

The **GSE** REPORT™

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Major Events

Fannie Mae says it will allow any lender to use its patented lending technology “on a non-exclusive and royalty-free basis”

Concerns remain that lenders may not be able to sign the license agreement as currently drafted

Fannie developing additional patents that may stray outside of charter

Fannie Mae says it will allow any lender to use its patented lending technology “on a non-exclusive and royalty-free basis”

- In a November 21 letter to seven major trade groups, Curtis P. Lu, Fannie Mae’s principal deputy general counsel, said that Fannie Mae would allow any lender to use new patented lending technology “on a nonexclusive and royalty-free basis,” in response to the groups’ complaints that the new patent would stifle market innovation. [Also, the groups are concerned that Fannie would stray from its role in the secondary market into the direct origination of loans in the primary market through this proprietary software.] “While Fannie Mae has a strong corporate interest to protect its intellectual property, it also has an interest in fostering innovation that would facilitate the secondary market,” wrote Lu. “We believe our actions with respect to the patent demonstrate our commitment to supporting innovation in the mortgage industry,” he said. However, Fannie Mae resisted the groups’ requests to completely place the patented technology in the public domain. “We are aware of the patent-infringement risks that threaten the mortgage industry,” wrote Lu. “It is therefore a reasonable and prudent business decision on the part of every financial-services company, including Fannie Mae, to protect its intellectual-property assets, including seeking patent protection for its technology innovations. (*Dow Jones Newswires*, Damian Paletta, 11/22/06; *Reuters*, 11/21/06)
- Anne C. Canfield, executive director of the Consumer Mortgage Coalition [CMC], responded to Lu’s letter with this public statement: “[Lu’s letter] is a good first step and we appreciate the overture by Fannie Mae. However, it falls far short of a contribution to the public domain; it calls for very complicated arrangements that appear to deter usage; and finally, it does not answer the charter violation issues. Fannie Mae has requested comments on the license, and we will be providing technical suggestions to them... We are hopeful that everyone can come to a mutual agreement on this very technical, but important issue, which will benefit industry and consumers alike.” (*Consumer Mortgage Coalition Statement to the Press*, 11/22/06)

Concerns remain that lenders may not be able to sign the license as currently drafted

- The *National Mortgage News* reports that “Lenders may not be able to sign a Fannie Mae licensing agreement due to the liability exposure and restrictions on third-party vendors, according to the Consumer Mortgage Coalition. ‘Without changes, I suspect it will be extremely difficult for lenders to sign the agreement,’ CMC executive director Anne Canfield said. Fannie is seeking comment on an ‘open license agreement’ that would allow lenders -- without paying fees or royalties -- to use its patented process for customizing mortgages. Under the agreement, lenders cannot share access to the patented process with third-party vendors, which lenders depend on for a variety of services. ‘While large lenders could potentially reorganize their businesses to bring third-party services in house, this option is not likely to be available to smaller banks and mortgage companies,’ the CMC says in a paper that outlines its concerns about the agreement. The CMC also notes that the agreement caps Fannie's liability at \$50,000, but damages for licensees is unlimited. ‘[I]f an entity were to sue Fannie Mae for violating any law or infringing on any patent that this license covers, the licensees would have to indemnify Fannie Mae for the losses,’ the CMC paper says.” (*National Mortgage News*, November 27, 2006)

Fannie developing additional patents that may stray outside of charter

- Fannie Mae continues its work in the development of propriety software which appears to stray [again] outside of its Charter Act. According to the *Washington Post*, “[On November 7, 2006,] Fannie Mae won a patent for a system to verify greenhouse-gas-reduction credits earned by homeowners, securing a foothold in a \$22 billion market while raising concerns about the federally chartered company overstepping its mission. The District firm’s ousted chief executive, Franklin D. Raines, is listed on the patent as an inventor of the system. The patent is held jointly with a subsidiary of Cantor Fitzgerald, a New York bond firm, but it gives Fannie Mae proprietary control over a method for pooling and selling credits to companies that cannot meet emission-reduction targets.” (*Washington Post*, 11/21/06)

Treasury Department completes its approval process for agency debt issuance

- On November 17, the Treasury Department announced that it has completed a process by which Fannie Mae and Freddie Mac would submit quarterly debt sales calendars, which outline the rationale behind their debt issuance plans and specify the gross and net issuance, before Treasury approves the issuance of new debt. As early as January 2007, Fannie and Freddie will begin submitting their quarterly debt requests, which will be certified by senior management as to their accuracy. As this process is put into place, the GSEs will submit their sales calendars about a month before the start of a new quarter to give Treasury time to review the requests and

respond to the GSEs. Treasury's response will be prompt enough to provide the GSEs sufficient time to make any necessary changes before the start of the quarter, said a senior Treasury official. The process also calls for annual meetings between GSE managers and Treasury officials to discuss debt issuances. The GSEs also will be required to seek prior Treasury approval for any changes made to debt issuances during the quarter. On balance, the procedure will add efficiency and transparency to the process and will not hamper the financial flexibility of Fannie and Freddie. Initially, this process will not apply to the FHLBs, because its procedures for issuing debt are more complex than those used by Fannie and Freddie. According to *Market News International*, the "politically sensitive" Farm Credit System has never operated under Treasury's debt approval restrictions and will not submit quarterly debt sales calendars.

- The Treasury official stressed that these changes were necessary because the prior system had been inconsistent between the GSEs and done on an "ad hoc" basis. In the past, the GSEs' treasurers or fiscal agents simply phoned in the amount and maturity of a new debt offering, often on the day of the announcement and without a prior plan in place. "This is about good government," the official added. He also downplayed suggestions that this process will be used to curb Fannie's and Freddie's borrowings and limit their future growth. "This has nothing to do with an expectation of debt issuances going up or down," said the official. "What I'm talking about does nothing in and of itself to limit debt issuance in any way. ...This is completely unrelated to the proposed [GSE regulatory reform] legislation."
- Outgoing chairman of the House Financial Services Michael Oxley (R-OH) welcomed Treasury's plan to formalize the debt approval process of Fannie Mae and Freddie Mac. In a statement, Oxley said, "I support the new Treasury process for greater oversight and potential limitation of GSE debt issuances. ...I look forward to learning about the plan in greater detail in the future, and also a timeline for implementation. I believe that the Treasury Department is on solid legal footing. Given Secretary Paulson's market expertise and the fact that Fannie Mae and Freddie Mac have \$1.5 trillion in outstanding debt, this move to formalize the debt approval process makes sense."
- By putting this process in place, many believe that Treasury is laying the groundwork for limiting the amount of debt that Fannie Mae and Freddie Mac can issue. Previously, Treasury had no formal procedures for the approval of agencies' debt issuance. Had the agency attempted to limit the issuance of the GSEs' debt without a formal approval procedure, Treasury feared that a court could have ruled that they acted arbitrarily, if the GSEs had challenged their debt limitation. With a formal structure in place, Treasury believes it can now withstand a legal challenge by the GSEs.
- Treasury's latest move is seen by some as an attempt to bring Fannie Mae and Freddie Mac back to the bargaining table on GSE reform legislation. "[Treasury] is sending a very powerful signal," said Bert Ely, an Alexandria, VA banking consultant

and GSE critic. “I think it’s leverage to get them to the table.” Many observers believe that the Bush administration’s power to control the GSEs has been weakened by the November elections that transferred control of the House and Senate to the Democrats, who generally have been defenders of the GSEs. “Even if Treasury were to try to use this system to hurt Fannie and Freddie, we believe that Democrats in the House and Senate would use their new majorities to protect the GSEs,” wrote Stanford Washington Research Group analyst Jaret Seiberg in a note to clients. (*Bureau of National Affairs*, Brett Ferguson and Richard Cowden, 11/20/06; *Market News International*, Joseph Plocek, 11/17/06; *American Banker*, Steven Sloan, 11/20/06; *Associated Press*, Marcy Gordon, 11/18/06; *American Banker*, Patrick Rucker, 11/17/06; *Market News International*, 11/17/06; *International Strategy Investment Morning Policy Report*, Tom Gallagher, Andy Laperriere, and Melissa Loesberg, 11/20/06)

