February 3, 2003

The GSE REPORT ™

www.gsereport.com

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Major Events

Treasury, OFHEO and SEC recommend Fannie & Freddie
provide more information on their MBS

- The Treasury Department, OFHEO, and the SEC February 3 issued a joint report on disclosure practices in the mortgage-backed securities (MBS) market, which recommended that Fannie and Freddie provide additional pool-level disclosures on the MBS they sell to investors. The additional disclosures recommended include: loan purpose; original loan-to-value ratios; standardized credit scores of borrowers; servicer information; occupancy status; and property type. The report noted that these additional disclosures would benefit the MBS market, and found that the "benefits of enhanced transparency would ultimately outweigh any costs." The report found no evidence to substantiate allegations that Fannie and Freddie were "cherry picking" the best loans by using non-public information for their respective portfolios.

- Last July, a voluntary financial disclosure agreement was reached among Fannie, Freddie, the SEC, OFHEO, and Treasury, in which Fannie and Freddie agreed to voluntarily register their common stock and file quarterly and annual reports with the SEC, while remaining exempt from registering their debt and MBS with the SEC. Treasury, OFHEO, and SEC agreed to conduct a joint report on MBS disclosure practices to promote a more level-playing field with respect to initial offering disclosures between GSEs and non-GSE MBS issuers.

- On the day the joint report was issued, Fannie and Freddie both pledged to voluntarily increase their MBS disclosures beyond what the joint Treasury-OFHEO-SEC report recommended and announced that they would begin providing the six additional kinds of disclosures recommended by the joint report. [Editorial note: More information on the joint report and Fannie and Freddie's announcement will be included in the next *GSE Report*.]

Freddie Mac Restates Earnings

OFHEO contemplates Freddie capital retest

- Freddie Mac's announcement January 22nd to restate at least two years of earnings (for 2002, 2001 and possibly 2000) because of a change in the accounting of certain derivatives transactions has heightened concerns over the agency. Shares of Freddie tumbled after the announcement, falling $2.30 to close at $61.60, a 3.5% drop. Freddie also announced the delay of issuance of a set of euro-denominated bonds until after it published unaudited figures for 2002 on January 27th, saying it expected those figures to show record earnings. Standard & Poor's Ratings Service affirmed all of its ratings on Freddie in light of the announcement: "the 'AAA/A-1+' unsecured senior debt ratings on Freddie Mac reflect the implied U.S. government support for the securities of this government-sponsored enterprise (GSE), as elaborated in its charter and governing legislation. The 'AA-' subordinated debt, preferred stock, and risk-to-the-government ratings are based on an analysis that considers the

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company's financial strength and the operating benefits it receives as a GSE."

- As a result of Freddie's actions, OFHEO is considering retesting Freddie's capital adequacy for the 3rd quarter using the new numbers, according to OFHEO spokeswoman Stefanie Mullin. The accounting move, prompted after Freddie's new auditor, PricewaterhouseCoopers LLC (PWC), raised objections to the way the company had been recording income for certain types of hedging instruments under the advice of now defunct Arthur Andersen, could also draw interest from the SEC which was recently handed new enforcement authority over Freddie and Fannie Mae. Freddie's accounting adjustment should bolster the company's earnings as well as its performance under OFHEO's risk-based capital test, according to the company and OFHEO. Freddie spokeswoman Sharon McHale said the higher earnings in 2001 and 2002 will likely translate into a slower growth rate for 2003, but would not impact the company's credit rating or interest-rate risk position.

- Industry observers claim this latest development is sure to re-ignite debate in Congress and elsewhere about the quality of the company's financial disclosures. Some lawmakers have been skeptical about how Freddie and Fannie account for their derivatives transactions, including last year's reclassification of a combined $210 billion in mortgage-backed securities during the 3rd quarter, dramatically changing the reported value of those assets under FAS 133 (new derivatives reporting rules adopted by the Financial Accounting Standards Board in January, 2001).

- Freddie's McHale says that with regard to recording income for certain types of hedging instruments, "It's not a question of malfeasance or integrity, it really is a question of interpretation." PWC is completing a new audit of Freddie's financial statements, which should be finished in the 2nd quarter. Seeking to distance itself from its mortgage counterpart, Fannie Mae said its auditor, KPMG LLP, approved of its accounting treatment of derivatives. Fannie relies far less on hedging than does Freddie. (*Dow Jones Newswires*, Dawn Kopecki, 1/23/03, *The Financial Times*, Vincent Boland, 1/23/03, *Reuters*, 1/22/03, *Market News International, Inc*., 1/22/03, and *The Washington Post*, Jackie Spinner, 1/23/03)

Fannie's profits take a dive in 4th quarter

- Fannie Mae's fourth-quarter profits dropped sharply, nearly 52% from those of a year ago (although operating earnings increased), bringing its net income to $4.62 billion ($4.53 per share) for the year, down 21.6% from $5.89 billion ($5.72 per share) in 2001. The company said its earnings were battered by accounting losses on derivative securities purchased to hedge interest rate risk.

- The results ended a 15-year string of record earnings under generally accepted accounting principles (GAAP) for the GSE. Income for the 4th quarter totaled $952 million ($.94 per share), down 51.7% from $1.97 billion ($1.92 per share) in the 4th quarter of 2001. However, net income includes the variability in the market value of purchased options and options

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embedded in callable debt, so the GSE said its management uses operating net income figures as the “primary performance measures” for the company.

- Operating net income totaled $6.39 billion ($6.31 per share) for the year, up 19.1% from $5.37 billion ($5.20 per share) in 2001, and $1.67 billion ($1.66 per share) for the quarter, up 16.3% from $1.44 billion ($1.40 per share) a year ago. Fannie’s CEO Franklin Raines, said that, “In an extremely difficult business environment that affected virtually every company in America, Fannie Mae’s operating results in 2002 were among the best in the company’s history.” Chief Financial Officer Timothy Howard said the company is comfortable with Wall Street’s estimates of 12–13% growth in operating earnings this year. (*The Washington Post*, 1/16/03)

- Favorable margins and a strong business environment, however, boosted operating income. Fannie executives say the writedown in the “time value of purchased options” is of little consequence, since Fannie plans to hold the assets until maturity and will not realize the losses. The company’s “mark-to-market” losses on its purchased options used to hedge interest rate risk jumped by $4.53 billion last year, including $1.88 billion in the 4th quarter alone, doing little to dampen enthusiasm by investors and analysts, who focused instead on strong underlying business trends at the GSE. Under Generally Accepted Accounting Principles, net income in 2002 was $4.62 billion, down from $6.39 billion in 2001 because of the mark-to-market loss on hedging instruments.

- One analyst suggested accounting rules should be amended to allow companies like Fannie that hold assets to maturity, to amortize derivatives used for hedging over time rather than marking them to market quarterly and pointing out that Fannie, if it doesn’t aggressively hedge, faces criticism for letting the duration between their assets and liabilities expand, and if it does aggressively hedge, new accounting rules force it to mark-to-market hedging instruments, which can eat up income as reported on a GAAP basis even though losses are unrealized. Fannie remains confident about its prospects for this year. Chief Financial Officer Tim Howard said the current analyst consensus of growth in the range of 12-13% in operating earnings per share “appears to be a reasonable centering point at this time.” He did not set a target for portfolio growth, but said a “reasonable expectation” might be somewhere in the mid-teens this year. (*National Mortgage News*, Ted Cornwell, 1/20/03)

OFHEO chief sounds alarm bell over Fannie’s investment portfolio, interest rate risk

- Armando Falcon, OFHEO’s director, in a speech delivered at Washington, D.C.’s Exchequer Club, a group of financial services executives and lobbyists, on January 15th, noted that Fannie and Freddie’s mortgage holdings had grown seven times to $1.3 trillion since 1992, he warned that “Managing the interest rate risk of these portfolios is a significant undertaking.” The OFHEO is releasing a report next month on Fannie and Freddie and systemic risk. The two largest mortgage buyers have tripled the volume of their outstanding mortgages to more than $3 trillion over the past decade. Falcon hit upon the essence of the problem, i.e. the more mortgages the two lenders own, the greater their demand for financial

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instruments designed to protect themselves against the potential losses from holding the mortgages. For example, if Fannie has borrowed at 5% to buy mortgages yielding 8%, it makes a profit on the difference. But if millions of borrowers decide to prepay their mortgages and take out new ones at 7%, Fannie loses some of its margin. That's why Fannie uses flexible debt issues and financial instruments called options, among other things, to protect its profits.

> "The perception of an implicit federal guarantee lowers the yields that investors require on Fannie Mae and Freddie Mac debt and MBS (mortgage-backed securities), and leads market participants to set less stringent limits on their credit exposures to each enterprise." Falcon explained that as a result, they "can issue much larger volumes of securities, without the necessity of obtaining private credit ratings on an issue-by-issue basis. " The perception "allows them to sell a much larger proportion of callable debt than private firms with comparable capital, and avoid the need to post collateral on derivatives transactions. Materially higher risk is unlikely to raise the borrowing costs of either enterprise to the same extent as it would in the absence of that perception."

- Falcon suggested the GSEs' spectacular growth was attributable in a large way to the "substantial benefits" they received from the federal government, and that the benefits of this relationship had lowered the operating costs of Fannie and Freddie by nearly $11 billion in 2000, according to a calculation by the Congressional Budget Office (CBO). Fannie's estimate, he said, of how much it saved was between $3 and 4 billion.

- Falcon notes that the two lenders have so far managed to find counterparties with which to enter a sufficient amount of options contracts, but he adds, "As Fannie and Freddie continue to grow, finding additional volumes of new options could be challenging." Falcon observed that Fannie and Freddie have become so large that when they try to do a big transaction in the market, they move prices materially, which can prevent them from achieving the original purpose of the maneuver. Refraining from mentioning Fannie, Falcon commented that recent attempts by the institution to rebalance its assets and liabilities had the "potential to move interest rates further in the direction of the changes that caused the need for rebalancing in the first place."

