

The **GSE** REPORT™

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Major Events

OFHEO turns up the heat and subpoenas Fannie Mae

- OFHEO turned up the heat on the Fannie Mae by sending the GSE subpoenas as part of its examination of Fannie's accounting practices, a source told the *Wall Street Journal*. The subpoenas came amid signs that OFHEO is trying to produce a report on the Fannie Mae exam within the next month or so, earlier than expected. Some believe that any new findings of flaws in Fannie's accounting methods or financial controls would make it more difficult for the GSE to resist the Bush administration's drive to tighten regulation of Fannie Mae and Freddie Mac. Such findings also would put pressure on Fannie's management, whose compensation levels are under scrutiny in Congress.
- Before the issuance of subpoenas, OFHEO had been probing Fannie by merely sending requests for information. In July, OFHEO's director Armando Falcon Jr. told a Congressional committee that Fannie's responses had been slow and incomplete in some cases. By using subpoenas, which could be enforced by the Justice Department, OFHEO has underlined its determination to force Fannie to cooperate fully and promptly. (*Wall Street Journal*, James R. Hagerty and John D. McKinnon, 08/20/04)
- In its June 30th 10-Q filing, Fannie Mae said it has given OFHEO "a considerable amount of information and documentation" during a special examination of accounting practices at the GSE. In the SEC filing, Fannie said it has made a number of its employees available to the regulator for the exam and continues to meet with the regulator on "a range of issues." Fannie's comments appear to be a response to remarks by OFHEO Director Armando Falcon Jr., who told lawmakers last month that Fannie's cooperation on the exam had been "spotty." After his testimony, Falcon told reporters that Fannie missed deadlines for submitting information requested by OFHEO without explanation, submitted incomplete information, and did not provide access to employees on a timely basis. Fannie did not comment on his remarks at the time. (*American Banker*, Rob Blackwell, 08/11/04)

SEC tells Freddie Mac that charges are likely over accounting

- Freddie Mac said that it might face civil action from the SEC for possible violations of securities laws. The GSE said it had received a "Wells Notice" indicating that SEC staff is considering recommending action against Freddie Mac to the full commission that may include a permanent injunction and monetary penalties for the GSE's possible violations of securities law including sections relating to deceptive practices and insider trading. According to the GSE, the SEC specifically cited possible violations of anti-fraud securities laws, which generally prohibit companies from deceiving investors with misstatements or misleading omissions of material

facts and bar companies from using manipulative or deceptive devices or schemes to defraud the public. “Freddie Mac has been cooperating with the SEC’s investigation and will continue to do so as we evaluate the manner in which we will respond to the receipt of the Wells Notice,” the GSE said. Freddie Mac will have an opportunity to present its case to the SEC, after which lawyers in the SEC’s division of enforcement will decide what to recommend to the SEC’s five commissioners. (*Reuters*, 08/19/04; *Dow Jones Newswires*, Dawn Kopecki, 08/18/04; *Washington Post*, Kathleen Day, 08/19/04)

Freddie Mac names former president of Fleet Bank its new chief operating officer
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- In its latest bid to restore consumer confidence, Freddie Mac hired Eugene McQuade as president and chief operating officer to replace Paul Peterson, a 15-year Freddie Mac veteran, who is expected to remain with the company during a transition period and then retire. Freddie Mac will pay McQuade \$900,000 in base salary, 92,650 shares of restricted stock, a \$2 million signing bonus and a minimum \$400,000 bonus for 2004. Starting in 2005, he will receive annual restricted stock and stock options worth at least \$6 million, according to Freddie Mac’s website.
- McQuade, who resigned from Bank of America in June, is receiving a \$25 million severance package after serving only three months as president of BofA, following its takeover of FleetBoston Financial Corp. While at FleetBoston, McQuade gained a reputation as a “fireman” by solving problems, including those stemming from the 1999 merger of Fleet with BankBoston Corp., said Gerard Cassidy, an analyst with RBC Capital Markets in Portland, Maine. McQuade “has demonstrated an ability to turn troubled companies around but simultaneously doing it in a way where the people who work with him in turning the ship around do so enthusiastically,” Cassidy said.
- McQuade is a “leading candidate” to succeed Syron as chief executive of the Freddie Mac, said the company’s spokesman David Palombi. In December, the GSE agreed with OFHEO to split the role, allowing Syron to remain as chairman and keeping some operational duties. McQuade can terminate his contract “for good reason” if he isn’t appointed to succeed Syron as chief executive by September 1, 2007, Freddie Mac said.
- McQuade said it will be his job to implement Syron’s plan to improve strained relations with Freddie Mac’s regulators, customers and investors, as well as delivering strong financial results and meeting the GSE’s mission of broadening home ownership. “That will be my primary focus here over the next couple years to make sure we translate the vision and mission and execute them at the highest level,” McQuade said. (*Bloomberg News*, Al Yoon and James Tyson, 08/05/04; *The Bond Buyer*, Matthew Badum, 08/06/04; *American Banker*, Jody Shenn, 08/06/04; *Reuters*, 08/05/04)

IMF joins call for greater regulatory oversight of Fannie Mae and Freddie Mac

- The International Monetary Fund has joined in the call for greater regulatory oversight of Fannie Mae and Freddie Mac. The IMF said the GSEs need a strong regulator who could limit their portfolio growth. The primary concern is that they continue to grow unabated under the impression that they are too big to fail or that the U.S. government would bail them out. “[IMF] Directors agreed with the ... concerns about the large and increasing share of mortgage backed securities held by the government sponsored enterprise and supported the [Bush] administration’s efforts to strengthen supervision of these enterprises,” the IMF said.
- Bill Murray, a member of the IMF’s media relations office, noted that this was not the first time the organization has mentioned the GSEs in relation to its overviews of the U.S. economy. “We have made reference to the GSE issue for quite some time now,” Murray said. (*The Main Wire*, Chris Middleton, 08/02/04; *Washington Post*, 08/05/04; *Daily Report for Executives*, Richard Cowden, 08/06/04)

Rabobank bid to buy Farm Credit Services of America challenges the viability of the Farm Credit System

- Rabobank of the Netherlands is challenging the viability of the Farm Credit System as the private bank offers to buy the Omaha-based Farm Credit Services of America (FCSA) for \$1.4 billion (\$600 million to the FCSA borrowers and an \$800 million exit fee paid to the Farm Credit System). “Nowadays, it is a competitive business. It is not an activity that necessarily still needs the support of a government,” said Cor Broekhuysse, an executive with Rabobank, the \$500 billion Dutch banking cooperative and agricultural lender which ranks as one of the 25 largest banks in the world. This transaction, scheduled to close in the first quarter of 2005, would be the first in which a commercial bank bought a Farm Credit Services lender.
- FCSA chief executive Jack Webster said the Farm Credit System was restricting his firm’s ability to offer services that go much beyond mortgages, crop, livestock and equipment loans and has made it difficult for FCSA to expand beyond its charters in Nebraska, Iowa, South Dakota and Wyoming. A merger with Rabobank would allow geographic expansion and a full array of services, including small business loans, checking and saving accounts, Broekhuysse said. The FCSA deal was the next logical step for Rabobank to becoming a leading agricultural lender in the United States, following its acquisition of two agribusiness lenders and a California community bank that specialized in lending to farmers over the past two years.
- John Blanchfield, director of agricultural and rural finance for the American Bankers Association said ABA did not know enough details to comment specifically about Rabobank’s offer, but it does believe the Farm Credit System should be privatized.

The system focuses its lending on larger and wealthier borrowers, abusing its federal sponsorship, Blanchfield said. Member institutions also have become valuable, as shown by Rabobank's offer, Blanchfield said. "If this transaction is completed it puts the entire GSE status of the Farm Credit System up for question," Blanchfield said.

