

The **GSE** REPORT™

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Major Events

House of Representatives overwhelmingly approves GSE regulatory reform
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- In a bipartisan vote of 331-90, the House of Representatives passed a GSE regulatory reform bill providing expanded oversight for Fannie Mae, Freddie Mac, and the FHLBs. The legislation would create the Federal Housing Finance Agency, a new regulator for the three housing GSEs, which is financed through assessments on the GSEs. It would have the authority to set capital requirements, reject new business products being offered by the GSEs, and limit their portfolio holdings only if the GSEs' holdings threaten their financial stability.
- The House bill requires Fannie and Freddie to allot up to 5% of their earnings for a newly created affordable housing fund for low-income residents. Democrats and more than 600 nonprofit and faith-based groups decried a provision which bars organizations involved in voter registration, get-out-the-vote efforts, and lobbying activities from participating in the AH fund. Some Republicans insisted on the restriction on AH funds because they feared the program would be used to fund liberal groups which would lobby on behalf of Fannie and Freddie. Democrats focused their criticism on the effect the sweeping ban would have on religious groups such as the Catholic Church, which provides shelter for the poor and advocates on their behalf. African-American lawmakers were particularly incensed with the “gag order.” Representative John Lewis (D-GA) complained, “This provision will take us back to the dark past. This is undemocratic and unconstitutional. In my estimation, it is dead wrong.” Representative Michael Oxley (R-OH) told lawmakers that the provision “provides accountability for where the money goes” and “ensure[s] that [the recipients are] not political front groups with a left or right agenda.” The manager’s amendment, which included AH restrictions, was approved by a close vote of 210-205 with 13 Republicans joining Democrats to vote against the amendment. Representative Barney Frank (D-MA) was unsuccessful in getting Republican leaders to allow a separate up or down vote on AH restrictions. After failing to strip the AH restrictions from the bill, Frank and a handful of liberal Democrats voted against the final bill, saying that they could not in good conscience vote to diminish the civil rights of poor people created by the restrictive provisions of the affordable housing fund. “Faith-based initiatives rest in peace,” said Frank.
- Fannie Mae, Freddie Mac, along with their political allies in Congress and the mortgage and construction industries, demonstrated their ability to influence the legislation by soundly blocking efforts to place restrictions on the GSEs’ portfolios, to eliminate the companies’ ability to borrow from the Treasury, to eliminate an increase in conforming loan limits in high cost markets, and to expand regulatory powers to raise minimum capital requirements for the GSEs. An amendment by Representative Ed Royce (R-CA) to strengthen the new GSE regulator’s ability to reduce Fannie’s and Freddie’s portfolios in order to curtail “systemic risk to the

housing or capital markets of the financial system” was rejected by a 346-73 vote. The House vote “demonstrates that the hardliners who want very tight constraints on Fannie Mae and Freddie Mac do not have strong support in Congress,” said James Vogel, head of agency research at FTN Financial in Memphis, Tennessee. On a vote of 371-47, the House overwhelmingly rejected an amendment that would have rescinded Treasury’s authority to buy as much as \$2.25 billion of Fannie Mae’s and Freddie Mac’s securities in the event of a financial crisis. The House also voted down an amendment by Representative Scott Garrett (R-NJ) to eliminate the increase in GSE conforming loan limits in high cost markets by a 358-57 vote. Garrett argued that the jumbo market is already well served by private lenders and that raising the GSEs’ conforming loan limits distracts Fannie and Freddie from their mission of serving low- and moderate-income homebuyers. The House rejected, 358-57, an amendment sponsored by Representative Jim Leach, which would have expanded the GSE regulator’s power to raise minimum capital requirements for Fannie and Freddie. By voice vote, the House approved an amendment that reinstates the presidential appointment of some directors for Fannie Mae, Freddie Mac and the FHLBs, which the GSEs supported. At the request of the Bush Administration, the bill passed out of the House Financial Services Committee had eliminated presidentially-appointed directors.

- The Bush administration announced its opposition to the House’s GSE regulatory reform bill because it is too weak to qualify as “real reform.” The House bill “is considerably weaker than that which governs other large, complex financial institutions,” said a Statement of Administration Policy issued by OMB. “[It] fails to include key elements that are essential to protect the safety and soundness of the housing finance system and the broader financial system at large. ... Given the size and importance of the [GSEs], Congress must ensure that their large mortgage portfolios do not place the U.S. financial system at risk. [The bill] fails to provide critical policy guidance in this area.” In a speech to the Center for National Policy, Treasury Secretary John Snow said, “In order to protect against systemic risk posed by the housing GSEs’ mortgage investment business, the [Bush] administration also recommends that limitations be placed on the size of housing GSEs’ retained mortgage investment portfolios.” When asked by reporters if the Bush administration will ultimately get what it wants in GSE regulatory reform legislation, Treasury Undersecretary of Domestic Finance Randal Quarles said, “I think that it’s quite achievable. The force of argument on the importance of these limits and the importance of limiting systemic risks of GSEs and the fact that the Senate is where it is, all of that is supportive of believing that we can come to a final resolution of this process.
- Fannie Mae spokesman Brain Faith said, “...[W]e remain committed to working cooperatively and constructively with members of Congress and we are hopeful a [GSE regulatory reform] bill will be signed into law.” Freddie Mac spokeswoman Sharon McHale said, “We look forward to working constructively with the House leadership and with the Senate to advance this effort and to achieve bipartisan legislation that will be signed into law.”

- The passage of GSE regulatory reform by the House elicited tepid responses from industry trade groups, which supported the lawmakers in moving the legislative process forward. The American Bankers Association applauded “movement on GSE reform.” The ABA lobbyist Floyd Stoner added, “These government-sponsored enterprises are vital to banks of all sizes in meeting our nation’s housing and community development needs. It is essential that the enterprises be governed by a responsible, independent and respected regulator. Passage of this bill in the House is an important step in the process.” Kurt Pfothauer, MBA senior vice president for government affairs, said “Today’s action by the House underscores the importance of bringing clarity to the GSEs’ defined role of supporting the secondary residential mortgage market. The GSEs play an important role in the continued success of America’s housing finance system, and the establishment of a strong and independent Federal regulator will provide the needed accountability to ensure the safety and soundness of the GSEs. We applaud Financial Services Chairman Michael Oxley (R-OH) and Congressman Richard Baker (R-LA) for their leadership on this issue.” The National Association of Realtors applauded the bill’s provision for raising conforming loan limits in high cost markets. Former Representative J.C. Watts (R-OK), chairman of FM Policy Focus, said, “We believe the bill reported from the Senate Banking Committee contains even stronger protections that are essential for true comprehensive regulatory reform.”
- Representative Richard Baker (R-LA) said, “What we finally passed is landmark [GSE reform] legislation achieving worthwhile public goals. I am certainly open to improvement and enhancement, but someone has to put it down in writing.” Baker, who has advocated GSE reform for more than a decade, said he finally sees the finish line. “We’ve never been this close. We ought to get together, determine how we can get an ultimate outcome with resolution. I’m for anything that can pass,” said Baker. “If there is a lawyer in the kingdom that can tell us how to improve it, let’s get this done, because this bill needs to be taken to conference. We need to get it in an acceptable condition and on the President’s desk. I’m anxious to see the Rose Garden.”
- The legislation now awaits action by the full Senate, which is not expected until 2006 following the completion of former Senator Warren Rudman’s independent review of Fannie Mae’s accounting for the company’s board of directors. On November 2, Rudman told *Dow Jones Newswires* that he still hopes to wrap up his investigation by January, but he “couldn’t guarantee anything.” Before the GSE regulatory reform legislation becomes law, its Republican sponsors must resolve differences between the House and Senate versions, including the restriction of the size of the GSEs’ portfolios, establishment of an affordable housing fund from GSE profits, and the expansion of conforming loan limits in high-cost markets. Signaling potentially tough negotiations ahead, Senate Banking Committee Chairman Richard Shelby (R-AL) said the House bill lacks “core elements that must be included” in any GSE regulatory reform legislation. Shelby spokesman Andrew Gray said, “[Shelby’s] not supportive of the affordable housing provision as structured. An affordable-housing

program based on the profits of the GSEs creates the wrong incentive for the companies to continue to grow, to continue to take on risk.” Howard Glaser, a mortgage industry consultant and former senior housing official in the Clinton administration, said “The House vote will strengthen the resolve of senators who oppose portfolio limits, and increase pressure for a compromise in the Senate, or ultimately in conference, that is less than what the White House would like.” (*American Banker*, Michele Heller and Luke Mullins, 10/27/05; *Dow Jones Capital Markets*, Campion Walsh, 10/26/05; *Reuters*, 10/27/05; *Dow Jones Newswires*, Dawn Kopecki, 10/26/05; *The Hill*, Elana Shor, 10/27/05; *Bureau of National Affairs*, Richard Cowden, 10/27/05; *Dow Jones Newswires*, Dawn Kopecki, 10/26/05; *Wall Street Journal*, Dawn Kopecki and James R. Hagerty, 10/27/05; *Washington Post*, Annys Shin, 10/27/05; *New York Times*, Stephen Labaton, 10/27/05; *Mortgage Bankers Press Release*, 10/26/05; *The Advocate* (Baton Rouge, LA), Gerard Shields, 10/27/05; *Associated Press*, Marcy Gordon, 10/27/05; *Connecticut Post* (Bridgeport, CT), Peter Urban, 10/30/05; *Bloomberg News*, James Tyson and Al Yoon, 10/26/05; *National Mortgage News*, Brian Collins and Paul Muolo, 10/31/05; *Dow Jones Newswires*, Laurence Norman, 11/02/05; *American Banker*, Rob Blackwell, 11/03/05; *Dow Jones Newswires*, Deborah Lagomarsino, 11/02/05)

