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Contents of GSE Report TM

Major Events

- [Fallout continues from Federal Reserve Bank of St. Louis President William Poole's warning that an unexpected financial shock at Fannie or Freddie could damage the economy \(p. 4\)](#)
 - Cong. Richard Baker calls Poole's comments "professional" and "objective"
 - Cong. Baker would like Poole to testify at hearings in late May or early June
 - Cong. Baker has had "meaningful discussions" at Treasury about the GSEs and would like the agency to comment on the oversight of the GSEs
 - Congressman Baker calls Fannie's defense against Poole's comments "inappropriate"
 - Poole has done a "public service by noticing the elephant in the economy," reports *Wall Street Journal* editorial
 - Cong. Max Sandlin defends Fannie & Freddie against Poole's comments
- [Senate Banking Committee Chairman Richard Shelby plans to review Fannie, Freddie, and FHLBanks' financial disclosures \(p. 8\)](#)
- [SEC calls for greater financial disclosures by the FHLBanks and says registration of FHLBanks' securities with the SEC won't impede markets \(p. 9\)](#)
 - SEC unconcerned whether FHLBanks register their stock or debt but more concerned about the quality of the FHLBanks' disclosures
 - HUD undecided on whether FHLBanks should register their stock with the SEC
 - ICBA raises concerns about requiring FHLBanks to register with the SEC
 - FHFBC Chairman continues to push to have all 12 FHLBanks voluntarily register their stock with the SEC but remains opposed to having FHLBanks register their debt with the SEC
 - FHFBC Chairman claims registering their stock with the SEC will lower FHLBank System's borrowing costs
 - FHFBC Chairman prefers voluntary registration - does not want to propose a regulation on disclosures
 - ACB calls for a rule-making process and submits FOIA request for FHFBC documents related to FHLBanks' disclosures and registration with the SEC
 - Former National Economic Council director confirms that Treasury Department's call for all GSEs to register their stock with the SEC was done with White House approval but claims the unique nature of the FHLBanks never came up in GSE policy discussions
 - Though Fannie initially opposed efforts to register its stock with the SEC, Fannie's Chairman says FHLBanks should register
- [Congressmen Shays and Markey to re-introduce bill by mid April that would remove Fannie & Freddie's SEC exemption \(p. 14\)](#)
- [HUD reviewing its oversight of Fannie & Freddie, including its authority to review and reject Fannie and Freddie's new business activities \(p. 14\)](#)
- [SEC still reviewing Fannie & Freddie's \\$1,000 debt notes to consumers, says America's Community Bankers \(p. 15\)](#)
 - ACB raises concerns about Fannie & Freddie's \$1,000 debt notes to consumers
 - ACB first complained to HUD about the note sales but ACB never received a response
- [FHLBank conducts first MPF Shared Funding transaction \(p. 16\)](#)

- Provides competition to Fannie & Freddie in the secondary mortgage market and reduces costs to consumers
- FHLBanks will provide more complete disclosures than MBS disclosures provided by Fannie & Freddie
- [FHFB Chairman says FHFB will not consider plans to allow FHLBanks to issue MBS this year \(p. 18\)](#)
 - Notes that the FHFB is still reviewing issues surrounding potential multi-district FHLBank membership
- [OFHEO report notes Fannie & Freddie's changing risk profiles \(p. 19\)](#)
 - Fannie & Freddie have shifted their business strategy to asset management, which increases interest rate risk
 - Fannie & Freddie have expanded their business products, which has raised the sophistication and complexity in Fannie & Freddie's risk profiles
 - Technology advances have increased Fannie & Freddie's operational risks
- [Congressman Ney opposes broad GSE reform if similar to previous bills but will consider any new GSE regulatory reform bills \(p. 21\)](#)

Fannie Mae and Freddie Mac

- [Former Treasury Assistant Secretary for Financial Institutions Sheila Bair suggests an overhaul of GSE oversight \(p. 21\)](#)
- [Privatize Fannie & Freddie to minimize economic risk, recommends AEI's Peter Wallison \(p. 22\)](#)
- [National Credit Reporting Association would like more government oversight of Fannie & Freddie's automated underwriting systems \(p. 23\)](#)
 - HUD has been reviewing Fannie & Freddie's AU systems for four years
- [Georgia legislator references an expected letter from Freddie to urge passage of an amended predatory lending bill \(p. 24\)](#)
 - Georgia State Senator Stephens says he was expecting a faxed letter from Freddie in 30 minutes warning that if the Georgia bill was not amended, Freddie would withdraw from the Georgia mortgage market
 - Stephens claimed Fannie would follow suit
 - Freddie letter arrives five days later
 - Stephens claims Freddie misled him and weakened its subsequent letter
 - *Atlanta Journal and Constitution* editorial claims Stephens and Governor Perdue misled everyone and that Freddie's letter does not support his earlier warnings
 - "Freeloading Freddie Mac" was "out of bounds," charges associate editorial page editor of the *Atlanta Journal and Constitution*
 - Legislator that pushed the original law calls for an investigation
- [Substantive changes in GSE policies are very unlikely in near-term, says ISI Group \(p. 27\)](#)
 - ISI gives "high" long-term odds of raising the GSEs' capital requirements and limiting the size of their portfolios
- [Fannie & Freddie cap some mortgage bond production for sixth month \(p. 28\)](#)
- [Are lenders paying too much in guarantee fees to Fannie & Freddie? \(p. 28\)](#)
 - The GSEs' raising their guarantee fees while enjoying record profits and low credit losses sparks criticism
- [GSE debt news: \(p. 30\)](#)
 - (1) Fannie to begin issuing short-term debt denominated in a foreign currency for the first time
 - (2) Fannie's Treasurer says foreign appetite for GSE debt growing
 - (3) Moody's affirms Fannie & Freddie's debt ratings

Fannie Mae

- [Fannie touts its S&P corporate governance rating of a 9 on a 10 point scale but is silent on its below-average rating from GovernanceMetrics International \(p. 32\)](#)
 - Freddie also receives a below average rating from GovernanceMetrics
 - Governance-reform advocates wonder whether S&P can be objective when it collects fees from the companies it rates

- [Fannie agrees to let CFN take over the servicing rights to its share of Conseco's manufactured housing portfolio \(p. 34\)](#)
- [Fannie claims it charges risk-based pricing fees on customized loans to manage risk \(p. 35\)](#)
- [Fannie is one of the founding members of Financial Services Sector Coordinating Council \(p. 35\)](#)

Freddie Mac

- [Freddie invests in luxury real-estate \(p. 36\)](#)
- [Freddie names Martin Baumann to new position of Executive Vice President, Finance \(p. 36\)](#)
- [Freddie hires former legislative director for Senator Tim Johnson \(p. 36\)](#)

Federal Home Loan Banks

- [FHFB Chairman to hold April 7 meeting with chairman and vice chairman of the FHLBanks to discuss controversial FHLBank issues \(p. 37\)](#)
- [FHLBanks had \\$87 billion unsecured credit outstanding, with debt obligations of other GSEs comprising 26% of that amount \(p. 37\)](#)
- [FHFB to reduce pay raises for most employees to bring its wages in line with other financial regulators \(p. 37\)](#)
- [FHFB issues proposed rule on public interest directors' qualifications \(p. 38\)](#)
 - Last year, two FHFB members claimed the process for selecting board members was too political
- [FHFB appoints FHLBank of Dallas President to the Board of Directors of the Office of Finance \(p. 38\)](#)

Farm Credit Administration/Farmer Mac

- [FCA considering a wide-ranging governance review, including a review of Farmer Mac supervision and consideration of requiring its institutions to register with the SEC \(p. 39\)](#)

Postal Service

- [Bill that would reduce the Postal Service's payment to the Civil Service Retirement \(CSRS\) fund included in the House & Senate FY 2004 budget resolutions \(p. 39\)](#)
 - Bill supported by the Postal Service, GAO, all four postal unions, and the postal management association
- [Postal Service top officers receive free tax advice, tax preparation and financial counseling \(p. 40\)](#)
 - No other federal agency offers such benefits
- [Postal Service's Office of Inspector General spends millions of dollars on "bizarre bonding and team-building exercises" while stamp prices soar, reports *New York Daily News* \(p. 40\)](#)
 - Senator Grassley and the President's Council on Integrity and Efficiency are probing the allegations
- [Presidential Postal Reform Commission holds March 18 field hearing in Austin \(p. 42\)](#)
 - Next field hearing is April 4 in Los Angeles
- [Presidential Postal Reform Commission receives rebuttal comments \(p. 42\)](#)
- [Postal Service defends non-postal offerings \(p. 42\)](#)

Major Events

Fallout continues from Federal Reserve Bank of St. Louis President William Poole's warning that an unexpected financial shock at Fannie or Freddie could damage the economy

Cong. Richard Baker calls Poole's comments "professional" and "objective"

Cong. Baker would like Poole to testify at hearings in late May or early June

Cong. Baker has had "meaningful discussions" at Treasury about the GSEs and would like the agency to comment on the oversight of the GSEs

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Poole has done a "public service by noticing the elephant in the economy," reports *Wall Street Journal* editorial

Cong. Max Sandlin defends Fannie & Freddie against Poole's comments

- Federal Reserve Bank of St. Louis President William Poole warned March 10 that an unexpected financial shock at Fannie or Freddie could cause considerable damage to the economy. "Any problem in the capital markets affecting these firms could become very large, very quickly," he stated. Poole expressed concern that given Fannie and Freddie's massive size and growth, combined with Fannie and Freddie's low capital levels compared to federally regulated banks, could potentially pose systemic risks to the economy. Poole recommended removing the GSEs' line of credit to the Treasury to address the market's perception that the GSEs have an implied government guarantee and increasing the GSEs' capital to protect against any financial shocks. [See March 10, 2003 *GSE Report* for more details on Poole's comments, www.gsereport.com] Poole made similar remarks in August 2002. [See August 2, 2002 *GSE Report* for more details, www.gsereport.com]

Cong. Baker calls Poole's comments "professional" and "objective"

- Capital Markets Subcommittee Chairman Richard Baker (R-LA) called Poole's comments "professional" and "objective." Poole "has expressed over some period of time his general concern" over Fannie and Freddie's "enormous rates of growth and the potential for systemic risk should either of those enterprises have difficulty," Congressman Baker told *Market News International*. "That's been the motivation behind my GSE reform efforts while I've been here," he stated. "Poole's comments only provide a professional, objective view about my concerns," he added. Congressman Baker further noted that no other financial regulator has yet dismissed Poole's comments. "It only galvanizes the fact that his comments were not off the mark," he said. (*Market News International*, Claudia Hirsch, 3/13/03)

Cong. Baker would like Poole to testify at hearings in late May or early June

- Congressman Baker said that he plans to hold hearings in late May or early June on the risks

Fannie and Freddie may pose to the US economy. Congressman Baker said he would like to have Poole testify at a hearing and that he would like the Treasury Department to comment on whether government oversight of Fannie and Freddie is adequate. (*Reuters*, Mark Felsenthal, 3/13/03)

Cong. Baker has had “meaningful discussions” at Treasury

- Congressman Baker told *Market News International* that he has had a series of “very meaningful discussions” with Treasury Undersecretary for Domestic Finance Peter Fisher, which has indicated to him that Fisher has “a desire to take additional steps” to craft Bush administration GSE policy. (*Market News International*, Claudia Hirsch, 3/13/03)

Congressman Baker calls Fannie’s defense against Poole’s comments “inappropriate”

- Fannie’s investor relations official Jayne Shontell claimed that Poole’s speech “suggests that Mr. Poole does not understand the capital regime that Congress put in place a decade ago for Fannie Mae and Freddie Mac.” She added, “Mr. Poole also seems to be unaware of the substantial discussions Fannie Mae and Freddie Mac had with senior Executive Branch policymakers in 2000...Fannie Mae is prepared to operate for three months at a minimum without any access to the debt markets.” Congressman Baker called this an “extraordinarily inappropriate response,” and noted that Fannie’s “first response is always to attack the intellect or capability” of any critic. (*Market News International*, Claudia Hirsch, 3/13/03)

Wall Street Journal editorial

- A March 12 editorial in the *Wall Street Journal* said Poole has done a “public service by noticing the elephant in the economy.” The editorial noted that other federal officials have been critical of Fannie and Freddie, including Federal Reserve Board Chairman Alan Greenspan, however Poole “sharpened the argument.”
- Fannie and Freddie's business has grown, particularly in the past three years, “generating increasing anxieties about their huge and growing debt. Investors are also wondering about the prospect that interest rates will head up again, leaving Fannie and Freddie with lower-yielding long-term assets and expensive short-term debt.”
- “Investors, too, might be looking at the prospect that Fannie and Freddie are increasingly exposed to political risk. Mr. Poole suggests that regulators might want to require more capital and take away their line of credit at Treasury. Others have mentioned limiting the size of their portfolios, restricting their activities, or -- gasp -- even privatizing them. Such sensible steps would erode Fannie and Freddie's ability to profit off the subsidy from their implicit government backing.”
- “Fannie responded to Mr. Poole's remarks with familiar grace, charging that he was uninformed. We’d say Mr. Poole has done a public service by noticing the elephant in the economy. Now it’s up to federal regulators, and Congress, to put a harness on it.” (*Wall Street Journal editorial*, 3/12/03) The *Wall Street Journal* also ran a copy of Poole’s remarks about the GSEs.