- The Farm Credit Administration, which oversees the Farm Credit System's 110 banks, associations and service corporations, must approve Farm Credit Services' request to leave the system. Among other things, the agency must consider whether letting a member leave would hurt the remaining institutions. That is one concern for the Mankato, MN based AgStar Financial Services, which made its own offer to buy FCSA that was not accepted by Farm Credit's board members. People who buy bonds and discount notes in the Farm Credit System could begin to question the system's viability, reducing investment in it and ultimately raising interest rates for farmers and ranchers needing the loans, said AgStar president and CEO Paul DeBriyn. While Farm Credit Services' charters could be allocated to other lenders in the four states it serves, there could be gaps in service as the system is rebuilt, DeBriyn said. DeBriyn declined to discuss his firm's offer in detail, but he said it is competitive with Rabobank's and it gives stockholders continued ownership and control. On August 18, AgStar announced a second (improved) offer for FCSA, raising the price paid to shareholders to \$650 million. The key difference between the AgStar offer and that of Rabobank is that the merged organization would stay within the Farm Credit System [and would not have to pay the \$800 million exit fee to Farm Credit insurance fund], said DeBriyn. AgStar may elect to go to Farm Credit Services' more than 50,000 stockholders with its offer, DeBriyn said. While Farm Credit Service's board of directors has approved the deal with Rabobank, its stockholders also must vote on the proposal with the Netherlands-based cooperative.
- FCSA's board will consider at AgStar's revised offer. FCSA's president and CEO Jack Webster said, "This is an offer from an association [AgStar], a fraction of our size, serving a fraction of our territory that is under the same regulatory constraints that we have. Just that alone is significantly different from having the opportunity to be part of a global (financial) provider with a stellar performance for over 100 years, with a AAA rating, and having the full flexibility of products and services for our farmers and ranchers into the future." He added that the AgStar offer would bring no new money into the Farm Credit System, as would Rabobank's offer.
- Other Farm Credit System members are on record as opposing the Rabobank acquisition, voicing a concern that other Farm Credit lenders will decide to sell to commercial banks, leaving farmers with fewer options. CoBank of Denver plans to "vigorously oppose" the Rabobank acquisition because it is "not consistent with the mission of the Farm Credit System." In a press release, CoBank said it plans to support AgStar Financial's competing offer for FCSA, encourage the Farm Credit Administration to veto the sale and support congressional intervention in the purchase. The Farm Credit Council (FCC), the trade group for the Farm Credit System, announced its opposition to the sale almost immediately and is busy "wiring Capitol Hill to oppose the sale, also," said the *Aberdeen American News* (South

Dakota). Kenneth E. Auer, the FCC's president and CEO, said FCSA should sell to another Farm Credit System institution whose mission is to guarantee farmers' access to credit, not make a profit.

- Clearly, the sale of FCSA to Rabobank will be contentious. Opponents to the FCSA acquisition argue that Rabobank's \$600 million price is a "flat-out steal" of Omaha's 43 offices and \$7.5 billion loan portfolio, according to FCS insiders. According to these sources, Omaha is "swimming in cash" with \$1.305 billion in unallocated retained earnings. Omaha will use approximately \$800 million to pay the exit fee from the Federal Credit System. Douglas Sims, CoBank's CEO, explains that Rabobank is "actually buying a big piece of the Farm Credit system with shareholders' own money. I don't blame Rabobank. If it can steal this bank, it should." By Sims' estimates, the Rabobank's purchase price will give Omaha shareholders about \$0.42 for each dollar of stock they own. "I don't understand why cooperative members should sell their co-op for 42-cents on the dollar when the going rate of farm banks is 2-to-2.5 [times] capital," he said.
- Senators Tim Johnson (D-SD) and Tom Daschle (D-SD) have called for hearings on the Rabobank proposal. The Senators said that the proposed sale has created "confusion, uncertainty and skepticism" for South Dakota farmers served by the lending cooperative and called for public hearings before the Senate banking and agricultural committees in September. In letters to the Agricultural Committee Chairman Thad Cochran (R-MS) and Farm Credit Administration chairwoman Nancy C. Pellet, the Senators said, "foreign ownership of an entity [FCSA] that has such financial impact in our communities naturally raises concerns about such a transaction."
- FCSA said it will issue a report in November outlining the Rabobank offer in detail and its 51,000 stockholders will have a month to analyze the report before voting on the sale in December. FCSA is following a government-imposed process that requires a "silent period" and cannot issue its full report until November when shareholders receive an official "information statement," said spokeswoman Michelle Ford. After providing that information to shareholders, it "would welcome the public hearings," she said. (*Associated Press*, Joe Ruff, 08/03/04; *American Banker*, Ben Jackson, 08/05/04; *Associated Press*, 08/08/04; *Omaha World-Herald*, Steve Jordan, 08/11/04; *Omaha World-Herald*, Chris Clayton, 08/11/04; *Aberdeen American News*, Alan Guebert, 08/15/04; *American Banker*, Ben Jackson, 08/16/04; *Omaha World-Herald*, Steve Jordan and Chris Clayton, 08/18/04; *American Banker*, Ben Jackson, 08/18/04; *Associated Press*, Tara Godvin, 08/18/04; *Omaha World-Herald*, Steve Jordan and Chris Clayton, 08/19/04)

Fannie Mae and Freddie Mac

While GSE reform is unlikely this year – next year may be more “conductive”

- While significant GSE regulatory reform is unlikely this election year, next year will be more conducive to opportunities to move GSE legislation, Senator Chuck Hagel (R-NE.) told members of Women in Housing and Finance. No GSE reform bill will get beyond the committee stage this year, Hagel said, citing the highly partisan political environment in this election year. He pointed to the hope of “new possibilities” of an improved environment in a non-election year next year for GSE regulatory reform.
- *Government Waste Watch* writes that GSE reform is in a critical stage. *GWW* reports that “Democrats appear ready to kill almost any reform effort, arguing that increased oversight will damage homeownership and that the reforms sought were nothing more than a backdoor path to full privatization and ‘the end of GSEs as we know them.’” Treasury Secretary John Snow asserts that the long-term effort to rein in the GSEs has gotten “jump-started” and that such significant regulatory changes take time to implement.
- In an interview with *American Banker*, Freddie Mac chairman and CEO Richard Syron predicted a bill to revamp regulation of Freddie and Fannie Mae would pass next year and warned of the dangers of GSE privatization. The chances for enacting a GSE bill next year are good, Syron said, because most of the key congressional players will still be there and interest in such a bill is high. The GSEs also want a bill, Syron said. “It’s in our interest to get involved, because markets hate uncertainty, and they would much rather know what is going to happen to us than be worried about headline risk all the time.”
- Syron said that he could have lived with the GSE regulatory reform bill that the Senate Banking Committee passed in April. The final bill included an amendment from Senator Bob Bennett (R-UT), which provided Congress a chance to veto any decision by a GSE regulator to put one of the companies into receivership. (The Bush administration continues to oppose this amendment.) Syron acknowledged that there was little economic difference between conservatorship, a statutory power currently provided to OFHEO, and receivership, which would give the agency the authority to close a GSE. Syron said that the symbolism of the issue became important, and that Freddie Mac’s debt would “suffer” if total receivership power were in the hands of the GSEs’ regulator. “Particularly as you get to overseas markets, where we sell 30% of our debt ...the question is how do they feel about one compared to the other,” he said. “And all indications from the people that help us place our debt was that they were quite concerned that it would be seen in a highly adverse way.”

- Syron added that he hopes the Treasury Department will not act to limit GSE debt. Earlier this year, Treasury said this year that it could limit GSEs' debt without any change in legislation, which would be bad for Freddie Mac. Syron said, "I don't know that it would be much of a restraint right now, given how slowly the market has grown and our retained portfolio has grown, but I think it would raise the question about, when there are opportunities to grow, whether you could. That would have an effect on how the debt markets and equity markets would look at us." (*BNA's Banking Report*, Karen L. Werner, 07/26/04; *Government Waste Watch*, Leslie Paige, Spring/Summer 2004; *American Banker*, Rob Blackwell, 08/20/04)

<p>Representative Baker asks OFHEO to analyze the GSEs' guarantee fees, the GSEs' compensation, and the GSEs' investments in affordable housing</p>