- Falcon said that controlling risk was one of six government expectations Fannie and Freddie must satisfy if they are to continue to enjoy federal subsidies, and argued that the GSEs are "…expected to maintain a conservative approach to risk management" and that, "It is neither in the public nor the shareholders' interests to put short-term gain ahead of long-term viability." Bank regulators have played a large role in changing what they didn't like over the past 18 months, and analysts wonder how long Fannie and Freddie can stay immune. Falcon did not shed light on how the OFHEO will minimize the systemic risk in the financial sector stemming from Fannie and Freddie's "preternatural growth over the past two decades." He did say his agency could stop Fannie or Freddie from offering a service or product if it deems the move a "threat to safety or soundness."

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- The OFHEO director also said the automated underwriting systems both companies have deployed has supplanted others that were developed by major financial institutions which may have been more innovative or beneficial. Fannie declined comment on the speech; Freddie spokeswoman Sharon McHale said Falcon "mischaracterized competition in the market," noting that the banks the GSEs compete with also get government support in the form of deposit insurance. (*TheStreet.com*, Peter Eavis, 1/15/03 *Bloomberg News*, 1/15/03, *The Financial Times*, Vincent Boland, 1/16/03, *National Mortgage News*, 1/20/03, and *The American Banker*, Barbara Rehm, 1/16/03)

OFHEO announces final rulemaking to amend risk-based capital regulation

- The OFHEO sent to the Federal Register a final rule amending OFHEO's risk-based capital regulation. The risk-based capital regulation currently incorporates Financial Accounting Standard 133 (FAS-133), but this amendment, which will be published in the Federal Register in approximately 2 weeks, more accurately incorporates and implements FAS-133 in the stress test and is intended to enhance the accuracy of the calculation of the risk-based requirement for the GSEs. (*OFHEO News Release*, 1/24/03)

Rep. Baker sees Freddie's earnings restatement as important, unsettling

- Rep. Richard Baker (R-LA), chairman of the House Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, responded in a press release to Freddie's announcement of the need to restate earnings for the past two years:

- "After two days of careful consideration, I have concluded, like OFHEO, that Freddie's announcement represents an 'important development,' but one that unfortunately also raises certain unsettling questions…I too wish to state openly that I agree it would be appropriate for OFHEO to run the test for the 3rd quarter again, provided that OFHEO also address several potential concerns before that test proceeds."

- Citing the unique extensive use of derivatives by Fannie and Freddie to hedge interest rate risk exposure, Rep. Baker contends, "…the issue for Freddie Mac is whether certain derivatives should be classified as assets rather than hedges for income-recognition purposes. This accounting treatment will obviously impact not only Freddie's earnings but its capital adequacy. I would question how a different FAS 133 interpretation could result in both higher earnings and a larger capital surplus over the same time period, and I hope OFHEO will assist in explaining this to the public.

- Baker also argues that given news report suggesting Fannie Mae and its accountant do not have a similar disagreement over FAS 133, it begs the question of whether there is consistency between how the two enterprises account for their derivatives use. If OFHEO is not requiring this accounting to be conducted and reported the same way for both enterprises,

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once it does, should the agency consider rerunning the test for Fannie as well? Baker concludes, "…I hope to make sense of this succession of events: OFHEO proposed a FAS 133-related change to the test; OFHEO ran the test without the change finalized; Freddie Mac announced FAS 133-related earnings restatements; OFHEO said it's mulling rerunning the test; OMB then cleared the FAS 133-related change. The coincidence of these developments leads me to believe that Congress will indeed have a lot to think about and discuss this year with regards to the GSEs and the competency of regulatory oversight." (*Press release from Richard H. Baker*, 1/24/03)

Rep. Baker may introduce GSE legislation this year, addresses Financial Services Roundtable

- Rep. Richard Baker (R-LA), chair of the House Financial Services Capital Market Subcommittee, said on January 29th that he was unlikely to introduce legislation to rein in the GSEs, but he subsequently amended his statement, saying legislation wouldn't be "the first order of business," according to his spokesman. Baker stated he hopes the Bush Administration, in particular, the OFHEO and the Treasury Department, will provide recommendations as to how best regulate Fannie and Freddie to ensure taxpayers are adequately protected should the bottom ever drop out of the mortgage securitization business. Baker vowed it has "never been my interest" to create investor doubt about the GSEs, which he said are healthy businesses. He added that he believes having both houses of Congress under Republican Party control boosts chances of toughening oversight of the mortgage giants.

- The Louisiana Congressman held a dozen hearings on the GSEs two years ago, with a concomitant seesaw impact on Freddie/Fannie stocks. Baker said that only two hearings in the last session of Congress should not be seen as any lack of interest on his part. Baker advocates moving OFHEO to the Treasury Department, removed from the annual appropriations process, and would give it more bank regulator-type powers to examine the GSEs for safety and soundness. Baker noted that Treasury, scheduled to issue recommendations on the GSEs last year, was delayed in its efforts due to Paul O'Neill's departure as Secretary.

- Former Assistant Treasury Secretary for Financial Institutions, Sheila Bair, speaking at a panel discussion on the GSEs sponsored by the Financial Services Roundtable, urged the GSEs be privatized. The government, noted Bair, has been a "victim of its own success" in promoting the GSEs to inject capital into the U.S. housing market, and has created an "unhealthy concentration" of interest rate risk. Bair described a regulatory bias prompting the rapid growth of the GSEs because OFHEO lacks authority and HUD "abdicated" its responsibility to oversee the GSEs. Bair agreed with Rep. Baker that OFHEO should be moved to Treasury.

- FM Watch, a group opposed to the GSEs, with members that compete with Fannie and Freddie, asked Federal Reserve Chairman Alan Greenspan, to ensure the GSEs maintain an

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adequate capital structure. FM Watch Director Mike House wrote to Chairman Greenspan, "Since OFHEO isn't up to the job and is the most surprised of all each time the GSEs have a new public revelation, we are respectfully requesting that the Fed advise the president and Congress of the steps that need to be taken to limit GSE risk and force them to hold bank-like capital…No change in law is needed to stop the flawed OFHEO capital rules and substitute them with standards comparable to those governing large, complex banks with comparable risk—only a change in policy is needed." (*Bureau of National Affairs*, Regulation and Law, 1/30/03 and *National Mortgage News*, 1/30/03 and *Reuters*, Mark Felsenthal, 1/29/03, *Dow Jones News Wire*, Dawn Kopecki, 1/29/03)

Financial Services Roundtable Holds Capitol Hill Forum on GSEs

- On January 29, 2003 the Financial Services Roundtable held a Capitol Hill briefing to announce the findings of a new report published by Tom Stanton entitled, "*On Shaky Ground: The Relentless Expansion of Fannie Mae and Freddie Mac in the US Housing Finance System*." The briefing was well attended by Capitol Hill staff, press and representatives of the financial services industry. In addition to Stanton, Congressman Richard Baker (R-LA); Sheila Bair, former Assistant Treasury Secretary for Financial Institutions; and Larry White, Professor of Economics at New York University's Stern School of Business spoke at the event.

- **Steve Bartlett**, the President & CEO of Financial Services Roundtable (FSR) introduced the panelists and offered brief remarks about the intent of Stanton's paper. Bartlett noted that the FSR's Anthony T. Cluff Research Fund funded the paper. It is not necessarily the viewpoint of all 100 members of FSR. The FSR has also enjoyed a close working relationship with Fannie Mae and Freddie Mac. Bartlett said that FSR asked Stanton to write a paper that would both review the current and future state of the GSEs, as well as to summarize policy options available to Congress to stabilize the GSEs. Bartlett added that this paper reflects many ideas and issues that have been reported in the past. However, this is the first time that all solutions are presented in one place. Bartlett concluded by noting that FSR offers the solutions in the "sprit of cooperation."

- **Congressman Richard Baker** (R-LA), the chairman of the House Financial Services Subcommittee on Government Sponsored Enterprises was somewhat of a surprise guest. He was not on the agenda, but spoke for a few minutes about his views on the GSEs and his hopes for the coming Congress, as well as answered questions from the audience. Baker noted that he has seen some progress with the GSEs, including their "involuntary agreement" of October 2000 where the GSEs agreed to submit to several risk-management tests. Other positive steps include the finalization of the OFHEO stress test. Baker said that even though his subcommittee had only two hearings on the GSEs in 2002, it does not mean that the issue is not important. He has several areas of concern, including the number of commercial banks that hold GSE debt. Fannie Mae's recent negative duration gap was also troubling to Baker, particularly the fact that Fannie's solution to the problem was to buy more mortgages and increase their size. Baker also stressed the need for transparency and said he was "troubled"

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with OFHEO's recent changes to the GSEs' stress test. A major priority this session will be to remove OFHEO from the appropriations process and to give the regulator the proper authority it needs. Regarding his subcommittee, Baker said he is not certain of the membership, but he assumes Cong. Kanjorski (D-PA) will still be the ranking member.

- In a brief question and answer session, Baker was asked if he plans on introducing any legislation on the GSEs. Baker said that he has no timeline, but would like to see a professional discussion and conclusion to many of the problems with the GSEs. Baker was also asked if there were any non-legislative solutions to strengthen regulation of the GSEs. He noted that he had hoped to receive a policy statement from former Treasury Secretary O'Neill. Since that is not going to happen, he expressed hope that the new Treasury officials will issue a statement on where the Administration stands. Baker was then asked if he had been in contact with Senate Banking Committee chairman Richard Shelby (R-AL). Baker replied that he had been in contact with Chairman Shelby and his counterpart on the Senate Banking Committee, Senator Enzi (R-WY) and both conversations were very positive. Baker also hopes that the Leadership of the House and Senate will look at the GSE issue this session. Finally, Baker was asked about his thoughts on the new FHLB Shared Funding Plan. Baker said he had not looked at it in great detail, but hopes to learn more about it.