Cong. Shays' comments

- “Any time you have a major institution that doesn’t have to play by all the rules, you’re going to have problems,” Congressman Chris Shays (R-CT) told *Dow Jones Newswire*, adding that Fannie and Freddie’s stock sensitivity to political news is a result of its special federal ties. (*Dow Jones Newswire*, Dawn Kopecki, 3/14/03)

Poole sets the market straight, says Stephen Lewis with Monument Securities

- Noting Poole’s recent comments, Stephen Lewis with Monument Securities stated: “It has become a truism of bar-room debate that the GSEs could present a threat to financial stability.” In a commentary published by *Dow Jones Newswire*, Lewis explained, “The reasons are clear. Their ratios of capital to assets, at around 5%, are much lower than for US banks, where typically the ratio is 11%. Further, their assets are not well diversified while there is a potential for mismatches to develop between the average terms of their assets and their liabilities.” He added that Poole isn’t the only Fed official “to feel uneasy about the GSEs.” Federal Reserve Board Chairman Alan Greenspan has also expressed his concerns on previous occasions. “The aim of these policymakers is to dispel any illusions there may be in the market that the GSEs are exempt from the risks that other lenders face.” (*Commentary by Stephen Lewis, Chief Economist, Monument Securities Ltd., London, independent brokers specializing in institutional business, Dow Jones Newswire, 3/11/03*)

Fannie & Freddie are sitting on a \$3.1 trillion time bomb, reports New York Post

- Poole noted that Fannie and Freddie own or guarantee \$3.1 trillion, or 45 percent of the residential debt outstanding in the US, an “enormous” and “frightening jump from just 25 percent in 1990,” reported John Crudele with the *New York Post*. Crudele noted that comments from Poole and Federal Reserve Board Chairman Alan Greenspan suggest that “if Fannie and Freddie cough, the vulnerable financial markets could have a seizure and kill the whole economy.” Crudele noted, however, that “actions speak louder than words,” and warnings by the Fed and the rest of Washington does not make these groups any less culpable if Fannie and Freddie’s derivative business collapses. Taxpayers should care about this issue for both practical and philosophical reasons. (*New York Post*, John Crudele, 3/13/03)

Fannie dismisses Poole’s comments

- In a March 10 interview with *CNBC*, Fannie’s Chairman Frank Raines claimed the company was not a risk to the economy. Raines stated, “The issue of Fannie Mae’s status is quite clear. It states on all of our debt obligations that our securities are not guaranteed by the federal government. And I don’t think there is much ambiguity about that in the capital markets. And we have made quite clear that we are not a risk to the economy, because we are so heavily regulated. And our capital is carefully ascribed to our risk, that if there is going to be a systemic risk caused by financial institutions, it is certainly not going to be caused by Fannie Mae.” (*CNBC/Dow Jones Business Video, Interview with Fannie’s CEO Frank Raines, 3/10/03*)
- Raines claimed that assets held by banks, such as credit card debt and commercial loans, were much riskier than Fannie’s residential mortgages, hence its lower capital requirements. Given that new rules for risk-provisioning by banks seek to link capital more closely to risk,

“it’s surprising to have a central banker advocate a one-size fits all policy,” he stated.
(*Reuters*, 3/11/03)

- In response to Poole’s recommendation to remove Fannie’s \$2.25 billion line of credit to the Treasury, Raines stated, “Well, obviously, this ability of the secretary of the Treasury, at his discretion, to buy our debt is not terribly meaningful from a financial standpoint. At one point \$2 billion would have been a large financing for us. But now we borrow that much every day. But it does have symbolic meaning to the housing market. We ought to think twice about whether or not we want to begin to pull the strands from this mosaic that has been created of private capital supporting housing in the United States...So even though it has primarily symbolic value, symbols matter.” (*CNBC/Dow Jones Business Video, Interview with Fannie’s CEO Frank Raines*, 3/10/03)

Freddie dismisses Poole’s comments

- In a statement, Freddie said that “while it is true that the absolute percentage of minimum capital we are required to hold is lower than that for banks and other insured depositories, Freddie Mac’s minimum capital is significantly greater than banks’ relative to the credit risks that GSEs and banks take.” (*New York Times*, Jonathan Fuerbringer, 3/11/03) Freddie’s Chief Economist Frank Nothaft argued that banks have higher capital requirements because their charge-offs are higher than those of Fannie and Freddie. Speaking on a panel at OFHEO’s March 10 conference on housing prices, Nothaft pointed out that despite Poole’s concerns about the GSEs’ inadequate capital levels, the GSEs in 2001 only had a single basis point in charge-offs as a share of total assets. In comparison, commercial banks had 25 basis points for single-family mortgages, while the total for all real estate lending was 100 basis points, he said. “The banks held more capital because they had more charge-offs,” he stated. (*Market News International*, Heather Scott, 3/10/03)
- “Freddie Mac’s minimum capital is significantly greater than banks’ relative to the credit risks that GSEs and banks take,” said Freddie’s spokeswoman Sharon McHale. “Banks engage in all sorts of risk lending. In contrast, Freddie Mac purchases only one, well-collateralized type of loan – US residential mortgage loans.” (*American Banker*, Barbara Rehm, 3/11/03)

Cong. Max Sandlin defends Fannie against Poole’s comments

- In a statement issued March 12, Cong. Max Sandlin (D-TX) defended Fannie and Freddie against Poole’s comments. Cong. Sandlin said he disagreed with Poole’s comments. While Poole noted that the GSEs have lower capital levels than banks, Congressman Sandlin said “it is appropriate that banks have higher capital requirements” since banks “have the explicit full faith and credit backing of the federal government” and they “operate with higher risk, higher earnings volatility, and have experienced institutional failures within the industry.” He argued that Fannie and Freddie operate with significant capital above that required for management of interest rate risk and credit risk and that they operate only in the conventional conforming mortgage market. “As we all know, mortgage loans on American households are the safest assets in the world.” Further, Fannie and Freddie “are well collateralized and geographically dispersed” and use credit enhancements, mortgage insurance and hedges to

share their risk with other investors. “Our nation and the world are experiencing sluggish economic growth, yet the housing sector is a firm rung on an otherwise shaky economic ladder. Therefore the timing of these remarks is as unfortunate as the content.” He urged the leadership of the regional Federal Reserve “to become familiar with the last few years’ significant enhancement in Congressional and Executive branch oversight and regulation of the housing GSEs.” (*Congressman Sandlin press release as printed in Market News International*, 3/12/03)

Senate Banking Committee Chairman Richard Shelby plans to review Fannie, Freddie, and FHLBanks’ financial disclosures

- Chairman Richard Shelby (R-AL) told participants March 12 at an American Community Banker’s conference that he plans to hold hearings this year on the quality of Fannie, Freddie, and the FHLBank System’s financial disclosures. Senator Shelby noted that the GSEs “do a lot of good, social good, economic good.” However, more and more investors want to see better transparency in the markets, he said. (*Dow Jones Newswire*, Dawn Kopecki, 3/12/03)
- The *American Banker*, however, reported that Senator Shelby said he plans to review Fannie, Freddie, and the FHLBanks’ financial disclosures but he did not say whether the committee would hold hearings or provide any timetable for when the oversight work would be completed. Senator Shelby said both the Financial Institutions Subcommittee and the full Senate Banking Committee might conduct the oversight. “We will look at the whole issue,” he stated to reporters at the conference. “We are all interested in disclosure and transparency. It’s a question of how we get there: Is it Fannie Mae and Freddie Mac, is it the Federal Home Loan Banks? That’s a very complicated issue, and that’s why we would do oversight on it to see what is going on.” (*American Banker*, Michele Heller, 3/13/03)

Background on GSEs’ financial disclosures

- Due to their GSE status, Fannie, Freddie and the FHLBanks are exempt from registering their securities with the SEC. Last July, the SEC, OFHEO, and Treasury reached an agreement with Fannie and Freddie, in which Fannie and Freddie agreed to voluntarily register their common stock and file quarterly and annual reports with the SEC (in compliance with the Securities Exchange Act of 1934), while remaining exempt from registering their debt and MBS with the SEC (1933 Securities Act). In July 16, 2002 testimony before the House Capital Markets Subcommittee, Treasury Undersecretary Peter Fisher called on all GSEs to comply with the same financial disclosure rules agreed to by Fannie and Freddie. In a follow-up to his testimony, Undersecretary Fisher sent letters in August of last year to the 12 FHLBanks and Sallie Mae, urging them to comply with the same voluntary financial disclosure rules agreed to by Fannie and Freddie. Until recently, all 12 FHLBanks had been opposed to registering their stock with the SEC. However, last month, breaking ranks from the other 11 FHLBanks, the board of directors of the FHLBank of Cincinnati voted unanimously to begin registering its stock with the SEC. Fannie and Freddie and all 12 FHLBanks and FHFB Chairman John Korsmo are unanimous, however, in their opposition to registering their debt with the SEC. As part of Fannie and Freddie’s voluntary agreement, the

Treasury, OFHEO, and SEC issued a joint report February 2003 that recommended Fannie and Freddie provide more disclosures on their MBS. The joint report found that Fannie and Freddie disclose less information than private-label issuers and that additional disclosures would not disrupt the market as Fannie and Freddie had argued previously. As a result of the report, Fannie and Freddie pledged to voluntarily provide more information on their MBS.

SEC calls for greater financial disclosures by the FHLBanks and says registration of FHLBanks' securities with the SEC won't impede markets

SEC unconcerned whether FHLBanks register their stock or debt but more concerned about the quality of the FHLBanks' disclosures

HUD undecided on whether FHLBanks should register their stock with the SEC

ICBA raises concerns about requiring FHLBanks to register with the SEC

FHFB Chairman continues to push to have all 12 FHLBanks voluntarily register their stock with the SEC but remains opposed to having FHLBanks register their debt with the SEC

FHFB Chairman claims registering their stock with the SEC will lower FHLBank System's borrowing costs

FHFB Chairman prefers voluntary registration - does not want to propose a regulation on disclosures

ACB calls for a rule-making process and submits FOIA request for FHFB documents related to FHLBanks' disclosures and registration with the SEC

Former National Economic Council director confirms that Treasury Department's call for all GSEs to register their stock with the SEC was done with White House approval but claims the unique nature of the FHLBanks never came up in GSE policy debate

Though Fannie initially opposed efforts to register its stock with the SEC, Fannie's Chairman says FHLBanks should register

SEC Commissioner calls for greater financial disclosures by the FHLBanks

- SEC Commissioner Cynthia Glassman called for increased disclosures by the FHLBanks during a question and answer session at a recent America's Community Bankers conference. "It is definitely helpful to the markets if the Federal Home Loan Banks – have appropriate disclosure... We are the disclosure agency and we are best equipped to make sure the disclosure is appropriate. I do see" FHLBank disclosure with the SEC "as making the market more transparent." (*American Banker*, Michele Heller, 3/13/03)

SEC Commissioner says registration of FHLBanks' securities with the SEC won't impede markets

- Glassman said registration of FHLBank securities with the SEC shouldn't impede the FHLBanks' ability to raise funds in the markets. Concerns that securities registration could impede the FHLBanks' ability to tap the market are unfounded, Glassman added. "That shouldn't be an issue" because there are a "number of large issuers that are in the market all the time and we aren't an impediment to them." (*Dow Jones Newswire*, Dawn Kopecki, 3/12/03; *American Banker*, Michele Heller, 3/13/03)

SEC is unconcerned whether FHLBanks register their stock or debt but more concerned about the quality of the FHLBanks' disclosures

- Glassman added that the SEC doesn't care whether the FHLBanks register their equity or debt with the SEC. "It doesn't matter what's registered, whether it's a debt issue or stock," she said. "My understanding is it's the act of registering something that triggers the disclosure requirement and it's the disclosure requirement that's important." (*Dow Jones Newswire*, Dawn Kopecki, 3/12/03)

HUD Secretary is undecided on whether FHLBanks should register their stock with the SEC

- In a March 11 speech before the America's Community Bankers, HUD Secretary Mel Martinez - whose proxy sits on the five-member FHFBS - made comments that "raised doubts" about FHFBS Chairman Korsmo's plans to have the FHLBanks voluntarily register their stock with the SEC. "I find the Home Loan Bank System to be a very important tool to achieve all the goals we have been talking about," Secretary Martinez said. "I am not in any way, shape, or form at this point [considering] any changes to the way the Home Loan Bank System currently operates." HUD representatives clarified that the Secretary's remarks should not be interpreted that HUD opposes the FHLBanks' registration of their stock with the SEC, but rather as an indication that HUD has not yet reached a final decision on the issue. John Weicher, who sits on the FHFBS as the HUD Secretary's designee, said in an interview March 11 with the *American Banker* that he regards the discussion of SEC registration as being in a very early stage and that HUD has not taken a position on the matter. As *American Banker's* Rob Garver explained, HUD's vote could be crucial because a vote by the five-member FHFBS would be required to make the registration a reality, and until this time most observers believed FHFBS Chairman Korsmo would win a 3-to-2 vote with the backing of his two fellow Republicans on the FHFBS [John Weicher and Timothy O'Neill]. The FHFBS's two Democrats, Franz Leichter and Allan Mendelowitz, have expressed concerns about requiring the FHLBanks to register their stock with the SEC. (*American Banker*, Rob Garver, 3/12/03)
- During a FHFBS hearing March 12, Weicher made a statement some read as support for Treasury's position to have the FHLBanks register their stock with the SEC, while others viewed his comments as an effort by HUD to reserve its right to make an independent decision. "I want to make clear...that the Treasury statement of last August calling for improved disclosure by all the GSEs is very important, and I am looking forward to seeing recommendations from the SEC and the recommendations from the staff as we continue to address this issue in the near future," he said. (*American Banker*, Rob Garver, 3/14/03)