- In a July 23 letter to OFHEO Director Armando Falcon, Representative Richard Baker (R-LA) asked why the guarantee fees that the GSEs charge lenders have not declined as credit quality has improved. "The stability of guarantee fees in the face of declining losses and increasing return on equity is troublesome," Representative Baker wrote. OFHEO should "determine if revenue generated by guarantee fees is used to supplement earnings rather than insure against potential losses or cover risk-related business costs," Baker added.
- By October 1, OFHEO plans to complete an analysis of the GSEs' guarantee fees, which generate about a third of the companies' profits, the agency's spokeswoman Corinne Russell said. Fannie Mae's income from such fees rose last year by one-third to a record \$2.4 billion, or 33% of core earnings totaling \$7.3 billion, OFHEO said.
- "When we have seen extraordinary low credit losses over the past few years, why has that not been reflected in reduced fees?" said Jay Brinkmann, an economist at the Mortgage Bankers Association. "Is it because we have only two firms doing pricing, and if we had a third competitor, would someone have a sharper pencil?" (*American Banker*, Michele Heller, 08/19/04; *Bloomberg News*, James Tyson, 08/17/04)
- Baker requested that OFHEO prepare a thorough analysis of the current GSEs' compensation compared to compensation of similar market participants. Baker asked Falcon to analyze the GSEs' executive compensation as it compares to corporations of similar size, function and sophistication to be sure it is "appropriate and reasonable."
- Baker requested that Falcon to turn over data relating to Fannie's cooperation with OFHEO's forensic accounting probe of the GSE.
- Baker also requested data from OFHO on the loan-to-value ratio of mortgages held in portfolio by Fannie and Freddie, saying he was concerned that the two GSEs are not

investing in loans to low-income and first-time homebuyers as much as they claim.
(*Dow Jones International News*, Dawn Kopecki, 08/18/04)

OMB authorizes HUD to release the GSEs' loan data used to meet AH goals
and the debate over HUD's AH goals continues

- HUD has been cleared by the OMB to release confidential data about the loans Fannie Mae and Freddie Mac use to meet their affordable housing goals that should shed more light on how the GSEs compare to the overall market in serving low-income and minority markets. OMB's order will allow public access as early as September to loan data that had been considered proprietary, HUD officials said. The HUD spokesperson declined to release a copy of the order or to elaborate on the nature of the data to be released.
- How well the Fannie Mae and Freddie Mac compare to the rest of the mortgage industry in meeting the needs of the AH market varies, depending on who is asked. The GSEs have been able to meet HUD's financing targets in all categories measured in each year through 2002, since the goals were first set in 1996. However, HUD officials have increasingly criticized the GSEs for trailing other mortgage companies in serving low-income and minority borrowers. Both GSEs and several trade groups dispute HUD's analysis of the broader market as well as Fannie and Freddie's individual performance. HUD officials claim their research is accurate, but it's difficult to independently verify because HUD's analyses are based on data that was not publicly available.
- OMB's order comes following HUD's proposal of aggressive new AH goals this year, which ratchet up by 2008 the percentage of loans Fannie and Freddie need to finance to low- and moderate-income borrowers from 50% to 57%. During the comment period for this proposal, HUD received more than 250 comments on its proposed AH goals for Fannie and Freddie. While the bulk of the letters supported new housing goals that force the GSEs to "stretch" their resources to finance more underserved borrowers, several trade groups made detailed rebuttals to HUD's economic analysis and cautioned HUD against setting goals that were too aggressive.
- In its June 30th 10Q filing with the SEC, Fannie Mae warned investors about the possible effects of a proposed hike in the HUD's affordable-housing goals, which Fannie said are too high and "are designed to change the companies' current mix of business." If HUD's goals are adopted, "and the mandated business mix goes beyond the mix of business available to us in the market, we may be forced to over invest in market categories that are more likely to generate goals-qualifying mortgages or to reduce our investment in non-goals-qualifying mortgages," Fannie said in the filing. (*American Banker*, Rob Blackwell, 08/11/04)
- In a recent interview with the *American Banker*, Freddie Mac's chairman and CEO Richard Syron answered critics' charges that he is being disingenuous by saying

Freddie wants to do more affordable housing while opposing higher proposed goals from HUD. He insists that the proposal's goals are just too high, given the mortgage market forecasts. "I see it largely as a technical dispute," he said. "Any differences we have had with HUD -- and we just filed our comments with them not long ago -- have been largely of a technical nature in how one measures the size of the market, the underserved market, and how do you do that."

- Syron said he wouldn't have a problem with steep goals if he wasn't concerned that critics would "misunderstand" and seize on any failure to meet the goals. "What it should be in a rational world is someone would have the freedom to set goals, even though you might not make them, because it's like your kids -- telling them what you want them to get for an average in school so they keep trying to reach higher and higher," Syron said. "The problem is that from our perspective, we are so public. ...There is a natural feel on our part that people wouldn't see it that way, that we wouldn't be able to explain it, even if we ended up doing a lot better than we did in the past." (*Dow Jones Newswires*, Dawn Kopecki, 08/20/04; *American Banker*, Rob Blackwell, 08/20/04)
- On another front, many lenders, apartment owners, and the government-sponsored enterprises themselves are "worried" that HUD's proposed AH goals could spur the GSEs to greatly ramp up their purchases of multifamily mortgages. Multifamily activity represents the most efficient way for Fannie and Freddie to increase the amount of AH in their mix of business without cutting back on nonqualifying single-family business, observers say. While HUD's proposed AH goals do not greatly increase the GSEs' specific multifamily targets, some experts predict that Fannie and Freddie will be somehow involved in "every apartment loan originated in coming years." The fear in the market is that to meet the goals GSEs would have to loosen multifamily underwriting standards and underprice risk. Such irrational behavior, observers believe, would enable too many buildings to get built and push traditional investors without the same regulatory concerns and funding advantages to leave the market.
- "Years from now you're not going to be talking about how great the goals were for multifamily housing, you're going to be talking about" how they contributed to a blowup, said Neil Cullen, a member of the office of the president at CharterMac's PW Funding Inc. unit. "In our world, there are some deals that just shouldn't be done," he said.
- However, such dire predictions are not universally shared. Many say the GSEs tend to do things "smartly," and that there are plenty of opportunities for Fannie and Freddie to increase their multifamily activity, particularly with smaller rental properties and seasoned loans, without hurting the market. While HUD acknowledged in its proposal that the multifamily market has "near-term risks," the agency said the GSEs have plenty of room to grow in it because of their conservative underwriting. The GSEs are "the logical institutions to identify and promote needed innovations and to establish standards that will improve market efficiency," HUD

wrote. “As their presence in the multifamily market continues to grow,” the proposal said, “the GSEs will have both the knowledge and the clout to push simultaneously for market standardization and for programmatic flexibility to meet special needs and circumstances.” (*American Banker*, Jody Shenn, 08/20/04)

AEI’s Pollock argues to use competition to privatize the GSEs

- Alex Pollock, former president of the FHLB-Chicago and resident fellow of American Enterprise Institute, said the key to privatizing Fannie Mae, Freddie Mac and the FHLBs is to create “a truly competitive secondary mortgage sector which would significantly reduce or eliminate the large duopoly profits now generated by Fannie and Freddie.” In an article published by AEI on August 10th, Pollock said “developing a common regulatory framework for the GSEs could be the basis of developing a competitive market [which] ...in turn would lead to the ultimate goal of complete privatization of the GSEs at the same time.”
- To do this, Pollock said, the GSEs, including the FHLBs, “must be considered and addressed together by guiding policy principles and resulting legislation.” He continued, “The goal should be maximum competition and minimum privileged profitability. The GSE structure should insure that Fannie and Freddie experience a ‘level playing field’ of competition from all 12 FHLBs, and through them, from thousands of private financial institutions that participate in FHLB mortgage financing programs.”
- “As the ability of GSE charters to generate duopoly profits is reduced, so will be the motivation to resist privatization,” Pollock said. “In other words, the costs and constraints of GSE status will become a worse trade-off versus economic rewards to Fannie and Freddie’s shareholders.” Pollock noted that the problems that the GSEs were created to solve are “long gone” and that the GSEs no longer need special privileges. Pollock adds, “The controversial structure of the GSEs combines huge size, political influence, and special privileges that implicitly subsidize profits, as well as political risk. The three housing GSEs ...have combined assets and off-balance-sheet securities guarantees of \$4.8 trillion.”
- Pollock recommended that the GSEs be subjected to common regulatory and tax treatment, including common capital standards, to level the playing field. “A 10-year transition period, with the sunset of both GSE status and GSE regulation at the end, will be the beginning of a more economically efficient, fairer, more robust housing sector.” He said most observers believe GSE reform legislation would be a high probability under a second Bush administration. (*Dow Jones International News*, John Connor, 08/11/04; *American Enterprise Institute Financial Services Outlook*, Alex J. Pollock, August 2004)
- As Pollock promotes the privatization of the GSEs, Freddie Mac’s chairman and CEO Richard Syron spoke out against the issue. Syron said the privatization of the GSEs

could have powerful, and likely negative, effects on the market. “Any time you are going to change, I think you want to pretty carefully think out what the potential consequences are,” he said. “These are all legitimate debates to have, but let’s not kid ourselves that you can have your cake and eat it too in every case. We are kidding ourselves very badly if we think the mortgage market in the United States wouldn’t be very different without the GSEs.” (*American Banker*, Rob Blackwell, 08/20/04)

