

The *GSE* REPORT TM

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Major Events

Federal Reserve Bank of St. Louis President William Poole warns that an unexpected financial shock at Fannie or Freddie could cause considerable damage to the economy

“Any problem in the capital markets affecting these firms could become very large, very quickly”

Expresses concern about Fannie & Freddie’s low capital levels

Recommends removing the GSEs’ line of credit to the Treasury and increasing the GSEs’ capital

“Why is the capital standard of GSEs so far below that required of federally regulated banks?”
Poole asks

Fannie dismisses Poole’s comments

- In a March 10 speech before the Office of Federal Housing Enterprise Oversight’s symposium on housing, Federal Reserve Bank of St. Louis President William Poole noted that an unexpected financial shock at Fannie or Freddie could cause considerable damage to the economy. Poole stated,
 - “Should either firm be rocked by a mistake or by an unforeseeable shock, in the absence of robust contingency arrangements the result could be a crisis in US financial markets that would inflict considerable damage on the housing industry and the US economy.”
 - “In the case of GSEs, the enormous scale of their liabilities could create a massive problem in the credit markets. If the market value of GSE debt were to fall sharply, because of ambiguity about the financial soundness of GSEs and about the willingness of the federal government to backstop the debt, what would happen? I do not know, and neither does anyone else.” (*Text of St. Louis Federal Reserve Bank of St. Louis President William Poole’s remarks at the March 10 OFHEO symposium, 3/10/03*)

Ambiguity about status of GSEs is a “fundamental risk” to the financial system

- Poole noted that there is “tremendous ambiguity about the status of the GSEs” that he sees as a “fundamental risk to the continuing stability of our financial system.” He explained, “The market prices the GSEs’ debt as if there were a federal guarantee, or a high probability of a guarantee, standing behind their entire outstanding obligations. Yet, there is no explicit guarantee in the law. Actual experience has left the markets with all of these important questions and ambiguities. It is not sufficient for any single GSE to argue that its own financial condition is sound. If one GSE comes under a cloud, others may also. That has been our experience with financial firms again and again. It is the process economists call ‘contagion’ whereby uninvolved or innocent firms are affected because the market has

difficulty distinguishing from those at risk.” (*Text of St. Louis Federal Reserve Bank of St. Louis President William Poole’s remarks at the March 10 OFHEO symposium, 3/10/03*)

Recommends removing the GSEs’ line of credit to the Treasury and increasing the GSEs’ capital

- Poole recommended two steps the federal government might take to “resolve the ambiguity” that he sees “as a fundamental risk to the continuing stability of our financial system:”
 - First, various aspects of federal sponsorship that the market reads as providing an implied guarantee of GSE debt should be withdrawn. The secretary of the Treasury has the authority to buy GSE obligations; in the case of Fannie Mae and Freddie Mac, the authority is up to a maximum of \$2.25 billion for each firm. The GSEs could easily replace this potential source of emergency financial support with credit lines at commercial banks, following the widespread practice among issuers of commercial paper. In any event, the amount available at the discretion of the secretary of the Treasury is far too small to deal with a crisis in the GSE debt market. Eliminating the Treasury's authority to lend to the GSEs would provide a signal that the government is serious when it says that there is no government guarantee of GSE debt.”
 - “Second, over a transitional period of several years, the GSEs should add to the amount of capital they hold... Capital is especially important for the GSEs because their short-term obligations are large. Fannie Mae and Freddie Mac have debt obligations due within one year of about 45 percent of their debt liabilities. Any problem in the capital markets affecting these firms could become very large, very quickly. It is important to understand what ‘very quickly’ means. Because of the scale of the short-term obligations of the GSEs, the GSEs are rolling over many billions of dollars of obligations each week. For this reason, a market crisis could become acute in a matter of days, or even hours.”
 - “Capital on the books of Fannie Mae and Freddie Mac is well below the levels required of regulated depository institutions.” Fannie and Freddie’s core capital requirement is 2.5 percent of on-balance sheet assets and 0.45 percent of outstanding mortgage-backed securities and other off- balance sheet obligations, while in the private sector, government securities dealers carry capital in the neighborhood of 5 percent, and other financial firms considerably more. For example, FDIC-insured commercial banks hold equity capital and subordinated debt of a bit under 11 percent of total assets.
 - “The issue with Fannie Mae and Freddie Mac is not primarily one of disclosure. Their annual reports disclose quite well the high degree of complexity of their operations, and the small amount of capital they carry above what is required by law. My questions are these: Given the complexity of their operations, is the capital standard in the law adequate? Why is the standard so far below that required of federally regulated banks? What will happen to the housing market if Fannie and Freddie become unstable? Reports issued by Fannie Mae and Freddie Mac, and the recent OFHEO report on Systemic Risk, indicate that the two firms employ state-of-the-art

risk management. Nevertheless, my sense is that the firms are vulnerable to nonquantifiable risks, because their capital positions are so low.”

- “In my judgment, the only way for financial institutions to insure stability in the event of nonquantifiable shocks is for them to maintain a substantial extra capital cushion above that deemed necessary by analysis of quantifiable risks...Dismissing the risks of nonquantifiable events on the grounds that they are too improbable to worry about is not a wise approach to public policy.” (*Text of St. Louis Federal Reserve Bank of St. Louis President William Poole’s remarks at the March 10 OFHEO symposium, 3/10/03*)

Raising Fannie & Freddie’s capital levels would not harm the US housing market

- Poole noted that raising Fannie and Freddie’s capital base over time would not harm the US housing market. “If we are to make progress in this situation, we ought to fix the roof while the sun is still shining.” He stated, “If it happened in modest degrees, and it saved us from a calamity, it would be worth it.” Fannie and Freddie’s current capital requirements are “too thin” to stabilize the companies. (*Dow Jones Newswire, 3/10/03*)

Removal of GSEs implied federal guarantee would help prevent a “calamity”

- Even if the removal of the perceived federal guarantee affected or slowed credit to the housing industry “to a modest degree” it “would be worth doing,” because a “calamity would shut down housing.” (*Bloomberg News, Craig Torres and Albert Yoon, 3/10/03*)
- Poole noted that his remarks at the OFHEO symposium were his own and did not necessarily reflect official positions at the Federal Reserve System. (*Text of St. Louis Federal Reserve Bank of St. Louis President William Poole’s remarks at the March 10 OFHEO symposium, 3/10/03*) [A copy of Poole’s remarks may be found at the St. Louis Federal Reserve Bank’s Web site: <http://www.stls.frb.org>]

Fannie dismisses Poole’s comments

- “There is nothing new in the personal opinions expressed today by St. Louis Federal Reserve President William Poole regarding Government Sponsored Enterprises,” stated Fannie’s Senior Vice President Chuck Greener. Poole “made almost identical comments last August. Unfortunately, his comments ignore key characteristics of Fannie Mae’s regulatory structure, capital requirements, and business approach that respond directly to the concerns he raises. There is no other company in America with more stringent requirements to ensure its safety and soundness.” (*Fannie Mae statement, 3/10/03*)
- Fannie is opposed to removing the GSEs’ line of credit to the Treasury, said Fannie’s spokeswoman Sharon McHale. “It’s an important symbol” for the government, she said. “We’ve never drawn on it and cannot think of any reason for doing so.” (*Bloomberg News, Craig Torres and Albert Yoon, 3/10/03*)

OCC sites Fannie & Freddie's predatory lending guidelines as a model

Fannie & Freddie call for federal legislation on predatory lending standards

- In setting the nation's first federal predatory lending standards recently, the Office of the Comptroller of the Currency cited Fannie and Freddie's predatory lending rules as a "good starting point" for national banks to follow. The OCC advised banks in a February 21 letter against certain abusive lending practices and cited Fannie and Freddie's predatory lending guidelines as a "useful reference or starting point for national banks in establishing or enhancing policies and procedures in this area." In 2000, Fannie and Freddie announced that they would no longer purchase loans or securities backed by loans that had points and fees in excess of 5% of the loan amount, that included single premium credit insurance or that failed to determine a borrower's ability to repay the debt. Both GSEs also restrict the use of prepayment penalties and fees used to finance credit-related products in the loans they purchase. (*Dow Jones Newswire*, Dawn Kopecki, 2/25/03)
- Fannie and Freddie have joined other financial services companies calling for legislation on federal predatory lending standards. (*Dow Jones Newswire*, Dawn Kopecki, 2/25/03) "We support a national standard. And we would like to see national legislation aimed at achieving that goal," said Freddie's spokeswoman Sharon McHale. (*National Mortgage News*, Brian Collins, 2/24/03) Speaking at a February 13 AARP Board of Directors meeting, Fannie's Chairman Franklin Raines also called for legislation that provides for a national lending standard. Raines stated, "Fannie Mae supports national policies that both protect consumers from predatory lending, and protect their access to safe, low-cost mortgage capital. The advantage of a national policy is that it would be uniform. And it would stop predatory lenders from simply picking up and moving their scam when the local laws get too tough. National laws mean these guys will have no place to hide." (*Prepared remarks of Fannie's Chairman Franklin Raines before the AARP*, 2/13/03)

HUD Secretary says the agency may institute a pre-clearance program to evaluate Fannie & Freddie's new activities

Senator Allard urges HUD to enforce this pre-clearance provision expeditiously and requests status report on HUD's progress

- During a March 5 House Financial Services Committee hearing, Congressman Scott Garrett (R-NJ) asked HUD Secretary Mel Martinez about HUD's role in pre-clearing Fannie and Freddie's new products. Congressman Garrett noted that since 1992, HUD has been required to pre-clear any new products that the GSEs issue. However, HUD has never done this. Congressman Garrett asked Secretary Martinez to comment. Secretary Martinez said that this is another issue that has long been a problem for HUD. Pre-clearance has never been addressed -- a rule has never even been written-- but HUD is moving forward. "We believe it is our responsibility and we are mandated to do it," Secretary Martinez stated. He added that

