targeting ads to them for years.” According to a new study, lenders are unsure of the purpose of the ads, but “some are clearly becoming irritated.” Fannie and Freddie are regular advertisers in consumer publications such as *The Wall Street Journal* and *New York Times*, and Fannie has run television ads for nearly seven years. However, borrowers cannot call either GSE to obtain a mortgage, and the GSEs' charters prohibit them from engaging in business directly with consumers. Lenders complain that the ads are confusing consumers in an already complex and emotional homebuying process.
- A Campbell Lewis Communications study found lenders are especially confused by the GSEs' ads given that few mortgage companies have national advertising campaigns themselves. “One complaint is that the ad campaigns perpetuate the notion that lenders are merely interchangeable vending machines for products branded by Fannie or Freddie, which undermines lenders' own identities in the mortgage process,” reported Fernandez.
- **“Many players in the lending community are very uncomfortable with the Fannie Mae advertising campaign because it plays on their fears that Fannie and Freddie are encroaching on their turf as primary lenders,”** said Elliot Sloane, president of Sloane & Co., a New York public relations firm. **“How many branded secondary-market layers are there? How many take out TV ads?”**
- **Jack Trout, of the consulting firm Trout & Partners Ltd., said the GSEs' media presence, especially on television, runs the risk of seriously angering customers. “One of the rules of the road is that you never compete with your customers,” he said. “That is never a good strategy.” Since Fannie and Freddie's customers are lenders, not consumers, they should get off consumers' radar screen, he said. “I don't think Fannie and Freddie should be doing TV advertising,” Trout said. “That is ego at play. These guys want to be a big deal.”** (*American Banker*, Tommy Fernandez, 5/24/02)

Alliance Bancorp plans to enter the Alt-A mortgage-backed securities sector to bring the Alt-A market “out of the hands” of Fannie & Freddie

- Kevin Donovan with *Asset Securitization Report* noted Alliance Bancorp unit AB Mortgage Securities Corp. is planning an entrance into the alternative-A sector of the securitization markets, to challenge Fannie and Freddie and create a third liquidity source for borrowers. **Donovan reported that Alliance is currently developing a redesigned Alt-A origination program, “based upon an underwriting model not weighted by the borrower's credit score, with the aim of bringing the Alt-A market back to where it was initially intended - out of the hands of Fannie Mae and Freddie Mac.”**

- Mary Glass-Schannault, executive vice president of Alliance Bancorp, is working with Lehman Brothers and PMI insurer Radian Group Inc. to develop a new underwriting model. Alt-A mortgages, which lack the income disclosure as standard conforming loans, were never intended to be credit score-based, claimed Glass-Schannault, who plans to examine more loan-to-value and residual income than FICO scores. “Due to the reliance on credit scoring as the be-all/end-all for loan underwriting,” Fannie and Freddie have “pulled the ‘cream of the crop’ out of the Alt-A sector, leaving a bifurcated pool of originations to securitize.” “We want this program to compete with the GSEs,” said Glass-Schannault. “I am looking to bring the Alt-A market back to where it was intended when we developed the idea in the early 1990s.” (*Asset Securitization Report*, Kevin Donovan, 5/27/02)

New York Times warns that the government does not back GSEs

“Perhaps the only warning label more ignored than the one on cigarette packs is the one stamped on debt offerings issued by government-sponsored enterprises like Fannie Mae, Freddie Mac and Farmer Mac.”

- Alison Leigh Cowan with the *New York Times* reported that the GSEs have bold disclaimers that note their securities are not backed by the US government, yet the warnings are dismissed by Wall Street. Cowan stated, **“Perhaps the only warning label more ignored than the one on cigarette packs is the one stamped on debt offerings issued by government-sponsored enterprises like Fannie Mae, Freddie Mac and Farmer Mac.”** According to Cowan, several market professionals said that even if the GSEs’ offerings did not have an overt government guarantee, there was an implied government guarantee, which was just as good.
- According to Cowan, the GSEs – including Farmer Mac – have lines of credit with the US Treasury. Fannie and Freddie both have \$2.5 billion lines of credit, while Farmer Mac has a credit line of \$1.5 billion. “Though the numbers sound big, the money would not go far, given how much these entities have grown,” stated Cowan. She further noted that “careful reading of the charters also suggests that the backstops [lines of credit] are there to protect the guarantees these entities affix on loans or securities in furtherance of their mission. It is far less clear whether these entities would be able to turn to the Treasury if they overextended themselves and had difficulty, say, rolling over their commercial paper, the preferred method for short-term financing.”
- Cowan reported that Farmer Mac only keeps \$1.4 billion in cash and securities on its balance sheet, in contrast to the \$2.2 billion of short-term obligations the company faces every week. Cowan noted that investors recently asked Farmer Mac executives in an April 8th meeting how it may handle a hiccup in the markets. According to meeting participants, Farmer Mac’s Chief Executive Henry D. Edelman said that in the event a sale of investments does not generate cash, **“well, we do have a \$1.5 billion guarantee from the US government.”** In a follow-up questions, Edelman did note that the Treasury funds could not be used to cover general obligations. Farmer Mac’s General Counsel Jerome G. Oslick refused to comment on the issue.
- Cowan added that **“for all the potential risks lurking on their balance sheets, the GSEs argue that the government gets a lot of bang for its theoretical buck. So long as the government never has to mount a rescue, they have a point. But the bigger they get, the greater the public’s exposure.”**
- Cowan concluded by noting that many in the government have raised caution about the GSEs. Federal Reserve Chairman Alan Greenspan warns of due diligence, while Congressmen Ed Markey