- **Tom Stanton** summarized his paper by noting that the GSEs are "fascinating institutions." The US has the best housing finance system in the world, but it is changing rapidly. Vulnerabilities have sprung up which need to be dealt with – including the GSEs' continual expansion. Fannie and Freddie have managed to double in size every five years – from $37.3 billion in mortgage holdings and MBS outstanding in 1975 to over $2.3 trillion today. Stanton said that the GSEs are a public policy concern because they are privately owned institutions that deliver a public service. In the markets the GSEs are treated as having the perception of an implied government guaranty. This means taxpayers would shoulder the burden if either were to fail. In addition, the GSEs have a tax and regulatory advantages over their counterparts in the private market. The GSEs' capital requirements are one third of other financial institutions. Since they have lower capital requirements, it is natural for mortgages to move into the GSEs, creating a system where the mortgages migrate into the place with the lowest capital, and also creating a system where the government is picking the winners, not the market. Federal Reserve Chairman Greenspan called this type of financial activity "regulatory arbitrage."

- Stanton noted that the regulator of the Fannie and Freddie is not effective. HUD is the GSEs' mission regulator and is supposed to give approval of any new programs. However, HUD seems to have given up. OFHEO has not been very effective either, added Stanton. Stanton noted that the regulators are a prime example of 'Stanton's Law" where "risk will migrate to the place where the government is least equipped to deal with it." However, some positive moves have been taken by the Federal Reserve, which has said that the GSEs pose a "significant financial risk." The Fed has begun to study the GSEs in greater detail.

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- Stanton outlined 6 options for solving the various issues connected to the GSEs:

    1. Improve federal supervision of the GSEs – including removing OFHEO from the appropriations process, and moving OFHEO to a stronger place, such as Treasury.
    2. Impose statutory limits on GSE expansion, such as portfolio limits.
    3. Regulate the GSEs as public utilities.
    4. Create competition from other secondary market institutions.
    5. Chartering competing GSEs, and
    6. Privatizing the GSEs.

- The next panelist, former Treasury official **Sheila Bair** said that she was not aiming to bash Fannie and Freddie – they are simply the victims of their own success. The GSEs' regulators are a problem – HUD is a bad safety and soundness regulator and OFHEO does not have enough power. Bair advocates moving OFHEO to the Treasury Department, since it has experience, creativity and money. A move into a strong regulator such as Treasury would also help shield the GSEs from their constant examinations in the public arena. While there has been some talk about moving OFHEO to OTS, Treasury would be the better option, noted Bair. Regarding Stanton's solutions, Bair said she is opposed to the option of chartering multiple competing GSEs. Privatization is the best solution, if it is done long-term. The government does not need to create more subsidies. Bair also expressed concern about the FHLB System, particularly their multi-district membership plan that seems like an attempt to create more dominant national institutions. Bair said she is of the opinion that the FHLB program is illegal and against their statute. The FHLBs do not have the same "bells and whistles" that the GSEs do and do not have a strong regulator. Bair concluded by reiterating that privatization is the only true solution.

- Economist **Larry White** began his presentation by noting that he is a former FHLBB director and in that capacity also served on the board of Freddie Mac in the mid-1980s. White said he had two main points. The first is that housing is vitally important. If Congress really wanted to advocate housing, they should change make it an on-budget priority. Instead, Congress uses broad-based approaches such as tax breaks that help people that are buying 5-bedroom homes and second and third residences. White said that his second point is that Fannie and Freddie have several advantages and several limitations. The GSEs are growing both vertically and horizontally. The GSEs are inching closer to originating loans. White concluded by noting that the only true solution is to privatize the GSEs – thereby removing the taxpayers from the equation. Then Congress should act by replacing the GSEs with explicit on-budget programs.

- A Q&A session followed the presentations. Highlights include:

    - A member from the audience asked what happens when (not if) the housing bubble bursts. **White** expressed disbelief that the housing market would fail. **Stanton** said that the problem is that OFHEO has a stress test, but the GSEs have such political power that the Congress enacted a test that is not truly representative of such a loss.

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Fannie and Freddie could fail way before their stress test indicates them failing.

- John Butler of the House Financial Services Committee asked if the Treasury Dept. would be issuing a GSE policy statement. **Bair** said she was unsure. Since there is a new Secretary coming in, Treasury is likely to focus on that and on advancing the President's Economic Plan.
- Todd Harper of Cong. Kanjorski's office said that both his boss and Cong. Baker are in agreement that OFHEO should be removed from the appropriations process. What is the FSR's position? **Bartlett** replied that FSR strongly supports a single regulator and will push for that in Congress. FSR also is in favor of taking OFHEO out of the appropriations process.
- A staffer for Maxine Waters (D, CA) asked about the FSR member-companies' commitment to affordable housing. Last year, Franklin Raines, CEO of Fannie Mae, pledged $700 billion. Would FSR's companies do this? **Bartlett** said yes – they do provide that kind of assistance and would be happy to sit down and show her the numbers. **Stanton** said that there is much evidence that shows Fannie and Freddie lag the market on providing low-income loans.
- Another member from the audience then said that the GSEs lag the market because they are not in the subprime market, not originating loans. **Stanton** said that is not the case – since the GSEs are so large they can adjust the prices they pay for low-income loans.
- Another member from the audience then said that this would be a case of the GSEs not able to enter the subprime market – if they are lagging the market; it is because they cannot buy subprime loans. **Stanton** said that therein lies the problem – the GSEs are a tool of government and have services to provide-- yet they also have a fiduciary responsibility to serve their shareholders first. This is why government-sponsored enterprises are not an ideal tool for implementing government policy. The GSEs should reserve more capital if they buy subprime loans and, if allowed, their entry in to the subprime market should be directed to only those consumers who are in need of a subsidy.
- A member from the audience asked about the FHLBs – are they a good solution when they do not even have the same regulation as the GSEs? **Stanton** said that the FHLBs are not necessarily his preferred solution – he was listing it as one option. Stanton said he has some concerns about the FHLBs, but he wasn't asked to write a paper on the FHLBs. The forum then concluded. (*Financial Services Roundtable Forum*; 1/29/03)

FM Watch urges Greenspan, Shelby and Oxley to review GSE risk profiles

- FM Watch, in letters to key Capitol Hill legislators, also appealed to Congress to begin a complete and thorough review of the GSEs' current risk profile. Mike House, FM Watch Executive Director, in an appeal to Federal Reserve Chairman Greenspan, Chairman Richard Shelby of the Senate Banking Committee and Chairman Michael Oxley of the House Financial Services Committee, said "Someone needs to mind this store or taxpayers will face a bailout that will dwarf the $250 billion spent during the S&L crisis." FM Watch's letters

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ask why the GSEs derive most of their profit from risky derivatives bets, not from promoting affordable housing? Congress, the advocacy group asserts, did not give them a more than $10 billion annual subsidy, to operate like unregulated hedge funds. Freddie's and Fannie's vulnerability to derivatives results from the fact that they derive the majority of their earnings from holding huge portfolios of mortgage assets instead of conducting the true secondary market activity for which Congress chartered them.

- Freddie's January 22nd announcement, House continues, that it might have to restate its earnings for 2002, 2001 and possibly the year 2000 as well, and Fannie's jump in interest-rate risk last year clearly demonstrate the need for enhanced Congressional scrutiny. House faulted OFHEO director Falcon for concurring precipitously with Freddie's assertion that the restatement would presumably result in an increase in the GSE's regulatory capital surplus. The assertion, House contends, was made without full knowledge, given that Freddie Mac officials were quoted as continuing to disagree with some of the restatement decisions of their accountant, and could ask the SEC to offer clarification.

- OFHEO is the only financial industry regulator in the U.S. and abroad which permits derivative-based hedges in a positive position to be treated under a risk-based rule as the functional equivalent of common stock and real contributions from shareholders willing to put their money behind management's risk-taking. What, he asks, is OFHEO doing to curb this interest-rate risk volatility? House's letter recommends that OFHEO undergo fundamental reform, starting with "a complete rewrite of the RBC (risk-based capital) rule to ensure that capital requirements comparable to those that have proven their value at large banks similarly govern Fannie Mae and Freddie Mac." (*FM Watch Press Release*, 1/30/03)

OFHEO announces March 10 symposium on house prices, U.S. economy

- The OFHEO will hold a symposium, "House Prices in the U.S. economy" on March 10, with speakers to include HUD Secretary Mel Martinez, Council of Economic Advisors, Glenn Hubbard, and the President of the Federal Reserve Bank of St. Louis, William Poole. Armando Falcon, Jr. of OFHEO is also a speaker, along with Barbara Miles of the Congressional Research Service, Susan Wachter, Professor at the University of Pennsylvania's Wharton School, the chief economists for Fannie and Freddie, the chief economists for the Mortgage Bankers Association and the National Association of Home Builders, and numerous other industry experts. (*OFHEO News Release*, 1/30/03)

Home loan heads reject filing request, conflict erupts between Korsmo, bank presidents

- The growing tense relations between the Federal Home Loan Banks and their chief regulator broke into open conflict on January 15 when the 12 banks' presidents refused to provide draft financial reports that would resemble public company filings. John Korsmo, chairman of the Federal Housing Finance Board, had requested two days earlier that bank officials provide drafts in preparation for possible registration of their capital stock with the SEC. Korsmo

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sent an email to the presidents summarizing a January 9th meeting between SEC staff, Finance Board Counsel Thomas D. Casey, and the banks' representatives.

