

The **GSE** REPORT TM

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Major Events

18 Congressional Members from the Western Caucus claim FHLBanks have strayed from their mission in developing a secondary market program - ask House Financial Services Committee Chairman to hold hearings on the FHLBanks

3 Western Caucus Congressional Members defend the FHLBanks

Did Fannie influence the letter writing against the FHLBanks' programs?

Fannie & Freddie to fight FHLBank securitization, reports *Market News International*

"This is the No. 1 issue for Fannie Mae," says a political consultant

FHLBank of Chicago President tells policymakers that more competition in the secondary mortgage market benefits homebuyers and market participants

- A letter being circulated among Western Caucus members claimed the FHLBanks are neglecting their traditional advance business as they develop secondary mortgage market programs. So far, 18 Members have signed the letter, asking House Financial Services Committee Chairman Michael Oxley (R-OH) to hold hearings on the FHLBanks. (*National Mortgage News Daily Website*, 4/9/03) In response, three Western Caucus Members - Representatives Doc Hastings (R-WA), Jennifer Dunn (R-WA) and George Nethercutt (R-WA) - sent an April 3 letter noting that "Any suggestion that the FHLBanks have 'moved away from their bread and butter product' is not true," and that the programs benefit small banks and thrifts "that traditionally have not received the best prices in the current secondary marketplace." (*National Mortgage News Daily Web site*, 4/10/03) The Western Caucus is an organization of over fifty western Members of Congress that was established in 1992 by former Congressman Jim Hansen (R-UT). Congressman Cannon was elected the new Chairman of the Western Caucus in January 2003. (*Congressman Chris Cannon press release*, 1/29/03)

Did Fannie influence the letter writing against the FHLBanks' program?

- Sources claim Fannie has been "stirring up questions" about the FHLBanks in order to stop the FHLBank System's mortgage purchase programs - MPF and MPP. *National Mortgage News* learned that a Fannie official attended a March 31 meeting of Western Caucus staff. (*National Mortgage News*, 4/14/03)

Fannie & Freddie to fight FHLBank securitization, reports *Market News International*

- In related news, *Market News International* reported that the FHLBanks may be in a tough fight against Fannie and Freddie, if steps toward mortgage securitization by the FHLBanks go much further, analysts said. Six years ago, the FHLBanks began the Mortgage Partnership Finance (MPF) program, a purchase program that competes with Fannie and Freddie in the secondary mortgage market. Then in December 2002, the FHFB approved the Chicago

FHLBanks' Shared Funding program, which would create mortgage securities for investment by the FHLBanks and their members, as part of the MPF risk management structure. The structure creates mortgage-backed certificates from conventional conforming mortgages as an alternative to agency mortgage backed securities guaranteed by Fannie and Freddie. Analysts view the Shared Funding program as a step towards securitization, but the Treasury Department has stopped short of asserting that. "Treasury has reviewed the Chicago FHLB's Shared Funding program and concluded that it is not a securitization plan," a Treasury spokeswoman recently told *Market News International*. (*Market News International*, Claudia Hirsch, 4/7/03)

- There is discomfort inside Fannie and Freddie, according to a source close to the agencies. "This is the No. 1 issue for Fannie Mae," said the political consultant. Once the Shared Funding program was approved, Fannie started to worry, he said. "These guys are ready to rock and roll," said the consultant, referring to the momentum generated by the Shared Funding program. "A lot of these things they're [FHLBanks] getting into would be competition to Fannie and Freddie," he added. Still, the FHLBank System could present "formidable competition," but the consultant said it is "not as politically astute" as Fannie and Freddie. "I think ultimately, Fannie Mae will win the day," said the consultant, and others agree. Bert Ely, a Washington-based financial analyst stated, "The last thing they [Fannie and Freddie] want is another competitor out there." Ely said Fannie and Freddie have already started to raise questions inside the Beltway about the FHLBanks' recent moves. (*Market News International*, Claudia Hirsch, 4/7/03)

FHLBank of Chicago President says more competition benefits homebuyers

- FHLBank of Chicago President Alex Pollock said that his bank "has continuing conversations" with "all relevant" officials in the Bush administration, in Congress, and at the regulators. "We have tried to make clear...that a more competitive secondary mortgage sector is better than a less competitive secondary mortgage sector" for both market participants and homebuyers. "I think it's safe to say that most people understand that," he said. (*Market News International*, Claudia Hirsch, 4/10/03)
- According to Pollock, the FHLBanks' MPF program is well outpacing growth of Fannie and Freddie's portfolios in MBS. Pollock reported that the MPF program grew 68 percent in 2002, while Fannie's mortgage and MBS portfolio grew 16 percent and Freddie's grew 15 percent last year. "We are clearly taking share on the margin," Pollock said. He noted that the FHLBanks' Shared Funding program expects to complete its second transaction in the second quarter. (*Market News International*, Claudia Hirsch, 4/10/03)

Congressman Baker solicits administration's position on housing GSE regulation and governance

Sends letters to Treasury, HUD, anticipates response from Greenspan

Congressman Baker likely to hold hearings after he receives responses

- Capital Markets Subcommittee Chairman Richard Baker (R-LA) sent separate letters April 11 to the Treasury Department and HUD, seeking the administration's position on both general and specific questions concerning housing GSE regulation and governance. Congressman Baker asked both agencies to respond in writing by April 24, 2003. (*Congressman Baker press release, 4/15/03*)
- Congressman Baker said he hopes to review the administration's position on regulation and governance within the context of concentration risk and potential systemic risk issues associated with the housing GSEs. Congressman Baker said he expects to receive a response soon to his February 13 letter to Federal Reserve Board Chairman Alan Greenspan seeking comments on financial institutions' holdings of housing GSE debt. (*Congressman Baker press release, 4/15/03*)
- Congressman Baker's letter to Under Secretary for Domestic Finance Peter Fisher can be found at: www.baker.house.gov/News/fisher_letter.htm. Congressman Baker's letter to Secretary Mel Martinez can be found at: www.baker.house.gov/News/martinez_letter.htm Congressman Baker's letter to Federal Reserve Board Chairman Alan Greenspan can be found at: www.baker.house.gov/News/greenspan_letter.htm (*Congressman Baker press release, 4/15/03*)
- A spokesman for Congressman Baker said the Congressman is likely to schedule a hearing on the housing GSEs once he hears from the administration and regulators. He may also wait for the newly named director of OFHEO to take office, the aide said. (*Reuters, 4/15/03*) Congressman Baker is interested in spurring action to replace the current director of OFHEO, Armando Falcon, with White House nominated – Mark Brickell, Director and CEO of Blackbird Holdings (electronic trading system for derivatives contracts). “We need the new guy in there,” said Congressman Baker's spokesman. A timetable for Brickell's nomination has yet to be disclosed and the Senate has not acted. (*BNA Daily Report for Executives, Adam Wasch, 4/16/03*)

Treasury letter

- Congressman Baker sent a letter to Treasury Undersecretary for Financial Institutions Peter Fisher asking whether comments made by Fisher's predecessor Gary Gensler at a March 22, 2000 Capital Markets Subcommittee hearing remain the official position of the Treasury Department on the housing GSEs. Congressman Baker asked that Fisher identify if there have been any changes in GSE governance policy and to explain the reasons for such modifications.

- Gensler testified in 2000 that the Treasury Department supported removing the GSEs' line of credit with the US Treasury and recommended limiting the amount of GSE debt that commercial banks can hold. Gensler also noted that Fannie and Freddie's debt was not guaranteed by the US government.
- Gensler testified, "Repeal of the line of credit would be consistent with the congressional requirement that all GSE securities carry a disclaimer that they are not obligations of the US government. Thus, as part of a package of reforms, we would support repeal of the line of credit."
- Gensler suggested placing restrictions or limiting the amount of Fannie and Freddie debt commercial banks can hold. "GSE debt obligations are exempt from banks' investment securities limits. We believe that Congress should seriously consider the best way to repeal such exceptions, including a sufficient transition period to prevent any market disruption." (*Congressman Baker's letter to Under Secretary Peter Fisher, 4/11/03*) [See April 7, 2000 *GSE Report* for more information on Gensler's testimony, www.gsereport.com]

HUD letter

- Congressman Baker asked HUD Secretary Mel Martinez how the Home Mortgage Disclosure Act (HMDA) applies to Fannie and Freddie. Under HMDA, mortgage lenders are required to publicly disclose certain information about lending practices. Congressman Baker questioned whether Fannie and Freddie are required to publicly disclose certain information about the loans they purchase and if not, to justify this disparity in disclosures.
- Congressman Baker also requested an update on HUD's fair lending review of Fannie and Freddie's automated underwriting system. He further requested that any comments Fannie and Freddie made to HUD about the study be forwarded to his office. (*Congressman Baker's letter to HUD Secretary Mel Martinez, 4/11/03*)

HUD has been reviewing Fannie & Freddie's AU systems since 1999

- HUD has been investigating Fannie and Freddie's automated underwriting systems since 1999 to ensure that the GSEs' systems comply with fair-lending standards. Secretary Martinez told reporters in December 2002 that the study would be released before year-end and later pushed that release date back to sometime in January 2003. When questioned about the status of the report recently, Secretary Martinez would not comment. HUD has also denied legal requests from reporters under the Freedom of Information Act to release the study, which many believe to be finished. (*Dow Jones Newswire, Dawn Kopecki, 4/15/03*)
- In March 1999, HUD commissioned an independent study by the Urban Institute, which found that Fannie and Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers. The report also noted that Fannie and Freddie "do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities." (*HUD/Urban Institute Study, "A Study by the GSEs' Single Family Underwriting Guidelines, April 1999*)

Fed letter

- Congressman Baker sent a February 13 letter to Federal Reserve Board Chairman Alan Greenspan asking the Chairman to comment on the following: (1) the extent to which GSE debt is currently held by federally insured depository institutions and the growth of such holdings over the last five years, including amounts by type of financial institution and relative to the institutions' capital; (2) the extent to which unlimited holdings by federally insured depository institutions could produce systemic risk issues, particularly for the safety and soundness of the U.S. banking system, in the event of default or failure of a GSE; (3) the effects on the GSEs, banking industry, and mortgage markets if prudent limits on the holdings of GSE debt were placed on federally insured depository institutions; and (4) recommendation whether a specific limit on such holdings should be required. (*Congressman Baker's letter to Federal Reserve Board Chairman Alan Greenspan, 2/13/03*)

Senator Sarbanes asks Fannie & Freddie to investigate Fairbanks

- Senate Banking Committee Ranking Democrat Paul Sarbanes (D-MD) urged Fannie and Freddie to investigate allegations regarding the loan-servicing practices of Fairbanks Capital Corp. HUD and the FTC are currently investigating allegations that Fairbanks overcharged and harassed customers.
- “Fairbanks...is reported to have caused some significant problems for a number of homeowners...including double charges, unnecessary insurance being forcibly added to mortgages at great costs to consumers, escrow problems, and even foreclosure,” Senator Sarbanes wrote in a letter to Fannie and Freddie executives. “I am sure you agree that such problems must be addressed,” he said. “To that end, I would appreciate your looking into these allegations.”
- Freddie's Chairman Leland Brendsel responded in a letter that the company takes the allegations “very seriously” and is “investigating the situation.” A Freddie spokeswoman noted that companies that do not meet Freddie's due diligence requirements – including compliance with lending laws – for selling and servicing loans lose their certification to do business with the loan financier. A Fannie spokeswoman stated that the company was also reviewing the servicing practices of Fairbanks. (*American Banker, Michele Heller, 4/8/03*)

OFHEO issues final rule on Fannie & Freddie's financial disclosures

Rule implements the voluntary financial disclosure agreement that was reached among Fannie, Freddie, the SEC, OFHEO, and Treasury last July