Presidential political rumblings in GSE land

- Bobby Rayburn, president of the National Association of Home Builders, released a 10-point housing platform for the delegates to the Democratic and Republican national conventions and candidates for political office. NAHB’s third point reads, “Credit is the lifeblood of the housing market. Maintaining an adequate flow of credit is fundamentally important. During the next decade, America’s families will need 125 million mortgage loans, or an average of \$3 trillion annually, for home purchases and refinancings. Therefore, *policy makers must guard against any backdoor attempts to alter the regulations affecting the housing government sponsored enterprises in a way that impedes the ability of Fannie Mae, Freddie Mac and the Federal Home Loan banks to provide lenders with new mortgage products and ensure an affordable and steady flow of credit for home mortgages.*” (*NAHB press release*, 08/12/04)
- Some investment analysts have noted that share prices of Fannie Mae and Freddie Mac would rise with a Democratic win. A Kerry administration would soften a stalled proposal by the Treasury Department to create a stricter regulator for the GSEs, allowing them “to put the political and regulatory uncertainty behind them,” International Strategy & Investment, a Washington-based investment firm, said in a report. “The stocks would rally in the event of a Kerry victory.” In a recent report, Friedman, Billings, Ramsey & Co. said, “We believe Fannie and Freddie would find their situation improved with a Kerry victory.”
- Greg Valliere, chief political analyst for Schwab Soundview Capital Markets, agreed, saying “Kerry and the Democrats are on record as favoring a much more lenient regulatory policy on Fannie and Freddie. As opposed to the Bush administration, these two stocks would do much better if Kerry were to win.” Charles Schwab Corp., the parent company of Valliere’s firm, is a member of the Financial Services Roundtable, which helps fund FM Policy Focus, a Washington-based coalition of companies critical of the GSEs. (*Bloomberg News*, James Tyson, 08/03/04)
- In an interview with *American Banker*, Freddie Mac chairman and CEO Richard Syron rejected assertions that the presidential election could significantly affect the GSEs. How a Kerry administration or another Bush administration treats the GSEs would depend on personnel appointments, he said. “It depends much more on who is the secretary of Treasury ...[and] who is the secretary of HUD.” Larry Summers, a Treasury secretary in the Clinton administration, “was as hawkish on the GSEs as

anyone in this administration,” said Syron. (*American Banker*, Rob Blackwell, 08/20/04)

- Low-income housing advocates are keeping a close eye on this year’s presidential race with hopes of creating a \$5 billion national housing trust fund to support affordable housing. H.R.1102, a bill that would create this trust fund by tapping the Federal Housing Administration single-family insurance fund for the \$5 billion for “startup-funds,” has been bottled up in House Financial Services Committee for the past two years. The National Low-Income Housing Coalition (NLIHC) is calling on nearly 5,000 housing, community and consumer groups and unions to lobby their congressional representatives during the August recess to sign a discharge petition for this bill. Since many congressmen are uncomfortable about tapping the FHA for funding, *NLIHC is beginning to look to Fannie Mae and Freddie Mac as alternative funding sources*. So far, Democratic Presidential candidate Kerry has not mentioned the housing trust fund legislation on the campaign trail and the Democratic Party platform doesn’t mention the trust fund either. (*National Mortgage News*, 08/02/04)

Lender coalition urges Fannie and Freddie to end ban on arbitration clauses

- In a July 30 letter, a coalition of lenders urged Fannie Mae and Freddie Mac to reverse a policy intended to curb predatory lending and resume buying mortgages that require borrowers with poor credit to settle disputes through arbitration. The rejection by Fannie Mae and Freddie Mac of mortgages with a mandatory arbitration clause denies “sub-prime” borrowers a “cost-efficient, effective, and fair” way to resolve conflicts, the Mortgage Bankers Association, Financial Services Roundtable, and four other financial industry groups said.
- Fannie Mae and Freddie Mac imposed this ban partly in response to pressure by the Bush administration to increase financing to low-income homebuyers, including those with a low credit standing, said Allen Fishbein, director of housing and credit policy at the Consumer Federation of America. “This was a pre-emptive strike” by Fannie Mae and Freddie Mac to avoid links to mortgage brokers and lenders who gouge sub-prime borrowers through mandatory arbitration, he said. “As Fannie Mae and Freddie Mac expand their presence in the sub-prime market, they’re likely to come across many loans with mandatory arbitration clauses,” Fishbein added.
- Freddie Mac spokesman Douglas Robinson declined to say whether the GSE has responded to the letter. Freddie Mac imposed the ban on August 1, he said, because “we believe that borrowers are best served when they have options to resolve disputes.” Fannie Mae spokeswoman Janice Daue declined immediate comment on matter. (*Bloomberg News*, James Tyson, 08/12/04)

Fannie Mae and Freddie Mac provide hurricane relief

- Freddie Mac and Fannie Mae are encouraging their servicers to give some relief to borrowers whose homes were damaged or destroyed by Hurricane Charley. Under Freddie Mac's disaster relief guidelines, servicers can reduce or suspend payments for up to 12 months. Freddie said it is also "strongly encouraging" servicers to help affected borrowers by waiving penalties or late fees, not reporting forbearance or delinquencies to credit bureaus, and expediting the release of insurance proceeds. A Freddie spokeswoman said it does not know yet how many of its loans would be affected by the hurricane or by Tropical Storm Bonnie, which was also mentioned in the press release. Freddie Mac has also donated \$100,000 to the American Red Cross to support temporary housing for hurricane victims.
- Fannie Mae said it lets servicers of loans affected by natural disasters suspend payments for up to three months or reduce them for up to 18 months "or more in special cases." (*PR Newswires*, 08/18/04; *American Banker*, Jody Shenn, 08/18/04)

Fannie Mae

Fannie Mae says it has fewer derivatives with top rated counterparties

- Fannie Mae said it has a smaller percentage of derivatives used to protect its \$891 billion portfolio against swings in interest rates with dealers rated AA or better. According to its filing with the SEC, 61% of the GSE's \$534 million in derivatives were held by six dealers rated AA or better on June 30. At the end of 2003, 71% of \$514 million was with six counterparties rated AA or better. The top rating is AAA.
- "Fannie Mae has never experienced a loss on a derivative transaction due to credit default by a counterparty," the GSE said in its filing. "The credit risk on our derivative transactions is low because we have stringent counterparty eligibility requirements, a conservative collateral policy, and an intensive credit exposure monitoring and management process." According to Fannie Mae spokeswoman Janis Smith, the \$534 million represents the "high-level of loss" if all counterparties defaulted, which is "highly unlikely." (*Bloomberg News*, Al Yoon, 08/09/04)

Fannie Mae's duration gap falls to zero in July

- Fannie Mae said its average duration gap narrowed to zero in July, compared with June's +2 months. The GSE also said its mortgage investment portfolio grew at an annualized rate of 2.1% during July to \$892.7 billion after rising 19% in June. Fannie Mae said it committed to buy \$19.5 billion in mortgages in July, down from \$29.7

billion in June and the lowest since February. The percentage of adjustable-rate mortgages originated in July “remained high” at 34.2%, the GSE said.