- In his email, Korsmo wrote that the SEC is "ready and willing" to agree to voluntary stock registration and to meet with the banks and their Office of Finance. The banks are unified in their opposition to voluntary registration, claiming such a move could harm them and is unnecessary for cooperatives that do not sell shares to the public. Korsmo's email said that the SEC was prepared to make "significant accommodations" to minimize any potential disruption, and that an SEC staff member had assured them the agency is not seeking debt registration. "Critical steps must still be taken before registration can be accomplished," Korsmo wrote, asking the presidents to assist by having their staffs draft 10-K filings, based on actual 2002 data, "as quickly as practicable."

- In an email to Korsmo, written on behalf of all 12 bank presidents, the President of the New York Home Loan Bank, Alfred DelliBovi, denied the request, challenged most of Korsmo's characterizations of the meeting, and indicated the bank presidents felt the board misled them. He added that the SEC staff had indicated that, if the Home Loan banks registered their stock, the system's debt securities would come under the SEC's purview as well—an eventuality that is anathema to the banks, and that the Finance Board publicly said was off the table.

- DelliBovi wrote: "The SEC said that its primary interest in the FHLBanks would be the regulation of the disclosures that accompany the debt securities of the system, because they are sold to the public, as opposed to the cooperative stock of the FHLBanks, which is owned by the financial institution members of the FHLBank System and not traded." He also noted that recent agreements between the SEC and Fannie Mae and Freddie Mac had not included any sort of registration of the two housing GSE's debt offerings. The Home Loan bank presidents have decided to undertake a study of the potential implications of registering their stock.

- DelliBovi also said, "The information communicated by the SEC suggests that the intense efforts, resources, and time that we have dedicated to studying disclosure issues over the last six months have been, in part, misdirected…If the FHLBanks must make a determination of whether they wish to volunteer to have their debt securities registered with the SEC while those of their GSE competitors are not, it creates an entirely new set of issues for the FHLBanks and, we trust, the FHFB to evaluate. He indicated that Korsmo's requested 10-K filings would not be forthcoming: "We suggest that there is little benefit at this time to creating draft 10-Ks until this work is complete…At the appropriate time, we will be happy to furnish draft 10-Ks to the FHFB to assist it in its continuing role as the regulatory entity with principal jurisdiction over such filings."

- A press release issued by the Board on Monday quoted Korsmo: "It seems to me the banks are not well-served by continuing to attack illusory targets, as Mr. DelliBovi's letter clearly does. Neither I nor the SEC has ever suggested registration of bank system debt offerings...My goal has always been to develop a method of disclosure that best informs and

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serves the interests of the taxpayers who stand behind the Federal Home Loan Bank System," pointing out that, "The Banks' resistance to this goal is mystifying, disappointing, and frankly, wrong-headed." (*The American Banker*, Rob Garver, 1/16/03)

Fannie Mae and Freddie Mac

CBO issues verdict on capital adequacy, stress test for Fannie, Freddie

- In a January 3rd letter to then Senate Banking Chairman Paul Sarbanes (D-MD), Dan Crippen, Director of the Congressional Budget Office (CBO), reported on the GSEs in response to the requirement by Congress that CBO comment on "the advisability and appropriate form" of one of the many specific features of the stress test used to develop a measure of capital adequacy for Fannie Mae and Freddie Mac." The law also mandated a report on the legislated assumption that the GSEs would not conduct new business under a period of financial stress. The CBO report makes no recommendations, and says "most of the issues considered seem to argue for retaining the current assumption rather than attempting to model the potential effects of new business on the enterprises' capital requirements." (*Congressional Budget Office* press release, 1/14/03, from Bloomberg.com)

Bush Admin. vetting former bank exec to succeed OFHEO's Armando Falcon, Jr.

- Sources say Mark C. Brickell, a former J.P. Morgan Chase & Co. managing director, has been nominated for the OFHEO job, one of the few still held by a Clinton appointee, Armando Falcon, Jr. as the Bush Administration nears the end of its second year in office. Brickell is currently chief executive officer of Blackbird Holdings, Inc., a New-York based firm that runs an online market for swaps and other private negotiated derivatives. He spent 25 years with J.P. Morgan Chase for before joining the firm in 2001 and is a former chairman of the International Swaps and Derivatives Association. Observers claim Brickell's expertise in the derivatives market makes him a good fit at OFHEO, charged with oversight of the safety and soundness of the mortgage market giants Fannie Mae and Freddie Mac. The GSEs make extensive use of derivatives to manage the risk in their mortgage portfolios.

- Falcon was confirmed by the Senate in 1999, and is serving a term that expires late next year. Falcon is expected to resign if asked to do so. Falcon took over an agency widely faulted for its failure for years to produce a capital standard for Fannie and Freddie. Two years later, OFHEO issued such a rule, which was officially applied to the GSEs' balance sheets for the first time in the 3rd quarter of last year. Widely praised for spurring OFHEO to finish the capital rule, Falcon has battled Rep. Richard Baker (R-LA) head of the House Financial Services Committee's capital markets subcommittee, who has been sharply critical of OFHEO's oversight of the GSEs. (*The American Banker*, Rob Garver, 1/17/03)

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Treasury Assistant Secretary comments on OFHEO's role, GSEs
Pat Cave to depart as Treasury point person on Fannie/Freddie

- Wayne Abernathy, former Republican staff director for the Senate Banking Committee, and newly at Treasury as Assistant Secretary for Financial Institutions, said Fannie Mae and Freddie Mac should not be considered as monopoly businesses even though they dominate their part of the housing market. The real concern is whether they are within their charter limits or not. Abernathy noted that specific regulators are on the front lines as monitors, and "Our job is to keep an eye on those regulators." He declined to comment on the performance of the Department of Housing and Urban Development (HUD) which oversees Fannie and Freddie's mission, but about the OFHEO, the financial regulator for the GSEs, he said, there were "no warning flags that I'd mention, just the continual concern of are they doing their job, do they have the resources, are they institutionally able to do what they do…We ask that about the major bank regulators. I think we ask that of ourselves."

- OFHEO, according to Abernathy, should be evaluated on the basis of its current potential to be effective, not its past performance. He claimed that there had been debate since OFHEO was created about "…whether or not they're up to the job." Abernathy said Treasury has not reached any conclusions on OFHEO's effectiveness or the regulatory structure in general. About the GSEs, Abernathy volunteered that based on the recent government capital adequacy tests, "They're extremely well-run companies." (*Dow Jones Newswire*, 1/16/03 and *Reuters*, 1/15/03)

Pat Cave to depart as Treasury point person on Fannie/Freddie

- Pat Cave submitted his resignation, announced on Wednesday, January 15th, as deputy assistant secretary for financial institutions and policy on government-sponsored enterprises (GSEs). He joined Treasury on January 15, 2002, after seven years on the staff of Rep. Richard Baker (R-LA), a vocal critic of the GSEs. Cave's last day on the job will be February 10th and he is joining the private sector, seeing a lull before the new Congress as an appropriate time to leave public service, according to his acquaintances. Cave reported to the new Assistant Secretary for Financial Institutions, Wayne Abernathy. (*Reuters*, 1/15/03)

Mortgage lenders push to rollback Georgia predatory lending law; Fannie & Freddie to stay in Georgia market
Minority bankers group sues to block Georgia law

- The predatory lending law has forced 26 lenders to bail out of Georgia, including OptionOne, a national company specializing in high-cost loans to people with credit problems, as well as several moderate-size lenders. There were reports that two of the biggest buyers of Georgia mortgages, Fannie Mae and Freddie Mac, could follow suit, driving up interest rates for credit-worthy borrowers. Janice Daue, vice president of public affairs at Fannie, rebutted the

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reports: "That's a rumor that's false…Fannie Mae is still purchasing loans in Georgia. That also includes the purchase of 'covered' home loans under the lending act, as long as they are not high-cost loans." Freddie Mac bought 92,343 Georgia mortgages valued at $12.4 billion in 2001, the latest figures available. Bob Long, legislative director of the Georgia Association of Mortgage Brokers, said lender flight could make it hard for would-be homeowners to find competitive loans, warning that, "If Freddie Mac and Fannie Mae pull out of the market, there is no money." He added that the likelihood of the GSEs pulling out was slim because the legislature would have the good sense to change the law.

- On January 22nd, the U.S. Office of Thrift Supervision, which regulates savings and loans in Georgia, exempted the institutions from key provisions of the measure. Last year, the National Credit Union Administration exempted nationally chartered credit unions operating in the state. Lenders say the availability of residential home loans in Georgia could shrink by as much as half unless the predatory lending law is revised or repealed. The opponents of the predatory lending law gained momentum when Standards & Poor's said it would not rate bonds backed by mortgages covered by the act starting on February 1, which is expected to result in other banks exiting the state. (*The Atlanta Journal and Constitution*, Ernest Holsendolph, Robert Luke, 1/23/03 and *The Associated Press*, 1/23/03)

Minority bankers group sues to block Georgia predatory lending law

- The National Minority Mortgage Bankers Association is suing to block Georgia's predatory lending law, saying it will hurt those it means to protect, primarily the poor and minorities. The political and financial storm that has enveloped Georgia may spread to New York, where controversial anti-predatory lending legislation may soon go into effect, perhaps in mid-February. Similar to the Georgia law in how it assigns liability, the New York City ordinance goes one step further. If the bank or underwriter or other parties involved in the loan have violated the ordinance, they will be banned from contracting with city agencies. Anti-predatory lending legislation is also pending in New Jersey. In Georgia, state legislators will not be able to approve changes in the law before Standard and Poor's credit rating agency says it will stop rating bonds backed by Georgia mortgages affected by the law. There would be no limit to how much could be collected in a class-action civil lawsuit if a loan is found to be predatory, leaving S&P officials with no way to quantify the risk involved in possible punitive damages from a borrower lawsuit, and therefore, they cannot rate securities including any loans governed by the Georgia Fair Lending Act. There have already been reports of removal of Georgia-originated loans from pending transactions in the secondary market. (Harry Weber, *Associated Press,* 1/29/03)

Fannie and Freddie cap some mortgage bond issuance

- Fannie Mae and Freddie Mac this month capped creation of certain mortgage bonds for the 4th consecutive month, a sign of the turmoil caused by historically low mortgage rates. The limits imposed by the mortgage giants come simultaneously with a massive home refinancing wave prompted by record low rates. A survey by the Mortgage Bankers Association (MBA) found refinancings jumped nearly 200% from a year ago and accounted for an estimated 8 of

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every 10 loans processed. The magnitude of the refi wave has swamped lenders with applications and slowed the entire loan process, creating a shortage of some mortgage bonds.