Fannie is "troubled" by the rule, claiming it is beyond OFHEO's authority

Freddie claims it "is unclear" whether OFHEO is imposing disclosures under the rule that are different from the SEC requirements under the July agreement

ACB supports the rule and believes it will strengthen the regulatory oversight of Fannie & Freddie

FM Watch says rule should be treated as an interim measure and recommends legislation to fully repeal Fannie & Freddie's exemption from securities laws

- OFHEO issued a final rule April 7 on securities and financial disclosures for Fannie and Freddie, which expresses the authority of OFHEO regarding disclosure of financial information and provides support for the voluntary registration of common stock by Fannie and Freddie under the Securities Exchange Act of 1934. The rule will be effective April 30, 2003. (*OFHEO press release, 4/2/03*)
- OFHEO said it issued the rule in part to facilitate the process of Fannie and Freddie's voluntary agreement to register under the Securities Exchange Act of 1934. Last July, the SEC, OFHEO, and Treasury reached an agreement with Fannie and Freddie, in which Fannie and Freddie agreed to voluntarily register their common stock and file quarterly and annual reports with the SEC (in compliance with the Securities Exchange Act of 1934). OFHEO's rule outlines the disclosures that Fannie and Freddie will need to make to the SEC and asserts OFHEO's authority over the GSEs' financial disclosures but directs the GSEs to file the documents with the SEC.
- The OFHEO rule also ensures that Fannie and Freddie follow the same disclosure requirements as other publicly traded companies for shareholder proxies and insider transactions – two types of disclosures that were not clearly covered under the terms of the July agreement, an OFHEO official said. (*Reuters, 4/2/03*)
- OFHEO reviewed the comment letters it received in response to its January 23 proposed rule. OFHEO received six comment letters on the proposal: Fannie; Freddie; America's Community Bankers; FM Watch; James McDonald, a self-described civil rights attorney from Virginia; and Yvonne Wohlers from Williamsburg, VA. OFHEO adopted the rule as it was proposed January 23. (*Federal Register, pages 16715-16718, 4/7/03*)

Fannie & Freddie questioned provisions that they claimed went beyond the Securities Exchange '34 Act

- Fannie and Freddie questioned what they regarded as provisions of the final rule that could go beyond the Securities Exchange Act of 1934. Fannie's comments indicated that the proposed rule could result in OFHEO substituting its judgment for that of the SEC in matters relating to disclosures and enforcements. OFHEO dismissed these arguments and noted that its "actions are guided by its statute that provides for oversight of Enterprise safety and soundness" and that it "anticipates no duplication of regulation in meeting its obligations." (*BNA Daily Report for Executives, Richard Cowden, 4/7/03*)

Fannie's comments

- Fannie said it agreed with OFHEO "on the importance of strong disclosures." However, "the approach OFHEO has chosen to implement these objectives is inconsistent with the policy announced by Treasury, the SEC, and OFHEO last summer, and are beyond OFHEO's regulatory authority." (*Fannie's Senior Vice President - Legal Department, Ann Kappler, letter to OFHEO, 3/24/03*)
- Fannie said it was "troubled" that OFHEO's rule goes beyond filling regulatory "gaps" and would create a parallel authority for OFHEO to act as a back-up regulator regarding requirements that are under direct SEC jurisdiction. "This assertion of overlapping authority is entirely unnecessary," Fannie said. "The regulation and enforcement of disclosure under the securities laws is the fundamental, bedrock mission of the SEC. It has been doing this for roughly seventy years and has accumulated vast institutional expertise and an unmatched perspective," the company said. (*Dow Jones Newswire, John Connor, 4/2/03; Fannie's Senior Vice President - Legal Department, Ann Kappler, letter to OFHEO, 3/24/03*)
- Saying "Congress has not charged OFHEO with the responsibility of investor protection," Fannie argued that, "OFHEO's attempt to assume this role, in addition to or in place of the SEC, would not only be outside its statutory charge, but would also be a waste of OFHEO's resources and an unfortunate diversion of its institutional focus away from assuring the safe and sound operation of Fannie Mae and Freddie Mac." Fannie warned that "the clear potential for regulatory conflict would exist" despite OFHEO's assertions otherwise. "Charging an additional federal authority with enforcing securities laws, exclusively reserved to the SEC, would lead to a divergence in regulatory paths and inconsistencies in the securities laws which would confuse investors and create legal uncertainty." (*Dow Jones Newswire, John Connor, 4/2/03; Fannie's Senior Vice President - Legal Department, Ann Kappler, letter to OFHEO, 3/24/03*)
- Fannie urged OFHEO to delete the portion of the proposed rule that would make failure to meet SEC requirements a violation of OFHEO's rules, and recommended that OFHEO make clear that it will not seek to deviate from the disclosure standards established by the SEC. "It would be at best duplicative for OFHEO to establish a requirement that Fannie Mae must perform acts that we now are bound legally to perform pursuant to a statutory and regulatory framework administered and enforced by the SEC," Fannie said. "Beyond that, it would be ill-advised for OFHEO to raise through this proposal the possibility that the agency might at

some point seek to substitute its judgment for that of the SEC with respect to disclosure regulation and enforcement.” (*Dow Jones Newswire*, John Connor, 4/2/03; *Fannie’s Senior Vice President - Legal Department*, Ann Kappler, letter to OFHEO, 3/24/03)

Freddie’s letter

- Freddie said that it “agrees with the substance of the proposed regulation,” subject to certain comments, one of which was that “it is unclear whether OFHEO’s proposed rule is imposing a disclosure obligation that is different from the specific SEC requirements that were the subject of the July 12, 2002 announcement.” (*Dow Jones Newswire*, John Connor, 4/2/03; *Freddie’s Vice President – Deputy General Counsel*, Allan Ratner, letter to OFHEO, 3/24/03)

America’s Community Bankers’ letter

- ACB said it supported OFHEO’s proposal and believed that “it is appropriate and necessary for OFHEO to set forth disclosure requirements to ensure the Enterprises are capitalized adequately and operate safely and in compliance with applicable laws, rules and regulations.” ACB believes OFHEO’s proposal supports these goals and believes the proposal “will help to strengthen regulatory oversight of the Enterprises and that, in turn, will benefit the Enterprises, private mortgage market participants and consumers.” (*ACB’s Director of Regulatory Affairs & Senior Regulatory Counsel*, Charlotte Bahin, letter to OFHEO, 3/25/03)

FM Watch’s letter

- FM Watch said OFHEO’s rule should be treated as an interim measure stating its position that parity of securities regulation can result only through enactment of legislation that would bring both firms “under the full weight of the Securities Act of 1933 and the Securities Exchange Act of 1934 by repealing their status as exempted securities.” FM Watch said, “We believe this change is essential to protect both investors and taxpayers.” OFHEO’s efforts “to end the major disparities between the securities and financial disclosures of the Enterprises and all other publicly traded firms, is only partially completed,” argued FM Watch. “Many disparities continue to exist, particularly regarding the fundamental areas of enforcement of appropriate disclosure, financial reporting and internal control standards for the Enterprises as compared to those imposed on all other publicly traded firms. Without the elimination of these disparities, there will never be investor protection and complete and transparent disclosure with regard to the Enterprises.” FM Watch recommended amendments to the proposed rule that would specify procedures to be used and possible sanctions available to OFHEO in enforcing compliance with the new disclosure requirements. (*BNA Daily Report for Executives*, Richard Cowden, 4/7/03; *Dow Jones Newswire*, John Connor, 4/2/03; *FM Watch’s Executive Director – W. Mike House*, letter to OFHEO, 3/24/03)
- “FM Watch strongly supports the OFHEO Proposed Rule as an interim measure and a significant step in the effort to require the Enterprises and their insiders to conform to the same disclosure and other requirements applicable to other publicly traded companies.” FM Watch, however, continues to believe that “the Proposed Rule and the July agreement are not a substitute for enactment of legislation that would repeal the exempted security status of the

Enterprises and fully subject the Enterprises to the same standards that apply to all other publicly traded companies.” (*FM Watch’s Executive Director – W. Mike House, letter to OFHEO, 3/24/03*)

- OFHEO rebuffed FM Watch’s suggestions, noting that “OFHEO possesses a broad range of explicit and implied authorities to address the Enterprises’ disclosure practices.” (*BNA Daily Report for Executives, Richard Cowden, 4/7/03*)

James McDonald and Yvonne Wohlers’ letters

- McDonald and Wohlers’ letters, while supporting greater financial disclosures by Fannie and Freddie, raised issues related to immigration matters that OFHEO felt were not germane to the purpose or scope of OFHEO’s proposed rule. (*Federal Register, pages 16715-16718, 4/7/03*)

Background on GSEs’ financial disclosures

- Due to their GSE status, Fannie, Freddie and the FHLBanks are exempt from registering their securities with the SEC. Last July, the SEC, OFHEO, and Treasury reached an agreement with Fannie and Freddie, in which Fannie and Freddie agreed to voluntarily register their common stock and file quarterly and annual reports with the SEC (in compliance with the Securities Exchange Act of 1934), while remaining exempt from registering their debt and MBS with the SEC under the 1933 Securities Act. Fannie March 31, 2003 filed for the first time its Form 10 registration statement and initial Form 10-K annual report to the SEC, providing its audited financial statements for 2002. Freddie has yet to file registration statements with the SEC. It plans to do so in June when it is finished restating earnings from previous years.
- In July 16, 2002 testimony before the House Capital Markets Subcommittee, Treasury Undersecretary Peter Fisher called on all GSEs to comply with the same financial disclosure rules agreed to by Fannie and Freddie. In a follow-up to his testimony, Undersecretary Fisher sent letters in August of last year to the 12 FHLBanks and Sallie Mae, urging them to comply with the same voluntary financial disclosure rules agreed to by Fannie and Freddie. Until recently, all 12 FHLBanks had been opposed to registering their stock with the SEC. However, in March, breaking ranks from the other 11 FHLBanks, the board of directors of the FHLBank of Cincinnati voted unanimously to begin registering its stock with the SEC. FHFB Chairman John Korsmo is in favor of having the FHLBanks register their common stock with the SEC. The SEC called for greater financial disclosures by the FHLBanks and said that registration of FHLBanks’ securities with the SEC would not impede the markets. HUD is undecided on whether the FHLBanks should register their stock with the SEC.
- Fannie and Freddie and all 12 FHLBanks and FHFB Chairman John Korsmo are unanimous, however, in their opposition to registering their debt with the SEC. As part of Fannie and Freddie’s voluntary agreement, the Treasury, OFHEO, and SEC issued a joint report February 2003 that recommended Fannie and Freddie provide more disclosures on their MBS. The joint report found that Fannie and Freddie disclose less information than private-label issuers and that additional disclosures would not disrupt the market as Fannie and Freddie had

argued previously. As a result of the report, Fannie and Freddie pledged to voluntarily provide more information on their MBS.

OFHEO to issue proposed rules to make Fannie & Freddie's numbers more comparable

OFHEO plans to develop measures of interest rate risk associated with Fannie & Freddie's retained mortgage portfolios

Earlier this year, Congressman Baker recommended OFHEO require Fannie & Freddie to disclose their comparable interest rate risk

- OFHEO Director Armando Falcon told participants at an American Land Title Association conference that OFHEO plans to issue proposed rules to make the numbers Fannie and Freddie disclose more comparable (e.g., Fannie and Freddie have different models and methodologies calculating their duration gap numbers). OFHEO also wants to develop measures of the interest rate risk associated with their retained mortgage portfolios, which now total close to \$1.4 trillion. (*National Mortgage News Daily Web site*, 4/14/03)
- As noted in the January 10, 2003 *GSE Report*, Capital Markets Subcommittee Chairman Richard Baker (R-LA) wrote to OFHEO Armando Falcon urging OFHEO to require Fannie and Freddie to disclose their interest rate risk in a comparable manner. Congressman Baker said, "These disclosures would be informative not only for the public and investors, but also for the enterprises themselves. I urge OFHEO to implement such a uniform standard in the near future and to ensure disclosures are made in an accurate, consistent, and timely manner." Congressman Baker questioned OFHEO's reliance on Fannie and Freddie to determine how they calculate and report duration gap and other measures of interest rate risk exposure, which OFHEO uses to test quarterly the GSEs' capital strength. (*American Banker*, Michele Heller, 1/9/03; *Reuters*, 1/8/03)

Subcommittee approves regulatory relief bill (HR 1375), which contains provision allowing privately insured credit unions to become FHLBank members

Congressman Kanjorski offers and withdraws an amendment eliminating this provision

Subcommittee approves amendment by Congressman Kanjorski that extends the term of the FHLBank Directors

- The House Financial Institutions Subcommittee approved by voice vote April 9 a regulatory relief bill (HR 1375) that would among other things, allow state-chartered, privately insured credit unions to become FHLBank members if they meet certain eligibility requirements. The bill now moves to the full Financial Services Committee.