Fannie Mae achieves its 30% capital surplus requirement by September 30

- OFHEO announced that Fannie Mae achieved its 30% surplus capital requirement on September 30th, as required in the company’s regulatory agreement, and deemed the GSE to be “adequately capitalized.” Fannie Mae had a \$9.1 billion surplus as of September 30 after factoring for losses related to hurricanes and accounting errors discovered last year, according to OFHEO. The company’s surplus exceeds the 30% capital mandate by \$752 million. “Based on current information, this surplus is sufficient to absorb uncertainties in the estimated impact to capital of potential additional accounting errors, which may arise during the restatement process,” said OFHEO. The agency said its next quarterly capital classification will be issued on December 31st, “once all capital-related data, including the risk-based capital report, is received.” (*Reuters*, 11/01/05; *Bloomberg News*, Al Yoon, 11/01/05; *Bureau of National Affairs*, 11/02/05; *Dow Jones Newswires*, John Connor, 11/02/05)

President Bush nominates Ben Bernanke as next Federal Reserve chairman
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- President George W. Bush nominated Ben Bernanke, the Chairman of the Council of Economic Advisors (CEA), to be the next chairman of the Federal Reserve, following Chairman Alan Greenspan’s retirement in January. Before becoming chairman of CEA in June 2005, Bernanke, 51, served nearly three years on the Federal Reserve’s Board of Governors. Prior to his government service, he was the chairman of the economics department at Princeton. Bernanke received his Bachelor’s Degree from Harvard and a doctorate from the Massachusetts Institute of Technology.

- President Bush said “[Bernanke] commands deep respect in the global financial community. And he will be an outstanding chairman of the Federal Reserve.” Bernanke said, “If I am confirmed by the Senate I will do everything in my power, in collaboration with my Fed colleagues, to ensure the continued prosperity and stability of the American economy. ...[M]y first priority will be to maintain continuity with the policies and policy strategies established during the Greenspan years.” Bernanke’s monetary policy is likely to resemble that of Greenspan’s with an emphasis on low inflation as the central bank’s primary goal; limited appetite for trying to burst stock-market or real-estate bubbles; and monetary policy based upon data and pragmatism, not ideology.
- A highly regarded monetary economist, Bernanke has strongly advocated adopting an inflation target and is a proponent of policy transparency at the Fed. He believes that the Fed is better off focusing on the broad economy than trying to affect asset prices when bubbles may be building. He has said the federal account deficit reflects a “glut” of foreign saving and has expressed optimism global trade and investment imbalances could be resolved without crisis. Bernanke has also voiced support for the Bush administration’s tax cuts and its efforts to toughen regulation of Fannie Mae and Freddie Mac. He has said the Fed should allow banks to fail, except when it needs to safeguard the wider financial system.
- Senator Richard Shelby (R-AL), chairman of the Senate Banking Committee, called the appointment of Bernanke a “good move” and has scheduled his confirmation hearing for November 15. Shelby said, “I look forward to a rigorous discussion of a variety of economic issues during Dr. Bernanke’s confirmation hearing. I am confident that this nominee will be thoroughly questioned but also well-received by all members of our committee.” Senator Paul Sarbanes (D-MD), ranking minority member of the Committee, said that lawmakers will need to examine Bernanke’s independence, as well as his support for inflation targeting. “While Bernanke said in his statement ...that he was going to maintain continuity with the Greenspan years, there’s an obvious question to be asked, ‘How are you going to sustain that continuity if you’ve been articulating a different standard [of adopting inflation targets]?’” said Sarbanes, noting that Greenspan has long been opposed to the adoption such targets. Senate Minority Leader Harry Reid (D-NV), said, “It will be important that Mr. Bernanke demonstrate that he is committed to guiding the economy to produce results for all Americans rather than promoting partisan policies that benefit special interests and an elite few.”
- Early reviews of Bush’s selection of Bernanke were positive. Economists praised Bush’s choice, noting that Bernanke will provide continuity when Greenspan leaves. “I think it’s an excellent choice. The administration recognized that it had to name someone who is well respected certainly in monetary policy circles,” said David Jones, president and CEO of DMJ Advisors. “I would view him as sort of an alter ego to Greenspan. He is someone whose speeches were listened to almost as closely as Greenspan’s when he was a Fed governor.” Micah Green, president of the Bond

Market Association, said, “We strongly believe Dr. Bernanke will do a fine job and the Fed will continue to control inflation and promote growth in the U.S. and the world.”

- Prior to joining the CEA, Bernanke had little contact with President Bush. While he may be the “antithesis” of the power-suited business executives that Bush has typically preferred, Bernanke appears to have earned the President’s trust. Earlier this year, Bush gently chided Bernanke for showing up at an Oval Office meeting wearing a dark suit with tan socks, according to people familiar with the “discussion.” Several days later, Bernanke came early for another White House meeting and distributed tan socks to the meeting’s participants, including Vice President Dick Cheney. Sources said that when Bush arrived, all were wearing tan socks—and the President laughed.
- The *Wall Street Journal* reports that Stanford economist Edward Lazear, a member of the President’s Advisory Panel on Federal Tax Reform, may become chairman of the Council of Economic Advisors, if Bernanke is confirmed to succeed Greenspan as the Fed chairman. MIT economist and fellow member of the panel James Michael Poterba previously declined to be a candidate for the CEA chairmanship. (*Reuters*, 10/24/05; *Wall Street Journal*, 10/25/05; *The Main Wire*, John Shaw, 10/28/05; *Dow Jones Newswires*, Henry J. Pulizzi, Deborah Lagomarsino and Dawn Kopecki, 10/24/05; *Reuters*, 10/23/05; *Wall Street Journal*, John Harwood, 11/04/05; *Associated Press*, 11/05/05)

President Bush awards Medal of Freedom to Federal Reserve Chairman Alan Greenspan

- President George W. Bush has announced that Alan Greenspan, chairman of the Federal Reserve, is among the recipients this year of the Presidential Medal of Freedom, the nation’s highest civil award. Greenspan, 79, will retire on January 31, 2006, after more than 18 years service at the helm of the central bank. On November 9, Bush will present the awards at the White House. Other recipients include former Representative Sonny Montgomery (D-MS); General Richard B. Myers of the Air Force, former chairman of the Joint Chiefs of Staff; Carol Burnett, Aretha Franklin and Andy Griffith, entertainers; Robert Conquest, historian; Vinton Cerf and Robert Kahn, designers of software code; Paul Harvey, radio personality; Muhammad Ali, Jack Nicklaus, and Frank Robinson, athletes; and Paul Rusesabagina, who sheltered hundreds of people in hotel rooms in 1994 during the genocide in Rwanda. (*New York Times*, John Files, 11/05/05; *Bloomberg News*, Michael McDonald, Elizabeth Stanton and Joshua Krongold, 10/31/05)

President Bush's tax advisory commission proposes comprehensive tax overhaul plans

- The president's tax-reform advisory panel has submitted two final proposals to the Treasury Department, both of which propose significant changes in how American households and businesses are taxed. Specifically, the panel backs two alternatives to the tax code: a streamlined version of the current tax structure and a revamped tax strategy designed to encourage more savings and investments. Both options propose to eliminate the alternative minimum tax (AMT) with an estimated cost of \$1.3 trillion over ten years. To offset AMT revenues, the panel proposes to curtail the deduction for mortgage loan interest and end deductions for second home mortgages and home-equity loans. Specifically, the panel recommended lowering the mortgage interest cap from \$1 million to the average regional housing price in the range of \$227,000 to \$412,000. The panel also recommended capping the amount of tax-free money that may be used to pay for health insurance to \$5,000 for single coverage or \$11,500 for family coverage and eliminating deductions for state and local taxes. While neither of the panel's proposals are unlikely to become law, their work will help shape the debate regarding how far tax policy should go to encourage homeownership.
- The housing industry was quick to criticize the panel's proposal to change mortgage deductions in the tax code. Freddie Mac president Eugene McQuade warned that any big change in housing-related tax benefits would "profoundly effect" the value of real estate. "Before we say we are going to change [the deductibility of mortgage interest], we better understand the broad implications that it will have on society," warned McQuade. "The tax deductibility of interest paid on mortgages is both a powerful incentive for homeownership and one of the simplest provisions in the tax code," said Al Mansell, president of the National Association of Realtors. "It should not be targeted for change." NAR warned that the plan would adversely impact the price of homes, particularly the upper-end ones. Jonathan L. Kempner, president and chief executive officer of MBA, said "...[W]e cannot support (the panel's) provisions ...that would harm the housing markets and hurt homeowners." Adam Carasso, an economist for the Urban Institute, said the proposed changes "would have a negative impact on the home-building industry."
- It is uncertain whether President Bush or GOP leaders will endorse the panel's suggestions, when they address an overhaul of the tax code in Congress next year. "Many stand waiting to defend their breaks, deductions and loopholes, and to defeat our efforts," acknowledged the tax panel members, led by former Senators Connie Mack (R-FL) and John B. Breaux (D-LA). "That is part of the legislative process." (*Wall Street Journal*, Robert Guy Matthews, 11/01/05; *CNN/Money*, Jeanne Sahadi, 11/01/05; *CQ Today Midday Update*, 11/02/05; *National Mortgage News*, 10/31/05)

