

The **GSE** REPORT™

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Major Events

CBO determines that proposed manager's amendment to H.R. 1461 will significantly reduce the bill's overall cost and makes it budget neutral

- CBO has concluded that the proposed manager's amendment for H.R. 1461, the bill that passed the House Financial Services Committee in May, would significantly reduce the cost of the overall bill and render it budget neutral over 10 years. House Financial Services Chairman Michael Oxley (R-OH) asked CBO to evaluate proposed changes to the affordable housing fund provision in H.R. 1461, which would divert a portion of Fannie Mae and Freddie Mac's profits into separate affordable housing funds. Oxley's revised provision would lower the bill's costs to the federal government from a total of \$300 million over ten years to zero. Oxley's amendment would reduce the companies' overall contributions to the affordable housing funds, thereby reducing H.R. 1461's overall costs, largely by terminating the funds altogether by 2011. The manager's amendment would also devote 25% of the funds, approximately \$720 million, toward the Treasury's debt servicing costs on the REFCorp bonds, which were issued by the federal government to cover costs related to the failure of thrift industry in the late 1980s. Based upon Oxley's proposed changes, CBO said the cost of H.R. 1461 is basically "a wash" from the perspective of the federal budgeting, costing the government \$3.2 billion while generating that same amount of revenue from 2006 through 2015. "The CBO score shows that, with proposed revisions, (the GSE bill) is budget neutral," said House Financial Services spokeswoman Peggy Peterson. "At a time when rents are rising, the fund would increase the stock of affordable housing with no negative impact to the taxpayers. At the same time, taxpayers would benefit from improved regulation of the secondary mortgage market that the bill provides."
- CBO's lower budget score will likely remove a potential procedural problem when H.R. 1461 is reconciled with a companion bill in the Senate. The Senate requires all bills with a CBO cost estimate of more than \$5 billion over ten years to automatically trigger a "point of order" - a rule designed to keep federal spending at a minimum by requiring a super-majority of 60 votes to pass instead of a simple majority of 51. (*Dow Jones Newswires*, Dawn Kopecki, 07/12/05; *The Main Wire*, Claudia Hirsch, 07/13/05)

Freddie Mac CEO Syron says Fannie and Freddie are no longer an oligopoly and shouldn't be overwhelmed with new regulations

- In remarks at Freddie Mac's annual shareholder meeting, the company's CEO Richard F. Syron told shareholders that Fannie and Freddie are no longer the oligopoly that they once were in the mortgage market and should not be overwhelmed with new federal regulations. According to a new report from OFHEO, Fannie Mae

and Freddie Mac bought 40% of the conventional mortgages issued in 2004, down from 66% in 2003. Syron said this finding should make Congress more cautious in writing new GSE regulations. "You can't put a lot of burdens on us that you could have maybe when we were more of an oligopoly and didn't face private competition," Syron said. He called H.R. 1461, the House version of GSE regulatory reform, "tough". He said that while Freddie Mac supports stronger regulation of the GSEs, "any solution must be consistent with long-term shareholder value." Syron said that Freddie Mac takes no position on the AH fund provision in H.R. 1461. "We've tried to make it clear we have no clear dog in that fight," he said. But he added that there are "a lot of complicated questions about how that might be set up, how that might be funded." He said that if Congress wants Fannie Mae and Freddie Mac to do more to finance affordable housing, it should take into account the companies' changing marketplace. "We can only do that if we're viable competitive entities," he said.

- Commenting on trends in the mortgage market, Syron said "These things go in cycles. Forty percent of the mortgages being originated now are interest-only mortgages. They are appropriate for some people, and for some people they don't make sense. As we move to more and more exotic products -- and I think we are at the apex of that movement -- for a variety of reasons, the private funders will increase their share" compared with the GSEs. He added, "We expect our share of the entire market to increase over time. Our share of the GSE market has increased quite dramatically. In one month this year we were almost parallel" with Fannie Mae in terms of production of MBS.
- Syron told shareholders that Freddie Mac is on track to provide regular financial reporting and anticipates releasing its first and second quarter results at the end of the summer. Freddie is currently testing its financial controls and is addressing remaining issues raised by OFHEO. "While a lot remains to be done, we made significant strides last year and we continue to improve and strengthen our internal controls," he said. "It is on the top of our agenda, but still a work in progress."
- Syron also announced that Joan Donoghue, the company's senior vice president and general counsel, will leave Freddie Mac at the end of the year. Donoghue, who joined Freddie Mac in August of 2001, replaced Ralph Boyd, Jr. in February, when Boyd was named the company's executive vice president of community relations. At the shareholder meeting, Donoghue was elected to the company's board of directors. Syron said that Donoghue would continue to serve on the board, until the board can elect her replacement. (*Reuters*, Julie Haviv, 07/15/05; *Washington Post*, Annys Shin, 07/16/05; *Reuters*, 07/15/05; *Bloomberg News*, Al Yoon, 01/15/05))

Fannie Mae and Freddie Mac

Senator Shelby plans to mark-up GSE regulatory reform the last week of July

- “We’re coming with a strong bill, a meaningful bill,” said Chairman of the Senate Banking Committee Richard Shelby (R-AL), adding that the bill could be ready for committee consideration the last week of July. In comments with reporters following an unrelated committee hearing on the federal backstop for terrorism risk insurance, Shelby said “We’re making real progress on a GSE proposal,” but declined to offer details on controversial aspects of the bill, including the House provision establishing a low-income housing fund to be financed with 5% of Fannie and Freddie’s net income. “We will address a lot of aspects of housing,” Shelby said. “We’re all committed to housing. We’ll look at different configurations.” When asked if his bill would require the new GSE regulator to impose limits on the GSEs’ retained mortgage portfolios, Shelby said, “You’ll have to wait on that. That is something we will be addressing.”
- Shelby said he will consult with Democrats prior to committee consideration of the GSE bill. In an interview with Market News International, Senator Chris Dodd (D-MD) said that Shelby has “generally speaking” reached out to Democrats. “He wants to work with us,” said Dodd, adding that Shelby has chaired the committee in a bipartisan fashion. “He’s fully aware, he can’t have a partisan bill,” Dodd added. He said that he is “confident” the panel can produce a workable GSE reform bill this year.
- For a GSE regulatory reform bill to advance through the Senate, Shelby must secure not only panel Democrats’ support, but also that of a number of Republicans with ties to Fannie and Freddie, said Charles Gabriel, a political strategist for Prudential Securities in Washington. “This thing is high risk to die in his arms, as it did last year,” said Gabriel. (*Market News International*, Claudia Hirsch, 07/14/05; *Congress Daily PM*, Molly M. Peterson, 07/14/05)
- The *National Mortgage News* reports, “[Senator Rick Santorum (R-PA)], a key Republican on the Senate Banking Committee, appears to support the creation of a GSE affordable housing fund, but he is willing to explore other AH proposals as the committee chairman drafts a bill to tighten regulation of Fannie Mae and Freddie Mac. ...According to sources, the Pennsylvania senator said he is willing to work with the committee chairman, but he will keep his options open as the committee moves toward a mark up of the GSE bill...” (*National Mortgage News*, 07/07/05)

