

# The **GSE** REPORT™

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## ***Major Events***

Senators Hagel, Sununu, Dole and Martinez re-introduce GSE regulatory reform bill
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- On April 12<sup>th</sup>, Senators Chuck Hagel (R-NE), John Sununu (R-NH), Elizabeth Dole (R-NC) and Mel Martinez (R-FL) introduced GSE regulatory reform legislation (S. 1100), a revision of which was introduced in the 108<sup>th</sup> and 109<sup>th</sup> Congresses. The legislation would (1) create an independent regulator to oversee the safety and soundness of the housing GSEs; (2) focus Fannie Mae's and Freddie Mac's combined \$1.4 trillion investment portfolio on their housing mission of promoting affordable housing; (3) provide the new regulator the authority to close down a failing GSE and protect against a taxpayer bailout; (4) give the new regulator greater discretion in raising capital standards to protect against insolvency; (5) provide the new regulator approval power over new programs and activities proposed by a GSE to hold GSEs to their Congressionally-chartered mission; (6) give the regulator greater authority to limit lucrative severance packages or "golden parachutes" of executives who are removed for cause; (7) require the annual audits of Fannie Mae's and Freddie Mac's affordable housing programs to ensure that these programs support and strengthen the GSEs' affordable housing mission; (8) strengthen Fannie Mae's and Freddie Mac's affordable housing goals; (9) require Fannie Mae and Freddie Mac to improve their financial disclosure; and (10) end presidential appointments to the board of directors of Fannie Mae and Freddie Mac, and require all FHLBs directors to be elected by FHLB members. The bill does not raise the GSEs' conforming loan limits in high cost real estate markets. Instead, the bill would direct GAO to conduct a study on whether increasing the conforming loan limit in high-cost areas would help promote affordable housing in those markets. The bill also does not create an affordable housing fund underwritten by the GSEs.
- According to Hagel's staff, the new GSE bill includes a number of changes from the reform bill (S. 190) passed by the Senate Banking Committee in 2006. The new legislation would require Fannie Mae and Freddie Mac to register their debt and mortgage backed securities with the SEC, a requirement that the companies have resisted in the past. Another provision addresses a long-standing concern that the GSEs have used their charitable foundations to exercise political influence on lawmakers. The new bill would require the new regulator to conduct annual reviews of the Freddie Mac Foundation and the Fannie Mae's Office of Charitable Giving and provide an analysis of the two companies' lobbying activities.
- In tying the GSEs' mortgage portfolios to affordable housing, the Senators are following the lead of Federal Reserve Chairman Ben Bernanke, who suggested last month to link the GSEs' portfolios to their AH mission. In a press release, Hagel said, "Our legislation refocuses the GSEs on their congressionally chartered housing mission. Congress must address this issue now." However, the bill faces an uphill

battle, given the Democrats' opposition to a similar bill in 2005 which stalled in the Senate.

- A spokesman for Senate Banking Committee chairman Chris Dodd (D-CT) said, "Senator Dodd has said that he believes that there is consensus on the need to create a stronger, more independent regulator with a deeper commitment to affordable housing. Senator Dodd appreciates the input of his colleagues on GSE reform and he intends to continue to work with Senator Shelby and members of the Committee to make progress on this important issue."
- In an April 11<sup>th</sup> interview with *Market News International*, Senate Banking Committee chairman Chris Dodd (D-CT) said he expects the panel to mark-up a new GSE reform bill "in the next few weeks." Noting that the House has passed a GSE reform bill recently, Dodd said he believes that it is time for the Senate Banking Committee to pass its own GSE overhaul plan. (*Bureau of National Affairs*, 04/13/07; *American Banker*, Steven Sloan, 04/13/07; *Press Release from Senators Chuck Hagel, John Sununu, Elizabeth Dole and Mel Martinez*, 04/12/07; *Market News International*, 04/11/07)

Fannie Mae and Freddie Mac "remain a significant regulatory concern"
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- In its 2007 Report to Congress, OFHEO concludes that while Fannie Mae and Freddie Mac have made progress in 2006 correcting their accounting and operational problems, the companies remain a "significant supervisory concern." According to the report, Fannie Mae and Freddie Mac have taken much more time and dedicated significantly more financial resources to the process of completing their financial restatements and establishing adequate internal controls than the companies or the regulator expected. Moreover, the companies are still struggling to install adequate risk controls. "They dug an extremely, extremely big hole," said OFHEO director James B. Lockhart III at a news conference. "They just basically ignored the infrastructure of these companies for years and years and years." [In a January interview, Freddie Mac chairman Richard F. Syron said his company is still in the midst of spending about \$1 billion to fix problems with its accounting and other financial reporting systems, which still aren't ready for prime time. "It was a supertanker on the chassis of a '49 Ford," said Syron, referring to the company's old accounting system and its inability to cope with the GSE's rapid growth. "Think of a 7-Eleven that became a Wal-Mart," he added.]
- OFHEO said that Fannie Mae has complied with 67% of the requirements set forth in the company's consent order entered into in May 2006. According to the regulator, Freddie Mac "is in satisfactory compliance with the Consent order dated December 9, 2003, but one provision that remains open is the separation of the CEO and [chairman of the board] positions." Richard Syron, who joined Freddie Mac in 2003, was expected to relinquish the title of CEO within three years. However, Syron continues to serve as chairman and CEO of the company. At an April 10<sup>th</sup> press conference,