ICBA raises concerns about requiring FHLBanks to register with the SEC

- In a recent letter to HUD Secretary Martinez, the ICBA raised concerns about requiring the FHLBanks to register with the SEC. “We are very concerned,” wrote Kenneth Guenther, president and CEO of the ICBA. “If the [Home Loan bank] system were subject to disclosures designed for publicly traded companies, unintended consequences could result, confusing investors and others who try to compare the system’s disclosures with those of other companies.” (*American Banker*, Rob Garver, 3/17/03)

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

- In a March 11 speech before the America’s Community Bankers, FHFB Chairman John Korsmo continued to push to have all 12 FHLBanks register their stock with the SEC. “I believe that the Federal Home Loan Banks should be role models and fully and freely disclose financial management information under the ’34 Act. I believe that’s going to happen. And when it does, the enhanced disclosure the Banks provide will be good news for homebuyers, for taxpayers, and for you who belong to America’s Community Bankers and are members of the Federal Home Loan Bank System,” he stated. (*FHFB Chairman John Korsmo’s remarks before the ACB’s Government Affairs Conference*, 3/11/03)
- In response to those who argue that registering their stock with the SEC is not necessary because it is a cooperative stock and no one trades it publicly, Korsmo responded, “But that misses an important point – a \$5 trillion point. The system borrowed some \$5 trillion last year...debt purchased by somebody, and those somebodies, the individuals and institutions who were the buyers of those obligations, have an intense interest – a financial self-interest – in knowing all they can about the System and the quality of its debt. And taxpayers or those who represent them have an intense interest in knowing whether the System can back up that debt.” (*FHFB Chairman John Korsmo’s remarks before the ACB’s Government Affairs Conference*, 3/11/03)
- In response to the plan pushed by the Council of FHLBanks to have the FHFB and not the SEC oversee the actual filings, Korsmo stated that the SEC was better suited than the FHFB to regulate financial disclosures. The SEC, he said, already has the staff and expertise to “do the job effectively, and thereby ensure the public and investors of the reliability and completeness of the disclosures.” He added, “we have found the SEC very willing to recognize and adjust for the unique nature of the Federal Home Loan Bank System. They understand that the System is a cooperative...SEC registration will not require the Banks to make any fundamental changes in how they conduct their business.” (*FHFB Chairman John Korsmo’s remarks before the ACB’s Government Affairs Conference*, 3/11/03)
- Korsmo concluded, “Enhanced disclosure, increased transparency, IS going to happen...The benefits will be greater public accountability for these government-sponsored enterprises, greater transparency in the management of Home Loan Bank affairs and control of their business risks, and greater reliance by investors on SEC filings rather than the doomsday backstop of a taxpayer bailout.” (*FHFB Chairman John Korsmo’s remarks before the ACB’s Government Affairs Conference*, 3/11/03)

FHFB Chairman remains opposed to having the FHLBanks register their debt with the SEC

- Korsmo stated, “No one – neither I nor the SEC – has any interest in registering Federal Home Loan Bank debt offerings under the ’33 Act. It is not feasible. It is not on the agenda. No one is calling for it. ’33 Act registration of debt offering is not necessary because ’34 Act registration – as done voluntarily by Fannie Mae and Freddie Mac – will accomplish the goal of providing public holders of System debt with additional, superior information. The SEC, too, has made it clear that they see ’34 Act registration as the means to better inform investors in the Federal Home Loan Bank System. (*FHFB Chairman John Korsmo’s remarks before the ACB’s Government Affairs Conference, 3/11/03*)

FHFB Chairman claims registering their stock with the SEC will lower the FHLBank System’s borrowing costs

- Korsmo stated, “Free markets have long demonstrated that superior information is rewarded with superior price...Once capital markets are able to price Home Loan Bank bonds on the basis of information disclosed under SEC standards and in the SEC format, the System should be rewarded with a better price. The Federal Home Loan Banks can borrow at a better rate, and ultimately, lower the cost of the borrowing all of you do through advances.” (*FHFB Chairman John Korsmo’s remarks before ACB’s Government Affairs Conference, 3/11/03*)

FHFB Chairman prefers voluntary registration - does not want to propose a regulation on disclosures

- In terms of implementing FHLBank registration under the ’34 Act, Korsmo told reporters: “My choice obviously is not to have to propose a regulation. Frankly, the first choice is still and has always been that the Banks will voluntarily decide to register their stock with the SEC. We’re still going through that process.” He added, “Several banks have come forward and are having no-commitment meetings with the SEC staff,” Korsmo said. (*Dow Jones Newswire, John Connor, 3/11/03; Dow Jones Newswire, Deborah Lagomarsino, 3/11/03*)

ACB calls for a rule-making process and submits a FOIA request for FHFB documents related to the FHLBanks’ disclosures and registration with the SEC

- In a March 11 letter to Korsmo from ACB Chairman D. Russell Taylor, the ACB noted that it is “greatly concerned that a number of issues or questions” on the issue of FHLBank disclosures “have not been fully analyzed or the results have not been publicized.” Taylor cautioned that the FHLBanks are still converting their capital structures to the new capital requirements that have been recently approved and amended and that “ACB’s members are concerned that SEC registration could cause a disruption to the stock conversion process.” Taylor added, “At a very minimum, ACB strongly believes that it would be prudent to coordinate any development of policies for disclosures that may come under a different regulator with an adequate period of time for the FHLBanks to complete the capital transition and stock conversion process.”
- The ACB also urged Korsmo “to work to ensure that disclosure requirements do not change the statutory structures of the FHLBank System” and “to develop regulatory disclosure requirements that conform to the structure and operations of the FHLBanks first and to the

regulatory agency structures second.”

- The ACB requested that Korsmo provide the group with “any and all documents that deal with the issues related to FHLBank or FHLBank System disclosures and/or registration with the SEC that are subject to a Freedom of Information Act (FOIA) request.”
- Finally, the ACB called for a “full rulemaking process,” which Korsmo had promised in a November 25, 2002 letter to the ACB, ABA and the ICBA. The ACB requested a public comment period for the rule making of at least 90 days. (*D. Russell Taylor, Chairman, ACB letter to FHFBC Chairman John Korsmo, 3/11/03*)

Former National Economic Council director confirms that the Treasury Department’s call for all GSEs to register their stock with the SEC was done with White House approval but claims the unique nature of the FHLBanks never came up in GSE policy debate

- In an *American Banker* interview, former National Economic Council director Lawrence Lindsey disputed the FHLBank of New York President’s claim that the Treasury Department’s call for the FHLBanks to register their stock with the SEC was done without clear White House approval. “The [Treasury Undersecretary Peter] Fisher testimony went through White House clearance,” Lindsey stated. “It carries the blessing of the administration.” FHLBank of New York President Alfred A. DelliBovi claimed that the Treasury Department’s call for the FHLBanks to register their stock with the SEC was done without clear White House approval. DelliBovi claimed there is no evidence that Fisher had ever fully vetted the plan with White House policymakers before recommending last July that all GSEs comply with the same financial disclosure rules agreed to by Fannie and Freddie. (*American Banker, Rob Garver, 3/10/03, 3/17/03*)
- Lindsey, however, admitted that the administration focused mainly on Fannie and Freddie when creating its disclosure policy for the GSEs and that the significantly different capital structures at other GSEs, such as the FHLBanks, were not discussed. “As I recall Peter Fisher’s testimony, the relevant threshold was registration of publicly traded equity; obviously, privately traded equity within any company isn’t subject to SEC jurisdiction,” Lindsey said. The end result of the policy decision was that “GSEs should ultimately, with regard to equity, have no different treatment than do other corporations....So I think the answer is that the Home Loan banks didn’t come up as a separate issue, because they don’t issue equity to the public,” he said. A Treasury spokeswoman, however, described the situation differently. She noted that a “number of administration officials were aware of the differences in the nature of Federal Home Loan Bank stock,” and that this knowledge was reflected in letters to FHFBC Chairman Korsmo and members of the FHLBank System in July and August. (*American Banker, Rob Garver, 3/17/03*)

Though Fannie initially fought efforts to register with the SEC, Fannie’s Chairman says FHLBanks should register their stock with the SEC

- Though Fannie “initially fought efforts by policymakers” to get it to register its stock with the SEC, Fannie’s Chairman Franklin Raines “has no sympathy for other GSEs engaged in a similar fight,” reported the *American Banker*. After an unrelated news conference on March

18, Raines said the FHLBanks are wrong to fight the proposal. "I agree with the administration that the Home Loan banks ought to register their common stock," he said. "It is good for them, and good for their investors and all their securities, to have a standard disclosure that looks like Fannie's. Other cooperatives register with the SEC, he added, and it's difficult to argue that a company is private when it has thousands of shareholders. "It will be untenable to have Freddie and Fannie filing 10-Ks, and they're not," he said. "It won't last. Better to go ahead and volunteer than to be brought in kicking and screaming," he added. "Voice of experience?," questioned the *American Banker*. (*American Banker*, 3/24/03)

Congressmen Shays and Markey to re-introduce bill by mid April that would remove Fannie & Freddie's SEC exemption

- Congressman Chris Shays (R-CT) stated March 13 that he plans to re-introduce a bill he co-sponsored last year with Congressman Edward Markey (D-MA) that would remove Fannie and Freddie's exemption from SEC requirements and would subject Fannie and Freddie to the same disclosure requirements as all other publicly traded companies. The two plan to offer the bill by the middle of April. (*American Banker*, Michele Heller, 3/14/03) "Fannie Mae and Freddie Mac are an accident waiting to happen if we don't start treating them like other publicly traded companies," Cong. Shays said through his chief of staff, Betsy Hawkings. (*Bloomberg News*, Al Yoon, 3/11/03) Although the bill did not pass last year, it is largely credited with the torrent of criticism about the GSEs' financial disclosures and resulted in Fannie and Freddie's agreement to voluntarily provide more financial disclosures. The Shays-Markey bill would force Fannie and Freddie to disclose to the SEC insider transactions and audited financial statements. They would also have to register and pay fees for new securities issues and adhere to the SEC's disclosure laws. Fannie and Freddie's voluntary agreement triggers some of the SEC's disclosure requirements, such as disclosing insider transactions and audited financial statements, but does not apply to their debt, nor does it require Fannie or Freddie to pay registration fees, as would be required under the Shays-Markey bill. (*Dow Jones Newswire*, Dawn Kopecki, 3/13/03)

HUD reviewing its oversight of Fannie & Freddie, including its authority to review and reject Fannie and Freddie's new business activities

- HUD Secretary Mel Martinez stated March 11 that the agency is reviewing its oversight of Fannie and Freddie. "We at HUD take our regulatory responsibilities seriously," he said in a speech to the America's Community Bankers. "Therefore, we are looking at the process by which these two very important institutions do their business and also the proper role HUD should play in their business," Martinez said. "We value the importance of these two institutions to provide liquidity to the mortgage market and we do understand at the same time, we do have a role. We intend to create a deliberative process to continue to look at our role," he stated. "We are going to look at our function and our obligation to ensure that we are carrying it [supervision of Fannie and Freddie] out in accordance with what the law

requires us to do.” (*Reuters*, Mark Felsenthal, 3/11/03; *Dow Jones Newswire*, Deborah Lagomarsino, 3/11/03) HUD regulates Fannie and Freddie’s mission oversight, while OFHEO regulates Fannie and Freddie’s safety and soundness.

- Secretary Martinez said March 20 that HUD is re-examining its “obligations and responsibilities” in regulating Fannie and Freddie, including its authority to review and reject new business activities. Reviewing new business activities “is an aspect of our oversight. And I know HUD hasn’t in the past been very active with that and it is something that we view as a responsibility of HUD,” Secretary Martinez told *Dow Jones Newswire* after testifying at an unrelated hearing before the Senate Banking Committee. “So we need to look at it and see how we need to address it.” (*Dow Jones Newswire*, Dawn Kopecki, 3/20/03)
- Responding to a question at a March 5 House Financial Services Committee hearing, Secretary Martinez said the agency may institute a pre-clearance program to evaluate Fannie and Freddie’s new activities. In a March 4 letter to HUD Secretary Martinez, Senate Banking Committee Housing Subcommittee Chairman Wayne Allard (R-CO) urged HUD to enforce this pre-clearance provision expeditiously and requested a status report on HUD’s progress. [See March 10, 2003 *GSE Report* for more details, www.gsereport.com]

SEC still reviewing Fannie & Freddie’s \$1,000 debt notes to consumers, says America’s Community Bankers

ACB raises concerns about Fannie & Freddie’s \$1,000 debt notes to consumers

ACB first complained to HUD about the note sales but ACB never received a response

- Community bankers charged March 11 that Fannie and Freddie have expanded outside their missions by offering \$1,000 debt notes to investors. “That to us is a movement into our market. They’re going after our customers,” said Russell Taylor, president of Rahway Savings Institution and President of the ACB. An official from Freddie said the investment notes meet mission restrictions because they are sold through brokers, not directly to investors. “There’s nothing inappropriate about us reaching out, expanding our investor base so we can fund mortgages at the lowest cost possible and pass those savings onto consumers,” said Freddie’s spokesman Douglas Robinson. (*Reuters*, Mark Felsenthal, 3/11/03) Fannie’s investment note program (launched in May 2001) is called “Investment Notes” and Freddie’s program (launched in April 2001) is called “FreddieNOTES.
- The SEC and Treasury Department are reviewing the way Fannie and Freddie are marketing the small-denominated notes, according to the ACB. “We have had communications with the SEC and it is in enforcement right now,” said ACB President Diane Casey Landry. ACB said it first complained to HUD about the note sales but ACB never received a response. (*National Mortgage News*, Lew Sichelman and Brian Collins, 3/17/03, 3/24/03)