HUD hopes to get a regulation to OMB in the near future and that HUD FHA Commissioner John Weicher is heading up the task. Congressman Garrett asked Secretary Martinez how long it would be before the rule was sent to OMB. Secretary Martinez said that their number one goal with the GSEs this year is to examine their housing role. The next issue is pre-clearance. Secretary Martinez estimated that it would probably be the end of this year or early next year when HUD gets a regulation to OMB. Congressman Garrett also asked Secretary Martinez' opinion of the GSEs' entry into new businesses. The Secretary responded that the GSEs' charters clearly define that their business should be in the secondary market, and not in the primary market. "The GSE charter is clear in defining their lines of business. The GSEs should be in the secondary market, not the primary market. By charter, that is their role and that is how they should be defined," stated Secretary Martinez. *(Oral Testimony from House Financial Services Committee hearing on Housing Related Agency Budgets for FY 2004, 3/5/03)*

Senator Allard urges HUD to enforce this provision expeditiously and request status report on HUD's progress

- In a March 4 letter to HUD Secretary Martinez, Senate Banking Committee Housing Subcommittee Chairman Wayne Allard (R-CO) said he was "pleased to see reference to reviewing the 'new program' requests of Fannie Mae and Freddie Mac" in the section of HUD's FY 2004 budget documents dealing with HUD's priorities for its oversight of the GSEs. He noted that the GSEs are required to bring new programs for HUD's review and prior approval before implementation, yet past administrations have not enforced this provision. "I am writing to applaud your efforts to enforce this provision and to urge you to do so expeditiously."
- Senator Allard added that the budget documents also note that each GSE "also markets technology and services to support the mortgage lending process." He cautioned HUD that "Many business activities conducted quite adequately by the private sector could fall within the scope of 'supporting the mortgage lending process,' and thus HUD's role as the implementing agency for proposed new lines of GSE business becomes all the more critical. Meaningful enforcement of this statutory mandate is merited for the same reason the provision was enacted originally to ensure that new programs by the GSEs are consistent with their charters and with the public interest."
- Senator Allard requested that HUD "provide information regarding the status of your efforts to establish an effective GSE 'new program' review process." *(Senator Allard letter to HUD Secretary Mel Martinez, 3/4/03)*

CBO identifies the imposition of an annual fee on the non-mission investments of GSEs as an option for increasing federal revenues

Identifies requiring the TVA to impose a transmission surcharge on future electricity sales as an option to reduce spending

Fee on the non-mission investments of GSEs

- The Congressional Budget Office (CBO) in its annual report to Congress identified the imposition of an annual fee on the non-mission investments of the GSEs as a revenue raising option. The CBO wrote,

“Four GSEs – Fannie Mae, Freddie Mac, Farmer Mac, and the Federal Home Loan Banks – have used their privileged borrowing to acquire and hold large portfolios of securities. Those investments consist mostly of mortgage-backed securities but also include other asset-backed securities, corporate bonds, and mortgage revenue bonds. At the end of 2002, the investment portfolios of those four enterprises totaled \$2 trillion, or 75 percent of their combined assets. The GSEs earn profits from the difference in yields on their investments and on their subsidized debt issues. Those profits, which owe much to the federal guarantee, accrue to shareholders and other GSE stakeholders.”
- The CBO estimated that imposing a 10 basis point fee (10 cents per \$1000 of investments) on the GSEs’ investment portfolios could raise nearly \$1.5 billion in 2004, \$8.2 billion over five years, and \$18.6 billion through 2013. The CBO noted that the “proceeds from the fee would equal about one-third of the federal subsidy estimated to be retained by equity investors and other stakeholders of the housing GSEs.”
- “Proponents of imposing the fee could argue that doing so would promote competition in financial markets and recover some of the federal subsidy retained by the GSEs without reducing their capacity to achieve their public mission,” CBO said. “Opponents of this option might argue that the GSEs either do not receive a government subsidy or that they pass all of it through to targeted borrowers and, hence, should not be subject to a fee.” (*Budget Options: Congressional Budget Office, March 2003*)
- The CBO made this same proposal in its 1999, 2000, and 2001 annual reports to Congress. (*Budget Options, Congressional Budget Office, February 2001; Budget Options, Congressional Budget Office, March 2000; “Maintaining Budgetary Discipline: Spending and Revenue Options,” Congressional Budget Office, April 1999*). [Note: CBO did not publish a 2002 Budget Options report.]

Require TVA to impose a transmission surcharge on future electricity sales

- The CBO also identified requiring the TVA to impose a transmission surcharge on future electricity sales as an option to reduce spending. The CBO wrote,

“This option would require the TVA to impose a surcharge on electricity transported over its transmission system, regardless of the source, to recover a portion of its past costs. That transmission surcharge would be set to recoup \$2.4 billion of the TVA’s \$4.1 billion investment in uneconomic assets over a period of 10 years. (The option would also redefine the TVA’s debt limit to include related liabilities arising from long-term contracts and gradually scale back that limit to \$20 billion – or \$5 billion below the current level of outstanding debt – to ensure that revenues collected from the surcharge would go toward lowering the agency’s debt burden.) Added receipts would total \$1.1 billion over the 2004-2008 period.”

- “Supporters of this option would contend that a surcharge on transmission services would lessen the possibility that taxpayers – rather than the TVA’s customers – were saddled with the cost of its past uneconomic investments...Opponents of this option might argue that if charges for past investments made the TVA’s rates uncompetitive, the region could suffer. They also might argue that requiring a transmission surcharge would constrain the TVA’s ability to formulate efficient plans for paying off uneconomic investments. (*Budget Options: Congressional Budget Office, March 2003*)

GAO report reviews the FHFB

Finds that the FHFB Chairman has greater authority than chairs at other financial regulators

Recommends greater participation of the FHFB’s board in administrative decisions

Criticizes the FHFB’s handling of staff reductions and refers the terminations to the EEOC

Expresses concern about the strength of the FHFB’s examination program but notes improvements have been made

Notes that the appointment of public interest directors to the FHLBanks has become increasingly politicized

FHFB Chairman plans no administrative changes

Senator Sarbanes is disturbed by the GAO’s findings

FHFB Chairman has greater authority than chairs at other financial regulators

- A GAO report found that the Federal Housing Finance Board (FHFB) Chairman has greater authority to make key administrative decisions than the chairs at five of the six other financial regulators GAO reviewed. Those agencies reviewed were the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the National Commodity Futures Trading Commission, the National Credit Union Administration, and the Board of Governors of the Federal Reserve Board. The GAO found that the FHFB and FDIC chairs have broader authority to make key administrative decisions

than the chairs of other financial regulators. Senate Banking Committee Ranking Member Paul Sarbanes (D-MD), Ranking Minority Member of the House Financial Services Committee Barney Frank (D-MA) and Capital Markets Subcommittee Chairman Richard Baker (R-LA) requested the report. (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

- The GAO noted that the FHFBB Chairman has the authority to appoint and remove officials and reorganize the agency without a vote by the board, which has “contributed to the sometimes bitter conflicts that have periodically characterized relations among board members over the past eight years.” The GAO noted that the Chairman’s authority has contributed to conflicts between the Chairman and the two Democratic board members who are in the minority on the five-member FHFBB. In contrast, statutes, regulations, and practices, limit the chairs’ authorities at most other regulators. In particular, the boards or commissions at these agencies approve most senior-level appointments and several boards approve major reorganizations. On January 29, 2003, the FHFBB considered and rejected by a 3 to 2 party-line vote a proposal to revise the delegation and limit the chair’s authority. [See February 24, 2003 *GSE Report* for more information on the proposal.] (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

Recommends greater participation of the FHFBB’s five-member board of directors in administrative decisions

- The GAO recommended that the FHFBB “should consider a range of options that could be implemented within the current delegation of authority,” which could include actions by the chair such as “notifying, briefing, and/or soliciting input from other board members on major administrative decisions prior to their implementation and...submitting key administrative decisions to that board for a vote or approval.” The GAO recommended “board members and their staffs hold discussions on approaches – including potential revisions to the delegation of authority – that would ensure board participation in key administrative decisions while preserving the chair’s authority to administer the agency on a day-to-day basis.” (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

Criticizes the FHFBB’s handling of recent staff reductions and refers the terminations to the EEOC

- “During the August 2002 reorganization, FHFBB took certain actions in conducting a RIF [reduction-in-force] that were not fully consistent with federal age discrimination statutes and regulations.” The GAO noted that “Although FHFBB provided significant financial compensation to staff subject to the RIF, its procedures were not fully consistent with all applicable federal age discrimination statutes and regulations.” As an example, the “FHFBB presented a settlement agreement to separated staff that offered 3 to 6 months salary in exchange for, among other things, the employees agreeing to waive their rights to file charges, complaints or appeals with the Equal Employment Opportunity Commission (EEOC).” However, the GAO noted “EEOC regulations implementing the Age Discrimination in Employment Act do not permit waivers of employees’ rights to file charges or complaints with EEOC. In addition, FHFBB did not advise the affected employees in

writing to consult an attorney prior to signing the agreement as well.” The GAO noted that it has informed the EEOC of its findings and recommended that the FHFB “fully comply with applicable federal age discrimination statutes and regulations in offering settlement agreements to employees subject to RIFs.” (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

Expresses concern about the strength of the FHFB’s examination program but notes improvements have been made

- “Although for several years FHFB did not take steps to correct weaknesses in its FHLBank examination program that GAO identified in a 1998 report, FHFB’s current Chair has recently undertaken several steps to improve its examinations. In 1998, we found that FHFB performed limited reviews of FHLBank functions – including internal controls and corporate governance – that are critical in managing the banks’ financial and operational risks. These functions continued to receive only limited reviews in examinations conducted from 1999 through 2001. FHFB’s limited reviews of key functions raise questions about the agency’s fulfillment of its safety and soundness oversight mission, particularly as interest rate and credit risks potentially increased in that period through the rapid growth of direct mortgage acquisition programs.” (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)
- The GAO noted that among other changes announced in 2002, the FHFB plans to increase the number of examiners from 10 to 24 and revise its examination approach to focus on the major risks and quality of controls at each FHLBank. “Although these changes have the potential to improve FHFB’s examination program, it is too soon to assess their effectiveness.” (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

Appointment of public interest directors to the FHLBanks has become increasingly politicized