OFHEO director James B. Lockhart, III said that Freddie Mac's transition process has been slowed by the company's contractual agreements. "We would have liked them to do it earlier but ... basically, the executives had contracts, which made it more difficult to make that change," said Lockhart. Also, one of Freddie Mac's 13 board members has exceeded the company's term limits policy. This (unnamed) director, who has been given a temporary extension by OFHEO, is slated to leave the board sometime this year. [According to *Dow Jones International News*, the director is "likely" Ronald F. Poe, who joined Freddie's board in 1990.] OFHEO's report also said that Freddie Mac's efforts to fix problems "suffered during 2006 from ineffective planning and inconsistent execution." According to the report, "All internal control-related material weaknesses and significant deficiencies identified [at Freddie Mac] during 2005 or prior years' annual audits remain outstanding. Although management and staff have worked hard to mitigate and remediate known control weaknesses, as of December 31, 2006, no remediation activity has been tested and verified to be effective." The agency said that Freddie Mac's senior management "continues to revise plans and reengineer processes to strengthen internal controls and remediate six material weaknesses and a number of significant deficiencies."

- OFHEO said that despite Fannie Mae's efforts to improve a number of shortcomings noted in the regulator's examinations "significant issues remain and are centered in data, systems, controls and risk measurement and management." According to the report, Fannie Mae's costs for outside contractors increased, in part due to a weak supervision program by the company's management. Specifically, Fannie had problems selecting contractors in the information-technology area, which led to "inefficiencies and adverse events." At one point, Fannie Mae "had... almost as many consultants as they did employees," said Lockhart. OFHEO also criticized how Fannie Mae measured its interest rate risk, which weighs risk based on different business lines but not on a companywide basis. By measuring the risk more broadly, Fannie Mae's management and the board of directors could "understand the full impact of interest rate risk on economic earnings and capital," said OFHEO.
- OFHEO reported that the GSEs' credit risk levels for both GSEs remained low for the year as a whole. During 2006, Fannie Mae's single-family delinquency rate fell 14 basis points to 0.65%, while Freddie Mac's delinquency rate fell 16 basis points to 0.53%. Lockhart said that the recent deterioration of the subprime mortgage market is "not a significant issue" for Fannie Mae and Freddie Mac, although the triple-A mortgage-backed securities (secured by subprime mortgages) that the GSEs own possibly risk credit downgrades in the future. Lockhart said, "They're seeing some small deterioration, but not large because they have really stuck to non-subprime mortgage products. The subprimes they own are in triple-A tranches which may diminish in value -- but they won't go belly up."
- According to the OFHEO report, Fannie Mae and Freddie Mac should diversify mortgage insurers, mortgage lenders and financial institutions that help hedge the interest rate risk in the GSEs' mortgage portfolios. "Concentrations in similar types of counterparties represent a significant risk for" Fannie Mae, said OFHEO. The top

seven mortgage insurers doing business with the company provide insurance for 17 percent of its \$2.5 trillion book of business,” said the regulator.

- Lockhart noted that despite a cap on Fannie Mae’s and Freddie Mac’s mortgage investment portfolios, the companies expanded their presence in the housing market in 2006. “Despite these constraints necessitated by their operational weaknesses, their support of the mortgage market grew by 8 percent in 2006 to \$4.3 trillion as their guaranteed mortgage-backed securities outstanding grew at double-digit rates,” said Lockhart. (*Office of Federal Housing Enterprises Oversight Report to Congress 2007*, OFHEO director James B. Lockhart, III, 03/30/07; *American Banker*, Steven Sloan, 04/11/07; *Wall Street Journal*, Damian Paletta, 04/11/07; *Washington Post*, David S. Hilzenrath, 04/11/07; *Knowledge@Wharton*, 01/10/07; *Market News International*, Margaret Chadbourn, 04/11/07; *Wall Street Journal*, Damian Paletta, 04/10/07; *Bloomberg News*, James Tyson, 04/10/07; *Reuters*, Patrick Rucker, 04/10/07; *Bureau of National Affairs*, Richard Cowden, 04/11/07)

<p>OFHEO director James B. Lockhart, III refuses to recuse himself from the agency’s lawsuits against Fannie Mae’s former management</p>
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- In an April 5<sup>th</sup> court filing, OFHEO director James B. Lockhart III refused to recuse himself from deciding the administrative charges against Fannie Mae’s former chairman and CEO Franklin D. Raines, former CFO J. Timothy Howard, and former controller Leanne G. Spencer. Raines has argued that Lockhart had prejudged the case, based upon his comments to the media, and called upon the director to withdraw from the proceeding. Lockhart told the court that he was still able to make a fair decision in the proceeding. He wrote, “The ostensible conflict that Respondents claim disqualifies me as decision maker is simply the nature of administrative law. ...[The law] “allows me to express the opinion that Fannie Mae management undermined internal controls and manipulated earnings.”
- OFHEO brought the charges against Fannie Mae’s former management team in the administrative law area. Administrative law judge William B. Moran is presiding over a hearing, currently set to begin in March, 2008, in which the judge will make recommendations to the OFHEO director, who would decide the matter. OFHEO is seeking to recover past compensation from the three executives, along with penalties which could exceed \$100 million. The defendants deny any wrongdoing.
- Raines has filed a motion with a federal court of appeals to have the charges moved from the administrative law arena to a federal court. To date, a ruling on Raines’ motion has not been made. “Mr. Raines’s position is simple: It is not fair for him to be a defendant in a proceeding where one person serves as the prosecutor, the judge, and the politician,” said Raines’ spokesman [and former Clinton administration spokesman] Mark Fabiani.