- Representative Michael G. Oxley will retire from Congress at the end of his current term, completing 25 years of service in Congress and a total of 33 years in elected office. Oxley, 61, is entering the final year of his six-year term as chairman of the House Financial Services Committee. House Speaker Dennis Hastert (R-IL) said “Mike Oxley has provided steady, dedicated leadership to House Republicans, and I am grateful for his service.” Representative Barney Frank, ranking Democratic member of the Financial Services Committee, said, “Mike Oxley has been a constructive, thoughtful mainstream conservative whose leadership of the Committee on Financial Services has given the House a demonstration of how a Member can be true to his ideological and partisan commitments without sacrificing fairness or appropriate bipartisanship. I am very proud of the cooperation that has existed between Chairman Oxley and those of us on the Democratic side, and it is important to note that this is not because we are in agreement on all or even most issues. What Mike Oxley has done is to show how a Member of Congress can fight for what he believes in, and differ with people on the opposing side, without letting those differences spill over into areas where cooperation should be possible.” The Mortgage Bankers Association said Oxley’s retirement is a “loss for the housing industry and consumers alike, as he recognized the role the housing industry played in the U.S. economy.” Kurt Pfothauer, MBA’s senior vice president of government affairs, said, “In an era when the term bi-partisanship has been reduced to a trivial pursuit question, Representative Oxley stands as an important example of how much a Chairman can get done with perseverance and compromise. Working with Representative Oxley on the variety of issues facing our industry has been an honor and a privilege.”
- Oxley’s chairmanship of the Financial Services Committee combined with his popularity on and off Capital Hill, could earn him a multimillion-dollar job in the private sector, according to lobbyists. While Oxley will likely receive numerous offers, one Republican lobbyist speculated that he will take a year or more before making post-retirement plans. “My guess is, given all the scrutiny, he’ll be smart about it and wait until next November before negotiating,” said the lobbyist.
- If Republicans retain their House majority in 2006, Representatives Richard Baker (R-LA) and Spencer Bachus (R-AL) are considered to be Oxley’s most likely successors. Other candidates include Representatives David Dreier (R-CA), Deborah Pryce (R-OH), and Bill Thomas (R-CA). Many observers agree that the chairmanship is Baker’s to lose. Republicans are strongly favored to retain Oxley’s 4th District, in which President Bush garnered 65% of the vote in the 2004 presidential election. The *Lima (Ohio) News* reports that GOP state Senator Jim Jordan became the first candidate to officially declare his candidacy for Oxley’s seat. Democrat Ben Konop, who drew 41% of the vote against Oxley in 2004, said he wants to make a political career for himself in his hometown of Toledo, which is outside the 4th District. According to the *Lima News*, Konop was the Democrats’ strongest candidate to make a run in the conservative district. (*Representative*

Michael Oxley Press Release, 11/01/05; Wall Street Journal, 11/01/05; Roll Call, Ben Pershing and Lauren W. Whittington, 11/01/05; Representative Barney Frank Press Release, 11/01/05; Mortgage Bankers Association Press Release, 11/01/05; CQ Today, Susan Ferrechio, 11/02/05; American Banker, Michele Heller, 11/02/05; U.S. Newswire, 11/01/05; CQ Today Midday Update, 11/04/05)

Fannie Mae and Freddie Mac

GSE regulatory reform debate continues:

Treasury Secretary Snow says Fannie's and Freddie's portfolios are too large

Freddie Mac President warns that limiting GSEs' portfolios will increase interest rates

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Former Representatives J.C. Watts and Jack Kemp debate GSE reform

Congressional Research Service analyzes the risks that GSEs pose to the economy

Treasury Secretary Snow says Fannie's and Freddie's portfolios are too large

- Treasury Secretary John Snow said that the \$1.45 trillion portfolios of Fannie Mae and Freddie Mac are “way larger” than either needs to carry out their role in supporting the secondary mortgage market. “It looks like those entities have portfolios designed for investment purposes,” Snow added. While members of Congress have told him that H.R. 1461 would give the GSE regulator the authority to set limits on Fannie's and Freddie's portfolios, Snow said, “We would like [the legislation] to be more specific.” (*Bloomberg News*, Kevin Carmichael, Alison Fitzgerald, and James Tyson, 10/31/05; *Washington Post*, 11/01/05)

Freddie Mac President warns that limiting GSEs' portfolios will increase interest rates

- Freddie Mac President Eugene McQuade warned that mortgage interest rates would rise further, if Congress approves legislation that would force Fannie Mae and Freddie Mac to shrink the size of their investment portfolios. McQuade said, “Limits

on our portfolio will have a significant impact on mortgages rates,” but declined to quantify an amount. He also said that portfolio limits could impact the GSEs’ ability to finance affordable housing. Speaking at the annual Mortgage Bankers Convention, McQuade said, “It’s absolutely critical that a bill ultimately passed does no harm to our industry.” (*Associated Press*, Aleksandrs Rozens, 10/24/05; *Reuters*, Lynn Adler, 10/24/05; *Washington Post*, 10/25/05)

Senators Hagel (R-NE) and Sununu (R-NH) send warning signal to Fannie and Freddie

- Senators Chuck Hagel (R-NE) and John Sununu (R-NH) briefly interrupted a budget debate in the Senate to signal to Fannie and Freddie that they intend to crack down on the housing GSEs. “We brought it up to send the very clear message that we intend to do this,” said Hagel. “We are very serious.” The Senators offered, then withdrew, Amendment No. 2391 to the budget bill that would have required the GSEs to register their securities and debt with the SEC “just like any other company,” according to Hagel. Sununu said, “This amendment takes an important step toward greater transparency for investors.” He said it sends “the wrong message” if Fannie and Freddie are treated differently than other large investment service companies and have no “credible regulator.” Sununu urged Congress to act on regulatory reform legislation to ensure the GSEs’ safety and soundness and to make certain that “they stay focused on their chartered mission, which is to provide liquidity in our secondary mortgage market.” The Senators withdrew the amendment rather than subject it to a vote requiring the support of 60 members of the Senate. Separately, OFHEO’s former director indicated the agency would require such disclosures, if Congress didn’t overturn the SEC exemption. “If the [SEC] exemptions [for Fannie and Freddie] aren’t repealed, we’ll move on the part of OFHEO to implement a system of mandatory disclosure requirements,” said former OFHEO Director Armando Falcon in his November 3, 2005 testimony before the House subcommittee on Commerce, Trade, and Consumer Protection. (*Dow Jones Newswires*, John Godfrey, 11/03/05; *Congressional Record*, S12319, 11/03/05; *Washington Post*, 11/04/05)

Editorial boards debate GSE regulatory reform

- The *Wall Street Journal* wrote in an October 25th editorial, “Every Congressional session can be counted on to produce its share of bad bills, and a few dreadful ones. But the ‘reform’ bill for Fannie Mae and Freddie Mac, due to hit the House floor tomorrow -- and certain to pass -- is in a class of its own. ...The bill sponsored by Congressmen Richard Baker and Michael Oxley is remarkable for not doing what it claims to do -- which is to reform both the operation and the oversight of Fannie Mae and Freddie Mac, the trillion-dollar, government-sponsored mortgage giants. And it is even more astonishing for the bad things it does instead -- e.g., skimming a portion of those companies’ profits to create yet another ‘affordable housing’ program. ...The bill’s new ‘affordable housing’ fund confiscates potentially billions of dollars of the profits of these nominally private companies to finance the pet projects of Barney Frank and other Democrats. This sort of targeted profits tax is not only a bad idea in its own right but also gives Members of Congress an even greater stake in

opposing any reform that might dent that profit stream. That is precisely why it is being promoted by the homebuilder lobby and others who benefit from Fannie subsidies.