- Congressman Paul Kanjorski (D-PA) offered and withdrew an amendment that would have eliminated the section of the bill allowing state chartered credit unions from being part of the FHLBank System. Congressman Kanjorski called the provision “dangerous” and expressed concerns that if these credit unions failed, it would have an impact on the FHLBank System and federally insured credit unions. (*CUNA News*, 4/10/03; *American Banker*, Michele Heller, 4/10/03)
- Subcommittee Chairman Spencer Bachus (R-AL) pointed out that non-federally insured institutions are already a part of the FHLBank System and that state chartered credit unions would not be allowed to join unless they are deemed to be safe and sound. Congressman Kanjorski withdrew the amendment and said he hoped to work with Congressman Bachus and others to find effective federal oversight before the bill is marked up in full committee. (*CUNA News*, 4/10/03)
- Another amendment by Congressman Kanjorski that would extend the terms of the FHLBank Directors from three years to four years was approved by voice vote. (*House Financial Services Committee press release*, 4/9/03)
- A regulatory relief bill (HR 3951), containing a provision that would allow privately insured credit unions to join the FHLBank System, was considered during the last session of Congress. The bill was approved by the House Financial Services Committee but never made it to the House or Senate floors. [See July 19, 2002 *GSE Report* for more information, www.gsereport.com]

Treasury’s comprehensive examination of the FHLBank System will not stop Treasury from pushing the FHLBanks to register their stock with the SEC

FHFB Chairman continues to push to have all 12 FHLBanks register their stock with the SEC

- Treasury’s plans to conduct an in-depth investigation into the FHLBank System will not prevent Treasury officials from continuing to push “hard” for the FHLBanks to register with the SEC, said Treasury Assistant Secretary for Financial Institutions Wayne Abernathy. Abernathy pointed to Fannie’s recent filing of its first 10-K with the SEC as evidence that a SEC disclosure regime is much tougher than voluntary standards, forcing Fannie to disclose some things that were not known before. (*National Mortgage News Daily Web site*, 4/8/03) The investigation, expected to take six months or longer, will be conducted by Treasury Deputy Assistant Secretary Gregory Zarzan. (*National Mortgage News*, 4/14/03)

FHFB Chairman continues to push to have all 12 FHLBanks register their stock with the SEC

- In an April 14 speech to the American Land Title Association, FHFB Chairman John Korsmo continued to push to have all 12 FHLBanks register their stock with the SEC. Korsmo noted that taxpayers and debt purchasers would benefit from the FHLBanks’ registration because the FHLBank System is such a large player in the debt markets. He supports registration in part because of the FHLBanks System’s very size and the nature of its GSE charter. (*FHFB*

Chairman John Korsmo's remarks before ALTA, 4/14/03)

- Korsmo noted that the System now issues just over \$4 trillion of discount notes each year, “(yes, that’s right, I said, trillion),” sold about \$420 billion in longer-term bonds in 2002, and at any given moment has roughly \$650 billion in debt outstanding. “That Bank System debt is purchased by somebody, and those somebodies, the individuals and institutions who are the buyers of Bank System securities, have an intense interest – a financial self-interest – in knowing all they can about the System and the quality of its debt. And, indeed, taxpayers or those who represent them also have an intense interest in knowing whether the System can back up that debt, debt that the capital markets believe the taxpayers stand behind.” (*FHFB Chairman John Korsmo's remarks before ALTA, 4/14/03)*)
- The FHLBank System’s “very size and the public nature of its charter, which makes it one of the most privileged businesses in America,” explains why Korsmo has joined the Administration in asking the FHLBanks to voluntarily submit to meeting the financial disclosure requirements of the 1934 Securities Exchange Act, as administered by the SEC. (*FHFB Chairman John Korsmo's remarks before ALTA, 4/14/03)*)
- Korsmo concluded, “I have publicly maintained that I believe voluntary SEC registration is the right thing to do for the Bank System. The SEC represents the ‘gold standard’ of financial disclosures. It is the proven expert, with the staff, expertise, and commitment to do the job effectively, and thereby ensure the public and investors of the reliability and completeness of System disclosures.” (*FHFB Chairman John Korsmo's remarks before ALTA, 4/14/03)*)

Background on the Treasury’s study of the FHLBanks

- Abernathy said the Treasury Department would examine the following issues: (1) Treasury’s call for the FHLBanks to register their common stock with the SEC; (2) FHLBanks’ MPF Shared Funding transaction (MBS backed by FHLBank mortgage loans); (3) executive compensation; and (4) FHLBanks’ mortgage purchase programs (MPF and MPP). “We’ll be asking if these (innovations) are helping them meet their mission or are they a distraction to their mission,” said Abernathy. He noted that the investigation could produce new regulations or legislative recommendations, but that he didn’t want to prejudge the results of the analysis. (*Dow Jones Newswire, Dawn Kopecki, 4/3/03)*)
- See [page 12](#) for more background on the GSEs’ financial disclosures.

Illinois Development Finance Authority first to settle with IRS over state and local bonds supported by standby letters of credit (LOCs) from the FHLBanks

S&P announces that the IRS audits will not pose a threat to the current ratings on the bonds

FHLBanks are lobbying to make the enhancements legal

- The Illinois Development Finance Authority April 10 approved the conversion of \$5.3 million of Coburn Steel Products Inc. tax-exempt industrial bonds to a taxable investment as part of a settlement agreement with the IRS. The IRS last year issued a preliminary determination that interest on the 2000 bond issue, sold on Coburn's behalf by IDFA, was taxable because of the deal's use of a standby LOC from the FHLBank of Chicago. The IRS determined last year that tax-exempt industrial development bond issues backed by standby LOCs provided by the FHLBanks constitute an illegal federal guarantee. Under the federal tax code, a non-housing bond issue that carries a federal guarantee cannot also qualify for tax-exempt status. (*Bond Buyer*, Yvette Shields, 4/11/03)
- The Illinois Development Finance Authority was the first FHLB LOC-backed bond transaction audited by the IRS. The IRS, which had considered auditing at least two dozen similar transactions, has since begun a second audit. Mark Scott, the IRS' director of tax-exempt bonds, said that a mid-March deadline for issuers of similar transactions had been extended into the month of April. So far, 10 issuers have approached the IRS seeking to enter into voluntary closing agreements. (*Bond Buyer*, Yvette Shields, 4/11/03)

S&P announces that the IRS audits will not pose a threat to the current ratings on the bonds

- Standard & Poor's Ratings Service April 9 announced that it views the upcoming IRS audits of industrial/economic development revenue bonds supported by FHLBank standby Letters of Credit (LOCs) as no threat to any current ratings. Although ratings do not address whether or not an issue is taxable, Standard & Poor's will continue to monitor the situation and ensure that redemptions/tenders are funded by the FHLBanks under any future standby LOCs to maintain credit quality in the event of a determination of taxability for such enhanced bonds. (*Standard & Poor's press release*, 4/9/03)
- Not including housing bond issues, Standard & Poor's has ratings on about 14 tax-exempt issues supported by FHLB standby LOCs that could have tax implications from the ruling. In the past year, apart from housing bond issues, Standard & Poor's has noted an increasing use of FHLBank standby LOCs to enhance bond issues. These transactions include taxable bond issues that are not subject to the IRS audits. (*Standard & Poor's press release*, 4/9/03)

FHLBanks are lobbying to make the enhancements legal

- As noted in the March 25, 2003 *GSE Report*, the 12 FHLBanks last summer asked the IRS for a private-letter ruling but withdrew it when the IRS advised that they would issue a negative ruling. (*Standard & Poor's press release*, 4/9/03) The FHLBanks want the same

exemption from the federal guarantee provision that Section 149 of the Internal Revenue Code grants to other GSEs, that, unlike the FHLBanks, have charters that limit their activities to insurance programs used to back tax-exempt housing and student-loan bonds.

- In October 2002, Congressman Amo Houghton (R-NY) and Congressman Richard Baker (R-LA) introduced a bill (HR 5670) that would have amended the Internal Revenue Code to allow bonds backed by FHLBank LOC to be treated as tax-exempt bonds. The bill would not apply retroactively to the transactions the IRS plans to audit. A similar bill is expected to be introduced this year. (*Standard & Poor's press release*, 4/9/03)

AFGI asks Congress and Treasury Department to block the FHLBanks from changing the tax code in favor of the FHLBanks

- As noted in the March 25, 2003 *GSE Report*, at least one organization has asked the Treasury and Congress to block the change. The Association of Financial Guaranty Insurers (AFGI) sent letters to federal policymakers saying that granting the FHLBanks the ability to back tax-exempt bonds would “ultimately overwhelm the existing private sector participants.” “It would create an unfair advantage,” said David Boyle, AFGI's chairman and vice-chairman of Ambac Assurance Corp. in Albany. “Using their implied government guarantee and lower cost of capital to go into any marketplace that already is well served serves no public purpose.” (*Bond Buyer*, Susanna Duff, 3/19/03) [For more information, see March 25, 2003 *GSE Report*, www.gsereport.com]

Fannie Mae and Freddie Mac

Former Treasury Assistant Secretary for Financial Institutions Sheila Bair suggests an overhaul of GSE oversight by merging OFHEO, the FHFB, and the OTS

Would provide a more credible GSE regulator and would bring GSE oversight into the financial regulatory mainstream

- A unified federal housing regulator to oversee thrifts and GSEs might improve supervision and slim down the complicated US regulatory system, said Bair at a recent conference sponsored by the Federal Deposit Insurance Corporation. She noted that the US has too many financial regulators. While some regulatory competition is good for the industry – too much causes confusion. She suggested two options: (1) consolidating the Office of Thrift Supervision with the Office of the Comptroller of the Currency and (2) merging the OTS with the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board, which was suggested in the aftermath of the saving and loan crisis in the 1980s. “Its chief advantages are that it would preserve the thrift charter, which is important to many community banks,” Bair said. “It might help the GSEs as well...I don't know how they feel about it, but at least Fannie and Freddie have got to be pretty tired of the constant sniping. It's not going away.” Bair now works at the University of Massachusetts-Amherst. (*Dow Jones Newswire*, Rebecca Christie, 3/14/03)

- Bair provided more details to the *American Banker* about her proposal of merging OFHEO, the FHFB, and the OTS into a “financial housing regulator” that the Treasury would oversee. “Its chief advantages are that it would preserve the thrift charter, which is important to many community banks, while better integrating the regulation of the major housing GSEs with regulation of lending institutions,” Bair said. Additionally, “it would arguably enhance the independence and effectiveness of GSE oversight.” The bottom line is that Fannie and Freddie need a more credible regulator, she said. “It seems to me this would be a way to enhance the credibility of their oversight among the investing public and among government officials.” Merging the OTS, OFHEO, and the FHFB would bring “GSE oversight into the financial regulatory mainstream,” she said. “Right now...they are by and large outside the financial regulatory mainstream. I think that deprives them of some collaboration and working relations” that exist among the bank regulators “that could be helpful to them as they deal with issues like what is the appropriate capital structure for Federal Home Loan Banks, what are the appropriate capital standards for Fannie and Freddie. It also would give them greater credibility in the markets.” (*American Banker*, Michele Heller, 4/11/03)