- “The longer you let a complex bill hang out there, the more issues that come up,” said Edward Yingling, the president of the American Bankers Association. Yingling’s words ring true with the GSE regulatory reform legislation (H.R. 1461), which is pending in the House. Controversy has now flared over provisions that would raise the conforming loan limit in high-cost areas and another that would make Fannie and Freddie register their debt. In recent weeks, more bankers have begun to object to the provision increasing conforming loan limits, arguing that letting the GSEs buy loans of wealthier borrowers and reducing their incentive to serve low- and moderate-income consumers would contradict the goal of reining in the GSEs. The provision would create “a tremendous risk to divert Fannie’s and Freddie’s attention from what they were chartered to do,” said F. Weller Meyer, the president and CEO of Acacia Federal Savings Bank in Falls Church, VA. “It certainly creates the potential to expand their mission beyond what it has been defined as.” Four trade organizations, including America’s Community Bankers, the Association of Financial Guaranty Insurers, the Consumer Mortgage Coalition, and the Financial Services Roundtable’s Housing Policy Council, sent a letter to all members of Congress, urging them to remove this provision. ACB president Diane Casey-Landry warned that her group may oppose the bill if the provision remains in the legislation. “We believe this provision undermines the intent of the bill,” said Casey-Landry. Several state trade groups have weighed in on the issue, saying the current jumbo market is well served already and that the GSEs’ presence in it wouldn’t lower prices by much. Mariel Donath, the president of the Community Bankers Association of New York State. “There is no reason to have Fannie and Freddie in this market for this level of housing.”
- Not all bankers agree, with the Independent Community Bankers of America, which represents small community banks, saying the provision could provide bankers more opportunities to sell their loans. The National Association of Realtors have also been lobbying for the provision, saying it would help lower the price of mortgages and increase competition – which the big banks don’t want.
- The ACB and ICBA also has voiced opposition to Senate Banking Committee Chairman Richard Shelby’s (R-AL) proposal to require Fannie Mae and Freddie Mac to register their debt with the SEC, arguing that the GSEs already disclose enough to the market. “It’s a dumb idea,” said Jim Giralдин, President of First Federal Bank of California and a director at the FHLB-San Francisco. “It will increase the cost of the debt securities. My fear is they will expand beyond Fannie and Freddie to the Federal Home Loan Bank System and that is anti-community lending.”
- H.R. 1461’s other major obstacles include limiting the size of Fannie and Freddie’s mortgage portfolios and a proposal to force the GSEs to devote 5% of their profits to an affordable-housing fund. Representative Deborah Pryce (R-OH), the fourth-ranking GOP leader in the House and the chairwoman of the House Republican Conference indicated that GSE regulatory reform legislation will

probably require some version of an affordable housing fund if the House is to approve the measure. “I think most likely it has to [be in] in order to get passed,” said Pryce. “That’s just the pragmatist in me.” She said the AH fund is the major focus of daily negotiations, while other disputes are “fairly minor,” adding “progress is being made.” Pryce also said the remaining weeks before the August recess may be too busy to finalize negotiations and schedule a House vote on the bill. When asked if a schedule slip into fall dooms chances of passage of GSE regulatory reform this year, Pryce replied, “No, I think we have a good chance to get it done.” (*American Banker*, Rob Blackwell, 07/07/05; *The Main Wire*, Claudia Hirsch, 07/14/05)

Victory lap for H.R. 1461?

- Many on Wall Street have grown pessimistic about the chances of GSE regulatory reform legislation in 2005 given controversies over provisions in H.R. 1461 and the tight calendar in that chamber, and the pending confirmation of a new member of the Supreme Court in the Senate, which will eat up time and political energy on Capital Hill. Apparently, the experts at Prudential Securities are a little more optimistic, as evidenced by a recent institutional-investor conference call, suggesting “that Fannie and Freddie partisans were ready to pop champagne corks.” Bethany McLean wrote in the July 11th issue of *Fortune*, “One consultant [participating in the conference call], Terry Haines, noted that the Baker bill was ‘hard evidence for the first time’ that the administration’s views were ‘marginal.’ He went on to criticize the White House for being ‘shrill’ and ‘late to the party,’ and he essentially dismissed Greenspan by saying that ‘the Fed is not exactly the housing regulator.’ Consultant Howard Glaser noted that another provision in the Baker bill, which requires that the companies devote 5% of their earnings to providing affordable housing, ‘creates real political power’ for the companies. (Glaser now says he wasn’t expressing his own views, he was merely explaining why critics fear the provision.) The call was in effect a victory lap, and publicly many of the bill’s supporters say the Baker legislation is on track to be signed into law.” (*Fortune*, Bethany McLean, 07/11/05)

A guide to tightening up GSE regulatory reform legislation

- A white paper titled “Tightening Up GSE Regulatory Reform Legislation: A Drafting Guide” provides an in-depth discussion of the changes that are needed in H.R. 1461 to avoid creating unnecessary difficulties for the new GSE regulator. The memorandum addresses 12 key drafting issues for GSE regulatory reform legislation, including significant definitions, agency structure, director’s duties, bright-line definition, approval of new Enterprise activities, assets and obligations of the GSEs, assessments of the GSEs, minimum capital levels, cease and desist authority, subpoena authority, enforcement and jurisdiction, affordable housing goals, effective date, discrimination by GSEs, private rights of action, consumer financial privacy, conforming loan limit, and provides the reader recommended language for each issue. A side-by-side analysis is provided in the July 12th memorandum entitled “GSE

REGULATORY REFORM—Current Law, S. 190, H.R. 1461 and Banking Law,” which includes more detailed drafting issues and the comparable bank law provisions. Both memoranda are available for review at www.gsereport.com.