- Meanwhile, the wrangling between Raines’ legal team and OFHEO continues over the document production. OFHEO argues that Raines has made such broad document requests that it would cost the agency millions of dollars to comply. According to *Bloomberg News*, OFHEO told the U.S. District Court for the District of Columbia that Raines should pay as much as \$8.6 million of those costs. A source close to Raines, who spoke on condition of anonymity, said Raines “offered to pay appropriate percentages years ago.” In the end, Fannie Mae may bear the costs, because the company is responsible for its former executives’ legal expenses. (*Washington Post*, David S. Hilzenrath, 04/06/07)

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

H.R. 1427: “The Fannie Tax”
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- In an April 12<sup>th</sup> editorial, the *Wall Street Journal* wrote, “Democrat Barney Frank and the Bush Administration seem to have found common ground on new rules for Fannie Mae and Freddie Mac. Naturally, there’s a catch. Late last month, Mr. Frank’s House Financial Services Committee passed a bill that would give a government overseer the power to limit the companies’ \$1.4 trillion in mortgage-backed securities. This has the potential to reduce the risk to taxpayers, and to the larger financial system, from the implicit federal subsidy the mortgage giants have used to grow like Google. That’s the good news.”
- “The bad news is that Mr. Frank is an expensive date, and his price for tolerating reform of his favorite corporate giants is dunning them for mega-bucks in the name of ‘affordable housing.’ His bill would tax Fannie and Freddie to the tune of 1.2 basis points of their total book of business -- or just over 1/100th of 1% of all the mortgages Fannie and Freddie have bought and packaged to sell to investors. That’s more than \$500 million a year, with potential to grow. The Bush Administration has insisted that the fund be disbursed based on non-political criteria, but, c’mon, this is Washington. While the first year’s payout is supposed to go for housing on the Gulf Coast, a honey pot this sweet will soon be passed out based on the interests of the most powerful Members.”
- “The larger political danger is that such a fund gives Congress an even greater stake in seeing Fan and Fred grow. The fund amounts to an annual dividend payout to Congress. The Fannie Tax would thus make it even less likely that these ‘government-sponsored enterprises’ (GSEs) will ever be weaned off their implicit taxpayer subsidy and act like normal private companies. Congress could also look at this earmarked tax precedent and try to apply it elsewhere—say, on the profits of energy companies for a ‘global warming fund.’”

- “One irony here is that Mr. Frank is taxing Fan and Fred in the name of ‘affordable housing,’ even as he is cracking down on other lending to non-rich borrowers. One reason so many more Americans have been able to afford homes in recent years is innovation in lending products by banks and other private financial companies, while Fannie and Freddie grew rich by expanding into more-affluent mortgage markets.”
- “And yet the current meltdown in the subprime and Alt-A mortgage markets has led to calls—by the same people now dunning Fan and Fred—for all kinds of new lending oversight, rules and restrictions. Mr. Frank’s latest brainstorm is to stick investors in mortgage-backed securities with the losses when subprime borrowers default. It’s hard to imagine a measure better designed to cut off credit to those Mr. Frank claims to want to help. If investors don’t have legal certainty about the debt they are buying, they won’t lend the money. And no new subprime lending means no homeownership for many Americans. But maybe this is what Mr. Frank meant when he told *Bloomberg News* that ‘more money was lent than should have been lent.’ The question is whether the other reforms in the bill are worth Mr. Frank’s political price. Most of our allies in the Fannie reform movement say yes. James Lockhart, the current Director of [OFHEO], says he believes the bill would give him the tools to rein in the growth of Fannie and Freddie’s mortgage-backed securities portfolios. These MBSs have been the main source of Fannie’s growth and systemic risk, as the companies tried to hedge their greater interest-rate and other risk with derivatives that it barely understood.”
- “Mr. Lockhart has used his limited powers to hold Fannie and Freddie to account since he took office last year, so his word counts with us. In his annual report to Congress, released Tuesday, Mr. Lockhart wrote that the bill ‘provides the basic building blocks of a strong, bank-like regulator for the GSEs.’ The political risk is what happens if the next regulator is a soft touch or works for an Administration that won’t back him up against Fannie’s many friends and retainers in Washington.”
- “We’d prefer the bill passed by the Senate Banking Committee last year that strictly limited the size of Fannie and Freddie’s MBS portfolios as a matter of law. But even a Republican Congress couldn’t get that bill past the companies and the homebuilder lobby. The Barney Frank-George Bush deal may be the best reformers can hope to get, though everyone should keep his eye on the fine print as it moves through Capitol Hill. The reason Fan and Fred became rich and unaccountable isn’t because they knew the housing marketplace; it’s because they knew how to work Congress.” (*Wall Street Journal*, 04/12/07)
- *Cato@Liberty* wrote, “Fannie Mae and Freddie Mac are quasi-private mortgage companies that receive huge implicit subsidies from taxpayers. So it is difficult to know how to react to a deal (H.R. 1427) between the Bush Administration and Congressman Barney Frank (D-MA) that would skim some money from Fannie and Freddie and use the money for so-called affordable housing. The bill would curtail the ability of Fannie and Freddie to use their subsidized status to expand into new

markets, which is good. The bill also would make Fannie and Freddie shareholders unhappy, which is good (or at least amusing) since they have been implicitly profiting from government rather than market forces. But the deal also means more money for politicians to redistribute, which is akin to giving an alcoholic keys to a liquor store.”  
(*Cato@Liberty*, 04/12/07)

