

The **GSE** REPORT™

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Major Events

Hurricane Katrina relief efforts take center stage:

President Bush proposes an Urban Homesteading Act to address Hurricane Katrina's devastation, as the rebuilding effort begins

Louisiana Senators Mary Landrieu and David Vitter propose massive disaster relief package

Housing GSEs and federal agencies step up with more relief for hurricane victims

Loss assessment grows, as the mortgage banking industry struggles to cope with the storm aftermath

- In an address to the American people on September 15, President George W. Bush said, "I ...offer this pledge of the American people: Throughout the area hit by the hurricane, we will do what it takes. We will stay as long as it takes to help citizens rebuild their communities and their lives." He noted that Congress had authorized more than \$60 billion of aid to fund the first stages of the relief effort. Now comes the second phase of recovery – the rebuilding efforts to help more than 500,000 evacuees put their life back together and rebuild their communities. He said, "[T]he federal government will undertake a close partnership with the states of Louisiana and Mississippi, the city of New Orleans, and other Gulf Coast cities, so they can rebuild in a sensible, planned way... The Federal government will be fully engaged in the mission, but Gov. Barbour, Gov. Blanco, Mayor Nagin, and other local leaders will have the primary role in planning for their own future." He added, "Our third commitment is this: when communities are rebuilt, they must be even better and stronger than before the storm ...[T]here is ...a some deep, persistent poverty in this region as well. ...We have a duty to confront this poverty with bold action. ...[W]e will not just rebuild, we will build higher and better."
- To meet these goals, Bush proposed three initiatives that he asked Congress to pass. He proposed the creation of a Gulf Opportunity Zone, encompassing areas impacted by Katrina in Louisiana, Mississippi, and Alabama, in which Congress would provide immediate incentives for job-creating investment, including tax relief for small businesses, incentives for companies to create jobs, and loans and loan guarantees for small businesses, including minority-owned enterprises. He proposed the creation of worker recovery accounts of up to \$5,000 for evacuees draw upon to obtain job training and education or cover childcare expenses to help them find work. To help lower-income residents, Bush also proposed that Congress pass an Urban Homesteading Act, through which government-owned property would be provided to the citizens as home sites free of charge through a lottery. In return the prospective

homeowner would pledge to build on the lot with either a mortgage or with help from a charitable organization. (CNN, President George W. Bush, 09/15/05)

- On September 16, White House aides elaborated on President Bush's proposals to rebuild the Gulf coast area impacted by the hurricane. Bush's proposals include the creation of a new Gulf Opportunity Zone, under which small business expensing would double from \$100,000 to \$200,000 for investments in new equipment; all businesses would receive a 50% bonus depreciation; and tax relief would be provided for the building of new structures. White House National Economic Council Director Al Hubbard estimates that these incentives would cost about \$2 billion and would terminate at the end of 2007. Under the proposed Worker Recovery Accounts, victims of Hurricane Katrina who need extra help finding a job would be provided up to \$5,000 to purchase training or supportive services, such as child care or transportation. If recipients find a job within 13 weeks after starting unemployment insurance benefits or disaster unemployment insurance, they can keep the funds remaining in their accounts. The Department of Education will assist local school districts opening their doors to the children of evacuees, by providing about 90% of the average per-pupil expenditure up to \$7,500. White House domestic policy adviser Claude Allen said Bush's education plan also would cost in the neighborhood of \$2 billion. HUD is working on draft legislation to establish the Urban Homesteading Act. No details are currently available. Senate Banking Committee Chairman Richard Shelby (R-AL) will be "intimately involved" in developing the new homestead program and "looks forward to hearing more about the program" in meeting with the White House and HUD, according to a Shelby aide. Beyond the homestead initiative, FEMA is buying several hundred thousand trailers and mobile homes to provide temporary and permanent housing. (*Congressional Quarterly*, Keith Koffler and Charlie Mitchell, 09/16/05; *Bureau of National Affairs*, Ralph Lindeman, 09/19/05; *Wall Street Journal*, Jackie Calmes, 09/19/05)
- In a letter to the president, Senate Republican leaders called for setting up a "Marshall Plan for the Gulf Coast" to coordinate rebuilding efforts. Former house speaker Newt Gingrich encouraged the White House to model the recovery effort using a government-sponsored entity called the Gulf States Redevelopment Corp., backed by the federal government but controlled and regulated by officials in the region, to issue bonds, make loans and grants, provide natural disaster insurance, raise taxes and finance public works, including levee construction. In an email to conservative Republicans, Gingrich said, "If we do not have a bold set of solutions to propose in the next week or two, the left will propose a huge government run bureaucratic rebuilding program with the maximum welfare and minimum progress."
- After learning that many of the damaged homes (particularly in New Orleans) had no flood insurance, lawmakers contemplated using Fannie Mae and Freddie Mac to act in a Resolution Trust Corp. role, as an investor and manager of delinquent loans for Katrina-related property. So far, the concept hasn't been "well received" by Republicans because the trade off would be that no portfolio limits would be placed

on the GSEs, according to a mortgage lobbyist. (*Wall Street Journal*, Jackie Calmes, 09/16/05; *National Mortgage News*, Paul Muolo, 09/19/05)

- “We are all flying blind here. We don’t have any examples in modern history of a million people being displaced in America.” Said Ronald Utt, a housing scholar at the Heritage Foundation. (*Wall Street Journal*, Jackie Calmes, 09/19/05)

Louisiana Senators Mary Landrieu and David Vitter propose massive disaster relief package

- On September 23, Senators David Vitter (R-LA) and Mary Landrieu (D-LA) proposed the Hurricane Katrina Disaster Relief and Recovery Act, a sweeping, 500-page redevelopment package touching on every sector of Louisiana’s economy [and the Gulf] and estimated to cost \$250 billion, *more* than the price tag for the war in Iraq. The bill includes a number of controversial items, including the set-aside of half of \$5 billion in federal offshore oil and gas royalties for hurricane protection and coastal restoration and the creation of \$4,000 student vouchers for displaced public school students to use in private, parochial schools. While national school vouchers have been adamantly opposed by Democrats and teachers unions, who fear they will trigger an exodus from the public school system, Landrieu said that extreme measures are needed to help with the displacement of 372,000 students along the Gulf Coast. “This government should step up and support students wherever they are,” she said.
- The bill also calls for \$50 billion for housing grants, \$5 billion for six months of mortgage relief, \$10 billion in economic development grants to revitalize New Orleans, and \$40 billion for hurricane protection projects proposed by the U.S. Army Corps of Engineers. It would require the federal government pick up 100% of the relief and recovery costs for two years, rather than the two months now in place. The bill also creates a presidentially-appointed czar, who would coordinate the multifaceted federal response with the power to “waive regulatory impediments” to a speedy recovery. “The person would have no authority the government doesn’t already have,” said Vitter. “It would be someone who could cut through the red tape.” Vitter and Landrieu will push to include some of their requests in the newest tax relief package being drawn up by Congress, which may be voted upon before the October 10th recess. (*Newhouse News Service*, Bill Walsh, 09/22/05)

Housing GSEs and federal agencies step-up with more relief for hurricane victims

- Fannie Mae plans to turn over to federal emergency officials 1,500 single-family homes that are in its inventory of foreclosed properties to temporarily house victims of Hurricane Katrina rent-free for up to 18-months. The company currently owns approximately 10,000 foreclosed single-family homes with about 3,200 located in the nine states that absorbed most of the storm’s evacuees, said Fannie Mae spokesman Brian Faith. “We think that we can have about half of those ready for tenancy in

pretty short order, which is why we've committed to the 1,500," Faith added. Freddie Mac spokesman Brad German said his company told lawmakers that it will provide 1,000 of its foreclosed housing units for the evacuees' use. HUD has already turned over 1,500 foreclosed single-family homes insured by FHA to FEMA, and is inspecting another 3,500 vacant single-family homes, 13,000 rental units and 10,000 manufactured homes in its FHA foreclosed property inventory in the South for possible use. "As these units become available, they will be made available... free of charge," said HUD Deputy Secretary Roy Bernardi. In addition, Ginnie Mae is extending its Targeted Lending Initiative to the areas hit hardest by the storm. "Using the TLI program to stimulate financing for affordable housing in the devastated areas will provide lasting relief for hurricane victims," said HUD Secretary Alphonso Jackson.

- Freddie Mac has also asked its 2,300 mortgage servicers to extend its mortgage forbearance program for hurricane victims to all members of the National Guard, who are working on the storm cleanup. Freddie's Multifamily Division has also announced a 90-moratorium on payments of principal and interest to borrowers whose properties that were located in areas designated by FEMA as major disaster areas qualifying for individual assistance. In addition, the Freddie Mac Foundation has committed \$1 million to help foster children who are victims of Hurricane Katrina, as part of the Foundation's \$5 million donation to support the Gulf residents affected by this storm.
- The FHLBs' Mortgage Partnership Finance Program has implemented special relief provisions designated to alleviate hardship for victims of Hurricane Katrina. MPF servicers are authorized to suspend mortgage payments for three months for properties located in the disaster area. Following the three month period, servicers have been asked to work out an appropriate plan for the continuation of the mortgage on a case-by-case basis. Also, the Federal Housing Finance Board is granting waivers for income limits to enable Katrina victims to use FHLB-financed affordable housing units. The FHLB-Dallas has already received this waiver and other FHLBs are encouraged to apply.
- Two FHLBs have pledged \$20 million to assist hurricane victims in securing permanent housing. The FHLB-Cincinnati is setting up a \$15 million fund to help meet housing needs of Hurricane Katrina evacuees in Kentucky, Ohio and Tennessee. The voluntary fund will provide grants over a two-year period for acquisition, rehabilitation or new construction of rental and owner-occupied housing. Housing organizations and social service agencies will partner with the Bank's member institutions to apply for Katrina grants. The FHLB-Dallas has established a \$5 million special Disaster Relief Grant Program to address the housing and community investment needs of communities in Louisiana and Mississippi devastated by Hurricane Katrina and support hurricane-displaced residents in other locations within the Bank's five-state District. The grants will be awarded through FHLB-Dallas member institutions for use in a variety of purposes including rehabilitation, construction, working capital, infrastructure development and capital improvements,

as well as for principle reduction and/or down payment and closing cost assistance for single-family homebuyers. “Our member institutions have already shown tremendous support for the devastated communities, and these grants will extend their ability to help individuals, families and small businesses disrupted by this storm,” said Terry Smith, President and CEO of the FHLB-Dallas. In addition, the Bank will also make charitable contributions toward the disaster relief effort, including \$100,000 on behalf of its member institutions and \$45,000 raised through an employee and director matching contribution program. (*Dow Jones Newswires*, Dawn Kopecki, 09/15/05; *Freddie Mac Press Release*, 09/16/05; *PR Newswire*, 09/22/05; *States New Service*, 09/08/05; *PR Newswire US*, 09/21/05; *Associated Press State & Local Wire*, 09/21/05; *Mortgage Partnership Finance Press Release*, 09/12/05; *National Mortgage News*, 09/14/05)