- “We’re not averse to profit-making. But Fannie and Freddie’s business model relies on borrowing money at taxpayer-subsidized rates and reinvesting that money to buy mortgage-backed securities, mostly of its own creation. This is a lucrative business, but it creates interest-rate and other risk for Fannie and Freddie, which they hedge by engaging in complex and opaque derivatives trading. ...In the event of a more serious misstep, Uncle Sam would be on the hook for some or all of the liabilities of these two federal nephews. This implicit taxpayer backing is the reason Fannie and Freddie can borrow at bargain-basement prices in the first place, and it is one of the reasons that Fed Chairman Alan Greenspan has argued that Fan and Fred pose a ‘systemic risk’ to financial markets. Chairman Oxley seems oblivious to all this, focusing instead on raising PAC contributions and showing he can pass a bill by giving Mr. Frank whatever he wants. His bill does nothing to empower Fannie and Fred’s regulator to reduce the size of their \$1 trillion-plus portfolios of mortgage-backed securities, which pose this systemic risk. ...The sad political truth is that a Democratic Congress probably couldn’t pass this stinker without being accused (accurately) of promoting state socialism. That an ostensibly conservative House will pass it is another embarrassment for Republican governance.” (*Wall Street Journal*, 10/25/05)
- *The New York Times* and *The Atlanta Journal-Constitution* published editorials protesting the restrictions placed on the affordable housing fund. In an October 26 editorial, *The New York Times* wrote, “House ideologues are advocating an outrageous and potentially unconstitutional provision that would bar the nonprofit groups that build most affordable housing from participating in the fund if they also participate in even nonpartisan voter registration. This would force such nonprofits to choose between their historically important roles: promoting civic engagement and providing housing and other services for low-income people. The provision would conflict with state laws that require housing grant recipients to do things like register voters and would put the federal government in the unacceptable position of actively discouraging political participation. The long-overdue housing fund contains numerous safeguards that would prevent grant recipients from using federal dollars for advocacy. A measure that would bar them from nonpartisan activities has absolutely no place in a democracy.” (*New York Times*, 10/26/05)
- On October 27th, *The Atlanta Journal-Constitution* wrote, “Our nation’s disadvantaged citizens should not be forced to choose between an affordable place to live and the unfettered ability to participate in the democratic process. ... [T]he Republican Study Committee, representing the Taliban wing of the GOP, has attached a poison pill to the [affordable housing fund]. It would bar all nonprofit housing groups from applying for federal affordable housing grants if they had participated in any voter registration efforts within the last year, even if they used their own money to do so. An RSC staff member claimed the provision merely seeks

to prevent nonprofit housing providers from also engaging in lobbying or electioneering, but existing laws already forbid such activities. The partisan intent of this provision couldn't be more obvious --- or odious. It would suppress voter registration, and get-out-the-vote efforts directed at the poor and minority groups that have historically supported Democrats. More disturbingly, the prohibition wouldn't apply to for-profit groups engaged in the same type of voter registration programs as their nonprofit peers. ...The House vote is particularly shameful because the establishment of an affordable housing fund to help low-income Americans is a laudable goal, and one that is long overdue." (*Atlanta Journal-Constitution*, 10/27/05)

- On October 29, Cynthia Tucker, the editorial page editor for the *Atlanta-Journal Constitution*, wrote an editorial entitled "House Bill Takes Aim at Voters of Color." Tucker wrote, "Last week, an ugly bit of business transpired in the GOP-dominated House of Representatives, where Republican hard-liners succeeded in passing a measure that would limit the ability of nonprofit groups to conduct voter registration drives. It was one of those moments when you don't have to wonder what the jihadist faction of the GOP is up to: They want to restrict the franchise to people who think as they do. Representative John Lewis (D-GA), a veteran of the civil rights movement, said the measure would 'take us back to 1964 or 1965. I just think they [Republicans] want to be in a position to stifle the participation of poor people and minorities in the political process. They want to take us back to another period.' ...This is not a poll tax; this is a poll ax. If this measure becomes law -- the Senate has not yet acted on it -- it will penalize countless organizations, including churches, that have run voter registration drives and also built high rises for the elderly and low-cost apartment complexes that accommodate store clerks, janitors and fast-food workers. ...GOP backers of the amendment say all they're trying to do is make sure that federal funds are not used to support partisan political activities. There's just one problem: That's already illegal. Indeed, many nonprofits have been more careful about observing restrictions against partisanship since the Christian Coalition lost its tax-exempt status in 1999 over voter guides that it distributed in churches. Given the apathy so many Americans show toward the franchise, you'd think our political leaders would be doing everything possible to encourage more citizens to vote. As Lewis put it, 'We go around the world telling people to participate in the political process.' Isn't that exactly what we should be telling people -- all the people, regardless of color or class or political affiliation -- here at home?" (*Atlanta Journal Constitution*, Cynthia Tucker, 10/29/05)

Former Representatives J.C. Watts and Jack Kemp debate GSE reform

- In a November 2 column in the *Washington Times*, FM Policy Focus chairman (and former Representative) J.C. Watts wrote, "Following an overwhelming bipartisan vote in the House of Representatives last week, Congress is closer than ever before to enacting comprehensive reform legislation to strengthen the oversight and regulation of Fannie Mae and Freddie Mac, the taxpayer-subsidized government sponsored enterprises (GSEs). That's welcome news. For the first time in more than a decade,

Congress has taken action to protect the American taxpayers from the risks posed by the GSEs. Now it is up to the Senate to finish the job so that President Bush can sign a strong, comprehensive bill into law.”

- “[T]he GSE accounting scandals represent a fundamentally more severe problem than previous business scandals. What makes these instances of cooked books, phony profits and cover-ups of particular concern to the public is that in the event of a financial meltdown at either company, taxpayers could be forced to bear the multibillion-dollar bailout cost — a sum that would make the tab for the Savings & Loan crisis look like chicken feed. Fannie and Freddie apologists would have us sweep this inconvenient history under the rug, or more likely, deny the existence of these facts. But as the late Senator Daniel Patrick Moynihan famously remarked, ‘Everyone is entitled to their own opinion — but not their own facts.’”
- “In addition to the taxpayer exposure, the entire economy is at risk should something go seriously awry. Federal Reserve Chairman Alan Greenspan warns at every opportunity about the ‘systemic risk’ posed by the GSEs. That’s Fed-speak. Translated into plain English, it means if Fannie Mae or Freddie Mac make a mistake in their risky and complex hedging strategies, the resultant financial shock-waves could be catastrophic, not only for the housing market, but the economy as a whole. Now that’s downright scary.”
- “...A stalwart band of reformers in the House and Senate are moving legislative proposals to address the problems with Fannie Mae and Freddie Mac before they metastasize into a full blown crisis. The strong vote in the House last week was a decisive step in moving the process forward and now is the time for the full Senate to take action.”
- “In the Senate, Banking Committee Chairman Richard Shelby, Alabama Republican, deserves great credit for shepherding a very strong bill through his committee. That legislation contains even stronger protections than its House counterpart, elements that my organization, FM Policy Focus, and many others consider essential for true comprehensive regulatory reform — particularly in the area of program review. That is, ensuring that the risky activities the GSEs engage in have strict scrutiny and robust oversight.”
- “[T]he same groups that have succeeded in derailing previous reform efforts are again hard at work to preserve the status quo. Congress and the administration have the chance to fix the roof while the sun is shining. Standing in their way are the entrenched defenders of a structure that has consistently failed to properly oversee Fannie Mae and Freddie Mac. GSE reformers need to finish the job and enact comprehensive legislation this year. For the sake of the American taxpayers, let’s hope they succeed.” (*Washington Times*, J.C. Watts, 11/02/05)
- Writing at *Townhall.com*, former Representative Jack Kemp wrote, “In good times, the GSEs make homeownership more accessible for millions of families seeking

affordable housing. In bad times like Hurricanes Katrina and Rita, the GSEs help provide a stabilizing force in the market, effectively serving as a shock absorber for the entire housing finance system. In response to the devastation of the hurricanes, the GSEs not only donated millions of dollars in relief, they also stopped collecting mortgage payments for homeowners in affected areas for at least three months. Freddie Mac recently committed to finance up to \$1 billion in below-market mortgages by purchasing state and local mortgage bonds in the Gulf region.”

- “Unfortunately, this kind of stability may be harder to achieve under a Senate bill provision that would stop the GSEs from buying and holding mortgage bonds and other types of mortgage assets in their portfolios. But it’s the very presence of those investments that make it possible for the GSEs to help the nation weather tough economic times. Some in Congress have also suggested placing a user fee on the GSEs’ business lines, effectively taxing homeownership to fund spending that the federal government can’t afford on its own. Once again, this would tie the GSEs’ hands in an emergency.”
- “Congress is absolutely right to pass regulatory remedies following the disclosure of accounting mismanagement at both companies. But the debate has turned partisan and, in some cases, vindictive as some are apparently seeking to punish the companies. It’s time to get the debate back on track and consider ways to use the GSEs to further expand homeownership and housing opportunities as weapons against poverty. ...Congress should also explore ways to boost organizations like Habitat for Humanity, which offer cost-effective ways to provide affordable homeownership opportunities for the most needy in our society. Habitat has built more than 200,000 homes with volunteer labor using 20-year no-interest loans, and is hard at work building homes for storm victims. My hope would be to allow the secondary market to purchase or guarantee mortgages made by Habitat for Humanity in states affected by Hurricane Katrina.”
- “House Financial Services Committee Chairman Mike Oxley, R-Ohio, recognizes how organizations such as Habitat can play a prominent role in rebuilding communities. His committee overwhelmingly passed H. R. 1461, a bill that would enhance development in the Gulf region and elsewhere, while creating an independent, strong regulator for the GSEs. H. R. 1461 offers a prudent approach, because it empowers the regulator, and not Congress, to determine how Fannie and Freddie take on risk. The Senate bill, in contrast, would arbitrarily force financially sound private companies to divest the bulk of their assets, hardly an approach that is in keeping with Republican economic philosophies. It would be a grave mistake to fundamentally restructure a housing finance system that today is helping drive the nation’s economic growth. In its upcoming floor vote, I strongly encourage the full House to follow in the committee’s footsteps by giving the bill its strong support. Housing and homeownership transcends partisanship, not the other way around.” [Kemp serves on the Board of Habitat for Humanity and is Chairman of Habitat's National Campaign for Rebuilding our Communities.] (*Townhall.com*, Jack Kemp,