***The tipping point for the Democrats’ “New Direction,” as party activists demand results:***

Housing activists demand relief for subprime mortgage borrowers

Senator Schumer proposes foreclosure bar and bailout for subprime mortgage market

House Financial Services Committee chairman Frank plans bill to regulate mortgage brokers and restrict securitization of subprime mortgages

Stakeholders explore ways to resolve the subprime mortgage crisis

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It’s not your parents’ mortgage market anymore: Subprime mortgages are here to stay

- With lawmakers on spring recess, Democratic leaders view their “New Direction [in government]” agenda to be at a tipping point, with party activists demanding results rather than rhetoric. In the House, the affordable housing issue —and AH activists— have taken center stage, following 12-years of “neglect” under Republican rule. House Financial Services Committee chairman Barney Frank (D-MA) and subcommittee chairman Maxine Waters, who are themselves affordable housing activists, promise passage of the first major housing legislation since the early 1990s. Through legislation addressing GSE reform, FHA reform and a Katrina relief bill, Frank and Waters hope to create a huge affordable housing trust fund to address the long-term needs of affordable housing. Additionally, they plan to expand rent subsidies and tax credits for low income housing and push the federal government back into the construction of apartments to meet AH needs. The leaders are trying to balance these goals with their assessments of what is fiscally and politically possible during the Bush administration. To that end, Frank is pushing low-cost measures that some Republicans can support, while promising the party’s liberal base that more will be done later. “Everything we do is a political calculation; we’re constantly thinking about what can become law,” said Frank. “We’re interested in getting practical results.”

- While Frank has introduced five bills related to financial services or housing and steered eight bills through his committee on controversial topics such as oversight of the GSE and shareholder votes on executive compensation, his counterpart in the other chamber – Senate Banking Committee chairman Chris Dodd (D-CT)—has used his gavel in a strikingly different way. Many observers view Dodd’s committee leadership through the prism of his presidential ambitions and his efforts to ramp up his campaign. “With Dodd running for president, that colors a lot of what’s going to happen in his committee,” said Brian Gardner, vice president of Keefe, Bruyette & Woods.
- Although housing activists are delighted to be working Democratic leadership, who are like-minded “housers,” some voice concern that their friends will take them for granted. “The big question is whether the Democrats are really committed to change, or whether they’re just making political statements,” said Barbara Sard, a housing activist with the liberal Center on Budget and Policy Priorities. (*Dow Jones Newswires*, Damian Paletta, 04/04/07; *Washington Post*, Juliet Eilperin and Michael Grunwald, 04/09/07)

#### Housing activists campaign for relief for distressed subprime borrowers

- Housing activists have focused media and Congressional attention on the plight of subprime borrowers, claiming more than 2 million borrowers are in risk of foreclosure due to the “predatory” nature of their mortgages and the mortgage brokers who sold them their loans. The Center for Responsible Lending (CRL) has led the charge, issuing studies to help “quantify” the problems in the subprime mortgage market and create a media template for the issue. According to the CRL, subprime loans accounted for 40% of all mortgages for Hispanic borrowers and 52% of mortgages to blacks, but only 19% of whites in 2005. In ranking cities with the highest subprime loans that are past due or in foreclosure, cities with a high share of minority residents top the list, says CRL. “The negative impact of foreclosures falls disproportionately on communities of color,” concludes CRL in a recent analysis. “[However] ...in absolute terms, white owners received three times as many higher-cost mortgages and therefore will experience a significant number of foreclosures,” the group conceded.
- AH activists are pushing for Congressional relief for subprime borrowers on two fronts: forbearance for subprime borrowers who are danger of those their home to foreclosure and changes in the bankruptcy law help bankrupt borrowers avoid losing their homes. On April 4, national civil rights groups, including the Leadership Conference on Civil Rights, the NAACP, the National Fair Housing Alliance, the National Council of La Raza, and the Center for Responsible Lending called on mortgage lenders, loan servicers and loan investors to institute an immediate six-month moratorium on subprime mortgage foreclosures “resulting from reckless and unaffordable loans in the subprime market.” The groups also called on Congress to

pass anti-predatory legislation, including a private right of action, to assure protection for minority and other communities.