(D-MA) and Christopher Shays (R-CT) have introduced legislation calling for the GSEs to register their securities with the SEC. Congressman Richard Baker (R-LA), the chairman of the House subcommittee that oversees the GSEs has commented on the new interest in the GSEs, noting, “more people are willing to stand up and say at least something should be done.” When asked about Farmer Mac, Congressman Baker noted, “the only solace I take is that it is not as big as the housing GSEs, so hopefully we can get to them when we get to them.” (*New York Times*, Alison Leigh Cowan, 5/21/02)

***Economist* says Fannie & Freddie “have become arguably the two most worrying concentrations of risk in the global financial system”**

- In a column entitled “Unexploded Bombs,” *The Economist* said Fannie and Freddie “have become arguably the two most worrying concentrations of risk in the global financial system.” *The Economist* added, “This is because of their portfolio of mortgages and securitisations, their use of derivatives and the habit of many other borrowers, including hedge funds, of using their debt as collateral.”
- The column noted that at the end of 2001, Fannie had a total credit risk of \$1.56 trillion (a \$705 billion mortgage portfolio and guarantees on securitized mortgages of \$859 billion). Freddie's was \$1.14 trillion (\$492 billion plus \$646 billion), adding up to a combined exposure of \$2.7 trillion, nearly double the 1996 figure of \$1.45 trillion. Bert Ely, an economist, calculates that the current level amounts to a hefty 13.9% of the total credit risk in the non-financial sector of the American economy, and 49.8% of home-mortgage credit risk.
- The *Economist*, noted however, that concerns are greater for Fannie and Freddie’s corporate governance and sheer size than to any evidence of poor risk management. Because they are “government sponsored,” it is “hard to imagine them being allowed to fail.” *The Economist* noted that one of the biggest risks for the GSEs was counterparty risk because the GSEs are heavily dependent for their risk-management programs with only a handful of investors. (*The Economist*, 5/18/02)

***Kiplinger’s Magazine* warns about Fannie & Freddie’s “growing mountain of debt” and their massive size**

- *Kiplinger’s Personal Finance Magazine’s* Jeffrey R. Kosnett and Seth L. Elan reported that Fannie and Freddie – “which for years owned a license to print money for their shareholders, are no longer as sure-footed.” They noted that shares of both have barely budged since December 1998, following 14 years of earnings growth for Fannie and a decade of similarly spectacular gains for Freddie.
- They contend that the case for owning the stocks, at least over the next year or so, is that the stocks offer good value, with both stocks selling for 13 times analysts' 2002 consensus earnings estimates. Moreover, they noted, the “likelihood that Congress will pass legislation to rein in Fannie and Freddie is slim.”
- “The longer-term outlook, however, isn’t as sanguine.” They argued that “two fundamental issues will remain long after critical lawmakers move on to other causes.”
- “For starters, both companies have issued a growing mountain of debt to buy mortgages. And although both S&P and Moody's give Fannie and Freddie their highest ratings for creditworthiness, all that debt is hard to manage. If the companies’ financial wizards failed to hedge properly--that is, by utilizing derivatives--Fannie and Freddie could face a crisis if, say, interest rates surged much faster than their economists anticipated.”