Loss assessment grows, as the mortgage banking industry struggles to cope with the storm aftermath

- With an estimated 360,000 homes directly or indirect affected by the storm, mortgage servicers are just beginning to get their arms around the magnitude of the problem that they face in the Gulf Coast region. Compared to Hurricane Andrew in 1992 and the September 11 terrorist attacks, the risk of property abandonment appears to be much larger in the aftermath of Hurricane Katrina, which magnifies the potential for defaults and disputes over insurance and the risk of shortfalls. Moreover, few properties in the New Orleans area carried flood insurance, which increases loss estimates. Countrywide Financial recently announced that it expects its losses to total more than \$70 million related to properties in the devastated region, while Regions Financial Corp, headquartered in Birmingham, AL, estimated expects the storm to cost it \$50 million. [Nearly 33% of Regions’ branches are located in the three states hit hardest by Katrina – Louisiana, Mississippi and Alabama.]
- In testimony before Congress, the Mortgage Bankers Association said, “The most immediate need of mortgage companies is liquidity” for the almost \$7 billion in government-insured loans are in the Katrina disaster area. MBA has requested that Ginnie Mae continue making payments on loans it has guaranteed there, but without declaring an affected issuer in technical default. “Such a determination of default creates a sizable business hardship for any financial institution,” said IndyMac Bank senior vice president J.K. Huey, in her prepared testimony.
- In a bid to avoid losses that total in the billions of dollars, lobbyists for major banks are floating a proposal on Capitol Hill to extend federal flood insurance retroactively to Gulf Coast residents whose homes were destroyed or damaged by Hurricane Katrina. “In the city of New Orleans, FEMA apparently did not declare a good part of New Orleans as a flood zone because they determined that residents would be protected by the levees,” said Anne Canfield, executive director of Consumer Mortgage Corporation. Officials estimate that roughly 40% to 75% of the houses in the areas hit by the hurricane are not insured for damage caused by floods. Unless the government can create a program to help these homeowners pay off their mortgages,

it will be very difficult to rebuild and stabilize their communities, said Canfield. Taking some of that money to provide retroactive flood insurance would be an “effective way” to help those people who have lost their homes but still have a mortgage, she said. (*American Banker*, Jody Shenn, 09/14/05; *American Banker*, Laurie Kulikowski, 09/14/05; *American Banker*, Jody Shenn, 09/14/05; *National Mortgage News Online*, 09/17/05; *Roll Call*, Tory Newmyer, 09/22/05; *Reuters*, Kristin Roberts, 09/21/05)

Federal Reserve Chairman Alan Greenspan issues strongest warning yet
on the size of Fannie and Freddie

- In his strongest warning to date, Federal Reserve Chairman Alan Greenspan said that Wall Street investment firms eventually might be incapable of hedging all of the financial risks posed by Fannie Mae and Freddie Mac, if Congress doesn't impose meaningful limits on their \$1.5 trillion mortgage portfolios. In a September 2nd letter to Senator Bill Bennett (R-UT), Greenspan wrote, “As Fannie and Freddie increase in size relative to the counterparties for their hedging transactions, the ability of these [companies] to quickly correct the inevitable misjudgments inherent in their complex hedging strategies becomes more difficult.” Already, market participants have reported occasional shocks when sudden zigzags in interest rates have brought the GSEs and other mortgage-market players into the swaps market suddenly. Greenspan concludes, “In the case of [Fannie and Freddie], excessive caution in reducing their portfolios could prove to be destabilizing to our financial system as a whole and in the end could seriously diminish the availability of home mortgage funds.”
- In his letter, Greenspan also dismissed concerns that restricting the growth of the GSEs would harm the U.S. housing market and result in increasing mortgage interest rates, as being “without merit.” Reductions in portfolios should have little impact on interest rates given the liquidity of the U.S. markets and should leave mortgage credit readily available, he added. While acknowledging that the portfolio limits would restrict the GSEs' earnings, Greenspan dismissed Fannie's and Freddie's arguments that these limits would hurt the companies' ability to fulfill their congressional mission.
- In response to Greenspan's comments, Freddie Mac spokesman David Palombi said, “Our portfolio is very conservatively managed and tightly regulated,” pointing to the elaborate tests that OFHEO runs to measure its safety. Palombi also suggested that the markets themselves would prevent untoward growth of the GSEs, and warned that “arbitrarily limiting our retained portfolio would decrease over time the availability of the long-term, fixed-rate, prepayable mortgage.” Fannie Mae decline to comment on the Greenspan's comments.
- While Fannie and Freddie have recently reduced their portfolio holdings following their respective accounting scandals, critics worry that if the current wave of Congressional scrutiny passes without strong new GSE regulatory reform being

enacted, Fannie and Freddie will be free to start growing again with no effective means in place to limit the growth of their portfolios. Such concerns led Greenspan to warn earlier this year that passing H.R. 1461, which places no limits on the GSEs' growth, would be worse than doing nothing at all. (*Correspondence to Senator Robert F. Bennett*, Federal Reserve Chairman Alan Greenspan, 09/02/05; *Dow Jones Newswires*, Dawn Kopecki, 09/14/05; *The Wall Street Journal*, John D. McKinnon and Dawn Kopecki, 09/15/05; *Reuters News*, Tim Ahmann, 09/14/05)

Fannie Mae dissolves its grass-roots lobbying network *and* steps up its PAC activities

- Fannie Mae has laid off 20 lobbyists and publicists in its five regional offices in a step to dismantle its grass-roots lobbying corps, which was considered among the most sophisticated and extensive political-influence machines in corporate America. Fannie Mae's job cuts effectively ends the company's long reign as the "king of ribbon-cutting politics," a controversial use of favors for members of Congress to achieve its political goals on Capitol Hill. As Fannie Mae wrestles with an estimated \$12 billion financial restatement and corporate reorganization, the layoffs are part of an effort by Fannie's CEO Daniel H. Mudd to de-emphasize the GSE's political maneuvering and refocus on the company's core mission of providing financing for the nation's home mortgage markets. Previously, Fannie Mae had disclosed that it was reducing its outside lobbyists by a third and would not renew the contracts of the nation's two most prominent experts in grass-roots politics, Michael J. Whouley of Dewey Square Group, who served as a senior aide in Senator John F. Kerry's 2004 presidential campaign, and Ralph E. Reed Jr. of Century Strategies LLC, former executive director of the Christian Coalition and an adviser to President Bush's campaign.
- Behind the scenes, Fannie Mae has also been dismantling its elaborate system of wooing legislators in their home states and districts and has closed the headquarters office that coordinated such grass-roots communications this spring. The company has also stopped using as a lobbying arm its 55 "partnership offices," located in all but three states and costing about \$50 million annually. In the past, these partnership offices were part business and part political operations. As political entities, the offices arranged frequent public events to launch the start of popular community development projects and spotlighted local lawmakers so they could take credit with the press. Fannie's offices typically conducted a thousand such ceremonies annually and once held as many as 2,000 in a single year. Fannie's regional and partnership offices also influenced lawmakers by recruiting people who were close to them, such as local bankers and heads of local charities, and then regularly asked the recruits to contact legislators on Fannie's behalf. At its height last year, Fannie had 2,000 such "affinity contacts" who had agreed to secure a response from lawmakers within 24 hours of Fannie requesting the contact. The company also had a database of 100,000 other supporters who would barrage lawmakers with Fannie Mae's material. One person close to Fannie Mae boasted that the network once got the barber of a House member to write a letter to the lawmaker as a way of promoting Fannie's cause.

Historically, these tactics have proved effective, as Fannie repeatedly derailed legislation it did not like, including an effort in 2004 that would have created a tough new regulator to oversee the company.