Title company executives disappointed that OFHEO has no position on Radian Guaranty’s alternative title insurance product

ALTA requested that OFHEO prohibit Fannie & Freddie from using alternative title insurance

- OFHEO Director Armando Falcon disappointed title company executives and agents when he told an American Land Title Association (ALTA) conference that OFHEO has not taken a position on alternative title insurance products, such as Radian Lien Protection. (*National Mortgage News Web site Daily*, 4/14/03)
- Falcon noted that title insurance is an important part of the risk management tools associated with mortgage finance, however, the Administration is looking at ways to lower the cost of settlement for the consumer, and title insurance should not be exempt from those cost savings. He said the industry needs to come up with a good argument for the current cost of title insurance since it is one of the higher costs of settlement. In terms of oversight of the GSEs, Falcon indicated that OFHEO is doubling the size of examiner staff to 60 over a three-year period. They currently have 45 examiners. OFHEO is also attempting to obtain permanent federal funding and to obtain receivership powers over the GSEs. (*ALTA E-News*, 4/18/03)

ALTA requested OFHEO prohibit Fannie & Freddie from using alternative title insurance

- As noted in the May 17, 2002 *GSE Report*, ALTA requested that OFHEO prohibit Fannie and Freddie from using alternative title insurance products. OFHEO’s Deputy Director Jimmy Barton said OFHEO was reviewing the issue and planned to issue an opinion. (*National Mortgage News Web site*, 5/8/02) Fannie and Freddie have been purchasing loans with Radian Lien Protection on a negotiated basis. (*National Mortgage News*, 10/29/01)

Fannie's Chairman claims its share of the mortgage market is relatively small

However, FHLBank of Chicago President says Fannie & Freddie control 73.8% of mortgage market

CBO reported that Fannie & Freddie controlled 75% of the market

- Fannie's Chairman Franklin Raines said his company "can keep growing because our market keeps growing." In a recently added feature on the company's Web site, Raines said Fannie has grown faster than its market for many years because it specializes in the most popular mortgage in the fastest-growing segment of the market (the long-term fixed-rate mortgage). "By the way," Raines said, "as big as Fannie Mae is our share of the market is relatively small. We own only 11% of mortgages in the market, and guarantee the credit on another 15%. That gives us plenty of room to grow within our mortgage market." (*Dow Jones Newswire*, John Connor, 4/8/03) Speaking to potential investors in London about its new program of short-term debt denominated in a foreign currency, Raines claimed that Fannie owns 11% of US mortgages, and Freddie 7%. (*Euroweek*, 4/14/03)
- Fannie and Freddie control 73.8% of the mortgage market, according to FHLBank of Chicago President Alex Pollock. Like Erick Keiter, a principal at hedge fund MKP Capital Management, Pollock said he would like to see something done about Fannie and Freddie's dominance. The two spoke at a session for participants of the Bond Market Association's mortgage- and asset-backed division during the BMA's annual meeting. (*National Mortgage News*, Bonnie Sinnock, 4/14/03)

CBO says Fannie & Freddie control 75 percent of the market

- In a June 21, 2001 letter to Fannie's Chairman Franklin Raines, then CBO Director Dan Crippen took issue with the manner in which Fannie criticized a 2001 CBO study, which found that Fannie and Freddie received \$10.6 billion in federal subsidies in 2000 and that the two GSEs passed along to homebuyers about 63 percent of the subsidy (\$6.7 billion) in the form of lower mortgage prices but retained more than a third of the subsidy (37% or \$3.9 billion). Fannie criticized some but not all of the assumptions that the CBO made in its analysis, said Crippen, focusing only on those that Fannie felt hurt its case and not the other way. "You selectively characterize markets in a way that seems to bolster your case – characterizations that are often irrelevant and occasionally misleading," wrote Crippen to Raines.
- The CBO took issue with Fannie officials who insist that Fannie and Freddie operate in a competitive environment and control only 27% of the mortgage market. "Fannie Mae and Freddie Mac intermediate a large and growing share of the 30-year conforming fixed-rate mortgage market. With only two competitors, that result is not surprising." Fannie and Freddie control nearly 75% of the market for 30-year conforming fixed-rate mortgages, and their market share is growing, according to Crippen. "It is clear...that they [Fannie and Freddie] control close to three-quarters of the relevant market (30-year conforming fixed-rate

mortgages) and are continuing to expand that share.” *Letter from CBO Director Dan Crippen to Fannie CEO Franklin Raines, 6/21/01*) CBO letter to Raines is posted at the following Web site: <http://www.cbo.gov/showdoc.cfm?index=2910&from=4&sequence=0>

GSE debt news:

- (1) Agency debt increases 32% in first quarter
- (2) Deutsche Bank was the lead underwriter of agency debt for first quarter
- (3) Fannie’s short-term debt denominated in a foreign currency grows quickly
- (4) Freddie begins program to repurchase callable notes
- (5) FHLBanks’ debt is attracting greater foreign interest

Agency debt increases 32 percent in first quarter

- US agency debt, sold by issuers such as Fannie, Freddie, and the FHLBanks, increased nearly 32 percent to \$316.6 billion in the first quarter of 2003 versus \$240 billion in the same quarter last year, according to Thomson Financial. Agency debt issuance set a record \$973.2 billion in 2002, up from \$900.9 billion in 2001, a Thomson Financial spokeswoman said. The FHLBanks were the top issuer in the first quarter with \$165.7 billion in proceeds, a quarterly record for a federal credit agency issuer and 70.1 percent higher than its issuance a year earlier. The prior record was also held by the FHLBanks, which in the third quarter 2002 raised \$122.7 billion in proceeds. (*Reuters*, Lynn Adler, 3/31/03)

Deutsche Bank was the lead underwriter of agency debt for first quarter

- Deutsche Bank was the lead underwriter sailing up from an eighth-place ranking a year ago. Merrill Lynch & Co., Inc. held in second place, while First Tennessee National Corp. jumped into third from 10th place, according to Thomson Financial. Last year’s leader, Morgan Stanley fell to sixth place. Deutsche Bank lead managed 101 agency debt issues totaling \$31.7 billion, capturing a 10 percent market share. Merrill Lynch underwrote 220 issues totaling \$22.8 billion for a 7.2 percent market share, while First Tennessee managed 501 issues totaling \$21.9 billion, with a 6.9 percent market share. Rounding out the top 10 agency debt underwriters were Salomon Smith Barney, J.P. Morgan Chase & Co., Credit Suisse First Boston, UBS Group’s UBS Warburg, Lehman Brothers Holdings Inc. and Goldman Sachs Group Inc. (*Reuters*, Lynn Adler, 3/31/03)

Fannie’s short-term debt denominated in a foreign currency grows quickly

- Volume in Fannie’s new short-term debt denominated in a foreign currency (FX Discount Notes) has grown to \$600 million in just a few days, noted Fannie’s Treasurer Linda Knight April 10 at the Bond Market Association annual meeting. (*National Mortgage News Daily Web site*, 4/11/03) Fannie announced the new program March 11 and began issuing the debt April 7. [See March 24, 2003 *GSE Report* for more information on Fannie’s FX Discount Notes program, www.gsereport.com]

Freddie begins program to repurchase callable notes

- Freddie announced that it would periodically repurchase its U.S. Dollar-denominated senior

callable notes. Notes eligible for callable repurchase operations will include all U.S. dollar-denominated senior callable notes with an outstanding principal amount of \$250 million or greater. Callable notes will be eligible for repurchase both before and after their respective call date. Callable notes will not be eligible for periodic repurchase operations during the three-month period following their issuance or reopening. Freddie also expects to continue repurchasing any outstanding medium term and callable notes on a negotiated basis in the secondary market, irrespective of the periodic repurchase operations.

- “Periodic repurchases of our callable notes, as a duration and convexity management tool, will allow Freddie Mac to further strengthen its asset and liability management strategies,” said Jerome Lienhard, senior vice president, global debt funding. “Callable repurchase operations will supplement our Reference Notes® and €Reference Notes® periodic repurchase operations, provide additional focus on our securities’ performance and enhance price transparency of this asset class.”
- Freddie expects to conduct callable repurchase operations from time to time, using its Internet-based platform and will provide a two-business day advance notice of repurchase activity. Results – including the amounts of each security the company has repurchased – will be posted within 15 minutes after the offering submission deadline. Any departure from this timetable should be for exceptional circumstances only.
- Freddie will consider multiple offerings per issue through the dealer group. Dealers invited to participate in the callable repurchases are ABN AMRO, Barclays Capital, Bear, Stearns & Co. Inc., Credit Suisse First Boston, Deutsche Bank Securities Inc., First Tennessee, Goldman Sachs, Greenwich Capital Markets, HSBC, Lehman Brothers, Merrill Lynch, J.P. Morgan & Co., Morgan Stanley, Salomon Smith Barney, and UBS Warburg. (*Freddie press release, 4/7/03*)

FHLBanks’ debt is attracting greater foreign interest

- Roughly 58 percent of a \$3 billion Federal Home Loan Banks note deal on April 11 was sold to US accounts, 24 percent to Asia, 14 percent to Europe and 4 percent to other regions. International investment in FHLBank global issues has been increasing. Excluding the April 11 sale, 44 percent of the agency’s global securities have been sold to foreign investors this year, up from 36 percent for all of 2002. Asia accounts purchased 28 percent of these securities this year, up from 21 percent in all of last year. The FHLBanks’ visits to accounts in Asia and additional financial reporting has likely increased brand awareness to overseas accounts that may be seeking to diversify their agencies securities holdings, said a FHLBank spokesman. (*Reuters, Lynn Adler, 4/11/03*)

Fannie & Freddie rank higher in 2003 Fortune 500 listing – Fannie ranks 16; Freddie ranks 32

- *Fortune* magazine’s ranking of the nation’s largest companies compiled by *Fortune* magazine on the basis of 2002 revenue:

Company – 2003 Ranking	Revenue (\$ in millions)	2002 Ranking	2001 Ranking	2000 Ranking
16. Fannie Mae	\$52,901.1	20	26	26
32. Freddie Mac	\$39,663.0	41	50	62

(*Associated Press*, 3/30/03; 4/31/02; 4/1/01)

Fannie Mae

Fannie posts higher net income in first quarter 2003

Fannie warns that housing market growth is slowing but the company believes it will report higher earnings growth than it originally projected in January

Fannie raises its guarantee fees by 9%, however, its credit losses remain “abnormally” low

- Fannie’s first quarter net income surged 61 percent to \$1.94 billion, or \$1.93 a share, up from \$1.21 billion or \$1.17 a share in the first quarter of 2002. (*Fannie press release*, 4/14/03) Some of the company’s increase in net income came from changes in the value of the company’s derivatives holdings rather than from its still-strong core business of buying mortgages. The results included a \$624.6 million unrealized loss in the value of some of the company’s derivatives holdings. But because the loss was narrower than in the year-earlier period, the company said, it made the company’s earnings look stronger in comparison. (*Wall Street Journal*, Patrick Barta, 4/15/03)
- Fannie said its strong growth in net interest income contributed significantly to the company’s reported results. Fannie’s net interest income surged 39 percent to \$3.37 billion from \$2.43 billion a year ago. (*Fannie press release*, 4/14/03) This increase was driven by an 11.7 percent rise in the average net investment balance and a 29 basis point increase in the net interest yield. Net interest income refers to profits the company receives from interest on its retained portfolio. (*Dow Jones Newswire*, Janet Morrissey, 4/14/03)
- Fannie believes the core business earnings measure better reflects Fannie’s financial results and risk management than net income based on generally accepted accounting principles (GAAP). Fannie said it relies primarily on core business earnings (a non-GAAP earnings measure), which is adjusted for the FAS 133 accounting differences and is the primary

earnings measure relied on by Fannie's management. Fannie's core business earnings were up 21.8 percent at \$1.85 billion, or \$1.84 a share in the first quarter from \$1.52 billion, or \$1.48 a share, a year earlier. These results exclude unrealized gains and losses on purchased options, but include amortized purchased options premiums. Fannie adopted the core business method on January 1, 2001, to comply with standard accounting rules for derivative instruments and hedging activities. (*Fannie press release*, 4/14/03)