OFHEO tightens its oversight of Fannie Mae and Freddie Mac
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- Effective November 8, OFHEO tightened its rules for overseeing the accounting, executive compensation and corporate governance practices of Fannie Mae and Freddie Mac. Through a series of “guidances” for its examiners, OFHEO addressed problems that the agency uncovered during its investigations of the accounting problems at Fannie Mae and Freddie Mac. “Many elements of the guidances are designed to prevent a recurrence of the serious problems found in OFHEO’s special examinations of Fannie Mae and Freddie Mac,” said OFHEO Director James B. Lockhart. “Key provisions of the guidances address the responsibilities and conduct of Enterprise boards and senior management in regard to compensation, risk management, internal controls and accounting. The guidances issued today further refine OFHEO’s regulatory expectations and reflect our ongoing policy of transparent supervision.” One of the points addressed in the guidances sets forth compensation standards for board members, executive officers and employees and requires the GSEs to include provisions in future employment contracts about returning bonuses and salaries if executives are fired “for cause” in cases of misconduct. Another guidance stipulates that the board of directors’ responsibilities go beyond a short-term focus on maximizing shareholder value to address internal controls and organization, including the assigning of the role of chairman to an independent board member. Fannie Mae and Freddie Mac have 150 days to tell OFHEO how the guidances will affect their business. (*OFHEO Press Release*, 11/08/06; *Washington Post*, Annys Shin and David Hilzenrath, 11/09/06)
- On November 22, OFHEO sent a final rule to the *Federal Register* for publication, which makes technical requirements to the risk-based capital requirements for Fannie Mae and Freddie Mac. According to the agency, “These amendments are capital neutral and codify existing practice. [These amendments] are intended to enhance the accuracy and transparency of the calculation of the risk-based capital requirement for Fannie Mae and Freddie Mac, and to update the risk-based capital regulation to incorporate new activities treatments.” (*Marketwatch*, 11/22/06)

- In the agency's 2006 Performance and Accountability Report, OFHEO said that Freddie Mac "has made slow and inconsistent progress" in fixing its accounting practices since the company discovered \$5 billion of accounting errors three years ago. Freddie Mac has also failed to meet a "top priority" of reversing a high rate of employee turnover and to complete a risk management assessment enabling it "to better understand and manage all risks," said the regulator. "Freddie Mac has not yet implemented its comprehensive plan to correct accounting and internal control deficiencies, despite extensive planning efforts." (*Bloomberg News*, James Tyson, 11/16/06)

Fannie Mae increases its estimate of restatement costs to nearly \$1.05 billion in FY2006

- In its SEC Form 12b-25 filing for the third quarter of 2006, Fannie Mae increased its estimate of "restatement and regulatory costs" for fiscal year 2006 to close to \$1.05 billion, up more than 30% from its previous estimate of \$800 million. The company estimated that in 2006 it would spend \$850 million to restate its financial records prior to 2004 and an additional \$200 million to prepare financial statements from 2004 to present. The GSE's disclosure on spending increases the total cumulative costs for faulty accounting to \$1.62 billion. "These are huge numbers," Fannie Mae CEO Daniel Mudd told analysts during an investor conference call. "As your CEO, I'm obviously anxious and I'm obviously going to drive to have expenses return to a more normal range." In the Form 12b-25 filing, Fannie Mae also substantially reduced its estimates of after-tax losses related damage to collateral properties by Hurricanes Katrina and Rita from a range of \$140 million and \$ 210 million down to \$97 million and \$160 million.
- Although the company has estimated its accounting errors to approximate \$10.6 billion, Fannie Mae said it could not quantify the "final financial statement impact of our errors" until it has completed and filed its 2004 Annual Report on Form 10K, which it plans to complete by year-end. Fannie Mae spokeswoman Janis Smith, said the company has not announced when it would complete financial statements for 2005 and 2006 and return to timely reporting. "Until such time as Fannie Mae has completed restatements and caught up on time periods we have missed while working on the restatement, we can't begin working on current reporting," said Smith.
- In response to an investor's question about the prospects for passage of GSE regulatory reform legislation, Fannie Mae's top lobbyist Duane Duncan said the company was still "hopeful" for legislation that would create new oversight for the GSEs. "We're committed to working with Congress to get this done," said Duncan. "It's just unclear if they can get it done this year or starting again next year." (*Dow Jones Newswires*, Damian Paletta, 11/08/06; *Bloomberg News*, 11/09/06; *American Banker*, William Launder, 11/09/06; *Dow Jones International News*, Damian Paletta, 11/08/06)

Former Fannie Mae chairman and CEO Raines wins \$2.6 million in arbitration ruling

- Fannie Mae's former chairman and CEO Franklin D. Raines has won an arbitration ruling over a portion of his pay, which awarded him \$2.6 million of his deferred compensation in a lump sum after his retirement instead of in annual increments spread over many years. On November 7, Fannie Mae entered into a binding consent agreement "partially resolving damages and deferring further arbitration proceedings." The dispute over Raines's deferred compensation focused on when his termination date became effective. Fannie Mae said, "As a result of the arbitrator's decision, we must give effect to Mr. Raines' election to receive a lump-sum payment of a portion of his deferred compensation and pay Mr. Raines any salary and other compensation to which he would have been entitled had he remained employed through June 22, 2005, less any pension benefits that Mr. Raines received during that period." According to a Fannie Mae filing, several other questions about Raines's compensation remain unresolved, including whether he is entitled to incentive pay for 2004 and 2005 which will likely be addressed after the company completes its financial restatements. The arbitration agreement comes in addition to Raines's \$19 million severance package that he received when he left Fannie Mae two years ago.
- OFHEO director James B. Lockhart, III has said he expects his agency will file a lawsuit against Raines related to his involvement in Fannie Mae's accounting scandal. "This matter involves Fannie Mae, a former employee and an arbitrator," said an OFHEO spokeswoman. "As stated previously, OFHEO is considering legal action against former Fannie Mae executives, including Mr. Raines, and this does not affect any action OFHEO may determine to bring." (*Washington Post*, David S. Hilzenrath, 11/15/06; *Dow Jones International News*, Damian Paletta, 11/14/06; *Dow Jones Newswires*, Damian Paletta, 11/14/06)
- The *Motley Fool* noted that accountability doesn't come cheap at Fannie Mae. The *Motley Fool* wrote, "[Fannie] paid disgraced ex-CEO Frank Raines \$2.6 million to settle a compensation dispute. Fannie had wanted to pay Raines only through his last day on the job. That was Dec. 21, 2004 -- the day the [SEC] Commission chased Raines out the door by disavowing Fannie's accounting practices. But an arbitrator ruled this month that under Raines' employment contract, Fannie owed him six months' worth of 'deferred compensation and certain other sums.' Other sums are plentiful in the Raines saga. Take \$10.6 billion, the amount by which Fannie overstated its profits on Raines' watch. Or \$400 million -- the record payout the company made to settle federal investigations that concluded Fannie's 'arrogant and unethical corporate culture' had led managers to earnings for the sake of hitting executive bonus targets."
- " 'Senior management of Fannie Mae benefited greatly from these manipulations,' James Lockhart, [OFHEO director], told Congress this summer. 'For example, the total compensation of former chairman and CEO Frank Raines exceeded \$90 million from 1998 through 2003. Of that amount, more than \$52 million was directly tied to achieving earnings-per-share targets.' Raines, who walked away with \$19 million in