- This month, Fannie Mae's partnership offices are being reorganized and renamed "community business centers." Fannie's local offices will continue its business of seeking loans for apartment buildings and single-family homes. In addition, the company plans to hire seven public relations workers, raising the prospect that Fannie will continue to play politics, albeit from the back of the room rather than in open sight. Nevertheless, Fannie Mae spokesman Charles V. Greener said the company is determined to stand clear of political hardball. "We're now taking some steps to better align our business with the needs and focus of our customers and partners," said Greener. "Our focus is on our business, and the community business centers will continue to serve as catalysts in their communities to expand affordable housing opportunities and to work with our customers and lenders to get more people into homes and help them remain in those homes." (*Washington Post*, Jeffrey H. Birnbaum and Annys Shin, 09/16/05)
- In a September 16th letter to Fannie Mae CEO Daniel H. Mudd, Senator Elizabeth Dole (R-NC) asked how his company will refocus its community business centers on the core goals of the GSE. Dole wrote, "I would like to know exactly how these community business centers would function, and I would be interested in learning about the new mission of these offices and how they intend to achieve it." She continued, "As you know, Fannie Mae was established to create greater liquidity in the home mortgage market and thereby lower the cost of home ownership across the nation. Hence, I would expect these offices to focus on Fannie Mae's over-riding mission to increase access to affordable housing, and not on developing new businesses in these communities." (*Correspondence to Fannie Mae President and CEO Daniel H. Mudd*, Senator Elizabeth Dole, 09/16/05)
- As the company has been dismantling its grass-roots lobbying apparatus, Fannie Mae has been building a political action committee from scratch, creating the ninth largest campaign donor among financial-services companies in a 19 month period. According to *PoliticalMoneyLine*, Fannie raised \$336,367 for its PAC during the first seven months of 2005, outpacing both Washington Mutual (\$271,588) and Citigroup (\$242,347). In 2004, the company's PAC gave more than \$600,000 to candidates. "Considering what has happened to them in the past year, they've decided to shift their strategy" for exerting political influence, said Tony Raymond, co-founder of *PoliticalMoneyLine*. He added, "It is an attempt at transparency," by making use of tougher federal disclosure rules for PACs rather than traditional lobbying. Fannie Mae spokesman Brian Faith said, "Through the creation of the PAC, we felt it reflects the company's commitment to transparency." (*Bloomberg News*, 09/16/05)

- On September 9, 2004, Freddie Mac entered into a stipulated order with OFHEO to settle the action against the company involving former CEO Leland Brendsel and former CFO Vaughn Clark, who allegedly engaged in improper accounting practices and failed to maintain proper internal controls. Under the agreement, Freddie agreed to reclassify the two former executives, who were originally deemed to have “resigned” from the company as “terminated for cause,” if the regulator’s final order against those executives calls for such a termination. Further, the company has agreed to produce certain documents and make available any current employees that OFHEO requests to interview in connection with the regulators efforts to recover compensation from Brendsel and Clark. According to OFHEO, if Brendsel loses the case entirely, he could have to pay at least \$34 million, including \$24.4 million in lost severance and benefits, \$5.8 million in fines, and \$3.8 million in past bonuses. If Clark loses, he could have to pay at least \$4 million, two-thirds of which consists of fines. Forfeited severance payments and bonuses would go to Freddie Mac, while the Treasury Department would receive any civil penalties. “This settlement with the company is a significant step forward and allows us to focus our resources on the cases against the former officers,” said OFHEO Acting Director Stephen A. Blumenthal.
- Freddie Mac said that the government does not require the company to terminate the former executives for cause now. Instead, the settlement simply takes Freddie out of the legal proceedings between OFHEO and the executives by agreeing to implement whatever final decision is ordered. Freddie Mac spokeswoman Sharon McHale said, “This settles the matter for us. ... We have consistently made clear that we will comply with any valid and effective order from OFHEO. Under the consent order today we’re simply agreeing to implement any final order that results from the pending proceedings between OFHEO and Brendsel and Clarke.”
- OFHEO could file similar charges against Fannie Mae’s former CEO Franklin D. Raines and former CFO J. Timothy Howard. It is not likely that OFHEO would file such charges before it completes its final report on Fannie Mae, which the agency expects to complete in 2006. (*Dow Jones Newswires*, Dawn Kopecki, 09/12/05; *Washington Post*, Annys Shin, 09/13/05; *New York Times*, Jonathan Glater, 09/13/05; *Reuters*, 09/12/05; *Market News International*, 09/14/05; *CFO.com*, Stephen Taub, 09/13/05; *Freddie Mac Supplement*, 09/15/05)

Fannie Mae and Freddie Mac

Oxley attempts to sweeten H.R. 1461's AH provision as temporary hurricane relief – and comes up “snake eyes”

- In a move to secure a floor vote for H.R. 1461 to provide GSE regulatory reform, House Financial Services Chairman Michael Oxley (R-OH) and bill co-sponsor Representative Richard Baker (R-LA) proposed an amendment to the bill's controversial affordable housing provision, that would give during the first two years “priority to new affordable housing proposals in the Gulf regions impacted by Hurricane Katrina.” Baker said, “The willingness to get this kind of legislation moved forward is significantly enhanced because of the Katrina circumstances.” According to *The Hill*, as Oxley and Baker prepared their announcement of the 5% fund's Katrina tie-in, their staff reached out to friends on K Street. “There was a flurry of calls between pro-reform guys and GOP leadership. Oxley and Baker [aides] called us and said, ‘We’re going to make this announcement. Can you help put some pressure on [Republican] leadership?’” said one lobbyist working on H.R. 1461. Like many colleagues, the lobbyist expressed surprise at Oxley and Baker's political miscalculation.
- Despite claims by Oxley that GOP leaders had cleared the way for a vote on H.R. 1461 the week of September 19, House Majority Leader Tom Delay (R-TX) put off the scheduled vote, saying that the bill needed more work. Speaking in an exchange on the House floor with Representatives Barney Frank (D-MA) and Maxine Waters (D-CA) on September 15, Delay said that he wanted to avoid a “contentious battle on the [House] floor” and that members hadn't resolved their differences over the affordable housing provision.
- Conservative Republicans remain vehemently opposed to the affordable housing provision, arguing that the AH funds would be used to lobby lawmakers by steering projects to key congressional districts. Critics also worry that Fannie and Freddie would lobby Congress through their nonprofit housing allies and advocacy groups. With regard to the amended AH provision, a GOP aide said, “There is no progress right now in terms of what we're trying to secure - a provision in the legislation that says none of the funds can go to any entity (or affiliate) that engages in federal election activity or lobbying. This seems to be a big area that the committee doesn't seem to be ceding ground on. I think it's overly optimistic for the committee to be out there saying that we're real close [to a deal] when we're not.” Another senior GOP House aide said, “We are at a stalemate. There is hope that this could be resolved. ...If it can't, that just confirms the belief of many [Republican Study Committee] members that this fund is not fixable, that it was a slush fund from beginning to end and that it ought not be in this bill.” A Financial Services Committee source said that the language that the RSC favors would prohibit charities that participate in the fund from even using their own money—separate from the AH

funds—for political activities such as voter registration drives. “That’s really quite extreme,” said the source. Representative Jeb Hensarling (R-TX), a member of the House Financial Services Committee, argued in support of the RSC language by saying, “Dollars are fungible and so if a dollar is used here, even if it may have some restrictions on it, it relieves another pot of money to go into funding political activism. I don’t believe that was the original purpose of the fund and we’re just looking at different legislative approaches to get that solved.”

- On Capitol Hill, tempers flared after Fannie Mae lobbyists obtained a copy of the closely-guarded affordable housing amendment proposed by Oxley, which was designed to break the logjam on H.R. 1461, according to several Republican aides. “They weren’t parties to the negotiation and tried to inject themselves into it. It had the effect of [ticking] everyone off - Oxley, Baker, DeLay,” said one lobbyist familiar with the negotiations. “I don’t think what [Fannie] did was particularly bad. If they were smart, they would have laid back. ...But those guys can’t leave well enough alone.” Two senior GOP aides said Oxley, Baker and DeLay were perturbed when Fannie Mae lobbyists obtained a leaked copy of the proposed amendment, which Oxley and Baker planned to offer the Republican Study Committee (RSC) and started lobbying for changes before the lawmakers themselves could meet to discuss the issue. Lawmakers were not only put off by Fannie’s actions, but they were also troubled by the fact that the legislation was leaked in the first place.
- In a speech to the National Association of Credit Unions, Oxley said that the amended affordable housing proposal which directs a portion of the GSEs’ profits to hurricane relief is “not about politics.” Oxley said, “This is not about advocacy, it’s not about lobbying, it’s not about politics. It’s about getting money to that region the first two years dedicated to the Gulf coast to build affordable housing.” He added, “Because of the [accounting] restatements and concerns many people have had about the GSEs, this legislation is critically important.”
- In an effort to end the stalemate, Representatives Oxley (R-OH), Baker (R-LA) and Ney (R-OH) sent a letter to Delay [on September 21], urging a floor vote on H.R. 1461. “Now is the time to act,” the lawmakers wrote. In a separate “Dear Republican Colleagues” letter, the lawmakers outlined the “safeguards” in H.R. 1461 that would prevent the housing fund from being used as a slush fund for advocacy groups. A GSE-friendly lobbyist said such letters among lawmakers are not unusual. “This is the way legislation works,” said the lobbyist. “Despite the best you’ve done, you can’t completely resolve differences. So, you’ve got to muscle your way to the top, and that’s what they’re doing.” He noted, the bill’s proponents are “pretty confident” they will get a vote on H.R. 1461. While the House leadership offered little reaction, a spokesman for Delay called the letters a “regular practice” of members and the majority leader will continue working with Oxley and other members on the legislation.
- Representative Paul Kanjorski (D-PA), the ranking minority member on the House Financial Services Committee, said that objections from conservative members of the

RSC would not prevent the House from taking up H.R. 1461. [The RSC's vow to block the bill is] not going to hold it up. The other issue, of portfolios, not the problem with the RSC," will hold up the bill, he said. He added that those fighting for the AH provision are "not just Democrats. There is a lot of support from Republicans" on the House Financial Services Committee.