- In response to the groups' appeal for forbearance, John Robbins, chairman of the Mortgage Bankers Association, said the mortgage industry is already working with distressed borrowers in an effort to help them avoid foreclosure. "They are trapped and we are doing everything we can to help them, including looking at new products designed to help troubled borrowers. However, Robbins said, "Forbearance... is not a sustainable solution. If we learned anything coming out of the Katrina and Rita disasters, it is that blank policies rarely have the desired effects. Each loan is an individual transaction and situation, one which needs to be addressed individually between the lender and the borrower."
- Even the mention of forbearance worries some involved in fixing the S&L mess in the late 1980s. "[Providing forbearance for delinquent subprime loans is] a very bad idea in this case," said L. William Seidman, FDIC chairman from 1985 to 1991. Borrower forbearance is suitable for an "act of God" such as the Gulf Coast hurricanes of 2005, he said. But, providing relief to those who did not fully understand the terms of their loan is misguided, he added. "Everybody in this made a deal with their eyes open based on a contract," said Seidman. "To abrogate that contract would be wrong." The real beneficiaries, he said, would be "the holders of the notes [which serve as collateral for mortgage securities]. And they above all people ought to take a hit."
- It is unlikely that the civil rights groups will prevail with their forbearance demands at this time. However, that may change, says Jim Saccacio, chairman and CEO of *RealtyTrac.com*, if foreclosure numbers increase and neighborhood values fall as a direct result which then causes widespread concern by voters. "The politics of foreclosure are clear, Saccacio added. "History tells us that there have been any number of foreclosure bans in the past. In every case such bans reflect public worries which have been converted into public policies. Given the growing number of foreclosures, there's little reason to believe that such bans could not arise again."
- A group of consumer organizations and lawyers are asking Congress to loosen bankruptcy laws to help protect subprime borrowers from foreclosures resulting from the subprime mortgage crisis. The National Association of Consumer Bankruptcy Attorneys, the Consumer Federation of America, and the Center for Responsible Lending propose a wide range of changes in the bankruptcy laws to eliminate or limit the provisions that exclude home loans from bankruptcy protection. Commercial banking representatives quickly opposed any calls for opening up the bankruptcy laws again. Floyd Stoner, head lobbyist for the American Bankers Association, said, "We believe that the bankruptcy reform is working. As near as we can tell ... the law did not remove bankruptcy as an option for those who need it. We believe that the actual data on the impact of the law should be gathered and examined, and we should not rely largely on reports from groups who opposed the law to begin with."  
(*American Banker*, Stacy Kaper, 04/13/07; *Bureau of National Affairs*, 04/13/07;

*Dow Jones Newswires*, Danielle Reed, 04/05/07; *American Banker*, Joe Adler, 04/02/07; *National Mortgage News*, Brian Collins, 04/09/07; *PR Newswire*, 04/11/07; *Business Wire*, 04/04/07; *Washington Post*, Dean Baker, 04/07/07; *Christian Science Monitor*, Mark Trumbull, 04/09/07)

### Senator Schumer proposes foreclosure bar and bailout for subprime mortgage market

- On April 11, Senators Charles Schumer (D-NY), Robert Menendez (D-NJ) and Sherrod Brown (D-OH) called on Congress to pass a government “bailout” worth “hundreds of millions of dollars” to help distressed subprime borrowers, who are in danger of losing their homes. The cash infusion, which is needed right away, should go both to fund community groups aiding troubled borrowers and to directly fund bailouts,” said Schumer. “All three of us are on the banking committee ... We will be proposing significant amounts of dollars to go here and do this. Could not tell you how much, but in the hundreds of millions of dollars for sure. Maybe more than that,” Schumer said. He plans to introduce legislation soon, setting forth their bailout plan.
- To support their proposed bailout, the Senators unveiled a 33-page report from the Joint Economic Committee (JEC), entitled “Sheltering Neighborhoods from the Subprime Foreclosure Storm.” According to the report, borrowers, lenders and local government would pay about \$80,000 per foreclosure, while aid to refinance a delinquent loan would only cost \$3,300. “We can’t afford to let these borrowers who are staring down the barrel of foreclosure lose their homes, and our local communities cannot afford the high-cost stakes of foreclosure,” said Schumer at a press conference. “Our report shows that acting to prevent foreclosure makes good economic sense ... so the logic is, let’s do something about it.” Although Senators declined to offer many details on how the proposed bailout would work, they suggested it was part of a multi-pronged strategy, including pushing for anti-predatory lending legislation and for a bill that would create federal standards for mortgage brokers.
- It is not clear how much support Schumer has garnered for the proposed bailout. Although Schumer told the press conference that he was working with Senate Banking Committee Chairman Chris Dodd (D-CT) on legislation, Dodd said in an interview he was “not totally” in agreement with the Senator on the bailout proposal. Dodd said he preferred that the regulators to address troubles in the subprime market. “The regulators have a greater responsibility,” he said. “I think the mortgage brokers do as well. But the regulators need to be doing the job under the authority we’ve given them. They haven’t been doing that in my view.” Later in an interview with *Market News International*, Dodd said that he has been uneasy with the response by federal regulators to use the laws on the books to adequately protect consumers and he is now “seriously considering” a legislative response to the subprime mortgage crisis, but declined to say what kind of package he might offer. Senator Richard Shelby (R-AL), the minority leader on the Senate Banking Committee, told reporters that he is waiting to hear more from regulators before deciding whether legislation is

needed. “I don’t think we can legislate and protect everybody, but we should work with our regulators and make sure people are not exploited,” said Shelby.