severance pay on top of all his other winnings, has long claimed he did nothing wrong. When he quit, after all, he was merely exercising his free will. ‘Although, to my knowledge, the company has always made good-faith efforts to get its accounting right, the SEC has determined that mistakes were made,’ Raines said in his retirement statement back in 2004. ‘By my early retirement, I have held myself accountable.’ ...If only he had retired about six years earlier.” (*Motley Fool*, 11/17/06)

Fannie Mae and Freddie Mac

Time is running out for passage of GSE reform in the 109th Congress

- Incoming chairman of the House Financial Services Committee Barney Frank (D-MA) and Senate banking Committee leaders continue to work on GSE regulatory reform even though chances of reaching a compromise and passing a bill this year are remote. “I have some hope that - maybe even in the lame-duck session - to be able to get the bill dealing with Fannie Mae and Freddie Mac passed,” Frank said in an interview on C-SPAN’s Newsmakers program aired November 19. “That would improve the quality of regulation of those agencies but it would also make several hundred million dollars a year - in the way we have it - for housing of people of low income.” Frank added, “Even if we don’t succeed - obviously we need a signature from the president - we might be in a position to make that one of our first orders of business next year.”
- While Frank maintains there is “still a chance” for passage this year, other lawmakers are less optimistic. “I won’t say it won’t happen, but the window’s closing,” said Senate Banking Committee Chairman Richard Shelby (R-AL) in a November 16th interview with Bloomberg Television. Senator Christopher Dodd (D-CT), who will serve as committee chairman next year, shared Shelby’s pessimism. “We’re not exactly the No. 1 priority,” said Dodd, following a meeting with Shelby at which they pledged to continue working together in a bipartisan manner. Dodd added, “[Passage of GSE reform legislation] depends on what the leadership wants to do. They[‘ve] got some appropriations bills to deal with, that is their No. 1 priority, to get those issues out of the way. If it could get done [this year], I’m all prepared on trying to get something done on it. Senator Shelby is absolutely correct, if it is not, then it has to be one of the priority items [next year].” In a November 20 interview, Dodd reiterated, “I believe that reform is absolutely essential for the GSEs.”
- Treasury Secretary Paulson has met with Shelby and retiring Banking ranking member Paul Sarbanes (D-MD) on the issue, but the differences over the placing restrictions on the GSEs’ portfolios have not been settled. According to sources, Paulson is insisting on language that would allow the new GSE regulator to use systemic risk considerations in determining the proper size of the GSEs’ portfolios. But, Democrats view the term “systemic risk” to be code words for portfolio limits. According to some industry lobbyists, Sarbanes has been the key obstacle because of his opposition to strict portfolio limits. In turn, a number of Democrats have complained the administration has not shown enough flexibility to strike a deal.
- Senator Tim Johnson (D-SD), who will serve as the second highest ranking Democrat on the Senate Banking Committee when a new Congress meets in January, said “I would be mildly surprised if we were able to get GSEs wrapped up [this year]. I do think there is a good possibility that we could come to a resolution to the problem in

the coming year. ...I think we will be taking a fresh look at [GSE reform next year]. Now, with change of leadership in the Congress, the question is can we come together? I am not ideological about this. I want to be pragmatic. On the other hand, we need to move away from where the administration has been up until now.” (*Reuters*, 11/13/06; *Congress Daily/P.M.*, Bill Swindell, 11/14/06; *Dow Jones Newswires*, Damian Paletta, 11/17/06)

- In the 110th Congress, five Democrats will join the Senate Banking Committee, including Senators Daniel Akaka (D-HI) and Herb Kohl (D-WI) and Senators-elect Sherrod Brown (D-OH), Bob Casey (D-PA) and Jon Tester (D-MT), while Senator Debbie Stabenow (D-MI) will leave the panel to take a seat on the Finance Committee. Akaka, 82, has served on the Banking Committee during his 16-year tenure in the Senate and has remained interested in banking issues since leaving the panel in 2002. “As a member of the Senate Banking Committee, I will continue efforts to increase financial literacy, consumer protection, and expand economic empowerment opportunities for families,” said Akaka. Kohl, 71, was first elected to the Senate in 1988, owns the Milwaukee Bucks professional basketball team. In addition to his seat on the Senate Banking Committee, Kohl also sits on the Appropriations and Judiciary Committees. In a statement, Kohl said, “I’ve been in business all my life. I’m looking forward to working with Senator Dodd and our colleagues on the Banking Committee on issues that impact businesses big and small in Wisconsin and across our country.” Less is known about the banking interests of the other new members. Brown, 54, is a House member, where he serves on the House Energy and Commerce Committee. Elected in 1992, Brown’s main legislative focus has been on pharmaceutical and other health-related issues. Tester, 50, previously was president of the Montana Senate, before defeating Senator Conrad Burns, who sat on the Senate Banking Committee. Casey, 46, was formerly the Pennsylvania Treasurer and represented several large regional banks such as PNC Financial Services Group and Mellon Financial Corp. Casey defeated Senator Rick Santorum, a member of the Senate Banking Committee. (*Dow Jones Newswires*, Damian Paletta, 11/20/06; *American Banker*, Stacy Kaper, 11/15/06)
- Senator Christopher Dodd (D-CT) announced that Shawn Maher will be the staff director and chief counsel of the Senate Banking Committee next year. Dodd also named his Banking Committee aide Alex Sternhell to be deputy staff director and a senior policy adviser. (*American Banker*, Stacy Kaper, 11/14/06)
- Lawmakers serving on the House Financial Services Committee, who lost their re-election bids, include former committee chairman [and 30-year veteran] Jim Leach (R-IA); Sue Kelly (R-NY); Jim Kyun (R-KA); Mark Kennedy (R-MN), and Mark Fitzpatrick (R-PA). Representatives Katherine Harris (R-FL) and Harold Ford (D-TN), who made unsuccessful bids for Senate seats, will also not be returning to Congress next year. (*National Mortgage News*, Brian Collins, 11/13/06)
- With her sights on serving as the chairwoman of the housing subcommittee, Representative Maxine Waters (D-CA) sang the praises of retiring House Financial

Services Chairman Michael Oxley (R-OH)—calling him a “great chairman”—and said his successor, Representative Barney Frank (D-MA), will follow in his footsteps. Waters even complimented former Representative Bob Ney (R-OH), who pleaded guilty earlier this year to corruption charges. “I think that Barney and Oxley and I - and even Bob Ney - we all got along very well together,” said Waters. “I worked very closely with Bob, because I was the ranking member on the subcommittee on housing and community development, and that’s the committee that I would hope to be able to chair,” she said.