AH fund: A recipe for misguided housing policy

- In its July 11th issue, the *Orlando Business Journal (OBJ)* writes, “The House is on the verge of enacting HR 1461, which would make ...Fannie Mae and ...Freddie Mac less vulnerable to a financial meltdown. ...What’s attracting attention to the measure, which was passed by the House Financial Services Committee in May, is a proposal that would mix mortgage risk evaluation and partisan politics in an unprecedented way. Chairman Michael Oxley, R-Ohio, is the prime mover behind a requirement to force the GSEs to devote 5 percent of after-tax profits to a proposed affordable-housing fund. In 2003, that pool would have been at least \$600 million. Eligible recipients of this largesse include lenders, builders, nonprofit groups and government agencies. It’s understandable why Fannie and Freddie are targets. They’ve had lots of bad publicity lately. And they’ve got lots of money -- courtesy of federal law.”
- While CBO estimates that homeowners receive 63% of the GSEs’ \$10.6 billion of subsidies, *OBJ* writes, “This isn’t quite the win-win situation for the American people that the GSEs and their political supporters would have us believe. In fact, there’s an inherent contradiction. On one hand, Fannie and Freddie must adhere to strict standards. On the other, they are under intense pressure to bend traditional mortgage underwriting standards to make more low-income households into first-time home buyers. Producing high returns for shareholders while complying with a wealth redistribution mandate is a balancing act that virtually invites creative bookkeeping. It may temporarily succeed during housing booms like the current one, but the bills inevitably come due.”
- “Fannie Mae and Freddie Mac are at once heavily subsidized and heavily regulated. That makes them vulnerable to shakedowns, especially by nonprofits that operate on a nationwide scale. The Association of Community Organizations for Reform Now, for one, has never shied away from putting the heat on the GSEs, banks and thrifts to increase their lending efforts on behalf of underserved populations and geographic areas. Fannie and Freddie’s typical response is acquiescence. From their standpoint, promoting risky lending is a cost of avoiding letter-writing campaigns, demonstrations and lawsuits. It’s a mistaken strategy.”
- “At least some members of Congress grasp what’s at stake. Representative Mike Pence, (R-IN), recently circulated a Dear Colleague letter that’s attracted more than 30 signatures. Terming the 5 percent affordable-housing initiative a “slush fund,” Pence is urging Congress to delay action on H.R. 1461. He recently won a key convert in Richard Shelby, R-Ala., who heads the Senate Banking Committee. Congress should heed Pence’s advice. Fannie Mae and Freddie Mac’s problems are real and need addressing. But routing a portion of their profits toward politically

connected builders and community groups will heighten, not lessen, the pressure to keep two sets of books.” (*Orlando Business Journal*, 07/11/05)

The National Association of Independent Mortgage Brokers voices their concerns about GSE regulatory reform

- In a July 5th letter to Chairman Richard Shelby (R-AL) and Ranking Member Paul Sarbanes (D-MD), the National Association of Independent Mortgage Brokers (NIMB) warned that the debate over GSE regulatory reform was in danger of drifting away from its focus of creating a robust soundness and safety regulator and drifting into areas that would give the regulator the authority to “fundamentally reshape the housing finance playing field.” Specifically, the NIMB voiced strong opposition to including a provision which would place a cap on the GSEs mortgage portfolios, arguing that the mortgage market demands for liquidity are “notoriously hard to predict” and that the GSEs’ liquidity is particularly important during times of crisis. While the group supports providing the regulator authority to adjust minimum capital requirements, they believe that such adjustments must be tied to safety and soundness concerns identified by the regulator and once such conditions change or problems are rectified, then the minimum capital should return to the statutory level. With regard to program and activity approval authority for the regulator, NIMB strongly urges the Senate Banking Committee to include provisions in their bill that clearly permit “new mortgage products” to be introduced on a *prior notice basis*, requiring a minimal waiting period. The group also argued against including a bright line test in the bill, arguing instead that “a strong, independent regulator using current GSE charter restrictions, prudent safety and soundness standards would have more-than-ample authority to address concerns about mission creep and undue risk.”
- NAIMB concluded, “Independent mortgage bankers are concerned that GSE oversight reform legislation is devolving into a battle over ‘level playing fields’ that could put at risk a housing finance market in which competition is already vibrant and intense. We urge Congress to proceed quickly on GSE reform, but with an unwavering focus on issues directly related to establishing a strong and effective safety and soundness regulator. The legislative process should not be distracted by provisions that have little to do with safety and soundness, but which may have far reaching and unpredictable consequences on the mortgage finance system.” (*Letter to Senators Richard Shelby and Paul Sarbanes from the National Association of Independent Mortgage Brokers*, 07/05/05)

House passes housing appropriations with full funding for OFHEO

- The House of Representatives passed a housing appropriations bill, providing for full funding for Fannie Mae and Freddie Mac’s regulator, OFHEO. H.R. 3058 includes \$60 million, which the Bush administration requested for OFHEO. (*National Mortgage News*, 07/11/05)

Moody's makes no changes in its updated ratings for Fannie Mae and Freddie Mac

- Moody's Investor Service's new rating methodology for government-related issuers has left the ratings of Fannie Mae and Freddie Mac unchanged. Fannie's subordinated debt and preferred stock ratings remain on review for possible downgrade, while the other major U.S. mortgage-related GSEs ratings remain stable. (*National Mortgage News*, 07/11/05)

Fannie Mae and Freddie Mac: On the road to redemption

- In a July 6th report, Morgan Stanley analysts Ken Posner and David Brown "peer through the mist of current political controversy" and envision the most logical regulatory structure for the GSEs and assess the implications such a structure could have on the Fannie and Freddie's business model. Under a worst case scenario, the analysts expect that a new GSE regulator would raise capital standards for the retained portfolios from 2.5% to 4-5% of assets and restrict risk-taking, significantly reducing their competitive advantage and leaving them with limited opportunities to grow. Based upon their economic analysis, Posner and Brown conclude that Fannie Mae and Freddie Mac's stock "now look attractively valued" even under this worst case scenario, with price targets for Fannie Mae changing from \$65 to \$67 and for Freddie Mac from \$80 to \$77. The analysts write, "The stocks appear to discount for [GSE regulatory] legislation that would mandate rapid elimination of retained portfolios — a worst-case scenario that we consider unlikely." They conclude, "Popular concerns over the risk of a housing 'bubble' appear to have left the stocks as a group undervalued." Noting the unclear outlook for passage of GSE regulatory reform in 2005, the analysts note that "without new legislation, the GSEs will operate under the existing regime, and every year of delay means another year where higher returns and faster growth are still legally possible," making the GSEs' stock "mathematically worth more." (Morgan Stanley Equity Research, *Industry Overview: Fannie Mae, Freddie Mac and the Road to Redemption*, Kenneth Posner and David Brown, 07/06/05)