- Some analysts look at another measure of the company's financial health. In Fannie's first ever 10-K filing with the SEC, Fannie provided a fair-value balance sheet that calculated the fair market value of the company's assets and liabilities in addition to its derivatives. By that measure, Fannie's net value declined \$545 million in 2002. The company doesn't provide a fair-value balance sheet on a quarterly basis. Fannie said because the fair-value balance sheet doesn't include future business opportunities, it isn't a reliable measure of the company's value as a going concern. (*Wall Street Journal*, Patrick Barta, 4/15/03)
- Fannie's net interest margins averaged 160 basis points, up from 131 basis points a year earlier. When expenses related to the amortization of derivatives are factored in, net interest margins averaged 125 basis points, up from 115 basis points a year ago and about 25 basis points above the average level. (*Dow Jones Newswire*, Janet Morrissey, 4/14/03; *Fannie press release*, 4/14/03)

Losses on purchased options

- Fannie recorded \$625 million of mark-to-market losses on purchased options in the first quarter compared with \$787 million in the first quarter of 2002. These unrealized losses were recorded in accordance with FAS 133. The reduction in unrealized losses positively affected reported results. (*Fannie press release*, 4/14/03)

Losses from debt repurchases and debt calls

- Fannie reported losses of \$392.2 million from the call and repurchase of debt compared with \$171.7 million a year ago. During the quarter the company realized \$377.8 million of losses on debt repurchases and \$14.4 million of losses on debt calls. Debt repurchased and debt called in the first quarter totaled \$3.6 billion and \$44 billion, respectively. (*Fannie press release*, 10/14/03)

Fannie raises its guarantee fees by 9 percent, however, its credit losses remain "abnormally" low

- Fannie reported guaranty fee income of \$546 million, up 34.1 percent. The increase in guaranty fee income was driven by a 22.7 percent rise in average outstanding MBS and a 9.1 percent increase in the effective guaranty fee rate on that business. The effective guaranty fee rate in the first quarter of 2003 was 20.3 basis points compared with 18.6 basis points in the first quarter 2002. Fannie said the increase in the guaranty fee was a result of higher fee rates on new business, together with the faster amortization of deferred fees due to accelerated prepayments. (*Fannie press release*, 4/14/03)
- "In general, in the past couple of years the guarantee fee levels the agencies have negotiated have risen – in the agencies' favor [not the lenders]," said Todd Householder, the executive

vice president in charge of secondary marketing at National City Mortgage Co. According to Householder, the turning point was in November 2001, when Freddie announced that it would not accept a guarantee fee lower than 16 basis points in any negotiation. “The GSEs are well aware of each other’s pricing strategies,” he said. Other factors, Householder noted were arrangements in which some lenders allowed the GSEs to “buy down” their servicing fees, in which the GSE pays a lender more cash up-front for loans in exchange for a higher guarantee fee and a lower servicing fee. Also, pool insurance, which allowed lenders to reduce its guarantee fees, “has become less valuable to both agencies,” because credit losses have become more expensive. Finally, the GSEs’ “hands have been strengthened,” because more small originators sell loans directly to Fannie and Freddie, rather than to bigger lenders that then resell to Fannie and Freddie. (*American Banker*, Marc Hochstein and Erick Bergquist, 4/15/03)

- Analysts were comforted by Fannie’s low credit losses. Credit-related losses were \$20.4 million in the first quarter, down from \$21.5 million a year earlier. “The strength of the Middle American housing market is reflected in Fannie Mae’s continuing abnormally low credit losses,” said Mike McMahon, analyst at Sandler O’Neill. (*Financial Times*, Jenny Wiggins, 4/15/03) Fannie’s Chairman Franklin Raines noted that Fannie’s first quarter credit-related losses were \$14 million below the previous quarter and \$1 million below the first quarter of 2002. Fannie’s credit loss rate (credit-related losses as a percentage of the average combined book of business) was 0.4 basis points in the first quarter 2003 compared with 0.5 basis points in the first quarter of 2002. Fannie’s Chief Financial Officer Timothy Howard said Fannie anticipates that its credit-related losses will rise moderately in 2003, paced by a likely increase in acquisitions of foreclosed properties. However, Howard noted that the company expected its credit loss ratio (credit-related losses as a percent of mortgages and MBS financed) to remain under one basis point this year. (*Fannie press release*, 4/14/03)

Fees increase

- Fannie also reported fee and other income of \$113.3 million, a significant increase, compared with \$3.6 million in the first quarter 2002. The surge in first quarter volume from a stronger refinancing market drove the combination of transaction, technology and multi-family fees to \$240.8 million, \$154.1 million higher than the previous year. Fees and other income includes technology fees, transaction fees, multi-family fees and other miscellaneous items. (*Fannie press release*, 4/14/03)

Portfolio growth

- Fannie said that during the first quarter, the company’s total book of business grew at an annual 24.7 percent, ending the period at \$1.923 trillion. This growth resulted from a 13.3 percent annual growth rate in the company’s mortgage portfolio and a 34 percent annualized growth rate in outstanding MBS. Fannie’s Chief Financial Officer Timothy Howard noted that the company’s mortgage portfolio had grown at a slower rate than its outstanding MBS during seven out of the last eight quarters. Howard noted that commercial banks and other investors have been strong bidders for fixed-rate mortgages. In response, Fannie increased its issuance of MBS, and purchased less mortgages and MBS for itself. “We do not expect the

current rate of growth in commercial bank holdings of fixed-rate mortgages to persist indefinitely. Once the pace of bank buying cools, mortgage spreads should widen and the volume of our portfolio purchases should pick up correspondingly.” Howard added, however, that if bank buying does not slow and spreads remain narrow Fannie would grow its mortgage portfolio more slowly. (*Fannie press release, 4/14/03*)

Duration gap closes – For the first time, Fannie reports the number as a monthly average

- Fannie also reported that its duration gap closed to minus two months at the end of March from February’s minus five months. Starting this month, the company said it is releasing the duration gap as a monthly average, similar to Freddie. Previously, duration gaps for the last business day of the month were published. The duration gap at end-March was negative 3 compared with February’s negative 5. For January, the duration gap as measured on the last business day of the month was negative 4, but the average for the month as a whole was negative 3. The duration gap measures how well cash flows from assets and liabilities match up in the agency’s portfolio. (*Dow Jones Newswire, 4/14/03*) Analysts became concerned last year that Fannie was becoming too exposed to interest rate risk when its duration gap widened to minus 14 months in August. (*Financial Times, Jenny Wiggins, 4/15/03*)

Fannie’s investment portfolio shrinks in March

- While most measures of Fannie’s interest rate risk fell in March, the size of the company’s investment portfolio, a key driver of its earnings, shrank at an annualized rate of 1.1 percent, the company said. It was the first decrease in Fannie’s investment portfolio size since last October, when it shrank 0.1 percent. (*Reuters, 4/14/03*)

Fannie’s CEO warns that housing market growth is slowing

- Fannie’s CEO Franklin Raines in an interview with *CNBC Television* April 14 warned that the housing market is slowing down. “The housing market is going to slow down. It’s already slowing down. Home prices won’t increase at the rate they have increased in the last two or three years,” Raines said. “We are going to see the natural process of gradual slowdown, which we have seen in the past. We never had a boom-bust cycle in the United States and we don’t expect to see one now.” (*CNBC/Dow Jones Business Video, Brad Goode, Emma Crosby, 4/14/03*)

Fannie estimates higher earnings growth than they originally projected in January

- Fannie said its earnings growth for the year should be “moderately higher” than the 12 to 13 percent growth it projected in January, but did not offer specific numbers. (*Associated Press, 4/14/03*)

Freddie delays its first quarter earnings

- Freddie announced March 25 that it has delayed its first quarter earnings until its restatement of its financial results for the last three years is completed. Freddie expects the effect of the restatements will materially increase its reported earnings for prior periods. The restatement process is expected to be completed by the end of the second quarter 2003, with results released shortly afterward. Freddie will publish other information about the corporation’s first quarter 2003 business performance in late April. The information will include business

volume (retained portfolio volume, total PC volume, liquidations, net growth and market share) as well as credit and interest-rate risk management results (delinquency rate, real estate owned (REO) activity, portfolio market value sensitivity (PMVS) and duration gap).
(*Freddie press release, 3/25/03*)

- Freddie's restatement of earnings was prompted after its new auditor PricewaterhouseCoopers LLP raised objections to the way Freddie had been recording income for certain types of hedging instruments under the advice of now defunct Arthur Anderson. [See February 3, 2003 *GSE Report* for more information on Freddie's restatement of earnings, www.gsereport.com]

Wall Street brokers have a conflict of interest when analyzing Fannie since they receive immense fees from the GSE, says James Cramer with *TheStreet.com*

- In a commentary entitled, "Fannie Mae's Generosity Guarantees Friends," Cramer noted that "One of the bigger conflicts of interest out there lies in the immense fees that Fannie Mae pays to just about everyone on the Street for doing giant deals." He added that "Fannie Mae is everyone's favorite client...The Street has worshipped at Fannie Mae's altar for years, and only some of it is that superior management. Fannie Mae is the gift that keeps on giving. It's a huge client...The shamelessness of the bargain has always bugged me...when the [broker's buy] reiterations of Fannie Mae come out, they won't include a mention of how much of each firm's earnings are dependent on the gift that keeps on giving. Maybe, this time, you should ignore the reiterations. They seem to be losing their impact. Maybe everyone's figured the game out." (*James Cramer, Director and Co-Founder of TheStreet.com, 3/10/03*)

Fannie invests in subprime home-equity deal

- Long Beach Mortgage Co., a unit of Washington Mutual Inc., plans to offer \$1.68 billion in asset-backed securities supported by subprime home equity loans, market sources said March 13. Part of the note offering, worth \$788 million, carries a financial guarantee from Fannie, they said. (*Reuters, 3/13/03*)
- The GSEs are starting to purchase home equity loans in the secondary market that are mainly used to pay off credit card debt or to make home improvements. "Home equity loans do not help families on the cusp of home-ownership get into homes." (*Citizens Against Government Waste; Government Waste Watch; Winter 2001, Leslie K. Paige*)

Fannie to offer new hybrid ARM MBS pooling option

- Fannie announced April 7 a new standard mortgage-backed security (MBS) pooling option for conventional hybrid adjustable-rate mortgages (ARMs). Effective for pool issue dates on or after May 1, 2003, Fannie will offer the new pooling option for 5/1 ARMs – known as

hybrid ARMs because they have a fixed interest rate for a set number of years and adjust annually thereafter. (*Fannie press release, 4/7/03*)

- Fannie’s 5/1 ARM is indexed to the one-year Wall Street Journal London Interbank Offered Rate (LIBOR). Rate increases are capped at 5 percent, 2 percent, and 5 percent, meaning interest rates to consumers can increase or decrease by no more than five percentage points at the initial adjustment date, no more than two percentage points at any annual adjustment period, and can increase by no more than five percentage points over the life of the loan. (*Fannie press release, 4/7/03*)
- According to Fannie, the volume of ARMs originated in the primary market has grown steadily in recent years, and 5/1 ARMs accounted for the largest share of ARM originations. Conventional conforming hybrid ARM originations in 2002 totaled approximately \$175 billion, and about half of those purchases were 5/1 ARMs. (*Fannie press release, 4/7/03*)
- “The basic idea is to create benchmark pricing levels for new production hybrid ARMs by mandating particular characteristics for the ARM pools to qualify for the program,” said Merrill Lynch analysts. The new product (which will carry a pool prefix of LA) will be issued in 25 basis point increments, which Merrill says is different from the weighted pooling structure that is utilized with current hybrids. Merrill further noted that despite the fact that Libor-indexed hybrids are now being issued, most of the outstanding hybrids are indexed to one-year constant-maturity treasuries. Analysts expect this distribution to change after the new Fannie program is implemented, resulting in Libor-indexed issuance becoming the largest component of both hybrid issuance and outstanding balance. (*Asset Securitization Report, Karen Sibayan, 4/7/03*)

Fannie’s workout ratios increase dramatically

- Fannie and its loan servicing partners helped 22,000 borrowers avoid foreclosure. Due to aggressive efforts by Fannie’s servicers, more than 90 percent of borrowers (20,000) who received a workout were able to remain in their homes in 2002. In 2002, Fannie’s workouts (repayment plans, loan modifications, deeds-in-lieu and pre-foreclosure sales) totaled 21,727, exceeding the company’s foreclosed property acquisitions of 19,500. Over the past four years, workouts have risen dramatically, from 12,065 in 1997 and the workout ratio (percent of problem loans worked out) has increased from 35 percent in 1997 to 53 percent in 2002. (*Fannie press release, 2/27/03*)

Fannie announces new vice presidents

- Fannie April 16 announced new vice presidents; Gabriel Galvan, vice president, emerging markets; Joseph J. Grassi, III, vice president and deputy general counsel, multifamily legal services; Monica Medina, vice president and deputy general counsel, corporate governance; and Jon M. Seward, vice president and deputy general counsel, fair lending.

