

# The **GSE** REPORT™

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## ***Major Events***

House Financial Services Committee reviews findings of Rudman Report
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- In testimony before the House Financial Services Committee, former Senator Warren Rudman said his 16-month investigation into Fannie Mae identified flaws in its accounting and management, but left the assignment of blame for wrongdoing to others. While he and his investigators were critical of Fannie Mae where appropriate, he felt it was “decidedly inappropriate” to blame anyone. “Someone in this government, at the Department of Justice, is going to have to decide” if criminal charges should be brought in this matter, said Rudman. He provided the panel a recap of the numerous accounting errors found in his investigation of Fannie Mae, caused in large part by the company’s desire to provide smooth earnings from quarter-to-quarter and meet Wall Street’s earnings forecasts. “Meeting earnings-per-share targets was an obsession of this company,” said Rudman. “There’s no question in my mind there was manipulation” to meet EPS targets which, in one case, generated \$27 million of bonuses for Fannie Mae’s management.
- “The accounting, financial reporting and internal audit operations of the second largest financial services company in the country [were] inadequate, both qualitatively and quantitatively,” Rudman told the panel. “The resources dedicated to these functions were insufficient. Senior managers in critical accounting, financial reporting, internal audit roles were unqualified for their positions.” While acknowledging that accounting for derivatives under FAS 133 is complex, Rudman said that Fannie’s accounting approach “was just plain wrong.” Attributing the accounting mess to “a competence flaw and a system flaw,” Rudman added that Fannie Mae’s managers were an arrogant “bunch” who thought that they (and the company) could do no wrong. Operationally, Fannie Mae was divided into “silos” run by junior executives with little interaction or “checks and balances,” who were dominated by CFO Howard, who held inordinate power over the company’s accounting, treasury operations and other duties, said Rudman. While he found no evidence that Fannie CEO Franklin Raines knew that the company’s accounting was “significantly” at odds with accounting rules, Rudman said that Raines “set the tone” at the GSE and emphasized the importance of meeting earnings targets. Rudman concluded that the board of directors was kept in the dark, noting that his report detailed “example after example of the board not being given information it should have been given” by management and “in some cases, they were misled.”
- When questioned about the size and composition of Fannie Mae’s portfolio holdings, Rudman said, “I know this committee and your counterpart in the Senate as well as the administration are concerned about ...the Fannie Mae portfolio. This issue, which of course relates to safety and soundness matters was beyond the scope of our inquiry... We have drawn no conclusions on that issue.”

- At the hearing Representatives Richard H. Baker (R-LA) and Barney Frank (D-MA) called on Fannie Mae’s board to demand repayment of executive bonuses to the extent that bonuses were inflated by improper accounting, specifically the \$27 million of bonuses the company paid in 1998. According to SEC filings, the major recipients of the 1998 bonus pool included James Johnson, Franklin Raines, Lawrence Small, Jamie Gorlick, Timothy Howard, and Robert Levin; with the exception of Levin [who was promoted in 2005 to Fannie’s chief business officer], all of the bonus recipients no longer work for Fannie Mae. (*Wall Street Journal*, James Hagerty, 03/15/06; *Dow Jones Newswires*, Judith Burns, 03/15/06; *Bloomberg News*, James Tyson, 03/14/06; *Bureau of National Affairs*, Richard Cowden, 03/15/06)
- Emil Henry, Assistant Treasury Secretary for Financial Institutions testified that the key issue is not the GSEs’ governance and accounting, but the systemic risk posed by their huge mortgage portfolios. Henry noted that the “elephant in the corner,” the size of Fannie’s and Freddie’s portfolios, is not getting the attention it deserves on Capitol Hill. He added that he didn’t want members of Congress to consider Rudman’s testimony on his report [which did not address the portfolio issue] as the “takeaway” and think that they were getting the entire picture. In fact, in Rudman’s report, there is “an acute and noticeable absence of the discussion of the link between activities which drove earnings and the company’s core mission,” said Henry, an absence which he viewed as “somewhat troubling.” While some of Fannie’s problems are “in the process of repair, I think it is clear that the elephant in the corner and the legacy of the era is the extensive retained portfolio ...which presents systemic risk,” he added. (*Market News International*, Denny Guilino, 03/14/06)
- In *National Mortgage News Online*, Paul Muolo wrote, “On [March 14] the House Financial Services Committee held its hearing on the long awaited ‘Rudman Report.’ Sen. Warren Rudman (retired) told the committee that Fannie Mae officials ‘manipulated’ accounting rules so they could meet earnings goals (and maximize bonuses) in 1998. Most of the 20 or so elected officials attending the hearing seemed outraged by the behavior of (now former) Fannie executives -- except one, Rep. Maxine Waters of California, who has long carried a torch for the GSE. Ms. Waters - - who I would wager hasn’t read the 600 page report (the main ‘paper’ version) -- said she ‘can’t believe’ the company didn’t ‘want to get it right.’ At the very least Ms. Waters should have one of her aides read it...” (*National Mortgage News Online*, Paul Muolo, March 18-19, 2006)

<p>Freddie Mac CFO Martin Baumann resigns, after receiving \$2 million “retention bonus” in December</p>
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- On March 22, Freddie Mac announced the resignation of Martin Baumann, executive vice president and chief financial officer, just three months after offering him a \$2 million retention bonus. The company’s president and COO Eugene McQuade will assume the CFO duties effective immediately, while Freddie Mac conducts a search for Baumann’s replacement. In an interview, Baumann, 58, said that while his last

day at Freddie Mac will be May 31, he will serve as a consultant to the company through the end of 2008. Baumann said he was resigning at this time because he felt he has accomplished the things he set out to achieve when he joined the company in 2003, quipping that his three years with Freddie “felt like about six.” As he worked on the company’s restatement, Baumann said he discovered that Freddie Mac’s accounting systems were in far worse shape than he had anticipated. “[T]he number of errors surprised me and the state of the infrastructure surprised me,” said Baumann. [He attributed the inadequacy of Freddie Mac’s internal controls, in part, to the GSE’s exemption from filing with the SEC.]

- Freddie Mac has entered into a separation agreement with Baumann providing him \$1.5 million in cash and \$1 million of restricted stock. Specifically, the agreement provides for Baumann’s continued service until May 31, 2006 at his current salary and a bonus of \$750,000 for his service in 2005; his availability to provide consulting services with the company on an as-needed basis until the end of 2008; a severance payment of \$540,000 payable over one year in semi-monthly installments beginning six months after May 31, 2006; and a \$2 million retention bonus [if he remained at the company through 2007], consisting of a cash payment of \$1 million and vesting of restricted stock units with a value of \$1 million on Dec. 31, 2007. A Freddie Mac spokesman said that Baumann “still gets [the retention bonus]” since he will be still working with Freddie as a consultant through 2007. The agreement provides for “forfeiture of all unvested stock options and restricted stock units as of May 31, 2006, other than restricted stock units awarded in 2003, 2004 and 2005, which will continue to vest until Dec. 31, 2008,” and the “forfeiture of any remaining payments and the prompt return to the company of certain compensation provided under the separation agreement in the event that Mr. Baumann materially breaches specified provisions of its terms.” This separation agreement is subject to the approval of the company’s Compensation and Human Resources Committee and OFHEO.
- Bauman’s resignation follows Freddie Mac’s recent delay in its financial reporting, when the company announced it would not meet its self-imposed March 31 deadline for releasing full-year 2005 results or return to timely reporting of its capital position to OFEHO on a basis complaint with GAAP by April. Freddie Mac said that the major issues it is now confronting in its restatement process relates to upgrading systems for accounting and reporting. In a recent interview, Baumann concurred, saying that the company’s challenges going forward include building a top-notch accounting infrastructure which doesn’t fall in his “skill set.” He added, “The real skill set the company needs to get through the final push here is ...stronger system skills.” Such work, Bauman acknowledged, is not his specialty, nor very interesting to him. It was his decision to resign, Bauman said, adding he had “a very amicable agreement” with Freddie Mac’s CEO and chairman Richard Syron and COO McQuade, who agreed that it is time for Baumann to move on. Freddie Mac’s spokesman David R. Palombi said the company “consistently [has] said we need to get the job done right and done as quickly as possible... The change announced today is the best way to meet those objectives.” Freddie Mac said that Baumann’s

resignation isn't expected to affect the company's plans to release its financial results for 2005 in May.