10/24/05; www.defenddemocracy.org, Biography of Jack Kemp, Chairman of the Board)

Congressional Research Service analyzes the risks that GSEs pose to the economy

- In an analysis of limiting the GSEs' portfolio size, CSR concluded, "At a summary level, [the GSEs'] risk has two dimensions: the probability that the [catastrophic] event will occur and the cost if it does. A complete approach to reducing risk works on both aspects. Reducing the size of the [GSEs'] portfolios would reduce both dimensions. With smaller portfolios, the GSEs would be able to adjust more nimbly to changing financial markets. The cost of bailing them out would, also, be reduced. Chairman Greenspan summarized the potential for both concerns when he wrote [in a September 2, 2005 letter to Senator Robert F. Bennett (R-UT)], "Today, the U.S. financial system is highly dependent on the risk-managers at Fannie and Freddie to do everything right.... The concentrations of mortgage-backed securities at Fannie and Freddie are well beyond what market forces would normally allow because there are no meaningful limits to the expansion of the GSEs' portfolios, which are funded with debt that the market believes to be federally guaranteed."
- "That is, the implied guarantee allows the GSEs to grow without the usual market forces that would raise their costs as their risks rose. As a result, Fannie and Freddie represent significant systemic risk to the nation's financial system, both because they can make mistakes and because their size and concentration raise the likelihood of high costs for the economy when they do."
- "Reducing the seriousness of the systemic risk requires reducing the size of the implied guarantee. Some have proposed complete privatization of the GSEs, such as occurred for the college student loan market when Sallie Mae gave up its Congressional charter and became entirely private. This would totally eliminate the implied guarantee. The GSEs would be subject to market forces that might drive them to reduce the size of their portfolios. This option is not currently before Congress. Closer regulation along the lines proposed in H. R. 1461 and S. 190 would reduce much of the operational risk, but risks coming directly from the size of the portfolios of mortgages and retained MBSs would remain as long as the portfolios remain larger than necessary to provide a liquid secondary mortgage market. While it is true that this would distribute the risk more widely, this is less of a concern because the cost of a bailout would be less for any one company. In addition, it is likely that these other companies would use simpler ways to fund their portfolios, which would reduce the risk of hedging errors." (*Congressional Research Report for Congress, "Limiting Fannie Mae's and Freddie Mac's Portfolio Size,"* Eric Weiss, 10/21/05)

Hurricane recovery notes:

U.S. economy weathers the hurricanes' impact

Department of Homeland Security appoints Donald E. Powell to coordinate the federal recovery and rebuilding efforts in the Gulf Coast

Senator Trent Lott (R-MS) introduces retro-flood insurance bill

CRS examines flood control issues in context of Hurricanes Katrina and Rita

Freddie Mac announces \$200,000 corporate grant for three Asian-American groups to assist nearly 1,000 families with storm recovery efforts

Fannie Mae and Freddie Mac announce mortgage relief for borrowers affected by Hurricane Wilma

U.S. economy weathers the hurricanes' impact

- Federal Reserve Chairman Alan Greenspan told Congress that fallout from Hurricanes Katrina, Rita, and Wilma could prove fleeting and that the economy remains sturdy. The trio of hurricanes is likely to “exert a drag” on employment and production in the short term and may aggravate inflation pressures, said Greenspan in testimony to Congress’ Joint Economic Committee. “But the economic fundamentals remain firm, and the U.S. economy appears to retain important forward momentum,” said Greenspan. (*Associated Press*, Jeannine Aversa, 11/03/05)
- According to the U.S. Department of Labor, the New Orleans metropolitan area lost 237,200 jobs, representing 38.5% of its employed workers in September as a result of Hurricanes Katrina and Rita. Despite the impact of the storms, the national job market has remained robust this fall with unemployment ticking up only two basis points in September to 5.1% and then falling one basis point to 5.0% in October. Employers added 56,000 jobs to nonfarmer payrolls in October, bouncing back from hurricane-induced losses in September. (*The Wall Street Journal New Alert*, 11/04/05; *Boston Globe*, Chris Reidy, 11/03/05; <http://www.ncesc.com>)

Department of Homeland Security appoints Donald E. Powell to coordinate the federal recovery and rebuilding efforts in the Gulf Coast

- In consultation with President Bush, Department of Homeland Security Secretary Michael Chertoff appointed Donald E. Powell as Coordinator of Recovery and Rebuilding in the Gulf Coast Region. Powell will serve as the Administration’s

primary point of contact with Congress, state and local governments, the private sector, and community leaders on mid and long-term recovery and rebuilding plans in response to Hurricanes Katrina and Rita. As Coordinator, Powell will be responsible for developing specific goals and coordinating policies and programs for mid-to-long-term federal recovery and rebuilding efforts in the Gulf States Region. He is expected to coordinate federal involvement in support of state and local officials on issues ranging from economic development to infrastructure rebuilding. Powell, who served as Chairman of the FDIC since 2001, has more than 30 years experience in the financial services industry. (*U.S. Department of Homeland Security Press Release, 11/01/05*)

Senator Trent Lott (R-MS) introduces retro-flood insurance bill

- On October 28, Senator Trent Lott (R-MS) introduced a bill to enable Hurricane Katrina victims whose homes were not covered by flood insurance to retroactively buy into the federally-subsidized flood insurance program. Lott's bill is a companion to the measure introduced by Congressman Gene Taylor (R-MS) in the House. Specifically, the bill instructs the Director of FEMA to make flood insurance coverage available for eligible structures (but not their contents) for flooding resulting from Hurricane Katrina or Hurricane Rita. The bill limits eligibility to structures located in an area not subject to the mandatory purchase requirements of the national flood insurance program, and which were not covered by such insurance at the time of the hurricanes, but were covered for wind or windstorm damage by an insurance policy. It limits the amount of a claim that can be paid to the lesser of the maximum coverage the property is eligible for under the national flood insurance program and the amount for which the property is insured against wind or windstorm damage. The bill requires the owner of the structure to pay premiums equal to 105% of what the owner would have been required to pay into the national flood insurance program for 10 years. The bill also requires structures covered under this program to maintain enrollment in the national flood insurance program and prohibits FEMA from considering the payments made or premiums collected under this program when setting future national flood insurance program premiums for the structures. (*Senator Trent Lott Press Release, 10/28/05*)

CRS examines flood control issues in context of Hurricanes Katrina and Rita

- In a CRS Report for Congress regarding flood risk management, CRS wrote, "Hurricanes Katrina and Rita have focused the nation's attention once again on issues that flood experts have debated for decades. The disasters have renewed public concerns about reliability of the nation's aging flood control levees and dams. The debate over what is an acceptable level of risk — especially for low-probability, high-consequence events — and who should bear that risk is taking place not only in the states affected by the hurricanes, but nationally. The concerns being raised range widely, including interest in providing more protection for concentrated urban populations, risk to the nation's public and private economic infrastructure, support

for reducing vulnerability by investing in natural buffers, and equity in protection for low-income and minority populations.”

- “The response to Hurricanes Katrina and Rita have included discussions of expanding mitigation activities (such as floodproofing structures and buyouts of structures on the most flood-prone lands), investing in efforts to restore natural flood and storm surge attenuation, and assuring vigilant maintenance of existing flood control structures, as well as interest in new and augmented structural flood protection measures. Although major flood events, such as the Midwest Flood of 1993, generally spur these discussions, the policy changes implemented often are incremental. The 109th Congress, like previous Congresses, faces a challenge in reaching consensus on how to proceed on anything other than incremental change because of the wealth of constituencies and communities affected by federal flood policy. Another practical challenge is the division of congressional committee jurisdictions over the federal agencies and programs involved in flood mitigation, protection, and response.”
- “There are many questions that remain about how events unfolded in the aftermath of Hurricanes Katrina and Rita, and much information that is still needed to understand how to apply and communicate the lessons learned to the rest of the country. Although there is no way to protect against all flood risk, it is clear that more information is needed to evaluate flood risk, to understand the reliability and residual risk of structural flood protection, and to incorporate the full range of flood consequences into local, state, and federal decision-making” (*CRS Report for Congress, “Flood Risk Management: Federal Role in Infrastructure,”* Nicole T. Carter, 10/26/05)

Freddie Mac awards \$200,000 corporate grant for three Asian-American groups to assist nearly 1,000 families with storm recovery efforts

- Freddie Mac has awarded a \$200,000 grant to enable three Asian-American organizations to send bi-lingual, bi-cultural staff to the hurricane disaster areas to help nearly 1000 families find temporary shelter and to apply for federal, state, local and private aid. The bi-lingual staffs the National Congress of Vietnamese Americans (NCVA), Boat People SOS, and the National Alliance of Vietnamese American Service Agencies (NAVASA) are expected to place 700 Vietnamese, Cambodian, and Lao families in temporary housing in Bayou La Batre, Alabama and Biloxi, Mississippi; provide housing assistance to an estimated 250 additional families returning to New Orleans; and help the Vietnamese community assess its rebuilding needs in areas affected by Hurricanes Katrina and Rita. (*Freddie Mac Press Release, 11/04/05*)

Fannie Mae and Freddie Mac announce mortgage relief for borrowers affected by Hurricane Wilma

- Fannie Mae and Freddie Mac announced disaster relief policies for borrowers affected by Hurricane Wilma in federally declared major disaster areas. The GSEs’

disaster policies enable mortgage servicers to suspend mortgage payments or provide other short-term relief to borrowers with Fannie Mae or Freddie Mac-owned mortgages following a hurricane or other natural disaster. Fannie Mae's policies allow borrowers to suspend mortgage payments for up to three months, reduce payments for up to 18 months and in severe cases create longer loan payback plans. Freddie Mac's policies give servicers the discretion to reduce or suspend payments for up to 12 months for the GSEs' mortgages. (*Fannie Mae Press Release*, 10/28/05; *Freddie Mac Press Release*, 10/27/05).