- As Fannie's vice president for emerging markets, Galvan is responsible for the emerging markets initiative reporting into the single-family mortgage business. He has responsibilities for the organization and execution of Fannie's mission to increase housing volumes in the African American, Hispanic American, and other emerging markets. Prior to coming to Fannie, Galvan worked for Hewlett Packard, BMC Software, and the IBM Corporation.
- Joseph Grassi, III was named vice president, deputy general counsel -- multifamily legal services. Grassi will be responsible for all legal services for the multifamily division of Fannie. Since 1999, Grassi served as the first general counsel of Fannie's American Communities Fund™ (ACF®). Prior to assuming his responsibilities at ACF, Grassi served as associate general counsel in Fannie's Northeastern Regional Office in Philadelphia, PA. Before joining Fannie in 1994, Grassi was senior counsel for Freddie, specializing in multifamily special asset management, creditors' rights, and loan restructurings. Grassi also was an associate with Obermayer, Rebmann, Maxwell & Hippel in Philadelphia, where his practice concentrated on commercial real estate.
- Monica Medina is Fannie's vice president and deputy general counsel for corporate governance. Medina will oversee all matters that pertain to corporate governance. Prior to her position at Fannie, Medina was a partner at Heller Ehrman White & McAuliffe, practicing law in the areas of environmental, commercial, and antitrust litigation, and counseling start-up companies on government contracts and government relations. Prior to joining Heller Ehrman, Medina was the general counsel of the National Oceanic & Atmospheric Administration (NOAA) of the Department of Commerce. Medina has also served as deputy associate attorney general at the Department of Justice, where she advised the Attorney General on environmental legislation and litigation and constitutional law. Prior to her tenure at the Justice Department, Medina served as senior counsel to the Senate Environment and Public Works Committee. Medina is a former Captain in the U.S. Army, where she served on active duty in the Army General Counsel's Office.
- Jon M. Seward is Fannie's vice president and deputy general counsel for fair lending. His duties include managing implementation of Fannie's anti-predatory lending guidelines across all business channels and ensuring compliance with fair lending and related laws. Prior to joining Fannie, Seward was the deputy chief in the Department of Justice, Housing and Civil Enforcement Section, where he was responsible for directing the department's fair lending enforcement program. Prior to that position, Seward was a trial attorney in the Fair Housing Division at HUD. (*Fannie press release, 4/16/03*)

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 57 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 57 partnership offices

- According to Fannie’s Web site, the company has 57 partnership offices open across the country (<http://www.fanniema.com/partnerhsipoffices/index.jhtml>) 4/14/03).

Fannie held press opportunities with the following officials:

- (1) HUD Secretary Mel Martinez and Kansas City Councilman Troy Nash (*Fannie press release*, 4/16/03)
- (2) Senator Mary Landrieu, Congressman William Jefferson (D-LA) and New Orleans Mayor Ray Nagin (*Fannie press release*, 3/24/03)
- (3) Senator Rick Santorum (R-PA) and Deputy Director of the White House Office of Faith-Based and Community Initiatives David Kuo (*Fannie press release*, 3/31/03)
- (4) Congressman Spencer Bachus (R-AL), Congressman Artur Davis (D-AL), Birmingham, AL Mayor Bernard Kincaid and City Council President Lee Loder (*Fannie press release*, 4/14/03)
- (5) Congressman Chris Chocoma and Elkhart, IN Mayor David Miller (*Fannie press release*, 4/17/03)
- (6) Congressman Devin Nunes (R-CA) and Orange Cove, CA Mayor Victor Lopez (*Fannie press release*, 4/4/04)
- (7) Congressman Brad Carson (D-OK) (*Fannie press release*, 3/28/03)
- (8) Congressman Mike Ferguson (*Fannie press release*, 3/24/03)
- (9) Congressman David Hobson and Springfield, OH Commissioner Martin Mahoney (*Fannie press release*, 3/24/03)
- (10) Congresswoman Sheila Jackson Lee (D-TX) (*Fannie press release*, 3/21/03)
- (11) Congresswoman Rosa DeLauro (D-NH) and New Haven, CT Mayor John DeStefano, Jr. (*Fannie press release*, 3/14/04)
- (12) Congresswoman Carolyn Cheeks Kilpatrick (D-MI) and Detroit, MI Mayor Kwame Kilpatrick (*Associated Press*, 3/14/03)
- (13) Wyoming Governor Dave Freudenthal (*Fannie press release*, 3/20/03)
- (14) Montana Governor Judy Martz (*Fannie press release*, 4/8/03)
- (15) Oklahoma City, OK Mayor Kirk Humphreys (*Fannie press release*, 3/31/03)
- (16) El Paso Mayor Raymond Caballero (*Fannie press release*, 3/24/03)
- (17) City of Manahawkin, NJ Mayor Carl Block (*Fannie press release*, 3/25/03)
- (18) Fort Worth City Councilman Frank Moss (*Fannie press release*, 4/11/03)

Fannie announces new members to its Housing Impact Advisory Council

- Fannie's Chairman Franklin Raines April 21 named 29 new members to the company's Housing Impact Advisory Council. The Housing Impact Advisory Council members meet three times a year with Fannie's senior management to discuss issues affecting products for low- and moderate-income home buyers and renters.
- The council has 61 members, including civic leaders; nonprofit, state housing agency and financial institution executives; developers; and legal, housing, and real estate professionals. Council members serve staggered two-year terms, with about half rotating off each year.
- The 2003 Housing Impact Advisory Council will be co-chaired by Bob J. Nash, vice-chairman of Shorebank Corporation, and Loretta A. Armenta, president and chief executive officer of the Albuquerque Hispano Chamber of Commerce, who is serving her first term. The following new members have been appointed to serve on the Housing Impact Advisory Council through November 2004:

Nancy O. Andrews, Oakland, CA, President & CEO, Low Income Housing Fund;

Loretta A. Armenta, Albuquerque, NM, President & CEO, Albuquerque Hispano Chamber of Commerce;

Tom Berseth, Fargo, ND, senior vice president, commercial real estate, State Bank of Fargo, ND;

Peter Carey, Visalia, CA, executive director of Self-Help Enterprises;

Lautaro "Lot" Diaz, Washington, DC, deputy vice president of community development, National Council of La Raza;

Monica Drapeaux, Kyle, SD, executive director, The Lakota Fund;

Gary L. Gordon, Washington, DC, executive director, National American Indian Housing Council;

H. David Hayes, Jefferson City, TN, owner, Hayes & Associates Real Estate and Auction Company;

Jay R. Helfrich, Seattle, WA, executive vice president, American Property Financing, Inc.;

Felix De Herrera, Las Vegas, NV, president, Realty Marketing Group;

Herbert H. Hilliard, Memphis, TN, executive vice president of risk management, First Tennessee Bank;

Abdur-Rahim Islam, Philadelphia, PA, President & CEO, Universal Companies, Inc.;

Mark R. Jarrell, New York, NY, senior vice president of debt group, Community Development Trust, Inc.;

Judith Kennedy, Washington, DC, executive director, National Association of Affordable Housing Lenders;

Jean Langendorf, Austin, TX, executive director, United Cerebral Palsy Association of Texas;

Joseph W. Mariano, Chicago, IL, executive director, National Training and Information Center;

John G. Markowski, Chicago, IL, commissioner for the city of Chicago Department of Housing;

Dr. Ronald Mason, Jackson, MS, president of Jackson State University;

Donovan Mouton, Kansas City, MO, neighborhood advocate, city of Kansas City, Office of the Mayor;

J. Benson Porter, Seattle, WA, senior vice president of community and external affairs, Washington Mutual Savings Bank;

John Saint, Mobile, AL, president and chief executive officer, The Mitchell Company, Inc.;

Michael Sciarrino, Maitland, FL, president and managing general partner, CED Capital Holdings Group;

Hattie Scott, Waldorf, MD, vice president and regional manager, Long & Foster Companies, Inc.;

Shanna L. Smith, Washington, DC, President & CEO, National Fair Housing Alliance;

James W. Stretz, Albuquerque, NM, executive director, New Mexico Mortgage Finance Authority;

Barbara J. Thompson, Washington, DC, executive director, National Council of State Housing Agencies;

Peggy Olsen Trenk, Helena, MT, government affairs director, Montana Association of REALTORS(R);

J. McDonald "Don" Williams, Dallas, TX, founder, Foundation for Community Empowerment;
and

Rick Williams, Cincinnati, OH, president and chief executive officer, Home Ownership Center

of Greater Cincinnati, Inc.