Other Wall Street items of interest

- Sanford C. Bernstein & Co. LLC has discontinued its coverage of the U.S. mortgage finance business and has withdrawn its ratings for eight companies in the sector, including Fannie Mae, Freddie Mac, Countrywide Financial Corp., Washington Mutual Inc., Golden West Financial Corp., MGIC Investment Corp., PMI Group Inc., and Radian Group Inc. Sanford also announced that Jonathan Gray, its veteran analyst for the sector, has been put on short-term medical disability leave. (*American Banker*, Jody Shenn, 07/06/05)

- A wise voice on Wall Street will be much missed, as senior analyst Peter Eavis leaves *TheStreet.com* to pursue a higher calling. On June 28th, Eavis posted the following on his blog, *New York City Pastor*: “I gave up reporting for pastoring three months ago. I love journalism, but I love pastoring more. It was very gratifying, then, to win a prestigious Loeb award for my 2004 reporting on Fannie Mae. ...I learned I was the winner of the Commentary prize at an awards ceremony at Cipriani in Midtown Manhattan tonight. ...Thanks to Pheobe for putting up with an intense journalist-type like me for so long. Thanks to my great friend and editor, Colin Barr, for being, well, a great editor and a great friend. And thanks to God for helping me out in so many ways as a reporter. It was a great 12 years in the business. I started out as a total know-nothing on a weekly in Prague in 1993 that was run on stolen money and ended up being the scourge of Wall Street. It’s very nice to bow out with a prize like this.” (*New York City Pastor*, Peter Eavis, 06/28/05)

EU regulators seek more disclosure from U.S. firms
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- In a report to European Union (EU) lawmakers, the Committee of European Securities Regulators (CESR) said U.S. issuers with securities trading in the bloc should detail some “special purpose entities” that are kept off the books under U.S. accounting standards. CESR called for U.S., Japanese and Canadian companies to disclose more information when their accounts differ from EU standards, but stopping short of recommending that firms keep a second set of books. “This is the absolute minimum requirement that we need,” said Paul Koster, a commissioner of the Netherlands Authority of Financial Markets and CESR member. “We’ve really tried to find a good balance between what is required for the investor and what is doable for the companies without too high a cost burden.” CESR said that the U.S., Canadian and Japanese companies won’t have to do a full reconciliation to spot every variance from IFRS. According to the report, it’s up to companies to determine what is “relevant and material.”
- CESR is providing advice to the European Commission, which must rule on the “equivalence” of third-country’s accounting standards, under EU prospectus and disclosure rules. The commission’s decision will determine whether foreign companies with stocks and bonds traded in the EU have to restate their accounts under IFRS beginning in 2007. EU companies switched to the new standard in 2005 Fannie Mae and Freddie Mac would be affected by the change in accounting disclosures, if the European Commission adopts CESR’s recommendations. (*Bloomberg News*, 07/05/05)

OFHEO reports sharp drop in Fannie and Freddie’s share of mortgage market

- According to a new report prepared by OFHEO, Fannie Mae and Freddie Mac’s combined purchase of conventional mortgages represented 40% of those originations

in 2004, compared to 66% in 2003. The companies' combined purchases of non-jumbo fixed rate mortgages represented 47% of originations of those loans in 2004, down from 70% in 2003. Moreover, the GSEs' purchases of conventional adjustable rate mortgages represented 25% of those originations, down from 43% in 2003. According to the OFHEO report, "The declines in the [GSEs'] shares of markets for fixed-rate and adjustable-rate loans last year were due to changes in the composition of originations in the primary market and heightened competition from other secondary investors. In the secondary market for [fixed-rate mortgages], Fannie Mae and Freddie Mac faced greater competition from banks and other non-GSE investors in 2004. Heightened competition reduced the yields on those loans and made them less attractive for the [GSEs]." While non-traditional hybrid ARMS and subprime mortgages were increasingly popular in 2004, Fannie Mae and Freddie Mac purchased such mortgages cautiously. (*OFHEO Press Release, 07/13/05*)

Chairman of the president's Council of Economic Advisors says much of price appreciation in housing market is "result of growing economy"

- In a July 8th interview on CNBC's *Squawk Box*, the chairman of the Bush administration's Council of Economic Advisors, Ben Bernanke, downplayed fears of a housing bubble. When asked if there is a housing bubble, Bernanke responded, "...Unquestionably, housing prices are up quite a bit. I think it is important to note that fundamentals are also very strong. We've got a growing economy--jobs [and] incomes. We've got very low mortgage rates. We've got demographics supporting housing growth. We've got restricted supply [of houses] in some places. So, it's certainly understandable that prices would ...go up some. I don't know whether prices are exactly where they should be. But I think it's fair to say that much of what has happened is supported by the strength of the economy." (*CNBC's Squawk Box, Ben Bernanke, 07/08/05*)
- Meanwhile growth in housing is expected to hit record highs in 2005, defying earlier forecasts of a slowdown this year as low interest rates keep demand robust, said Freddie Mac's chief economist Frank Nothaft. Freddie Mac has boosted its forecast for new and existing housing sales to 7.21 million for 2005, up from its previous forecast of 7.1 million. In 2004, house sales hit a record 7.17 million. "The robust housing activity is directly related to the level of mortgage rates, said Nothaft. "The dip in 30-year fixed rate mortgages to a 14-month low in June rekindled housing demand and sparked the record pace of sales activity." (*Reuters News, 07/07/05*)
- Cantor Fitzgerald economist and market bull John Herrmann said, "We continue to expect that mortgage rates are headed towards 4.0% over the next three and a half years and not towards 7% over the next three and a half years..." Hermann argues that competitive pressures and the resulting efficiencies --such as new, every more exotic mortgages, better "early payoff" predictions, etc—that are likely to emerge will drive rates lower. "If he's right, this real estate market may have a LOT more

steam left,” writes Alex J. Stenbeck on his blog, *Behind the Mortgage*. (*Behind the Mortgage*, Alex J. Stenbeck, 07/08/05)

- Another factor contributing to price appreciation in the U.S. real estate market is the influx of foreign investment. In a Florida study conducted from May 2004 to May 2005, international buyers accounted for roughly 15% of total home sales in Florida. The majority of international homebuyers were from Europe, while buyers from South American, Central America and the Caribbean comprised 33%. “The exchange rate is finally catching people’s attention,” said Ronald A. Shuffield, president of Esslinger-Wooten-Maxwell Realtors. According to the study, cash is king for the foreign buyers, with more than a third of the international buyers paying cash for their homes compared to just 10% of Florida home purchasers. “No question, foreigners are part of the bubble,” said Stephen Wayner, first vice president for Bayview Financial Exchange Services, Miami, FL. (*Miami Herald*, Matthew Haggman, 07/15/05; *Christian Science Monitor*, 07/15/05)