- “Then there's Fannie's and Freddie's sheer size. They are already involved in almost half of all mortgage lending. Because they are so dominant, Fannie and Freddie will find it increasingly difficult to maintain their earlier growth rates. That will mean slower earnings growth, which should become obvious by decade's end.” (*Kiplinger's Personal Finance Magazine*, Jeffrey R. Kosnett and Seth L. Elan, June 2002)

<i>USA Today</i> notes that Fannie & Freddie face several critics
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- Thomas A. Fogarty's *USA Today* article outlined the various forms of criticism facing the GSEs. Fogarty noted that Congressman Richard Baker (R-LA) is planning on holding hearings on the GSEs in June. Congressman Baker told Fogarty that “the gorilla has outgrown the cage, and we don't know what to do with him.” The GSEs have also faced criticisms from the following: Federal Reserve Chairman Alan Greenspan, investor Warren Buffett, consumer advocate Ralph Nader, FM Watch, free-market think tanks, and the editorial page of the *Wall Street Journal*, which recently compared Fannie Mae's hedging practices to those of Enron. Fogarty added, “It becomes clear that good works and image-building advertising might not save Fannie and Freddie from the boiling pot.”
- Critics are concerned that Fannie and Freddie are so large that their failure could jeopardize the whole US economy, with taxpayers on the hook for a bailout. Others are concerned that Fannie and Freddie's market dominance stifles competition and innovation.
- Several critics are concerned about the GSEs' size. Currently Fannie and Freddie have \$2.7 trillion in public mortgage debt. In comparison, the US Treasury has \$3.4 trillion in public debt. The GSEs also guarantee more than 70% of all conforming mortgages in the U.S. In the event of an economic crisis, Fogarty added that investors “assume that in a crunch, taxpayers would step in... since Fannie and Freddie are government-chartered institutions. That perception of safety allows Fannie and Freddie to issue debt at only a slightly higher interest rate than paid by the US Treasury.”
- Critics allege that Fannie and Freddie – motivated by the need to meet the high expectations of Wall Street --- continue to aggressively expand into new roles in home finance. “That would be business as usual for most corporations, but mortgage industry critics say the benefits conferred by their government charters give Freddie and Fannie unfair advantages,” reported Fogarty. Examples of the GSEs' attempts to enter other businesses include: establishing a brand name for consumer recognition; entry into mortgage insurance; guaranteeing second mortgages; technology advancements – particularly the use of their automated underwriting systems; and reaching out to small investors. Fannie's Vice President Arne Christenson told Fogarty, “Critics overestimate the competitive value of the firm's charter and underestimate its constraints.” Christenson also told Fogarty that commercial banks benefit from their government-backed deposit insurance.
- Fogarty noted that the financial underpinnings of Fannie and Freddie “appear rock solid.” However, the recent Enron scandal has caused several to question the GSEs' SEC exemption. Congressman Baker told Fogarty that the SEC exemption will be discussed at his upcoming hearing, but his ultimate goal is to remove Fannie and Freddie's GSE charters to compete on an equal basis with other financial companies. However, he acknowledged that this is “too ambitious to accomplish any time soon,” and that he would settle for tighter government control in the short run. Congressman Baker admitted he's in the fight for the long haul, comparing his efforts to melting an iceberg with a blow-dryer. After years of effort, he said, “I'm just now beginning to see the first few drops of water.” (*USA Today*, Thomas A. Fogarty, 5/21/02)