- Returning members of the advisory council include: Milroy Alexander; James C. Ballentine; Darlys J. Baum; Joseph B. Blake; Mary Salinas Duron; Patricia B. Fennell; John S. Galeotos; Maria J. Garcia; The Honorable Ed Garza; Sarah Sheon Gerecke; Bruce C. Gunter; Paul F. Hancock; Bishop Thomas L. Hoyt Jr.; Hal Keller; Karen L Krautheim; Trinh LeCong; Edward London; F. Lynn Luallen; Donald Martin; Jeffery Paul May; Terri Y. Montague; Bob J. Nash; Dennis Penman; Chief Gregory E. Pyle; Marco Antonio Reyes; Abraham Rodriguez Jr.; Nan Roman; Marcia Rosen; Eric S. Stein; Gregory St. Etienne; Susan Taoka; and Jaye Morgan Williams. (*Fannie press release, 4/21/03*)

Freddie Mac

Multi-family market buyer accuses Freddie of skimming off the cream in a multi-family deal

- In early April, underwriters led by Wachovia and Nomura brought an \$891 million securitization to market, of which \$704 million was rated triple-A. The \$250 million A-1A tranche – one of three triple-A rated tranches totaling the \$704 million – had cash flow directed solely from 56 multi-family properties and was purchased by Freddie. This was unusual. In the past, Freddie has generally participated in securitizations composed of at least 30 percent and not much more in multifamily loans, as opposed to drawing solely from multifamily loans. The market didn't seem to be enthralled with the structure. As one large triple-A buyer who declined to participate opined, "They've skimmed off the cream." Wachovia, which had estimated that prices of the triple-A rated class A-2 would equal the going rate on interest-rate swaps plus 0.43 percent, had to widen the spread to 0.45 percent to attract sufficient buyers. (*Barron's Online, John Levy, 4/14/03*)

Freddie testifies in favor of Administration's "American Dream Downpayment Act"

- Craig Nickerson, Freddie's Vice President of Community Development and Lending, testified at an April 8 House Financial Services Committee hearing in favor of the Administration's proposed American Dream Downpayment Initiative (ADDI), and legislation (HR 1276 and S. 811) that would implement the program. The program would provide \$200 million to help low-income families make down payments on their first homes. The measure would give 40,000 families an average of \$5,000 each to help buy homes, HUD Secretary Mel Martinez said in testimony. Freddie's Nickerson said the bill would particularly benefit low-income and minority families and estimated that the provision of a 3 percent down payment would increase the share of rental households otherwise qualified to become homeowners by as much as 5 percentage points. Among African American and Hispanic renters, however, it would increase homeownership potential by 8.4 percentage points and 9.0 percentage points respectively. A copy of Nickerson's testimony may be found online at: <http://financialservices.house.gov/media/pdf/040803cn.pdf> Copies of all the testimony at the

hearing may be found online at:

<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=203> (*House Financial Services Committee hearing, 4/8/03*)

- The Mortgage Bankers Association of America, Fannie Mae, the National Association of Realtors, the National Association of Mortgage Brokers and America's Community Bankers wrote letters in support of the bill. (*Washington Post – Bloomberg News, 4/12/03*)

Federal Home Loan Banks

Growth in FHLBanks' debt fueled by technology

- John Darr, the FHLBank System's Managing Director for its Office of Finance, said the rapid growth in FHLBank debt offerings has been fueled largely by technology improvements that were hastened by regulatory scrutiny. Darr noted in a panel discussion that just a few weeks after he joined the FHLBank System in 1992, a regulator said the FHLBank System's back office was "unsafe and unsound" and in need of a major overhaul. Since then, the System automated many of the processes involved in its sales of bonds, discount notes and overnight securities, and volumes have soared. The FHLBank System now issues just under \$1 trillion of discount notes each year. "We wouldn't have done it without the technology," he said. (*Dow Jones Newswire, Rebecca Christie, 4/10/03*)

FHLBank of Atlanta hires former ACB lobbyist as VP, Director of Government Relations

- The FHLBank of Atlanta announced April 9 that Eric Mondres has joined the Bank as Vice President, Director of Government Relations. Mondres will be responsible for developing and executing government affairs strategy, while providing member education on legislative issues that affect the Bank and its membership.
- Since 1994, Mondres has served as director and government affairs counsel for America's Community Bankers (ACB) in Washington, D.C. His prior work experiences include: serving as director of congressional affairs for the Thrift Depositor Protection Oversight Board; executive vice president of U.S. Consultants, Inc., and vice president of government affairs for the Society of American Florists. He also served in President Reagan's administration as the deputy director of the U.S. Department of Agriculture Congressional Relations Office. (*FHLBank of Atlanta press release, 4/9/03*)

FHFB fills vacancies by appointing four new public interest directors

- The FHFB April 9 appointed public interest directors to the boards of four FHLBanks. A total of 82 public interest directors sit on the boards of the 12 FHLBanks. Two public interest directors at each Bank are designated as Community Interest Directors because of a history of involvement in their communities. As required by FHFB regulation, each board of directors must convene a minimum of six in-person board meetings annually. April 9's appointments, adopted unanimously, resulted from vacancies opening up on the boards of the four respective Banks.
- The appointments are: (1) Gene Giles Chandler, Bartlett, NH to FHLBank of Boston; (2) Karen Basha Egozi, Miami, FL to FHLBank of Atlanta; (3) Carl F. Wick, Centerville, OH to FHLBank of Cincinnati; and (4) John T. Wasley, Los Angeles, CA to FHLBank of San Francisco. (*FHFB press release, 4/9/03*)

Former managing director of FHFB claims that the removal of the FHFB's salary caps for FHLBank presidents has resulted in the sharp escalation of the presidents' salaries

- In response to an April 3 *American Banker* article – “FHLB Income Declining: Chiefs’ Paychecks Aren’t,” former managing director of the FHFB James Bothwell disputed arguments made by Chesley Brooks, Jr. (member of the board of the FHLBank of Dallas) and John Connelly (Chairman of the FHLBank of Pittsburgh) that the FHLBank presidents’ salaries were artificially depressed by the FHFB prior to 2000, “implying that rapid and substantial increases since then are in large part a product of a ‘catching up to the market’ phenomenon.” Bothwell argued that this “salary-suppression theory” doesn’t “fit the facts.”
- Bothwell noted that from 1997 to 1999, the FHFB established FHLBank Presidents’ salary caps that were calibrated, based on the results of an annual salary survey of comparable top executives of similar-sized financial institutions (“i.e., commercial banks and thrifts that, unlike the Federal Home Loan Banks, enjoy no monopoly franchises and no preferential access to the capital markets, but that do have independent directors”). The individual FHLBanks determined the salaries, as they do now, with the only constraint being that the salaries could not exceed the caps. Bothwell argued that if the caps were artificially low, the salaries would have been tightly clustered at or near the ceilings and the Presidents would have been prime targets of corporate recruiters. This, however, was not the case.
- “Rather than artificially depressing the presidents’ salaries, the evidence suggests that the Finance Board caps provided a needed counterweight to the presidents’ dominance over board members who are critically and exclusively reliant on them for access to below-market GSE funding, thus leveling the playing field and allowing the boards a better opportunity to negotiate reasonably fair, market-based salaries,” noted Bothwell. Removing this counterweight resulted in the sharp escalation of the presidents’ salaries since 1999, he

argued. “The hard-pressed American taxpayers, who ultimately bear the risk of the over \$1 trillion in annual Federal Home Loan Bank borrowings and whose credit card in effect gets used to pay their expenses, must surely wonder how such increases can be justified.”
(*American Banker*, Letter-to-the-Editor, James Bothwell, Independent consultant and former managing director of the FHFB, 4/11/03)

Ginnie Mae

Ginnie Mae issues proposed rule to release loan-level data on its MBS to the public

- Ginnie Mae issued a proposed rule to announce its intent to make certain loan-level data available to the public on Ginnie Mae multi-family securities. According to a *Federal Register* notice, the securities industry and issuers/servicers of Ginnie Mae guaranteed multifamily securities have asked Ginnie Mae to make delinquency information available to the public on the multifamily loans that back Ginnie Mae securities. Ginnie Mae proposes to make this information public. Currently, issuers/servicers are free to disclose this information to the public, but there is no requirement to do so. Some issuers/servicers disclose this information, while others do not, and still others selectively disclose the information. “Unless this information is publicly available, investors may use less favorable assumptions when pricing multifamily Ginnie Mae securities. Making this multifamily loan information available to investors should lead to greater investor confidence and more accurate pricing on these securities. This could decrease the cost of borrowing to finance apartment buildings, and thus decrease the rents of low- and moderate-income families that live in those buildings. Comments on the proposal are due May 8, 2003. (*Federal Register*, page 17252, 4/8/03)

Sallie Mae

Sallie Mae acquires second mortgage company

- SLM Corp., commonly known as Sallie Mae, has completed the purchase of Pioneer Mortgage, a Novi, MI-based mortgage banking company. The acquisition extends the fee-based, mortgage-banking services provided by Sallie Mae’s SLM Financial Corp. subsidiary. Founded in 1992, Pioneer Mortgage provides mortgage-banking services in Michigan and Arizona. Under the agreement, Pioneer Mortgage will operate its business as a wholly owned subsidiary of SLM Corp. In December 2002, Sallie Mae announced the purchase of First Trust Financial, a Weymouth, MA-based mortgage-banking company with operations in Massachusetts, Rhode Island, and New Hampshire. (*Sallie Mae NewsLink*, 4/9/03;

Postal Service

President Bush expected to sign bill that would reduce the Postal Service's payment to the Civil Service Retirement System (CSRS) fund

- President Bush is expected to sign legislation that would reduce the Postal Service's payment to the CSRS fund. The bill, S. 380, requires the Postal Service to use some of the savings to pay down its \$11.1 billion debt with the Treasury. By law, the agency is prohibited from borrowing more than \$15 billion. Other savings would be used to continue funding retiree health benefits. The legislation was prompted by reports by the Office of Personnel Management and GAO, which found that the Postal Service had overpaid the CSRS fund. The Postal Service, however, could reduce its payments to the CSRS fund without approval from Congress.
- The House voted 424-0 to approve S. 380 on April 8; the Senate unanimously approved S. 380 by voice vote on April 3. (*BNA Daily Report for Executives*, Derrick Cain, 4/9/03)
- By changing the way the Postal Service's retirement benefits are calculated, the bill could help keep postal rates flat until FY 2006. Projected savings include \$2.9 billion this fiscal year and \$2.6 billion in FY 2004. The Postal Service cannot use the savings to pay executive bonuses. (*Associated Press*, Jim Abrams, 4/9/03) After FY 2005, any savings would be held in escrow until Congress approves a Postal Service plan for spending the money. (*Washington Post*, Christopher Lee, 4/9/03)

Many applaud passage of the bill

- Passage, the Postal Service said in a statement, "is good news not just for the Postal Service, but for everyone who uses the mail." Without the legislation, said Postal Service spokesman Gerry Kreienkamp, the post office would have to consider another rate increase next year. (*Associated Press*, Jim Abrams, 4/9/03)
- "This will help mailers who are just getting back on their feet from the recession," said Bob McLean, executive director of the Mailers Council. "It also gives printers and paper companies a break since mailers will probably continue to mail with no rate increase hanging over their heads." (*Direct*, Larry Riggs, 4/8/03)
- "This legislation will save the postal service \$3 billion this year and, according to the Postmaster General, postpone any postage rate increases until 2006 – three years from now," said Direct Marketing Association CEO H. Robert Wientzen in a statement. "This delay will do much to encourage growth in the nine-million job mailing industry." (*Direct*, Larry Riggs, 4/8/03)
- "The Magazine Publishers of America and its members congratulate and thank Congress for giving final approval to the Postal Civil Service Retirement System Funding Reform Act of 2003," said CEO Nina Link. "The passing of this legislation, which will save mailers \$7

billion in postage costs over the next three years, means that magazines' postal rates will now remain stable until at least 2006." (*Direct*, Larry Riggs, 4/8/03)

Many argue that more postal reform is needed

- “The fact remains that we still face stiff challenges in the years ahead,” said Postmaster General John Potter in address at the National Postal Forum. “We still face an uncertain economy, stiff competition and the reality of electronic diversion. The reality is that we have an old business model that is flawed, and that won’t serve us much longer.” (*DM News*, Melissa Campanelli, 4/15/03)
- “We credit Congress for acting swiftly to correct a shortcoming in USPS finances,” said Neal Denton of the Alliance of Nonprofit Mailers. “However, the long-term viability of the Postal Service remains extremely precarious... We are hopeful that the new Presidential Commission on the USPS will present sound recommendations to shore up the national mail delivery network... This is an urgent, non-partisan problem that affects the lives of every American – every day. Postal reform must be addressed before the Postal Service can sign, seal and deliver more rate hikes to the American public.” (*US Newswire*, 4/8/03)
- “By requiring the Postal Service to reduce its debt to the Treasury, it helps to lay the foundation for systematic reforms that are so desperately needed in the nation’s mailing system,” said William Davis, head of R.R. Donnelly. (*Statement by William Davis, head of R.R. Donnelly*, 4/8/03)
- The legislation offers a “reprieve, for now,” said *DM News* editor in-chief Tad Clarke in a *DM News* editorial. “The postal service is in dire need of reform. Let no one think that this reprieve should change anything on the agenda for the President’s Commission on the Postal Service. The USPS needs a new business model, and this provides the opportunity to present a meaningful plan to Congress... What this does, though, is offer time – time to get the work done without the worry of another rate hike nagging in the distance. Time for the Postal Rate Commission to approve negotiated service agreements with mailers. Time to explore phased rates more thoroughly. Time to get meaningful reform through.” (*DM News Editorial, Tad Clarke*, 4/7/03)
- Daniel Gross who writes *Slate*’s “Moneybox” column, called the legislation another “shortsighted plan to bail out the Postal Service.” He claimed the legislation “is primarily a boon to junk mailers and magazine companies” and it’s “bad news” for taxpayers. “For while it appears to relieve the Postal Service of certain burdens, it adds to the burgeoning federal deficit... [and] ignores a larger problem with the Postal Service’s retirement planning that will require either vast rate increases or a taxpayer bailout in years to come.” (*Slate commentary, Daniel Gross*, 4/11/03)