MERS starts E-Delivery

- At the request of its members, the Mortgage Electronic Registration System (MERS) will be offering electronic delivery on its existing electronic registering platform. "We've been asked by several of our large members to provide a simple vehicle to transport electronic files from one MERS eRegistry member to another," said Dan McLaughlin, MERS' executive vice president and product division manager. "The first premise is that this would be companies that are using MERS to register e-notes. The scope is very simple in that we already use MISMO standards for the request response to communicate with the registry, and we already use MISMO standards for the envelope specification. So, this would be taking that same vehicle and saying, 'If you're a MERS eRegistry member and you want to send an e-note to Fannie Mae you can use this delivery vehicle to send that e-note.' Likewise, if you're a correspondent of Countrywide and you need to send an e-note to them you can use the MERS e-delivery mechanism to do that as well." (*Origination News*, Anthony Garritano, November 2005)

Fannie Mae

Fannie Mae's portfolio shrank 48% on an annual basis in September

- Fannie Mae's mortgage investment portfolio shrank for an 11th consecutive month in September to its smallest since early 2002. The company's investments contracted by \$40.5 billion or 47.8% on an annual basis to \$727.8 billion. In September, Fannie Mae's sales from the portfolio increased to \$31.1 billion, more than the previous three months combined. The company said it had contracts to buy \$477 million in mortgages in the month versus contracts to sell \$21 billion in August, suggesting Fannie's portfolio shrinkage may subside. Year-to-date, Fannie Mae has cut its retained portfolio \$185 billion to meet the company's 30% capital surplus requirement mandated by OFHEO. According to AG Edwards' analyst Matthew Park, Fannie Mae "may be at an inflection point" on its portfolio after September. "If they do have the capital surplus, then we should see less pressure on the portfolio," said Park. According to a research note by Lehman Brothers' analyst Bruce Harting, Fannie Mae told the investment banking company that there are no longer "internal" constraints on the GSE's ability to grow the portfolio. Fannie's average duration gap was a positive one month in September versus zero months in August. (*American Banker*, 10/31/05; *Reuters*, Julie Haviv, 10/28/05; *Bloomberg News*, Al Yoon, 10/28/05)

Mark Winer Appointed Fannie Mae's Deputy and Acting Chief Risk Officer

- Fannie Mae has appointed Mark Winer as the Deputy and Acting Head of the company's Chief Risk Officer (CRO) Organization. Winer, who joined the company in August 2004, has been serving as the Vice President for Portfolio Strategy. Prior to joining Fannie Mae, he was responsible for the financial and prepayment modeling area at BlackRock, Inc. Earlier in his career, Winer was PNC Financial Services' Senior Vice President of Balance Sheet Management of PNC Financial Services, responsible for the management of interest rate, liquidity, and market risks. Daniel Mudd, Fannie Mae's President and CEO said, "Mark [Winer] has a clear grasp of the risks of the mortgage business and the role of the Chief Risk Officer Organization. ...Mark immediately will move forward with a plan to fully staff the CRO Organization, which was formed earlier this year. This CRO Organization will touch every corner of our business and ensure the utmost in risk and operational discipline throughout the company."
- Fannie Mae also announced that Adolfo Marzol, the company's interim Chief Risk Officer, will be leaving the GSE during the first quarter next year. Mudd said, "Last January I asked Adolfo to serve as our interim Chief Risk Officer, a new position at the time and a critical leadership role responsible for the credit, interest rate, and operational risk at the company. Adolfo immediately stepped up to his new role

when the company needed him. However, he has now informed us that it is important for him to turn his time and attention to his family over the next year. We certainly understand, and are very grateful for all he has done for this company throughout his ten years of service. Because of his leadership and knowledge of mortgage finance and credit risk, Fannie Mae has been able to help serve more families with affordable mortgage financing.” (*Fannie Mae Press Release*, 11/03/05)

Fannie Mae announces investor/analyst conference call for the third quarter

- Fannie Mae will host its Third Quarter 2005 Investor/Analyst Conference Call for the investment community on Thursday, November 10, 2005 at 8:30 a.m. Eastern Time, following the early morning filing of the company’s Form 12b-23 with the SEC. The dial-in number for the call is (800) 288-8960 and the confirmation code is 802019. The conference call will be webcast at <http://www.fanniemae.com> and will be available for 30 days after the call. (*Fannie Mae Press Release*, 11/04/05)

Former Fannie Mae CEO Franklin Raines is one of Steve Case’s “tarnished stars,” who is helping him launch a “Revolution” in health care

- Steve Case, AOL founder and former chairman of AOL Time Warner, plans to lead a revolution in health care in America, through his holding company Revolution Health Group, a conglomeration of twelve companies related to resorts and spas, cable and radio networks, and health. Case as invested \$250 million in his venture and plans to double his investment “soon.” David Stires writes in *Fortune Magazine*, “If you wonder whether the health of Case’s reputation may be part of the subtext to this business, consider the board of directors he has recruited for Revolution Health Group. Some are, like Case, tarnished stars whose business judgment has come under fire: Carly Fiorina, who was ousted as CEO of Hewlett-Packard earlier this year after the merger she engineered with Compaq Computer failed to bring the growth she’d promised; Franklin Raines, who stepped down as CEO of scandal-plagued Fannie Mae last December; and Steve Wiggins, the erstwhile chief executive of Oxford Health Plans, who resigned following a spectacular stock flameout.” Case’s primary focus is the Health group, which he believes will strike gold in the consumer-driven market. In 2006, Revolution plans to launch a web portal which will help patients find doctors, schedule appointments, and manage health spending accounts. “Our goal is bold but simple: Build the leading online resource for health care period,” said Revolution’s CEO John Pleasants. (*Fortune Magazine*, David Stires, 11/14/05)

Fannie Mae Foundation receives the Foundation Partner Award

- On November 14, the Fannie Mae Foundation will receive the Foundation Partner Award for its philanthropic work in the Washington, D.C. area at the Fourth Annual National Capital Philanthropy Day award ceremony. (*US Newswires*, 11/02/05)

Freddie Mac

Freddie Mac's retained portfolio grows for second month

- Freddie Mac's retained portfolio grew for a second consecutive month at an annualized rate of 12%, bringing the year-to-date increase to 6.5%. The company's retain portfolio increased \$6.76 billion to \$684.5 billion on September 30. Freddie's growth in September came from purchases of non-agency securities and purchases of its own participation certificates. Freddie said its duration gap averaged zero months in September, unchanged from August.
- On September 9, Freddie Mac affirmed its positive outlook for portfolio growth by announcing plans to increase its reference note debt by as much as \$15 billion during the fourth quarter. Previously, Patricia Cook, the company's vice president for investments said that Freddie Mac planned to hit at least a 5% target for portfolio growth in 2005. (*Bloomberg News*, Al Yoon, 10/25/05; *Reuters*, 10/25/05)

Freddie Mac names CIT Group's CEO Jeffrey Peek to board of directors

- Freddie Mac announced that Jeffrey M. Peek, the chief executive of consumer and commercial lender CIT Group, will join its board of directors on January 1, 2006 to fill the seat currently held by Joan Donoghue. Upon joining the board, Peek will serve on the Finance and Capital Deployment Committee and the Mission and Sourcing Committee of Freddie Mac's board. "His experience will be valuable as we continue to steer the company to meet its mission as well as increase shareholder value," said Freddie Mac chairman and CEO Richard Syron. (*Reuters*, 11/03/05; *Freddie Mac Press Release*, 11/03/05)

Freddie Mac's Controller resigns

- Freddie Mac's Senior Vice President, Corporate Controller and Principal Accounting Officer John F. Woods has resigned effective October to join Washington Mutual Inc., as Controller and Principal Accounting Officer. Freddie Mac has not named Woods' successor. Separately, Washington Mutual announced its hiring of Woods

effective December 1 for a salary of \$400,000. Woods will also receive a \$500,000 signing bonus, \$100,000 relocation bonus, \$700,000 of restricted stock, and an option to buy 27,273 shares of common stock. (*Washington Post*, 10/28/05; *Dow Jones Newswires*, Ed Welsch, 10/27/05; *Dow Jones Newswires*, 10/27/05)