- “The credibility of Syron and McQuade will be tested in the next two months,” said Prudential Equity analyst Matthew Park. Should McQuade “deliver by May, I think the whole story will go into a tailspin,” said Park. Moshe Orenbuch, a Credit Suisse analyst, said Baumann’s resignation “further increases the chances that Freddie’s ability to return capital to shareholders in 2006 will be put on hold.” OFHEO’s capital surcharge may not be lifted until year-end and a delay in the company’s preferred stock sale is also likely, Orenbuch added. (*Wall Street Journal*, James R. Hagerty, 03/23/06; *Washington Post*, Annys Shin, 03/23/06; *Bloomberg News*, Al Yoon, 03/22/06; *American Banker*, Jody Shenn, 03/23/06; *Dow Jones International News*, John Connor, 03/22/06; *American Banker*, Jody Shenn, 03/23/06)

## ***Fannie Mae and Freddie Mac***

GSE regulatory reform watch
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- At a March 13 conference sponsored by the Institute of International Bankers, House Financial Services Committee chairman Michael Oxley (R-OH) said a compromise can be worked out to limit the size of the GSEs’ portfolios. “We are ready to sit down and negotiate this important issue,” said Oxley. Although the Senate has yet to take up S. 190, Oxley said that once this bill passes, a compromise can be worked out to secure passage of GSE reform legislation. “Yes I think we can compromise [on] that [portfolio limits]. I think we can work that language out, whatever the Senate passes. But we can’t get to that point until Senator Shelby brings the bill upon the floor and passes it in the Senate and we get to conference.” (*Bureau of National Affairs*, R. Christian Bruce, 03/14/06)
- Representative Barney Frank (D-MA), ranking member on the House Financial Services Committee, said that the House will not accede to the Senate’s provision to require cuts in the GSEs’ portfolios by allowing a profit-funded affordable housing measure to stay in the GSE regulatory reform bill. Frank said, “I think frankly the reason that [the portfolio provision] has been held to be controversial in part is because some people in the Senate might think that they can get us to give up on portfolio if they give us the 5%. That deal is not going to work because we think we’re going to get the 5% anyway.” (*Reuters*, Kristin Roberts, 03/15/06)
- Although Treasury Secretary Snow raised hopes among observers that a compromise could be reached on GSE regulatory reform legislation, Senate Banking Committee chairman Richard Shelby (R-AL) extinguished any hope that a compromise on GSE

legislation would occur in the near-term. In a March 14 speech to America's Community Bankers (ACB), Snow told the audience that the Bush administration insisted in a fixed limit on the GSEs' portfolios was a "misunderstanding" of their position. Snow said, "Congress, in our view, should make the determination that the GSEs are subject to the strong and competent regulator--strong, competent regulator--with a directive from the Congress to look at the portfolios and not allow the entities to have portfolios vastly larger, greatly bigger, than is required to carry on their statutory mission." In a speech at ABC the following day, Shelby offered no hint of a breakthrough in the legislation. Instead, he indicated that his committee was awaiting further reports on Fannie Mae's accounting and management from OFHEO and the SEC before moving toward a Senate vote. (*Bureau of National Affairs*, Richard Cowden, 03/16/06; *Bureau of National Affairs*, R. Christian Bruce, 03/15/06)

- In a joint statement, Senators Chuck Hagel (R-NE) and John Sununu (R-NH) said that their proposed amendment to a lobbying reform bill, requiring a review of the GSEs' lobbying activities, is "a common sense amendment that will ensure that Fannie and Freddie are operating within their housing mission." The amendment directs the GAO to study the lobbying activities of the two companies to determine if the activities further their statutory housing mission and requires HUD to conduct annual audits of the companies' charitable foundations. Hagel and Sununu cited a published report that Fannie and Freddie spent nearly \$23 million on lobbying in 2005, as Congress considered GSE regulatory reform legislation. "How does this lobbying further their GSE mission?" asked Hagel. Sununu said, "Fannie Mae spent more than \$10 million 2005 lobbying Congress, up from nearly \$9 million in 2004—a substantial amount of money used largely to obstruct legislation that would strengthen their regulation." He added, "Our amendment is an important component to the lobbying reform bill, shedding light on the activities supported by millions spent by the GSEs and examining whether or not their functions bear any relation to furthering their statutory housing mission." (*Dow Jones Newswire*, John Connor, 03/14/06)
- To get a temperature reading on GSE regulatory reform, John Connor with *Dow Jones* asked a number of industry observers about the odds for passage of a GSE bill this year. Jerry Howard, CEO of the National Association of Home Builders, said odds of passage are "considerably less than 50-50," unless the center of gravity tilts toward the House version which has no restrictions on the GSEs' portfolios. Estimates on Wall Street range from 55% likelihood of passage by Lehman Brother political analysts to 37% probability by Kenneth Posner of Morgan Stanley. While Senate Banking Committee chairman Richard Shelby (R-AL) isn't giving odds, he has said flatly that a GSE bill will be enacted in 2006. Given Shelby's attitude that "we've got all year" to pass the bill, some theorize that if GSE regulatory reform legislation is passed this year, "it will be in the 11<sup>th</sup> hour, after all the underbrush has been cleared away and all the deals cut," according to Connor. Former Representative J.C. Watts, now chairman of FM Policy Focus, told *Market News International* that he remains confident that a GSE bill will ultimately pass in Congress. "I agree with what Congress is trying to do and I remain optimistic that we

will get a bill,” said Watts. “I get perplexed from time to time and wonder what’s so hard about getting reforms for these companies that have had to restate earnings over \$15 billion combined.”

- In a March 21 letter to Ben S. Bernanke, chairman of the Federal Reserve, FM Policy Focus chairman J.C. Watts, Jr. asked the Federal Reserve “to add its public voice to the debate over the proper regulation of new GSE ventures under both current law and the pending reform legislation,” specifically regarding the GSEs’ credit derivative positions and Fannie Mae’s acquisition, development and construction program, recently approved by HUD. “Further, we hope that you will make it clear to Congress how critical it is for the [GSE] reform legislation to include a new-product review process akin to that used by the banking agencies,” said Watts.  
(*Correspondence to Federal Reserve chairman Ben S. Bernanke, J.C. Watts, Jr., 03/21/06*)