- According to people close to negotiations, the White House has threatened House leaders that they will issue an official statement of administration policy opposing H.R. 1461 if they bring it to the floor in its current form. Sources say that White House officials are already drafting the statement, which condemns H.R.1461 as lacking key elements of reform, including limits on the companies' portfolios and regulatory authority to freely raise their capital requirements or liquidate their assets if either should fail.
- To help offset the ballooning costs of Hurricane Katrina, the RSC suggested that Congress consider charging a fee against Fannie Mae's and Freddie Mac's investment portfolios to offset costs. As part of a broad package of budget proposals nicknamed "Operation Offset" to rein in federal spending, the RSC estimates that such a fee could generate \$2.1 billion next year and \$10 billion over five years.
- While many lobbyists have steered clear of the turmoil between Oxley, Baker and the RSC, Habitat for Humanity, ACORN, and other community development groups have accelerated their push to keep the AH fund amendment alive. "Rather than playing politics as the country tries to recover from the worst natural disaster ever to hit our shores, we ask Congressman Pence to trade in his suit for some Dickies [construction workers' clothing] and join us in helping American families who have lost everything they own to recover," said ACORN President Maude Hurd.
- Prudential Securities analyst Charles Gabriel said tying H.R. 1461's affordable housing fund to rebuilding the Gulf Coast makes it politically harder for Federal Reserve Chairman Alan Greenspan and the White House to prevail in their moves to limit the size of the GSEs' portfolios and eliminate the AH fund provision from GSE reform legislation, because it "does a good job of reminding people of the positive things" Fannie Mae and Freddie Mac can do. (*Dow Jones International News*, Dawn Kopecki, 09/14/05; *Washington Post*, Annys Shin, 09/15/05; *Dow Jones Newswires*, Dawn Kopecki, 09/15/05; *Dow Jones Newswires*, Dawn Kopecki, 09/16/05; *The Hill*, Elana Schor, 09/20/05; *Bloomberg News*, James Tyson, 09/21/05; *Dow Jones Newswires*, Dawn Kopecki, 09/20/05; *National Journal's Congress Daily*, 09/21/05; *Market News International*, Claudia Hirsch, 09/21/05; *CQ Today*, 09/22/05; *The Hill*, Elana Schor, 09/22/05; *Dow Jones Newswire*, Dawn Kopecki, 09/23/05)

Hurricane Fannie Mae

- In a September 23rd editorial titled "Hurricane Fannie Mae," the *Wall Street Journal* wrote, "Maybe there is a limit to what can be shoe-horned into 'disaster relief' after

all. Last week, with the post-Katrina spending frenzy in Congress at its peak, some Congressmen saw an opportunity to revive a foundering bill to ‘reform’ Fannie Mae and Freddie Mac by -- what else? -- tying it to hurricane relief. This is the sort of ruse that bears watching. The bill was essentially the same one we warned about in June. It would have done little to restrain the growth of the mortgage giants’ mortgage-backed securities (MBS) portfolios or strengthen oversight. But it would have diverted 3.5% of their profits into an ‘affordable-housing fund’ that, in the bill’s latest incarnation, would initially have been directed toward areas damaged by Katrina.”

- “Perversely, skimming the two companies’ profits would do nothing to reduce the risk that their \$1 trillion portfolios pose to the financial system and the economy at large. But by capturing a portion of their profits and dedicating it to social programs, this would enhance their political power. By contrast, reducing Fan and Fred’s MBS portfolios or increasing their capital ratios -- two reforms seen as vital by none other than Alan Greenspan -- would likely dent their profitability, and so reduce the kitty available to pet Congressional causes. For a while last week, it looked like hitching a ride on Katrina was just what House Financial Services Committee Chairman Michael Oxley’s non-reform bill needed to get going. But the Republican Study Committee, which has been steadfast in calling for spending restraint in the wake of Katrina, was instrumental in preventing the bill from coming to the House floor for a vote this week.”
- “The fiscally conservative Study Committee would prefer that there not be an ‘affordable housing’ fund at all, since it will be abused for political ends. But its Members have insisted that, if the Oxley bill goes ahead, it should state clearly that the money go to groups that do not engage in lobbying or federal election activities, including get-out-the-vote efforts. This has led, bizarrely, to the accusation that House conservatives oppose the affordable-housing fund because they want to prevent people from registering to vote or voting, according to one committee aide quoted anonymously in a story in this newspaper. If you’re confused, join the club; we thought this bill was about regulating Fannie Mae and Freddie Mac. Or about Katrina. Or something. But it turns out it’s about getting out the vote too--a telling admission that the affordable-housing fund really is a political slush fund. Congressman Oxley said Tuesday that the fund was ‘not about politics,’ but the bill’s backers have so far refused to consider language that would bar groups that engage in politics from accepting the money.”
- “Mr. Oxley also says that Fan and Fred’s recent accounting troubles make reform urgent. If he means it, he should look to the Senate, which already has a strong bill that would require the two ‘government-sponsored enterprises’ to substantially reduce their holdings of mortgage-backed securities while subjecting them to stronger regulation. No slush funds, no getting out the vote. If House Republicans really want to address the risk to the financial system posed by Fannie and Freddie, they’d dump Mr. Oxley’s embarrassment and adopt the Senate bill.” (*Wall Street Journal*, 09/23/05)

“...Stay tuned for GSE reform,” says Senate Banking Committee Chairman Shelby

- In an interview with *Market News International*, Senate Banking Committee Chairman Richard Shelby said that he still wants Congress to pass a “good GSE bill,” but said he is not certain if the legislation could pass this year. “Katrina has pushed the schedule around. When we take up the GSE bill is strictly a leadership decision, a leadership call,” he said. “Remember a Congress lasts two years and this is just the first year of the (109th) Congress. So stay tuned.” Asked if S. 190 would “kick over” to next year, he replied, “I just don’t know at this point.” Shelby said he believes Fannie and Freddie “want a bill now, they really want some certainty at this point,” but GSEs also want to maintain “as much flexibility as they can regarding their portfolios.” (*Market News International*, John Shaw, 09/22/05)
- Shelby said he has been following developments in the House regarding the affordable housing provision, which he does not support, along with the Bush Administration and Federal Reserve Alan Greenspan. While Shelby said “there could be no more worthy cause” than directing aid to areas hit by Hurricane Katrina, he said he continues to “harbor deep concerns” about creating a profit-based AH fund financed by the GSEs and believes there are better ways for Fannie and Freddie to promote affordable housing. “We must provide the right motivation for the GSEs to promote homeownership,” Shelby said. “Structuring a program that creates incentives for the GSEs to grow larger, and take on more risk, is the fundamentally wrong approach.” Shelby and the Bush administration believe that the AH fund tied to GSEs’ profits would increase Wall Street’s perception that the GSEs are backed by the federal government. Further, they believe that the fund would create additional incentives for the GSEs and Congress to grow their portfolios and take on more risk. (*Dow Jones Newswires*, Dawn Kopecki, 09/16/05)
- Shelby spokesman Andrew Gray said that while GSE regulatory reform legislation “remains a priority,” lawmakers are no closer to reaching a consensus on the portfolio limits or affordable housing issues. He added, “No substantial progress has been made.” (*Congressional Quarterly Today*, 09/21/05)
- Jim Vogel, agency strategist at FTN Financial Capital Markets in Memphis, TN, said “Any movement in the House would be news, but decisions in the Senate are a far more important barometer” in GSE regulatory reform. (*Market News International*, Claudia Hirsch, 09/15/05)

The Bush administration weighs on GSE regulatory reform legislation

- The Bush administration’s position regarding the AH provision in H.R. 1461 is unchanged, said spokesman Trent Duffy. “While we certainly appreciate the desire to help people affected by Hurricane Katrina ...the need for strong reform” of Fannie Mae and Freddie Mac remains, “including the need for limitations for the portfolios.” (*Washington Post*, Annys Shin, 09/15/05)

- HUD Secretary Alphonso Jackson told *Bloomberg News* that Fannie Mae and Freddie Mac shouldn't be required to channel a portion of their profits for an affordable housing fund for hurricane survivors. "I don't think we should be dictating what they do as basically quasi-private entities." He added, "If they chose to give, that should be from their perspective" rather than coerced through a federal mandate. (*Washington Post*, 09/23/05; *Bloomberg News*, 09/22/05)
- HUD Assistant Secretary Steven Nesmith told reporters that while the Bush administration considering ways the GSE regulatory reform bill could be used to help in the hurricane recovery effort, the administration remains opposed to creating a GSE affordable housing fund, which is part of a House GSE bill, even if the funds are targeted at helping with the hurricane recovery effort. (*National Mortgage News*, 09/19/05)
- Meanwhile as Fannie Mae and Freddie Mac do their best to stoke fears that legislative efforts to restrict the GSEs' portfolios could prick the housing bubble, Treasury Secretary Snow said, "I think the bubble is a gross misnomer. Prices have risen, and there will be a flattening out in the rate of increase." However, a collapse in the housing market is "improbable," Snow said. (*Bloomberg News*, 09/20/05; *Wall Street Journal*, David Wessel, 09/24/05)

<p>Shadow Regulatory Committee endorses S. 190's provision requiring mandatory receivership for an insolvent GSE</p>
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- The Shadow Financial Regulatory Committee (SFRC) has endorsed a provision in the Senate draft of GSE regulatory reform bill (S.190) that would require a new supervisor to place an insolvent GSE in receivership. The SFRC said that S. 190 improved upon an earlier proposal by requiring "the appointment of a receiver if the liabilities of a GSE exceed its assets, or if a GSE is not meeting its obligations as they come due." The SFRC recommends strengthening the provision even further by requiring that a receiver be appointed if a GSE becomes "critically undercapitalized--the same rule adopted in [the Federal Deposit Insurance Improvement Act] for banks and savings and loan associations."
- The SFRC also "strongly endorses" the S. 190's provision that would sharply reduce Fannie's and Freddie's mortgage portfolios, which currently aggregate \$1.5 trillion. In the SFRC's view, limiting the GSE portfolios to the amount needed to facilitate securitization is good policy, since it would eliminate a substantial portion of the GSEs' systemic risk and enable the companies to continue their activities through securitization of mortgages.
- In Statement No. 221, the SFRC concluded, "The Committee does not believe there is any need for government-backed activity in the secondary market and has long believed in a true privatization of Fannie and Freddie... However, if Congress is

unwilling to fully privatize these two GSEs, a sharp reduction in the risks they create—through a substantial reduction of their portfolios—is the next best thing. (*Statement of the Shadow Financial Regulatory Committee on the Federal Housing Enterprise Regulatory Reform Act of 2005 (S. 190)*, Statement No. 221, 09/12/05; *BNA's Daily Report for Executives*, Richard Cowden, 09/13/05)