- The GAO noted that according to Center for Responsive Politics (CRP) data, “50 (or 67 percent) of the 75 public interest directors that the FHFB appointed from January 1, 1988 through May 8, 2002, reported making one or more political donations prior to their initial appointments. During that period, three FHFB chairs were in office (Morrison, Apgar, and Korsmo) when public interest directors were appointed. The percentage of appointees who made political contributions prior to their initial appointments during the tenures of the three chairs ranged from 56 percent (Morrison) to 76 percent (Korsmo). CRP data also indicate that the median value of each contribution that the directors made prior to their appointments ranged from \$3,250 (Apgar) to \$8,364 (Korsmo).” (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)
- The GAO also analyzed data obtained from Fannie and Freddie to determine the political contributions of members of their boards of directors who are appointed by the President. Using CRP data, the GAO determined the political contributions of Fannie and Freddie directors appointed from January 1, 1988 through 2002 and found that 18 of the 19 (95 percent) of the Fannie and Freddie directors appointed during that period had made political

contributions in the 8-year period prior to their initial appointments. (*GAO Report: Financial Regulation: Review of Selected Operations of the Federal Housing Finance Board*, GAO-03-364, February 2003)

FHFB Chairman plans no administrative changes

- In response to the GAO report, FHFB Chairman John Korsmo said through a spokesman that the report's recommendations would not affect his administration of the agency. "[Korsmo] has no intention of changing the way the administrative issues are handled. But, in fact, the chair already regularly consults with the other directors, including consultation on administrative issues," said Carter Wood, a Korsmo spokesman. Wood noted that the report simply said the board should "consider" such actions. "Certainly [Korsmo] will consider it," Wood said. "The delegation has been in place since 1990 and the board recently considered the issue, but has no immediate plans to change it," he said. Wood also noted that the report provided favorable comments about Korsmo's performance as chairman, particularly his efforts to upgrade the FHFB's examination process. (*BNA Daily Report for Executives*, Richard Cowden, 3/3/03)
- The GAO report also included a response to the GAO's findings by Judith L. Hoffmann, the director of the FHFB's office of management. She noted that the FHFB disputed the GAO's finding that the delegation of authority should be changed. She noted that in January, the FHFB considered and rejected proposed changes to the delegation of authority. She wrote that "ratification of the existing delegation reflects a belief on the part of the majority of the current board that investing in the chairman broad responsibility to administer the agency is the best method of managing the Finance Board's day-to-day operations." A second response from the two Democrats (Franz S. Leichter and Allan I. Mendelowitz) on the majority Republican FHFB was included in the GAO report, which largely supported the GAO's findings. The Democrats said they did not consider Hoffmann's response to be the board's official position. "Because the Finance Board has neither considered nor approved an agency response to your draft report, there is no agency response and each board member must provide his or her own comments." (*American Banker*, Rob Garver, 3/3/03)

Senator Sarbanes says he is disturbed by the GAO's findings

- Senator Sarbanes said he was disturbed by the GAO's findings as well as the FHFB's unwillingness to capitulate to the GAO. "Particularly troubling is the GAO's conclusion that this broad delegation 'potentially frustrates one of Congress' objectives in establishing a board to regulate the FHLBank System," he said. Senator Sarbanes said he will continue to monitor the FHFB's progress. (*Dow Jones Newswire*, Dawn Kopecki, 2/28/03)

FHLBank of Cincinnati votes to begin registering stock with SEC but opposes registering debt

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

FHLBank of New York President claims the Treasury Department's call for the FHLBanks to register their stock with the SEC was done without clear White House approval

Treasury dismisses claim

America's Community Bankers calls for a formal rule-making on the issue so parties may comment

ABA, ACB and ICBA urge FHFB to retain securities authority and not relinquish responsibilities to the SEC

- 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. (*Dow Jones Newswire*, Dawn Kopecki, 2/26/03; *American Banker*, Rob Garver, 2/27/03) FHFB Chairman John Korsmo and the Bush Administration have been pushing the 12 FHLBanks to register their common stock with the SEC, urging them to comply with the same voluntary financial disclosure rules agreed to by Fannie and Freddie last July. Under the agreement with the SEC, OFHEO, and Treasury, 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 (1933 Securities Act). In July 16 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 financial disclosure rules agreed to by Fannie and Freddie.
- The FHLBank of Cincinnati is now waiting for directions from the FHFB before approaching the SEC. (*National Mortgage News*, 3/3/03)
- Until this time, the FHLBanks were all opposed to registering their common stock and filing disclosures on their debt securities with the SEC. Their concern with registering their common stock was in part because the FHLBank System is organized very differently than Fannie and Freddie. Unlike Fannie and Freddie, the FHLBank System does not issue stock to the public and it is organized as a cooperative. "FHLBank stock is a very different kind of security than other GSE stock," said Buck Woodford, Chairman of the Cincinnati FHLBank board of directors. "One of the things that [has] caused the other banks to pursue another avenue other than registration is because the stock is quite different now." (*Dow Jones Newswire*, Dawn Kopecki, 2/26/03)

Other FHLBanks considering plan to register and file their disclosures with the FHFb and not the SEC

- The Council of FHLBanks, representing 10 of the 12 FHLBanks, is pushing an alternative plan that would allow the SEC to write disclosure rules for the system with the FHFb overseeing the actual filings. The plan would use a little-known provision in securities law that lets some commercial banks and thrifts issue stock without registering and filing their disclosures with the SEC. “That way the SEC would retain a meaningful role in writing the regulation and the Finance Board retains their safety and soundness role,” said John von Seggren, president of the Council of FHLBanks. (*Dow Jones Newswire*, Dawn Kopecki, 2/26/03, 3/4/03)
- However, a Treasury Spokeswoman February 13 offered little hope that the administration would find the proposal acceptable. “Treasury advocates that all GSEs comply with the ’34 Act administered by the SEC,” she said. “This means disclosing to the SEC. Disclosing to the Federal Housing Finance Board is not the same thing.” (*American Banker*, Rob Garver, 2/14/03) Further, the FHLBank of Cincinnati’s decision to register its stock with the SEC could also adversely affect that proposal, particularly as the board of directors of the Cincinnati FHLBank said in separate letters sent to the Council and the FHFb that SEC stock registration could be “accomplished with minimum disruption to the operations of the Federal Home Loan Bank System.” (*Dow Jones Newswire*, Dawn Kopecki, 2/26/03)

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

- In a March 4 speech before the Independent Community Bankers of America, FHFb Chairman John Korsmo continued to push to have all 12 FHLBanks register their stock with the SEC. “I believe that the Federal Home Loan Banks should be role models and fully and freely disclose financial management information under the ’34 Act. And I believe it’s going to happen. When it does, the enhanced disclosure the Banks provide will be good news for homebuyers, for taxpayers, and...independent community bankers and members of the Federal Home Loan Bank System,” he stated. (*FHFb Chairman John Korsmo’s remarks before the ICBA*, 3/4/03)
- In response to those who argue that registering their stock with the SEC is not necessary because it is a cooperative stock and no one trades it publicly, Korsmo responded, “But that misses an important point – a \$5 trillion point. The system borrowed some \$5 trillion last year, debt purchased by somebody, and those somebodies, the individuals and institutions who were the buyers of those obligations, have an intense interest – a financial self-interest – in knowing all they can about the System and the quality of its debt. And taxpayers or those who represent them have an intense interest in knowing whether the System can back up that debt.” (*FHFb Chairman John Korsmo’s remarks before the ICBA*, 3/4/03)
- In response to the plan pushed by the Council of FHLBanks to have the FHFb and not the SEC oversee the actual filings, Korsmo stated that the SEC was better suited than the FHFb to regulate financial disclosures. The SEC, he said, already has the staff and expertise to “do the job effectively, and thereby ensure the public and investors of the reliability and completeness of the disclosures.” He added, “we have found the SEC very willing to

recognize and adjust for the unique nature of the Federal Home Loan Bank System. SEC registration will not require the Banks to make any fundamental changes in how they conduct their business.” (*FHFB Chairman John Korsmo’s remarks before the ICBA, 3/4/03*)

- Korsmo concluded, “Enhanced disclosure, increased transparency, IS going to happen. The Banks, I believe, are coming to realize this fact.” (*FHFB Chairman John Korsmo’s remarks before the ICBA, 3/4/03*)

FHLBank of Cincinnati and other 11 FHLBanks oppose registering FHLBank debt with the SEC

- While it approved registration of its stock to the SEC, the board of directors of the FHLBank of Cincinnati agreed with the other 11 FHLBanks by remaining strongly opposed to any registration of FHLBank debt with the SEC. (*American Banker, Rob Garver, 2/27/03*) In a report drafted by the FHLBank presidents explaining their concerns, the presidents noted that “Requiring the FHLBanks to register their debt, while not requiring the same of Fannie Mae and Freddie Mac, could result in disadvantageous treatment of FHLBanks and a commensurate increase in the FHLBanks’ cost of funds.” (*National Mortgage News, 3/3/03*)

FHLBank of New York President claims the Treasury Department’s call for the FHLBanks to register their stock with the SEC was done without clear White House approval

- FHLBank of New York President Alfred A. DelliBovi told the *American Banker* in an interview March 7 that the Treasury Department’s call for the FHLBanks to register their stock with the SEC was done without clear White House approval and that the industry is lobbying Bush administration officials to rein in the Treasury Department. DelliBovi claimed there is no evidence that Treasury Under Secretary for Domestic Finance Peter Fisher had ever fully vetted the plan with White House policymakers before recommending last July that all GSEs comply with the same financial disclosure rules agreed to by Fannie and Freddie. A Treasury spokeswoman dismissed the claims and noted that administration officials always clear such testimony before it is delivered. “This statement was developed in close consultation with both the National Economic Council and the Council of Economic Advisors and was cleared as a statement of administration policy,” she stated.
- DelliBovi said that the administration is beginning to notice the FHLBanks’ concerns. “I don’t think anyone at the White House deliberately went out to inconvenience (the banks). Now that people at higher levels are recognizing that there is an issue here, we’re getting more response.” (*American Banker, Rob Garver, 3/10/03*)