Hot new housing market in the making: Mortgages to undocumented aliens

- The number of the lenders accepting ITIN for income verification for undocumented aliens is growing, creating a “hot new market” in the mortgage lending. In 2004, the IRS issued 900,000 ITINs and a total of eight million since 1996. In Chicago, Second Federal Savings has 620 ITIN loans totaling \$90 million on its books and expects demand to grow now that the Wisconsin and Illinois state housing development agencies have agreed to start buying ITIN loans. Cincinnati-based Fifth Third Bancorp, the nation’s 13th-largest bank, introduced several ITIN products in 2004, including mortgages, home equity lines of credit, and car loans. “We’re committed to making the American Dream possible; our obligation is to provide products that allow people to assimilate into the U.S. economy,” said Saul R. Boscan, the Bank’s director of special initiatives in the Chicago market. With hundreds of thousands of illegal alien households earning enough to qualify for \$95,000 mortgages, ITIN and conventional mortgages taken out by illegals could be worth as much as \$60 billion over the next five years, according to the National Association of Hispanic Real Estate Professionals. Big banks such as JPMorgan Chase & Co. are now studying the market and increasing the pressure on Fannie Mae and Freddie Mac to create a secondary market for ITIN loans. (*Business Week*, Brian Grow, 07/18/05)

Competition everywhere in the mortgage market

- *National Mortgage News Online* reports that the U.S. Rural Housing Service is conducting a pilot program with Chase Home Finance to provide low- and moderate-income rural residents 100% construction/permanent financing in California, Florida, Georgia, North Carolina, Ohio, and Texas. According to *MNO*, the single-family construction loans automatically convert to fixed-rate 30-year loans and are

guaranteed by the Rural Housing Service. (*National Mortgage News Online*, 07/12/05)

Fannie Mae

When Self-Help Credit Union's president speaks, Fannie Mae listens
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- Within weeks of becoming chief executive of Fannie Mae, Daniel H. Mudd visited the Self-Help Credit Union in Durham, NC to seek the counsel of its president, Martin Eakes. When Mudd came to call, Eakes told him that Fannie Mae pays its executives too much. [Twenty-five years after receiving his law degree from Yale University, Eakes earns just \$60,000 a year, the top pay allowed by the rules of Self-Help.] Mudd, whose base salary is \$850,000 and who stands to earn millions of dollars more each year through bonuses and stock awards, says he welcomes Eakes's straight talk. "We're working on making sure our pay and incentives are tied up with getting our mission and our business done," Mudd added.
- In 1980, Eakes and his then-fiancée (and now his wife), Bonnie Wright, formed Self-Help shortly after he finished law school with plans to advise jobless workers on how to set up cooperative businesses. Instead, Eakes found that would-be entrepreneurs needed cash more than his advice, so Self-Help turned into a credit union and lender to small businesses. Today, Self-Help's assets total approximately \$1 billion, largely in the form of home mortgages and small-business loans. With the initial financial support of Ford Foundation, Self-Help developed a nationwide business of financing homes for low-income people who otherwise would have trouble obtaining credit. Through this program, Self-Help encourages banks to make loans to people who wouldn't qualify for conforming loans financed by Fannie Mae or Freddie Mac. Self-Help buys these loans from the lenders, retains some of these loans as investments, and sells the remaining loans to Fannie, with the credit union's guarantee that the loans will be repaid.
- According to the *Wall Street Journal*, "Self-Help's managers, who tend to wear jeans and sneakers and to lack formal financial training, taught themselves how to use derivative contracts to hedge the interest-rate risks on the organization's \$694 billion portfolio of mortgage loans. 'It's not rocket science,' says Eric Stein, president of Self-Help, whose office book shelf includes a textbook called *Corporate Finance*." (*Wall Street Journal*, James R. Hagerty, 06/12/05)

Fannie Mae Foundation sponsors its 10th Fellowship Program
at the Kennedy School of Government

- Since 1996, the Fannie Mae Foundation has partnered with the John F. Kennedy School of Government at Harvard University to offer the Fannie Mae Foundation Fellowship Program for elected and appointed officials as well as senior managers in nonprofit organizations. To date, more than 250 local and state officials and senior nonprofit executives have received Fannie Mae Foundation Fellowships and participated in the three-week Senior Executives in State and Local Government Program. In addition, the Fannie Mae Foundation Fellows attend special housing sessions coordinated by the Joint Center for Housing Studies of Harvard University, members of the Kennedy School faculty, and Fannie Mae Foundation staff. These sessions address housing issues, trends, policies, and successful models of public/private housing partnership. According to the Fannie Mae Foundation website, the cost per attendee is \$10,300, which is paid by the Foundation. (*Fannie Mae Foundation Press Release*, 06/06/05; *Fannie Mae Foundation Press Release*, 07/05/05)

Another “world class” company

- Just what the health care industry needs: a “world class” board and investor group partnering with Steve Case to create Revolution Health Group [according to the RHG’s press release]. The major investors in the company to create a “more consumer-centric health care system,” include AOL co-founder Steve Case; former Secretary of State Colin Powell; former Fannie Mae CEO Franklin Raines; former CEO of Netscape Jim Barksdale, former CEO of Oxford Health Plans Steve Wiggins; and venture capitalist Miles Gilburne. (*Business Wire*, 07/07/05)

Freddie Mac

Freddie Mac to disclose more information on adjustable MBS

- In September, Freddie Mac will provide more information on its adjustable-rate mortgage-backed securities to investors. When issuing ARM participation certificates and ARM giant PCs, Freddie Mac will provide the original weighted average loan age and original loan term, the current weighted average remaining months to maturity, loan age and original loan term. At issuance, Freddie Mac will disclose the original weighted average loan age and original loan term, while current weighted average remaining months to maturity, loan age and original loan term will be updated monthly. The GSE also plans to disclose the original and current weighted average months to amortization for initial interest fixed-rate securities and ARM PCs. “Expanding disclosure capabilities increases the transparency of our ARM PCs and contributes to investors’ increased understanding of our securities,” said Mark Hanson, Freddie Mac’s vice president of mortgage funding.
- Analysts and investors are more interested in the effects on prepayment speeds of the potential payment shock to borrowers from the popular hybrid ARMs and interest-only loans. “Certainly, some of the things we’ve put out here will help address the understanding of that phenomena, but I would not call that the impetus,” said Phil Guth a vice president of mortgage securitization at Freddie Mac. (*Associated Press*, 07/08/05; *American Banker*, Jody Shenn, 07/15/05)