Representative Richard Baker responds to the <i>WSJ</i> ’s criticisms of H.R. 1461
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- In a March 14 editorial in the *Wall Street Journal*, Representative Richard H. Baker (R-LA) responded to the *Journal*’s February 24 editorial titled “Fannie Mae’s Funny Business.” Baker wrote, “In your Feb. 24 editorial..., you rightly restated the dangers posed by the combination of the size, the implicit government guarantee and the inadequate oversight of the housing [GSEs], as gleaned from the Rudman Report on the accounting and management troubles at Fannie Mae. As someone who has been at pains to alert people to these same dangers for a decade, and who first introduced legislation to reform the GSEs in 2000 -- years before accounting scandals at Fannie and Freddie Mac even came to light -- I have appreciated your persistence and tenacity in helping to keep the issue in the foreground.”
- “Which is why I find it surprising that you would label as ‘laughably weak’ reform legislation (H.R. 1461) that passed the House last year by an overwhelming margin of 331-90. As the bill’s author, I must defend it and remind you of your earlier writings on this subject. My favorite is from June 2003, advocating the need for congressional action in the wake of Freddie’s accounting scandal: ‘Yet in Congress. Louisiana Republican Richard Baker has been a lone voice demanding more disclosure. . . . House Speaker Dennis Hastert should now give Mr. Baker a platform for wider hearings, if not a promotion.’ There is little substantive difference between the bill I introduced that year, which elicited your flattery, and last year’s version, which you dismiss with mockery. In fact, the main substantive difference is that H.R. 1461 actually takes a tougher stance on the risk of the GSEs’ retained portfolios than did my previous bills, which contained no provisions on the subject whatsoever. How ironic that the portfolio issue now appears to constitute the sole basis for your assessment of the bill as weak.”
- “It’s all the more unfortunate in the context of the golden opportunity that now exists for sober-minded legislative resolution on reform, and when few major differences

exist between the House and Senate versions of the bill on such important matters as receivership, oversight of capital levels and product approval. There is also broad consensus that a new GSE regulator should have within its regulatory arsenal the weapons necessary to ensure that the companies' portfolios do not represent a risk to the safety and soundness of the institutions or the financial system. The debate occurs because members of the House believe that the regulator should be given the discretion to decide when to fire those weapons, how and at what target, and the power to act on its determinations instead of having them arbitrarily imposed by Congress."

- "You correctly point out that the Rudman Report 'only looked at the accounting issues posed by derivatives and hedging, so the public still knows precious little about the extent of the portfolio risk.' Evidently the public is not alone. During our hearings on this legislation, I inquired of numerous high-level government officials as to what level the portfolios should be reduced and what method employed so as to avoid unnecessarily roiling the financial markets. I am still waiting for my answer." (*Wall Street Journal*, Representative Richard H. Baker, 03/14/06)

GSE portfolios: A look at then versus now
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- In 1989, then Freddie Mac chairman and CEO Leland Brendsel testified to the House Ways and Means Oversight Subcommittee that his company, since its inception, had adopted a business strategy of avoiding interest rate risk. Brendsel told the panel, "We avoid interest rate risks by financing about 95% of all mortgages we purchase with mortgage-backed securities. As a result, we are insulated largely from the squeeze on earnings experienced by most depository institutions when interest rates rise, as they did in the early 1980s." Committee chairman J.J. Pickle (D-TX) asked Brendsel, "How much risk would it pose if you began a large portfolio lending program?" And he added, what would prevent Freddie from becoming a large portfolio lender?
- To the latter question, Brendsel said, "Me, the board of directors..." Pickle replied, "'Me' is not the law." Brendsel responded, "No, I understand, Mr. Chairman. The mission of the corporation is to increase the availability and the affordability of mortgage money for home buyers and renters throughout the country. In order to do that, we must operate in a safe and sound manner."
- That was then—and this is now with Fannie and Freddie having aggregate portfolios of \$1.5 trillion. Despite the Congressman's concerns, Congress did nothing to during Pickle's stint as the leading GSE watchdog to restrict the growth of the GSEs' portfolios. How the GSEs' "legislative melodrama" will play out in 2006 remains to be seen. (*Dow Jones Newswires*, John Connor, 03/24/06)

### Treasury Department is studying the risks of derivatives

- The U.S. Treasury is studying the various changes in the financial markets, including the “explosion” in the use of derivatives and rapid growth of the GSEs to better understand the risk in the marketplace, said Under Secretary for Domestic Finance Randal Quarles. The Treasury wants “to ensure that the magnitude of risk and exposure are properly measured and that investors and market participants have full and adequate disclosure upon which they can make informed decisions,” said Quarles in a speech to the Institute of International Bankers in Washington.
- Quarles continued, “Looking forward, the Treasury will be focused on seeking to understand in the most comprehensive way possible whether and how changes in the structure of the financial services industry have affected the way markets operate -- put another way, whether the growth of certain types of institutions or instruments have materially affected the efficiency with which markets intermediate risk, whether risk is placed or pooled in different ways or different places than it has been in the past -- and if so, what appropriate policy responses might be.”
- “We will seek to be forward looking and to think about these changes not in a fragmented fashion -- as has too often been the case up to now -- but in a comprehensive way. At the moment it is too soon to say what initiatives will result from this focus -- we do have a fairly significant agenda to execute on in the next few months -- but this is the lens through which we will filter the various ideas and efforts with which we will all be grappling over the next few years.” (*FDCH Political Transcripts*, Randal R. Quarles, 03/13/06; *Dow Jones Newswires*, John Connor, 03/13/06)

### Pollock’s seven laws of the financial markets

- AEI resident fellow Alex J. Pollock shared his observations on risks, instruments and institutions in mortgage finance at JP Morgan’s Conference in Secondary Mortgage Markets in Emerging Economies in Paris on March 17. Pollock told his audience, “What makes financial markets endlessly interesting is their recursiveness. They are full of feedback loops, of past expectations already priced in, and of constant adjustments to changing expectations and new information. Financial markets turn subsidies into increased prices of the subsidized asset, risk support into increased risk taking, and GSEs into what no one ever intended or imagined.”
- “I would like to propose two laws and two corollaries for your after-dinner consideration:
  - Kindleberger’s Law, from Charles Kindleberger, the economic historian: No matter how any government tries to control money, financial markets will create however much near-money they want.

- Pollock’s Corollary to Kindleberger’s Law: No matter what any government or regulator does, in optimistic times financial markets will create however much risk they want.
- Stanton’s Law, after my friend, Tom Stanton, an expert in government credit programs: Risk always migrates to the hands least competent to manage it.
- Pollock’s Corollary to Stanton’s Law: Clever insiders capture the subsidy, while transferring risk to the less competent and less informed.”
- “I further would like to suggest four lessons from housing finance experience: [1] Pit the clever in competition against the clever: this is market discipline. [2] Make sure originators of mortgage loans keep meaningful credit exposure to their loans, as new financing structures are developed. [3] Keep new instruments relatively simple as you introduce change. [4] Never, never give a GSE a perpetual charter.”
- “Alexander Hamilton’s First Bank of the United States was given a 20-year charter, but this traditional wisdom was forgotten, and Fannie, Freddie and the Federal Home Loan Banks were given perpetual charters. Over the decades, all of them grew and changed beyond recognition. All GSE-like entities, if you do decide to create them, should have a sunset, or a required reauthorization, so they can be reconsidered in the light of experience.”
- “I’ll mention one more law, Pollock’s Seventh Law: In any complex, recursive situation, you never know what you’re really doing. In designing the movement of risks, introducing new financial instruments, and developing institutions, there will always be change, surprises, learning, and never a final answer.” (*Prepared Remarks by Alex J. Pollock, 03/17/06*)
- The Chinese appear to have been listening to Pollock’s warnings about the risks of GSEs. Former OFEHO director Armando Falcon said that China has no desire to create a Fannie Mae- or Freddie Mac-style GSE to help develop their mortgage market. In a meeting with senior officials with the People’s Bank of China [the country’s central bank], Falcon was told that the Chinese are adamant about having private sector mortgage lenders that are not reliant on government subsidies. Falcon noted that Americans are still living with the unintended consequences of Fannie and Freddie, which were formed during the Depression in the 1930s. “The unintended consequences are their portfolios create systemic risk to the financial system,” he added. “My advice to governments around the world is to try and promote private sector mortgage lending not reliant on government subsidies.” (*Reuters, Bei Bei She, 03/23/06*)