GSE portfolio limits won't hurt the residential real estate market, experts argue

- Panelists at a September 13th policy forum at American Enterprise Institute disputed assertions that proposed limits on GSEs' portfolios would adversely impact the residential mortgage market. Peter Wallison, resident fellow at AEI presented an analysis of the GSEs' mortgage purchases during September 2001 following the 9/11 terrorist attacks and noted "no shock absorbing effect of the portfolios" during this period of crisis. Lawrence J. White, professor of economics at New York University's School of Business, said that banks and thrifts would likely increase their acquisition of mortgages and MBS, if GSE regulatory reform legislation imposed significant limits on Fannie's and Freddie's mortgage holdings. Placing this restriction on GSEs would not have a significant effect on the mortgage finance market, but would spread out the interest rate risk that Fannie and Freddie hold, said White. With the GSEs' portfolios reduced and more mortgage assets held by private competitors, White said, "Mortgage rates will probably rise relative to baseline levels by a few basis points." He said that such a development "is a good thing, something to be encouraged—get us closer to where we should be," since housing is over-subsidized in today's housing finance system. White advocated a shift to greater reliance on free markets and urged Congress to adopt on-budget housing assistance programs, if they determined that subsidies are warranted to meet the needs of low- and moderate-income families. (*BNA's Daily Report for Executives*, Richard Cowden, 09/14/05)

GSE portfolio limits are the ballgame

- In the September issue of *Financial Services Outlook*, AEI fellow Peter J. Wallison wrote, "The taxpayers and the economy will benefit because they will be relieved of the risk of a GSE default, with the resulting taxpayer bailout and possible systemic effects. For the GSEs, however, the result will be a sharp reduction in profitability - perhaps as much as an 85% decline - as they are compelled to carry out their mission through the less risky technique of securitization and the issuance of mortgage-backed securities," he said. (*Dow Jones Newswires*, John Connor, 09/15/05)
- Robert Lacoursiere, principal and senior equity research analyst at Banc of America Securities, appears to agree with Wallison about the potential impact that restricting the GSEs' portfolios would have on the companies' profitability. Lacoursiere said, "We concluded that this business ain't worth as much as it is if [the GSEs] can't

retain their portfolios. ...When we did a little exercise trying to figure out how profitable this business was, we discovered that on average from 1992 until 2004 -- this is the period when they rapidly built up the portfolio -- it produced a return on equity of about 30 percent. There was a slight difference between the two, but roughly 30 percent. That is double the rest of the business, the mortgage-insurance business. And so the first conclusion is it is very profitable. The second conclusion we came up with is that it has almost unlimited growth potential. Unlike the rest of their business, which we will call the mortgage-insurance business, they were able to grow beyond the bounds of the underlying mortgage business. And if you know anything of equity, the value of an equity is determined by how profitable it is, how fast it grows. And there is one other element: how risky it is perceived to be. And this is a third and important conclusion that this portfolio actually turned out to mitigate the underlying risk of their mortgage-insurance business. So we have a more profitable business that is growing faster and it is seen as less risky. The three things together made this a very valuable equity to hold.”

- Lacoursiere added, “We believe in the long run that these portfolios will shrink and that in doing so the market will realize that these equities are riskier, they will grow slower and they’re, as a result, worth less.” In keeping with this outlook, Banc of America Securities reduced its price target 19.8% on Fannie Mae to \$42.50, a 19.8% reduction from its prior estimate of \$53 on September 23, 2005. It also reduced its target price on Freddie Mac 12% to \$58 from \$66. (*Bloomberg News, James Tyson, 09/13/05; Reuters News, 09/23/05*)

Assistant Treasury Secretary nominee vows close scrutiny of GSE reform legislation
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- In his September 20 confirmation hearing before the Senate Banking Committee, Assistant Treasury Secretary nominee Emil Henry promised to closely monitor GSE regulatory reform legislation that could limit the size of Fannie Mae’s and Freddie Mac’s retained portfolios. Henry also said his “instinct” is that the \$8 trillion credit markets could absorb any of Fannie’s and Freddie’s retained portfolio that the companies sold off. Committee Chairman Richard Shelby (R-AL) said Henry’s confirmation would be approved by his panel “expeditiously” and would then be sent to the full Senate for consideration. (*Dow Jones International Newswires, John Godfrey, 09/20/05*)

Standard & Poor’s quits rating corporate governance and withdraws its corporate governance score for Fannie Mae

- Standard & Poor’s Governance Services announced it will no longer provide corporate governance scores (CGS) for U.S. companies and withdrew its CGS on Fannie Mae. In early 2003, S&P first issued a strong 9 out of 10 CGS score for Fannie Mae, which the company publicized in defense of its operating practices. Subsequently, S&P lowered Fannie Mae’s score CGS-7 and later to CGS-6 to reflect

“deterioration in the timeliness of disclosure as the company works to complete its financial restatement.” George Dallas, the manager of S&P’s global governance services out of London, said the direct withdrawal of Fannie Mae’s score is as direct result of the firm’s quitting the governance scoring business. Dallas added the S&P will continue offering the service in emerging markets such as Russia—
”marketplaces where a lot of international investors have reason to be concerned by virtue of where they are domiciled.” (*Dow Jones Newswire*, Phyllis Plitch, 09/09/05; *Reuters News*, 09/09/05)

FAS 133 deeply flawed and should be scrapped
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- AEI fellow Alex J. Pollock argues that the grand irony behind the Fannie Mae, Freddie Mac, and FHLBs’ restatements is that FAS 133 “is such a bad rule, and so fundamentally flawed, that all the effort and enormous sums of money to comply produce distorted, misleading, and opaque financial statements.” Pollock continues, “As everyone in the mortgage business knows, the Byzantine complexity of FAS 133 means whatever the most recent group of accountants to get involved say it means-- and what they say it means keeps changing. ...From the time it was first proposed, financial experts have rejected not just the complexity but, much more importantly, the fundamental concepts of FAS 133. Indeed, the experts who actually manage financial risks have made the following criticisms:”
 - “FAS 133 marks to market for accounting purposes only one side of what are in fact two-sided positions;”
 - “It treats positions with identical net cash flows differently;”
 - “It requires the pretense that all hedging is “micro” hedging of specific items, while the reality is macro hedging of combined balance sheet risks;”
 - “It requires assigning hedges to specific assets or liabilities, while the real risk is the relationship between assets and liabilities.”
 - “It requires, as the result of a political compromise, direct debits and credits to the capital accounts, bypassing the profit-and-loss statement.”
 - “It not only allows, but actually requires, deferral of certain realized cash losses.”
 - “It diverts organizational effort from risk management to complicated bookkeeping exercises.”
 - “As a result of all of the above, FAS 133 creates a strong and perverse incentive not to hedge. In other words, it makes accounting risk a bigger problem than real risk and thus tends to increase real risk.”

- “All this is particularly disturbing because FAS 133 is also politically potent. As a HUD Office of Investigation report correctly pointed out last year: ‘On [Capitol] Hill everybody runs for cover if somebody’s accusing a company of some impropriety in terms of their accounting.’ Seldom or never has a rule adopted with the goal of clarifying a situation so failed in its purpose and spread confusion instead. Considering what to do next with FAS 133, FASB and the SEC should take to heart a saying of John Maynard Keynes. When accused of changing his position, Mr. Keynes replied, ‘When I discover I have made a mistake, I change my mind. What do you do?’ In other words, don’t stick with a loser. FAS 133 is so deeply flawed that it should be scrapped altogether and re-thought from scratch.” (*American Banker*, Alex J. Pollock, 09/09/05)

Wall Street investment bankers propose “fix” for backlog of credit derivatives paperwork
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- Major Wall Street banks have proposed a solution to a backlog in credit derivatives paperwork that has concerned the Federal Reserve Bank of New York. The banks suggest that hedge funds outsource--for a fee--many of their trade processing obligations to investment banks’ prime brokerage units. Transferring the processing to banks could make sense for hedge funds, which have been slow to build the complicated processing systems needed for the rapidly growing \$8.42 trillion credit derivatives market. Some fund managers caution that the solution is not a panacea and needs to be combined with other technological upgrades in the industry.
- For this market which has outgrown many traders’ processing systems, the stakes are high. Concerned that a series of high-profile defaults could leave investors and dealers unsure of their trading partners, sending the market into confusion, the New York Fed met on September 15th with 14 banks to discuss problems with unsigned trades and delays in informing parties when contracts changed hands. “At the end of the day there is more operating risk in this business than investment risk,” said Samuel Cole, chief operating officer at BlueMountain Capital Management. At the meeting, dealers vowed to take concrete steps to resolve lags in their back offices and said the banks would be tough on hedge funds they viewed as being lax in processing trades. (*Reuters*, Dan Wilchins and Karen Brettell, 09/22/05)

2006 election issue: The need for affordable housing
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- “Homes for New Jersey” (HNJ) is a non-profit coalition of more than 200 organizations that plans to make affordable housing an issue in the November race for governor between Senator Jon Corzine (D-NJ) and Republican opponent Douglas Forrester, as well as in the elections for 80 Assembly seats. Through a combination of initiatives including state incentives for cooperating municipalities, the coalition hopes to create 100,000 affordable housing units in New Jersey over the next decade. In addition to offering incentives to municipalities, the group espouses increasing funding for the state rental-subsidy program, changing the Council on Affordable