- On the other side of the aisle, Representative Richard Baker (R-LA), who had hoped to replace Oxley as committee chairman if the Republicans retained control of the House, took a similar tack. “I do believe I’ll be the ranking member on Financial Services,” said Baker, who will likely face a challenge for the spot from Representative Spencer Bachus (R-AL). According to sources, Representative David Dreier (R-CA) could seek to become the ranking Republican on the committee. [Drier currently is in line to be the ranking Republican on the House Rules Committee.] Representative Deborah Pryce (R-Ohio) might also be interested in the post since giving up her position as House Republican Conference chairman. For the time being, Baker is planning ahead for what he would do as the panel’s ranking Republican. Baker said, “So in my role I believe I will have significant ability to mold to some extent the decisions the chairman may make. ... I have had good opportunities to work with Congressman Frank over the last several years and have always found him to be willing to discuss issues and to do it in a professional way.” (*American Banker*, Stacy Kaper and Joe Adler, 11/13/06)

OFHEO director Lockhart still “hopeful” that GSE reform regulation will be passed this year
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- In a November 9 speech at the New York Bankers Association annual convention, OFHEO director James B. Lockhart, III said he is “still hopeful” about the possibility that Congress will pass GSE regulatory reform legislation this year. He noted that progress is being made to a “compromise approach” on the issue of reducing the size of the GSEs’ portfolios. “Despite the hard fought election, I am still hopeful that we can get something done” to pass GSE regulatory reform legislation. Lockhart said that the GSEs’ claims that it would be a violation of the Board of Directors’ and management’s fiduciary duty to shareholders to support limits on their portfolios “is nonsense.” He argued, “If there is one lesson that these two companies should have learned from their multi-billion dollar scandals, large SEC fines, and massive shareholder suits, it is that unconstrained growth focusing on earnings-per share is much worse for shareholders.”
- In his speech, Lockhart detailed the reasons why the Bush administration had concerns about the systemic risk posed by the GSEs’ \$1.4 trillion of mortgage holdings. Lockhart said, “The systemic risk of Fannie Mae and Freddie Mac is real and the benefits of shrinking their portfolios are significant. Risk of enterprise failure

would be reduced, as well as any potential adverse effects on financial markets. The Enterprises could perform their important missions and respond rapidly during times of turmoil with much smaller portfolios. Although the Enterprises have questioned portfolio limits, I believe that a key part of restoring confidence is to convince the markets that they will never grow out of control again... The regulator should be empowered to set limits based upon the risks the portfolios present to the Enterprises and financial markets and upon guidelines that ensure the companies can fulfill their housing mission.”

- Lockhart said a recent comment by an “unnamed” GSE chief executive officer which implied systemic risk is being “misapplied to the GSEs,” is off-base. Lockhart argued that his statement ignores the fact that systemic risk is much broader than market risk “and can be caused by credit or operation problems, including deficiency models or unauthorized trading. ...The systemic risk of Fannie Mae and Freddie Mac is real and the benefits of shrinking their portfolios are significant.” He added, “[OFHEO has] made much progress in regulating these two companies, but we need more tools.” Lockhart concluded, “There is no doubt in my mind that GSE reform legislation is critically needed for more enhanced supervision and a stronger regulatory environment.” (*Market News International*, Margaret Chadbourn, 11/10/06; *GSe-news*, Volume III, No. 24, J.C. Watts; *Prepared Remarks of James B. Lockhart*, III, 11/09/06)

St. Louis Federal Reserve President Poole says GSEs pose big risk to financial system

- During a panel discussion at the Cato Institute on the role of the Fed in financial crises, St. Louis Federal Reserve President William Poole said, “I believe that supervisory oversight is in pretty good shape, with one glaring exception. Government-sponsored enterprises are not adequately capitalized and the supervisory powers of the Office of Federal Housing Enterprise Oversight (OHFEO) are inadequate. ...Although the GSEs are not formally insured by the federal government, the market clearly believes that they are effectively backstopped. As I’ve emphasized before, the Federal Reserve does not have the legal authority to bail out a troubled GSE. The Fed can provide liquidity support through its discount window, but only indirectly through collateralized loans to banks that would then bear the credit risk of making loans to a troubled firm. Under emergency conditions, the Fed does have the authority to make loans directly to a GSE, but the loans must be fully collateralized. The Fed is obviously disinclined to use its emergency powers to lend to firms other than banks; despite numerous financial upsets over the years, the Fed has not used this authority since the 1930s.”
- “Given the obvious moral hazard facing the GSEs, the first best solution would be to turn the GSEs into fully private firms subject to normal market disciplines and with no special connection to the federal government. Absent that step, what supervisory policy actions could reduce the threat they pose to financial stability? The two items of highest priority are, first, that the GSEs’ portfolios should be limited in both scope

and scale to assets with a clear public purpose; and, second, capital at the GSEs should be higher—substantially higher. As I have argued before, the capital standards applied to the GSEs are simply inconsistent with the interest rate risks the firms have assumed. It does not make sense for public policy to permit GSEs to hold far less capital than required in large banks given that GSEs have substantially similar or even greater risks than large banks.”

- “Finally, Congress should create a prompt corrective action (PCA) policy regime for the GSEs that truly mimics the one that was introduced into U.S. banking law 15 years ago. The idea behind PCA is simple—if a regulated firm holds only a small buffer of capital to protect the firm’s debt holders from loss, it is critically important that the firm face immediate and increasingly stringent restrictions on its activities as its capital dwindles. Otherwise, an undercapitalized firm experiences even stronger incentives to exploit its unpriced real or perceived guarantees. The PCA regime is well established for banks but the situation for the housing GSEs is not so clear. Unfortunately, OFHEO did not publish a final rule implementing its version of PCA until 2002, and even now OFHEO lacks the legal authority to impose the ultimate PCA sanction on a critically undercapitalized GSE, namely, closure of the institution and appointment of a receiver. Thus, the promise of PCA for reducing risks to financial stability posed by the GSEs remains unfulfilled. New legislation should provide the GSEs’ supervisor with clear and credible receivership authority. Carried out faithfully, a distressed GSE would be subject to a PCA regime of phased early intervention (including prompt closure, if warranted) and required recapitalization.”
- “The PCA regime has a major advantage for regulators in that they are instructed by law not to engage in regulatory forbearance, the source of some of the problems that eventually led to the collapse of numerous savings institutions in the 1980s and early 1990s. The only way to deal with time inconsistency is to make bailouts unlikely by tying the hands of regulators. Taking away the power to provide a bailout permits regulators to put more pressure on firms earlier. Moreover, in the absence of regulatory discretion, firms know that a bailout requires a successful approach directly to Congress, which might or might not be successful. Uncertainty over congressional action adds to market discipline.”
- Poole concluded that the “largest” risks on his radar screen arises from the “thin capital positions maintains by the [GSEs] and the ambiguity of whether Congress would or would not act to bail out a troubled [enterprise].” He added, “The time to deal with potential financial instability caused by structural weakness of the GSEs and their regulatory regime is before instability strikes.” (*Prepared remarks by St. Louis Federal Reserve President William Poole, 11/16/06; Market News International, Margaret Chadbourn, 11/16/06*)
- Representative Barney Frank (D-MA), incoming chairman of the House Financial Services Committee, publicly criticized Poole’s comments concerning the need to privatize Fannie Mae and Freddie Mac because of their “alleged risk” to the financial markets. In a press statement, Frank said, “It is clear from [Poole’s] comments today

that there is a lack of understanding of the importance of the GSEs to affordable housing and mortgage markets. I hope we can work together to strengthen and reform the GSEs so that their core mission is not compromised, and we can ensure that affordable housing in this country is not placed on the endangered species list.”
(*Dow Jones International News*, Damian Paletta, 11/16/06)