- Freddie and Fannie limited the production of these complex securities because lenders are not able to process the underlying loans quickly enough. The agencies told Reuters they had enacted the limits. The simplest of these bonds, known as pass-throughs, are backed by home loans and are used to create complex bonds known as collateralized mortgage obligations (CMOs) and Remics (real estate mortgage investment conduits). Fannie and Freddie capped creation of Remics backed by 15-year 5% securities backed by pass-throughs for February delivery and 30-year 5-1/2 percents backed by pass-throughs, also for February delivery.

- Freddie said, "In our judgment, the strong demand for REMIC securities utilizing these coupons made the possibility of a 'squeeze' or difficulty to deliver mortgage-backed securities in to the REMIC commitment a possibility…Since Freddie Mac has a strong desire to preserve liquidity in the mortgage pass-through market, we made the decision to temporarily suspend additional securitization activity." Evidence of the hot demand for these securities has been seen in the dollar roll market, where the 30-year 5-1/2% and 15-year 5% have been in short supply. (*Reuters*, Aleksandrs Rozen, 1/17/03)

President's tax plan seen as benefiting Freddie, Fannie

- President Bush's plans to eliminate the federal income tax on corporate dividends, the so-called "double taxation of dividends" would in principle, reduce the capital gains taxes on investments in profitable, tax-paying companies that steadily build up their retained earnings. If they also pay a nice dividend, so much the better—stockholders would qualify for both tax breaks. No companies fit that description better than Fannie and Freddie which have both been stellar long-term investments, and would be even more appealing under the plan proposed by the Bush Administration. Though Fannie Mae is often criticized for not paying D.C. taxes, its profits are taxed at the federal level, as are Freddie's.

- Friedman, Billings, Ramsey's senior analyst, Paul Miller, noted, "Fannie and Freddie look very attractive…If my crystal ball told me this was going to pass tomorrow, I would be talking these stocks up a lot." Fannie pays a quarterly dividend of 33 cents per share, which comes to a 1.9% annual yield based on January 10th's closing price of $68.65. Freddie pays 22 cents a share quarterly, a 1.4% yield with the stock selling at $63.20. Miller said both have a lot of retained earnings, and while they do pay dividends, they have very low payout ratios compared with total profits, adding, "They could easily ramp up their dividends and their stock would really move" if the President's plan is enacted. (*The Washington Post*, Jerry Knight, 1/13/03)

Freddie, Fannie break purchase records

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- Freddie acquired $91.22 billion in home mortgages during December, yet another record month for the secondary market giant. Freddie bought a record $642.3 billion in product, a 35% increase from the 2001 level. Fannie bought $1.09 trillion in mortgages last year, also a record. Together, Fannie and Freddie bought about $1.7 trillion in product, meaning the two consumed 65% of all loans originated in 2002, a market share number based on an estimated $2.6 trillion in mortgage production. (*National Mortgage News*, 1/27/03)

Fannie Mae

Fannie Duration Gap widens

- Fannie's duration gap, a measure of how well cash flows from assets and liabilities match up, widened during December to negative five months from positive two months in November. November's positive gap was the first positive reading since March 2002 and was considered an accomplishment given that the widely watched gap was negative 10 months back in September and a market, rattling, negative 14-month in August, its largest gap ever. Fannie spokeswoman Janis Smith said, "The duration gap moved back into negative territory, but continued to be within Fannie Mae's target range," which is negative-six to plus-six months. Smith pointed out that the yield on 10-year Treasury notes fell over 39 basis points from November 30, '02 to December 31, '02, a move driving mortgage rates lower and fueling waves of homeowner refinancings. As a result, mortgages were coming off Fannie's books at a rapid pace, shortening the duration of its asset portfolio and turning its duration gap negative. But new mortgages were also being created, which were available for Fannie to purchase.

- Agency market players largely shrugged off the Fannie Mae seven-month leap between November and December, becoming more comfortable with Fannie's ability to handle interest rate risk. Fannie said it bought nearly $68 billion in mortgage loans during December, $20 billion more than in November. For the year, its portfolio, which totaled $790.8 billion, grew at a rate of 11.9%, slower than 2001's 15.9%. For all of 2002, it bought $370 billion in mortgage assets, a major increase from $270.6 billion the previous year, and Fannie predicted, "Future portfolio growth should continue to be strong." (*Dow Jones Newswire,* Julie Haviv, 1/16/03 and *Reuters*, Richard Leong, 1/15/03)

Fannie receives a 9 rating from S&P

- Fannie Mae was given corporate governance rating of 9 from Standard & Poor's, with the system ranging from 1 to 10. The strong rating, the first corporate governance score to a U.S. company, comes amidst a week of attacks on Fannie and Freddie from FM Watch and the Financial Services Roundtable. S&P said Fannie scored "strongly" or "very strongly" in four key areas: financial transparency and information disclosure; ownership structure and

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influence; shareholder rights; and, board structure and process. It said Fannie's voluntary disclosures to the SEC generally meet and in some cases, exceed those of SEC-registered peers.

- Andrea Esposito, Managing Director for Governance Services at S&P's in New York, said, "This score marks an important development in bringing greater transparency about corporate governance to U.S. investors…In the wake of last year's governance breakdowns, investors are recognizing increasingly that corporate governance is an important risk factor, and are demanding higher governance standards and the ability to have a clearer understanding of the relative strengths and weakness of individual companies' governance practices. By being the first US company to publish its governance score from Standard and Poor's, Fannie Mae is not only demonstrating its own strong governance practices, but is also showing leadership in the US with regard to providing greater openness and disclosure about its corporate governance standards." (*National Mortgage News*, 1/30/03 and *PR Newswire,* 1/30/03*)*

Raines interviewed by CNBC on 4th quarter results, SEC disclosure

- Franklin Raines, Fannie Mae's Chairman and CEO, was asked by CNBC about pro forma versus GAAP numbers. Raines explains there's a simple difference, "…and that is a couple of years ago GAAP included something called FAS 13, which was a treatment for certain kinds of options that we use that requires that they be treated as though you realized gains or losses on them, even though you haven't sold them. And so now the GAAP numbers have this number that keeps moving back and forth, whereas the numbers that we use and the numbers our analysts use, the numbers we've been reporting over the last 15 years are much more consistent with the operating income. So you to (sic) pay attention to both of these numbers, but the ones that management uses to run the company and that outsiders use to analyze us are the operating income."

- On Raines' opposition to the reporting of GAAP, Raines said, "we're not opposed to reporting…we agree with the SEC that the investors ought to have a view of how management looks at the company. And that's what pro forma earnings are supposed to be…in the end, we're going to be very happy with how the SEC comes out on this." Raines added that Fannie doesn't see a bubble in housing country wide, but noted some areas with weakness and delinquencies rising in the Midwest, and the Southwest. He said he expects housing prices to rise, but not as fast as they rose last year. (*CNBC/Dow Jones Business Video*, Liz Claman, anchor, 1/15/03)

Raines predicts housing shortage

- Fannie Mae chairman Franklin Raines says the talk about a housing price bubble is nothing but hot air, expressing concern over the country's housing supply. "If supply falls too far behind demand, we could wind up with a widespread housing affordability crunch or even a national housing crisis," Raines told the National Association of Home Builders' Executive

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Board during their annual International Builders Show. Raines said the "one major caveat" with regard to Fannie's American Dream Decade is a lack of new and affordable homes for people to purchase and predicted a widening gap between housing "haves" and "have nots." Land constraints and growth restrictions, he warned, will mean builders having a hard time erecting the 1.6 million new homes needed each year until the end of the decade to meet the projected growth in households. He cited the lack of buildable land as the "biggest constraint on housing today" and noted the cost of land going up in every place where growth control measures restrict development, from California to North Carolina.

- Raines also pointed out that the strong housing demand would help Fannie continue to provide the low-risk growth of its business model, and offered a four-part Housing Affordability Action Plan to avert the crisis:

  - <u>"Smart" smart growth policies that promote, not prevent, the expansion of affordable housing</u>, calling for communities to plan for and accommodate their anticipated growth in activity, population and housing demand, and harness creative land use strategies, and that Fannie's position it to promote, not prevent expansion of affordable housing;

  - <u>Strong national policies for affordable housing</u>, citing the Bush Administration's $200 million per year for downpayment assistance, increased access to home buyer education, and a proposed housing tax credit to boost production of 200,000 affordable homes, as a great example of positive national policy;

  - <u>Harness the power of unity in the housing and mortgage finance industries</u>, urging those who sell, build and finance homes to continue working together to protect and defend the nation's housing system, and recognizing the growing role of disparate groups such as the Homeownership Alliance, with membership including bankers, insurance agents, realtors, and housing and consumer advocates. (Raines applauded the NAHB for playing a strong central role in the Homeownership Alliance.) (*National Mortgage News Daily*, 1/21/03 and *Fannie Mae press release*, 1/18/03)

Raines to communicate in person through the Internet

- Fannie Mae Chairman, Franklin Raines, will begin answering questions personally on the company's web site in mid-February to help investors better understand its finances. Raines complains that critics and some analysts and media outlets fail to understand Fannie's interest rate risk and have made wrong assumptions about Fannie's financial health. Raines does not know the name for the page on the web site that will feature him, but said some variation of "Answers from the CEO," which will feature his voice addressing some of the most common questions posed to him. Raines said, "We want to answer questions directly, not filtered through (the media) or anyone else." (*Bloomberg News,* 1/30/03)