***Fortune Magazine* does not believe criticisms of Fannie & Freddie are likely to stop anytime soon**

- An article in *Fortune* by Janice Revell and Melanie Shanley compared Fannie to a “wealthy, eccentric great-aunt” who is “often regarded as the wise matron who always does the right thing; these days, however, she’s getting a rep as the crazy old lady who discovers amphetamines and Harleys when yogurt and a wheelchair seem more appropriate.” Revell and Shanley noted that congressional and industry criticism of the GSEs “have had an impact: Despite the stellar earnings performance, the stock has barely budged over the past year.”
- Revell and Shanley reported that Fannie receives a “host” of government perks and Fannie has been able to steadily gain market share of the long-term, fixed-rate mortgage market. **“Between them, Fannie Mae and Freddie Mac either own or insure the risk on almost 45% of America’s \$6.2 trillion in residential mortgage debt.”** Many of Fannie and Freddie’s competitors “don’t like the idea of a quasi-governmental entity having that kind of market share” and fear that the GSEs will soon run out of market share and expand their charters into new territories such as mortgages above their conforming limit or even loan origination. **“In essence, critics say, Fannie is a two-ton gorilla that has used a grossly unfair competitive advantage to crush private-sector competitors and is now charging toward markets it was never chartered to serve.”** Revell and Shanley reported that at a recent Bond Market Association meeting former Federal Reserve Board Chair Paul Volcker agreed: **“Their mandate originally was not to dominate the home mortgage market...It was solely to develop a secondary market, and they’ve gone way beyond that.”**
- Some in Congress are upset about Fannie’s attempts to enter the subprime market while simultaneously trying to exempt themselves from recently introduced state and local predatory lending bills. Congresswoman Janice Schakowsky (D-IL) recently brought Fannie’s attempts into light, forcing Fannie to step back from attempts in Georgia, although it was successful in California. Another area of criticism is the GSEs’ use of derivatives. Federal Reserve Chairman Alan Greenspan told a group of international bankers that investors may be underestimating the risk associated with the GSEs’ use of derivatives.
- Revell and Shanley concluded by noting that the criticism “isn’t likely to stop anytime soon.” A bill has been introduced in Congress to strip the GSEs’ SEC exemption [HR 4071]. And while Fannie has begun to disclose more information about its use of derivatives, Congress is not likely to step down. **Congressman Richard Baker (R-LA) likens SEC registration to “putting a license plate on a speeding truck. You’re still going to get run over, but at least you’d have a number to report to accident with.”** Revell and Shanley added that with all the current criticism, Fannie’s stock has been stagnant. However, **“Raines is well on track to fulfill a goal he set when he took over as CEO in January 1999; to double earnings per share by the end of 2003.”** (*Fortune Magazine*; Janice Revell and Melanie Shanley, 5/27/02)

OFHEO hires Steve Blumenthal as Counsel to the Director

- OFHEO Director Armando Falcon announced the appointment of Stephen A. Blumenthal as Counsel to the Director. Most recently, Blumenthal served as a political analyst and Vice President of Schwab Capital Markets and Trading, Washington Research Group. From 1989 to 1995 he served as Finance Counsel for the House Commerce Committee and was Vice President and Director of Regulatory Relations at the Securities Industry Association from 1979 to 1987. Blumenthal began his legal career in Washington as an Attorney in the Office of General Counsel for the National Association of

Securities Dealers. Blumenthal received his law degree from Rutgers Law School and his undergraduate degree from Johns Hopkins University. Blumenthal will begin at OFHEO June 3, 2002. (*OFHEO press release, 5/22/02*)

Fannie Mae

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

Fannie has 51 Partnership Offices open across the country

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

Fannie has 51 partnership offices

- According to Fannie’s Web site, the company has 51 partnership offices open across the country (http://www.fanniemae.com/contact/partnership_offices.html) 5/31/02). Fannie announced the opening of a new partnership office in Sacramento, CA. (*Fannie press release, 5/31/02*)

Senator Jeff Sessions (R-AL)

- Fannie joined Senator Sessions to convene a housing roundtable to discuss affordable housing in West Alabama. (*Fannie press release, 5/30/02*)

Congressman Bob Ney (R-OH) and Zanesville, OH Mayor Jack Fenton

- Fannie joined the above named officials to announce the \$2.7 million redevelopment of historic Harper-Cosgrave Block Building into affordable apartments for seniors. (*Fannie press release, 5/20/02*)

Congressman Harold Ford (D-TN) and Memphis, TN Mayor Willie Herenton

- Fannie joined with the above named officials to celebrate the grand opening of Alpha Renaissance Apartments, an affordable rental housing community in South Memphis. (*Fannie press release, 5/28/02*)

Congressman Sam Johnson (R-TX) and McKinney, TX Mayor Don Dozier

- Fannie joined the above named officials and ten local lenders to celebrate Collin County Housing Finance Corporation’s Eyes of Texans Mortgage Program. (*Fannie press release, 5/20/02*)

Congressman Doug Bereuter (R-NE) and Lincoln, NE Mayor Don Wesely

- Fannie joined the above named officials for a ribbon cutting ceremony of 14 affordable homes in Olympic Heights. (*Fannie press release, 5/18/02*)

Congressman Doug Ose (R-CA)

- Fannie joined Congressman Ose in announcing a five-year \$20 billion affordable housing plan for the Central Valley and to announce the opening of a new partnership office in Sacramento. (*Fannie press release, 5/30/02*)

Congressman Ronnie Shows (D-MS)

- Fannie joined with Congressman Shows to convene a housing roundtable to discuss affordable housing and community development in Southwest Mississippi. (*Fannie press release, 5/28/02*)

Congressman Denny Rehberg (R-MT)

- Fannie joined with Congressman Rehberg and housing leaders from the public and private sectors to discuss expansion of homeownership opportunities in underserved communities. (*Fannie press release, 5/29/02*)