- As noted in the June 14, 2002 *GSE Report*, the Treasury Department had earlier raised concerns about the marketing of Fannie and Freddie's \$1,000 investment notes to consumers. In a June 4, 2002 letter to the SEC, then Treasury Assistant Secretary for Financial Institutions Sheila Bair noted that these retail investment securities are not sold directly by Fannie and Freddie, but through securities broker-dealers. She noted, "Some broker-dealer marketing efforts rely heavily on the GSEs' relationship to the government as a selling tool. While the GSEs are required to and do clearly disclose that the Federal government does not guarantee their securities, little or no mention of the lack of a Federal guarantee is typically included in broker-dealers' marketing efforts." (*Treasury Assistant Secretary Bair's letter to SEC*, 6/4/02; *Reuters*, Mark Felsenthal, 6/5/02)
- Bair noted that sales literature circulated by some brokerage firms seems to "skimp on the warning label" that the GSEs' debt notes are not government guaranteed. Bair cited as an example a sales piece by Edward D. Jones, a regional brokerage firm that was offering Freddie's bonds in denominations sized for retail investors. The brochure noted that the issuer was "created by Congress" but never stated that the government does not guarantee its debt. (*New York Times*, Alison Leigh Cowan, 6/6/02) *Dow Jones Newswires'* Dawn Kopecki reported that Treasury's letter was prompted by a March 8 letter by ACB which asked the Treasury Department to prohibit Fannie and Freddie from targeting their core customers, complaining that Fannie and Freddie's investment notes were being marketed as a safe alternative to bank certificates of deposit, which are backed by the FDIC. (*Dow Jones Newswire*, Dawn Kopecki, 5/9/02, 6/5/02; *ACB's Diane Casey letter to Treasury Secretary Paul O'Neill*, 3/8/02)

FHLBank conducts first MPF Shared Funding transaction

Provides competition to Fannie & Freddie in the secondary mortgage market and reduces costs to consumers

FHLBanks will provide more complete disclosures than MBS disclosures provided by Fannie & Freddie

- The Chicago FHLBank announced March 21 the completion of the first transaction through the MPF Shared Funding™ program. The structure creates mortgage-backed certificates from conventional conforming mortgages as an alternative to agency mortgage backed securities guaranteed by Fannie and Freddie. As an addition to the FHLBank's existing Mortgage Partnership Finance® Program (MPF), the Shared Funding program "adds competition and efficiency to the secondary mortgage market, helping to reduce the costs of homebuying," reported the FHLBank of Chicago. (*FHLBank of Chicago press release*, 3/21/03)
- The first transaction involved the creation of privately-placed certificates, consisting of multiple classes or "tranches", by One Mortgage Partners Corp., a Bank One subsidiary and member of the Chicago FHLBank. The certificates are backed by approximately \$475 million

of single-family conventional conforming fixed-rate mortgages provided by affiliates of National City Mortgage and Wells Fargo Home Mortgage. (*FHLBank of Chicago press release, 3/21/03*)

- The Chicago, Des Moines and Pittsburgh FHLBanks purchased two senior tranches, rated “AAA” and “AA” by Standard & Poor’s, in private transactions for investment as core mission assets. The subordinate tranches, which provide credit enhancement for the senior tranches, were acquired by a Bank One affiliate. The National City affiliate is a member of the Pittsburgh FHLBank while the Wells Fargo affiliate is a member of the Des Moines FHLBank. Future transactions also will include the sale of highly rated senior tranches with attractive risk characteristics to FHLBank member institutions for their investment needs. (*FHLBank of Chicago press release, 3/21/03*)

Provides competition to Fannie & Freddie in the secondary mortgage market and reduces costs to consumers

- Many in the industry see the MPF Shared Funding program as a viable alternative to Fannie and Freddie. (*Dow Jones Newswire, Dawn Kopecki, 3/21/03*)
- "We view the MPF Program as providing essential competition to the secondary market for residential mortgage loans thereby lowering the cost of credit," said Steve Bartlett, President of The Financial Services Roundtable. "The new Shared Funding initiative will attract additional capital to the mortgage market, lower mortgage rates for consumers, and diversify credit risk throughout the financial system." (*FHLBank of Chicago press release, 3/21/03*)
- "Shared Funding will help the MPF Program develop to its full potential as a strategic alternative for our member lenders," said Alex J. Pollock, President and Chief Executive Officer of the Chicago FHLBank, which developed the MPF Shared Funding program. (*FHLBank of Chicago press release, 3/21/03*)
- "As part of the MPF Program, Shared Funding is fully consistent with the housing finance mission of the Home Loan Banks, and Shared Funding is designed to strengthen the cooperative nature of membership," said Pat Conway, President and Chief Executive Officer of Des Moines FHLBank. (*FHLBank of Chicago press release, 3/21/03*)
- "This is an important tool in providing the FHLBanks with balance sheet management flexibility, which will enhance our ability to serve the housing market effectively," said James D. Roy, President and Chief Executive Officer of the Federal Home Loan Bank of Pittsburgh. "Shared Funding is good for member financial institutions, and it's good for homebuyers." (*FHLBank of Chicago press release, 3/21/03*)
- "The secondary mortgage market competition provided by the Shared Funding program is a very positive development for homebuyers," said Tom Neary, Executive Vice President, Capital Markets, Wells Fargo Home Mortgage. "When lenders have more funding choices, the secondary market competition will translate to better prices for consumers." (*FHLBank of Chicago press release, 3/21/03*)

- Todd Householder, Executive Vice President, National City Mortgage, emphasized, "We are pleased to be a participant in this initial Shared Funding transaction, which is a great opportunity from our perspective. Through the efforts of Ted Tozer, Senior Vice President, Capital Markets, along with the Federal Home Loan Banks in Pittsburgh and Chicago, this unique offering is definitely a 'win-win' for everyone, especially our mortgage customers." (*FHLBank of Chicago press release, 3/21/03*)

Shared Funding program different than other agency MBS

- Unlike agency MBS, which are guaranteed by Fannie and Freddie, the FHLBanks do not guarantee Shared Funding certificates. Credit support for the senior tranches is provided by the FHLBank member through its purchase of the subordinate tranches. Funding for the mortgages is provided by the FHLBanks through their purchase of the senior tranches. The FHLBanks also manage the interest rate risk of the senior certificates. (*FHLBank of Chicago press release, 3/21/03*)

More complete disclosures than MBS disclosures provided by Fannie & Freddie

- Shared Funding certificates are offered only in private placement transactions, not in public offerings. The financial disclosures pertaining to Shared Funding certificates will be equivalent to those for private-label MBS, which are broader and more complete than the MBS disclosures provided by Fannie and Freddie. The Chicago FHLBank is the master servicer and master custodian in the transaction announced March 21. Banc One Capital Markets, Credit Suisse First Boston and Morgan Stanley acted as placement agents and Lehman Brothers acted as financial advisor. LaSalle Bank, an affiliate of ABN AMRO and a member of the Chicago FHLBank, will serve as Trustee. (*FHLBank of Chicago press release, 3/21/03*)

FHFB Chairman says FHFB will not consider plans to allow FHLBanks to issue MBS this year

Notes that the FHFB is still reviewing issues surrounding potential multi-district FHLBank membership

Says FHFB will not consider plans to allow FHLBanks to issue MBS this year

- In a March 11 speech before the America's Community Bankers, FHFB Chairman John Korsmo, said that securitization is not on the FHFB's agenda this year. Banks are not clamoring for it as they don't believe there's a way to make money through issuing mortgage-backed securities, he stated. (*Dow Jones Newswire, Deborah Lagomarsino, 3/11/03*) "No such proposal [on the issuance of MBS] has come forward, and at the Finance Board, we are not at present studying the issue. In short, securitization is not on our agenda for this year." (*FHFB Chairman John Korsmo's remarks before the ACB's Government Affairs Conference, 3/11/03*)
- According to an internal September 10, 2002 draft memo, the FHFB had considered developing a securitization program for its Mortgage Partnership Finance program (MPF)

and Mortgage Purchase program (MPP). However, according to the draft memo, under the current system, a securitization program would lose money. (*American Banker*, Rob Garver, 9/27/02) [See October 11, 2002 *GSE Report* for more details. www.gsereport.com]

Notes that the FHFB is still reviewing issues surrounding potential multi-district FHLBank membership

- In terms of the issue of multi-district FHLBank membership (allowing a bank to belong to more than one FHLBank), Korsmo stated that the FHFB has backed away from a proposal it released last summer and is taking a fresh look at the issue. “We are stepping back. Staff is looking at some of the issues,” he said. He noted that it would “be a while” before another study on the multi-district issue will be released. (*Dow Jones Newswire*, Deborah Lagomarsino, 3/11/03)
- The FHFB recently asked the FHLBanks to comment on the issue of multi-district membership. Only five of the 12 FHLBanks said that they support FHLBank multi-district membership, according to letters submitted recently to the FHFB. [See February 24, 2003 *GSE Report* for more details.] Korsmo said he planned to begin a formal rule making in June if the FHFB’s analysis of membership issues determines that action is warranted. (*FHFB press release*, 2/13/03) Last year, the FHFB received over 150 comment letters reflecting the industry’s cautious support of multi-district membership. [See March 15, 2002 *GSE Report* for more details, www.gsereport.com] Treasury Undersecretary for Domestic Finance Peter Fisher and then Treasury Assistant Secretary for Financial Institutions Sheila Bair stated that they did not believe the FHFB had the legal authority to allow institutions to belong to more than one FHLBank. [See May 3 and May 17, 2002 *GSE Reports* for more details, www.gsereport.com]

OFHEO report notes Fannie & Freddie’s changing risk profiles

Fannie & Freddie have shifted their business strategy to asset management, which increases interest rate risk

Fannie & Freddie have expanded their business products, which has raised the sophistication and complexity in Fannie & Freddie’s risk profiles

Technology advances have increased Fannie & Freddie’s operational risks

- In its FY 2002 Performance Report, OFHEO noted that Fannie and Freddie were adequately capitalized each quarter and exceeded their safety and soundness standards, yet OFHEO cautioned about Fannie and Freddie’s changing risk profiles. At the end of FY 2002, OFHEO reported that Fannie and Freddie held or guaranteed about \$3 trillion in mortgages. (*OFHEO FY 2002 Performance Report*, 2/27/03)

Fannie & Freddie have shifted their business strategy to asset management, which increases interest rate risk

- “The Enterprises have realigned their businesses to emphasize asset management rather than credit guarantee. At year-end 1992, Fannie Mae and Freddie Mac held 19 percent of their book of business in portfolio and guaranteed 81 percent in the form of mortgage-backed securities. By September 2002, the proportion of the book of business held in portfolio had increased to 43 percent, with a corresponding decline in the guarantee business to 57 percent of the total. This realignment in business strategy significantly alters the risk profile of the Enterprises, shifting risk management from credit guarantee to both credit risk and interest rate risk management. Thus, OFHEO has had to shift its oversight activities to focus more on interest rate risk management, even as credit exposures were growing rapidly.” (*OFHEO FY 2002 Performance Report, 2/27/03*)

Fannie & Freddie have expanded their business products, which has raised the sophistication and complexity in Fannie & Freddie’s risk profiles

- In response to more ambitious affordable housing goals and the shift in business strategy, Fannie and Freddie “have expanded their business products, with increasing sophistication and complexity.” This includes the following: purchasing high loan-to-value loans, promoting the expansion of reverse mortgages for elderly borrowers, developing the means to reach less creditworthy borrowers, and funding their expanded portfolios with innovative debt products. To manage these assets and liabilities, Fannie and Freddie have increased their use of derivative instruments from a notional amount of \$72 billion at year-end 1993 to \$1.3 trillion in September 2002 – a more than eighteen-fold increase. “Each of these initiatives represents a heightening of the sophistication and complexity embedded in the risk profiles of Fannie Mae and Freddie Mac.” (*OFHEO FY 2002 Performance Report, 2/27/03*)

Technology advances have increased Fannie & Freddie’s operational risks

- “Dramatic advances in technology provide the foundation for these business initiatives. The Enterprises employ cutting-edge risk management techniques, built on quantitative models, to manage the many alterations of their risk profiles. Automated underwriting and related technology innovations by Fannie Mae and Freddie Mac have revolutionized the mortgage finance process and have led to significant shifts in the structure of the mortgage finance industry. Communication technologies and E-Commerce represent further expansion opportunities for the Enterprises to streamline their businesses. These technologies carry with them operational challenges that not only permit Fannie Mae and Freddie Mac to leverage their resources but also heighten their operational risks. Those trends are very likely to continue as the Enterprises search for new opportunities to meet their stated financial goals of continued strong earnings growth.” (*OFHEO FY 2002 Performance Report, 2/27/03*)

OFHEO renews its call to be removed from the appropriations process

- OFHEO also reiterated its call to be removed from the appropriations process. “Given the Enterprises’ rapid growth in volume, complexity, and new activities, this [appropriations] process limits OFHEO’s flexibility to adapt quickly to the Enterprises’ changing risk profiles.” Fannie and Freddie provide the funds for their own regulation, but determining the level of funding has been subject to the congressional appropriations process. Other federal

financial regulators, such as the OCC and OTS, are not subject to the appropriations process, and thus, simply collect their fees directly from the banks and thrifts they supervise. President Bush's FY 2003 and 2004 budgets also recommended that OFHEO be removed from the appropriations process. (*OFHEO FY 2002 Performance Report*, 2/27/03)