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Mortgages can be customized, says Raines

- Fannie Mae's Chairman, Franklin Raines, told investors he wants to shift from the view that mortgages are a commodity toward the idea that loan-products can be custom-made. Raines, during a webcast from Salomon Smith Barney's financial services conference, said the GSE has about $1.4 billion in guarantee fees from up-front payments Fannie charges to offset the higher risk of newer products the company is offering in pursuit of that customization goal, characterizing these loans as part of the alternative-A credit risk market. *(National Mortgage News*, 1/30/03*)*

Fannie and First Horizon announce new $40 billion 5-year lending initiative expansion

- Fannie and First Horizon Home Loan Corporation announced the expansion of First Horizon's Home on the Horizon (SM) affordable lending initiative, setting a more ambitious $40 billion nationwide goal, designed to provide affordable mortgage financing to thousands more families over the next five years, including a specific $10 billion goal to help more minority borrowers purchase homes. Since June, 2001, Home on the Horizon, headquartered in Irving Texas, has reached an initial $10 billion goal and helped more than 59,000 low and moderate income families and 16,000 minority families of all income levels achieve the dream of homeownership. The partnership between Fannie and Horizon has permitted many low-income families utilizing Fannie Mae's MyCommunityMortgage ™, a set of mortgage options offering borrowers living in underserved communities and earning up to 100% of the area media income low-cost financing with down payments as low as $500 or 1% of the home purchase price, generous debt-to-icome ratios and significant credit flexibilities. First Horizon currently is Fannie's number one originator of MyCommunityMortgage, having delivered more than $159 million in loans in 2002. (*Business Wire*, 1/13/03)

Fannie partners with J.P. Morgan Chase Bank for East Harlem project

- Fannie, J.P. Morgan Chase Bank agree to credit enhance $44 million in tax-exempt bonds issued by the New York City Development Corp., for development of a 231-unit apartment building in East Harlem. Fannie executives described as "no small task" to constitute such a complex transaction for the "first time in New York." J.P. Morgan Chase has provided the construction loan enhancement, while Fannie arranged the long-term credit enhancement. "Middle income housing" is a new HDC program for mixed-use, mixed-income rental housing operated in cooperation with the New York City Department of Housing Preservation and Development, who sold the land site to the developer. HPD requires that once property is resold, "the difference between the appraised value and the one-dollar amount will be repaid to New York City." Forty-seven units will be available to low-income households that earn no more than 50% of the area median income at $31,400, another 63 units are reserved for middle-income households earning up to 250% of area median income

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at $157,000 and the remaining 121 units will be rented at market prices. The building will include retail space at street level, a community facility, parking, a fitness center and a roof-deck with the same services as nearby luxury buildings. (*National Mortgage News*, 1/20/03)

WAMU, Fannie link up in home-lending accord

- Washington Mutual entered into an agreement with Fannie to boost home lending by $85 billion over 5 years to minorities and low and moderate income families. The Seattle-based thrift will begin by focusing on Los Angeles and Dallas. Under the program, Washington Mutual will originate the loans and sell them to Fannie Mae. The $85 billion is part of the $375 billion the thrift pledged to lend in September, 2001, over a 10-year period to low and moderate income communities, the largest commitment of its kind by a financial institution. (*The Seattle Post-Intelligencer*, 1/29/03)

GMAC commercial mortgage affordable housing division arranges Fannie credit enhancement

- GMACCM AHD (GMAC Commercial Mortgage Affordable Housing Division) announced it has arranged a Fannie Mae credit enhancement for $67,500,000 of tax-exempt and $3,000,000 of taxable variable rate bonds. The bonds were issued by the Association of Bay Area Governments to finance construction of The Crossings—a 446-unit multifamily housing project located in San Bruno, California. The financing was the largest single multifamily tax-exempt bond issuance in California for 2002. Steve Fayne, managing director of GMACCM AHD, said, "GMACCM AHD was able to come up with a unique structure to provide for an earnout of additional loan proceeds which had not before been utilized in a Fannie Mae tax exempt bond structure." In 2003, GMAC hopes to become Fannie Mae's leading provider of affordable housing finance under the Delegated Underwriting and Servicing (DUS) program. (*Business Wire*, 1/13/03)

HomeStreet Capital Names Colliers Cauble & Co. as correspondent for Fannie's DUS

- Colliers Cauble will represent HomeStreet Capital's multifamily financing, through the Fannie Mae Delegated Underwriting and Servicing (DUS) multifamily product line in Georgia, Alabama, Tennessee and South Carolina. Dick Cardwell, President of Colliers Cauble, announced, "We are flattered to be associated with HomeStreet Capital…the Fannie Mae DUS products will allow us to better serve our customers in the southeast, offering them a wider and very attractive range of options." HomeStreet Capital, headquartered in Seattle, has been providing loans for multifamily and commercial real estate products in the Pacific Northwest since 1921 and offers services and loans for permanent, construction, bridge, forward, renovation and refinancing of income property through a wide range of loan programs, including Fannie Mae. (*Bloomberg.com*, 1/15/03)

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Fannie courts multifamily sellers but small banks balk

- Fannie says it is ready to spend tens of billions of dollars over the next 8 years on small multifamily loans, but is having trouble finding banks willing to sell. Fannie's senior vice president for multifamily business, Richard Lawch, said the GSE is still looking for partners in such markets as Minneapolis, Detroit, Boston, Atlanta, San Francisco, Washington, and Miami. Since March 2000, when the 10-year effort to increase housing options for the poor and minorities began, Fannie has bought about $7 billion of such loans, each worth $3 million or less. Purchase volume is not the problem, because participants include two behemoths, Bank One Corp. of Chicago and Washington Mutual Inc. of Seattle. Where the shortage of lenders has been felt is in distribution of those purchases. They are concentrated in Chicago and L.A., where Washington Mutual is a big multifamily player, as well as in New York, home to one of the few participating community banks, $8 billion-asset Independence Community Bank.

- Fannie added another community bank last month, when $2.5 billion asset Dime Community Bancshares Inc. agreed to sell $200 million of multifamily loans over the next 18 months, but that will not widen the geographic network since Dime is also based in New York. $3.5 billion-asset Anchor Bancorp, Inc. of Madison, Wisconsin, and $3.5 billion-asset First Interstate Bancsystem Inc. in Billings, Montana have agreed to sell to the GSE.

- Fannie is asking its multifamily partners to originate some longer-term, fixed rate credits. That might move the dynamics of the multifamily market away from the short-term (typically five years) floating-rate deals that bankers prefer. Some critics have condemned Fannie for pumping too much liquidity into the rental housing market and encouraging over-construction. The GSE says it bought $8.7 billion of multifamily loans during the first 6 months of last year, but most of that money was spent on large projects. Only $1 billion went toward small loans. (*American Banker*, John Reosti, 1/13/03)

Bank of America severs alliance with Fannie Mae

- Bank of America Corporation, the third-biggest U.S. bank, ended its three and a half year arrangement to sell home mortgages to Fannie Mae, the *American Banker* reported. The Charlotte, N.C.-based company terminated the alliance as part of its strategy to reduce paperwork for customers applying for home loans, according to the bank's president of consumer real estate, Kevin Shannon, who said the bank could advance its strategy better in an open and competitive market. Bank of America intends to sell loans to a variety of players, including less to Freddie Mac. The firm is the fourth-largest retail originator of home loans and hopes to become the biggest in the U.S., according to the newspaper. (*Bloomberg News*, Chris Burritt, 1/29/03)

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Fannie's callable bonds gain market interest

- Interest in Fannie's callable debt is growing, with the biggest accounts beginning to get involved, says Beth Hammack, the head of agency debt at Goldman Sachs Group Inc. From July 2001 to November 2002, the GSE sold $30.3 billion of its large, benchmark callable-note issues, which form the basis of most secondary-market trading. Three years ago, Linda Knight, treasurer of Fannie Mae, began looking for a way to increase use of callable debt, recognizing the importance of callable debt to Fannie's hedging strategy. She collaborated with Bloomberg LP and TradeWeb LLC, the largest online bond-trading platforms, to create standards for pricing Fannie's callable debt, with the result a function on Bloomberg terminals that incorporates TradeWeb's government bond prices, current Fannie yield curves, and real-time changes in market volatility. Before Fannie issues callable debt, Ms. Knight's staff calculates a likely price level and spread. Wall Street underwriters use that data to develop their own models and present the offering to their customers. After receiving feedback on what investors think of the deal, Ms. Knight and staff review printouts showing different scenarios and then set the bond issue's final price and structure.