ACB calls for a formal rule-making

- Diane Casey Landry, the president of ACB, raised similar issues to DelliBovi. “We have not seen a rulemaking process or a solicitation of views so that people could be providing input,” she said. “We’d like to see this done in a formal rulemaking process.”
- The Treasury spokeswoman pointed out that all calls for GSEs to register their capital stock with the SEC have sought voluntary compliance. The Treasury spokeswoman said the industry would have ample opportunity to present its point of view if a rulemaking were needed or legislation was considered. (*American Banker, Rob Garver, 3/10/03*)

ABA, ACB and ICBA urge FHFB to retain securities authority and not relinquish responsibilities to the SEC

- In related news, the ACB signed a joint letter with the American Bankers Association and the Independent Community Bankers of America urging the FHFB to retain its authority over the FHLBank System securities disclosures and not relinquish its responsibilities to the SEC. The trade groups expressed serious reservations about the apparent intention of the Finance Board to delegate its authority to the SEC” and said issues of proper disclosure and reporting requirements “are of the utmost importance to the future of the Federal Home Loan Bank System and are inextricably linked to the system’s safety and soundness.” The groups expressed concern that if the System were subject to disclosures designed for publicly traded companies “an unintended consequence could result, confusing investors and others who try to compare the system’s disclosures with those of other companies.” (*Bank News*, January 2003)

FBI investigating alleged political fundraising improprieties at FHFB

- The investigation into alleged political fundraising improprieties at the FHFB has broadened, with FBI agents joining the investigation, according to the *American Banker*. FBI agents reportedly questioned executives regulated by the FHFB and others about a broad range of practices at the FHFB, including the political activities of FHFB Chairman John Korsmo and activities by his senior staff, as well as practices at the FHFB before Korsmo took office. A FHFB spokesman said that though Korsmo has not been contacted by the FBI and was unaware of the FBI’s inclusion in the investigation, he welcomes it and is confident that it will show the Chairman has done nothing wrong. (*American Banker*, Rob Garver, 3/5/03)

Background

- As noted in previous *GSE Reports*, Korsmo has been the subject of an investigation into his participation as a “special guest” at an October 2002 political fundraiser for Rick Clayburgh, a friend of Korsmo, a Republican candidate for Congress from North Dakota. Korsmo’s attendance was criticized because the presidents of several FHLBanks were invited to the fundraiser, just weeks after the FHFB adopted new ethics rules that declared the FHFB to be the “arms-length regulator for the safety and soundness” of the FHLBanks. (*American Banker*, Rob Garver, 10/1/02) Korsmo said he had checked prior to the fundraiser with his general counsel, Arnold Intrater, and Greg Walden, a Washington attorney who helped the FHFB develop its ethics rules. (*Associated Press*, Dale Wetzel, 10/2/02) Walden subsequently wrote a letter to the FHFB’s Inspector General that Korsmo’s participation at the fundraiser was “lawful and appropriate.” (*National Mortgage News*, Brian Collins, 11/11/02)
- House and Senate lawmakers requested a federal investigation into Korsmo’s participation in the fundraiser. Senator Paul Sarbanes (D-MD), then Senate Banking Committee Chairman, and Senator Phil Gramm (R-TX), then Ranking Committee Member, sent letters to the Government Accounting Office, the FHFB’s Inspector General and Korsmo requesting a

federal investigation. Congressman Henry Waxman (D-CA) also sent a letter to the House Government Reform Committee Chairman Dan Burton (R-IN) raising concerns about Korsmo's participation in the fundraiser. Federal investigators searched the FHFB offices and seized computer data on October 28 as a routine part of the federal examination. [See the October 11, November 1, and November 15, 2002 *GSE Reports* for more information about Korsmo's participation at the fundraiser, www.gsereport.com]

Fannie Mae shareholder introduces resolution requiring Fannie to pay \$100 million a year for DC schools in lieu of taxes

As GSEs, Fannie & Freddie are exempt from paying state and local income taxes

- A Fannie Mae shareholder, John Capozzi, has introduced a resolution for this year's annual shareholder meeting that would require Fannie to pay \$100 million a year in lieu of taxes to rebuild schools in DC. Fannie and Freddie's charters exempt them from paying state and local income taxes. Capozzi, a DC activist and former DC "shadow representative," unsuccessfully pushed a similar "Fannie Must Pay" resolution in 1996. Approximately 1% of the shareholders supported the measure.
- Capozzi noted that if Fannie's local tax-exemption was repealed and it became liable to pay taxes on 10% of its income, the DC government would reap \$450 million a year. The DC school system has estimated that it would cost about \$2 billion to rebuild its schools over the next decade. Capozzi said the resolution "goes to the mission of the company," since rebuilding schools would promote homeownership in DC. Capozzi's draft resolution stated, "Fannie Mae suffers from the perception that it is a poor corporate citizen." In order to reverse this trend, "Fannie Mae should voluntarily enter into an agreement with the government of the District of Columbia to make a payment in lieu of taxes that would assist in rebuilding every DC school," the resolution said. (*Dow Jones Newswire*, Rob Wells, 2/24/03, 2/26/03)
- Fannie's spokeswoman Janice Daue said the company is reviewing the resolution and no decisions have been made whether it will be presented for a shareholder vote. (*Dow Jones Newswire*, Rob Wells, 2/24/03, 2/26/03)
- Capozzi also submitted a resolution requiring Farmer Mac to pay \$100,000 in lieu of taxes. (*Dow Jones Newswire*, Rob Wells, 2/24/03)

Fannie Mae and Freddie Mac

Treasury announces new Deputy Assistant Secretary for Financial Institutions – will manage GSE policy

- The Treasury Department announced March 3 that Gregory P.J. Zerzan has been appointed as Deputy Assistant Secretary for Financial Institutions Policy. He began his new post March 3. In this position, Zerzan is responsible for legislative and policy matters related to the financial services sector – including commercial banks, investment banks, insurance companies, credit unions and savings and loans. He manages Treasury policy regarding Government Sponsored Enterprises and the agencies that regulate and insure these entities. He also oversees the Treasury’s Terrorism Risk Insurance Program. Zerzan was most recently the Senior Counsel for Legislation at the House Financial Services Committee and had worked on the former House Banking Committee. Previously, he served as Counsel for the House Agriculture Committee from 1997 until 2000. He worked from 1996 to 1997 as an Associate at the Portland, OR law firm of Kell, Alterman & Runstein, LLP. (*Treasury press release, 3/3/03*) Zerzan replaces Pat Cave, who submitted his resignation January 15th, to join the private sector.

OFHEO receives increased funding in Omnibus Spending bill

- President Bush signed into law the \$397.4 billion Omnibus Spending bill (H.J. Res. 2) February 20, which included a provision that increases the budget for Fannie and Freddie’s safety and soundness regulator, OFHEO, by \$3 million to \$30 million.
- The bill also requires OFHEO to provide a detailed report” by August 15 on “whether additional staff is required to fully meet its regulatory mission” of overseeing Fannie and Freddie. (*National Mortgage News Daily Web site, 2/18/03*)
- In related news, President Bush’s FY 2004 budget, released on February 3, 2003, recommended another \$2 million increase in funding to OFHEO to \$32 million. The increase in funding would be paid by Fannie and Freddie through semi-annual assessments, and not by taxpayers. Fannie and Freddie provide the funds for their own regulation, but determining the level of funding has been subject to the congressional appropriations process. (*Budget of the United States Government, Fiscal Year 2004*) The Administration’s FY 2004 budget recommended that OFHEO be removed from the appropriations process. The budget stated, “In order to treat OFHEO similarly to other financial regulators, including the regulator of the Federal Home Loan Bank System, the Budget proposes legislation that would provide direct funding of OFHEO’s activities with mandatory assessments on Fannie Mae and Freddie Mac.” (*Budget of the United States Government, Fiscal Year 2004 - Appendix, p. 519*) The recommendation was also included in the Administration’s FY 2003 budget, but was never acted upon. [See February 24, 2003 *GSE Report* for more information on the Administration’s FY 2004 proposed budget.]

- OFHEO Director Armando Falcon has repeatedly called for OFHEO to be removed from the appropriations process and given authority to control its own budget. OFHEO's recent systemic risk report on Fannie and Freddie also recommended that OFHEO be removed from the appropriations process. Other federal financial regulators, such as the OCC and OTS, are not subject to the appropriations process, and thus, simply collect their fees directly from the banks and thrifts they supervise.

Andrew Davidson & Co Inc. says Fannie & Freddie's new voluntary MBS Disclosures are "a move in right direction" but loan-level disclosures are needed

- Andrew Davidson, a financial consultant whose firm researches mortgage markets and offers mortgage models, recently reviewed the GSEs' new mortgage-backed securities (MBS) disclosures that came as a result of a staff report by Treasury, OFHEO and SEC. In his report, Davidson noted that the GSEs' new disclosures are a "positive step" for the mortgage market. Davidson noted that the GSEs hold a large range of loans in their portfolio with varying credit quality and loan sizes, meaning, "investors cannot assume that all loans are interchangeable. Differences in pool composition can make a substantial difference in prepayments and, consequently, in investment results." That is why investors have been looking for additional information about the GSEs mortgage pools. Davidson added, "the additional disclosures will serve to level the playing field, somewhat, as more pool information will be made available."
- The joint staff report recommended several additional disclosures for the GSEs: Loan Purpose, Original LTV, Standardized Credit Scores of Borrowers, Servicer of Pool, Occupancy Status, and Property Type. Davidson noted that Fannie and Freddie will begin to disclose the recommended information, beginning in April 2003 and June 2003 respectively. However, the report did not recommend, and the GSEs will not disclose, loan level amounts. The task force found "that market participants generally sought aggregate pool information as opposed to loan level information." However, he noted, "it would be surprising to us if modelers of prepayments did not request loan level detail. Currently, such detail is available in the non-agency market. If we merely relied on pool information, we would find it much harder to construct prepayment models for jumbo and subprime mortgages." Davidson added that loan level data allows investors to see the impact of varied LTVs on prepayment risk. Loan-level data is also important when there are many factors that affect prepayments and it is "impossible to separate effects of coupon, loan size and LTV within a pool, since the pool averages do not show the relationship between these variables."
- Davidson concluded by noting that even without loan level data, mortgage trading and prepayment modeling will change as the new disclosures come into effect. "This new information does create the risk of impacting the liquidity of the TBA [to-be-announced] market, it is more likely that trading practices will develop that use the new information to enhance liquidity and overcome the current fragmentation of the market... The new disclosures are a move in the right direction. We hope they will be followed by additional

loan-level disclosures, which will help prepayment modelers provide tools to investors to fully harness the value of the new disclosures.”