- At the end of the second quarter, Fannie Mae’s liquid assets represented about 5.2% of total assets, the filing said. Fannie Mae’s liquid assets had comprised 6.4% of its total assets at March 31 and 6.5% at December 31, 2003. The GSE’s filing did not explain why its liquid assets fell roughly \$11.6 million between March 31 and June 30.
- Slower portfolio growth and the switch to longer-dated, more costly debt to fund purchases will curb the GSE’s return on equity to the “mid- single-digit range” in 2004 from 16% percent last year, Fannie Mae said. (*Reuters*, 08/16/04; *Bloomberg News*, Al Yoon, 08/16/04; *Dow Jones Corporate Filings Alert*, David Enrich, 08/10/04)

Fannie Mae Chairman Franklin Raines ranks at the fifth highest paid CEO in DC area
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- According to the *Washington Post*, the fifth highest paid executive in the DC area was Franklin D. Raines, chairman and chief executive of Fannie Mae. Raines received \$5.3 million in cash compensation in 2003, while Fannie delivered a return of 19.6% last year on its stock, below the median 50% for local companies. (*Washington Post*, David S. Hilzenrath, 08/16/04)

Fannie Mae Board member Frederic V. Malek settles SEC probe

- The SEC announced that Thayer Capital Partners and its chairman, Frederic V. Malek, agreed to pay \$250,000 to settle charges of misleading Connecticut’s pension funds. Malek, a prominent Washington businessman, agreed to pay a civil penalty of \$100,000 to the SEC, while Thayer Capital Partners paid \$150,000 to settle the charges without admitting or denying wrongdoing. Malek also serves on the board of Fannie Mae. Since the SEC settlement did not ban the parties from serving as an officer or a director, Malek will continue his service on Fannie’s board.
- The SEC accused Malek, Thayer and its affiliates of failing to disclose that they had paid William A. DiBella, an associate of the Connecticut treasurer, while trying to win business from the Connecticut pension fund. The SEC said DiBella “did no meaningful work” while serving as a consultant to TC Partners IV, an affiliate of Thayer. The SEC has sued DiBella, the former majority leader of the Connecticut state senate. The SEC said DiBella participated in the scheme with former Connecticut Treasurer Paul J. Silvester. (*Dow Jones Newswires*, Siobhan Hughes, 08/12/04; *Dow Jones Newswire*, Janice Daue, 08/13/04)

Washington Post spotlights side deals for Fannie's board members

- In an expose on corporate Washington's executives and board members, *Washington Post's* David Hilzenrath points out that in addition to regular compensation some board members are paid for legal work, consulting or lobbying. Hilzenrath reports that last year Fannie Mae paid \$375,000 to the Duberstein Group, a lobbying and consulting firm led by Fannie Mae director and former White House chief of staff Kenneth M. Duberstein. In 2001, Fannie hired a son of board member H. Patrick Swygert, president of Howard University. Fannie Mae said its hiring of Swygert's son after Swygert joined the board "does not impact Mr. Swygert's independence," but Fannie Mae does not consider Duberstein, the lobbying firm executive, to be independent. (*Washington Post*, David S. Hilzenrath, 08/16/04)

Fannie's debt calendar rewrite adds uncertainty in the market

- Competition for mortgages has curtailed Fannie Mae's portfolio growth and reduced their need for debt to meet funding needs, which has introduced a new kind of uncertainty into the debt issuance market. Fannie Mae has entered into what it calls the "next stage in the evolution" of its so-called Benchmark debt program with the GSE no longer promising to issue debt on a schedule set at the start of the year. For at least the remainder of the year Fannie Mae may skip planned monthly sales of either callable or noncallable bonds. "Really, what we're hoping to do here is not get locked into an issuance pattern that is driven by a calendar rather than specific other needs that we may have," said J. Timothy Howard, Fannie's chief financial officer.
- The most recent evidence of Fannie's changed funding needs came on August 9th, when the GSE said it would skip the sale of callable debt scheduled for this month. It was the second opt-out in two months, the fourth this year and likely not the last, Fannie Mae said.
- Analysts and traders say the new uncertainty about issuance has had little discernable effect on the agency debt market. Fannie and Freddie had already reduced issuance and seemed sure to retire more debt or move away from their calendars. Rajiv Setia, a fixed-income strategist at Merrill Lynch & Co., said "Next year it won't be a surprise if both [Fannie Mae and Freddie Mac] ...gave themselves a lot more flexibility," but "...abandoning the calendar totally would be a negative in the long run for liquidity."
- Most observers agree that the regular calendar has indeed boosted liquidity for GSE debt, but many say ongoing headline risk, large U.S. deficits, and other factors mean the idea of GSE debt as a benchmark may have passed. "Over the last couple of years, [the GSEs have] given themselves more flexibility to issue the things they specifically need to issue, and they've moved away from trying to mimic the Treasury," said Nancy Vanden Houten, an analyst at Stone & McCarthy Research

Associates. Moshe Orenbuch, a Credit Suisse First Boston analyst, said the GSEs' increasing purchases of ARMs limits their need for long-term debt. "To the extent the paper they're buying is not the same type of paper they've been historically buying, the rules are changing," Orenbuch said. (*American Banker*, Jody Shenn, 08/11/04)

Fannie Mae purchases \$160.6 million of AH multifamily loans from GMAC

- GMAC Commercial Mortgage Affordable Housing Division (AHD) announced the \$160,560,000 financing of a Fannie Mae credit facility for six properties located in Florida and Georgia. This transaction involved the acquisition financing of a six-property portfolio through a Fannie Mae credit facility that provided credit enhancement for multifamily housing revenue bonds in the amount of \$104,325,000 and taxable variable rate securities in the form of discounted mortgage-backed securities issued by Fannie Mae in the amount of \$56,235,000. Five of the six properties are located in the Atlanta MSA in Fulton County, Gwinnett County and Cobb County with the remaining property located in the Orlando MSA in Apopka, Fla. (*Business Wire*, 07/30/04)

Are AVMs making inroads at Fannie Mae?

- The *National Mortgage News* reports that Fannie Mae has been accepting automated valuation models (AVM) on vanilla purchase loans from Countrywide and Bank of America, according to several mortgage technology sources. A Fannie Mae spokesperson said that while the company does not comment on contracts or relationships with customers, "...certain customers have unique processes and we try to accommodate them in some cases. So, in that respect it wouldn't be unusual." (*National Mortgage News*, Anthony Garritano, 08/16/04)

Native American tribe reforms laws to help stimulate homeownership

- Fannie Mae and the Crow Indian Tribal Chairman signed an agreement that will make conventional mortgage financing available by removing the tribe's jurisdiction over all land on reservations. The new tribal law allows members to use either land allotted to them or a long-term lease on tribal land as security for a loan. The law specifies that in the event of a foreclosure, the land or lease can only be resold within the tribe. This provision helped reassure skeptics who worried that the Crows might lose control of their lands. By passing this law, the Crow Indians can take advantage of Fannie Mae's pledge to invest \$1.25 billion on reservations by the end of this decade. (*Voice of America News*, Kathy Witowsky, 08/08/04)

Freddie Mac

Freddie Mac revamps its lobbying efforts

- In a move designed to polish the tarnished reputation of its lobbying operation, Freddie Mac has created a political fundraising arm and has begun to clean out its long roster of outside lobbyists by the end of the year, as part of its broader effort to revamp its government affairs practice. Freddie Mac's chairman and CEO Richard Syron and Hollis McLoughlin, one of his top aides, hope to complete much of the reorganization between the November elections and the beginning of the next session of Congress, Freddie Mac officials say. A Freddie Mac spokeswoman declined to comment on internal matters, but several Freddie Mac lobbyists confirmed the moves.
- Freddie Mac wants to see whether Democrats or Republicans control the White House and Congress before selecting a successor for Mitch Delk, who headed the company's government affairs office before being fired earlier this year after a series of fundraisers he orchestrated for Republican lawmakers became subject of an investigation by the FEC. "If Kerry were to win, you would see a high-profile Democrat. If Bush were to win, you might see a high-profile Republican," says one source close to the board.
- If Senator John Kerry (D-MA) wins the presidential election or the Democrats win a majority in the Senate, Freddie Mac could give the top lobbying position to Clarke Camper, a Democrat who serves as the senior vice president of government relations and public policy on an interim basis. If the GOP maintains with political power in Washington, Freddie Mac is expected to hire a Republican to head its lobbying operation.
- According to lobbyists familiar with Freddie Mac's search, top candidates for the post range from Terry Haines, a former chief aide to House Financial Services Chairman Mike Oxley (R-OH) to Hollis McLoughlin, who served as a top Treasury Department official in the first Bush administration before joining Freddie Mac as a top aid to Syron. Freddie Mac's choice of a head lobbyist is critical because the Bush administration and key lawmakers are weighing an overhaul of Freddie's privileged status as a GSE.
- Freddie Mac officials have also decided to review all of the firm's lobbying contracts — a number that involves nearly three dozen outside firms, many of which were hired by Delk. "They spend a lot of money [\$10 million in the second half of 2004], and they want to see who is value-added and who is not," said one Freddie Mac lobbyist. "They want to see if they are getting their money's worth." Freddie Mac executives would like to give the newly appointed chief lobbyist a clean slate to use in rebuilding the GSE's lobbying efforts.