Congressman Ney opposes broad GSE reform if similar to previous bills but will consider any new GSE regulatory reform bills

- House Financial Services Housing Subcommittee Chairman Bob Ney (R-OH) told *Market News International* March 7 that he will continue to defend Fannie and Freddie should broad new GSE reform proposals materialize. "I will have the same attitude as last time," he stated. "Fannie and Freddie have done an awful lot of outreach to expand homeownership across the country." He noted that any new GSE regulatory reform bill "deserves to be looked at. Maybe there'd be parts of it that would be okay." However, he promised to oppose any measure that would "gut" either GSE, which he claimed previous sweeping reform bills would do. Questioned about the possibility of replacing the current GSE safety and soundness regulator, OFHEO, Ney responded, "I'd have to see where the dilemma is. They've [OFHEO] done a decent job." Last May, Congressman Ney mobilized opposition to the Shays-Markey bill that would have required Fannie and Freddie to submit to the same securities laws and disclosure regulations as other publicly traded companies. (*Market News International*, Claudia Hirsch, 3/7/03)

Fannie Mae and Freddie Mac

Former Treasury Assistant Secretary for Financial Institutions Sheila Bair suggests an overhaul of GSE oversight

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

- “The only protection against the systemic risk associated with Fannie and Freddie is their full privatization, so that a fully competitive secondary mortgage market will develop in the country” recommended American Enterprise Institute’s (AEI) resident fellow Peter Wallison in an *American Banker* commentary. Therefore, “if one or more of the players encounters financial difficulties there will be no collapse in residential lending and no systemic effect on the general economy.”
- A recent systemic report on Fannie and Freddie by OFHEO essentially stated that there “is no significant danger [to the economy] now, because Fannie and Freddie are currently healthy, but even today they are so large that an unresolved financial crisis affecting either of them could seriously damage the nation's economy as a whole. And since they are growing rapidly, the threat they pose grows along with them.” [See February 24, 2003 *GSE Report* for more information on OFHEO’s systemic risk study, www.gsereport.com]
- OFHEO was unable, however, to include in its report the two most significant reasons why Fannie and Freddie create systemic risk, noted Wallison.
- “First, it would have been impolitic for OFHEO to point out to Congress that the health of the entire home financing structure in this country rests on the decisions of only two small groups -- the executives of Fannie Mae and Freddie Mac. It is, after all, Congress that established and perpetuates this structure, and it is not for regulatory agencies to question the wisdom of Congress. Yet the fact remains that if the management of either of these companies seriously miscalculates its company's risks, both the residential financing system and the real economy of the United States will be in serious trouble.”
- OFHEO also could not mention in its report that “one of the best defenses against a collapse” by Fannie or Freddie is OFHEO's ability to “stop bad decisions before they damage safety and soundness.” However, this idea is “unrealistic.” He explained, “As we saw in the S&L crisis, efforts by a regulatory agency to limit an industry's growth are often met by congressional opposition if it will mean higher costs for consumers. If OFHEO, finding risky activities at Fannie and Freddie, tried to restrict their growth, it would be strongly opposed both by the two companies themselves and by those in Congress who fear the resulting rise in home mortgage rates...The likelihood, then, is that Fannie and Freddie will be allowed to stay on their risky course -- as were the S&Ls -- because Congress does not want to face the short-term result of a regulatory crackdown. Full privatization is the only solution to Fannie and Freddie’s systemic risk. (*American Banker, Viewpoints by AEI Resident Fellow Peter Wallison, 3/7/03*)

National Credit Reporting Association would like more government oversight of Fannie & Freddie's automated underwriting systems

HUD has been reviewing Fannie & Freddie's AU systems for four years

- Inaccuracies in credit reports are putting 8 million consumers at risk of being misclassified as subprime credits and charged higher mortgage rates, according to a joint study by the Consumer Federation of America and the National Credit Reporting Association. At a press conference announcing the study, NCRA Executive Director Terry Clemans said he would like to see more government oversight of the major credit repositories (Equifax, Experian and TransUnion), which produce the credit scores and Fannie and Freddie's automated underwriting systems that depend on credit scoring. "The systems of Fannie Mae and Freddie Mac are excellent tools for most of the population. But as efficient as they are, they are not perfect," Clemans said. (*Origination News*, 1/03)
- In related news, Fannie announced new features to its automated underwriting system, Desktop Underwriter (DU) that includes a new design, consolidated access to DU for wholesale lenders and a new online help center. (*Fannie press release*, 3/10/03)

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

- HUD has been investigating Fannie and Freddie's automated underwriting systems since 1999 to ensure that the GSEs' systems comply with fair-lending standards. Back in October of last year, HUD Secretary Mel Martinez said he expected to release the results of its fair lending study of Fannie and Freddie's automated underwriting systems by year-end. (*Reuters*, Mark Felsenthal, 10/22/02) However, in December, Secretary Martinez said that the release of HUD's fair lending study was still under review but that HUD wanted to have it out soon. (*Reuters*, Mark Felsenthal, 12/11/02) In March 1999, HUD commissioned an independent study by the Urban Institute, which found that Fannie and Freddie's underwriting guidelines may inadvertently have a disparate impact on minority borrowers. The report also noted that Fannie and Freddie "do not appear to have gone as far as some primary lenders to serve low-income and moderate-income borrowers and to minimize disproportionate effects on minorities." (*HUD/Urban Institute Study*, "A Study by the GSES' Single Family Underwriting Guidelines, April 1999)
- A 2001 Mercer Management Consulting study found that Fannie and Freddie's AU systems resulted in a smaller percentage of loan approvals for minorities than AU systems created by other companies. [See March 30, 2001 *GSE Report* for more information, www.gsereport.com]
- Both Fannie and Freddie are also facing class action lawsuits over their automated underwriting systems. [See November 1, October 11, and September 27, 2002 *GSE Reports* for more information, www.gsereport.com]

Georgia legislator references an expected letter from Freddie to urge passage of an amended predatory lending bill

Georgia State Senator Stephens says he was expecting a faxed letter from Freddie in 30 minutes warning that if the Georgia bill was not amended, Freddie would withdraw from the Georgia mortgage market

Stephens claimed Fannie would follow suit

Freddie letter arrives five days later

Stephens claims Freddie misled him and weakened its subsequent letter

Atlanta Journal and Constitution editorial claims Stephens and Governor Perdue misled everyone and that Freddie's letter does not support his earlier warnings

"Freeloading Freddie Mac" was "out of bounds," charges associate editorial page editor of the *Atlanta Journal and Constitution*

Legislator that pushed the original law calls for an investigation

- On March 6, Georgia State Senator Bill Stephens (R-Canton) – Governor Sonny Perdue's floor leader - announced to a "hushed chamber of fellow senators" that in 30 minutes a letter from a Freddie official would be faxed to him warning that if the state did not act on the predatory lending bill within 48 hours, the GSE would withdraw from the Georgia mortgage market. Fannie would also soon be following suit, Stephens warned. "There was a Colin-Powell-at-the-UN kind of feel to the room as the hushed chamber listened...The clock kept ticking. The letter never came. But Stephens' motion carried, and the Senate agreed with the much more extensive House rewrite of last year's landmark predatory lending law," reported Tom Baxter with the *Atlanta Journal and Constitution*. The Senate went on to vote 29-26 for the revised bill. (*Atlanta Journal and Constitution*, Tom Baxter, 3/9/03, Rhonda Cook, Nancy Badertscher, 3/24/03)
- "Invoking the names of the two government-sponsored institutions was a chilling move, since they are the largest purchasers of home loans in the state," reported the *Atlanta Journal and Constitution*. "The move would be like dropping a bomb on the home loan industry, said Senator Casey Cagle (R-Gainesville). "It would be huge – devastating," he said. "The industry would suffer." However, the letter never came. "We did not send a letter to the Legislature," said Freddie's spokeswoman Sharon McHale in an interview. "Back in November, we stopped buying high-cost loans in Georgia. We are buying all other loans." During the debate, Senate Minority Leader Michael Meyer von Bremen (D-Albany) called a Fannie representative, who said the company was not going to take sides. "We did not issue an ultimatum," said Fannie's spokesman Chuck Greener. "But like everybody else, we

expressed to all parties our concern that the issue be resolved as expeditiously as possible.” Consumer advocates were incensed. “I think it’s reprehensible that this tactic was used,” said AARP lobbyist Kathy Floyd. “It had an impact on the vote count and the consumer is the loser.” (*Atlanta Journal and Constitution*, Henry Unger, 3/7/03; *Associated Press*, Barnini Chakraborty, 3/6/03)

- “So whether the letter was real or not, the governor acted as though the threat was. Some Perdue allies argued later that the letter wasn’t the decisive factor in the vote, and they’re probably right. But it sure seemed symptomatic,” reported Baxter. Hours after the Senate agreed with Stephens’ motion, Erin O’Brien, Perdue’s communications director, said a barrage of phone calls from advocacy groups had caused Freddie to hold up on faxing the letter. (*Atlanta Journal and Constitution*, Tom Baxter, 3/9/03)

Freddie letter arrives five days later

- Five days after he promised it, Senator Stephens produced a letter from Freddie on March 12. A letter from Mitch Delk, senior vice president for government relations at Freddie, was sent to Governor Sonny Perdue on March 11. Delk wrote that Freddie had discussed with Perdue’s staff plans to “withdraw from the Georgia market at the end of February, if a legislative solution was not forthcoming.” Stephens commented, “Everything we said...was true,” responding to suggestions that he misled fellow senators. “The only thing that wasn’t true was they were faxing a letter.” Senate Minority Leader Michael Meyer von Bremen (D-Albany) was distressed that the letter was not sent for five days. “As critical as this was to the banking community and to consumers, I regret that the Senate did not have an opportunity to see this letter,” he said. (*Atlanta Journal and Constitution*, 3/13/03)
- Delk acknowledged that Freddie had set a February deadline for fixing problems in the law, but he said that conversation had come two months ago and not at the last minute, as legislators for the governor had suggested. “I never intended to be the pawn in the political process,” Delk said. “We had one specific provision we were interested in achieving, and we had no interest in undermining the substantive borrower protections embedded in the act.” (*Atlanta Journal and Constitution*, Rhonda Cook and Nancy Badertscher, 3/24/03)

Stephens claims Freddie misled him and weakened its subsequent letter

- In an op-ed in the *Atlanta Journal and Constitution*, Senator Stephens claimed Freddie misled him and weakened its subsequent letter. “In January, the Governor’s Office and the Georgia General Assembly were informed of Freddie Mac’s decision to withdraw from the Georgia market at the end of February unless required changes were made to the act’s provisions.” He noted that on the morning of March 6th, “top staffers in the Governor’s office were told that a letter from Freddie Mac was being prepared confirming its decision to exit the Georgia mortgage market.” He noted that Freddie officials gave the Governor’s office a time to expect the letter by fax, which coincided with the beginning of the debate on the predatory lending bill. Stephens stated, “Believing this information to be absolutely accurate, I made a statement during debate referencing the pending arrival of the letter and its contents.” The debate, however, concluded with Freddie “having failed to transmit the letter as previously discussed.”

- “Four days after the debate, the Freddie Mac letter arrived. In a way only a federally financed entity can manage, the promised tone and content had been modified with the benefit of hindsight and Monday morning quarterbacking precision. The letter's weakened tone was disappointing to the governor, legislative leaders and those on both sides who fought nobly for what they believed to be the right policy.” Senator Stephens denied that legislators were coerced to pass the modified version of the law and that the Georgia Fair Lending Act, even with its modifications, “remains the toughest anti-predatory lending law in the nation.” (*Op-ed by Senator Stephens, Atlanta Journal and Constitution, 3/19/03*)

Atlanta Journal and Constitution editorial claims Stephens and Governor Perdue misled everyone and that Freddie's letter does not support his earlier warnings

- A March 19 editorial accused Governor Sonny Perdue's team of twisting facts. The editorial noted that the “pivotal moment” during consideration of a predatory lending bill was Senator Stephens' announcement that Freddie “was about to fax a letter to the state threatening to stop doing business in Georgia if the state did not reform its predatory-lending law within 48 hours.” Senator Stephens also warned that Fannie would withdraw from the state.
- “Oddly, though, the letter that Stephens claimed was coming immediately did not appear that day -- or the next. When a letter from Freddie Mac finally did appear, five days after the crucial Senate vote, Perdue and others quickly cited it as vindication of the pressure they had exerted on the Senate to act. But no fair reading of the actual letter supports such a claim. To the contrary, the letter, written by Freddie Mac senior vice president Mitchell Delk, criticizes the House bill for going too far and for unnecessarily weakening consumer protections.”
- Delk also rebukes Perdue for using Freddie as the deal closer in the Senate debate on the lending law, saying, “... last week's political scramble resulted from the Legislature's inability to resolve this issue -- rather than an 11th hour ultimatum by the secondary mortgage market.” Stephens still insists that the Freddie letter justified his dire warning from the Senate floor. However, the editorial noted, “It's hard to understand how any reasonable reading of the Freddie Mac letter could bear out that conclusion.” The editorial also ran a complete copy of Freddie's March 11 letter. (*Editorial, Atlanta Journal and Constitution, 3/19/03*)

“Freeloading Freddie Mac” was “out of bounds”

- Jim Wooten, associate editorial page editor of the *Atlanta Journal and Constitution*, wrote a March 23 opinion piece entitled, “*Freeloading Freddie Mac out of Bounds.*” Wooten wrote: “Get the arrogance of this: An officer of a taxpayer-cushioned enterprise that pays lavish salaries, an enterprise that enjoys an indefensibly unfair privilege against private-sector competitors, presumes to lecture the Georgia General Assembly and a freely elected governor on how they should serve the people of a sovereign state. Arrogant? Supremely.”
- Yet, he noted, this was the context of the letter written by Freddie's Mitch Delk. Wooten explained that the Congressional Budget Office in 1996 estimated that Fannie and Freddie retain about \$2 billion per year in taxpayer subsidies estimated to be worth \$6.2 billion and

that neither pays state or local income taxes and both enjoy other advantages over their private-sector competitors. Among those advantages are exemptions from Securities and Exchange Commission registration fees and lower borrowing costs possible because their debt is presumed to come with a taxpayer-bailout promise.