(Andrew Davidson, www.ad-co.com/newsletter/Feb03/Consult3.htm , 2/3/03) [For more information about Fannie and Freddie’s new MBS disclosures and the joint staff report recommendations by Treasury, OFHEO, and the SEC, see the February 24, 2002 *GSE Report*, www.gsereport.com]

Fannie continues to respond to questions about why it bid on Consecos servicing rights

Wall Street observers express concern about Fannie’s exposure to manufactured-housing and claimed Fannie “propped up” Consecos

- Peter Eavis, Senior Columnist with *The Street.com*, noted that Fannie is still responding to potentially damaging questions about why it placed a \$70 million bid February 19 for the servicing rights to \$23 billion in manufactured-housing mortgages in the bankruptcy of Consecos Finance Corp. Although Fannie claimed it didn’t expect to service the loans, Fannie holds about \$7 billion worth of bonds backed by Consecos’s mobile home loans, “and it appears to be acting aggressively to maintain the value of those bonds.” (*The Street.com*, Peter Eavis, 2/27/03) [See February 24, 2003 *GSE Report* for more information about Fannie’s bid for the servicing rights in the bankruptcy of Consecos Finance, www.gsereport.com]
- Eavis continued, “Skeptics note that Fannie’s capital is not that far above a minimum” set by its regulator, OFHEO, and that a large writedown in Consecos bonds could therefore help push Fannie below the OFHEO minimum. “Even a 10% reduction in its Consecos holdings, or around \$700 million, could erase much of the \$877 million cushion that exists between Fannie’s core capital and its minimum capital requirement at the end of 2002.” In addition, a big writedown “could raise questions about the propriety of Consecos’s lending practices.” Eavis explained, “When defaults rise to very high levels, it is often evidence that the lender has been too generous with people who never really had a chance of paying back the loans. In many cases, Consecos made 30-year home loans that were not likely to maintain their value over that period. This practice could be considered an example of predatory lending. Though Fannie says it is very much opposed to predatory lending, it may have acquired exposure to Consecos loans that are possibly unfair.” (*The Street.com*, Peter Eavis, 2/27/03)
- Fannie claimed that its bid was to protect the integrity of the servicing, however, an attorney for one of the bidders on Consecos said Fannie’s argument about protecting the servicing “is laughable.” He said, “I don’t buy that argument at all. There are plenty of specialized servicers out there who can handle this assignment.” One mortgage executive stated, “There are a lot of people ticked at Fannie over this.” (*National Mortgage News*, Paul Muolo, 3/3/03)

Wall Street observers expressed concern about Fannie’s exposure to manufactured-housing and claimed Fannie “propped up” Consecos

- Erick Bergquist with the *American Banker* noted that although critics most recently claimed

Fannie's bid was another instance of "mission creep," observers on Wall Street were more concerned about the revelation of Fannie's exposure in manufactured-housing bonds: \$10 billion, including \$7 billion issued and serviced by Consecos finance unit. Vincent Daniel, an analyst at Keefe, Bruyette & Woods Inc., noted, "The big issue for Fannie Mae is why the company made a major investment in Consecos [bonds] at all."

- Bergquist noted that players in the asset-backed securities market knew Fannie's activity in this area, but its growing position in manufactured housing securities was not apparent from its financial disclosures. Fannie began purchasing manufactured housing securities from several issuers in 1995, said Fannie's spokeswoman Janice Daue. Bergquist noted, "Manufactured housing loans are considered far riskier than the conventional mortgages that are Fannie's bread-and-butter, but Ms. Daue said that it bought only the cream of the crop: investment-grade-rated, credit-enhanced tranches. Nonetheless, its investment in such a risky asset class, which began when underwriting standards in the manufactured housing market were deteriorating and continued even through that market's implosion in 1998, has turned heads."
- "Lending standards in manufactured housing were severely relaxed in 1995 and 1996, just when Fannie started to buy," said William Ryan, an analyst at Portales Partners LLC. "Loans were moving out to 30-year terms, increasing their loan-to-value ratios, and firms were accepting lower down payments than ever before," Mr. Ryan said. "These loans eventually blew up in 1998. This was evident long ago, and it should have been picked up by [bond] investors as a red flag." However, Fannie believes that Consecos bankruptcy "will not have any material impact on Fannie's financial statements," Daue said. "We are well insulated from any losses."
- In a February 25 report, entitled "Lender of Last Resort," Ryan's firm claimed that Fannie intentionally propped up Consecos by buying these bonds — a charge Fannie denies. Ryan claimed that Fannie became the "primary provider of liquidity to Consecos in more difficult markets, including the fall of 1998 and the Long Term Capital Management crisis," when credit dried up for manufactured housing and subprime lenders. Consecos would not have been able to complete its bond sales were it not for Fannie's purchases, which persuaded other investors to participate, Ryan claimed. In 1998 and 1999 when other investors shied away as Consecos's credit problems "snowballed," Fannie continued to buy Consecos's paper, and in doing so, Fannie "extended the life of Consecos beyond its natural term," stated Ryan's report. (*American Banker*, Erick Bergquist, 2/27/03)

ACB includes GSEs as one of the group's top legislative goals for 2003
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- America's Community Banker President Diane Casey Landry outlined the group's legislative agenda at the ACB's National Lending Conference recently. Financial privacy of its customers was at the top of its legislative agenda for 2003, while other items on the list include: new savings vehicles outlined by President Bush, working with Fannie and Freddie to make certain the role of the GSEs is appropriate, deposit insurance reform and financial

literacy. (*National Mortgage News*, Lew Sichelman, 2/24/03)

Analyst says Fannie & Freddie would reap significant benefits if they decided to privatize

- In an interview with *National Mortgage News*, Sandler O’Neill analyst Mike McMahon said there could be a significant upside if either Fannie or Freddie decided to privatize. “These two firms are making more money than ever, but their valuations keep going down... They’re not down on fundamentals – they’re down on political fears.” He believes that if they decided to give up their charters, Fannie and Freddie’s cost of funds would increase, but the yield they gain by entering new markets – jumbo, subprime, Alt A – would more than compensate. O’Neill also noted that Fannie and Freddie, if privatized, would be able to “get into mortgage insurance and ancillary services.” (*National Mortgage News*, Paul Muolo, 2/24/03)

Chairman of Home Loan Center says Fannie & Freddie’s automated underwriting systems do not promote housing

- In an article regarding the Bush Administration’s budget proposal to create a FHA subprime loan product, Anthony Hsieh, chairman and chief executive of the Internet-based mortgage lending company Home Loan Center in Irvine, CA, said the FHA needs to design a subprime product that complements the private sector. He also stressed that it is important for the FHA to disclose the underwriting parameters of its subprime products so that Realtors can work with potential buyers and pre-qualify them for a loan. He noted that Fannie and Freddie’s automated underwriting systems are “black boxes” and lenders do not know whether a borrower would qualify for an A-minus loan until the application is run through an automated underwriting system. “It does not promote housing,” he said. (*Origination News*, Brian Collins, March 2003)

GSE debt news:

- (1) For the first time foreign investors purchased more bonds issued by GSEs than debt issued by the US government and by US companies
- (2) GSE long-term debt increases to a record \$1.04 trillion in 2002
- (3) Fannie & Freddie’s callable debt issuance soared in 2002
- (4) Fannie continues to court Asian investors to purchase its debt

Background on GSE debt and the supply of Treasurys

- Over the past few years, as the US was running budget surpluses, and the national debt was being paid down, the supply of Treasury securities shrunk. Investors, traders, borrowers, and even the US Federal Reserve were being forced to find new benchmark securities to replace the shrinking number of Treasurys. Among possible alternatives as a benchmark were: (1) the debt securities of Fannie and Freddie; (2) derivatives tied to the swaps market; or (3)

high-grade corporate bonds. Investors view the debt securities of Fannie and Freddie as “almost” as good as US Treasury’s because of the implicit government guarantee of Fannie and Freddie’s securities. Fannie and Freddie began bond issuance programs (Fannie – Benchmark bond program; Freddie- Reference bond program) to mirror traditional Treasury operations in size and regularity as an alternative benchmark. Given the expected budget deficits in the next few years, resulting in increased issuance of Treasuries, the search for alternative benchmark investments may be lessened.