Freddie Mac offers Loan Prospector to counselors

- Freddie Mac is making their Loan Prospector available to housing counselors as a “business-growth tool.” Freddie’s vice president of housing and investment, Tricia McClung told *National Mortgage News*, “We are not making [housing counselors] into lenders, we’re giving them tools so that when they do work with lenders they can do a much better job upfront using this technology to assess when a customer is ready to become a borrower.” (*National Mortgage News*, Amilda Dymi, 10/24/05)

Freddie Mac to make loan level disclosures available on December 1st

- On December 1, 2005, Freddie Mac will make loan-level disclosures available for its newly issued single-family fixed-rate and adjustable-rate mortgage (ARM) Participation Certificate (PC) securities. Shortly thereafter, the company also will disclose certain algorithms and business rules used to produce loan level information for each pool in addition to those used to derive pool level disclosures. “By providing loan-level disclosures for our newly issued PC securities, we believe we are increasing the transparency of our securities and providing the market information that is highly useful,” said Mark Hanson, Freddie Mac vice president, mortgage funding. (*PR Newswires*, 11/03/05)

Freddie Mac will update its service performance profiles in January ‘06

- Freddie Mac plans to incorporate property management and disposition, REO management, and claims group activity into its servicer performance profiles in January 2006. According to Bill Merrill, Freddie Mac’s managing director for default servicing, the GSE will be paying close attention to the management of new affordable housing loan products and will highlight incentives for early intervention in the case of loan delinquency and data quality issues. (*Mortgage Servicing News*, November 2005)

Federal Home Loan Banks

FHLB-Boston completes its registration with the SEC

- On November 1, the FHLB-Boston announced that it had registered with the SEC. The Bank became only the third of 12 FHLBs to do so, despite an August 30 deadline set by the Federal Housing Finance Board. Only the FHLBs of New York and San Francisco made the August 30 deadline. The other FHLBs' registrations have been delayed due to accounting problems.
- In its SEC filing, the FHLB-Boston stated that "negative accounting and other announcements by Fannie Mae and Freddie Mac have created pressure on their debt pricing, as investors have perceived such instruments as bearing increased risk." The Bank added that similar restatement announcements by the FHLBs "may contribute to this pressure on debt pricing." The Bank added, "As a result of ...growth [in GSE debt issuances] and perceived increased risk, the FHLB System may have to pay a higher rate of interest in its [consolidated obligations] to make them attractive to investors," adversely impacting the Bank's financial obligations with respect to such COs and its ability to access the capital markets. (*American Banker*, Rob Blackwell, 11/02/05; *Dow Jones Capital Markets Report*, John Connor, 11/03/05; *Dow Jones Capital Markets*, John Connor, 11/01/05)

FHLB-Des Moines announces plans to restate its 2001-2004 financial statements

- The FHLB-Des Moines announced it will restate its 2001-2004 financial statements to correct certain errors related to the application of the accounting standard known as FAS 133. "For known items, management of the FHLB-Des Moines believes that the restatement could result in a net cumulative gain in retained earnings of \$100 million or more, net of assessments for the Resolution Funding Corp. and the Affordable Housing Program, as of Sept. 30, 2005," said the Bank. The Bank said it continues to review "several other accounting issues, the outcome of which could result in a material change to this estimate for known items to date." It added, "However, in all outcomes evaluated by management to date, the bank's current retained earnings are expected to be positive, although prior and future (until the relevant derivative positions are closed out) income statements will likely reflect a significant increase in earnings volatility and the exact amount of the restatement of each affected quarterly and annual period is not known at this time." Patrick Conway, president and CEO of the Bank, said "The purpose of the restatement is to ensure that we have properly applied the SFAS 133 accounting rules." He said the bank's management "believes these accounting issues will not have a material negative or positive impact on the market value of the bank's assets or liabilities." (*Dow Jones Newswires*, John Connor, 11/03/05)

FHLB-New York approves 5.25% dividend for third quarter

- The FHLB-New York approved a 5.25% dividend rate for the third quarter, a 5% increase over the Bank's second quarter dividend of 5%. Member institutions received the third quarter dividend payment on October 31. "The dividend reflects the Bank's low-risk profile and conservative investment strategy," Alfred A. DelliBovi, the president of the FHLB-New York. (*American Banker*, Luke Mullins, 05/25/05)

Farm Credit System / Farmer Mac

Farm Credit System reports third quarter results

- On September 30, the Farm Credit System reported \$135.4 billion in assets, \$102.5 billion in net loans and \$22.7 billion in total capital. The System reported combined net income of \$530 million and \$1.547 billion for the three and nine months ended September 30, 2005, compared to net income of \$487 million and \$1.416 billion for the same periods last year. Net interest margins increased one and five basis points to 2.60% and 2.59% for the three and nine month periods ending September 30, relative to the corresponding periods the prior year. The System's effective tax rate decreased from 6.4% for the nine months ended September 30, 2004 to 4.6% for the nine months ended September 30, 2005 due to increased patronage distributions by taxable System institutions. Nonperforming loans increased \$13 million to \$756 million at September 30, 2005, representing 0.73% of the System's outstanding loans. While hurricanes have had a substantial impact on the general economies of the Gulf Coast, the System expects the impact on the agricultural economy to be significantly less. "While the impact on System borrowers cannot be determined at this time, their risk of loss is expected to be mitigated by insurance proceeds, disaster relief, and the overall financial strength of borrowers," said Federal Farm Credit Banks Funding Corporation. "The ultimate risk of loss, in the aggregate, is not anticipated to have a significant adverse impact on the System's overall financial condition or results of operations." (*BusinessWire*, 10/31/05)

FCA tries to expand its members' mortgage lending into federal disaster areas

- American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA) recently discovered that the Farm Credit Administration was seeking to attach an amendment to an agriculture appropriations bill that would permit Farm Credit System (FCS) lenders to make home loans in communities of up to 50,000 residents that are declared federal disaster areas. (Currently, FCS lenders cannot make mortgage loans in towns with populations exceeding 2,500). Mark K.

Scanlan, the director of agricultural finance at the ICBA, said that if the FCS received such authority, it could wind up making loans in suburbs of major cities. “We’ve seen language that would allow FCA to have a waiver, and we think it is an attempt to profit from people who have had a weather disaster,” he said. John M. Blanchfield, the director of the ABA’s Center for Agricultural and Rural Banking, said the proposal was a backdoor means of giving the FCS lending powers it has been seeking for years. “One of the Holy Grails of the Farm Credit System has been to do home loans in towns of up to 50,000 people,” he said.

- Within days the ABA and the ICBA fired off letters urging lawmakers to oppose any expansion of the FCS’s mortgage authority. “This egregious proposal is an attempt to profit from the misfortune and misery of victims of natural disasters and is completely unnecessary and inappropriate,” ICBA president and CEO Camden R. Fine wrote in a letter to Senator Robert Bennett (R-UT), the chairman of the Senate Appropriations subcommittee on agriculture and rural development. The trade groups also brought the proposal to the attention of House Banking Committee Chairman Michael G. Oxley, (R-OH), and the committee’s ranking Democrat, Representative Barney Frank (D-MA), who questioned the House Agriculture Committee’s jurisdiction over the FCS. The proposal “is not a matter that has fully been vetted by our committee,” wrote Oxley and Frank in a letter to the House Agriculture subcommittee on agriculture and rural development. “We hope you will reconsider this proposal as you further evaluate the unintended consequences it could cause in the marketplace.”
- Martha Schober, a FCA spokeswoman, said that FCA’s board recently abandoned the idea. “Right now was not just the appropriate time to continue pursuing this,” said Schober. (*American Banker*, Ben Jackson, 10/28/05)

“AgriConsumers” represent <i>big</i> lending opportunity for FCS
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- In *Farm Credit Watch*, Bert Ely reviews recent marketing materials from two FCS associations to illustrate how the System is reaching far beyond its original mission to meet non-farming credit needs. Ely writes, “The Greenstone FCS presentation, ‘Marketing to the AgriConsumer,’ illustrates how far the FCS has drifted from its original mission as it seeks to lend to the ‘AgriConsumer,’ a customer class readily served by the banking industry. ...Greenstone defines the ‘AgriConsumer’ as ‘customers whose farm income represents no more than 30% of total income and all rural residential customers who have no farm income.’ No mention is made of the fact that an FCA regulation (12 C.F.R. Sec. 613.3005) states that FCS ‘loans to farmers shall be on an increasingly conservative basis as the emphasis moves away from the full-time bona fide farmer to the point where agricultural needs only will be financed for the applicant whose business is essentially other than farming’ [emphasis supplied]. Greenstone notes that in 2002, 42.9% of the farms in its territory had agricultural sales of less than \$2,500 annually and another 36.9% had agricultural sales between \$2,500 and \$50,000. The individuals and families engaged in these

farming activities are vital, important contributors to a healthy, vibrant rural economy but the FCS is not authorized to meet their non-farming credit needs -- banks can and do readily meet those needs.”