Congressman Joe Baca (D-CA)

- Fannie joined Congressman Baca, Chase Manhattan Mortgage and local real estate brokers to increase awareness of new affordable mortgage financing alternatives for minority families. (*Fannie press release, 5/24/02*)

Congressman Elijah Cummings (D-MD)

- Fannie joined Congressman Cummings to announce the availability of Fannie's Expanded Approval with Timely Payments Rewards option, through Fannie's automated underwriting system – Desktop Underwriter. (*Fannie press release, 5/17/02*)

Other local officials with whom Fannie held press opportunities:

- (1) Omaha, NE Mayor Mike Fahey (*Fannie press release, 5/29/02*)
- (2) Miami, FL Mayor Manny Diaz (*Fannie press release, 5/22/02*)
- (3) Chippewa Falls, WI Mayor Virginia Smith (*Fannie press release, 5/17/02*)

Freddie Mac

Freddie offers a new fixed-to-float option for multi-family mortgages

- Freddie announced that it has added a new financing option to its suite of multifamily products. The new Fixed-to-Float Option is available for newly originated fixed-rate mortgages with terms of 5 and 15 years. Borrowers will realize both a reduction in pricing and additional flexibility at maturity, claimed Freddie. The price reduction averages approximately 5 basis points, depending on market conditions and the term of the fixed-rate period. With the Fixed-to-Float Option, borrowers agree to a yield maintenance provision that applies to the full fixed-rate loan term, i.e., a 10-year loan would have a full 10-year yield maintenance provision. In return, borrowers get a reduced interest rate and can extend their loan term for one year, at which time the mortgage rate converts to a floating-rate equal to 250 basis points (gross) over the 1-month Freddie Mac Reference Bill[®] index. Borrowers can pay off their loan at anytime without paying a premium and an interest-rate cap is not required during the 1-year floating-rate period.
- “The immediate benefit for the borrower is a lower interest rate due to the full yield maintenance structure in place during the fixed-rate term. In addition, our new Fixed-to-Float Option gives borrowers more time to seek refinancing, while enjoying a rate based on the Freddie Mac 1-month Reference Bill, an index that has historically traded at a 15- to 25-basis point discount to LIBOR,” said Mitchell Kiffe, vice president of multifamily loan production at Freddie. (*Freddie press release, 5/22/02*)

Freddie announces cash pricing on its Internet Web site so that lenders may price loans for cash

- Freddie announced that mortgage lenders who want to sell loans to it for cash may obtain cash prices on Freddie's Web site, freddiemac.com. Freddie's Gold Cash pricing tool provides Seller/Service providers access to Gold Cash pricing for fixed and adjustable-rate products, and related mortgage-backed securities and Required Net Yield pricing. Prices are updated throughout the day. Customers will be able to access freddiemac.com for snapshots of prices across a range of interest rates and delivery periods.
- By using the Web-based pricing tool, Seller/Service providers are not limited to a single data terminal to receive competitive pricing information for loans. Nor do they have to worry about installing or maintaining additional software. All that is needed is an Internet connection and an ID and a password to get pricing updates. (*Freddie press release, 5/23/02*)

Freddie hires a number of employees from its former auditor - Arthur Anderson

- Freddie fired Arthur Anderson as its auditor in early March, but has been hiring former employees from the consulting firm, according to *Dow Jones Newswire*. Freddie hired John Woods, a former senior manager and 16-year veteran of Anderson, as senior vice president of control and accounting in its funding and investments divisions. Freddie has also hired as many as eight other former Arthur Anderson employees, according to Freddie's spokeswoman Gisela Vallandigham. Most of the new employees were brought in at the "director" level. More specific information about the titles and responsibilities of the new hires was unavailable, said Vallandigham. (*Dow Jones Newswire, John Dooley and Janet Whitman, 5/15/02*)

Federal Home Loan Banks

Federal Housing Finance Board (FHFB) to review the FHLBanks of Cincinnati and Chicago capital plans at its June 5 meeting

FHFB expects to approve all 12 FHLBank capital plans by the summer; FHFB has approved 4 of the 12 FHLBank capital plans so far

FHFB regulates the FHLBank System

- The FHFB plans to review the FHLBanks of Cincinnati and Chicago capital plans at its June 5 meeting. (*Federal Register, page 36598, 5/24/02*)