Foreign investors purchased more bonds issued by GSEs than debt issued by the US government and by US companies

- Foreign investors, for the first time, purchased more bonds issued by US agencies than debt issued by the US government and by US companies. A UBS Warburg report by Ian Douglas found that last year foreign investors continued switching out of equities and corporate bonds and into quasi-government assets. In 2002, net foreign buying of debt issued by US agencies such as Fannie and Freddie reached \$192 billion, exceeding the \$182 billion of demand for corporate bonds for the first time. US agency buying was up 17% from 2001, with demand for corporate bonds down 27%. The report also noted that net demand from non-US investors in 2002 for US equities fell to \$50 billion from \$116 billion in 2001. Net foreign buying of US Treasuries has risen dramatically, however, by 336% to \$83 billion from \$19 billion in 2001. Of this buying, much of the increase came from Asia, with European investors buying less than in 2001. (*Financial Times*, 3/4/03)

GSE long-term debt increases to a record \$1.04 trillion in 2002

- Federal agencies increased long-term new issue volume to a record \$1.04 trillion in 2002, according to a report by the BMA, up 13% percent from the \$921.5 billion in 2001. The spike in issuance activity in 2002 was attributable to increased activity in the home mortgage market. Long-term issuance by all federal agencies increased, with the exception of Fannie and the Tennessee Valley Authority. (*Research Quarterly, Bond Market Association*, 2/2003)

Long-term federal agency debt issuance:

\$ billions	2000	2001	2002	YTD-to-YTD %Change	YTD-to-YTD \$Change
FHLB ¹	190.8	383.0	435.4	13.7%	52.4
Freddie Mac	95.2	235.2	295.5	25.6%	60.3
Fannie Mae	110.2	249.4	238.5	-4.4%	(10.9)
Sallie Mae	16.5	19.5	20.5	5.1%	1.0
Farm Credit System	13.1	31.0	50.1	61.6%	19.1
Tennessee Valley Authority	2.3	3.4	1.5	-55.9%	(1.9)
Totals	428.1	921.5	1,041.5	13.0%	120.0

¹ Percentage and amount change between 12/31/02 and 9/30/02
Source: *Research Quarterly, Bond Market Association*, February 2003

- Short-term federal agency debt outstanding increased to \$668.5 billion as of the end of December, up 5.8% from the \$631.9 billion outstanding at the end of September. However, the volume of debt outstanding decreased 6.9% when compared to the \$718.3 billion outstanding at the end of December 2001. Fannie accounted for most of the increase in short-term outstanding, totaling \$303.8 billion at the end of December, up 18.1% from the \$257.2 billion outstanding at the end of September. (*Research Quarterly, Bond Market Association, February 2003*)

Short-term federal agency debt outstanding:

\$ billions	12/31/01	9/30/02	12/31/02	% Change *	\$Change *
FHLB	139.8	140.1	147.0	4.9%	6.9
Freddie Mac	222.8	172.8	164.1	-5.0%	(8.7)
Fannie Mae	288.5	257.2	303.8	18.1%	46.6
Sallie Mae	31.1	28.7	25.6	-10.8%	(3.1)
Farm Credit System	33.6	29.6	24.8	-16.2%	(4.8)
Tennessee Valley Authority	2.5	3.5	3.2	-8.6%	(0.3)
Totals	718.3	631.9	668.5	5.8%	36.6
* Percentage and amount change between 12/31/02 and 9/30/02					
Source: <i>Research Quarterly, Bond Market Association, February 2003</i>					

- Issuance of agency MBS increased to \$1.46 trillion in 2002, up 33.7% from the \$1.09 trillion issued in 2001. Issuance was particularly strong in the fourth quarter of 2002, totaling \$509.6 billion, up 62.6% from the \$313.5 billion issued in the third quarter of 2002, and up 54% from the \$331.0 issued in the fourth quarter of 2001. Fannie's new issuance totaled \$739.6 billion in 2002, up 40% from the \$528.4 billion issued in 2001. Freddie's new issuance increased 40.4% in 2002, up from the \$389.6 billion issued in 2001. Issuance of Ginnie Mae MBS remained relatively flat, totaling \$174.0 billion in 2002, compared to the \$174.6 billion issued in 2001. (*Research Quarterly, Bond Market Association, February 2003*)
- Issuance of agency collateralized mortgage obligations (CMO) increased to \$540.9 billion in 2002, up 49.3% from the \$362.3 billion issued in 2001. On a quarterly basis, CMO issuance totaled \$171.6 billion in the fourth quarter, up 33.7% from the \$128.3 billion issued in the third quarter, and relatively flat from the \$169.3 billion issued in the fourth quarter of 2001. Freddie's CMO new issue activity totaled \$331.7 billion, up 72.3% from the \$192.5 billion issued last year. Fannie's issuance increased to \$143.9 billion in 2002, up 16.5% from the \$123.5 billion issued in 2001. Ginnie Mae's issuance increased to \$65.3 billion in 2002, up from the \$46.3 billion issued in 2001. However, Ginnie Mae's CMO issuance levels decreased to \$14.7 billion in the fourth quarter of 2002, down 12% from the third quarter of 2002, and down 39.3% from the fourth quarter of 2001. (*Research Quarterly, Bond Market Association, February 2003*)

Fannie & Freddie's callable debt issuance soared in 2002

- *Euroweek* noted that if “there is one phenomenon that defined last year’s agency market,” it was the growth in callable debt issuance. While Fannie and Freddie’s calendar bullet issuance declined, callable volumes soared. In parallel, over 2002 the bullet new issue market decreased, as the two biggest agencies’ calendar sales were generally smaller and buybacks to manage outstanding liabilities became more regular. Freddie started 2002 with an aggressive target of \$50 billion growth in callable debt outstanding and has achieved \$80 billion. In 2001, Fannie issued \$1.76 trillion in short-term debt, and by the end of November 2002 had issued just less than \$1.5 trillion. Its bullet Benchmark Note and Bond issuance had dropped from \$84.75 billion for the whole of 2001 to \$56.75 billion by the end of November, leaving it with only \$8 billion on its calendar for December. Its Callable Benchmark issuance, in contrast, more than doubled from \$10 billion in 2001 to over \$20 billion last year. (*Euroweek*, January 2003)
- In related news, Fannie’s CFO Timothy Howard noted at a Smith Barney conference that callable securities, which “effectively” represent over 50% of Fannie’s debt, have become a “cornerstone” in Fannie’s efforts to get the optionality it needs to manage its portfolio risk in various rate scenarios. (*National Mortgage News*, Bonnie Sinnock, 3/3/03)

Fannie continues to court Asian investors to purchase its debt

- At the end of October 2002, a team at Fannie including Chairman and CEO Franklin Raines and Treasurer Linda Knight chose Hong Kong as the venue to announce Fannie’s benchmark debt calendar for 2003. The reason Fannie picked Hong Kong, amid a four-day investor relations tour that included Singapore, Beijing and Tokyo, is to acknowledge the role Asian investors play in these securities, reported *Asiamoney*. This was Fannie’s 18th annual visit to the region. Asian investors account for 14% of investors in benchmark notes and bonds. Fannie believes that amount should increase. “I think it can only increase, as long as the dollar assets in Asia that are available for investment continue to increase,” said Raines. “There is no sign that is going to stop any time in the near future, and as Asian investors’ portfolio management becomes more sophisticated they will simply move up the scale in the range of securities we offer that they will acquire.” *Asiamoney* noted that central banks are disproportionately the prominent buyers in Asia. Since the available pool of assets is increasing in many markets, such as Taiwan, Korea, Malaysia and Australia, Raines and Knight are considering increasing the scale of their trips to Asia in 2003 or sending the CFO over separately. (*Asiamoney*, December 2002/January 2003)

Fannie Mae

Fannie unveils program to have real estate agents promote Fannie's mortgage products to consumers

- Fannie announced a new program, "Borrow with Confidence" with the Texas Association of Realtors that will educate real estate agents on Fannie's mortgage products. Agents are expected to pass the information on to homebuyers. As an added incentive to realtors, agents will earn state-mandated continuing education credits. Fannie's efforts to promote its seven programs for credit-challenged and cash-strapped buyers it introduced two years ago has been limited in part because some of Fannie's products compete with lenders' products. Fannie officials hope for better success with real estate agents. Several San Antonio agents agreed that they are the logical choice for promoting Fannie's products. Real estate referrals can be tricky. Federal rules prohibit real estate officials from making referrals if they will receive a commission for them. However, HUD officials said February 19 that Fannie's program should avoid legal pitfalls because it is not limited to one lender and will not pay agents for referrals. (*San Antonio Express-News*, Aissatou Sidime, 2/20/03) Fannie held press conferences in San Antonio, Greater El Paso, and Austin to promote the program. (*Fannie press releases*, 1/22/03, 2/18/03, 2/20/03)

Fannie forms partnership with National Association of Real Estate Brokers

- Fannie and NAREB announced a three-year partnership to support NAREB members' activities. As a result of the partnership, Fannie estimates that it will purchase at least \$100 million in mortgages generated by NAREB Realtists through participating lenders. NAREB Realtists will work with Fannie's local partnership offices and Fannie Mae-approved lenders in targeted locations, and will get access to, and training on, Fannie products and technology. In addition, Fannie and NAREB will work together through technology innovations, local housing broker pilots, and other training and outreach efforts. (*Fannie press release*, 2/21/03)

Fannie names new members to its National Advisory Council

- Fannie announced 20 new members to the company's National Advisory Council. Council members meet three times a year with Fannie's senior management to advise the corporation on housing and mortgage finance industry issues and the expansion of homeownership opportunities. The council, formed in 1971, has 46 members, including mortgage bankers; commercial bankers; investment banking executives; real estate agents; home builders; government and community leaders; housing authority officials; and representatives of consumer groups. Council members serve two-year terms, with approximately half of the membership rotating off at the end of each year.
- The Chairman of the 2003 National Advisory Council is Kenneth Koranda, president of Mid America Bank, in Naperville, Illinois. Koranda serves as a member of the Mortgage Bankers

Association's board of directors and its Residential Board of Governors.