## OFHEO names new director of supervision

- OFHEO has promoted Len Reid to director of supervision, a new position with responsibility for six key divisions in the agency, including the examinations of Fannie Mae and Freddie Mac. In 2001, Reid joined OFHEO as the associate director overseeing the capital levels [of GSEs], after 24 years with the Office of Comptroller of the Currency. In his position, Reid will oversee capital supervision, GSE exams, the agency's chief accountant, and its compliance, policy and research, and external relations divisions. Along with the general counsel and executive director, Reid will be one of three top officials under OFHEO's director and deputy director. (*American Banker*, Barbara A. Rehm, 03/24/06)

## Louisiana struggles to recover from Hurricanes Katrina and Rita—as a nation watches

- In a speech in Baton Rouge, LA, Senator David Vitter (R-LA) said, “The state needs to have a single unified, clear plan” on how it will help communities bounce back from the hurricane devastation more than six months ago. “There has been great progress in developing a plan, but we all need to keep pushing. We need to go further and do better,” particularly with more cooperation between the Louisiana Recovery Authority and the New Orleans area, as they develop rebuilding plans. The next step needs to be the consolidation of government in New Orleans, by consolidating the jobs of seven assessors into one; merging the civil and criminal courts; combining the jobs of civil and criminal courts into one and combining the civil and criminal sheriffs' jobs into one. The defeat of bills merging the assessors, courts and court officials in the legislature's special session in February was “noticed” in Washington, said Vitter. “[Federal officials] perceive that seven assessors [and other overlapping offices] are a waste of taxpayer money,” he added. Washington wants to see “more forceful leadership on the ground in New Orleans” in deciding how the city will be rebuilt, said Vitter. “There is a concern [in Washington] that there is no consensus on rebuilding and how to develop New Orleans.” (*Times-Picayune*, Ed Anderson, 03/21/06)
- Local outcry over the state legislature's failure in February to consolidate the seven property assessors into one position has resulted in a slate of candidates running on the “I Quit” (I.Q.) ticket, who vow to resign their position before taking the oath of office for the \$90,000 salaried-position. For decades, when a local resident had a complaint they took it to one of seven assessors, who would give the resident a break on their taxes for their vote in the next election. “It has been a near perfect system,” according to the *New York Times*, “except for the estimated \$80 million in lost revenue annually for a hard-up New Orleans. ...The I.Q. candidates want the deal-cutting, high-earning, sinecure-holding assessors out, replaced by a single professional who will not systemically undervalue the city's properties ...by 25% to 41%.” Poll results for the I.Q. candidates (and mayor) will gauge how committed

New Orleans voters are to reforming their government. (*New York Times*, Adam Nossiter, 03/17/06)

- In a March 22 editorial, the *Times-Picayune* wrote, “Moldering vehicles in the tens of thousands still mar the New Orleans landscape seven months after Hurricane Katrina, and getting rid of them will take at least another six months and \$23 million if Mayor Nagin signs the contract his administration is negotiating. That’s an awfully long wait and a lot of money for a cash-strapped city struggling to recover -- especially since car-crushing companies have offered an alternative that’s far faster and a potential money-maker for the city. K&L Auto Crushers of Tyler, Texas, approached the mayor last October with an offer to remove flooded, abandoned vehicles in 15 weeks [and pay] \$100 apiece, according to the company. At that time, 50,000 vehicles were on the streets. Had the administration agreed, New Orleans streets would have been free of junked cars by now, and the city would have \$5 million to spend on its many pressing needs.” Looks like it’s back to business as usual in the “Big Easy.” (*Times-Picayune*, 03/22/06)
- On March 20, Mayor Nagin has endorsed a proposal that would allow *all* residents in New Orleans to rebuild their homes, ignoring all of the recommendations by Bring New Orleans Back Commission’s that the city go slow in rebuilding low-lying areas and consider replacing flooded neighborhoods with parks. Nagin said residents can rebuild anywhere, but warned that homeowners in flood-prone neighborhoods would do so at their own risk. He added, “I’m confident that the citizens can intelligently decide for themselves.” He also called for instituting a living wage policy for public contracts, expanding the free bus service between New Orleans and Baton Rouge, maximizing reconstruction opportunities for local companies and training construction workers, and offering housing subsidies for workers and job seekers. [Clearly, Nagin is running for re-election on April 22.] (*Times Picayune*, Bruce Egger, 03/21/06; *Dow Jones Newswire*, 03/21/06; *Associated Press*, 03/21/06)
- In a March 21 editorial, the *Times Picayune* wrote, “If New Orleans allows residents of all flood-ravaged areas to rebuild at their own risk, city officials need to help people figure out how dire that risk might be. Mayor Ray Nagin’s administration has been issuing building permits throughout the city, and he doesn’t plan to stop doing so. However, the final recommendations from his Bring New Orleans Back Commission warn residents that some areas are flood-prone -- and that a cash-strapped city may not be able to provide even minimal police, sewer and garbage services in some places. Such a warning is in order. But if this is the mayor’s strategy for discouraging redevelopment in certain areas -- and any property owner in his or her right mind would be discouraged by it -- the city needs to specify which services it expects to provide where. People need to make educated decisions. More than six months after Katrina, the lack of firm guidelines is holding back New Orleans’ recovery and keeping residents from moving on with their lives.” (*Times Picayune*, 03/21/06)

- Voicing concern about the direction of the future direction of state government, *The Advocate* wrote in a March 26 editorial, “First, do no harm. That ancient admonition for doctors treating their patients is also good advice for Louisiana’s governor and lawmakers as this year’s regular session of the Legislature opens on [March 27]. This is the third session since the hurricanes of 2005, and it seems that all the talk about changing Louisiana’s political institutions to reflect new realities is losing some steam. ...Louisiana cannot accept business as usual if it wants to find a future for itself beyond the ruins of Katrina and Rita. Public institutions have to be downsized where appropriate to fit post-Katrina realities, and stronger ethics laws also are crucial as the nation mulls over how much to invest in Louisiana’s recovery. We do not see a great deal of momentum for these kinds of changes at the Capitol these days. It would be even worse if the fledgling reforms of recent months were reversed out of a mistaken belief that Louisiana’s crisis has passed. Distressingly, there has been talk of reinstating legislative slush funds — pots of money doled out at the governor’s discretion to favored lawmakers for pet projects in their districts. Criticized by good-government groups for years because they circumvented the normal legislative process, the funds were phased out in 2005 as a passing gesture toward budget reform. It would be a mistake to bring them back.”
- “The centerpiece of Blanco’s legislative agenda is the budgeting of approximately \$105 million for a K-12 teacher pay raise and \$90 million in increased spending in higher education, including faculty pay raises. While we support vigorous investment in education, such spending must come from expressing honest priorities, rather than depending upon overly rosy scenarios to avoid fiscal discipline in other areas of the budget. Of special concern is the budget’s reliance on more than \$400 million in one-time Medicaid money from the federal government. In advance of the session, Blanco has tapped former Speaker of the House Hunt Downer to head her lobbying efforts in the Legislature. While Downer’s legislative experience could be a plus for the governor, success will depend upon clear, consistent leadership from the governor herself. Though the upcoming session is called a “regular” session, there’s been little regular about life in Louisiana since the hurricanes. These are extraordinary times that demand extraordinary leadership from the governor and the Legislature. We call upon them to rise to the challenge.” (*The Advocate*, 03/26/06)
- According to a new RAND Corp. study, the population of New Orleans will stand at 272,000 by September 2008, roughly 58% of the area’s pre-Katrina population. The study said that the higher cost of building materials and shortage of contractors will contribute to higher rents, which “implies fewer low-wage and nonworking people will live in New Orleans.” It also found that many parents were reluctant to return their children to the troubled New Orleans schools. “If early returnees experience a difficult time... the overall effect will be to reduce the likelihood of others returning,” the study concluded. (*Associated Press*, 03/15/06)
- According to the Mortgage Bankers Association (MBA), the seasonally adjusted delinquency rate for one-to-four residential mortgages rose 32 basis points from a year earlier to 4.7% on December 31, 2005. The effects of Hurricane Katrina

contributed 15 basis points to the year-over-year rise with almost 123,000 borrowers in Louisiana and Mississippi delinquent in their mortgage payments during the fourth quarter of 2005. According to the MBA, about 12% of mortgage holders in Louisiana and 8% in Mississippi were more than 90 days delinquent on their mortgage payments at year-end. (*Washington Post*, Kirstin Downey and Annys Shin, 03/15/06; *American Banker*, Matthew Quinn, 03/17/06; *Times-Picayune*, Mary Judice, 03/15/06)