CCAGW and NTU urge FTC to investigate Postal Service's "misleading" ad campaign under "Truth in Advertising" laws

PostalWatch releases a study accusing the Postal Service of running ads that misrepresent priority mail as a 2-day delivery service

- The Council for Citizens Against Government Waste (CCAGW) and the National Taxpayers Union April 18 called on the Federal Trade Commission (FTC) to investigate whether the Postal Service's promotions of its Priority Mail delivery service violate the nation's "truth in advertising" laws. CCAGW and NTU wrote letters to Mary Engle, the FTC's Associate Director in the Division of Advertising Practices, requesting the investigation. (CCAGW press release, 4/18/03; NTU press release, 4/18/03)

CCAGW letter

- In a letter to FTC's Engle, CCAGW charged that the Postal Service's advertising campaign significantly misrepresents the reliability of its Priority Mail service. The advertising campaign, which has been ongoing since mid-February, markets the Postal Services' Priority Mail as a reliable two-day delivery service.
- "In reality, the USPS' Priority Mail product fails to deliver on its promise of reliable two-day delivery in a significant percentage of cases," CCAGW Vice President Leslie Paige said. "The USPS itself admits that it was only able to deliver Priority Mail within the promised two days 82.4 percent of the time, and that rate was only achieved in the first quarter of 2003. During the same quarter of 2002, the on-time delivery scores for this service were a weak 63.5 percent. The fact is consumers would be better off mailing an important document using First-class mail. First-class often gets to its destination before Priority Mail and yet, Priority Mail costs consumers more than 10 times as much as a stamp. Comparable industry standards for two-day delivery are between 90 and 97 percent. The USPS should have to comply with the same advertising standards as any private company."
- Although the Postal Service claims it is exempt from many federal statutes, in a 1997 lawsuit brought by Federal Express, both the trial court and the 6th District Appeals Court opined that the USPS was not exempt from truth-in-advertising laws when it was engaging in competitive activities outside of its core mission of delivering mail. The trial court specifically stated that it did not believe that Congress "intended to create a federal corporation immunized from the very law that protects consumers and competitors from deceptive commercial practices."
- "CCAGW respectfully requests that the FTC initiate an investigation to determine whether or not it has jurisdiction over the USPS when it comes to deceptive advertising," Paige concluded. (CCAGW press release, 4/18/03)

NTU letter

- In the letter to FTC's Engle, NTU Director of Government Affairs Paul Gessing wrote that despite recent, record-setting on-time delivery rates for Priority Mail, "the typical [long-term] success rate hovers between 70 and 75 percent. In the meantime, a 1998 comparison done by Consumer Reports found FedEx to have a 97 percent success rate with its 2-day delivery product and United Parcel Service a 90 percent success level. It is our opinion that the Postal Service's efforts to position Priority Mail as the equivalent of other carriers' 2-day deliveries is misleading."
- Gessing contended that this disparity in claimed versus actual performance vis-à-vis its competitors puts the Postal Service in conflict with Sections 5 and 12 of the FTC Act (which relate to "truth in advertising"). He also asserted that the FTC had solid grounds for asserting its jurisdiction over the Postal Service, just as it would have over a purely private firm.
- "Short of complete privatization, the least Americans expect from the Postal Service is accountability on a level playing field with its competitors," Gessing concluded. "For the sake of consumers and taxpayers alike, the USPS should rescind its advertisement for 2-day delivery." Gessing's letter to the FTC as well as other NTU studies and statements on postal reform, may be accessed online at www.ntu.org (NTU press release, 4/18/03)

PostalWatch study

- Another watchdog organization, PostalWatch, released an April 18 study accusing the Postal Service of "executing a massive deceptive advertising campaign promoting Priority Mail as a low-cost 2-day delivery service while as much as 27 percent of Priority Mail fails to reach its destination within 2 days." The advertising campaign includes a billboard in Times Square, a 30-second television commercial and a full-color ad placed in major newspapers. "The ads misrepresent Priority Mail as a low-cost 2-day service, while failing to disclose that First-Class letters, at nearly one-tenth the cost (\$0.37 vs. \$3.85), generally arrive at their destination just as soon, if not sooner than do Priority Mail letters," according to PostalWatch executive director Rick Merritt in his study, "Priority Mail Sham." (US Newswire, 4/18/03) A copy of the study may be accessed online at www.postalwatch.org/priority_mail/index.htm

Postal Service response

- A Postal Service spokesman had no comment on the groups' charges. (Dow Jones Newswire, John Connor, 4/18/03)

AEI holds March 17 session on Postal reform as part of its Postal Reform Initiative

Future sessions to be held April 30 and May 29

- AEI is sponsoring a Postal Reform Initiative – a series of conferences and publications to assess the mission and operations of the Postal Service, propose a vision of a modern postal industry, and suggest how the US could arrive at this destination. President George W. Bush recently established the Commission on the United States Postal Service, whose final report

in August 2003 may lay the groundwork for the first major reform of the U.S. Postal Service in thirty years. Mirroring the administration's initiative, AEI is sponsoring its own Postal Reform Initiative. The March 17 opening session of the Initiative discussed key objectives that the President's Postal Reform Commission should strive for and how those objectives can be realized. The Initiative, led by Rick Geddes, an AEI adjunct scholar, parallels the work of the Presidential Commission.

- The first session was also a book event because AEI Press has just published Geddes' new book – "Saving the Mail: How to Solve the Problems of the US Postal Service."

John Panzar, Northwestern University

- Panzar noted that the need for postal reform is not as urgent as many people seem to think and that in contrast to the radical changes being implemented overseas, changes in the US should be made on an incremental basis. A copy of Panzar's paper can be found online at: http://www.aei.org/docLib/20030314_JCPAEIpostal.pdf

Maurice McTigue, George Mason University

- McTigue discussed his hands-on experience with postal reform in New Zealand.

Rick Geddes, Cornell University

- Geddes discussed some of the key points in his new study, "Saving the Mail: How to Solve the Problems of the US Postal Service." Geddes concluded that significant reform of the Postal Service is warranted. One of the main causes of the Postal Service's recurring problems is that the property rights to the net cash flows of the Postal Service, or its residual claims, are poorly defined and not transferable. He recommended creation of a well-defined, transferable ownership claim. He also recommended that the government should continue to guarantee nationwide delivery of mail; the powers of the Postal Rate Commission should be increased to more closely reflect those of a public utility commission; and finally the Postal Service's letter delivery monopoly should be more clearly circumscribed, and then reduced. A summary and information about ordering a copy of Geddes' book can be found online at: http://www.aei.org/publications/bookID.321/book_detail.asp Geddes also published a March 1 paper, "Why We Need Postal Reform and What it Should Entail," for AEI for its series of Postal Reform Papers. http://www.aei.org/include/pub_print.asp?pubID=16582
- A transcript of the first session can be found at the following AEI link: <http://www.aei.org/events/eventID.257/transcript.asp>

Second session to be held April 30 on universal service and mission of Postal Service

- AEI is holding an April 30 session, entitled "The Mission of the Postal Service and the Universal Service Obligation." The second session of the AEI Postal Service Initiative will focus on the mission of the U.S. Postal Service, how technology has affected this mission, and the meaning of universal service. Future conferences will address competition issues caused by postal reform and, upon its release, the implications of the commission's proposal.

- The following is the schedule for the April 30 session:

9:00 a.m. Registration

9:30 Introduction: J. Gregory Sidak, AEI

Speakers: Michael Crew, Rutgers University
 Damien Geradin, Harvard Law School
 Robert Cohen, Postal Rate Commission

Moderator: Rick Geddes, Cornell University

10:45 Discussion

11:30 Adjournment

To register for the session: <http://www.aei.org/events> (*AEI notice for April 30 session*)

- The third Initiative session will be held on May 29, which will address competition issues concerning the Postal Service. AEI also expects to have a similar event this summer once the Presidential Commission comes out with its report.

IRET says current comprehensive postal reform bill would not deliver postal reform
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- The Institute for Research on the Economics of Taxation (IRET) released an advisory noting that two prominent legislative proposals (HR 22 and HR 4970) would not provide a sound foundation for postal reform. “The Postal Service’s financial problems are mainly due to its high costs, not restrictions on its rates or on expansion. Unfortunately, both H.R. 22 and H.R. 4970 virtually ignore the Postal Service’s costs. One of the main reasons why the labor-intensive Postal Service has high costs is that it pays its workers much more than the same workers would earn in the private sector. Both H.R. 22 and H.R. 4970, however, promise *not* to touch the postal pay premium. If anything, the bills would make it harder to control labor costs by placing a union appointee on the Postal Service’s Board. High labor costs could be made less burdensome by easing restrictions in current law that limit postal worker productivity, but neither bill contains pro-productivity reforms. Nor does either bill include reforms for reducing the Postal Service’s nonlabor costs.”
- “Expansion and greater price setting power are questionable in any case and particularly ill-advised when dealing with a government agency burdened with cost problems. A more fruitful legislative approach would be to ease various provisions in current law that push the Postal Service’s labor costs above those for comparable work in the private sector, increase its nonlabor costs, and hold down its productivity. Bills like H.R. 22 and H.R. 4970 would almost certainly fail to meet their objectives of strengthening the Postal Service financially while keeping postal rates low.” (*IRET Congressional Advisory, No. 152, “Postal Reform*

New bonus program for Postal Service managers in plans

- The Postal Service and postal manager groups are working out the details of a new merit-based bonus program for about 80,000 managers, supervisors and support staff. The new program, which would hinge bonuses on individual performance, is expected to be ready by September. The Postal Service is discussing what the new program’s goals should be with the National Association of Postmasters of the United States, the National League of Postmasters and the National Association of Postal Supervisors.
- Postal Service spokesman Gerry Kreienkamp said the merit bonus system will be similar to the system put in place last September for vice presidents and top managers in which individual goals are set at the beginning of the fiscal year by each person’s superiors. Setting specific goals up-front would be a major improvement over the previous bonus program, called the economic value added (EVA) program, which was cancelled last year, said Vincent Palladino, president of the National Association of Postal Supervisors. Neal Denton, executive director of the Alliance of Nonprofit Mailers, said the EVA program created political problems for the Postal Service. The EVA program drew criticism for providing managers with merit bonuses while the Postal Service was losing money and increasing postal rates. National Association of Postmaster of the United States President Wally Olihovik said the upcoming program may encounter the same criticism, but offering pay rewards for good performance is a standard practice for any company. (*Federal Times*, Stephen Losey, 4/7/03)

Presidential Postal Reform Commission to hold April 29 field hearing in Chicago

- The Presidential Postal Reform Commission will hold a field hearing April 29 in Chicago. Witnesses will testify at the invitation of the Commission. At the meeting, the Commission will examine issues relating to the Postal Service’s workforce, including the collective bargaining process and binding arbitration. (*Federal Register*, page 18328, 4/15/03) The testimony submitted by various parties will be posted on the Commission’s Web site: <http://www.treas.gov/offices/domestic-finance/usps/witness-testimony.html>

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