Housing's regulations to increase affordable housing obligations, increasing state relocation allowances, protecting residential areas from eminent domain, and creating a statewide homeowner support system. The coalition consists of banks, housing advocates, church organizations and nonprofit groups, such as United Way, unions, mental health organizations, power companies and food pantries. The issue is more than just finding a place to live –it's about jobs, social and family networks, and the make-up of communities. To date, 30 state legislators or candidates have endorsed HNJ's campaign. (*Daily Record* [Morristown, NJ], Mike Daigle, 09/15/05; *Philadelphia Inquirer*, Kera Ritter, 09/16/05; *Ashbury Park Press* [NJ], Joseph Picard and Nina Rizzo, 09/16/05)

Fannie Mae

Fannie Mae makes tender for \$19.2 billion of callable debt

- On September 19th, Fannie Mae began a tender offer to repurchase as much as \$19.2 billion of callable debt. The lead manager for the tender offer is Goldman Sachs with assistance provided by Merrill Lynch and UBS Securities. The buybacks end on September 23, 2005. (*Bloomberg News*, James Tyson, 09/19/05)

Fannie Mae tests the water for debt cancellation loans

- Five years after the GSEs declared they would not finance mortgages with single-premium credit insurance, Fannie Mae is now accepting debt cancellation loans – providing a similar type of coverage which is considered “more consumer-friendly.” Single-premium credit insurance fell out of favor following criticism that the insurance was poorly disclosed and made loans less affordable because the premium was often financed in the loan balance. In contrast, debt cancellation is payable monthly and may be cancelled by the borrower at any time. The coverage forgives a number of mortgage payments for the borrower under certain circumstances, including job loss, disability, death, or health problems. Proponents of this insurance argue that the coverage can improve loan performance by helping borrowers at least temporarily deal with some of the top causes of delinquency and avoid late fees and the black mark of a missed payment. Fannie Mae said it has made provisions in its loan guidelines for debt cancellation to ensure the product does not facilitate the kind of consumer abuses associated with single-premium credit insurance.
- Katrina Jones, the company’s director of product management said, “We’re gradually getting into this space,” with Fannie buying loans with the feature from “a few” lenders. “We focused on what we would consider appropriate consumer values, consumer things that made sense,” said Jones. A counterparty risk assessment is a prerequisite for selling loans with this feature, she added. “We ... look at their exposure and how much debt cancellation they can actually write and forgive,” Jones said. The feature is “not necessarily limited to the well-heeled lenders” that are better capitalized, she said. “If that customer does not meet our minimum counterparty risk requirements, they can go out and acquire backside insurance, such as a contractual liability policy.”
- Jim Cotton, the vice president of single family marketing for Freddie Mac, said his company is not yet comfortable with debt cancellation because of “the potential for complicating and increasing our risk.” Freddie Mac fears troubled borrowers might turn to it, rather than to the lender, to forgive payments — particularly if the lender runs into financial difficulty. (*American Banker*, Erick Berququist, 09/13/05)

- Paul Muolo reports in the *National Mortgage News*, “We understand that former Fannie Mae CEO Franklin Raines is looking to buy land down in the West Palm Beach area of Florida—to build a 12,000 square foot home.” (*National Mortgage News*, Paul Muolo, 09/19/05)

Freddie Mac

Freddie Mac CEO Syron warns Congress:
“[Don’t] make any hasty or ill-considered changes to the housing GSEs”

- In a September 13th speech at Lehman Brothers Financial Services Conference, Freddie Mac CEO Richard Syron issued a warning to Congress: “This is not a time in which you want to go fooling around [with the nature of housing finance system and the GSEs] without thinking it through.” Concerns about effects of Hurricane Katrina, rising gas prices, and possible housing bubbles “make it very, very important that there not be any hasty action,” Syron added. “...Freddie Mac strongly supports the need for strengthened regulatory oversight. ...That said, any regulatory reform must take into consideration the risks it poses for the housing sector – given that housing has become an essential pillar of the economy and an engine of economic growth. ...So while Freddie Mac continues to be a strong supporter of regulatory reform and strengthened oversight, our ability to help keep the housing market robust should not be put at risk.”
- Addressing investor issues, Syron said the company will be able to return more money to shareholders as he expects OFHEO will lift a capital surplus mandate. The elimination of the 30% capital surplus requirement is a key assumption in Freddie Mac’s forecasting of a “mid-teens” percentage rate of growth in the company’s fair value, said Syron. He noted that while Freddie’s share of that market increased to 30% to 45% against Fannie, the company was grabbing a larger piece of a “less robust pie.” He added, “We’re extremely focused on market share between the GSEs.”
- While it is too early to determine the exact extent of Freddie’s exposure to destruction wrought by Hurricane Katrina, he said the mortgages that the company guarantees in the affected areas account for a little less than \$10 billion, or less than 1% of its \$1.2 trillion total portfolio. Our current risk position is very sound,” said Syron, referring to both the company’s credit and interest-rate risk. He pointed out that the vast majority of the company’s mortgage portfolio is comprised of fixed rate mortgages (59% of the portfolio), followed by 15-year fixed rate mortgages (27%), adjustable

rate mortgages (9%), balloon loans (2%), interest only mortgages (1%) and option ARMs (1%). (*Freddie Mac Press Release*, Prepared Remarks of Dick Syron, 09/13/05; *Market News International*, Claudia Hirsch, 09/13/05; *Dow Jones Capital Markets*, Allison Bisbey Colter, 09/13/05; *Reuters News*, 09/13/05; *Washington Post*, 09/14/05; *American Banker*, Jody Shenn, 09/14/05)

Reprise: Freddie Mac COO McQuade urges “less haste” in GSE reform

- Freddie Mac President and COO Eugene McQuade reiterated his company’s view that legislative reform of the housing GSEs being debated by Congress shouldn’t be undertaken with haste, given the vulnerability of the U.S. housing market in the wake of Hurricane Katrina. Speaking at a Bank of America Investor Conference, McQuade said concerns about a housing market bubble is one more reason why Congress should proceed with caution in crafting GSE regulatory reform.
- McQuade also said that Freddie Mac intends to “stay competitive” by reaching beyond its “traditional strength in 30-year, fixed-rate product.” He added, “We are shifting our strategy [on adjustable rate mortgages]. We can’t sit back and hope that the mix of mortgage products will cycle back to our traditional strengths.” McQuade also downplayed concerns about interest-only loans and other exotic mortgages, saying, “On the I/Os and the neg-ams, on the stuff that we have seen come through us, the credit quality is actually higher than on the 15- and 30-year fixed.” Several lenders were surprised by McQuade’s comments.
- Thomas Atteberry, a vice president for First Pacific Advisers Inc. in Los Angeles, said, “I’m surprised by that comment that it’s higher quality. Maybe it is for what he sees in his book, because he only sees conforming I/O stuff.” Herbert Sandler, co-chief executive of Golden West Financial Corp., which specializes ARMs, said he fears lenders chasing market share are too willing to skimp on paperwork, or accept “generous” appraisals on home values. “I’m scared to death” about some of the riskier loans, said Sandler. “There’s been too rapid (price) appreciation in many areas of the country, which typically results in problems.” Fitch Ratings has concluded that new mortgage products in the U.S. housing market may hold greater risk for borrowers and for financial institutions which retain these new products in their portfolios. Marc Yaklofsky, a director in Fitch’s financial institutions group, said, “With higher-yielding assets gradually being replaced by lower [yielding] ones, financial institutions have struggled to maximize net interest margin in the current low-rate environment. As a result, banks and consumer finance companies have retained a greater proportion of mortgage loans, especially alternative mortgages, on their balance sheets, particularly as commercial and industrial lending has been challenged.” Fitch said it is looking to capital levels and earnings diversification as “possible mitigating ratings factors” to offset the increased credit risk from retained alternative mortgages. (*Bloomberg News*, Al Yoon, 09/20/05; *Reuters*, Jonathan Stempel, 09/19/05; *Dow Jones Newswires*, Danielle Reed and Dawn Kopecki, 09/20/05; *National Mortgage News Online*, 09/23/05)

Freddie Mac's retained portfolio grows at an annual rate of 32.2% in August

- Freddie Mac went on a buying spree in August, adding nearly \$17 billion of mortgage-backed securities for an annualized growth rate of 32.2% -- the highest growth rate since 2003. At month end, the company's retained portfolio totaled \$677.76 billion versus \$660.04 billion at the end of July. Liquidations of mortgage bonds in Freddie's portfolio increased to \$17.55 billion in August, up from \$17.18 billion in July and \$16.1 billion in June, as homeowners continued to refinance their mortgages. Freddie Mac made up for the MBS runoff with additional purchases, adding \$40.43 billion of securities while selling just \$5.15 billion. A large part of Freddie's purchases were non-agency, or private-label securities, which grew to \$227.95 billion at the end of August from \$217.05 billion at the end of July. Freddie also added to its holdings of its own MBS for the first time in six months, bringing the total to \$338.5 billion from \$329.93 billion, while its holdings of whole mortgage loans also rose slightly to \$61.65 billion from \$61.08 billion. Freddie's holdings of securities issued by Fannie Mae and Ginnie Mae continued to decline during the month, falling to \$49.66 billion from \$52.98 billion. While Freddie's purchase commitments nearly tripled to \$34.17 billion in August, spokesman Michael Cosgrove said the majority of these forward commitments actually settled during the month of August, which means the company's Freddie's mortgage holdings won't necessarily grow as fast in September as they did last month. Cosgrove noted that growth in Freddie's mortgage holdings for the year to date is running at roughly the same pace it was in May. For the first eight months of 2005, the retained portfolio rose at an annualized rate of 5.7%, which is in line with the growth the company has said it is targeting for 2005 as a whole. Freddie also said its duration gap remained at zero months in August. (*Dow Jones Newswires*, Allison Bisbey Colter, 09/23/05; *Reuters*, Julie Haviv, 09/23/05)
- Over the past year, Freddie Mac has hired about 200 permanent employees as it has cut about 1,700 consultants brought on to help the company with its financial restatement. Today, the company has 5,200 full-time or part-time employees and about 1,200 consultants, according to Freddie Mac president and COO Eugene McQuade. The company has also extended its contract with BlackRock, Inc. for five years to provide derivative systems for the GSE. (*American Banker*, Jody Shenn, 09/20/05)

Freddie Mac announces plans to make data available
for individual loans in MBS

- Freddie Mac will make data on individual loans available for its mortgage-backed securities, which will be posted on the company's website beginning in the fourth quarter of 2005. While data has previously been available for the pools of loans that back the securities, this is the first time Freddie Mac is making the data available on the individual mortgages. The loan disclosures will include credit scores, loan ages,

original loan amounts, maturity dates, original loan-to-value ratios, the state the property is in and property types. The information will be available for Freddie Mac's newly issued fixed-rate and adjustable-rate single-family PC securities. Data will continue to be available at the pool level for new and previously issued PC securities, said Freddie Mac.