NAMB members ask Freddie Mac to get wholesalers more involved in offering the GSEs’ new products

- While mortgage brokers welcome Freddie Mac’s recent expansion of its loan product line, they said they would like to see more wholesaler involvement, according to feedback from attendees at a recent National Association of Mortgage Brokers meeting. While bringing wholesalers on board has been taking some time, Freddie Mac vice president Patricia McClung said she believed at least two or three wholesalers were about to bring the new set of products online. “It takes some time to make system changes,” said McClung, adding she believed that “a lot” of wholesalers would make the products available in July.
- Brokers had a lot of questions for the Freddie Mac representatives as to whether borrowers with various individual circumstances would match the GSEs’ loan products and how to submit loan information properly. One attendee asked if Freddie could be flexible regarding the nonpayment of taxes by a potential borrower. “If you don’t pay Uncle Sam, you don’t get a loan from Uncle Freddie,” responded Freddie Mac trainer Helene Albanese. (*Origination News*, Bonnie Sinnock, July 2005)

Freddie Mac extends mortgage relief to borrowers affected by Hurricane Dennis

- Freddie Mac's full menu of relief policies for borrowers affected by disasters is being extended to families whose homes have been damaged by Hurricane Dennis. "Freddie Mac and the nation's mortgage servicers are working together to bring some measure of financial relief to homeowners affected by Hurricane Dennis," said Ingrid Beckles, the company's vice president of default asset management. "Borrowers affected by Hurricane Dennis can contact their mortgage servicers for mortgage relief if their homes have been damaged or destroyed." Freddie Mac strongly encourages servicers to extend several other measures to help the affected borrowers with Freddie Mac loans, including the expedition of release of insurance proceeds to help borrowers repair their homes; the waiver of assessments of penalties or late fees for borrowers with damaged homes; and the elimination of credit bureau reports regarding forbearance or delinquencies caused by the hurricane. (*PR Newswire*, 07/13/05)

Federal Home Loan Banks

FHLB-Seattle reports 46% drop in first quarter income

- The FHLB-Seattle reported a 46% decline in its first quarter profits from a year ago, reporting net income of \$12.3 million, compared with \$23.0 million for the first quarter of 2004. The FHLB-Seattle told its members that management anticipates the Bank will report net losses for 2005 and 2006, with the potential for net income in 2007.
- During the quarter, the Bank's advances outstanding increased 11.1% to \$16.6 billion, reflecting the Bank's increased emphasis on advance lending as its primary business. The growth in the FHLB-Seattle's advances reverses the trend in year-over-year declines in new advances activity that the Bank reported in its 2004 financial results.
- The FHLB-Seattle reported net unrealized market value losses of approximately \$300 million for the first quarter of 2005 relative to \$2.1 billion in total capital, and an increase in net unrealized market value losses, to \$400 million, as of May 31, 2005. To protect against further unrealized market value losses, the Bank adopted a more aggressive hedging program in the first quarter, including the purchase of \$49 million in interest-rate exchange agreements. Nevertheless, the Seattle Bank expects its unrealized market value loss position will continue to put pressure on future earnings. (*FHLB-Seattle Press Release*, 07/01/05; *American Banker*, Rob Blackwell, 07/05/05)

The FHLB-Seattle provides “severance pay” to retired CEO Rice and former CFO Bono

- In the FHLB-Seattle’s Form 10 filing with the SEC, the Bank outlined the severance packages awarded to its former president and CEO, Norman B. Rice, and former executive vice president and CFO, Kelli L. Bono. On March 15, 2005, Rice announced his retirement from the FHLB-Seattle, after the Bank was placed under stricter regulatory scrutiny after problems surfaced in the Bank’s mortgage purchase program. While Rice’s departure was called a retirement, he received separation pay of \$367,333 under a “resignation and release agreement” with the Bank, along with \$60,000 in retirement benefits beyond what had accrued to him during his six years with the FHLB-Seattle. In 2004, Rice received \$444,763 in salary and a bonus of \$80,621 paid for performance in 2003.
- Effective November 30, 2004, the FHLB-Seattle entered into a resignation and release agreement with Bono, under which she received severance payments equal to her annual salary of \$315,000, her full bonus payment of \$15,229, and \$15,000 in outplacement services. Additionally, the Bank agreed to pay Bono \$680,093 in accrued retirement benefits plus an additional gross amount of \$59,000 to compensate for additional tax liabilities. Bono had 20 years service with the FHLB-Seattle. In 2004, Bono received \$331,073 in salary and a bonus of \$50,218 paid for performance in 2003. (*FHLB-Seattle Form 10*, 06/30/05; *The Seattle Post-Intelligencer*, Bill Virgin, 06/02/05)

FHLB-Seattle elects two new directors to its board

- The FHLB-Seattle’s board of directors elected Russell Lau and Don Rhodes to serve as the Bank’s directors. Lau is vice chairman and chief executive officer of Finance Factors, Ltd. in Honolulu. His term as the Bank’s director will expire on December 31, 2006. Rhodes is the chairman and chief executive officer of Heritage Financial Corporation and chairman of its Heritage Bank subsidiary in Olympia, Washington. His term as director expires on December 31, 2005. Lau and Rhodes fill the terms of board positions that have been vacant since May 2005, following the resignation of directors who sold stock in the FHLB-Seattle before the announcement of financial problems at the Bank. (*Business Wire*, 07/12/05)

Former Finance Board Chairman Korsmo sentenced to 18 months probation

- In a plea deal with prosecutors, John Korsmo, the former chairman of the Federal Housing Finance Board, has been sentenced to 18 months of probation on a felony count of making false statements about his involvement in a 2002 political fundraiser. On July 11, U.S. District Judge Henry H. Kennedy, Jr. sentenced Korsmo to 18 months of unsupervised probation and fined him \$5,000, along with a \$100 special assessment for his role in an October 2002 dinner for Republican candidate Rick

Clayburgh, who unsuccessfully challenged Representative Earl Pomeroy (D-ND) in 2002. Korsmo also has agreed not to work in the executive branch of government for 10 years and has provided law enforcement officials with samples of his DNA, due to his legal status as a felon. Expressing his remorse to Judge Kennedy, Korsmo said, “I am very sorry for the way in which I conducted myself during the investigation. I exercised some terrible judgment at a key part [in the investigation].”