- Regarding the Georgia predatory lending bill debate, Wooten wrote, “The Freddie Mac letter was so over the line, so arrogant and inappropriate, that it is surprising that it was written at all. Between the time that state Sen. Bill Stephens (R-Canton) stood in the well and announced its imminent arrival, and the actual production of something entirely different in tone five days later, only two explanations are possible. One is that the governor of Georgia lied to his floor leader and sent him forward to get trapped in a lie -- a palpable absurdity. The other is that politically savvy activists got to the vulnerable Freddie Mac.”
- “The result was a letter that lectured the governor and legislators. Inappropriately, the Freddie Mac officer declared a preference for the bill activists wanted. ‘Unfortunately, this [bill] was not good enough for the House,’ wrote Delk, pronouncing the House guilty of ‘weakening substantive provisions of GAFLA (the Georgia Fair Lending Act).’” Delk opined, “The Senate was left with no time to respond.”
- Wooten concluded, “So here we have this private company that doesn't even pay taxes in Georgia lecturing elected officials on how they should perform their jobs. That's meddling -- something Congress should do to end the unfair tax advantages that Freddie Mac enjoys.” (Opinion piece by Jim Wooten, associate editorial page editor of the *Atlanta Journal and Constitution*, 3/23/03)

Legislator that pushed the original law calls for an investigation

- On March 21, the legislator that pushed the original law last year - Senator Vincent Fort (D-Atlanta) – wrote to state Inspector General James Sehorn and described the situation as “the Freddie Mac letter fiasco.” Sehorn confirmed that he had discussed the issue with Senator Fort but that he had not determined whether he will get involved. Sehorn said he asked state Attorney General Thurbert Baker for an opinion. However, Sehorn is unsure whether his responsibilities to investigate fraud, waste and abuse extend to allegations that false statements were made on the floor of the Legislature. (*Atlanta Journal and Constitution*, Rhonda Cook and Nancy Badertscher, 3/24/03)

<p>Substantive changes in GSE policies are very unlikely in near-term, says ISI Group</p> <p>ISI gives “high” long-term odds of raising the GSEs’ capital requirements and limiting the size of their portfolios</p>
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- The ISI Group (International Strategy and Investment) noted that although Federal Reserve Bank President of St. Louis William Poole’s comments “reflect the thoughts they hear repeatedly inside the Fed and the Treasury Department, and changes of the kind outlined by Poole are likely in the long run, substantive policy changes are very unlikely in the near

term.” The ISI Group outlined some of the different policy options regarding the housing GSEs, along with their view on the long run odds of reform: (1) create stronger regulator, moderate odds; (2) tighten GSEs’ charters to limit activities, moderate odds; (3) raise capital requirements, high odds; (3) limit size of portfolios, high odds; (4) require GSEs to file with SEC, moderate odds; (5) require GSEs to pay state and local taxes, low odds; (6) eliminate “credit line” to Treasury Department, moderate odds; (7) eliminate single issuer exemption, moderate odds; (8) issue additional GSE charters, low odds; (9) fully privatize GSEs, moderate odds; and (10) allow Ginnie Mae to compete, low odds. (*ISI Morning Political Report, International Strategy & Investment*, Tom Gallagher, Andy Laperriere, Melissa Loesberg, 3/11/03)

Fannie & Freddie cap some mortgage bond production for sixth month

- Fannie and Freddie this month capped creation of certain mortgage bonds for the 6th consecutive month, a sign of the turmoil caused by historically low mortgage rates. The limits imposed by Fannie and Freddie come simultaneously with a massive home refinancing wave prompted by record low rates. The magnitude of the refi wave has swamped lenders with applications and slowed the entire loan process, creating a shortage of some mortgage bonds.
- Fannie and Freddie limited the production of these complex securities because lenders are not able to process the underlying loans quickly enough. 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). The agencies told *Reuters* they had enacted the limits to ensure there are enough pass-throughs for a liquid market. Fannie capped limited creation of CMOs backed by 15-year, 5% pass-throughs for April delivery at \$9 billion. Fannie also said it has limited creation of CMOs backed by 30-year, 5 ½ percent pass-throughs to be delivered in April at \$11 billion. Freddie said it limited the creation of CMOs backed by 30-year, 5 ½ percent securities and 15-year, 5% pass-throughs for April delivery. (*Reuters*, Aleksandrs Rozen, 3/13/03)

Are lenders paying too much in guarantee fees to Fannie & Freddie?

The GSEs’ raising their guarantee fees while enjoying record profits and low credit losses sparks criticism

- “Do lenders pay too little, or too much, to protect themselves from credit risk on loans sold to Fannie and Freddie?” asks *Mortgage Servicing News*. Fannie and Freddie have both indicated that they’d like to see the average guarantee fees stabilize or even increase this year. Traditionally, lenders paid 19 basis points annually for the imprimatur of a GSE backing full payment of principal and interest to investors, a rate not much smaller than the traditional servicing fee of 25 basis points that is paid to the lender to manage the loans. Meanwhile, the

credit losses at Fannie and Freddie are incredibly low. At Freddie, credit losses represented just 0.7 basis points of its average total outstanding mortgage portfolio in 2002. *Mortgage Servicing News* noted, “It’s easy to see why managing credit risk is a very, very profitable business for the GSEs. It’s also easy to see why lenders...are seeking ways to minimize the fees they pay for credit protection. We don’t expect to see any substantial rise in g-fees anytime soon. Unless delinquencies and defaults on prime loans start to rise marketedly, it is unlikely that the GSEs will be able to increase the g-fee rates anytime soon.” (*Mortgage Servicing News*, 3/03)

When Freddie announced an increase in guarantee fees for 2002, criticism mounted

- When Freddie announced that it was raising its guarantee fees and setting a floor of 16 basis points on its guarantee fees for 2002, criticism mounted. First, there was criticism over the very public way Freddie announced the guarantee fee minimum in a statement published on its Web site.
- MBA Chairman James M. Murphy sent a December 21, 2001 letter to Freddie’s executive vice president Paul Peterson raising concerns that Freddie’s announcement on guarantee fees could create the perception of what it calls “signaling” [to Fannie]. The MBA added that it “could be interpreted by some as laying the groundwork for potential collusion.” (*National Mortgage News*, Paul Muolo, 1/21/02)
- Secondly, lenders and critics of the GSEs believed it was unreasonable for Freddie to increase its guarantee fees when the company is profitable and suffering little credit losses. “It’s outrageous that Freddie Mac is raising the g-fees in a year that they were having record profits and at the same time the country is in a recession,” said Michael House, Executive Director of FM Watch. (*Dow Jones Newswire*, Joy Shaw, 1/24/02) One lender stated, “I’m not sure if this [minimum guarantee fee] was written for the benefit of their (stock) analysts, but I find the statement quite shocking,” said one lender, requesting anonymity. He added, “This is a unique situation. You have two firms [Fannie and Freddie] that control access to the secondary market and then one comes out and says they are going to set a price...this is impossible to rationalize. They’re making record profits.” (*National Mortgage News*, Paul Muolo, 12/21/01)
- Freddie’s Paul Peterson said the floor was being put in place because leading economic indicators pointed to a “higher credit cost environment.” (*National Mortgage News Daily Web site*, 12/21/01; *National Mortgage News*, Paul Muolo, 12/31/01) Peterson said that lenders could expect guarantee to increase by 1 to 2 basis points, or 0.01 to 0.02 percentage points on average. Mortgage analysts said the increase is substantial “considering mortgage lenders frequently fight over a fee difference as little as ¼ of a basis point.” (*Dow Jones Newswire*, Joy Shaw, 1/24/02)
- One lender argued that Freddie’s economic argument was flawed. “The actual losses that they are suffering are less than one basis point, so the rest of the (average guarantee fees) is pure profit,” the lender said. Freddie recently announced that its 2001 credit losses fell to a historical low of 0.7 basis point. Freddie said it expected credit losses to increase somewhat

in 2002 but remain less than two basis points of its average portfolio for 2002. (*Dow Jones Newswire*, Joy Shaw, 1/24/02) [See January 25 and March 1, 2002 *GSE Reports* for more details, www.gsereport.com]

GSE debt news:

- (1) Fannie to begin issuing short-term debt denominated in a foreign currency for the first time
- (2) Fannie's Treasurer says foreign appetite for GSE debt growing
- (3) Moody's affirms Fannie & Freddie's debt ratings

Background on GSE debt and the supply of Treasuries

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

Fannie to begin issuing debt under a foreign currency for the first time

- Fannie announced March 11 a new debt issuance vehicle - FX Discount Notes – a “multi-currency debt issuance vehicle for short-term debt.” Fannie's Chairman Franklin Raines noted that Fannie will issue predominantly in the euro, British pound, Swiss franc and Japanese yen, in addition to “other currencies as warranted by investor demand.” Raines added that Fannie will swap these foreign currency borrowings into US dollars to help finance its mortgage portfolio, which is dollar denominated. Fannie's Senior Vice President and Treasurer Linda Knight said the FX Discount Notes window will open for business on April 7, 2003. Knight told a news briefing in London that the new debt program would allow Fannie to extend its investor base to include accounts in Europe and Asia, which are not dollar-based. Knight said Fannie would market the notes in Europe ahead of the April 7 launch date. (*Fannie press release*, 3/11/03; *Reuters*, Catherine Evans, 3/12/03) Knight said Fannie did not have a specific target for how much it wanted to issue through the program. (*Financial Times*, Adrienne Roberts, 3/12/03)
- Knight said Fannie continued to target a cost of funds equal to or less than it would pay in dollars – currently around eight to 10 basis points below Libor for one-month to six-month debt. Fannie will continue marketing its long-dated, dollar-denominated benchmark notes in Europe and Asia. Foreign investors bought about 36% of the \$85 billion of benchmark notes Fannie issued last year. Knight said the cost of raising long-term funds via foreign currency

bond sales remained uncompetitive compared with what it pays in its home currency. “For longer-dated debt the best execution remains in the dollar market,” she said. “(But) if someone brought us an attractively-priced transaction in a foreign currency tomorrow, we are fully prepared to do it.” Freddie already issues in euros, having sold the first bond from its euro reference note program – equivalent to Fannie’s benchmark notes -- in September 2000. Freddie’s euro reference notes have attracted a growing following among European investors, although competition from local borrowers such as the European Investment Bank has meant funding costs have often been higher than in dollars. (*Reuters*, Catherine Evans, 3/12/03)

- Knight said Fannie’s 2003 long-term debt issuance will likely total \$290 billion, including \$95 billion to \$100 billion through its two benchmark programs. (*Dow Jones International News*, Henry Pulizzi, 3/11/03)
- Fannie’s new FX Discount Notes will have maturities of between five and 183 days. Initially the securities will be offered through a small dealer group consisting of Citigroup, Credit Suisse First Boston, Deutsche Bank Securities, Goldman Sachs, J.P. Morgan, and Lehman Brothers. Fannie said these dealers were selected based on their expertise in the euro commercial paper market and their activity in underwriting Fannie’s short-term debt securities. In addition, Fannie recently extended its funding desk hours to provide international investors the opportunity to execute new issue, long-term debt securities through dealer underwriters on a real-time basis more closely aligned with their own trading hours. Beginning January 27, 2003, Fannie opened its funding desk at 5:00 a.m. EST to execute long-term debt securities transactions. (*Fannie press release*, 3/11/03)

Fannie’s Treasurer says foreign appetite for GSE debt growing

- A trend is in place for continued growth in foreign demand for Fannie’s debt products and increasingly strong liquidity during London trading hours, Fannie’s Treasurer Linda Knight told *Market News International* March 21. “We continue to broaden out our investor base throughout Europe,” she said. Knight just returned from a European road show with Fannie’s Chairman Franklin Raines, which included approximately 25 presentations. European investors’ performances are increasingly being evaluated by external benchmarks, like Lehman’s or Salomon’s indices, which include agency debt and sometimes callable agency paper, Knight said. She described this as a “big development” that is drawing new kinds of European investors into agencies, like pension fund managers and insurance companies. Approximately 30 percent of the company’s investment capital is derived overseas. Raines noted recently that he would not be surprised to see the proportion of foreign investment reaching 40 percent. Of particular focus to Fannie is growing its investor base in the UK, Ireland, Germany, Switzerland, Italy, Spain, Holland, Denmark and Sweden, as well as Japan, South Korea, Hong Kong, China, Taiwan, Singapore, and Malaysia. Knight also noted that the last few years have seen a “very significant increase” in central banks’ commitment to agency holdings. “We would expect that to continue,” she said. (*Market News International*, Claudia Hirsch, 3/21/03)