- “Greenstone’s ambitions to serve the under-\$50,000 sales market are hardly modest. On June 30, Greenstone had \$2.85 billion of loans on its books. According to one slide, titled, ‘Market Potential by Market Segments,’ in which it notes that its potential is “Limited in Traditional Farmer Group,” Greenstone has set these goals for increased lending: Ag sales less than \$1,000 -- 4,316 new customers generating \$358.2 million in new loans (\$83,000 average); ag sales between \$1,000 and \$49,999 -- 5,327 new customers generating \$442.2 million in new loans (\$83,000 average); ag sales \$50,000 to \$1 million -- 1,026 new customers borrowing \$148.1 million; ag sales over \$1 million -- zero. Total lending increase -- \$948 million, or 33%.”
- “The other presentation, ‘Marketing to the Lifestyle Customer,’ came from Louisville-based FCS of Mid-America, the largest FCS association, with \$9.1 billion of assets at June 30. This presentation, aimed at its lending officers, encourages them to get even more aggressive in serving the ‘lifestyle customer.’ Top-performing lenders were listed by name -- the top producer generated \$19.2 million in new loans in 2004. Another slide set out the minimum and maximum amount of new business expected of a lender at various grade levels -- a Grade 8 lender must get ‘new business’ between \$3.75 million and \$5.625 million while a Grade 11 lender must do between \$6.8 million and \$10.2 million of new business. Surely, lender compensation and bonuses are tied to the amount of new business obtained. It appears to be working as FCS of Mid-America’s ‘residence loans to farmers’ (Are these Mid-America’s lifestyle customers?) grew \$781 million, from the end of 2002 to the end of 2004, to \$2.34 billion, while ‘long-term agricultural mortgages’ (presumably to real farmers) grew just \$132 million, to \$2.74 billion, over the same period. Soon, Mid-America FCS may lend more to its lifestyle customers than to true farmers and ranchers, the people FCS was chartered to serve.” (*Bert Ely’s Farm Credit Watch*, Bert Ely, October 2005)

Postal Service

The buzz on postal reform:

USPS is “doubtful” about postal reform passing this year

Senators Collins and Bond meet to discuss Bond’s “Hallmark Hold”

Is it time to rethink postal reform?

USPS “doubtful” about postal reform passing this year

- Tom Day, USPS senior vice president of government relations, expressed doubt that Congress will pass postal reform before the holiday recess at a recent Mailer’s Technical Advisory Committee quarterly meeting. “This is just a guess, but we think when [Congress] come[s] back, we are going to be dealing with this in the winter and next spring,” said Day. In his presentation, Day reiterated the USPS Board of Governors’ position on postal reform bills by discussing a letter the Board sent to lawmakers in September. “The issue of governance has become really a front-burner issue beyond trying to get past the fair and ethical issue,” said Day. (*DMNews.com*, Melissa Campanelli, 11/04/2005)

Senators Collins and Bond meet to discuss Bond’s “Hallmark Hold”

- On October 27, 2005, Senate Homeland Security and Governmental Affairs Chairwoman Susan Collins (R-ME) and Senator Kit Bond (R-Mo) met to discuss his “Hallmark Hold” on sweeping postal overhaul legislation that Collins’ committee passed earlier this year. Bond is urging Collins to include language from the House version of the measure that would allow mailers to challenge prices for first class mail if they feel the rates are not “fair and equitable.” Bond says his provision, backed by the Missouri-based Hallmark and other companies that rely on first-class mail, would protect consumers from being hit with higher postage rates to subsidize discounts for large bulk mailers. However, large catalog mailers, such as Freeport, ME-based L.L. Bean, want the USPS to be able to set rates in a way that recognizes market dynamics. Collins pushed to get the provision stripped from the Senate version, because she believes it would reduce the Postal Service’s ability to set its own rates. A spokeswoman for Collins and a spokesman for Bond said that while the hold remains in place, the Senators will continue to discuss their differences.
- In a November 2 editorial, columnist Stephen Barr examined the Senators’ dispute over rules for setting postal rates. Barr wrote, “A Senate bill that would overhaul the U.S. Postal Service appears stalled by a dispute over how to ensure that big and small mailers fairly share the burden of mail costs. ...Bond and other supporters of the

[House] provision contend that it is the only way to protect small-volume mailers and consumers from getting hit with high postal rates if the Postal Service needs to cover discount or subsidy costs for bulk mailers. Collins took a different approach to rate setting in the Senate bill as part of a larger effort to give maximum flexibility to the Postal Service. Her bill would put a cap on overall rate increases by linking them to inflation and, supporters contend, would create a more dynamic business operation in the Postal Service that could take into account changes in technology and the marketplace.”

- With the withdrawal of the Miers’ nomination to the Supreme Court and growing dismay with the Hallmark Hold on S. 662, the National Association of Postmasters (NAP) believes that Senate Majority Leader Bill Frist (R-TN) may clear the way for a vote on the bill. In the October 28 issue of e-NAPUS Legislative Newsletter, NAP wrote, “The combination of the two factors creates a new opportunity for the full Senate to consider S. 662. The first factor is time. ...The time vacuum created by the Miers withdrawal permits the Senate Leadership to schedule legislation that has widespread bipartisan support. S. 662 is one such measure. The second factor is that the growing number of interest groups and influential Senators who are dismayed by the failure of Senator Chris Bond (R-MO) to reach accommodation with Chairman Susan Collins over language he is advancing on behalf of Hallmark Cards. Consequently, it appears likely that Senate Majority Leader Bill Frist (R-TN) will request that the Senate take up S. 662 and an amendment to be offered by Senator Bond under ‘unanimous consent.’ ...The tactic would clear the way for a Senate vote on S. 662.” (*Associated Press*, Sam Hananel, 10/31/05; *Washington Post*, Stephen Barr, 11/02/05; *CongressDaily*, 10/28/05; *E-NAPUS Legislative Newsletter*, NAPUS, 10/28/05)

Is it time to rethink postal reform?

- In an October 27 editorial, Cary H. Baer, past chairman for the Association for Postal Commerce, stated, “Time is running out as the Senate has its hands full with Iraq, Katrina financing, Supreme Court nominees, bridges in Alaska and the aforementioned deficit. It appears clear that postal legislation isn’t on the Senate’s horizon. It seems to this writer that it’s time for industry leadership to tell Congress thanks, but no thanks. It is time to can the current bill and go back to square one.” (*Association for Postal Commerce*, Cary H. Baer, 10/27/05)

Price of stamps is going up

- The cost of mailing a letter in the U.S. will rise two cents to \$0.39 under a rate hike approved by the USPS Postal Rate Commission (PRC) on November 1, 2005. The increase, the first in three years, is expected to take effect in early 2006. The cost of a first-class postage stamp will rise from \$0.37 to \$0.39, while the cost of sending a postcard will increase by one penny to \$0.24, said the PRC. The USPS requested a 5.4% across-the-board rate increase to meet a \$3.1 billion escrow payment due in

2006, said the commission. The new rate plan approved by the PRC will cut mailing costs for small local newspapers by 2.3%, but recommended a 12.7% increase in rates for books and media material to cover handling costs. (*Postal Rate Commission Press Release*, 11/01/05; *CNN Money*, 11/02/05)

To avoid future postal rate hikes, the USPS must cut costs

- In a November 2 Issue Brief, Sam Ryan of the Lexington Institute stated, “On Nov. 1, the Postal Rate Commission approved an across-the-board rate increase – essentially at 5.4% with some small variations. Postal analysts are now predicting that USPS will request another, larger increase next year. This may signal the beginning of a pattern of increasingly frequent rate hikes. Adding to this concern is the fact that USPS is asking Congress for freedom to break an inflationary rate cap that would be imposed by pending legislation. This strongly suggests that the Postal Service is no longer confident in its ability to keep prices within inflation, as it has done for over 30 years. However, breaking an inflationary cap would place an undue burden on captive Postal consumers. A far more sensible and efficient solution would be to expand measures -- or implement new ones -- to control spending.” (*Lexington Institute*, Sam Ryan, 11/02/05)

USPS drastically curtails its moving-expense bonus policy for executives

- In reaction to recent publicity about the USPS’s generous moving-expense bonus program for senior executives, the Postal Service has drastically curtailed the program, ending payments of up to \$25,000 that allowed officials to pocket thousands of unspent dollars. In a letter last month to Senator Chuck Grassley (R-IA), Thomas G. Day, the USPS’ senior vice president for government relations, said that the bonuses, which supplement government payments for housing assistance and shipment of household goods, will now be capped at two weeks’ salary. In a written response to Day’s letter, Grassley said he was satisfied. “I understand the need for a miscellaneous relocation allowance, but I feel that past payments of \$10,000, \$25,000, and in one case, \$50,000 were excessive and amounted to an abuse of the system,” Grassley wrote. (*Associated Press*, Larry Margasak, 11/01/05)

President Bush nominates Mark Acton to Postal Rate Commission

- On November 4, President George W. Bush announced his intention to nominate Mark Acton, of Kentucky, to be a Commissioner of the Postal Rate Commission, for the remainder of a six-year term expiring October 14, 2010. Acton currently serves as Special Assistant to the Chairman for the United States Postal Rate Commission. Prior to this, Action served as Staff Director for the Counsel’s Office of the

Republican National Committee. (www.whitehouse.gov, White House Press Release, 11/04/05)

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