FHFB is evaluating the capital plans for the 12 FHLBanks

- The Gramm-Leach-Bliley Act (GLB), signed into law on November 12, 1999, amended the provisions of the FHLBank Act that relate to the capital structure of the FHLBanks. The law mandated the replacement of the existing subscription capital structure with a modern capital structure, with risk-based and leverage capital requirements that are similar to those of depository institutions. (*FHFB press release, 3/13/02*) As required by GLB, all of the FHLBanks submitted proposed capital structure plans to the FHFB by October 29, 2001. Each FHLBank must obtain FHFB approval of its internal risk model and risk assessment procedures and controls prior to implementing its capital plan. (*FHFB press release, 2/13/02*)

- The FHFBS has approved capital plans for the FHLBanks of Seattle, Atlanta, Boston and Pittsburgh. It expects to approve all 12 FHLBanks by the end of the summer. (*Dow Jones Newswire*, John Connor, 5/7/02)

President Bush intends to nominate Diana Furchtgott-Roth to be a director of the FHFBS

- The President intends to nominate Diana E. Furchtgott-Roth to be a Director of the FHFBS for the remainder of a seven-year term expiring February 27, 2004. She has served as Chief of Staff at the Council of Economic Advisors since March 2001, and from 1993 to 2001, she was a Resident Fellow and Assistant to the President at the American Enterprise Institute. Furchtgott-Roth served in the White House from 1991 to 1993, first as Associate Director and Deputy Executive Secretary of the Domestic Policy Council, and then as Associate Director of the Office of Policy Planning. She holds a bachelor's degree from Swarthmore College and a Master's degree from Brasenose College of Oxford University. (*White House press release*, 5/24/02) Furchtgott-Roth will succeed Timothy O'Neill, a Republican, who was appointed by President Clinton and remained on the five-member board after losing the chairmanship in December to John Korsmo. (*American Banker*, Rob Blackwell, 5/29/02)

FHFBS is considering expanding the System's Office of Finance to include all 12 FHLBanks

FHFBS to hire a new Office of Finance Chairman (making at least \$700,000 in compensation)

- As noted in the May 17, 2002 *GSE Report*, FHFBS Chairman John Korsmo, speaking May 13 to the Independent Community Bankers Association said that the FHFBS is considering expanding the System's Office of Finance to include all 12 FHLBanks. The office, which issues the consolidated debt obligations by which the system raises its funds, currently consists of just two bank presidents and a public interest director who serves as chairman. The expansion, Korsmo said, was suggested by the FHLBanks to reduce the costs of raising money in the debt markets. "It makes sense to me that all banks should be represented on that board, along with the public interest chairman," Korsmo said. Korsmo noted that he is also seeking a new individual to serve as the public interest director to head this expanded board of directors of the System's Office of Finance. Korsmo said, "I am searching for a special individual to serve as the board's new chairman – someone with experience and authority enough to tell a dozen, well-compensated Bank presidents to sit down, be quiet, and get something done." (*Dow Jones Newswire*, Dawn Kopecki, 5/13/02; *Dow Jones Newswire*, John Connor, 5/14/02; *Remarks by FHFBS Chairman Korsmo to the ICBA*, 5/13/02)
- In two follow-up articles by John Connor with *Dow Jones Newswire*, Connor noted that the new board chairman of the Office of Finance was expected to make at least \$700,000 a year in compensation and would be able to hire staff at his/her discretion. The office could be staffed by full- or part-time employees, agents or attorneys, who would report directly to the chairman, unless otherwise directed, according to a draft regulation of the plan. The discussion draft said the new chairman would receive compensation "that shall not exceed 100% of the average of the total salary and additional compensation paid to the three highest-compensated (FHLBank) presidents." Initial reports from the FHFBS and others within the system estimated that the compensation would be in the range of \$700,000 a year, but some subsequent indications are that the number is at least \$750,000. Replacing the current three-person Office of Finance Board with a 13-person board comprised of the 12 FHLBank presidents and a new public interest chairman "looks like a classic centralization play," reported Connor. A FHFBS spokesman called the draft regulation a discussion draft that is subject to change before it is considered by the FHFBS, probably in July or August. **Connor noted that the**

Office of Finance expansion plan “is raising eyebrows – and concerns – among some FHLBank System officials for reasons ranging from internal power and local control considerations to the possibility that another fat FHLBank System salary would play into the hands of system critics on Capitol Hill.” (*Dow Jones Newswire*, John Connor, 5/20/02; 5/23/02)

FHFB is conducting a review of the agency and possibly reorganizing its supervisory staff, compensation packages and budget processes