Moody's affirms Fannie & Freddie's debt ratings

- Moody's Investor Service affirmed Fannie and Freddie's debt rating March 13 of Aaa on Fannie and Freddie's senior debt, Aa2 on their subordinate debt, and Aa3 on their preferred stock. It also maintained its Prime-1 ratings on the GSEs' short-term debt and A-minus on their financial strength. Fannie and Freddie have "well-structured" ways to deal with risk management and enough capital to endure market shocks, Moody's said in a press release. The President of the St. Louis Federal Reserve William Poole, however, noted a day before the Moody's press release, that Fannie and Freddie hold capital below the levels required of federally regulated banks and that Fannie and Freddie may lack enough capital to withstand a disruption in the capital markets. (*American Banker* as reported by *Bloomberg News*, 3/13/03) [See March 10, 2003 *GSE Report* for more information on Poole's comments, www.gsereport.com]

Fannie Mae

Fannie touts its S&P corporate governance rating of a 9 on a 10 point scale but is silent on its below-average rating from GovernanceMetrics International

Freddie also receives a below average rating from GovernanceMetrics

Governance-reform advocates wonder whether S&P can be objective when it collects fees from the companies it rates

- When Standard & Poor's gave Fannie a gold star in corporate governance in January (a 9 on its 10-point scale), the company wasted no time in publicizing the rating. However, back in December, Fannie "had no such cause to crow," reported Phyllis Plitch with *Dow Jones Newswire*. That is when GovernanceMetrics International (GMI), in launching its new governance ratings system, ranked Fannie at the bottom of the pack with a score of 2 (out of 10), one of 164 companies to draw a below-average rating. Institutional Shareholder Services, the first major firm to rate US companies on governance, won't even rank Fannie because it's not required to abide by US securities rules. The disparity in Fannie's ratings shows that judging corporate governance can at times be a qualitative exercise, reported Plitch. (*Dow Jones Newswire*, Phyllis Plitch, 2/24/03)

S&P and GMI take different approaches to rating corporate governance

- S&P takes a markedly different approach than GMI in assessing a company's corporate governance. While data used by GMI are found in publicly available corporate documents, S&P's governance rating depends on analysts' personal meetings with board members and executives, and access to non-public information, such as board minutes. In contrast to GMI, which is building its database of rankings whether the company is on board or not – S&P is building its primary ratings model around companies buying into the rating, which essentially means companies *hire* S&P to undertake an in-depth governance analysis. "That difference may help explain how Fannie Mae managed to look so much better in S&P's estimation than

in GovernanceMetrics,” reported Phyllis Plitch with *Dow Jones Newswire*. (*Dow Jones Newswire*, Phyllis Plitch, 2/24/03)

- Fannie was the first company S&P assigned its corporate governance score. (*S&P press release*, 1/30/03) Only ten companies have signed up for S&P’s service and only Fannie chose to make its rating public. The *Washington Post* estimated the cost of a company hiring S&P to review its corporate governance practices is \$50,000 to \$150,000. GMI also offers a governance assessment beyond only publicly available documents for \$50,000. Unlike S&P however, GMI does not plan to give companies the option of keeping their ratings private. “If a company wants us to come in and go into that kind of deep analysis we want to include whatever we find in our published ratings,” said GMI Chief Executive Gavin Anderson. (*Washington Post*, Ben White, 2/15/03)
- “For S&P’s competitors and some academic experts, [Fannie’s] high score raised a question about S&P’s approach: Why should a company get to choose whether its rating is made public? Several governance-reform advocates also wonder whether S&P can be objective when it collects fees from the companies it rates. (*Washington Post*, Ben White, 2/15/03)

Fannie & Freddie receive below-average ratings from GMI

- GMI, an independent corporate governance ratings agency, launched December 3 a corporate governance rating service for institutional investors and the completion of its ratings for all of the S&P 500 companies. GMI’s rating system incorporated more than 600 variables across seven broad categories of analysis, including board accountability, disclosure, executive compensation, shareholder rights, ownership base, takeover provisions and corporate behavior and social responsibility. Ratings will be recalculated approximately every six months and developments are updated daily. GMI is initially starting with the S&P 500, but plans to cover 2000 companies by the end of 2003. Of the S&P 500 companies five received the highest rating of 10, which GMI describes as “well above average” in their governance policies and practices, while 164 companies, including Fannie and Freddie, drew a below-average rating. GMI scores companies relative to each other; they are not scored against some theoretical gold standard. Accordingly, the company believes that its ratings reflect real world experience. Gavin Anderson, GMI’s chief executive officer cautioned, however, that a “company receiving a low score in our ratings does not necessarily mean that it has woeful governance, although that is possible. It definitely means that it has relatively poor governance features compared to others in this particular universe. It is possible that such a company may do better when compared to other companies that we have yet to rate in a larger universe.” (*GMI press release*, 12/3/02)

S&P gives Fannie a top rating

- S&P in issuing its rating of Fannie said that Fannie scored “strongly” or “very strongly” in four key areas: ownership structure and influence, financial shareholder rights and relations, financial transparency and information disclosure, and board structure and process. S&P further noted that in the area of financial disclosure, despite the company’s exemption from SEC requirements, Fannie’s voluntary disclosures generally meet and in some cases exceed those of its SEC-registered peers. (*S&P press release*, 1/30/03; *Fannie press release*, 1/31/03)

Fannie agrees to let CFN take over the servicing rights to its share of Conseco's manufactured housing portfolio

- A US bankruptcy judge on March 14 approved Conseco Inc.'s sale of its troubled finance unit for \$1.095 billion to CFN Investment Holdings LLC and a General Electric unit. The sale is expected to be completed by May 31. Under terms of the approved deal, CFN will pay \$772 million for substantially all of Conseco Finance's assets and GE Consumer Finance will pay \$323 million for the Mill Creek Bank assets. The last stumbling block to the deal was removed on March 14 when Fannie agreed to let CFN take over the servicing rights to its share of Conseco Finance's \$23 billion manufactured housing loan portfolio. Under the agreement, CFN will collect fees at a rate of 1.25 percent of the value of loans per year, which is higher than the industry average. When the loans were originally issued, the servicing fee rate was 0.5 percent. Some Conseco creditors opposed the large hike in servicing rates. CFN can charge 1.25 percent servicing fees on Conseco Finance's manufactured home loans for the first 12 months after the deal closes. The rate falls to 1.15 percent after that. (*Reuters*, David Bailey, 3/14/03) The reduction in servicing fees after the first year added an estimated \$70 million to the value of the deal, according to Conseco attorneys. (*Reuters*, David Bailey, 3/14/03) That would bring the total value of the sale to almost \$1.37 billion, Conseco attorney Richard Wynne said. (*Bloomberg*, Mary Wisniewski, 3/14/03) CFN also agreed to take on \$200 million of liabilities from Conseco Finance. (*Reuters*, David Bailey, 3/14/03) A hearing on Conseco's plan to emerge from bankruptcy is set for May 28. (*Bloomberg*, Mary Wisniewski, 3/14/03)
- CFN and GE Consumer Finance, which together had bid \$1.01 billion in cash at auction, increased the cash portion of their offer to \$1.095 billion on March 14. Raising the cash value of the sale and changing the service agreement helped them overcome opposition, including an objection by Fannie, Wynne said. Last week, Fannie said it favored a rival bidder, Berkadia LLC, a joint venture of Warren Buffett's Berkshire Hathaway and Leucadia National Corp. Berkadia lost at a court-supervised auction March 5, and failed two days later in an attempt to restart the bidding with a \$1.15 billion offer. (*Bloomberg*, Mary Wisniewski, 3/14/03)
- In a prepared statement, a Fannie spokesman said, "our review of the new servicing protocol gives us confidence that the manufactured housing securities will be serviced in an efficient and effective manner going forward. We look forward to working with CFN." (*Dow Jones Newswire*, Ann Keeton, 3/14/03)
- As noted in earlier *GSE Reports*, Fannie had to respond to potentially damaging questions about why it placed a \$70 million bid February 19 for the servicing rights to \$23 billion in manufactured-housing mortgages in the bankruptcy of Conseco Finance. Fannie holds about \$7 billion worth of bonds backed by Conseco's mobile home loans. [See March 10, 2003 and February 24, 2003 *GSE Reports* for more information, www.gsereport.com]

Fannie claims it charges risk-based pricing fees on customized loans to manage risk

- During a Web cast Wall Street conference recently, Fannie's CEO Frank Raines noted that the company has been managing the risk of more customized loans it is seeking to increasingly offer by charging risk-based pricing fees that have amounted to \$1.4 billion. Raines said this \$1.4 billion in unamortized risk-based pricing fees on Fannie's books have been collected up front, "but have not yet booked as income, consistent with generally-accepted accounting principles." Raines characterized the customized loans as part of the alternative "A" credit risk market and, when asked about who previously absorbed the risk from these loans before Fannie entered the market, said that it had been the domain of B-piece buyers in the subprime mortgage market. (*National Mortgage News*, Bonnie Sinnock, 2/3/03)

Fannie is one of the founding members of Financial Services Sector Coordinating Council

- Twenty-three financial services trade associations, financial institutions utilities and exchanges March 5 announced the formal, legal formation of the Financial Services Sector Coordinating Council created to help protect America's financial infrastructure. The new group formalizes the structure of an existing group, the Financial Services Sector Coordinating Council for Critical Information Protection and Homeland Security. The latter group was formed in June 2002 by the private sector with recognition from the Treasury Department. (*SIA press release*, 3/5/03; *Origination News*, Brad Finkelstein, 4/03)
- Rhonda MacLean, director of Corporate Information Security for Bank of America, will continue to chair the council. MacLean has served as the coordinator of the council since her appointment by the Treasury Department in May 2002. The council has focused its activities on four primary areas: (1) effective and rapid information dissemination of threat and incident information; (2) crisis management and response coordination; (3) outreach and organizational engagement; and (4) knowledge sharing and best practices to leverage existing work, which can be shared across the sector to improve security and business continuity practices that protect the financial services infrastructure. The Council plans to work closely with the Treasury through its Financial and Banking Information Infrastructure Committee. (*SIA press release*, 3/5/03)
- Founding members of the council include: America's Community Bankers; American Bankers Association; American Council of Life Insurers; ASIS International; Bank Administration Institute; Consumer Bankers Association; Credit Union National Association Fannie Mae; Financial Services Information Sharing and Analysis Center, LLC; Financial Services Roundtable and BITS; Futures Industry Association; Independent Community Bankers of America; Investment Company Institute; Managed Funds Association; NASDAQ Stock Market; National Association of Federal Credit Unions; NACHA - The Electronic Payments Association; The Clearing House; Securities Industry Association; The Bond Market Association; The Options Clearing Corporation (*SIA press release*, 3/5/03)

Freddie Mac

Freddie invests in luxury real-estate

- Freddie announced December 9 that it purchased a \$140 million mortgage from HSBC BANK USA to finance The Caroline, a mixed-use property located in the Chelsea section of Manhattan. The Caroline comprises 431 dwelling units, 105,000 square feet of retail and a 278-car parking garage. The \$140 million loan is one of the five largest loans ever purchased by Freddie. (*Freddie press release*, 12/9/02) According to Citi-Habitats.com, a penthouse apartment at The Caroline can set a consumer back \$14,900 a month. (www.citi-habitats.com, 3/18/03) The property includes a 12,000 square foot landscaped private roof deck and formal landscaped European garden with Carrera statuary, indoor valet parking, maid and valet services, linen service, room service from first class dining establishments located at The Caroline, and laundry and dry cleaning services. The building also includes the New York Health and Racquet Club at The Caroline, a 44,000 square foot facility – the largest NYHRC in the City and includes a 50-foot sky lit swimming pool. All kitchens have imported blue pearl granite counters. (www.thecarolineny.com, 3/18/03)

Freddie names Martin Baumann to new position of Executive Vice President, Finance

- Freddie March 19 announced that Martin F. Baumann has been named as executive vice president for Finance with responsibility for accounting, corporate planning, taxation, shareholder relations, and market and operating risk oversight. Baumann will report to David W. Glenn, vice chairman and president of Freddie. Baumann joins Freddie having served as partner, deputy chairman of the World Financial Services Practice, and as global banking leader for PricewaterhouseCoopers. During his 30-year career at PwC, his clients have included some of the largest financial services firms in North America. Baumann has led numerous projects in risk management, infrastructure development and internal controls. Baumann is also well known to the banking industry for his leadership role with respect to credit loss accounting issues. Baumann earned a B.A. in accounting from Queens College and an MBA, Finance from Baruch College. He also completed the Executive Program in Business Administration at Columbia University, and is a certified public accountant (CPA). (*Freddie press release*, 3/19/03)

Freddie hires former legislative director for Senator Tim Johnson

- Dwight Fettig is leaving his post as legislative director for Senator Tim Johnson (D-SD) to become director of congressional relations for the company. (*CQ Daily Monitor*, 3/17/03)

Federal Home Loan Banks

FHFB Chairman to hold April 7 meeting with chairman and vice chairman of the FHLBanks to discuss controversial FHLBank issues

- In a March 18 letter, FHFB Chairman John Korsmo invited the Chairman and Vice Chairman of the 12 FHLBanks to an April 7 meeting in Washington. The participants will be briefed on a number of issues that Chairman Korsmo and the FHLBanks' presidents "have serious disagreements," such as SEC registration of the FHLBanks' common stock and multi-district FHLBank membership, reported the *American Banker*. The *American Banker* speculated that because Korsmo has been "under fire" from the presidents of the 12 FHLBanks, he "has decided to go over their heads." (*American Banker*, 3/24/03)

FHLBanks had \$87 billion unsecured credit outstanding, with debt obligations of other GSEs comprising 26% of that amount