- In addition to reorganizing its lobbying operation, Freddie Mac has also added a political action committee to its arsenal. “We really wanted to give our employees a mechanism for supporting Freddie Mac,” said company spokeswoman Shawn Flaherty. “Most large corporations already have a PAC, and we wanted to have one, too.”
- Freddie Mac filed the paperwork with the Federal Election Commission to start the PAC in late July. Company officials hope to start making contributions to Members of Congress by the end of the year, Flaherty said.
- Freddie Mac gave \$4 million in soft-money contributions to the Republican and Democratic parties during the 2001-02 election cycle, making the firm the largest corporate soft-money giver of the cycle, according to PoliticalMoneyLine. Now that corporations are banned from writing such hefty checks to the national political parties, companies like Freddie Mac must channel political giving through a political action committee. Corporate PACs are funded by individual donations from company executives, not from company funds. “It’s really a great way for our employees to participate,” Flaherty said. (*Roll Call*, 08/16/04; *Financial Times*, Joanna Chung, 08/20/04)

<p style="text-align: center;">Freddie Mac CEO Syron challenges journalists to hold the GSE accountable – and <i>Washington Post</i>’s Hilzenrath answers the challenge</p>

- In a speech at the Unity Convention of minority journalists, Freddie Mac’s chairman and CEO Richard F. Syron challenged the attendees, “Hold Freddie Mac accountable” for “providing help to minorities, immigrants, working class families and other underserved communities to gain access to affordable housing finance.”
- Two days later, *The Washington Post*’s David Hilzenrath answered Syron’s challenge by putting the spotlight on Freddie Mac’s use of “upscale mortgages” to meet quotas for disadvantaged homeowners. Hilzenrath illustrates a “loophole” in the HUD’s affordable housing rule, under which Freddie Mac’s purchase of a \$275,000 loan in 2001 that was secured by a \$930,000 Tudor house bought by Jeffrey and Lisa Stegman on nearly two acres in Cincinnati, Ohio, which qualified as an affordable housing loan. How did this loan qualify? Since Stegman’s house was located within a census tract that met HUD’s definition of an “underserved area,” and because the couple put down \$655,000 cash and didn’t need a jumbo mortgage, their loan qualified for credit toward the Freddie Mac’s affordable housing goals.
- Hilzenrath writes, “...It’s not a loophole--it’s federal housing policy in action. The Stegman’s stately Tudor may be an extreme example, but it illustrates the tensions inherent in a system that looks to two profit-driven companies to help low-income and minority home buyers.”

- Freddie Mac spokeswoman Sharon McHale said Freddie does not deliberately try to skim the most expensive homes or the most affluent borrowers in underserved areas. But “it may be a residual effect of our credit policies that we’re getting those loans,” she said. The company has higher credit standards than some lenders, and that “would mean that we would be tending to purchase the higher quality loans,” McHale said. She would not comment on individual mortgages such as the Stegman’s. If such a loan met HUD’s criteria, Freddie Mac would count it toward the affordable housing goals, McHale said. (*Freddie Mac Press Release*, Richard F. Syron, 08/06/04; *Washington Post*, David S. Hilzenrath, 08/07/04)

Freddie Mac’s chairman Syron shares his vision of Freddie Mac’s future
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- In an interview with *American Banker*, Freddie Mac chairman and CEO Richard Syron acknowledged that the GSE’s restatement had battered its reputation among policymakers, investors, and the public. “Quite candidly, probably too candidly, I like to think we are rebuilding it, but I think it was hurt considerably,” Syron said. “Reputations are extraordinarily fragile. ...Once you damage them, it takes a significant amount of time to rebuild them. I think the only way you can do it is by -- as the trite expression goes -- walking the walk. You have to tell people what you are going to do and then actually do it. No amount of hortatory rhetoric recaptures a reputation.” When asked where he would like to see the GSE in five years, Syron said that he wants Freddie Mac to be trusted. “I would like to see us, as an aspiration, very much to be in a situation where no one questions our credibility, or that what we say is what we do,” he said. “I would like to see us be very transparent in our financials, both from the perspective of the public and from the perspective of investors, debtholders, etc.”
- Syron said Freddie Mac was on track to comply with stock registration and return to timely quarterly reporting. He expects Freddie to release its 2004 data during the first quarter of 2005. “It won’t be long after that that we get back on a regular schedule,” he said. “We are talking about it being months before we get there, not years.” (*American Banker*, Rob Blackwell, 08/20/04)

Freddie Mac CEO Syron hints that the GSE may set up risk sharing agreement in AH for new multifamily programs

- In an effort to get Freddie Mac to finance more affordable-housing units, Richard Syron, the GSE’s chairman and chief executive, hinted he is considering setting up a risk-sharing arrangement with the lenders that sell multifamily loans to Freddie. “I think there are kinds of approaches as we get to new multifamily programs where we will look more extensively at risk-sharing than we have in the past,” said Syron. The lack of such an arrangement has long differentiated Freddie’s main multifamily

program from that of Fannie Mae's, which allows lenders retain some of the risk on loans they sell to the GSE.

- Syron also said Freddie Mac would like to find more ways to lay off credit risk in the capital markets. "We are terrific at dealing with interest rate risk," he said, but when it comes to transferring credit risks to other parties "we haven't done anywhere as much of that as we hope we can do." Freddie is "just now starting to explore that in some detail." (*American Banker*, Jody Shenn, 08/19/04)

Bank of America faces fallout from servicing agreements (from Freddie Mac?)

- In a July 30 letter, the SEC staff notified Bank of America (BofA) that it "has concerns with respect to the intent and interpretation of certain contractual provisions" that BofA believes support its mortgage servicing rights (MSR) accounting. BofA said it remains in talks with SEC staff "regarding the prior accounting." SEC spokesman John Heine declined to comment. In an August 9 filing with the SEC, B of A said that it changed the way it accounts for MSRs during the second quarter because unnamed counterparties decided to terminate \$2.2 billion of "excess spread certificates," financial instruments that allowed B of A to simplify accounting by treating MSRs as a security.
- B of A spokesman Robert Stickler declined to name the counterparties in the MSR-related contracts or to elaborate on the SEC's concerns. He also said the accounting change resulted from the counterparties' decision to terminate the contracts, and that it was not related to the SEC's interest, which came later.
- Observers speculate that Freddie Mac might be one of the counterparties. In May, sources familiar with Freddie Mac said its outside law firm, Baker Botts LLP, and OFHEO were examining the GSE's servicing arrangements with BofA. A Freddie spokeswoman declined to comment for this story. (*American Banker*, David Boraks, 08/12/04)

Freddie Mac's former CFO sues OFHEO for compensation

- Freddie Mac's former CFO Vaughn Clarke has joined former CEO Leland Brendsel in suing OFHEO to release withheld compensation. Clarke accused the OFHEO of violating his constitutional rights by directing Freddie Mac to freeze roughly \$1.1 million in assets without due process, according to a lawsuit filed in the U.S. District Court of the District of Columbia. Like Brendsel, Clarke argues in his lawsuit that OFHEO lacked the legal authority to enforce such an action.
- U.S. Judge Richard Leon could hand down a decision soon in Brendsel's case, which is seeking the release of roughly \$54 million in cash, stock and other compensation.

At a July 6 hearing, Leon questioned OFHEO's authority to freeze executive pay at Freddie Mac and Fannie Mae in what could be a precedent-setting case for the regulator's enforcement powers. Leon repeatedly asked the agency's attorneys to provide evidence that the 1992 statute that created OFHEO to oversee the two housing GSEs gave it authority to withhold Brendsel's pay.