- At the press conference, Schumer said that he is still deciding how to structure a foreclosure prevention program, in which he envisions using community groups to help reach troubled borrowers and that the GSEs, banks, and other lenders could also play a role. “There are lots of nonprofits in these communities that can help people refinance their loan and avoid foreclosure,” he said. “We are proposing that the federal government, in coordination with the FHA, give some immediate emergency money to those nonprofits in the communities affected so that foreclosure will not increase dramatically in these communities, decreasing property values, decreasing revenue for local governments, and increasing the costs to the variety of lenders.”
- In addition, Schumer said another critical step to helping subprime borrowers would be “strengthening and reforming FHA, which right now issues more than \$100 billion in mortgage insurance annually for loans made by private lenders, and have them get involved as we refinance.” Menendez said FHA reform would be a vital part of the solving the subprime mortgage crisis, since the FHA is virtually worthless in high-cost real estate markets, including New Jersey, due to its low lending limits. “Raising those FHA levels... is something that I think could be done in relatively short order,” he said. “[Such reform would] cover a lot of those loans that are in potential default,” Menendez added, and the FHA has an existing process in place and consumer safeguards.
- Schumer reiterated calls for tighter regulation of mortgage brokers through a bill that would restrict lenders to making loans that are “suitable” for the borrower, a standard which the banking industry has opposed, arguing it would be subjective and open them up to increased legal liability. Schumer says he’s not proposing a new regulatory agency to oversee mortgage brokers. “We would basically license brokers,” Schumer said. “We are not talking about a new federal regulator, but we want to see mortgage brokers close to banks.” When asked if he would hold Wall Street firms and others responsible for abusive loans bought on the secondary market, Schumer said, “You can’t do that ex post facto.” He added, “What we do believe... is the so-called suitability rule which applies to stockbrokers [and] should apply to those who issue mortgages and those who refinance mortgages. We would make the same suitability rule apply to mortgages, and that would apply up and down the line to the mortgage broker to the mortgage lender.”
- On April 11, the Mortgage Bankers Association issued a statement applauding the JEC for its efforts to curb foreclosures, but expressed reservations about the committee’s report. MBA chairman John Robbins, said, “It is important to note, we believe the report overstates the potential number of foreclosures. By relying on faulty, inflated data to draw its conclusions, the report paints a far more dire picture of the landscape than MBA’s studies support.” The trade group has also criticized projections by the Center for Responsible Lending, which the JEC cited, that project 2.2 million foreclosures for borrowers who received subprime loans between 1998

and 2006. “[Such estimates are] based on unrealistic, worst-case assumptions,” said MBA. “In addition, the report relies heavily on foreclosure estimates from RealtyTrac, an internet-based firm specializing in marketing foreclosed properties. MBA estimates that RealtyTrac overstates the number of foreclosures by around 30 percent.” (*Reuters*, 04/12/07; *Bureau of National Affairs*, Richard Cowden, 04/12/07; *American Banker*, Stacy Kaper, 04/12/07; *Market News International*, 04/11/07)

House Financial Services Committee chairman Frank plans bill to regulate mortgage brokers and restrict securitization of subprime mortgages

- In an interview with the *Financial Times*, House Financial Services Committee chairman Barney Frank (D-MA) said he will introduce legislation that could make it less attractive for banks to repackage risky mortgages into MBS and sell them to investors. The proposal, which would make investors that buy MBS liable for deceptive or bad loans, will be debated at the Committee’s April 17<sup>th</sup> hearing. “More money was being lent than should have been lent,” said Frank. “[Growth in mortgage bonds] provided liquidity without responsibility.” If Wall Street had not embarked on its frenetic embrace of securitization, there would not have been so much capital unleashed into the mortgage world, said Frank. “Securitization has not been an unalloyed good thing,” he concludes, adding that if the securitization business slows, it could help slow some of the excesses of the mortgage sector. While Frank declined to describe what he would specifically include in a bill, he told *Financial Times* in an interview, “We will regulate mortgage brokers.” Frank also indicated his committee is considering if the GSEs should help restructure some private sector subprime mortgages and related securities. “We are in the process of talking to Freddie Mac and Fannie Mae about what type of instrument they may come up with,” said Frank. “They may be willing to take something of a haircut to stop the market from collapsing.” This issue will also be discussed at the Committee’s April 17<sup>th</sup> hearing, at which representatives of Fannie Mae, Freddie Mac, the FHA, mortgage industry and consumer organizations will testify.
- In an April 10<sup>th</sup> statement, minority leader Max Bachus (R-AL) said, “There has been no specific agreement between Chairman Frank and me regarding the inclusion of any provision in subprime lending reform legislation. Since March of 2006, I have stated that a workable national standard on assignee liability would be helpful in any subprime reform and that the New Jersey statute provisions on assignee liability have been shown to be effective and could be the starting point for national legislation. It’s very important to preserve the liquidity in the subprime lending market. As we saw in Georgia, an ill-conceived assignee liability law restricts the ability to market mortgage securities, ultimately making it more difficult for low-and-middle-income homebuyers to secure financing. That is why I support consideration of an assignee liability provision modeled after the New Jersey law, which includes ‘safe harbor’ provisions that allow purchasers of securitized loans to protect themselves from liability via due diligence. The New Jersey law also includes a provision that allows individual private rights of action rather than class action lawsuits.” (*Reuters*,

04/06/07; *Reuters*, 04/11/07; *Bloomberg News*, James Tyson, 04/10/07; *Republican House Financial Services Press Release*, Representative Spencer Bachus, 04/10/07)