- Of the 113,053 single-family homes in Louisiana that sustained hurricane-related flood damage in 2005, at least 72,787 homes (64%) were covered by flood insurance compared to just 30% of the 28,800 homes flooded in Mississippi. By February 22, Louisiana residents had received \$12 billion in flood insurance payments for hurricane-related damage, nearly as much as all of the [pre-Katrina] flood claims paid by the National Flood Insurance Program since its creation in 1968. To pay Katrina claims, FEMA has borrowed \$18.5 billion from the U.S. Treasury. On March 23, President Bush signed a bill boosting FEMA's borrowing authority to \$20.775 billion to provide the agency the means to meet future flood claims. (*Dow Jones Newswires*, Henry J. Pulizzi, 03/23/06; *Times-Picayune*, Jeffrey Meltrodt and Rebecca Mowbray, 03/19/06)
- Senators Mary L. Landrieu (D-LA) and David Vitter (R-LA) joined Freddie Mac president Eugene McQuade and officials from the Louisiana Housing Finance Agency (LHFA) to announce nearly \$36 million in new below market 30-year fixed rate mortgages and \$1 million in downpayment and closing costs assistance to promote recovery in federally designated hurricane disaster areas and foster homeownership opportunities for police officers, teachers, and qualified low-income borrowers. "This \$36 million investment in affordable mortgages is very good news for Louisiana families, particularly those most devastated by Hurricanes Katrina and Rita," said Vitter. "I'm particularly pleased to see that some of this funding will benefit first responders. Our first responders and other essential personnel play such a key role in the recovery of south Louisiana, and this will continue the momentum as we rebuild and revive Louisiana's communities." The new bonds will provide approximately 300 borrowers with 5.35% or lower 30-year fixed-rate mortgages that can be used to repair existing homes or purchase new ones. Subsidies from the Police Foundation, LHFA and \$1 million from the state of Louisiana's federal HOME grant will be used to subsidize special mortgage set-asides with even lower rates for police, teachers, and low-income borrowers, providing rates as low as 3.85% in some cases. (*Freddie Mac Press Release*, 03/13/06)

House Financial Services Committee's markup of credit rating agency bill on hold
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- The House Financial Services Committee failed to start marking up the proposed "2005 Credit Rating Agency Duopoly Relief Act [H.R. 2990], sponsored by Representative Michael Fitzpatrick (R-PA), due to "lack of time," according to a committee staffer. Committee chairman Michael Oxley (R-OH) said in a speech

before the Institute of International Bankers that the panel hopes to mark up the bill “before the end of the month.” H.R. 2290 would change the SEC’s role in giving the “national recognized statistics rating organization” (NRSRO) designation for which only five of approximately 120 rating agencies qualify. Under the proposal, the SEC would be responsible for registering eligible rating agencies which meet a new definition of the term and providing regulatory oversight of the agencies, through inspections, examinations and enforcement actions. The SEC is calling the Committee’s move to review H.R. 2990 and possibly sending the bill to the House floor for a final vote “sudden.” SEC Commissioner Annette Nazareth said, “It’d be very helpful for [lawmakers] to have a dialogue with the Commission” about this issue.

- The Senate Banking Committee chairman Richard Shelby (R-AL) said the issue of credit rating agencies is a priority this year for his committee, which is considering new rules aimed at expanding the number of agencies. (*Bureau of National Affairs*, 03/16/06’ *CQ Today*, Michael R. Crittenden, 03/15/06; *Marketwatch*, Robert Schroeder, 03/13/06)

FAS 156 simplifies accounting for servicing of financial assets
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- On March 17, FASB issued FAS 156, Accounting for Servicing of Financial Assets, which should simplify the accounting for servicing assets and liabilities. FAS 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. The Standard also (1) clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability; (2) requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable; and (3) permits an entity with a separately recognized servicing asset or servicing liability to choose either the amortization method or fair value method for subsequent measurement. The new Standard, which is an amendment to FAS 140, is available on the Internet at [www.fasb.org/pdf/fas156.pdf](http://www.fasb.org/pdf/fas156.pdf). (*FASB Press Release*, 03/17/06)

S& P to publish the S&P/Case-Shiller Metro Area Home Price Indices
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- In conjunction with MacroMarkets and Fiserv, Standard & Poor’s will begin publishing in the second quarter the S&P/Case-Shiller Metro Area Home Price Indices for 10 individual metropolitan areas, along with a weighted composite index of house prices. The Chicago Mercantile Exchange will list futures and options contracts on S&P’s new indices. (*National Mortgage News Online*, 03/22/06)

## Fallout from HUD's violation of fair housing laws in Baltimore

- Roughly 14 months after finding that HUD had violated fair housing laws by failing to take regional approach to the desegregation of city public housing in Baltimore, U.S. District Judge Marvin J. Garbis begins a two week hearing on the appropriate remedy for HUD's violations. Lawyers for area public housing residents have asked the judge to order the creation [over the next decade] of 3,000 new low-income housing units and an additional 3,750 housing vouchers, mostly in well-off suburban neighborhoods with good schools and access to jobs. In addition to considering remedies for HUD's failure to "affirmatively further fair housing" under the 1968 Fair Housing Act, Garbis will also determine if the agency violated the constitutional rights of public housing residents by failing to erase the vestiges of its prior, intentional discrimination. Such a finding could provide a firmer legal foundation for ordering a regional remedy, if any decision were to be appealed.
- This phase of the 11-year-old housing case is being closely watched by civil rights and fair housing advocates nationwide. "It's the most important case right now nationally on the question of fair housing and HUD's obligation to reverse some of the unfair policies it has pursued over the last several decades," said Philip Tegeler, president and executive director of the Poverty and Race Research Action Council. One. Nearly 20 desegregation cases have been successfully litigated over the past 30 years against HUD and local housing authorities, of which about half of the cases involved metropolitan solutions. (Baltimore Sun, Eric Siegel, 03/21/06)

## ***Fannie Mae***

### Fannie Mae' trader mind-set

- Fannie Mae's accounting mess forced the company to take a more opportunistic approach to mortgage investment and a recent public disclosure signaled that this is now a "normal" way for the GSE to conduct its business. In a March 10 disclosure with the SEC, Fannie Mae announced the restructure of the management of its portfolio investment and renamed it the "capital markets group," reflecting the company's new trader's mentality. The company stated the group's tasks, which include actively buying and selling mortgage debt and explicitly called this new approach "an enhancement to our prior strategy." Fannie Mae said, "Consequently, our portfolio may grow or decline based upon specific market dynamics during a given period, and management will not view portfolio growth per [se] as a primary measure for success." As a result of the company's shift from buy-and-hold investing to continuously looking for highest total returns, Fannie Mae's asset sales surged nearly sevenfold in 2005 to \$113 billion. With the annual growth of Fannie's and Freddie's portfolio slowing to about 3% from a historically double-digit pace, Morgan Stanley analyst Ken Posner said trading more actively is a logical response, since "the buy-and- hold strategy gets very dull in periods when spreads remain tight and do so for protracted periods of times." (*American Banker*, Jody Shenn, 03/14/06)