The following new members have been appointed to serve on the council until October 2003:

- Gary Acosta, co-founder and president, SDF Realty Inc., San Diego, CA – also serves as vice chairman and CEO of the National Association of Hispanic Real Estate Professionals (NAHREP)
- David W. Bird, president, Heartwell Mortgage, Grand Rapids, MI - started his career at Heartwell in 1972, became president of Heartwell in 1985 and in 1986 he officially became owner of the company. He is the chairman of America's Mortgage Cooperative.
- Suzanne Boas, president, Consumer Credit Counseling Service of Greater Atlanta, Atlanta, GA - currently a member of the board of directors of the Federal Reserve Bank of Atlanta, the board of visitors of Emory University, and a founding board member of the Georgia Consortium for Personal Financial Literacy
- Armand Cosenza Jr., CRMS, secretary/treasurer, Commonwealth Financial Services Inc., Richmond Heights, OH - also president of the National Association of Mortgage Brokers (NAMB)
- Hans Dekker, executive vice president, Baton Rouge Area Foundation, Baton Rouge, LA - leads the nearly \$200 million Foundation's investment in the development of new retail, housing, and economic development projects in downtown Baton Rouge.
- Kenneth Gamble, founder and chairman, Universal Community Homes, Philadelphia, PA - initiated one of the city of Philadelphia's largest community revitalization efforts in its history. Additionally, he has assisted, developed, and founded numerous organizations, including The African American Foundation, Universal Institute, The Universal Community of Truth, and the South Philadelphia Ministries Task Force.
- Robert Griffith, president and CEO, Irwin Mortgage Corporation, Fishers, IN – also a director of the Irwin Financial Foundation and the Indianapolis Neighborhood Housing Partnership.
- Tom Grudnowski, CEO, Fair, Isaac, Minneapolis, MN
- Terry J. Jorde, president and CEO, CountryBank USA, Cando, ND – also active in the Independent Community Bankers Association of America (ICBA), having served on the Executive Committee as treasurer and as chairman of ICBA's Community Banking Network and Agriculture-Rural America Committee. She is past president of the Independent Community Banks of North Dakota and a past member of the Federal Reserve Board Consumer Advisory Council.
- Charles J. Kovaleski, president, Attorneys' Title Insurance Fund, Inc., Orlando, FL – also

currently a member of the board of governors and president-elect of the American Land Title Association

- Dale Leighty, chairman and president, First National Bank of Las Animas, Las Animas, CO – also the current vice chairman of the ICBA, has served on various committees for the ICBA, and is a past president of the Independent Bankers of Colorado.
- Rodrigo López, president, AmeriSphere Multifamily Finance, L.L.C., Omaha, NE – also serves on the board of directors of the Greater Omaha Chamber of Commerce. He is a member of the Commercial/Multifamily Board of Governors of the Mortgage Bankers Association of America and chairs the board's Legislative Committee.
- Al Mansell, CEO, Coldwell Banker Residential Brokerage (formerly Mansell & Associates), Salt Lake City, UT – also the 2003 first vice president of the NATIONAL ASSOCIATION of REALTORS
- Robert F. (Bob) Nielsen, president, Shelter Properties, Inc., Reno, NV – also one of the founders of the Affordable Housing Resource Council
- Doug Paul, vice chairman, Credit Suisse First Boston, New York, NY – also serves as a board member of Credit Suisse First Boston and is chairman of its Global Recruiting Steering Committee
- Michael F. Petrie, CMB, president of P/R Mortgage & Investment Corporation, Indianapolis, IN - currently serves as vice chairman of the Mortgage Bankers Association of America
- Bobby Rayburn, president, Rayburn and Associates, Madison, MS – also the 2003 first vice president of the National Association of Homebuilders (NAHB).
- John S. Skubik, senior vice president, consumer finance, Nationwide
- Genevieve Smith, executive vice president, Home Loans and Insurance Services, Washington Mutual, Emeryville, CA
- Robert Strickland, executive director, Alabama Housing Finance Authority, Montgomery AL - also currently serves as president of the National Council of State Housing Agencies. Additionally, he serves as the public interest director of the Federal Home Loan Bank of Atlanta's board of directors.

Returning members of the National Advisory Council include:

- Jerry Baker, president & chief executive officer, First Horizon Home Loan & Financial Centers, Irving, TX;
- The Honorable Kay Barnes, mayor of Kansas City, MO
- Deborah C. Bochain, executive vice president of personal lending, Liberty Bank,

Middletown, CT

- The Honorable Willie Brown, mayor of San Francisco, CA
- Graham L. Champion, senior vice president & manager of governmental affairs, AmSouth Bank, Montgomery, AL
- C. Kent Conine, president, Conine Residential Group, Frisco, TX
- Robert M. Couch, president & chief executive officer, New South Federal Savings Bank and managing director of Collateral Mortgage, Ltd., Birmingham, AL
- Curt S. Culver, president & chief executive officer, MGIC Investment Corporation, Milwaukee, WI
- Hattie B. Dorsey, president & chief executive officer, Atlanta Neighborhood Development Partnership, Inc., Atlanta, GA
- C. Kendric Fergeson, chairman of the board & chief executive officer, National Bank of Commerce, Altus, OK
- Joseph Haskins Jr., chairman, president, & chief executive officer, Harbor Bankshares Corporation, Baltimore, MD
- Kenneth Koranda, president, Mid America Bank, Naperville, IL
- Chris Lamberti, member of the American Association of Retired Persons (AARP) Board of Directors, Houston, TX
- Edward London, chairman & chief executive officer, EC London and Associates, Atlanta, GA
- Walter T. McDonald, owner/broker, Walt McDonald Real Estate, Riverside, CA
- Michael W. Perry, vice chairman & chief executive officer, IndyMac Bancorp, Inc., Pasadena, CA
- Terry Peterson, chief executive officer, Chicago Housing Authority, Chicago, IL
- Stephen J. Rotella, president & chief executive officer, Chase Manhattan Mortgage Corporation, Edison, NJ
- Bruce Smith, president, Smith Quality Homes, Alamo, CA
- D. Russell Taylor, president & chief executive officer, Rahway Savings Instit., Rahway, NJ
- Gary Thomas, president, RE/MAX Real Estate Services, Aliso Viego, CA
- Frank Torres, III, legislative counsel, Consumers Union, Washington, DC
- David L. Vigen, president & chief executive officer, ESL Federal Credit Union, Rochester, NY
- David Walker, managing director & chief credit officer, Countrywide Credit Industries, Inc., Calabasas, CA
- Mark H. Wright, president & chief executive officer, USAA Federal Savings Bank, San Antonio, TX
- James E. Young, president & chief executive officer, Citizens Trust Bank of Atlanta, Atlanta, GA (*Fannie press release, 3/4/03*)

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 51 Partnership Offices open across the country

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

Fannie has 51 partnership offices

- According to Fannie’s Web site, the company has 51 partnership offices open across the country (http://www.fanniemae.com/contact/partnership_offices.html) 3/6/03).

Fannie held press opportunities with the following officials:

- (1) Senator Max Baucus (D-MT), Missoula, MT Mayor Mike Kadas (*Fannie press release*, 2/19/03)
- (2) Congressman Rick Renzi (R-AZ) and Phoenix Mayor Skip Rimsza (*PR Newswire*, 2/18/03)
- (3) Congressman Charles Gonzalez (D-TX) (*Fannie press release*, 2/18/03)
- (4) Congressman Artur Davis (D-AL) (*Fannie press release*, 2/18/03)
- (5) Denver, CO Mayor Wellington Webb and City Councilwoman Happy Haynes (*Fannie press release*, 2/13/03)
- (6) Senator Kent Conrad (D-ND) and Fargo City Commissioner Thomas Lane (*Fannie press release*, 2/10/03)
- (7) Senator Jon Corzine (D-NJ); Congressman Donald Payne (D-NJ); and East Orange, NJ Mayor Robert Bowsver (*Fannie press release*, 2/3/03)
- (8) Congressman Phil English (R-PA) (*Fannie press release*, 1/31/03)
- (9) Miami-Dade County Commission Chair Dr. Barbara Carey-Shuler and Miami-Dade County Commissioner Betty Ferguson (*Fannie press release*, 1/31/03)
- (10) San Diego City Councilman Scott Peters (*Fannie press release*, 1/29/03)
- (11) Texas State Senator Royce West (D-23rd) Austin Mayor Pro Tem Jackie Goodman (*Fannie press release*, 1/22/03)
- (12) Congressman Mike Doyle (D-PA) (*Fannie press release*, 1/17/03)
- (13) Minneapolis, MN Mayor R.T. Rybak (*Fannie press release*, 1/9/03)
- (14) Congressman Earl Pomeroy (D-ND) and North Dakota Lieutenant Governor Jack Dalrymple (*Fannie press release*, 12/17/02)
- (15) DC Mayor Anthony Williams and Councilmember Sharon Ambrose (*Fannie press release*, 12/17/02)
- (16) Congressman John Dingell (D-MI), Ypsilanti, MI Pro Tem Mayor S.A. Trudy Swanson, and Ann Arbor Mayor John Hieftje (*Fannie press release*, 12/16/02)
- (17) Congressman Collin Peterson (D-MN) (*Fannie press release*, 12/16/02)
- (18) Jacksonville, NC Mayor Elise Smith and Millie Lilley, District Director for Congressman Walter Jones (R-NC) (*Fannie press release*, 12/12/02)
- (19) Kansas City, MO Mayor Kay Barnes and Independence, MO Mayor Ron Stewart (*Fannie*

- press release, 12/11/02)*
- (20) West Palm Beach, FL Mayor Joel Daves (*Fannie press release, 12/11/02*)
 - (21) Selma, AL Mayor James Perkins (*Fannie press release, 12/10/02*)
 - (22) Congresswoman Julia Carson (D-IN), Indianapolis Mayor Bart Peterson, Indianapolis Deputy Mayor Carolyn Coleman, and Peoria, IL Mayor David Ransburg (*Fannie press release, 12/4/02*)
 - (23) Ohio State Senator-Elect Ray Miller (D-OH) (*Fannie press release, 12/3/02*)

Freddie Mac

Freddie seems to be more conservative than Fannie

- In a recent article in *Mortgage Servicing News*, Ted Cornwell noted that Freddie seems to be more conservative than Fannie. Cornwell noted that while Fannie was “taking some heat” for their negative duration gap last fall, Freddie’s duration gap was nearly zero. Cornwell added that Freddie’s duration gap remained close to that level throughout the year, despite lower interest rates. Freddie also reported record earnings for 2002. However, Cornwell noted that Freddie’s new accountant PriceWaterhouseCoopers is requiring Freddie to restate earnings for past periods to reflect the timing of gains and the purchase of treasury securities. [For more information, see the February 4, 2003 issue of the *GSE Report*, www.gsereport.com]
- The earnings restatement may have put a “damper on investor enthusiasm,” noted Cromwell. However Freddie’s CEO Leland Brendsel assured investors that the company’s business practices were safe and strong. Cromwell added that the “numbers suggest he is right. Not only did Freddie report record earnings, but its measures of interest rate risk reveal an institution that is well insulated from potential shocks in the interest rate environment.” (*Mortgage Servicing News*, Ted Cornwell, 2/14/03)

Federal Home Loan Banks

Regulatory relief bill to contain provision allowing privately insured credit unions to become FHLBank members