#### Stakeholders to explore ways to resolve the subprime mortgage crisis

- On April 16<sup>th</sup>, the FDIC is hosting an interagency forum to meet privately with services, lenders, investment bankers, and lawyers to solicit their advice on how “find solutions for borrowers already trapped in mortgages they can not afford,” according to FDIC chairman Sheila Blair. Senate Banking Committee chairman Christopher Dodd (D-CT) is planning to hold a similar summit to address the foreclosure crisis. “I intend to ask leaders from all the stakeholders - regulators, investors, lenders, GSEs, FHA and consumer advocates - to come together and try to work out an efficient process of providing relief to homeowners,” said Dodd. (*Bureau of National Affairs*, Richard Cowden, 04/12/0; *National Mortgage News*, Brian Collins, 04/09/07)
- The Neighborhood Assistance Corp. of America announced that Bank of America and Citigroup, Inc. have agreed to fund a \$1 billion refinancing program to help troubled subprime borrowers. NACA said the program will refinance 7,000 to 10,000 subprime mortgages as 30-year, fixed rate loans at 5.5% with no down payment and no fees. NACA will act as broker, by choosing the borrower, counseling her or her, underwriting the loan and processing the application. BofA and Citigroup will own the loans. The program is being funded by previous donations to NACA that the banks had made. (*American Banker*, Cheyenne Hopkins, 04/12/07)

#### Subprime market implosion unlikely to impact the national economy

- During an April 11<sup>th</sup> speech in Chicago, Michael Moskow, president of the Federal Reserve Bank of Chicago acknowledged that there have been excesses in the subprime market that created dramatic financial losses by firms that originated the risky loans, but argued it was “unlikely” to spill over and create weaknesses in the overall economy. He added that it was easy to do “Monday morning quarterbacking” about Fed policies that may have contributed to or encouraged lenders to offer mortgages to “credit challenged” borrower. The increased home ownership that resulted from flexible loans “far outweighs the cost” of the losses on subprime mortgages which impact a “relatively small group of people.” Timothy Adams, Treasury Undersecretary for International Affairs, said, “We have seen a significant correction in the housing market and in our view we are in the process of working through that. By mid-2007, the worst should be behind us. ...As you peel back those layers, it affects only one or two percentage points of the overall mortgage stock.” (*Dow Jones Newswires*, Elizabeth Price, 04/12/07; *Dow Jones Newswires*, Howard Packowitz, 04/12/07)

## Subprime lending—just another “classic credit cycle”

- In an April 11<sup>th</sup> *Special Commentary*, the Wachovia Economics Group wrote, “America’s latest credit cycle, subprime lending, is not a unique experience but rather the latest variation of a traditional cycle of innovation, excess and correction compounded by public policy laxity followed by overreaction. Indeed there is very little new or creative in the whole subprime saga. This is disappointing because the subprime credit patterns we observe are so typical that they suggest much of the recent experience could have been avoided.”
- “...For subprime lending, private actors have a decision to make with respect to lending standards and the price of credit to allow for variations in the riskiness for subprime loans. Public policymakers have a choice on how to set standards on the quality and quantity of loans they will accept for federal forms of insurance or their portfolios. Change is a choice but to choose not to change is also a choice—and often a fatal one. If Federal policymakers and private lenders do not alter prior rules on subprime lending then another credit cycle is likely. However, if lending guidelines are tightened too much ...then a true credit crunch becomes more likely and the downdraft in the housing cycle will be amplified. Credit constraints will generate even greater rates of delinquencies and foreclosures. This credit reign of terror was the pattern for the high-yield bond market during the 1990-1992 period. In today’s cycle, we can see that the rapid rise in the net percentage of banks tightening standards sets up the preconditions for a rout if public policy amplifies the call for the exits.”
- “...For housing and mortgage markets the credit dynamic today can be further complicated by policymakers. In recent weeks, federal authorities have issued guidance to tighten mortgage lending standards. Moreover, Freddie Mac has issued tighter guidelines on the subprime mortgages it will accept. Unfortunately, this is all after the horse has left the barn. Tighter standards will make it more difficult for future buyers to qualify and, thereby, reduce the demand for homes. This accentuates the downward price momentum and, thereby, the upward swing in delinquencies. How much and how quickly do regulators raise credit standards to where they ‘should have been’ without shutting out all transactions that might clear the existing overbuilt market? All this suggests that policymakers tread carefully given the current below trend pace of economic growth.”
- “Moreover, policymakers in Washington suggest bailing out the delinquent borrowers. This creates a risky set of incentives and a hopelessly complicated set of regulations. How will government determine the truly unfortunate as compared to the simply speculative borrowers? Many subprime mortgage brokers are headed for failure, but then who will make up the payments to investors? Will future tax payers be asked to pay interest on bonds to fund current speculators? If no new credit is forthcoming, then many homes and developments will not be finished, neighborhoods will take years to complete and community and personal stress will remain elevated.”

- “Today’s interaction between finance and economics is a dynamic process with many unanticipated twists in the course of market adjustments. Too often, both private and public policymakers fail to heed the implications of change. Moreover, too much decision making only considers the very first step in the process. Effective leadership must look down the road to anticipate the second and third turns to judge the effect of current decisions. Subprime lending is simply the latest example of a long history of such dynamic processes with uncertain outcomes and unanticipated results.” (*Special Commentary: Subprime Lending as Classic Credit Cycle*, The Wachovia Economics Group, 04/11/07)

Other policy issues raised by “subprime “meltdown”