### Fannie Mae trims its mortgage holdings again in February

- Fannie Mae's portfolio contracted at a 7.2% annual rate in February, declining \$4.5 billion to \$720.8 billion. According to Fannie Mae's executive vice president Peter Niculescu, Fannie Mae may not make additions to its portfolio in the near future because the high price of mortgage-backed assets has limited the opportunities for the company to earn acceptable returns. Niculescu said, "Although our debt is priced very, very attractively right now, and although mortgages have cheapened a little bit over the last few weeks, the opportunities to grow the portfolio are not there right now."
- In February, Fannie Mae sold \$5.1 billion of mortgage debt from its portfolio, the highest sales volume since September, in addition to the \$10.8 billion retired as borrowers paid down loans. The company entered contracts to buy \$9.7 billion in mortgages in February, compared with \$9.2 billion in January. Fannie Mae also said its duration gap averaged zero months in February, unchanged from the three previous months. (*Bloomberg News*, Al Yoon, 03/23/06; *MarketWatch*, 03/23/06; *Dow Jones Newswires*, Allison Bisbey Colter, 03/23/06)

## ***Freddie Mac***

Freddie Mac's portfolio activity nearly twice that of Fannie's in February
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- In February, Freddie Mac held the size of its mortgage bond portfolio steady, despite tight spreads making it difficult to replace the securities that matured or were paid off early. The company said its retained portfolio increased \$1.15 billion to \$705.32 billion in February for an annualized rate of growth of 2.0%. Freddie's portfolio growth contrasts sharply with that of Fannie Mae, which reported a 7.2% annualized decline in mortgage holdings in February. "Freddie Mac's portfolio activity in February was almost twice the run rate of Fannie Mae's," said Jim Vogel, executive vice president at FTN Financial. "While Fannie fell \$5 billion in February and apparently made few new forward purchases, Freddie grew \$1 billion and increased its commitments."
- Freddie purchased \$22.48 billion of mortgage bonds in February, offsetting the \$8.06 billion that it sold and the \$13.28 billion that matured or was paid off early. All of Freddie Mac's growth came from non-agency securities, which rose \$2.11 billion to \$243.29 billion in February. Freddie's holdings of its own participation certificates declined \$770 million slipping to \$355.15 billion, while its holdings of securities issued by other housing agencies fell \$240 million to \$43.92 billion. The company's mortgage purchase agreements rose to \$17.6 billion in February from \$13.5 billion in January. Freddie also said its duration gap, averaged zero months in February, unchanged from the past 12 months. (*Dow Jones Newswire*, Allison Bisbey Colter, 03/24/06)

## ***Federal Home Loan Banks***

The “war of the worlds” begins  
over proposed changes to the FHLBs’ capital requirements

- An industry observer, who asked not to be identified, said, “[The Federal Housing Finance Board’s proposal to raise the FHLBs’ capital requirements] will be a war of the worlds—the members will not stand for it.” Truer words were never said. John von Seggern, president and CEO of the Council for FHLBanks, told *Market News International* that the Finance Board’s proposed capital rule was “controversial” and “unnecessary” and warned that the rule could severely hamper the FHLBs’ current mortgage programs. Under the proposed rule, the FHLBs would be forced to retain capital amounting to at least 1% of all assets less advances, plus \$50 million -- an almost 80% increase from the Banks’ current capital requirements. “My concern is that in dealing with theoretical risks we may have realistic outcomes that could hamper the banks mortgage programs,” von Seggern said. “I think they came out with a very, very harsh proposed rule based on a simplistic cookie-cutter formula that does not accurately reflect risk. It [has] not been met with open arms.” Von Seggern argues that each FHLB is unique and has ample capital. “Our purpose is not so much profit as it is to make sure we give our members access to liquidity,” he said. “Our members range from tiny credit unions to large commercial banks. They are very possessive of the FHLB system and that’s a good thing.”
- Stephen Cross, the Director of the Federal Housing Finance Board’s Office of Supervision, argued that agency’s proposed rule is intended to protect the FHLBs by absorbing any potential losses and to conserve the par value of the banks stock owned by its members. “Banks will have to hold more retained earnings, [for those Banks which hold] more mortgages than advances, but we don’t think this is a substantive cost to the banks for having mortgages,” said Cross, adding that the proposal does not affect the mortgage programs, other than indirectly. “The mortgage programs expose the banks to some degree of risk from changes in interest rates. We are requiring the banks to have retained earnings to absorb any losses that might occur as a result of those risks.”
- Finance Board chairman Ronald Rosenfeld acknowledged that under the proposal, which would require the FHLBs to cut dividends in half until they boost their retained earnings, community banks could experience a short-term reduction in dividend income. But, Rosenfeld argued, the proposal is critical for protecting FHLB System long term stability. “Any businessperson has a visceral reaction -- if it’s going to reduce my near-term dividends, gee, I’m opposed to it,” said Rosenfeld. “But I think that, by and large, thoughtful people can see that we all benefit from this Home Loan Bank System. It is an enormous benefit [to member banks]. Given that situation, they will be very, very respectful that the system remains strong.”

- The FHLB System has a unique capital structure, where the majority of capital is held in stock with a fixed par value of \$100 and is redeemable by member institutions. If the Banks do not hold enough in retained earnings to cushion against losses, they could be forced to dip into their stock capital and effectively reduce the par value, which would have serious repercussions at member institutions, said Rosenfeld. “If the value of your bank’s capital stock were to be impaired, how willing would you be to take out new advances if you had to pay par for stock that would be redeemed for a lesser amount? How would your quarterly financial statements be affected?” asked Rosenfeld in a speech before America’s Community Bankers. “I believe we have a shared interest in strengthening the capital structure of the Federal Home Loan banks.” Rosenfeld encouraged the banks to weigh in during the 120-day comment period and noted that the proposal is not set in stone. “We are not geniuses, but we are going to protect the system and, with their help, create the best capital structure that we can,” he said. (*Market News International*, Margaret Chadbourn, 03/17/06; *Market News International*, Margaret Chadbourn, 03/21/06; *American Banker*, Patrick Rucker, 03/15/06; *American Banker*, Rob Blackwell, 03/10/06)

FHLB-Cincinnati reports 3.2% decline in net income for FY2005
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- The FHLB-Cincinnati reported net income of \$219.7 million in FY2005, down \$7.4 million or 3.2% from the prior year. Assets rose 0.8% to \$77.2 billion at year-end 2005, while advances to members and the Mortgage Purchase Program declined 1.5% to \$49.9 billion. The Bank’s capital stock totaled \$3.5 billion on December 31, down 7.8% from year-end 2004. A merger of two large member institutions with out-of-district institutions resulted in the reduction of capital stock of \$346.4 million. Retained earnings increased 24.0% to \$207.8 million on December 31. On March 16, the Bank’s board of directors declared a dividend rate of 5.75% per annum for the first quarter of 2006, payable in addition shares of capital stock on March 31, 2006. (*Primezone Media*, 03/20/06)
- In its SEC filing, the FHLB-Cincinnati said that if financial and accounting issues at the GSEs continue or expand, they have the potential to “reduce our profitability and our competitiveness” in key business lines. The Bank wrote, “Our debt costs and spreads to LIBOR and U.S. Treasuries will continue to be volatile and will require close monitoring in order [to] secure the lowest possible all-in funding costs. The unfavorable news in the several years involving financial and accounting issues with other GSEs, including Fannie Mae and Freddie Mac and other FHLBanks, has increased the volatility of debt spreads. If these issues continue or expand, they have the potential to both reduce our profitability and our competitiveness as a source of advance funding and mortgages sales.”(*Dow Jones Newswires*, John Connor, 03/23/06)