- The ultimate fate of the enforcement cases versus Clarke and Brendsel might not be determined until 2006 when they are scheduled to go to trial. Clarke continues to battle OFHEO on a subpoena to turn over documents and testify on the accounting problems and appealed a federal court ruling ordering his testimony. (*Dow Jones Newswires*, Dawn Jones, 08/10/04; *Bloomberg News*, James Tyson, 08/10/04)

Freddie's former CEO joins DebtX

- Greg Parseghian, who stepped down as CEO of Freddie Mac following an accounting scandal, has emerged at DebtX, one of the nation's largest loan sale advisors for commercial, consumer and specialty finance debt. Parseghian will play an advisory role rather than assuming a full-time position. He will help spearhead the marketing and development strategy for DX Mark, a new DebtX product aimed at risk managers and credit policy executives that estimates the value of commercial real estate loans. (*eFinancialNews*, Vivek Ahuja, 08/10/04; *PR Newswire*, 08/09/04)

Freddie Mac study calls for more outreach to Latino homebuyers

- The increasing Latino population, which is expected to account for 31% of U.S. household growth this decade, aspires to homeownership, but more outreach programs are needed to maximize this market's potential, said a report titled "El Sueno de su Casa: the Homeownership Potential for Mexican-Heritage Families" from the Tomas Rivera Policy Institute at the University of Southern California. By 2010, an estimated 1.5 million Latino households will have bought homes, but more aggressive real estate industry programs, including bilingual ones, could reach an additional 700,000 families, said the report funded by Freddie Mac. According to the report, 84% of Latino renters want to buy a house and that 55% plan on doing so in the next five years.
- The report noted that Latino families wanting to buy a home face several hurdles, especially getting accurate information about qualifying for a mortgage. For example, 64% of the potential buyers lacked familiarity with the mortgage process, 53% said it's difficult to save for a down payment and a like amount had trouble finding a trustworthy adviser. (*Los Angeles Daily News*, Gregory J. Wilcox, 08/05/04)

Associated Software Consultants develops interface with Freddie Mac's LP

- Associated Software Consultants, Inc. (ASC), a provider of loan automation software to the mortgage industry, announced today that it has developed its system-to-system interface between PowerLender®, ASC's Java-based loan origination system (LOS), and Freddie Mac's Loan Prospector®. The interface provides PowerLender customers with a seamless connection to Loan Prospector. (*Business Wire*, 08/17/04)

Federal Home Loan Banks

FHLB System reports strong results for second quarter

- During the second quarter, the FHLB system reported strong growth in assets, advances, net income, and retained earnings, reported the Office of Finance. The FHLBs' assets increased nearly 11%, to \$896 billion, from a year earlier, while their net income rose 17.5%, to \$530 million. Higher volumes of mortgage loans and advances drove earnings, though they were partially offset by higher expenses in the FHLBs' affordable-housing programs. Retained earnings grew 23%, to \$1.6 billion, and total capital stood at more than \$42 billion on June 30, 2004. The FHLBs' asset and liabilities remained closely matched with their duration gaps ranging from 2.5 months to minus 0.2 months at June 30, 2004. (*The Main Wire*, 08/10/04; *American Banker*, Rob Blackwell, 08/11/04)
- The FHLBs' Mortgage Partnership Finance (MPF) assets grew to \$89.3 billion as of June 30, up 29.8% from \$68.8 billion a year earlier. During the second quarter, the FHLBs funded \$7.6 billion of mortgages through the MPF program, down 66% from the same quarter a year ago, when \$22.6 billion of mortgages were funded through the program. According to a FHLB-Chicago spokesman, the drop-off in MPF originations reflects the overall slowdown in the mortgage market and increased preference for adjustable-rate mortgages. On June 30, the number of MPF participating financial institutions was 784, up 43% from 548 institutions a year earlier, and 88 lenders are in the process of joining the program. (*Dow Jones International News*, John Connor, 08/11/04; *National Mortgage News*, Brian Collins, 08/16/04)

FHLB-Seattle reports 21.8% *plunge* in earnings for second quarter

- The FHLB-Seattle reported net income for the second quarter was \$25.5 million, a decrease of 21.8%, when compared with second quarter 2003. During the quarter, the Bank's financial performance was impacted by the effects of historically low interest rates that have accelerated prepayment of mortgages. Despite a decline in earnings,

the FHLB-Seattle paid its member institutions a 4% annualized stock dividend for class B(1) shares, which compared favorably with prevailing market rates during the period. “Although we contended with the significant effects of low interest rates again this quarter, we remain a solidly profitable bank, and made progress in achieving the objectives laid out in our strategic plan,” said Norman B. Rice, president and chief executive officer of the FHLB-Seattle. (BusinessWire, 08/10/04)

FHLB-Chicago hires consultants and begins the search for its CEO
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- According to the *National Mortgage News*, the FHLB-Chicago has hired the Secura Group as a consultant to help the Bank evaluate its management and recommend improvements in its operations, industry sources said. A source close to the FHLB-Chicago said the Bank will hire at least three different consulting firms to aid it as it reviews operations, as required by the supervisory agreement with the Federal Housing Finance Board.
- The Secura Group or one of its affiliates also is acting as a headhunter to help the FHLB-Chicago find a president. Industry sources said that John Darr, chief executive of the FHLB System’s office of finance, is being mentioned as a candidate for the position. (*National Mortgage News*, Jessica Forres and Paul Muolo, 08/16/04; *National Mortgage News*, Paul Muolo, 08/16/04)

FHLB-Boston announces McLaughlin promotion to general counsel

- The FHLB-Boston has promoted Ellen McLaughlin to general counsel and senior vice president. Since 1997, McLaughlin had been associate general counsel. She joined the bank in 1990. As general counsel she succeeds Gerard Champagne, who recently retired. (*American Banker*, Christopher Wood, 08/09/04)

International GSEs

Cutting through the spin --*few* foreign countries opt to use
Fannie Mae and Freddie Mac model

- In response to the *Wall Street Journal's* article reporting on how Fannie Mae and Freddie Mac are viewed around the world, Torben Gjede, the Director General of the Association of Danish Mortgage Banks (Copenhagen), wrote in a Letter to the Editor, "Soula Proxenos, a Fannie Mae representative, is quoted in the article as saying that 'in the housing-finance space, there is no question that the U.S. is in the lead.' No doubt Fannie Mae does a great job of spreading the U.S. mortgage system, and is very good at marketing its work. Ms. Proxenos is wrong in her assertion, however, that the Danish model cannot be an inspiration to other countries, including developing countries. In fact, Chile has a Danish-inspired mortgage system, and Mexico is working on a similar project. And the countries of Ireland, Poland, Norway, Finland, the Czech Republic, Slovakia, Hungary and Latvia have all developed new mortgage systems in recent years that are inspired by the German and Danish bond-based mortgage model."
- Peter Williams, Deputy Director General of the Council of Mortgage Lenders (London), also wrote, "Ms. Proxenos's statement that 'there is no question that the U.S. is in the lead' is a very challengeable assertion. Certainly U.S. homeowners enjoy one of the most subsidized housing systems in the world. But despite this, the U.S. homeownership rate is well below a number of other countries. Few other countries would opt to replicate the U.S. system, which costs the U.S. government and taxpayers a great deal through tax relief, tax credits and, of course, the implicit guarantee/contingent liability to the government-sponsored enterprises. And via those GSEs, U.S. housing market risk is sold on to other countries. One might reasonably ask, 'In the lead of what?'" (*Wall Street Journal*, Torben Gjede, 08/03/04)

Sallie Mae

Sallie's shenanigans

- The *Christian Science Monitor* wrote in its July 17th editorial, "Sallie Mae, the nation's largest federal student-loan financier, is quite shrewd when it comes to using plenty of money to influence legislation on Capitol Hill. It is not alone: Federal Election Commission (FEC) records show that student loan and related industry officials contributed mightily (almost \$1 million) to many of the 49 members serving on the House Committee on Education and the Workforce. Why? They're responsible for laws governing federal student loans. Sallie Mae, no surprise, was the largest donor to those members, giving some \$185,000 over the past 18 months."
- "Much is at stake. In May, the House introduced legislation to renew the 1977 Higher Education Act, which will determine how student loans can be constructed over the next 10 years. Sallie and others in the student-loan business want Congress to change the way students can combine and refinance loans. So far, they've gotten their way. If the current re authorization bill passes, for instance, students won't be able to lock in low-interest 30-year rates as they can now. With variable rates, loan consolidation programs wouldn't be as attractive to borrowers."
- "Sallie Mae and other big banks have lost student loans to companies that specialize in refinancing. Those companies have fought back with political contributions to the same members of Congress, to the tune of \$104,000, mostly to Republicans. Whose dollars will hold sway? Stay tuned. The bill is stalled over partisan bickering. But when the money flow to politicians can be so clearly connected to the development of this education bill, the need for voters to better hold politicians accountable - and for politicians to avoid even the appearance of being bought off - is plain." (*Christian Science Monitor*, 08/17/04)

In major step to privatization, Sallie Mae offers to buy subsidiary's debt

- On July 28, Sallie Mae offered to buy for cash \$4.3 billion of its Student Loan Marketing Association subsidiary's debt, in a major step toward privatizing the GSE. "The market is receptive to our offer, and we want to take advantage of that investor interest," said Sallie Mae spokeswoman Jennifer Galloway. The subsidiary's remaining \$3.6 billion in outstanding debt is in bonds which mature between now and early 2005, she added. "Sallie Mae is on track to fully convert to a private-sector company in early 2005," Galloway said. "We have accelerated the process and expect to complete it a full three years ahead of the original government deadline," she added.