The Bush administration’s options on GSE regulatory reform

- The Democrat’s decisive victory in the November elections may force the Bush administration to make a painful compromise on GSE regulatory reform legislation. To get a bill enacted, the administration will be forced to abandon a provision restricting the growth of the GSEs. According to GSE insiders, the pressure will be on the White House to craft a suitable compromise. “They have to signal they want a bill,” said one GSE source. “The onus is on them. Now we know the outcome of the election, so there’s no question who’s driving it from the Hill.”
- The White House’s options include accepting a bill without portfolio caps, vetoing a bill supported by Democrats, holding up the legislation, or pursuing its objectives through regulatory actions. Kurt Pfothauer, the Mortgage Bankers Association’s lead lobbyist, said “I don’t know how much capital the administration would spend in trying to keep some form of portfolio restriction in the bill.” If the Bush administration remains firm in its demands for a portfolio restriction, then Senate Republicans could hold up a bill to ensure that it never passed out of the chamber. [With only a one vote majority, Senate Democrats are unlikely to succeed next year in passing a bill without some Republican support]. In a post-election speech, OFHEO director James B. Lockhart, III argued again for Congress to pass portfolio restrictions, reflecting no softening of the Bush administration’s position on this issue to date.
- Instead of legislation, the Bush administration could utilize the existing regulatory authorities of Treasury and HUD to achieve its objective of restricting the GSEs’ growth. The Treasury Department could make good on its threat to limit Fannie’s and Freddie’s debt issuances, effectively capping their portfolios. “I think both GSEs are extremely concerned,” said one GSE source. Jim Vogel, the head of fixed-income research at FTN Financial Capital Markets, said, “The administration is still going to be tempted to come up with rules outside the intent or boundaries that were in the House bill. The administration, between HUD and Treasury, have been holding these things as weapons in hopes that they wouldn’t have to use them.” However, limiting the GSEs’ debt is not without risk. Opponents warn that limiting the GSEs’ debt would disturb the housing market, sector already on the decline. “I don’t see why the administration would want to be blamed for disrupting the housing market,” said Jaret Seiberg, senior vice president at Stanford Washington Research Group, adding that it might also spur the Democrats to revisit Treasury’s power in legislation. “Congress could overrule them and strip Treasury of this power,” said Seiberg [assuming

enough Senate Republicans would support such a measure]. (*American Banker*, Steven Sloan, 11/13/06)

National Association of Realtors wants “strong, viable and flourishing GSEs”

- Thomas M. Stevens, president of the National Association of Realtors, said that it is in the best interest of homeowners, home buyers and sellers, that the nation has strong viable and flourishing GSEs. “Congress has been stalemated on what to do [on GSE reform legislation] and the Bush administration continues to press for regulatory reform that essentially means more regulation -- tighter regulation -- of the housing enterprises. Severely limiting regulation does not serve the housing, real estate industry or the financial industry well,” said Stevens. According to the trade group’s press release, “NAR believes it is in the best interest of home sellers and buyers that housing GSEs not become over-regulated and restricted from achieving their important mission of providing affordable mortgages to all qualified potential home buyers.” (*PR Newswire*, 11/11/06)

OFHEO establishes procedures for setting the GSEs’ 2007 conforming loan limit

- On November 16, OFHEO published procedures to determine how conforming loan limits would be calculated during a year in which housing prices decline. Although the agency will not publish its October 2006 housing price data until November 28, OFHEO reported that an annual average housing price decline appears likely. In a statement, Agency director James B. Lockhart, III said, “If house prices fall, loan limits should reflect that, but we need to ensure an orderly and transparent process for any downward adjustment. We want to make sure that guidance exists to avoid disrupting the end-of-the-year pipeline of mortgages or the market for mortgage-backed securities.”
- According to OFHEO’s new procedures, the maximum conforming loan limits will be adjusted upward by the percentage increase in price if the average October 2006 price exceeds that of October 2005. If the October-to-October price is negative, its effect on the maximum conforming loan limits will be deferred for one year, leaving the loan limit unchanged at the 2006 limit of \$417,000. The decrease for 2006 will be netted against any increase next year in determining the 2008 limits. If housing prices decline in 2007, the maximum loan limits for 2008 will decline by at least this year’s percentage decrease in average prices. Early next year, OFHEO will provide more detailed guidance for 2008 and future years. (*OFHEO News Release*, 11/15/06; *Bureau of National Affairs*, Richard Cowden, 11/17/06)

Bush administration changes

- President George W. Bush announced his intention to nominate Anthony Ryan, a senior advisor to Treasury Secretary Henry Paulson, to serve as assistant secretary of the Treasury for financial markets. Ryan, who completes the Secretary's domestic finance team, will have primary responsibility for managing Treasury's debt-market portfolio. Ryan, 43, previously was a partner at Grantham, Mayo, Van Otterloo & Co, LLY, a Boston-based investment firm with a \$121 billion portfolio. (*Wall Street Journal*, 11/07/06)
- *National Mortgage News* reports that according to rumors, HUD Secretary Alfonso Jackson will step down in the next few weeks. Paul Muolo wrote, "...[H]ere's a prediction: look for [HUD] secretary Alphonso Jackson to announce his departure in the next few weeks. Yes, I know that on Friday the White House denied that any immediate changes are afoot at HUD, but in a lame-duck administration, why stick around with a bunch of lame ducks? The big question for the mortgage industry is this: what does his expected departure mean for RESPA reform? Stay tuned..." (*National Mortgage News Online*, Paul Muolo, November 11-12, 2006; *National Mortgage News*, Brian Collins, 11/13/06)
- In early November, Keith E. Gottfried, HUD's general counsel left the agency after just more than a year in his post. According to an Inspector General report issued in September, Gottfried acknowledged that he and Jackson were not close and he wasn't part of the Secretary's "inner circle." Robert M. Couch temporarily replaces Gottfried, as HUD's fourth general counsel since Jackson assumed office on March 31, 2004. Couch has served as president of Ginnie Mae since June 29, 2006. (*Dow Jones Newswires*, Damian Paletta, 11/13/06; *Mortgage Banking*, 08/01/06)

Former Federal Reserve Chairman Greenspan and Freddie Mac agree: The worst of the housing slump has passed

- Former Federal Reserve chairman Alan Greenspan said that while the housing market is not out of the woods yet, the current slump may not worsen. "I think that while we are past most of it there are a lot of negatives ...but it is no longer subtracting from the [gross domestic product] growth" said Greenspan. "The economy is obviously going through a significant slowing period, which as best I can tell is more than likely temporary." (*Dow Jones Newswires*, Benton Ives-Halperin, 11/06/06)
- Freddie Mac agrees that the biggest slowdown in the housing market may be past and that falling mortgage rates may help stimulate the market. "We've probably seen the worst of the housing slump, although it may not have entirely bottomed out yet," said Freddie Mac chief economist Frank Nothaft. "Lower mortgage rates should help stimulate activity in the housing market." (*Puget Sound Business Journal* [Seattle, WA], 11/17/06)