#### FHLB-Atlanta files Form 10 with SEC

- On March 17, the FHLB-Atlanta filed its Form 10 with the SEC, which included financial statements for the fiscal year ending December 31, 2005, as well as restated financial results for prior periods. During FY2005, the Bank's net income grew 17% to \$344.1 million, while its assets grew 6.9% to \$143.2 billion. The Bank's restatement, which included a number of adjustments related to FAS 133, resulted in a cumulative decrease in net income of \$35.2 million, which will reverse in future periods as hedging relationships mature. (*PRNewswire*, 03/17/06)

#### FHLB-Boston announces changes to its board of directors

- Charles F. Frosch will resign his position as director of the FHLB-Boston effective April 1, 2006. Frosch's resignation coincides with his upcoming retirement from his position as CEO of Union Savings Bank, of Danbury, CT on March 31. The FHLB-Boston's board appointed R. David Rosato to fill the vacancy created by Frosch's resignation for a term commencing on April 20 and expiring on December 31, 2006. Rosato is senior vice president and treasurer of Webster Bank, N.A., of Waterbury, Connecticut and serves as senior vice president and treasurer of Webster Financial Corporation. (*PR Newswire US*, 03/23/06)

#### FHLB-Dallas announces promotions

- The FHLB-Dallas has announced the promotion of Mark Wert to Treasurer and Bud Gill to Assistant Treasurer. Wert, who joined the FHLB-Dallas in 2002 as Funding Manager, will be responsible for managing the Bank's investment activities, funding and balance sheet hedging. Formerly, Wert was with Banc of America in a variety of roles, including derivative sales and high-grade debt origination. Gill joined the FHLB-Dallas in 2001 as Portfolio Manager. Formerly, he was vice president of analytics for Corporate Network Brokerage Services. (*PR Newswire U.S.*, 03/20/06)

#### How can the Federal Home Loan Bank help bring housing development to Liberia?

- In a March 21 State Department briefing on Liberia's post-conflict transition, this question was posed to Liberian president Ellen Johnson Sirleaf: "I'm -- Watchen Harris Bruce, and I currently work for a federal housing agency in Washington called the Federal Home Loan Bank as well as with Neighborhood Reinvest Corporation. Both of my agencies or bosses from -- my employers they want to know how can this support in the housing endure? These are our housing agencies. They want to know what mechanism have you set up for redeveloping housing because this is one of the basic needs and also an economic development activity. So my question is, *how can they help bring development -- housing development to Liberia?*"

- President Johnson Sirleaf responded, "...[Y]ou're absolutely right, housing is very essential, you know, at all levels of income. And whatever programs you've got will be very welcome. [Fannie Mae recently disbanded its consulting program with foreign countries. Is the Federal Home Loan Bank planning to take its place?] (*Federal News Service*, Remarks by Liberian President Ellen Johns Sirleaf to the United States Institute of Peace, 03/21/06)

## ***Farm Credit System / Farmer Mac***

FCA board wants to "correct" regulations that create a barrier for young people entering agriculture

- In a speech at the Women in Agriculture Conference, FCA chairman and CEO Nancy Pellet said, "Today, ...as evidenced by the Farm Credit System's Horizons project and other long-range planning efforts by ag groups and industries, agriculture is looking ahead and making strategic decisions... Let me give you just a couple of examples from my current position to illustrate how significant policy issues affect your family and agriculture as a whole. The Farm Credit Administration is the regulator of the Farm Credit System – several institutions of which are co-sponsoring this conference. We are the equivalent of the Comptroller of the Currency or the FDIC to the banks. We determine the rules and regulations that Farm Credit associations and banks operate within and ensure that they are safe and sound. Those regulations determine who can borrow from the Farm Credit System. For example, your son or daughter may wish to farm part-time or become involved in your farming operation while having a full-time job. However, they may not qualify for a loan for non-agricultural purposes from the System because their outside non-farm income is far greater than their farm income. We want young people to enter agriculture – an industry that fails to bring in the young, new, or diverse will soon lose its vigor and competitive edge. So, regulations that discourage or are a barrier to young people concern me and my colleagues on the FCA Board and we want to do all we can to correct them for current and future young and/or beginning farmers." (*Remarks by FCA chairman and CEO Nancy C. Pellett*, 02/17/06)

Farmer Mac reports FY2005 results

- The Farmer Mac reported net income of \$27.3 million or \$2.37 per diluted share for the year ended December 31, 2005, compared to \$28.2 million or \$2.32 per diluted share for FY 2004. For fourth quarter 2005, the agency's net income was \$6.5

million or \$0.57 per diluted share, compared to \$9.8 million or \$0.82 per diluted share for fourth quarter 2004. For FY 2005, core earnings were \$28.7 million or \$2.50 per diluted share, compared to \$27.4 million or \$2.25 per diluted share for the year ended December 31, 2004. Core earnings were \$7.2 million or \$0.63 per diluted share for fourth quarter 2005, compared to \$9.9 million or \$0.82 per diluted share for fourth quarter 2004. (*PR Newswires News*, 03/16/06)

#### Rabobank speaks out

- Rabobank Group, the Dutch banking giant that attempted to acquire a large Farm Credit System lender in 2004, vented its frustration in a comment letter regarding the FCA's proposed rules governing the process under which Farm Credit lenders could privatize or merge with private-sector banks. In its comment letter, Rabobank said that FCA's proposed changes would make the process of merging with a private-sector company so "onerous" that no Farm Credit lender would consider it. Rabobank also noted that there is an "inherent contradiction" in the proposal, because it seeks to tighten certain restrictions at a time when lenders themselves are trying to broaden their powers. Robert Bucklin, the head of corporate banking for Rabobank International's North America operations, said in a press release summarizing his company's comment letter, "We believe that it is unfair for [Farm Credit] institutions to use their virtually tax-free status and low ... cost of funds to compete in the same arena as other tax-paying, non-government-sponsored banks." (*American Banker*, Ben Jackson, 03/16/06)

## ***Postal Service***

#### Stakeholders speak out on postal reform

- While the postal unions and management associations do not agree 100% on the merits of postal reform, there are basic principals that they share, which were outlined in a March 16 letter to Senator Susan Collins (R-ME), chair of the Senate Committee on Homeland Security and Governmental Affairs. "While we have differed on specifics, our goal is to ensure a financially sound, operationally healthy Postal Service that provides high quality universal service for its customers at affordable rates," said the letter, which was signed by the presidents of the Postal Service's seven unions and management associations. Specifically, the groups advocate (1) the repeal of the CSRS escrow fund; (2) the elimination of the CSRS military pension obligation; (3) the establishment of rate setting exigency flexibility, as provided by H.R. 22; (4) the establishment of "banking authority, contained in S. 662, which authorizes the Postal Service to save any "unused" price-hiking authority under the CPI cap for use for up to five years, subject to an annual limitation of up to two percentage points; and (5) the definition of single-piece parcels belonging in the

“market dominate” category, as defined by the Senate bill. (*Correspondence to the Honorable Susan M. Collins, William Burrus, Ted Keating, Steve LeNoir, Donnie Pitts, William H. Young, Dale Goff, and John Hegarty, 03/16/06*)