- The FHLBanks had total unsecured credit outstanding of \$87 billion as of January 31, 2003, with debt obligations of other GSEs comprising 26 percent of that amount, according to the FHFB's Office of Supervision. "The principal trends have been an increase in the holdings of the debt of other GSEs over the past two years, and a decrease in overnight and term extensions of credit to private counterparties over the past four months," the Office of Supervision noted. "As of January 31, 2003, unsecured investments of the FHLBanks aggregated to 11.4% of total assets," the Office of Supervision said. "Included in this total are investments in the debt obligations of other GSEs that aggregate to 3.2% of the FHLBanks' assets." (*Dow Jones Newswire*, John Connor, 3/12/03)

FHFB to reduce pay raises for most employees to bring its wages in line with other financial regulators

- The FHFB plans to reduce pay raises for most employees, freeze some salaries and reduce all performance-related bonuses this year to bring wages in line with other financial regulators, reported Dawn Kopecki with *Dow Jones Newswire*. OFHEO is also planning to increase contributions to its employee health coverage and create a new 401(k) retirement plan. The changes were recommended in report by the Hay Group, which compared the salaries and benefits of the FHFB to the Federal Reserve, Office of the Comptroller of the Currency, Office of Federal Housing Enterprise Oversight, Office of Thrift Supervision, and National Credit Union Administration. The report found that the FHFB's salaries were not in line with other federal regulators, both above and below the average pay for comparable positions. In total, the report found 13 employees at the FHFB with salaries that were 25 percent or more than their counterparts at other regulators. Some of those positions will experience salary freezes this year as the Hay Group reviews their responsibilities in more detail, said FHFB

spokesman Carter Wood. On the other hand, the FHFB had to increase the compensation for its examiners to bring their pay closer to the average annual salaries for other federal examiners. (*Dow Jones Newswire*, Dawn Kopecki, 3/7/03)

- The FHFB has been criticized in the past for its high compensation. An *American Banker* survey found that the FHFB and the National Credit Union Administration paid some of the highest salaries for financial regulators. The article noted that seven of the 20 highest-paid regulators work for these two agencies; the rest are either Fed employees or the presidents of some of the 12 Federal Reserve banks. (*American Banker*, Rob Blackwell, 8/27/02) [See September 13, 2002 *GSE Report* for more details, www.gsereport.com.]

FHFB issues proposed rule on public interest directors' qualifications

Last year, two FHFB members claimed the process for selecting board members was too political

- The FHFB is asking for public comment on a proposed rule to set the qualifications for public interest directors who serve on the boards of the 12 FHLBanks. The FHFB adopted the rule, which would require at least one of the public interest directors on each of the 12 FHLBanks to possess "strong understanding of the risks, including the interest rate risk, market risk and options risk," arising from a FHLBanks' activities. FHFB Director Allan Mendelowitz proposed the change to FHFB regulations to strengthen each Board's ability to deal with complicated financial issues. A total of 82 public interest directors serve on the boards of the 12 FHLBanks. They are appointed to three-year terms by the FHFB. The deadline for public comments is June 17, 2003. (*FHFB press release*, 3/12/03; *Federal Register*, pages 13238-13239, 3/19/03)
- Last year, the two Democrats (Franz S. Leichter and Allan I. Mendelowitz) on the five-member FHFB criticized the selection of the directors and complained that they had been shut out of the nominating process. See April 5, 2002 *GSE Report* for more information, www.gsereport.com)

FHFB appoints FHLBank of Dallas President to the Board of Directors of the Office of Finance

- The FHFB appointed March 12 Terry C. Smith, president of the FHLBank of Dallas, to a three-year term on the Board of Directors of the Office of Finance. Smith will replace Patrick J. Conway, president of the FHLBank of Des Moines, whose term on the three-member board expires March 31, 2003. The Office of Finance's primary function is to issue and service all debt securities for the Banks. The Office of Finance also provides the Banks with credit and general capital market data and manages their relationship with the credit rating agencies. In addition, it administers two other funding programs, the Resolution Funding Corporation (REFCORP) and the Financing Corporation (FICO). (*FHFB press release*, 3/12/03)

Farm Credit System/Farmer Mac

FCA considering a wide-ranging governance review, including a review of Farmer Mac supervision and consideration of requiring its institutions to register with the SEC

- The FCA is considering a far-ranging governance review that would consider disclosure policies, audit committee rules and oversight of member institutions, according to FCA's 2003 regulatory agenda approved by board members February 20. The agenda also includes a review of Farmer Mac's supervision to determine "what changes, if any, are needed to enhance the FCA regulatory and supervisory framework of Farmer Mac." (*Dow Jones Newswire*, Rebecca Christie, 2/20/03)
- FCA officials also approved an interim final rule on capital adequacy standards on risk-weighting for non-agency asset- and mortgage-backed securities. The FCA said it went straight to an interim final rule based on changes adopted by other financial regulators in 2001. FCA is also planning on updating its capital adequacy standards on derivatives accounting policy. When asked whether the FCA is considering requiring its institutions to register with the SEC, a FCA spokeswoman said the governance review would include a broad range of disclosure issues. (*Dow Jones Newswire*, Rebecca Christie, 2/20/03)

Postal Service

Bill that would reduce the Postal Service's payment to the Civil Service Retirement (CSRS) fund included in the House & Senate FY 2004 budget resolutions

Bill supported by the Postal Service, GAO, all four postal unions, and the postal management association

- A bill that would reduce the Postal Service's payments to the CSRS fund has been included in the House and Senate budget resolutions, which Congress is expected to act on by April 15. The bill, HR 735, which was unanimously approved by the House Governmental Reform Committee March 5, requires the Postal Service to use some of the savings to pay down its \$11 billion debt in fiscal years 2003, 2004, and 2005. Other savings would be used to continue funding retiree health benefits. (*DM News*, Melissa Campanelli, 3/21/03)
- A similar bill, S. 380, was unanimously passed out of the Senate Governmental Affairs Committee. Both bills have received the support of the Postal Service, the General Accounting Office, all four postal unions, and the postal management associations, according to House Government Reform Committee Chairman Tom Davis (R-VA). (*BNA Daily Report for Executives*, Derrick Cain, 3/11/03) The House bill currently has 55 co-sponsors; the Senate bill 15 co-sponsors. (http://www.postcom.org/public/csrs/csrs_tally.htm) One difference between the two bills is that the Senate bill requires the Postal Service to report to

Congress on how it intends to use any savings before filing rate increases. (*DM News*, Melissa Campanelli, 3/7/03)

- A copy of the portion of the House Budget Report (108-037) that pertains to its consideration of the budget impact of HR 735 has been posted on the following Web site:

<http://www.postcom.org/public/csrs/house%20budget%20rpt.htm>

Bills prompted by OPM and GAO reports

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

Postal Service top officers receive free tax advice, tax preparation and financial counseling

No other federal agency offers such benefits

- *Knight-Ridder* reported that "come April 15, top officers at the US Postal Service have another reason to smile. Thanks to a little-know perk, postal rate players have been picking up the tab for officers' tax preparation since 1998. The federal agency has also provided its top brass with individual financial counseling, including retirement and estate planning. No other federal agency offers such benefits." The perk came into light recently when the Postal Service advertised for a new firm to handle the service. Arthur Anderson's accounting firm previously held the contract. (*Knight-Ridder*, 3/17/03)

Postal Service's Office of Inspector General spends millions of dollars on "bizarre bonding and team-building exercises" while stamp prices soar, reports *New York Daily News*

Senator Grassley and the President's Council on Integrity and Efficiency are probing the allegations

- The *New York Daily News* conducted a special investigation into the Postal Service's Office of Inspector General's spending of millions of dollars on "bizarre bonding and team-building exercises," while stamp prices soar. The mission of the Office of Inspector General is to

make the mail more efficient and cost-effective by rooting out waste, fraud, abuse and mismanagement. “Yet hundreds of IG staffers have been taking part in bizarre bonding and team-building exercises and playing goofy games that burn up millions of dollars – and appear to do little or nothing to curb postal inefficiencies,” the investigation found. While the IG spends millions of dollars on these bonding exercises, stamp prices and postal deficits have soared over the past few years. Consumers pay the bill for these “shenanigans,” reports the *New York Daily News*. “Every penny of the IG’s \$117 million annual budget comes from the stamp-buying public.”

- “Every time your Aunt Minnie sticks a 37-cent stamp on an envelope, she’s funding an agency that’s off track, off message, off mission – and off its rocker,” said Citizens Against Government Waste Vice President Leslie Paige.
- “So much agency time, energy and money has been consumed in retreats, conferences, picnics, parties and game-playing, team-building outings that the mandate to ferret out USPS ineptitude has taken a back seat,” noted a dozen current and former employees to the *New York Daily News*. (*New York Daily News*, Douglas Feiden, 3/9/03)

Senator Grassley and the President’s Council on Integrity and Efficiency probing the allegations

- After some 50 past and present staffers approached Senate Finance Committee Chairman Chuck Grassley (R-IA) with allegations of waste and mismanagement, the Senator launched an ethical conduct investigation into Postal Inspector General Karla Corcoran’s six-year tenure. “I question whether spending tens of thousands of dollars for an afternoon of treasure hunting sets the gold standard for prudence,” Senator Grassley told the *New York Daily News*. The President’s Council on Integrity and Efficiency, which polices the federal inspector-general community, is also probing the allegations. (*New York Daily News*, Douglas Feiden, 3/9/03)

IG’s Office defends its programs

- The IG’s Office said the team-and-leadership development programs are similar to those offered by large corporations and consume only minimal resources. The exercises also teach acceptance of five core workplace values that the agency instills in its staffers – teamwork, leadership, communication, creativity, and conceptualization.
- The newspaper provided several examples of the team-building exercises the IG’s office has conducted over the past few years. A few examples include: (1) a \$35,000 leadership retreat building sandcastles at Ocean City, MD; (2) a \$1.2 million recognition conference at in Washington, DC, singing, performing skits, and wearing colored dots; (3) \$1.3 million recognition conference in Washington, DC, scat singing, hoisting blindfolded Inspector General Karla Corcoran aloft; (4) \$100,000 leadership retreat studying civil war history in Gettysburg, PA; and (5) \$1.1 million recognition conference in Washington, DC, treasure hunting and animal mimicking. (*New York Daily News*, Douglas Feiden, 3/9/03)

Presidential Postal Reform Commission holds March 18 field hearing in Austin

Next field hearing is April 4 in Los Angeles

- The Presidential Postal Reform Commission held a field hearing March 18 in Austin, TX. Witnesses testified at the invitation of the Commission. The Technologies Challenges and Opportunities Subcommittee also reported to the Commission. (*Federal Register*, 3/4/03; pages 10309-10310) The testimony submitted by various parties has been posted on the Commission's Web site: <http://www.treas.gov/offices/domestic-finance/usps/witness-testimony.html>
- Representatives from Pitney Bowes, Lockheed Martin, the Envelope Manufacturers Association and the Postal Service provided testimony involving electronic diversion of First-Class letter mail, automation and other technologies used by the Postal Service, and opportunities that may result from technological innovations. (*DM News*, Melissa Campanelli, 3/21/03) Pitney Bowes and the Envelope Manufacturers Association also submitted papers at the request of the Commission on intelligent mail, <http://www.treas.gov/offices/domestic-finance/usps/documents.html>
- Other upcoming field hearings include: April 4 in Los Angeles and April 29 in Chicago. At the April meeting, the Commission will examine the role of the private sector in the mail delivery system through outsourcing, worksharing, and retail partnerships, and Postal Service competition with the private sector. (*DM News*, Melissa Campanelli, 2/21/03, 3/19/03)

Presidential Postal Reform Commission receives rebuttal comments

- Organizations have submitted reply comments to public comments that have been already submitted to the Commission on postal reform. The Presidential Postal Reform Commission announced that March 13 would be the deadline for rebuttal to written comments on postal reform already submitted to the Commission. The Commission initially received written comments from 250 organizations, companies, government officials, and individuals by its February 12 filing deadline. The Association for Postal Commerce, Continuity Shippers Association, and the Mailers Coalition submitted rebuttal comments by the March 13 deadline. Copies of the letters are available on the *PostCom* Web site. (*PostCom*, 3/14/03) The comments are also expected to be published on the Commission Web site.

Postal Service defends non-postal offerings

- The Postal Service recently submitted a report to the Postal Rate Commission on its nonpostal initiatives. The report responds to a petition filed by Consumer Action on October 15, 2002, when the Postal Service noted that at a later date it would file a report concerning nonpostal services. The report: generally describes the results of an internal evaluation by the

Postal Service; summarizes the business review process; discusses the processes for initiating new products and services; outlines the procedures established to monitor and measure goals of the initiative; briefly describes the marketplace conditions that require a flexible and rapidly evolving approach to certain new initiatives; and addresses the evolution of nonpostal services. Rationale for new services: The United States Postal Service has a responsibility to create and implement new technologies to enable faster, more efficient communication to meet the changing needs of postal customers. To fulfill its universal service mandate and mission, the Postal Service must find ways to use existing resources to generate new revenue. This goal becomes even more important in light of expected losses from electronic diversion. The Postal Service must also provide the ability for customers to access its products and services wherever and whenever they consider convenient. To accomplish these goals, and to fulfill the vision of the Congress, the Postal Service has striven to offer innovative postal services, as well as engaging in other activities that complement these services, serve the needs of customers, and otherwise maximize the value of the Postal Service's assets in a businesslike fashion. (*Postal Service Report before the Postal Rate Commission on nonpostal initiatives*, 3/10/03; *PostalWatch.com*, 3/10/03; *Alliance of Nonprofit Mailers Breaking News*, 3/12/03)

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