- FHFB John Korsmo said he is conducting a top-to-bottom review and possible reorganization of the agency’s supervisory staff, compensation packages and budget processes, according to *Dow Jones Newswire*. “Of our 110 staff, only 14 of them are in supervision. That doesn't seem to me like an appropriate allocation of our resources,” Korsmo told *Dow Jones Newswire*. Korsmo recently hired banking regulator Stephen Cross from the Federal Deposit Insurance Corp. to head up the Finance Board’s Office of Supervision. Korsmo said he plans to name another well-known finance professional as the division’s deputy shortly. The Office of Supervision is the board's lead office that oversees the safety and soundness of the regional banks as well as the system's Office of Finance. (*Dow Jones Newswire*, Dawn Kopecki and John Connor, 5/14/02)

Postal Service

Government Accounting Office (GAO) to investigate whether postal rates subsidize big mailers

- The American Postal Workers Union (APWU) announced that it is grateful that Senator Daniel K. Akaka (D-HI) and Congressmen Henry A. Waxman (D-CA) and Danny K. Davis (D-IL), have asked the GAO to investigate whether postal rates subsidize big mailers. “We are concerned with recent reports that the United States Postal Service may be offering ‘worksharing’ discounts to mailers that exceed the cost-savings realized by the Postal Service,” the Congressmen told GAO Comptroller General David M. Walker in their May 15 letter.
- “Given the Postal Service’s severe financial problems, it is important that no worksharing discounts be offered when the size [of] the discount exceeds the cost-savings to the Postal Service.” The Congressmen requested that GAO determine if, and to what extent, major mailers’ discounts are justified by examining “the adequacy of the costing data and formulas used by the Postal Service to make avoided-cost calculations, as well as the economic assumptions underlying such calculations.”
- In investigating the discounts, the Congressmen asked GAO to “visit a range of mail processing facilities that receive mail subject to worksharing discounts and consult with officials of the Postal Rate Commission, postal management and the American Postal Workers Union, as well as other postal stakeholders.” (*APWU NewsService*, Volume 32, No. 9, May 15, 2002)

Mark-up on postal reform bill postponed indefinitely

- *DM News* reported that a postal reform bill that was scheduled to be marked-up on May 23 by the House Committee on Government Reform has been postponed indefinitely, according to congressional aides. The bill included parts of two postal reform drafts - one by Congressman John McHugh (R-NY) and the other sponsored by Congressman Henry Waxman (D-CA). “We are close to a bipartisan agreement on a postal reform bill,” said an unidentified staff member of the committee.

“[There] are a few more details to nail down, and both sides agreed more time would be beneficial.” A spokeswoman for Congressman Waxman said the mark-up was postponed “because there are still more issues to be resolved.” (*DM News*, Melissa Campanelli, 5/23/02)

APWU President William Burrus opposes a Presidential postal reform commission

- APWU President William Burrus wrote President Bush on May 14 urging him to oppose the creation of a presidential commission to shape the Postal Service’s future. Burrus argued that APWU “does not believe that the Postal Service is in need of reform.” The group believes the Postal Service could solve its financial difficulties by discontinuing the subsidies it provides major mailers through discounted postage rates. According to the APWU, “These annual subsidies are larger than the Postal Service’s yearly deficits.” The APWU believes that “if the postage discounts were adjusted to reflect only the costs the Postal Service avoids by accepting presorted mail, postal ‘reform’ would be unnecessary.” The APWU contends that unless the Postal Service addresses this issue, “a Presidential Commission cannot solve the Postal Service’s financial difficulties without proposing drastic modifications to its universal service mandate.” The APWU said it strongly opposes the creation of a Presidential Commission. (*APWU NewsService*, Volume 32, No. 9, May 15, 2002; *APWU Letter to President George W. Bush*, 5/14/02)

Houston Chronicle editorial says Congress should say “no” to the Postal Service’s transformation plan that would transform the Postal Service into a commercial government enterprise

- A *Houston Chronicle* editorial says, “Congress should say no” to the Postal Service’s transformation plan that would turn the Postal Service into more of a commercial enterprise. The transformation plan “would increase the unfair competitive advantages the Postal Service already enjoys against the private sector, businesses that pay the taxes that subsidize the government-owned service,” said the editorial. “Instead, the Postal Service should cut its fat and pay more attention to improving performance of its real mission – delivering letters and packages to millions of homes and businesses around the nation.”
- The editorial argued that giving the Postal Service more flexibility in rate setting and authority to offer volume discounts to the biggest mailers “are terrible ideas.” The principle problem with the Postal Service, contended the editorial, was its overlarge work force. The editorial concluded that the Postal Service “should strive to do a better job at what it does best – delivering mail. It shouldn’t continue its efforts to drive private delivery companies out of business.” (*The Houston Chronicle*, 5/20/02)