- During the week of March 20, over 1,000 postmasters descended on Capitol Hill to urge Congress to support postal reform. The effort was promoted by the 41,000-member National Association of Postmasters of the United States. (*PostalWatch.com, 03/17/06*)

#### President Bush addresses postal reform

- At a recent National Newspaper Association Government Affairs Conference President Bush responded to a question on postal reform. An attendee said, “Postal reform, which has been going on in Congress for about 10 years, was really pushed forward by a commission that you appointed, and it was passed overwhelmingly by both Houses. And we have this bill going to conference in April or May. There’s some concern that the administration may want to oppose this bill or veto it if it’s so-called not favorable to the federal budget. But there are things in that bill that are very important to the newspaper industry, and part of that is the funding that keeps rates fair -- because of some overpayment of military pensions -- that we don’t think should be put on the taxpayers, the rate payers. So we’d ask your support on behalf of us ...to support that bill as it’s in the Congress, if it comes to your desk, sir.”
- President Bush responded, “As you know, we do support postal reform. And as you accurately noted, we’ve got the process started, and we look forward to working with Congress on an acceptable bill. Frankly, this issue hasn’t made it to my desk prior to me arriving at this meeting. I’m mindful of the bill. I need to know more about the particulars before I make you a commitment one way or the other.” (*The Alliance for Nonprofit Mailers, 03/13/06*)

#### USPS’s bottleneck to future productivity growth

- In a March 23 issue brief, Charles Guy, an adjunct fellow for the Lexington Institute, wrote, “The Postal Service’s quarterly financial reports over the last three years show a steady decline in the volume of first class mail, accompanied by a steady increase in productivity. While First Class Mail volume has continued to fall, the growth we have seen in postal productivity has come to a halt and even reversed. Productivity gains had already been shrinking quarter-by-quarter for the last few years. Now, for the first quarter of 2006, productivity fell by 0.6 percent over the first quarter of 2005. In the past, the cost pressure put on the USPS by the fall in First Class Mail volume was offset in part by the cushion of growing productivity. With productivity increases at the USPS more difficult to achieve, and First Class Mail volume still falling, the Postal Service will now face additional pressure to control costs. So the

question is, what is USPS management doing to reduce costs and resolve this bottleneck to future productivity growth?"

- "... [W]hile ...streamlining [to achieve operating efficiencies] is important, the Postal Service is still not taking advantage of its best current options. The USPS should view its ongoing labor negotiations as a chance to make a strong case for cost reduction. In the 1980s, the Postal Service missed a major opportunity, failing to increase productivity even as mail volume was growing rapidly. It would be a shame – and an expensive mistake – to miss that opportunity again." (*Lexington Institute Issue Brief: Why (and How) the Postal Service Must Bring Costs Under Control*, Charles Guy, Ph.D., 03/23/06)

#### USPS posts net loss of \$154.7 million in February

- The Postal Service reported a net loss of \$154.7 million in February after escrow allocation, on total revenues of \$5.64 billion. Total revenues increased 5.5%, while total expenses increased 3.9% compared to the same period last year. Total mail volume was up 0.2% for the month, with first class mail volume down (0.9%) and standard mail volume up (0.8%). Express mail and Priority continued to show strong growth, but represent less than 10% of total USPS revenue. (*PostalNewsblog.com*, 03/24/06)

#### Postal Service announces new management appointments

- The USPS has named Robert Pedersen as Acting Chief Financial Officer and Executive Vice President, succeeding Richard Strasser, who will retire on April 3. Pedersen will head the Postal Service's Finance, Treasury, Information Technology, and Supply Management activities and will serve as a member of the Executive Committee and Chairman of its corporate Capital Investment Committee. According to the Postmaster General, Pedersen and Strasser will be working together to over the upcoming weeks to implement a smooth succession. (*USPS News Link*, 03/22/06)
- Susan Brownell has been named Vice President, Supply Management, responsible for the Postal Service's more than \$12 billion in annual supply management expenditures. Brownell reports to the Chief Financial Officer and Executive Vice President. Previously Brownell served as manager, Mail Equipment portfolio, responsible for supporting postal operations nationwide by obtaining state-of-the-art automated mail processing, material handling and mail transport equipment, including services and parts. (*Alliance for Nonprofit Mailers*, 03/22/06)

## USPS plans to offer customized stamps to businesses

- In the near future, the Postal Service plans to allow businesses to use made-to-order stamps bearing corporate logos or advertisements. In a *Federal Register* notice, the USPS invited companies that produce customized stamps to participate in a test beginning after March 20. (*MarketWatch*, 03/13/06)

## TVA

### TVA says its emissions are the lowest in its history

- TVA said its smokestack pollution from its coal-fired plants has reached historically low levels, after reducing its sulfur dioxide emission by more than 80% since 1977. However, TVA's emissions are still 30-thousand tons more than the agency is allowed under the Clean Air Act. On January 30, North Carolina Attorney General Roy Cooper filed a lawsuit against TVA, claiming that the agency's pollution is wafting on prevailing east-west winds across the Smokey Mountains, "making North Carolinians sick, damaging our economy and harming our environment." (*Associated Press*, 03/15/06; *Associated Press*, 03/19/06)
- In a meeting with mayors of 14 counties in the Knoxville, TN area facing sanctions if their pollution isn't brought under control, Senator Lamar Alexander (R-TN) said he won't be satisfied until the TVA has a scrubber on every one of its smokestacks. "I'd like to see TVA put sulfur controls on all of its power plants sooner rather than later," said Alexander, the Senate Energy subcommittee chairman, with TVA President Tom Kilgore sitting across the table. The Senator praised TVA's ongoing efforts to cut pollution at its coal-fired power plants and support of "clean" nuclear power. To date, TVA has spent some \$4.4 billion installing six scrubbers at three coal-fired power plants in Tennessee and Kentucky, with a seventh coming on line this summer and three more at two East Tennessee plants by 2010. Alexander said further controls are needed and will be "expensive." He added, "And we are going to have to recognize that here in the Tennessee Valley." Kilgore responded, "TVA is very serious about this. We have put our money where our mouth is. We have spent about \$4 billion and could spend that much more as we go forward to clean the air." (*Associated Press*, Duncan Mansfield, 03/20/06)

### Memphis City Council demands representation on the TVA board

- On March 21, the Memphis City Council unanimously passed a resolution encouraging Tennessee's elected officials in Washington to urge President Bush to nominate an individual to the TVA board representing Memphis and Shelby County. While the city and county are the utility's largest distributors of electricity, the area

has never had a representative on TVA's board, states the resolution. "Nobody else ignores their largest customer," said council member Barbara Swearengen Holt. (Commercial Appeal [Memphis, TN], Jacinthia Jones, 03/22/06)

TVA's expanded board arrives March 31
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- The most significant management restructuring in the history of the Tennessee Valley Authority will begin on March 31, when six new members on the expanded board of directors take the oath of office in a swearing-in ceremony at TVA headquarters in Knoxville. One of the board's first orders of business will be to select a chairman, and then launch a search for TVA's first chief executive officer, who will assume day-to-day management of the utility while the part-time directors take a more of a policy setting role. The new members include Donald DePriest of Columbus, MS.; Susan Williams and William Sansom of Knoxville, TN; Howard Thraillkill, of Huntsville, AL.; Robert "Mike" Duncan, of Inez, KY.; and Dennis Bottorff, of Nashville, TN. Of the new board members, only DePriest has utility experience, having served as chairman of the Columbus Utilities Commission. All of the new members are successful business people, who are civic minded and active contributors to Republican candidates and causes. (*Associated Press*, Duncan Mansfield, 03/22/06)

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