- Sallie Mae has “dramatically changed from a wholesale buyer of education loans to a retail provider of them” since 1997, Galloway noted. “Over the last seven years, Sallie Mae has enhanced its loan origination business, and expanded to provide loan processing, collection, and delivery services to its customers, which include lenders, loan guarantors, and federal agencies.” Sallie Mae’s GSE charter limited it to serving only as a secondary market for federal student loans, Galloway explained. “Shedding the GSE status, Sallie Mae will have greater freedom to expand its student loan business and to pursue other activities, such as loan origination and collection,” she said. (*Daily Report for Executives*, Marcia Kass, 08/02/04)

Sallie Mae announces agreement to acquire Southwest Student Service Corp
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- Sallie Mae announced that it has reached agreement with the Helios Education Foundation to purchase the outstanding stock of its student loan subsidiary, Southwest Student Services Corporation (Southwest). The transaction includes Southwest’s student loan portfolio, which today totals more than \$4.5 billion, its Phoenix-based loan origination and servicing center, and its sales and marketing operations. Southwest is among the top 30 originators of federal student loans, issuing more than \$300 million in Stafford and PLUS loans and \$1.5 billion in consolidation loans annually, and it is the nation’s ninth largest holder of federal student loans. (*PR Newswire*, 08/05/04)

Farm Credit System/Farmer Mac

FCA’s risk-based capital rule could force Farmer Mac to obtain credit rating
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- The Farm Credit Administration’s proposed risk-based capital rule will probably force Farmer Mac, the largest unrated debt issuer in the U.S., to obtain a credit rating. “The market has historically regarded securities issued by government-sponsored agencies as posing minimal risk,” the proposed rule reads. “However, we are concerned that (certain investments) that are not highly rated or are unrated may pose significant risks” to FCA institutions. “The proposal allows the Farm Credit System to use credit more efficiently because it allows institutions to better align their capital requirement with their risk,” said FCA spokeswoman Dana Wyckoff. Wyckoff said the rule, which provides an 18-month transition period, contained few changes from the original plan approved by the FCA board in early June.
- In the past, the FCA treated Farmer Mac for regulatory purposes the same as Fannie and Freddie, which are both triple-A-rated, requiring FCA institutions to hold only 20% in capital against the assets invested in the three GSEs. The 20% risk assessment will remain in place for securities and other investments that are rated, issued or guaranteed by an institution with a rating of double-A or higher. FCA’s

new rule will require FCS institutions to hold more capital, 50%, for single-A-rated securities and reserves for securities issued or guaranteed by unrated institutions such as Farmer Mac equal to 100% of the value of those investments, which will dramatically raise costs for both Farmer Mac and its investors. Farmer Mac can offer “no assurance” that it will receive a double-A rating or better and company officials recently speculated that a significant portion of its \$2.8 billion in outstanding guarantees currently held by FCS institutions “might be subject to early termination.” FCA officials dismissed those concerns, saying that Farmer Mac could sell bonds backed by farm mortgages to raise the cash needed in case banks start liquidating their Farmer Mac holdings. (*Dow Jones Newswires*, Dawn Kopecki, 08/06/04)

Postal Service

Postal reform anyone?

- Tad Clark, the Editor in Chief of *DMNews.com*, wrote “Several months ago, I said reform of the U.S. Postal Service never would get through Congress during an election year. Then, the House Government Reform Committee and Senate Committee on Governmental Affairs passed separate versions of the Postal Accountability and Enhancement Act of 2004. Suddenly, it looked like lawmakers actually cared about passing reform for the first time in three decades, and mailers started getting excited. Silly us. Something must have been in the water. It’s an election year, remember? Congress is now adjourned until September 7, and the legislative session is scheduled to end October 1, though that could always be extended a few days. Heck, give ‘em another month, they still won’t pass anything this complicated and controversial just days before a national election.”
- “Want to prove me wrong? Then do as the Direct Marketing Association requested last week in its action alert urging members to write letters to their respective lawmakers using its political action Web site. You just have to type in your ZIP code and up pops your respective representatives, and then you personalize the letter that’s already written. It takes no effort. (I sent mine in less than two minutes.)”
- “...Only if enough voices are heard will Congress get off its collective butt and do something. It’s probably too late for this year, but it’s worth a try. So, why isn’t reform going anywhere in the Senate? Politics. Budget Committee chairman Don Nickles, R-OK, is unhappy with Sen. Susan Collins, R-ME, for failing to support his effort to have a budget that includes tax cuts approved. Therefore, Nickles is holding her reform bill hostage.” (*DMNews.com*, Tad Clarke, 08/02/04)

Reading the tea leaves on the future postal rate increases

- According to the *Red Tag Newsletter*, “The USPS will to file a rate case at the end of this year with new rates expected to hit mailers at the beginning of 2006...Rumors are that the USPS will be re-introducing the concept of “phased in” rate hikes and that the overall effect will be double digit increases. Conjecture is that there will be no radical shift to a more “cost based” price structure but there will probably be some rule changes regarding containerization that will have an incremental effect in modifying mailer behavior.” (*Red Tag Newsletter*, August 2004)

Groups voice their opposition to Tisdale’s nomination to the Postal Rate Commission

- In a letter dated August 11th, the Americans for Tax Reform, the National Taxpayers, Union, the Small Business Survival Committee, the American Conservative Union, the 60 Plus Association, the Frontiers of Freedom Institute, and Postal Watch called on President Bush not to exercise his authority to appoint Dawn Tisdale to fill a vacancy on the Postal Rate Commission during the summer recess. The groups make this request in order for the Senate confirmation process to continue and provide the senators the opportunity to thoroughly investigate and question the nominee’s positions on a number of issues of concern. (*PostalWatch.com*, 08/11/04)

USPS’ use of U.S. Treasury debt drops to zero in June

- The Treasury’s lending to the USPS dropped to zero in June, as a result of the Postal Service’s restructuring. Richard Strasser, USPS chief financial officer and executive vice president, said the USPS likely will incur losses in certain months, including July and August. “The USPS is delivering less mail to more households every day,” he said. “I don’t want the debt situation to mask the real problem, which is that the revenue line is not growing, and we don’t really anticipate it to grow much next year. We still have other obligations, like the health benefits for retirees and workers’ compensation costs, on our balance sheet.” Strasser said the USPS originally planned to reduce debt to \$2.6 billion to \$3.1 billion by the end of this year, but “we think we are going to end the year at about \$2 billion in debt because of our increased productivity.”
- The USPS published its financial and operating statements for June, FY 2004, which reported net income of \$2.81 billion -- \$853.4 million over budget -- between October 1, 2003, and June 30, 2004. Mail volume was up and expenses were under plan in the period. Revenue totaled \$52.1 billion, 0.5% better than planned, but was down 0.1% compared with the year-ago period. Expenses of \$49.3 billion were 1.2% under the planned budget, but up 2.8% versus the year-ago period.

- Volume of 155 billion mail pieces rose 1.4%. International and Standard mail grew 6.7% and 4.9%, respectively. However, several mail classes experienced declines. Periodicals fell 3.3%; Express Mail, 3.1%; Priority Mail, 2.5%; First-Class, 1.4%; and Package Services, 0.7%. (*DMNews.com*, Melissa Campanelli, 08/16/04; *Dow Jones Newswires*, Campion Walsh, 08/09/04)