Deseret News calls for careful review of postal reform

- An editorial in the *Deseret News* noted that the Postal Service always seems to be in the red. Now executives have presented Congress with a new business transformation plan to increase efficiency. Postal officials claim that the Postal Service had been operating under a business plan put into effect before 1970 – long before computers and the Internet changed the way Americans communicate. While the editors agree with this assessment, the editorial noted that when the postal service ventures beyond first-class mail delivery, it runs into direct competition with private companies such as Federal Express and UPS. **“Government always should tread lightly when it comes to direct competition with the private sector.”**
- The editorial also noted that the Postal Service receives many perks from their government-status – its trucks are exempt from taxes and they can park wherever they want without a ticket. Part of the new

plan calls for special price breaks to companies that mail large volumes, and higher prices to businesses that use less mail. However, this system would be a threat to the Postal Services' competitors. The editorial concluded by warning that the "parcel delivery industry, like any other industry would benefit from, an increase in level competition, not a decrease." (*Deseret News*, Editorial, 5/12/02)

***Providence Journal-Bulletin* editorial calls for postal subsidies and profit incentives**

- Phillip Terzian, associate editor of the *Providence Journal-Bulletin* wrote an editorial outlining the problems facing the Postal Service. If Congress were to completely privatize the Postal Service, he claimed postal service could suffer, and Americans may not be able to have their mail delivered every day. But the current system can be "unwieldy and redundant," yet customers remain satisfied. Terzian also questioned the need for the Postal Service to pay for itself – he noted that the government does not ask the Marine Corps to pay for itself. But he does concede that the government must enact some reforms so that the Postal Service does not remain in such dire financial straits. "There are plenty of ways in which the Postal Service can be modernized, and costs are controlled...But it probably requires permanent subsidies as well as profit incentives, and that's a fair trade for what we've grown to expect." (*Providence Journal-Bulletin*, Philip Terzian, 5/2/02)

Heritage Foundation Research Fellow says the reforms outlined in the Postal Services' transformation plan are not enough

- A commentary by James Gattuso, a research fellow at the Heritage Foundation, in the *Washington Times*, calls for another look at the Postal Services' recent business transformation plan. Gattuso noted that the Postal Service has been losing business to the Internet and to private shipping companies for several years. Now it faces a \$1.35 billion deficit. Realizing their dire problem, the Postal Service issued a new "transformation plan" to Congress calling for a rate increase on stamps, along with other reforms. However, Gattuso says the reforms are not enough. Instead of fully going private, the Postal Service is still a GSE with increased flexibility. However, they are trying to "have its package and eat it too," as the Postal Service wants to be a flexible company that still gets government perks like tax exempt status, backing from the Treasury, and a monopoly of first class mail.
- Gattuso concluded, **"letting USPS enter new markets without eliminating its special protections is a recipe for economic distortion...this kind of protection is exactly what fostered the Postal Service's famous inefficiency in the first place. The culture needs to change, and more competition, not less, is the way to do it."** (*Washington Times*, James Gattuso, 5/13/02)

Postal Service/Postal Rate Commission hold May 28 Ratemaking Summit

Follow-up meeting to be held in June

- Panelists and audience members at the May 28 Ratemaking Summit sponsored by the Postal Service and the US Postal Commission discussed new rate structures, electronic filing of comments and other proposals to improve the process of setting postal rates, reported *DM News*. More than 150 people attended the summit.
- William J. Olson, an attorney who has worked on several omnibus rate cases, said during one panel session that rate case proceedings could be more productive if the Postal Service changed some of its costing methodologies. Still, he thought the system needed only modification and not an overhaul.
- Another panel discussed possible changes in how rate cases are filed with the Postal Rate Commission along with changes for discovery practices and procedures during rate case proceedings. Among other ideas, most summit participants supported the Postal Rate Commission's recent proposal to accept comments in future rate cases and other proceedings electronically rather than in hard copy. Panelists and audience members also spoke about the time and cost involved in rate case proceedings for both the Postal Service and mailers and discussed how the process could be less expensive and less time-consuming. Also discussed was a way to make price changes more regular and predictable
- A second ratemaking summit is scheduled for June 27. Besides following up on suggestions from the May 28 session, the June meeting will discuss negotiated service agreements and other customized rate approaches. (*DM News*, Melissa Campanelli, 5/31/02)

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