- Last year, Fannie took advantage of falling rates with its callable debt. Its ability to call bonds helped it weather the impact of the fastest quarterly interest rate drop in 2 decades, said one analyst. Fannie sold about $130 billion of callable debt issues in the first 11 months of last year, almost 6 times as much as it sold in all of 2000. About 25% of the benchmark issues have been sold in Asia. (*American Banker*, 1/14/03)

Fannie extends funding desk hours

- Fannie announced it will extend its funding desk hours to enable international investors to execute new long-term debt securities through dealer underwriters on a real-time basis that is more closely aligned with their own trading hours. Under the new schedule, Fannie will open its funding desk at 5 a.m. EST to execute long-term debt securities transactions. The extended funding desk hours will take effect January 27th and will be conducted as a six-month pilot. (*National Mortgage News*, 1/14/03)

Fannie ranks 5th among top 30 companies for executive women

- Fannie Mae ranked fifth in 2003 among the Top 30 companies in the U.S. for affording women the best opportunity for success, according to the National Association for Female Executives (NAFE), the largest women's professional and business association nation-wide, founded in 1977. Maria Johnson, vice president of Fannie for diversity, health and worklife initiatives, said, "Our success is part of a commitment to diversity that Fannie Mae made back in the 1980s…As a result, women make up 51% of Fannie Mae's work force, and almost 43% of its management group." The list, which ranks publicly held Fortune 100 companies with at least 2 women on the board of directors and a significant percentage in

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senior management, found Fannie a place offering growth and advancement, and a work culture where female executives can prosper, yet attain work-life balance. (*Fannie Mae News Release*, 1/29/03)

Fannie reaches $1.09 trillion in home mortgage acquisitions in 2002

- Fannie's acquisition in 2002 of a record $1.09 trillion in home mortgages is almost as much as the entire industry originated in the year 2000, thanks to a stellar refinancing and purchase money market, and a record year for originations. Fannie's loan acquisitions soared by 60% in 2002 and its MBS issuance came close to the three-quarters of $1 trillion mark ($723 billion). Its business volume in 2002 was $848 billion, a 37% gain from the previous year. The net yield on the company's massive $790 billion portfolio now stands at just 5.42%, which means unless rates fall dramatically, the loans on its books could be around for a long period of time. According to the company's earning statements, the average guaranty fee (g-fee) it charges lenders rose to 20.4 basis points in the 4th quarter from 18.3 basis points two quarters ago. (*National Mortgage News*, Paul Muolo, 1/20/03)

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

Congressman Mike Doyle (D-PA) joins Fannie, ACORN on $15 million initiative to increase Hispanic homeownership

- U.S. Representative Mike Doyle (D-PA) joined with representatives from Countrywide Home Loans, Inc., the Hispanic/Latino Center, Inc; ACORN (Association of Community Organizations for Reform Now); Penn State McKeesport; and Fannie Mae, to announce a three-year, $15 million initiative aimed at increasing homeownership among Hispanic residents in the Pittsburgh area. Countrywide, the number-one lender to Hispanics for six years in a row according to the firm, indicates it will be able to originate $15 million in mortgages through this initiative over the next three years. Fannie will purchase all eligible loans. The initiative will provide information to new Hispanic residents on homeownership and educational opportunities through the Hispanic/Latino Center; Countrywide will offer affordable mortgage financing to eligible residents; ACORN will provide credit and homeownership counseling to prospective home buyers, and Penn State University McKeesport will offer educational programs for those wishing to further their learning. (*Fannie Mae press release*, 1/17/03)

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Freddie Mac

Freddie curtails part of subprime business

- Freddie Mac will stop helping lenders create securities out of bundles of mortgages that include loans to borrowers with tarnished credit. The company is not getting out of the business of financing loans to higher credit-risk borrowers, known as the subprime market, said a Freddie official, and will continue to buy mortgage-backed securities that have subprime loans in them as long as they do not contain abusively high fees or interest rates, known as predatory lending. Freddie spokeswoman Sharon McHale said:

  > Our commitment to the subprime market sector is as strong as ever and we have no intention of decreasing our involvement in that sector of that market. We're just going about it in a different way…We just go in, we say we'll bind on any deals that meet our predatory lending requirement and our counterparty requirements.

- Several states, including Georgia, New York and North Carolina, have passed tough laws aimed at curbing abusive lending practices, and Freddie last year told lenders it would no longer buy high cost home loans in Georgia because the new state law could expose it to lawsuits. Subprime lending increased in the '90s as lenders were able to charge high enough interest rates to justify extending credit to riskier borrowers, but the softening economy has brought higher losses from loan defaults. (*Reuters*, 1/10/03)

Freddie reaches out to American Bankers Association

- In an ongoing effort to make small lenders more competitive in the secondary market, Freddie is expected to announce that it will give the ABA members increased access to Freddie's technology and a wider variety of products, tools, and services, as well as better pricing than many of them could obtain on their own. ABA members will also get access to private-label sub-servicing through Dovenmuehle Mortgage, Inc., an agreement to go into effect February 10th. Freddie's vice president of business and market management, Iliana Ghanem, noted, "This will help to make sure that small community banks stay competitive in mortgage lending." Joe Pigg, ABA senior counsel, claimed member banks should be able to get better pricing across the board for the loans they sell to Freddie, though the exact price and other benefits will vary from bank to bank. (*The American Banker*, Tommy Fernandez, 1/23/03)

Freddie hires new director of Congressional relations

- Freddie Mac has hired a former lobbyist for the Federal Home Loan Bank of Atlanta as its new director for Congressional affairs, Brian Smith. (*The American Banker*, Michele Heller and Rob Garver, 1/21/03)

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Freddie finishes '02 with record unaudited net income of $5.76 billion

- Freddie Mac reported its record unaudited net income of $5.76 billion ($7.95 per share) for 2002, up 39% from $4.15 billion (%4.64 the year before), but results are preliminary and will be restated. After PricewaterhouseCoopers finishes auditing Freddie's books, the results are expected to be revised upward. Leland Brendsel, CEO of the GSE said he expected no adverse impact from the reaudit on the company's fundamental strength. Freddie highlighted its finances, including: total mortgage portfolio growth of $173 billion, or 15%; retained portfolio growth of $76 billion, or 15%; and credit losses representing only .7 basis points of its average total mortgage portfolio. (*National Mortgage News*, 1/27/03)

Freddie reports Loan Prospector AU service reaches 25 millionth loan

- Freddie announced that Loan Prospector evaluated its 25 millionth loan December 18, 2002, one of some 8.2 million loans run through the system in that period. The service was inaugurated in 1995 and has set eight consecutive volume records since then. In 1995, the system evaluated more than 38,000 loans; in 2001, it reached the 10 million mark, and 18 months later, in June 2001, it reached the 20 million mark. Tricia McClung, vice president of Loan Prospector, noted the "record volume is further testament to the importance the industry has placed on electronically evaluating mortgage loans faster, fairer and more accurately," and that, "The mortgage industry could not have processed the record volume in 2002 without automated underwriting."

- Another milestone for the Loan Prospector service was the December 8th launch of loanprospector.com, featuring automatic data transfer and making available an online fulfillment management service allowing mortgage lenders and brokers to order appraisals, flood determinations, title products and property surveys from vendors. (*Freddie Mac press release*, 1/13/03)

Freddie teams to give renters $1500 in cash to purchase homes

- Renters will be allowed to receive $1500 cash from their landlords to spend toward a down-payment for a new home in an arrangement between a property owners, a mortgage lender, and home finance giant Freddie Mac. A property renter who rents from Apartment Investment and Management Company (AIMCO) can claim up to $500 a year over 3 years towards the costs of closing a mortgage with American Home Mortgage Holdings, Inc., a lender. AIMCO operates 1800 properties that include around 327,000 apartments. The benefit was made possible when Freddie, the nation's number two mortgage finance company, agreed to buy those loans. It is unusual for a program to reward renters with credit towards homeownership, says Freddie Mac. The program will help first-time buyers with the biggest obstacle to homeownership, finding funds for a down payment. (*Reuters*, 1/13/03)

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Freddie and ESIC expand commitment to affordable housing with new $100 million initiative

- Freddie Mac has partnered with ESIC, the Enterprise Social Investment Corporation. The Freddie Mac Equity Plus II-ESIC LP, a $100 million equity fund will target housing efforts in underserved markets, including urban, suburban and rural areas across the country. ESIC will manage the fund and underwrite affordable housing projects for this fund through the federal government's Low Income Housing Tax Credit Program. Freddie is building on its success of its first single-investor fund with ESIC, the $50 million Freddie Mac Equity Plus I-ESIC LP fund, created in 2001, which led to creation of more than 1,000 additional units of affordable housing, according to ESIC senior vice president Frank Narron. ESIC has been active in the Low Income Housing Tax Credit program since its inception. ESIC organized and manages equity funds at the regional level, in 9 states and eight cities, many of which includes investments from Freddie Mac.

- This second single-investor fund was established through Freddie's Equity Plus initiative, and allows Freddie Mac to invest up to 100% of the equity in specific multifamily projects and are just one of a variety of tax credit equity investment approaches Freddie uses in its efforts to increase availability of affordable rental housing. Freddie also invests in multiple-investor funds and purchases interests in the secondary market. (*Freddie Mac press release*, 1/10/03)

Freddie provides $8,000 in adoption assistance to employees

- Freddie Mac was ahead of the curve, two decades ago, in offering adoption assistance to its employees. An employee then sought to adopt two children orphaned by a fire in the next door house, but the process was costly, so Freddie offered assistance and set up a program, according to company spokeswoman Shawn Flaherty: "The adoption assistance program treats the cost of adoption like we treat the birth of a child," and therefore, pays the same cost, $8,000. (*The Washington Post*, 1/26/03).

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Federal Home Loan Banks

GAO draft report faults limited review by FHFB of its FHLBanks

- According to a draft report by the General Accounting Office, GAO, the Federal Housing Finance Board is trying to improve its examination of the 12 Federal Home Loan Banks it regulates, but has "performed limited reviews" of functions "critical to managing the banks' financial and operation risks." The report will bolster critics of the FHLBanks of Chicago's Mortgage Partnership Finance Program, because GAO finds shortfalls in the examination process of the FHLBanks. GAO points out its previous criticism of the Finance Board for "weak" off-site monitoring of the Banks, and says political donations by the FHLBank public interest directors are increasing, with the percentage of appointees who made political donations prior to their initial appointments now at 75% under current Finance Chair John Korsmo, compared with 56% for previous chair, Bruce Morrison. (*National Mortgage News*, 1/27/03)

Atlanta FHLBank gets green light to expand MF program

- The Atlanta Federal Home Loan Bank was granted regulatory approval to expand its Affordable Housing Multifamily Participation program to invest up to $100 million in multifamily loan participations. The FHLBank normally takes a 50%-80% majority interest in a loan participation that is backed by low-income housing tax credit projects. The Atlanta bank is the only FHLBank offering the AHMP program. (*National Mortgage News*, 1/30/03)

Former Treasury official warns Federal Home Loan Bank System not changing for the better

- The system's most aggressive banks, its largest members, and an "accommodating regulator" have been busily remaking the Federal Home Loan Bank System. The banks have been a cooperative source of liquidity for banks and thrifts, particularly small banks and thrifts. Gregory Baer, a former Assistant Secretary at Treasury whose duties included supervising the GSEs, (now with Wilmer, Cutler & Pickering with some clients who oppose recent actions by the Home Loan banks) contends the stakes are high, with the Home Loan Bank System passing the Treasury Department as the world's largest issuer of debt in the first half of 1998. The system's issuance topped $5.1 trillion in 2001, and through the 3rd quarter of last year, its assets were $761 billion. With an "impenetrable structure and vastly underestimated political might," few policymakers try to understand or challenge the system. Since the '30s, the system's structure has remained the same, with 12 regional Home Loan banks, modeled after the Federal Reserve Banks, where members own stock in their local Federal Reserve bank. Its statutory mission also has stayed the same, to make fully collateralized loans (known as advances) to member thrifts, and later banks, primarily to support mortgage lending.