- According to an analysis by *National Mortgage News*, the popularity of “exotic mortgages” continues to eat away at Fannie Mae’s and Freddie Mac’s share of the purchase loan market. For the first half of 2006, Fannie and Freddie had a combined market share of 33.75%, compared to 36.25% in 2005 and 51.51% in 2003. “I believe that Fannie and Freddie will no longer rule the market like they used to,” said Jeff Levine, managing director of Merchant Milestone Partners. Fannie and Freddie had hoped that demand for exotic mortgages would slip with the softening of home prices and increased regulatory scrutiny of the exotics and that 30-year fixed rate mortgages would once again become the mortgage of choice. However, recent surveys by *National Mortgage News* show that origination of payment option ARMs and interest-only mortgages is continuing at a healthy clip. (*National Mortgage News*, Paul Muolo, 11/06/06)
- According to *Mortgage Banking*, “[I]nnovative [private-label] mortgage products, enthusiastic investor support and consumer demand for new affordable loans have all come together to give extraordinary new power to the private mortgage-backed securities market. This has left the private sector setting the rules once largely dictated by Fannie Mae, Freddie Mac and FHA. ... Now, issuers of private-label residential MBS are holding the aces that were once held by ... Fannie Mae and Freddie Mac. Once a junior--but powerful--player in the market, private-label residential mortgage-backed securities (RMBS) are now the leading force driving product innovation and the net overall volume of mortgage origination. Further, it appears that the new dominant role for private-label RMBS may be here to stay. ‘I do believe it is a permanent change,’ says Alec Crawford, managing director and head of agency MBS strategy at Greenwich Capital Markets, Greenwich, Connecticut. There may continue to be a tug-of-war back and forth between agency mortgages and non-agency mortgages, but at this point what’s happened is innovation on the non-agency side has accelerated to such a point that it’s going to take the agencies a while to catch up.’ ... A handful of issuers are emerging as the dominant players in the private-label RMBS, led by pace-setter Countrywide Financial Corporation, Calabasas, California. Countrywide issued \$75.8 billion in private-label securities the first half of 2006--far ahead of No. 2, Seattle-based Washington Mutual, at \$38.9 billion Countrywide Financial is the largest issuer of mortgage-backed securities in each of the following categories: jumbo prime, alt-A and home-equity loans. Countrywide, however, ranks fourth in subprime RMBS issuance, behind subprime specialists Irvine, California-based Option One and Irvine, California-based New Century, followed by Washington Mutual. As a giant in a fast-growing RMBS sector that is now dominating the mortgage industry, ‘Countrywide is emerging as the private-sector alternative to Fannie Mae and Freddie Mac,’ says [Mike] McMahon,” a Sandler O’Neill & Partners analyst. (*Mortgage Banking*, Robert Stowe England, 10/01/06)

Alternatives to credit scores being “promoted”

- In early November, Barrett Burns, CEO of VantageScore LLC, a joint venture of the three major credit bureaus that is offering an alternative to FICO scores, visited Washington to meet with regulators, trade groups, and GSEs to educate them about the firm’s product. “We’re responsible for educating the regulators to the score, as well as the GSEs ...and trade groups,” said Burns. “So it’s important that we are accessible” In an interview with *American Banker*, Burns declined to specify which regulators met with him, but said they were “very receptive” to VantageScore’s method of computing credit scores. Burns said he also met with Fannie Mae officials, which is testing the scoring system along with Freddie Mac. While he did not meet with Freddie Mac officials, Burns said that “both GSEs are in the testing mode and my understanding is that it’s coming out favorably.” In October, Fair Isaac Co., a Minnesota company that produces FICO scores, filed a lawsuit against the three credit bureaus, accusing them of violating antitrust laws and engaging in unfair competitive practices in promoting their product. Burns has no comment about the lawsuit, but noted it was “without merit.” (*American Banker*, 11/06/06; *Mortgage Line*, 11/17/06)
- According to the National Association of Hispanic Realtors (NAHR), the slumping housing market could get a \$200 billion boost from new immigrant home buyers, if mainstream lenders would use alternative methods to scoring credit. Today, immigrants who lack Social Security numbers or legal status often are rejected by the three major credit bureaus. Gary Acosta, the group’s co-founder, said that NAHR is discussing the alternative credit programs with officials at Fannie Mae and Freddie Mac. Both GSEs require that borrowers for loans they underwrite be legal residents, but Fannie Mae accepts some alternative credit data. “One of our most widely used products uses rental housing payments and utility accounts to underwrite loans for people who lack traditional credit records,” said Fannie Mae spokeswoman Cristina Miranda. “We keep on looking at the impact that certain changes will have on the impact of minority homeownership.” (*Associated Press*, Garance Burke, 11/03/06)

E-recording of mortgages is “open for business”

- Although many contended that county recorders would be the hurdle to e-mortgage adoption, that may no longer be the case now that roughly 50% of loan originations can be e-recorded. “The big message for e-recording is that it is open for business,” said Andrew Dubinsky, president of Encomia, a Houston-based e-mortgage software company. “There are a few more counties that have come online and have invested in systems. However, they want to see activity. Today there are a number of lenders doing e-recording around lien releases for example. Some lenders are doing e-recording on the deed as well. That’s in a lot more counties than people believe. You can e-record about 50% of the mortgages in the country today. That’s a critical mass

and the title companies are on board as well. It's a function of lender demand now.”
(*National Mortgage News*, 11/06/06)

Fannie Mae

Fannie Mae hires Rahul Merchant as its chief information officer

- On November 8, Fannie Mae announced it has appointed Rahul Merchant to be its executive vice president and chief information officer (CIO) to oversee all of the company's technology efforts and manage the employees in the CIO function, representing approximately a third of the company's workforce. Merchant's duties will include the build-out and management of the Fannie Mae's technology operations and networks; designing and building new technology platforms to support the businesses; development of the internet technology architecture; and internet technology risk management. Previously, Merchant was head of global business technology for Merrill Lynch & Co., where he directed more than 6,000 employees and was responsible for the technology and platform support for the company's three main divisions. (*Fannie Mae Press Release*, 11/08/06)