- Mark Hanson, Freddie Mac's vice president of mortgage funding, said that there are two big benefits for the new disclosures. The first benefit is transparency for investors. "We think it takes a significant step forward for transparency, and that should help the liquidity of our securities," he said. Also, the new disclosures will allow Freddie Mac to bid for more loans and to commingle slightly different types of loans into the same pool when and if investors want that. If two hybrid ARM loans had slightly different interest rate caps, he said, "in the past we've always had to separate those products," into different pools. With loan-level disclosures, Freddie Mac can now package the two types of loans together "if markets are interested," Hanson added. By disclosing data on individual mortgages, Freddie Mac will be able "to keep pace with product development and be able to bid more loans on a daily basis," he said. (*Dow Jones Capital Markets*, Danielle Reed, 09/15/05)

CUNA and Freddie Mac update and "improve" their alliance agreement
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- Under a newly restructured alliance agreement with the Credit Union National Association (CUNA), Freddie Mac is providing additional services to credit unions to improve their access to the secondary mortgage market and furnish the latest mortgage technology. The GSE will provide a special account management team for credit unions and secondary-market execution for single-loan transactions. Other advantages include implementation and transaction fee discounts for Web-based Mortgagebot with the Loan Prospector business-to-consumer website and a private label servicing option through CUNA Mutual Mortgage Corp. Wes Miller, CUNA senior vice president, said, "Through Freddie Mac, credit unions will have affordable lending solutions to meet the needs of low- and moderate-income borrowers." (*Freddie Mac Press Release*, 09/21/05).

Freddie Mac once again named on <i>Working Mothers Magazine's</i> "100 Best Companies for Working Mothers"

- *Working Mothers Magazine* has named Freddie Mac in its list of top "100 Best Companies for Working Mothers," because of the company's innovative programs and policies that help its employees' families achieve work/life balance. Freddie's family-friendly programs include the company's free, on-site health center, providing preventative care and other medical treatments; an online concierge that offers assistance with travel, dining, entertainment, maid service and grocery delivery; seminars on stress reduction, parenting, elder care and balancing work and family; health coverage for domestic partners; and flextime and telecommuting options. (*Freddie Mac Press Release*, 09/23/05)

Federal Home Loan Banks

Federal Housing Finance Board approves FY2006 budget

- On September 14, the Federal Housing Finance Board adopted a FY2006 budget of \$35.9 million, \$576,000 less than the agency's budget for FY2005. "We are driven to be the very best regulator we can be to assure the safety and soundness of the Federal Home Loan Bank System and to do it in the most economical way possible," said Chairman Ronald Rosenfeld. The FY2006 budget includes a 19% increase in funding and a 17% percent increase in staffing for the Office of Supervision. Approximately 83% of the agency's budget is allocated to its supervision program. "We execute our primary responsibility through the Office of Supervision and, thus, that office will continue to get the resources it needs to fulfill its duties," said Rosenfeld. (*Federal Housing Finance Board Press Release, 09/15/05*)

FHLB-Des Moines delays the declaration of its dividend

- On September 14, 2005, the FHLB-Des Moines' board of directors authorized the Bank to submit a request to the Finance Board's Office of Supervision for the Bank to be approved to pay a cash dividend of 1.40% per annum for the three month period that ended August 31, 2005. The Bank is unable to predict when and if it will receive approval from the Finance Board to declare the dividend. Moreover, the Bank cannot predict the amount or timing of any future dividend, until it obtains effective registration statement status with the SEC pursuant to the Finance Board's regulations. (*PrimeZone Media Network, 09/16/05*)

FHLBs coming back?

- In a September 19th editorial, *National Mortgage News* wrote, "It hasn't been a great year for the Federal Home Loan Bank System. But we feel this multi-hundred-billion-dollar asset GSE soon will snap back from these temporary doldrums. Most recently, 10 of the 12 [FHLBs] missed a Securities and Exchange Commission deadline to register their stock, because of accounting concerns. Before that were some hits to earnings and an inside stock inquiry at the Seattle district bank. And, the system's mortgage purchase programs have seen declines in volumes. The first thing to realize is that, compared to their cousins, Freddie Mac and Fannie Mae, the troubles at the FHLBs, while real, aren't as great as the others have faced."

- “...We still feel the district banks could mount decent secondary market efforts, especially if capital concerns arising from having those mortgages in their portfolios are successfully addressed. And right now, the system could play a vital role in taking the lead on rebuilding the Gulf Coast, both through local members and a nationwide effort. This could be done both through the system’s normal efforts and its admirable Affordable Housing Program, where 10% of system profit each year is dedicated to funding exactly the kind of housing that will be most needed in restoring housing for those left vulnerable by Hurricane Katrina. Adding it all up, next year should be a much better one than this for this long-time provider of local mortgage money and nationwide mortgage investment.” (*National Mortgage News*, 09/19/05)

In four months, FHLB-Des Moines commits to \$78 million in Rural Capital Advances for economic development of rural markets

- In four short months, FHLB-Des Moines’ members have reserved more than \$78 million in Rural Capital Advances for financing housing and economic development projects in rural areas. In April, the Des Moines Bank committed to set aside \$100 million a year for five years to support and stimulate economic growth in rural America. Of the first \$100 million, \$10 million is reserved for each of the five states in the Bank’s District to ensure that each state receives a portion of the pool. After a state uses its \$10 million, the other \$50 million pool is available to members on a first come, first serve basis. “The Bank’s goal was to disburse the first \$100 million by the end of this year,” noted FHLB-Des Moines’ COO Amy Angle. “We are well on our way to reaching this goal and excited that three states in our District -- Iowa, Minnesota and Missouri -- have used much more than their initial reserve pool of \$10 million. We encourage our members in North Dakota and South Dakota to do the same.” (*PrimeZone Media Network*, 09/20/05)

FHLB-Seattle announces senior management appointments

- The FHLB-San Francisco has named J. Todd Roof Senior Vice President and Director of Internal Audit and Susan F. Comstock, Vice President, Portfolio and Derivative Operations. Roof, who directs the Bank’s internal audit function, was previously the Global General Auditor for Barclays Global Investors. He has over 17 years of public accounting experience, primarily in New York serving large multinational banks and investment managers.
- Comstock manages the FHLB-San Francisco’s business area responsible for portfolio and derivative operations and accounting. Prior to joining the Bank, Comstock was an accounting specialist with OTS. Prior to joining OTS, Comstock had over 20 years of financial accounting and auditing experience in the financial services industry, including 10 years in public accounting. (*FHLB-San Francisco Press Release*, 09/16/05)

Farm Credit System / Farmer Mac

FCA appoints Robert Coleman as Director of the Office of Secondary Market Oversight

- The Farm Credit Administration (FCA) has appointed S. Robert Coleman as Director of the Office of Secondary Market Oversight (OSMO), responsible for the examination, supervision and regulation of Farmer Mac. In 1986, Coleman joined FCA following his graduation from Virginia Polytechnic Institution and State University in Blacksburg, Virginia, with a bachelor's degree in Agricultural Economics. He has held several positions with the FCA, beginning with the Office of Examination as a FCA Examiner. Since 2003, Coleman has served as the Director of the Regulation and Policy Division, responsible for managing and coordinating the development of the FCA policy and regulations and oversaw Farm Credit System bank debt issuance. (*FCA Press Release, 09/13/05*)

Postal Service

Postal reform: doubtful
Postal rate increase: definitely

- The U.S. Postal Service's Board of Governors muddled the outlook for post office reform legislation by expressing their concern about provisions in H.R. 22 and S. 662. "Regrettably, despite the intentions of all parties, it is our considered opinion that the bills provide neither the requisite flexibility nor the authority to accomplish our mission," the Board said in a letter to members of Congress. The Board agreed that federal regulators should have enhanced and final authority over setting mail rates, but objected to provisions that the Board said would permit regulators to hold sway over the agency's business operations. The Board also raised questions about whether rate-setting would be fair and manageable under the bills. The Board expressed support for financial relief proposals that would divert several billion dollars from a special escrow account for retiree health care to cover operational costs and would transfer responsibility for paying military pension costs of postal employees to the Treasury Department. All member of the Board of Governors signed the letter, including James C. Miller III, chairman of the Board of Governors, John E. Potter, the postmaster general, and Patrick R. Donahoe, deputy postmaster general.
- Tom Day, senior vice president for government relations at the USPS, said the board was not undercutting the reform effort, but was trying to make clear where key

changes need to be made in the bills. “We would still like to see legislative reform. It is a question of what form it takes,” said Day. He said that the agency has developed plans to manage effectively, even within what many consider an obsolete business model, for the next two years. If changes in the bills cannot be made, he said, “We would rather stay with current law.” Jen Burita, a spokeswoman for Senator Collins (R-ME), said, “The Postal Service has assured us that the letter is not an attempt to stop movement of the bill. Rather, it is meant as an attempt to maintain a constructive dialogue going towards conference.” (*DMNews.com*, Melissa Campanelli, 09/15/05; *Washington Post*, Stephen Barr, 09/15/05)