- In April, Korsmo pleaded guilty to criminal charges for lying to a Senate committee and an investigator examining his role in an October 2002 campaign fundraiser that solicited donations from the banks he regulated. Korsmo had faced a maximum penalty under federal guidelines of up to five years in prison and a \$250,000 fine. In March 2004, Korsmo resigned from the Finance Board. (*Dow Jones Newswires*, Dawn Kopecki, 07/11/05; *American Banker*, Hannah Bergman, 07/12/05)

Farm Credit System / Farmer Mac

FCA announces management and organization changes

- On July 7, the Farm Credit Administration’s board of directors announced organizational and personnel changes that implement recommendations from strategic studies the board initiated last fall to review the Agency’s efficiency and effectiveness. The board named Martha Schober as the agency’s Director of the Office of Congressional and Public Affairs. Prior to joining FCA, she served as a congressional liaison in the Office of Congressional Relations at the Department of Agriculture. The board also named Andrew D. Jacob as the agency’s Director of the Office of Regulatory Policy. Jacob, who served as FCA’s Director of the Office of Secondary Market Oversight (OSMO) since August 2004, began his career with FCA as a credit examiner in the Sacramento Field Office in 1986.
- The board has named William J. Hoffman, OSMO’s Associate Director for Examination and Supervision, as the Acting Director of that office, which oversees the examination and regulation of the Federal Agricultural Mortgage Corporation. The board also named Stephen G. Smith, FCA’s Inspector General, as the agency’s Director of the newly created Office of Support, which consolidates responsibilities that formerly were carried out by the offices of the Chief Information Officer, the Chief Financial Officer, and the Chief Administrative Officer. Carl Clinefelter, who most recently has served as FCA’s Acting Director of the former Office of Communications and Public Affairs, has been named Inspector General. (*Farm Credit Administration Press Release*, 07/07/05)

Farmer Mac announces global debt program

- Farmer Mac announced the formation of a global debt program to help fund its growth. The GSE said it may list global notes issued under the program on the NYSE or a foreign exchange. (*National Mortgage News Online*, 07/14/05)

FCA approves final rule which increases the liquidity requirements of its banks

- The Farm Credit Administration's board approved a final rule that increases the minimum liquidity reserve requirement and the maximum eligible investment limit for FCS banks. The final rule increases the minimum liquidity reserve requirement from the current level of approximately 15 days to a minimum of 90 days; changes the eligible investment limit from 30% to 35% of total outstanding loans; enhances the requirements for calculating the liquidity reserve, including a new discounting method that more accurately reflects true market conditions; and requires System banks to develop and maintain a liquidity contingency plan. The final rule will help ensure that FCS banks have adequate liquidity if a market disruption or other extraordinary situation occurs. The rule will become effective 30 days after publication in the Federal Register during which either or both Houses of Congress are in session. (*FCA Press Release*, 07/14/05)

Postal Service

Postal reform languishes in Congress – as negotiations with the White House continues

- According to the July 15th issue of the *NAPUS Legislative Newsletter*, with only two weeks remaining before Congress' month-long August recess, Leadership is scrambling to allocate precious floor time to their pet legislative priorities—and only time will tell if postal reform is one of those priorities. “Further delay could doom legislation this year, since the fall congressional schedule will be loaded with must-pass spending bills, and the Senate will be debating a Supreme Court nominee.” Now that the White House has apparently taken its hold off of postal reform legislation, the only hurdles between getting floor time and languishing in legislative limbo are House Majority Leader Tom DeLay (R-TX) and Senate Majority Leader Bill Frist (R-TN).
- One of the remaining hang-ups to scheduling postal reform legislation is “cost.” The House and Senate leadership are being extremely deferential to White House's requirement that postal reform legislation be “cost-neutral.” The staff of Collins' and Davis' Committees are working to address the budget issue with Leadership and Budget Committee staff, as OMB monitors the congressional deliberations over

scoring the bills. “The bulk of the cost of H.R. 22 and S. 662 is attributable to the elimination of the CSRS escrow account. Under current law, beginning in 2006, the USPS would start contributing its CSRS ‘overpayment’ into the account, and these deposits would be revenue for the U.S. Treasury. H.R. 22 and S. 662 suspend the overpayment and, as a consequence, reduce the income which the OMB relied upon to help mask the budget deficit. The Administration believes that the CSRS overpayment should be redirected to pay down the USPS’ unfunded FEHBP liability. In the White House view, the benefit of this strategy is to continue the USPS revenue stream into the U.S. Treasury. This USPS payment reduces the deficit. ...[T]he White House has suggested that Congress increase USPS borrowing authority in order to finance the projected 5.4% rate increase attributed to the escrow.” (*NAPUS Legislative Newsletter*, 07/10/05)

- On June 30th, Representative Pete Sessions (R-TX) and 50 other Members of Congress signed a letter to Chairman Tom Davis of the Government Reform Committee, urging “prompt consideration of H.R. 22” and offering “our support to move this bill.” (*Letter to the Honorable Tom Davis*, 06/30/05)

CBO releases cost estimate of S. 662

- In a cost estimate report regarding S. 662, the Congressional Budget Office stated, “Enacting S. 662 would not affect how much the federal government spends on pension or health care benefits for USPS retirees. By increasing how much the Postal Service pays to finance those benefits and by eliminating the current-law escrow account requirements, however, the bill would increase future budget deficits—as measured by the unified federal budget—for 2008 through 2015, and for several years after 2015. (We estimate a small decrease in the deficit for 2006, and a near-zero impact for 2007.) Eliminating the escrow account requirement for the USPS would allow that agency to increase spending for capital improvements or other projects, pay down its outstanding debt, postpone or diminish future rate increases, or some combination of these options. Enacting the bill also would reduce direct spending mostly by making the costs of the Postal Rate Commission (PRC) and the USPS Office of the Inspector General subject to appropriation. Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting S. 662 would cause an increase in direct spending to the unified budget of greater than \$5 billion in the 10-year period beginning in 2016. The bill would not increase on-budget direct spending by more than \$5 billion during any of the four 10-year periods from 2016 through 2055.” (*CBO Cost Estimate: S. 662 Postal Accountability and Enforcement Act*, 07/01/05)

Direct mail spending forecasted to rise 8.5% in 2005
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- Direct mail spending in the U.S. is forecast to rise 8.5% in 2005 to \$56.6 billion, according to Robert J. Coen, senior vice president and director of forecasting with