Litigation notes

- U.S. District Court Judge Richard Leon has ordered OFHEO to provide documents to former chairman and CEO Franklin D. Raines and former CFO Timothy Howard, who are defendants in at least six shareholder lawsuits. Leon ordered OFHEO to present non-privileged documents in four, month-spaced installments beginning December 12. According to the judge's order, Raines and Howard must submit a prioritized list of documents requested a month in advance of each production deadline; November 13 is the first deadline for submitting that request. Previously, Raines and Howard have filed subpoenas for "millions of pages of confidential and privileged agency records," according to an OFHEO statement, and "nearly ten million pages of Fannie Mae documents" have already been released to the defendants. OFHEO is working with the Justice Department to determine how best to respond to the request, said the agency in a statement. "Separately, OFHEO is considering legal action against former Fannie Mae executives, including Mr. Raines and Howard, to recoup their ill-gotten gains." (*Reuters News*, 11/08/06; *Washington Post*, 11/08/06)
- Former Senator Warren Rudman, who conducted an internal review of Fannie Mae's accounting on behalf of the company's board of directors, said he would only turn over records of notes and interviews to former chairman and CEO Franklin D. Raines and former CFO Timothy Howard if ordered to by a U.S. District Court Judge. "We have always felt that there are certain internal work products of any law firm that should be protected," Rudman said in an interview with *Dow Jones Newswires*. "[Since the matter was up to the court,] we'll comply with any court order," he added. According to court records, Howard's attorneys have served Rudman's law firm, Paul Weiss, Rifkind, Wharton & Garrison LLP, with a subpoena,

demanding documents related to his internal review of Fannie Mae. On November 3, Howard's lawyers filed a "Motion to Compel," alleging that Paul Weiss has refused to turn over the records. (*Dow Jones Newswires*, Damian Paletta, 11/06/06)

- According to a court filing, Goldman Sachs denied that it intended to deceive Fannie Mae investors when it helped the company shift \$107 million of earnings to future periods. The investment banker also said that it never participated in Fannie Mae's accounting decisions. In a class action suit, Ohio Attorney General Jim Petro alleged that Goldman Sachs created two mortgage-backed securities totaling \$30 billion for Fannie Mae that violated generally accepted accounting principals, which contributed to Fannie's \$10.6 billion earnings overstatement. (*Washington Post*, 11/15/06)

Fannie Mae expands its presence in Pasadena, CA

- Fannie Mae has expanded its offices space from 49,000 square feet to nearly 62,000 square feet by signing a 10-year, \$24.7 million deal at the Maguire Properties building in Pasadena, CA. The company acquired the additional space to add new employees and accommodate its growing business. (*GlobeSt.com Commercial Real Estate News and Property Resource*, Bob Howard, 11/17/06)

Biloxi Housing Authority announces partnership with Fannie Mae
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- The Biloxi Housing Authority (BHA) plans to rebuild or develop more than 1,500 homes with financial assistance from Enterprise Community Partners and Fannie Mae, among others. In Mississippi, Fannie Mae is reviewing an \$18 million line of credit, joining Enterprise's \$500,000 line of credit, and the two organizations are giving a combined \$325,000 grant to the Biloxi Housing Authority to help them build 1,500 new homes and apartments. After losing more than 70% of its housing units during Hurricane Katrina, BHA renewed its committed to rebuilding affordable housing units for the citizens of the City of Biloxi. The lines of credit and grant funding will enable the BHA to secure new sites for the development of affordable housing units. (*Enterprise Community Partners Press Release*, 11/20/06)

Freddie Mac

Freddie Mac's mortgage portfolio increases at an annualized rate of 3.4% in October

- In October, Freddie Mac's aggregate retained mortgage portfolio increased to \$704.4 billion at October 31 for an annualized rate of increase of 3.4%. Year-to-date, the company's total mortgage portfolio has increased at an annualized rate of 8.3%. During the month, Freddie Mac entered into \$19.4 billion of net retained portfolio mortgage purchase agreements, up from \$15.3 billion entered into in September. The GSE's total guaranteed PCs and structured securities issued increased 10.6% year-to-date and in the month of October. The company's duration gap was 0 months in October, unchanged from September. (*October Monthly Volume Summary*, Freddie Mac)

OFHEO is mum on the impact that recent rule changes will have on Freddie Mac's management

- After releasing its guidelines calling for GSEs to separate the chairman and CEO positions, OFHEO refused to discuss the impact that guidelines could have on Freddie Mac. When the new guideline went into effect on November 8, Richard Syron was serving as both chairman and CEO of Freddie Mac, in violation of the new rule. OFHEO spokeswoman Corinne Russell said, "At Freddie Mac, pre-existing contracts are in place, and this is being addressed by OFHEO and Freddie Mac." A Freddie Mac spokeswoman added that the company is "working with OFHEO to assess the impact." Freddie has 150 days to submit a report to OFHEO, detailing the impact of the new rule will have on its operations. (*American Banker*, Steven Sloan, 11/10/06)

Freddie Mac announces its Financial Education Awards

- On November 9, Freddie Mac announced the winners of its inaugural 2006 Successful Models in Financial Education Awards and its Champions of Financial Literacy Awards. The four honorees for the Successful Models awards included The University of Missouri-Columbia Office of Financial Successes; The Women's Institute for a Secure Retirement and Mothers' Voices of Georgia for their financial and retirement education programs for minority women in Georgia; Lighthouse Credit Foundation's program, LifeSmarts; and Neighborhood Housing Services of Great Falls, MT program for foreclosure prevention. This year, Freddie Mac also awarded the Champions of Financial Literacy Awards to Representatives Judy Biggert (R-IL); Spencer Bachus (R-AL); Ruben Hinojosa (D-TX); Mike Honda (D-CA), and Mel Watts (D-NC). (*PR Newswire*, 11/09/06)

Federal Home Loan Banks

FHLBs' combined assets exceed \$1 trillion on September 30

- The FHLBanks Office of Finance announced that the System's total assets increased to \$1.0 trillion at September 30, 2006 compared with \$997 billion at the close of 2005. During the third quarter, FHLB Advances increased 4% to \$644 billion, representing 63% of total assets. Investments rose 1% to \$270 billion, and member mortgage assets, totaling \$100 billion, were down 5% from year-end. The FHLBs' combined net income for the three months ended September 30, 2006 declined 27% to \$661 million, compared with \$910 million for the three months ended September 30, 2005. Of the \$249 million decline in net income, \$224 million relates to one FHLB that reported a \$245 million net gain on the sale of certain investment securities in last year's third quarter. The System's combined net income for the nine months ended September 30, 2006 increased 3% to \$1,929 million, compared with \$1,871 million for the same period one year earlier. The FHLBs' total combined capital rose 2% from year-end 2005 to \$45 billion, representing 4.5% of total assets. (*FHLBanks Office of Finance Press Release, 11/15/06*)

The debate over the Federal Housing Finance Board's refusal to appoint public interest directors continues

- In an October 31 letter to Federal Housing Finance Board chairman Ronald Rosenfeld, Senator Paul Sarbanes demanded answers regarding the agency's plan to replace public interest directors at the FHLBs, whose terms have expired. "I would like to know specifically what actions you plan to take to satisfy the statutory requirement that the Finance Board appoint directors to the Banks' boards and your schedule for doing so," wrote Sarbanes. "Effective corporate governance at the Federal Home Loan Banks requires the full complement of directors called for by the Federal Home Loan Bank Act,"
- Since taking office, Rosenfeld has not appointed any new public interest directors to the FHLBs' boards, noting that "it is inappropriate for a regulator to appoint the regulated." In December, the last of the public interest directors' terms will expire, leaving the boards at about 60% of capacity. On November 8, Rosenfeld reiterated that he will not appoint public-interest directors, despite pressure from the industry and several lawmakers. "While the GSE legislation is pending, I do not believe it is appropriate for us to make the appointments," Rosenfeld told *American Banker*. Bert Ely, an independent consultant in Alexandria, VA, said, "Early next year, I think

Rosenfeld's going to be on the carpet up there, especially on the issue of directors," (*American Banker*, Steven Sloan, 11/09/06; *Dow Jones Newswires*, Damian Paletta, 11/07/06)