- In the September 19th newsletter of the National Association of Postal Supervisors, Government Relations Director Bob Levi suggests, “Despite the best efforts of Chairman Collins (R-ME) to resolve the still outstanding “Hallmark matter,” the combination of the USPS letter carriers opposing her postal bill and the busy Senate schedule, it appears unlikely that the Senate will take up S. 662 in September.” (*e-NAPUS Legislative Newsletter*, Bob Levi, 09/16/05)
- The Alliance of Nonprofit Mailers writes, “It will be some time before the domestic policy agenda in Washington, DC, returns to a “pre-Katrina” type of agenda. We often observe that public policy officials work on a triage system, where the most important and pressing issues take precedence, and clearly Capitol Hill must continue to focus on important issues surrounding the relief efforts and the homeland security questions that have emerged in the fallout from Hurricane Katrina. However, work continues on efforts to address postal reform legislation.” (*Alliance for Nonprofit Mailers*, 09/16/05)
- In his September 12th commentary, *DM News* editor in chief Tad Clarke said, “Let me predict that postal reform won’t happen again this year. ...One thing is certain: Postage rates will rise as expected next year — sooner rather than later — because of the damage and loss of revenue caused by Katrina. Destroyed postal facilities [totaling over \$100 million], which in all likelihood will have to be paid for by the USPS, not the federal government, will need to be rebuilt. After all, it is an independent agency that the president and Congress want to be self-sufficient. With threats of increases coming on an annual basis, the steady rates of the past few years will become just a pleasant memory.” (*DMNews.com*, Tad Clark, 09/12/05; *DMNews.com*, Melissa Campanelli, 09/12/05)
- According to a September 15th filing in the Federal Register, the USPS also seeks to raise international postal rates by 5.9%, concurrent with the implementation of new domestic rates and fees in 2006. While no date has been set for the increase in postal rates, observers say it is likely to occur on Martin Luther King Day. (*DMNews.com*, Melissa Campanelli, 09/16/05)

USPS financial results of August

- In August, the USPS reported year-to-date total revenue of \$1.4 billion or 2.2% over plan based on YTD total mail volume of 5.5 billion pieces, or 2.9% over plan. The most significant mail volume increase occurred in the lower revenue-per-piece Standard Mail category, which increased 5.1 billion pieces or 5.9%. Year-to-date personnel costs are \$54 million or 0.1% over plan, while non-personnel costs are \$135 million, or 1% below plan.
- For the month of August, the Postal Service reported a net loss of \$17.7 million on total revenues of \$5.86 billion. Total revenues were up 5.8%, while total expenses increased 6.8% compared to the same period last year. (*PostalNews.com*, 09/23/05; *Association for Postal Commerce*, 09/22/05)

USPS has bigger problems than email

- Dr. Charles Guy, adjunct fellow of the Lexington Institute, argues in an editorial, “Both Congressional plans to reform the U.S. Postal Service prescribe the wrong medicine for the ailing USPS. That’s because lawmakers have misdiagnosed the problem, attributing the Postal Service’s financial woes to a fall-off in the volume of mail. This fall-off of hard copy mail is widely presumed to be the long expected consequence of the ongoing electronic revolution. You can hardly blame the lawmakers, though, since nearly every recent analysis of the Postal Service has cited a drop in mail volume as a major factor in the organization’s decline.” Guy continues, “Current Congressional reform measures focus on granting USPS leadership the greater pricing ‘flexibility’ they seek – in other words, the freedom to raise rates with less regulatory oversight. This is supposed to make up for earnings lost due to a presumed further fall-off in First-Class Mail. Effective reform must recognize that the Postal Service’s current problems run much deeper than a short-term decline in First Class mail volume. USPS needs to focus on cutting costs and boosting productivity, not raising prices.” (*Lexington Institute*, Dr. Charles Guy, 09/19/05)

Japan’s “action man”—Prime Minister Koizumi—crushes his rivals and sets his country on the road to reform

- Japan Prime Minister Koizumi scored a stunning electoral victory on September 11, which resulted in his party, the Liberal Democratic Party (LDP), winning 296 of the 480 seats in the house of representatives. Many observers were startled by the results, including Thomas Berger, a scholar at Boston University, who said, “I can only marvel at the breadth and depth of Koizumi’s victory.” (*The Australian*, Richard Halloran, 09/18/05)

- In the September 19th issue of *Business Week*, R. Glenn Hubbard wrote, “Koizumi has made substantial progress in banking reform. Japan’s bank regulator is no longer a captive of its regulated clients. Nonperforming loans have been reduced. And wasteful public-works spending has been trimmed. Those developments have helped taxpayers and borrowers alike. But Koizumi faces a far bigger challenge in his bid to break up and introduce competition for the postal system, Japan Post, whose \$3.3 trillion worth of deposits and life insurance policies lie at the heart of Japan’s financial restructuring and growth ills. By offering subsidized rates to depositors and policyholders, Japan Post puts private commercial banks and insurers--both Japanese and foreign--at a competitive disadvantage. That the funds are used in part to finance subsidized loans and public-works projects further distorts the nation’s allocation of capital. A breakup of Japan Post would both stimulate competition in the financial sector and limit the flow of public funds to wasteful public projects. In short, picking this fight was a smart economic policy move. And what a fight it is.” (*Business Week*, R. Glenn Hubbard, 09/19/05)
- On September 13th, Koizumi formally agreed to postpone the postal services privatization until October 2007, as the government decided to proceed with most of the undertaking as scheduled, said Postal Services Minister Heizo Takenaka. An aide to the prime minister said the Koizumi Cabinet will submit the legislation to the Diet in late September, which is expected to be passed by an extraordinary Diet session by the end of October. The new legislation is essentially the same as that which was defeated in the previous Diet session, except it does not give a consumption tax reduction for privatized postal corporations as demanded by some LDP lawmakers, according to government officials. The legislation provides that Japan Post would be privatized into a holding company; a postal saving company; a postal insurer; a post office company; and a mail delivery company in October 2007. By 2017, the postal savings and postal insurance firms would be fully privatized, and afterwards, the holding company can buy back the two companies’ stock shares, officials said. (*Bureau of National Affairs*, Toshio Aritake, 09/14/05)

TVA

Federal judge dismisses global warming suit against TVA and other utilities

- A lawsuit filed by eight states aimed at capping carbon dioxide emissions from TVA, American Electric Power Co., Southern Co., Xcel Energy Inc., and Cinergy Corp. was dismissed by U.S. District Court Judge Loretta Preska in Manhattan. The states, including New York, California, Connecticut, Iowa, New Jersey, Rhode Island, Vermont and Wisconsin, sued the utilities which own 174 fossil fuel-burning power plants, claiming as the five largest carbon dioxide emitters in the nation the utilities contribute to the problem of global warming. However, Judge Preska said that in asking the court to set CO2 reductions, the states want the judiciary to craft wide-ranging environmental policies that would affect the economy, national security and foreign policy. Such decisions should properly be considered by the president and Congress, she argued. “Cases presenting political questions are consigned to the political branches that are accountable to the people, not to the judiciary,” wrote Preska. The attorneys general promised to appeal the ruling.
- “We are disappointed that the court has taken an unduly narrow view of its power and obligation to decide cases that come before it,” said New York Attorney General Eliot Spitzer spokesman Marc Violette. “Because the science is clear that global warming poses a real and inevitable environmental threat with grave human consequences, we will appeal this decision and continue to work on other fronts to demand action on this critical problem.” (*Associated Press*, Michael Hill, 09/15/05)
- “Judge Loreta A. Preska deserves a medal for clearly explaining why legal restrictions on CO2 emissions are ‘transcendently legislative’ and thus could not be imposed by a court without violating separation of powers and the judicial doctrine that prohibits courts from reviewing ‘non-justiciable political questions,’” said Competitive Enterprise Institute (CEI) Senior Fellow Marlo Lewis, Jr. The global warming lawsuit would have required Preska to develop an elaborate set of legislative responses, including determination of proper levels of greenhouse gas emissions, necessary reduction levels for each company and appropriate impacts on U.S. national security and international treaty negotiations, among others. “The CO2 litigation game has always been about bypassing the political branches,” Lewis added. “By refusing to legislate from the bench, Judge Preska has squashed the latest attempt by the state attorneys general to substitute their will for that of the people’s elected representatives.” (www.cei.org, Competitive Enterprise Institute, Richard Morrison, 09/15/05)

North Carolina moving forward with lawsuit against TVA for clean air violations

- North Carolina's Council of State has authorized more than \$80,000 in legal fees for hiring outside attorneys to sue the TVA for polluting the State's air with its coal-fired power plants. "If we don't get out [sic] counties into air quality attainment, then economic development is thwarted," said Attorney General Roy Cooper. "Our tourism economy, in western North Carolina particularly, is critically important, and it depends a lot on clean air." Labor Commissioner Cherie Berry objected to the litigation, saying she believes the state will lose its legal battle. (*News 14 Carolina*, 09/13/05)

TVA site makes the cut as possible site for new nuclear power plant

- TVA's unfinished Bellefonte twin reactors near Scottsboro, AL is one of two potential locations under consideration for a nuclear power plant which may be built by Nustart Energy Development, a consortium of eight utilities and two reactor manufacturers. It could be the first such plant built in the United States since 1973. The utility consortium narrowed the potential locations to TVA's site and to a site adjacent to the existing Grand Gulf nuclear power plant, operated by Entergy near Port Gibson, MI. While the group had not decided whether to build a new reactor, it is developing an application for advanced approval for these two sites, which would allow for quicker completion of the project if a go-ahead is given. "Our country needs these advanced plants. We must reduce our dependence on imported energy," said Marilyn Kray, president of Nustart and an executive of Exelon, the country's largest operator of nuclear power plants. (*Associated Press*, H. Josef Hebert, 09/22/05; *Reuters*, 09/22/05)

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