- House Financial Services Committee Chairman Michael Oxley (R-OH) and Senate Banking Committee member Wayne Allard (R-CO) told the Credit Union National Association that they support including provisions in regulatory relief legislation that would allow certain privately insured credit unions to become FHLBank members if they meet certain eligibility requirements. The Senate Banking and House Financial Services Committees are expected to consider regulatory relief legislation this year. The two Members were speaking February 25 at a Credit Union National Association governmental affairs conference. (*American Banker*, Michele Heller, 2/26/03) 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. [See July 19, 2002 *GSE Report* for more information, www.gsereport.com]

- Currently, privately insured credit unions are excluded from FHLBank membership. The National Credit Union Administration insures nearly 97% of the country's 10,079 credit unions. Private insurers cover most of the other 240, primarily American Share Insurance in Dublin, OH. Less than 10% of federally insured credit unions have actually joined a FHLBank. (*American Banker*, Laura Thompson, 5/8/02)

Three FHLBanks purchase \$17.2 billion through MPP program, a competitor to Fannie & Freddie in the secondary mortgage market

- The three FHLBanks participating in the FHLBank System's Mortgage Purchase Program (MPP) – the FHLBanks of Seattle, Cincinnati, and Indianapolis - purchased \$17.2 billion of single-family loans from member banks and thrifts in 2002. The Atlanta FHLBank is waiting for regulatory approval to offer the MPP program. (*National Mortgage News*, 3/3/03)

Postal Service

House and Senate Committees approve bills reducing the Postal Service's payment to the Civil Service Retirement (CSRS) fund

Postal Service is pleased

- The Senate Governmental Affairs Committee approved March 5 by voice vote a bill (S 380) that would reduce the Postal Service's payments to the CSRS fund that pay its retirees by \$2.9 billion in FY 2003 and another \$2.8 billion in FY 2004. The bill, introduced February 12 by Senators Susan Collins (R-ME), Tom Carper (D-DE), and Sam Brownback (R-KS), would require the Postal Service to use the savings from the reduction to pay down its \$11 billion debt to the Treasury Department in FY 2003, 2004, and 2005 and to continue to fund retiree health costs. Beyond 2005, the postal service and the Office of Personnel Management (OPM) would be required to calculate the difference in the cost to fund CSRS under the bill and the cost under the existing law. This amount would be held in escrow until Congress decided what to do with the money. (*DM News*, Melissa Campanelli, 3/6/03; *CQ Daily Monitor*, Kelly Field, 3/5/03) Chairman Collins noted that the reduction in payments to the CSRS fund should head off expected postal rate increases until at least 2006. (*CQ Daily Monitor*, Kelly Field, 3/5/03)
- An amendment offered by Senate Governmental Affairs Committee Chairman Collins, and approved by voice vote, would also require the Postal Service to submit to Congress and the General Accounting Office (GAO) a report outlining how it would apply future savings. (*CQ*

Daily Monitor, Kelly Field, 3/5/03)

- The House Committee on Governmental Reform approved unanimously a similar bill (HR 735) on March 6. Representatives John McHugh (R-NY), Henry Waxman (D-CA), Tom Davis (R-VA), and Danny Davis (D-IL) introduced the bill. One difference between the two bills is that the Senate bill requires the Postal Service to report to Congress on how it intends to use any savings before filing rate increases. (*DM News*, Melissa Campanelli, 3/7/03)
- “This is very good news for the mailing community,” said Bob McLean, executive director of the Mailers Council. “Both markups went very smoothly.” He is optimistic that the bills will move to the House and Senate floors in a few weeks, adding that HR 735 has 20 co-sponsors so far, while S 380 has 14 co-sponsors. But because the bills differ slightly, he said, “we are headed to a conference committee, which [is] oftentimes time consuming to schedule.” (*DM News*, Melissa Campanelli, 3/7/03)

Bills prompted by OPM and GAO reports

- The bills were prompted by reports by the OPM and GAO, which found that the Postal Service had overpaid the CSRS fund. The Postal Service, however, cannot reduce its payments to the CSRS fund without approval from Congress. The GAO report released January 31 found that the Postal Service overpaid the CSRS fund even more than it had originally calculated. The GAO examined the November 2002 OPM’s analysis and concluded that OPM’s analysis underestimated the overfunding, in part because the OPM included costs for military service of Postal Service employees. The GAO estimated the Postal Service’s projected overpayment would total \$103.1 billion versus the over \$70 billion the OPM initially projected. The GAO said Congress should determine whether some of the projected surplus should be used to pay the Postal Service’s \$11.1 billion debt and address its \$40 to \$50 billion in unfunded health obligations for retirees. (*GAO Report: “Review of OPM Analysis of USPS Costs,”* GAO-03-448R, 1/31/03; *GovExec.com*, Matthew Weinstock, 1/31/03; *Washington Post*, Christopher Lee, 2/1/03)

Postal Service’s comments

- The Postal Service said March 6 that it “is pleased that legislation to correct the Civil Service Retirement System (CSRS) fund overpayment matter has been voted out of the appropriate committees in both the House and Senate with strong bipartisan support. Full Congressional consideration and passage of this bill is important to any business that uses the mail. It will keep the Postal Service from overpaying into the Civil Service Retirement System, thereby allowing postage rates to remain unchanged until 2006. Stable postage rates will be a big boost for the bottom line of businesses that depend on the mail. That’s why over 100 companies and organizations in the mailing industry have voiced their support for this legislation. Without this needed legislation, postal ratepayers would ultimately be forced to overpay into CSRS by \$78 billion. This would needlessly inflate the price of postage and put the Postal Service’s financial future at risk. We are hopeful that Congress will pass this legislation.” (*Postal Service press release*, 3/6/03)

House Government Reform Committee creates special postal reform panel

- Congressman John McHugh (R-NY) has been tapped by Government Reform Committee Chairman Tom Davis (R-VA) to head the Committee's Special Panel on Postal Reform and Oversight for the 108th Congress. Other Committee Members appointed to the panel are: Reps. Edward L. Schrock (R-VA); Candice Miller (R-MI), Tim Murphy (R-PA), William Janklow (R-SD); Danny K. Davis (D-IL), Major R. Owens (D-NY); Carolyn Maloney (D-NY); and Wm. Lacy Clay (D-MO).
- The panel will work closely with the nine-member Presidential Postal Reform Commission President Bush appointed in December to study the future of the postal industry and help the Postal Service control consumer rates, operating costs and job cuts, and to help ensure universal service. (*Congressman McHugh press release, 2/28/03*)

American Enterprise Institute forms Postal Reform Initiative – plans to hold March 17 conference

- 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. The AEI project will focus on the potential of modern communications technology and a more open and competitive market environment to solve the problems with the US postal industry, and it will review the experiences of other countries that have enacted postal reform in recent years.
- The March 17 opening session of the AEI Postal Service Initiative will suggest key objectives that the President's Postal Reform Commission should strive for and how those objectives can be realized. Discussion will focus on the industry as a whole. The objectives for postal reform established at this conference will form a framework for the entire series. Future conferences will address competition issues arising in postal reform and the Postal Service's mission in the context of its universal service obligation.
- The March 17 conference agenda follows:

9:00 a.m.	Registration
9:30	Speakers: Rick Geddes, Cornell University Maurice McTigue, George Mason University John Panzar, Northwestern University
	Moderator: J. Gregory Sidak, AEI
10:30	Open discussion

11:30

Adjournment

- You may register online at www.aei.org/events (*AEI Announcement of March 17 conference, "What Should the Goals of Postal Reform Be?"*)

Presidential Postal Reform Commission establishes March 13 deadline for rebuttal to public comments that have been already submitted to the Commission on postal reform

Commission to hold March 18 field hearing

- The Presidential Postal Reform Commission announced that March 13 would be the deadline for rebuttal to written comments on postal reform already submitted to the Commission. The Commission received written comments from 250 organizations, companies, government officials, and individuals by its February 12 filing deadline. Most of these comments are now posted on the Commission's Web site at <http://www.treas.gov/offices/domestic-finance/usps>.
- The Commission noted that rebuttal comments should clearly indicate the specific assertion or recommendation that is being challenged as well as the party that had advanced this assertion or recommendation in its public comment. The Commission also announced specific methods in which to submit rebuttal comments. (*Federal Register*, page 10068, 3/3/03; *DM News*, Melissa Campanelli, 3/4/03)
- The Presidential Postal Reform Commission plans to hold its next meeting March 18 in Austin, TX. The Commission plans to examine: (1) the impact of the electronic diversion of First-Class letter mail; (2) the automation and other technologies currently utilized by the USPS; and (3) potential opportunities for business growth that may be available as a result of technological innovations. Witnesses will testify at the invitation of the Commission. The Technologies Challenges and Opportunities Subcommittee will also report to the Commission. (*Federal Register*, 3/4/03; pages 10309-10310) Other upcoming field hearings include: April 4 in Los Angeles and April 29 in Chicago. (*DM News*, Melissa Campanelli, 2/21/03)

Congressional Research Service publishes two reports on the Postal Service

- CRS has published a February 25 issue brief for Congress on recent matters pertaining to postal reform, and a February 25 second brief pertaining to the Postal Service's funding of CSRS. Copies of both briefs have been posted on the PostCom Web site, www.postcom.org (*PostCom Web site*, 2/27/03)

GAO revisits postal information technology center closing

- Postal Service employees at the San Mateo, CA Information Technology Center anticipate a loss in wages or possible family separations if the center is closed to save costs, according to a GAO report. Before making the final decision to close the center, which employs 243 people, the GAO recommended that the Postal Service update the analyses on the closing to reflect changes in job availability in the three years since they were performed. The Postal Service should also consider helping union employees who choose not to relocate. “In 2000, USPS’ economic analyses included an assumption – and San Mateo employees believed – that local jobs would be available for those who did not want to relocate,” the report said. “However, local postal jobs are no longer available, and nonpostal IT job opportunities have tightened considerably in the Bay area.” Closing the San Mateo IT center would save the Postal Service \$74 million over the next 10 years, postal officials said. (*FCW.com*, Sara Michael, 3/5/03) House Governmental Affairs Committee Ranking Minority Member Henry Waxman and Reps. Chaka Fattah and Tom Lantos requested the report. (*GAO Report: Postal Service: Employee Issues Associated with the Potential Closure of the San Mateo IT Center*, GAO-03-205, January 2003)

March 10, 2003

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