Farm Credit System / Farmer Mac

Farm Credit System ramps up its campaign spending

- The Farm Credit Banking System has increased its campaign spending ahead of a possible Congressional battle over expanding its lending authority in agribusiness and housing. Through the middle of October, the Farm Credit Council's PAC contributed more than \$826,000 to Congressional candidates, nearly double its spending in 2002. FCC spokesman Mike Mason said, "It enables us to better communicate our message to lawmakers."
- Earlier this year, the Council released a report that recommended several legal changes that would require congressional action, possibly as amendments to next farm bill that Congress is due to write in 2007. The FCC recommended that a change be made to allow Farm Credit's banking associations to invest in ethanol plants and other agribusinesses regardless of whether they are controlled by farmers. The Council also suggested that the law be changed to allow Farm Credit banks to make home loans in communities of up to 25,000 in population. [The FCS is currently limited to making home loans in towns with populations of 2,500 or less.] (*Des Moines Register*, Philip Brasher, 11/06/06)

Congress must act quickly to corral the Farm Credit System, say bankers

- According to a recently released report sponsored by the American Bankers Association, Congress must act quickly to corral the Farm Credit System, particularly in light of the Farm Credit Council's Horizons project. "The changes outlined in the Horizons project reflect an unspoken mantra," said Bert Ely, author of the report. "They want to lend to anyone, anywhere, for any purpose - at the expense of farmers and ranchers." Ely recommends that Congress take five steps to bring the FCS back to its original mission: (i) Establish explicit public-policy goals for the FCS; (ii) Publish the outcome of FCA enforcement actions; (iii) Require the FCS to register with the Securities and Exchange Commission; (iv) Limit FCS agricultural lending to individuals and corporations who report farming income; and (v) Claw back the taxpayer subsidy now flowing to large, creditworthy FCS borrowers. (*USAgNet*, 11/16/06)

Postal Service

Without Congressional action on postal reform in December, Senator Collins said, “I fear it will never pass.”

- Senator Susan Collins (R-ME) said she has not given up on postal reform legislation and will try to win approval of the bill during the lame-duck session in December. Collins has met with the chief Democratic sponsor, Senator Thomas R. Carper (D-DE), and has talked with White House officials about ways to revive the bill. “I’m not optimistic I will be successful,” Collins admitted. “I’m still stunned that the bill did not pass. ...I just find it inconceivable that the unions and mailers and other affected parties would walk away from a proposal that would put billions of dollars on the table.” She added, “This is the year. [Without Congressional action in December,] I fear it will never pass.” (*Washington Post*, Stephen Barr, 11/15/06)

Postal Service reports \$2.1 billion deficit, after payment of escrow, for FY2006

- The USPS ended fiscal year 2006 with a \$2.1 billion deficit, after the payment of \$3 billion in escrow as required by law. Rising fuel and labor costs, coupled with the congressionally mandated escrow payment, wiped out the Postal Service’s record revenues of \$72.8 billion for FY2006 and put the agency back into debt. Rising fuel prices drove up the USPS’s transportation costs to \$1.7 billion — \$260 million over budget. The agency’s total expenses, excluding the escrow payment, increased 4.9% to \$71.9 billion. Total mail volume in fiscal 2006 increased 0.7% to 213 billion pieces, earning the bulk of the Postal Service’s \$72.8 billion in revenue. Growth in standard and priority mail helped offset a 0.5% decrease in first-class mail volume, the Postal Service’s traditional moneymaker. (*Bureau of National Affairs*, Derrick Cain, 11/06/06)

USPS and its four largest unions extend contract negotiations until November 30

- The Postal Service and its four largest unions have agreed to extend contract negotiations in an effort to reach negotiated settlements. Contract negotiations have been extended until midnight November 30 with the National Association of Letter Carriers, AFL-CIO (NALC), National Rural Letter Carriers’ Association (NRLCA) and National Postal Mail Handlers Union (NPMHU). Contract negotiations have also been extended for the American Postal Workers Union, AFL-CIO (APWU). Negotiations will resume on Monday, November 27. (*Association for Postal Commerce*, 11/22/06)

- *PostalReporter.com* reported, “In a telephone message on the eve of the expiration of the contract..., APWU President William Burrus told union members that although final agreement is beyond reach at this time, ‘I am convinced that agreement is possible.’ Negotiations are continuing, he said, with health benefits and wages dominating the discussions.” (*PostalReporter.com*, 11/21/06)

Homeland Security and Governmental Affairs Committee votes favorably
for nominations to BOG and Postal Rate Commission

- On November 17, the Senate Homeland Security and Governmental Affairs Committee order favorably by voice vote the confirmation of James H. Bilray and B. Thurgood Marshall, Jr. to the USPS Board of Governors and Dan G. Blair to be chairman of the Postal Rate Commission. (*DMNews.com*, Melissa Campanelli, 11/20/06)

Postal Service reduces the time its takes to become eligible to appear on postage stamp

- Postmaster General John E. Potter announced that the USPS is reducing the length of time it takes for a person to become eligible to appear on a postage stamp following death from 10 years to five. (*Postcom Association for Postal Commerce*, 10/15/06)

TVA

TVA chairman says the board will likely vote to ban the sale of the agency’s land

- At the request of elected public officials, TVA has extended its comment period regarding a draft TVA Land Policy from November 3 to November 28. Among those requesting an extension was Representative Bud Cramer (D-AL), who said “I advocated for the extension of the public comment period to ensure that the residents in north Alabama and the entire Tennessee Valley have the opportunity to voice their concerns. Our economic development activities are critical to the future of the valley. “It is important that the board carefully consider all perspectives and the potential benefits and consequences associated with this draft plan.”
- During the initial comment period, TVA received more than 4,000 responses from interested parties, including environment groups urging that the proposal be adopted to preserve the agency’s public land, while numerous public officials and developers voiced opposition, arguing that it would stymie economic growth in the region. The agency’s board is scheduled to consider the Land Policy at their next board meeting scheduled for November 30. TVA chairman Bill Sansom said that the public utility’s

board will likely vote at this meeting to ban the sale of its federal land for residential or commercial development, which would affect more than 293,000 acres TVA manages along the 652-mile Tennessee River system and its tributaries. (*The Oak Ridger*, John Huotari, 11/20/06; *Times Daily* [Florence, AL], Dennis Sherer, 11/19/06; *AP*, 11/24/06)

TVA CFO resigns to take position in the private sector

- Michael E. Rescoe, TVA's chief financial officer since 2003, announced he is leaving the agency to become CFO of Travelport, Ltd. In the interim, TVA senior vice president and treasurer John Hoskins will serve as the utility's CFO, while a search for Rescoe's replacement is conducted. (*Chattanooga Times Free Press*, Dave Flessner, 11/14/06; *Knoxville News Sentinel*, 11/14/06)

TVA director Robert Duncan selected chairman of the Republican National Committee

- TVA director Robert "Mike" Duncan was selected by President Bush to serve as the chairman of the Republican National Committee. If approved by the 168-member RNC in January, Duncan will run the Committee's daily operations while Senator Mel Martinez (R-FL) will serve as the public face of the party. Duncan and Martinez will replace chairman Ken Mehlman, who is not seeking re-election. (*Lexington Herald-Leader*, 11/17/06)

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