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- Today some of the Home Loan banks and their regulator, the Federal Housing Finance Board, are rechartering the system. The Finance Board took the position that the Home Loan banks could buy and hold mortgages, since this was the functional equivalent of lending with mortgages as security. When that rather odd interpretation survived a court challenge, the Finance Board grew bolder, and now seems intent upon extending this logic to let the banks deal in mortgages, selling mortgages to any bank in any part of the country, and eventually to guarantee and securitize them, like Fannie Mae and Freddie Mac. The Finance Board clearly has signaled its intent to let any bank or thrift join as many Home Loan banks as it wishes.

- The impact of the move to multibank membership would be significant, destroying the regional, cooperative character of the system and potentially recreating each of the 12 Home Loan banks as a nationwide GSE. Such a deal is prohibited by the Federal Home Loan Bank Act, which limits a given bank or thrift to membership in only one Home Loan bank, the same as with Federal Reserve banks. The Bush Treasury Department wrote the Finance Board stating as much. The Finance Board did not accede to Treasury's interpretation, or ask the Justice Department's Legal Counsel for an authoritative view, but rather paid a law firm which validated its approach.

- The ultimate plan is for some or all of the Home Loan banks to securitize mortgages. Congress never intended for the banks to enter this business, and the charter for the system does not mention buying or selling mortgages, issuing guarantees or any other mechanics of securitization. Congress has never imposed on the banks the conforming loan limit, housing goals, mortgage insurance requirements, or other restrictions it deems necessary for Fannie and Freddie, but the push is clearly on. The theme of the recent changes is on serving the needs of the largest members, i.e. the ones joining multiple Home Loan banks. Already, two Federal Home loan banks have more than 25% of their stock owned by a single thrift, and every Federal Home Loan bank or thrift owns at least 10% of its stock. In contrast, under banking laws, control of a bank is presumed at 10% of voting shares, and established at 25% of voting shares.

- Under the Federal Reserve's rules on presumption of control (10% of voting shares), every Home Loan bank is under control of at least one large bank or thrift. Such control will be enhanced now that some of the Home Loan banks are encouraging their members to buy excess stock in them, thereby converting stock ownership from a cooperative duty to an investment decision. Some of the recently enacted capital plans for the Home Loan banks disfavor the system's traditional advance business, relied upon by small banks, in favor of the new mission advocated by its largest and most powerful members. The Home Loan banks justify their reinvention by promising to provide competition to Fannie and Freddie and by claiming these changes are needed to permit that competition. This argument has won plaudits from Fannie and Freddie's critics who view the enemy of one's enemy as a friend.

- Would septupling the number of GSEs securitizing mortgages make U.S. economic life better, and would anyone rationally contend the best vehicle for such competition is 12 government-sponsored, bank-owned cooperatives, in competition with each other, but jointly liable and subject to no statutory restrictions on which loans they securitize and how? Home

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Loan banks pay no federal taxes, no state tax on their debt, can issue tax-deferred stock dividends, are exempt from securities laws, and unlike Fannie and Freddie, rebuff Treasury demands that they register voluntarily with the SEC. Congress gave the Federal Home Loan banks free rein 20 years ago to let the nation's savings and loans grow out of their troubles. The time its successor agency is allowing the Federal Home Loan banks to grow beyond their charter, but does anyone on either end of Pennsylvania Avenue care enough to ask if that makes sense? (*American Banker*, Gregory Baer, 1/17/03)

Home Builders give strong support to Shared Funding, back MPF expansion

- The National Association of Home Builders has given its "strong support" to a plan by the Federal Home Loan Bank of Chicago to add a shared funding enhancement to its highly successful Mortgage Partnership Finance program. The NAHB had been asked by the FHLBanks of Chicago and Pittsburgh, as well as Wells Fargo, to sign a joint letter to the Federal Housing Finance Board supporting the shared funding program, but the association's leadership decided to send its own letter to better voice its own interest in expanding the MPF beyond just single-family mortgages. The NAHB would like to see the MPF and the SFP programs used to facilitate development of additional FHLBank programs, including multifamily mortgages and housing production loans, NAHB President Gary Garczynski wrote in a letter to Finance Board Chairman John Korsmo. (*National Mortgage News Daily*, 1/21/03)

Sallie Mae

Sallie prices $5000 million of short-term floating rate notes

- Sallie Mae today announced an offering of $500 million of short-term floating rate notes. These notes, as well as GSE debut currently outstanding and new debt issued in the future by the GSE subsidiary, will maintain its GSE status. The notes were priced at par to yield a variable rate equal to 5 basis points above the bond equivalent yield of the 91-day Treasury bill auction rate and are due July 17, 2003. (*PR Newswire*, 1/13/03)

Co-founder Robert Lawhorn retiring, but continuing service as consultant

- Sallie Mae announced that co-founder and executive vice president of General Revenue Corp. (GRC), Robert Lawhorn, is retiring after 21 years with the company. Lawhorn officially will retire in the spring of this year, but will serve as a consultant to the company through year-end. GRC provides student loan collection services for more than 800 clients, primarily for higher education institutions. The company became part of Sallie Mae's Debt Management Operations in early 2002. Jim Eickhoff, president of the Sallie Mae subsidiary Student Loan Funding, will begin transitioning to GRC on February 1, and ultimately will assume Lawhorn's duties. (*PR Newswire*, 1/17/03)

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Ginnie Mae

Ginnie revamps Ginnie Mae II securities

- Ginnie Mae has revamped its Ginnie Mae II securitization program in an effort to increase volume and improve the pricing of the mortgage-backed securities it guarantees. Ginnie cut the minimum number of basis points that issuers of federally guaranteed mortgages must set aside for servicing from 44 to 19. The changes, effective July 1, 2003, apply only to the GNMA II mortgage-backed securities program. The reduction should benefit consumers by cutting the cost of these loans, and should also serve to make GNMA II securities more attractive to investors. Ginnie Mae officials said increased lender flexibility and a more appealing security should result in more capital available for government-insured mortgages. Ginnie Mae President Ronald Rosenfeld said the lowered service fee minimum aims to give issuers of GNMA II securities more flexibility in how they assemble mortgages into securities: "We have made the GNMA II program more effective for all types of lenders…Historically, the program has best served those lenders that prefer to generate their greatest revenue through mortgage servicing. Now, those lenders that prefer to generate their greatest revenue through the origination of Ginnie Mae securities will also benefit." (*Inman*, 1/15/03)

- One change will narrow the spread on the note rates that can be included in a Ginnie Mae II single-family pool from 100 basis points to 50. Mortgage Bankers Association vice president Steve O'Connor said, "This should make the prepayment speed more predictable, which will help improve pricing." (*National Mortgage News*, 1/14/03)

Farm Credit System/Farmer Mac

Farmer Mac 4th-quarter profit falls 39% on derivatives

- Farmer Mac said its fourth-quarter earnings fell 39%, reflecting a decline in the value of financial contracts used to hedge against interest-rate swings. Farmer Mac's net income fell to $3.34 million, or 23 cents a share, from $5.48 million, or 46 cents, a year earlier, the company announced January 23rd. Profit, excluding changes in the value of derivatives holdings and the expense of repurchasing debt, increased 14 percent to a record $5.9 million, or 49 cents a share, from $5.2 million in the 4th quarter of 2001, the company also reported. Farmer Mac's shares fell to a 19-month low at $20.80 in July after reports by Gotham Partners LP alleged the mortgage buyer was sure to fail because it didn't raise reserves as farm loan delinquencies rose and had too much short-term debt in relation to investments. Gotham acknowledged it had investments that would profit if Farmer Mac fails. (Al Yoon, *Bloomberg News*, 1/24/03)

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Postal Service

USPS, trying to curb costs, seeks OPM permission for early retirements

- The U.S.P.S. is seeking permission to give early retirement to employees who are no longer needed because of automation. The postal service projects that by September, automation will eliminate 16,000 jobs. Most of the jobs will be abolished as workers quit or retire, but early-outs will be needed to reach its job reduction target. Generally, workers taking early retirement must be at least age 50 with 20 years of service, or any age with 25 years of service. Employees in the old Civil Service Retirement System lose 2% of their annuity for each year they are younger than 55. In most cases, there is no annuity reduction for workers covered by the FERS or Federal Employees Retirement System.

- The postal service's chief operation officer requested OPM (Office of Personnel Management) for authority to offer early retirement to employees covered by the American Postal Workers Union contract. Of 310,000 APWU members, some 58,000 are eligible for early retirement, but the union only expects 3,00 to accept the offer. The postal service will not be offering cash buy-outs. APWU's contract prohibits layoff of employees who have been on the job for at least six years. The postal service, struggling to shrink costs, reduced its staff by 23,000 employees over 2 years, including 800 employees at postal headquarters. (*The Washington Post*, Stephen Barr, 1/30/03)

February 3, 2003

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