Universal McCann. In the June 2005 issue of *Insider's Report*, Coen said direct mail spending grew 8.5% during the first quarter of 2005 as marketers sought alternatives to their former telemarketing programs. For the balance of the year, Coen said, “[V]olume growth is expected to be further stimulated by extra prospecting mailings preceding the rate increases scheduled to take place in 2006.” Such growth in direct mail should further benefit the financial fortunes of the USPS. (*DMNews.com*, Melissa Campanelli, 07/08/05)

<p>Japan's Prime Minister Junichiro Koizumi bets his administration on the privatization of Japan Post</p>
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- The curtain has risen on Act Two of a Japanese political drama, pitting Prime Minister Junichiro Koizumi against ruling party rebels who oppose his plan to privatize the country's postal system -- a battle Koizumi has threatened would spark a snap election if he loses. The government has presented its case for legislation to privatize Japan Post, the country's postal delivery, savings and insurance system, to parliament's upper house after winning a slender victory in the lower chamber. Economics Minister Heizo Takenaka told a plenary session of the upper house, “The privatization of Japan Post, by leaving as much as possible to the private sector, will contribute to the realization of a freer and more vigorous economy and society.” Koizumi has said failure to enact the legislation would be tantamount to a no-confidence vote for his government, a tacit threat to call snap elections. [General elections are not mandated until 2007.] “I think the legislation will be enacted, so I am not thinking of dissolving the lower house,” Koizumi told reporters. The lower house approved the legislation, the centerpiece of Koizumi's reform platform, by just five votes during the week of July 5th with 51 of the 250 members of Koizumi's Liberal Democratic Party (LDP) in the 480-seat lower chamber voting no or abstaining in defiance of party policy.
- The bills to privatize Japan Post could be rejected in the upper house if only 18 of the LDP's 114 members in the 242-seat chamber vote against the measures, a move likely to kill chances of enactment during the current parliamentary session. Analysts said the LDP's leaders would be searching for a way to compromise with party rebels to enact the legislation by August 13th, when the current session of parliament ends in order to avoid an election that the ruling camp might well lose. “A snap election is possible, but a month is a long time and there is 50 percent chance that the LDP would lose an election, so it's probable that they will seek a compromise,” said Jun Iio, a professor of government at the National Institute for Graduate Policy Studies in Tokyo.
- With a network of almost 25,000 post offices and \$3 trillion in assets, Japan Post is the world's biggest deposit-taking institution, and its life insurance business equals that of Japan's four biggest private insurers combined. Japan Post has been criticized for funneling private savings into wasteful public works long used by LDP lawmakers

to win voter support, especially for members of a once all-powerful party faction seen by Koizumi as his arch-rivals.

- The media has floated four possible scenarios concerning the outcome of the battle over Japan Post. Perhaps the most likely outcome is that the bills are enacted, if only by a scant margin, and Koizumi remains in office until his term as LDP president expires in September 2006. Alternatively, the bills pass but Koizumi, having achieved his political dream and aware that possible successors are already jockeying for his job, steps down. If the bills fail to be adopted, Koizumi could make good on his threat to call a general election. Or, as his rivals suggest, Koizumi could resign to be replaced by another LDP lawmaker in a party presidential poll. Many analysts argue that even if he remains in office, Koizumi's clout is likely to fade in his final year in office. "The battle to succeed Koizumi has already heated up," Iio said. (*Reuters*, Linda Sieg, 07/12/05)

TVA

Former Memphis Light Gas & Water executive sues the utility for retaliating against him for cooperating with the FBI in their investigation of MLGW's bond deal with TVA

- Larry Thompson, the former chief operating officer for Memphis Light Gas & Water (MLGW), alleges Memphis Mayor Willie Herenton hand-picked the head of MLGW to benefit his banking friends and to siphon money from the utility to the city budget. Thompson filed a lawsuit in Shelby County Chancery Court, alleging that MLGW President/CEO Joseph Lee and Herenton conspired to eliminate his job in September because he cooperated with FBI agents looking into the mayor's involvement in the public utility. According to Thompson's suit, "The FBI had been investigating...the involvement of Herenton...to retain certain lawyers" in a "possible sale of MLGW." Thompson alleges that talk of a sale was part of a plan "to steer [MLGW's] bond issue to certain banking" friends of the mayor. [According to public records, MLGW paid its underwriters \$6 million and attorney fees of \$500,000 for the \$1.5 billion municipal bond offering.] Thompson alleges that he "met with the FBI" and told agents that Herenton considered having "money transferred from MLGW ...to the city for budgetary purposes," a violation of the utility's contract with the TVA. According to the lawsuit, Herenton fired Herman Morris as president and CEO of MLGW, and then hired Lee "with absolutely no experience" in the utility industry. After Thompson told Lee and Herenton taking such actions would be a violation of contract and law, MLGW's began taking steps to fire Thompson and strip him of his severance benefits totaling \$266,731, according to the lawsuit.
- Ron Krelstein, Thompson's lawyer, says among his exhibits will be sworn affidavits by former MLGW board members Olan Morris and Reverend James Netters. Krelstein says the affidavits admit to private board conversations about rescinding the

utility's severance policy. Krelstein says those conversations violated Tennessee's Open Meetings Law. "I think if those private conversations occurred, they were wrong," says E.C. Jones, Memphis city councilman and vice chairman of the council's utilities committee. "This is a publicly-owned utility company, and you can't deal in private." Thompson is seeking \$5.3 million in back salary, pension and punitive damages in the lawsuit. Lee called the lawsuit frivolous, unwarranted and without merit. (*WREG News Channel 3*, Andy Wise, 07/13/05; *Commercial Appeal*, Lawrence Buser, 07/15/05; *WREG News Channel 3*, Andy Wise, 07/15/05)

- In a draft copy of the city's state legislative agenda for 2005, Herenton proposed to implement an income-based rate structure for MLGW subscribers. Subsequently, TVA informed MLGW that basing its utility rates on the customers' incomes could violate the utility's electrical-supply contract with the TVA, which requires MLGW to sell power "without discrimination among consumers" and prohibits offering special rates or concessions to select customers. *The Commercial Appeal*, Tom Charlier, 12/12/04)

It pays to be "dry" in Alabama

- TVA makes in-lieu-of-tax payments to each state in the TVA region, and each state distributes the money to counties. In Alabama, the state keeps 20% of the TVA payment and distributes 75% to TVA-served counties and 5% to counties not served by TVA *whose local laws prohibit the sale of alcohol*. "There's some logic in that, but it escapes me," said Decatur (AL) Utilities' General Manager Kem Carr. "If you don't have alcohol and you're not served by TVA, you like TVA." (*The Decatur Daily*, 07/13/05)

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