- In the *Washington Post*, Dean Baker, co-director of the Center for Economic Policy Research, urged Congress to re-examine the government’s policy of promoting home ownership in the context of the collapse of the subprime mortgage market. Baker wrote, “[While the] full effects of the collapse of the subprime market remain to be seen, ...it is not too early to talk about the policies that got us here. In particular, the government policy of promoting homeownership should be examined. Proselytizers of homeownership can be found in both political parties. Democrats have long argued for lending policies that allow easier mortgage credit to low-income families to help remove an important obstacle to achieving financial security. Republicans tend to frame their support for homeownership as part of their drive to create an ‘ownership society’ in which everyone owns a piece of the country and can share in its prosperity. The result has been a range of policies that promote homeownership while generally neglecting renters.”
- “While homeownership is often desirable as a means for accumulating wealth and obtaining secure housing, it will not always be a good mechanism for either. People often find it necessary to move for reasons that are not easily controlled. For example, sickness, death or unexpected family break-ups may require changes in living arrangements. Similarly, in the dynamic U.S. economy, where job security is a relic of the past, workers frequently have to move to maintain or advance their careers. Since large transaction costs (typically close to 10 percent of the sale price) are associated with buying and selling a home, it generally does not make sense for someone to buy a home unless he or she can stay in it for a substantial period. A University of Washington study found in 2004 that among low- and moderate-income home buyers in the 1980s and ‘90s, the median family owned its home for less than four years (higher turnover rates in recent years have almost certainly shortened this period). This means that the transaction costs associated with buying and selling a house, such as Realtor fees, financing fees and other closing costs, must be averaged over just four years. If, say, those fees came to 10 percent on a \$200,000 house, or \$20,000, then the transaction costs would have added \$5,000 per year to the housing cost for a typical moderate-income home buyer. Since the median annual rent in Washington is only around \$9,000, the transaction costs associated with buying and selling a home are significant. A family that lived in a home for only four years almost certainly would have been better off renting. The situation is even worse if the

home purchase price was driven up in a speculative bubble, as was the case with many homes in recent years. Not only will some home buyers incur large transaction costs, but in today's market they are also likely to be forced to sell their houses for less than they paid. This is precisely why so many moderate-income home buyers are defaulting on their mortgages. They have been stuck with mortgages that they cannot afford, on homes that are worth less than their purchase price. In this situation, many people wind up losing whatever savings they put into their house."

- "While there are losers in this story, there are also winners. The transaction costs borne by home buyers are income for those in the real estate industry. Upwards of 2 million subprime borrowers are expected to default in the next few years, with as many as 20 percent of subprime borrowers being hit over this period. If the average purchase price for these borrowers' homes was \$200,000, these home buyers would have generated close to \$40 billion in real estate and mortgage fees. That considerable sum is likely to persuade many to hear the gospel of the ownership society."
- "A serious housing policy should recognize that renting can be a better option for many Americans, especially for tens of millions of families with low and moderate incomes. The country cannot allow its housing policy to be determined by ideology or the interest groups that benefit from this ideology." (*Washington Post*, Dean Baker, 04/07/07)

#### It's not your parents' mortgage market anymore: Subprime mortgages are here to stay

- In an April 6<sup>th</sup> analysis of the subprime market, former member of the Federal Reserve Board of Governors and Urban Institute fellow Edward Gramlich wrote, "Is the American housing dream going sour? The Dow Jones industrial average tumbled 243 points in early March when missed payments by holders of subprime mortgages hit a four-year high and foreclosures on all homes a four-decade peak."
- "The homeownership dream first solidified in the 1950s. Then, the mortgage of choice was the 30-year, fixed-rate mortgage with 20 percent down. Millions of middle-class households bought suburban houses, erected backyard swing sets, and sent their kids to new public schools. The overall homeownership rate shot up from 45 percent to 65 percent in just more than a decade. But most lower-income families either could not make the down payment or the monthly payments. Racial and ethnic minorities faced discrimination to boot. Most of these households continued to rent, and the American homeownership rate stabilized near 65 percent for 35 years."
- "Following that postwar boom, other seismic shifts reverberated in mortgage markets—usury laws ended, credit scoring developed, and Fannie Mae and Freddie Mac made advances in packaging mortgages into securities. The Community Reinvestment Act obligated banks and thrifts to make low- and moderate-income mortgage loans. Many new independent mortgage companies sprang into action. As these factors converged, the subprime mortgage market blossomed. Lending swelled

from almost zip in the mid-1990s to more than \$600 billion today, one-fifth of all new mortgages. About 12 million new homeowners emerged—including many moderate-income households and minorities previously excluded—raising the overall U.S. homeownership rate to about 69 percent, among the world’s highest.”

- “While an arbitrary threshold (defined by the rate of interest charged) delineates the lower edge of the prime mortgage market from the subprime market, the two are different animals. Most prime mortgages go to credit-worthy households; most subprime mortgages go to those with less-stellar credit records and carry higher rates, points, and fees. Most prime mortgages feature down payments; many subprime mortgages don’t. Made by banks and thrifts, most prime mortgages are fixed-rate. Negotiated by independent mortgage brokers, many subprime mortgages are adjustable. Most prime mortgages carry no prepayment penalties; most subprime mortgages do.”
- “The bottom line? The new subprime mortgage market is far riskier than the old prime market. The foreclosure rate in the prime market has typically been less than 1 percent, compared with about 7 percent in the subprime market. Now, the interest rates of the recent raft of subprime mortgages are about to rise (since they track short-term interest rates). The Center for Responsible Lending predicts foreclosure rates of about 20 percent, excluding distress sales. Millions of new homeowners who stretched to make their payments when short-term interest rates were very low are beginning to lose their homes.”
- “Should we close down the subprime market and return to the world of the early 1990s? No way. Regrettable foreclosures notwithstanding, three-quarters of new homeowners are making their payments, building wealth and participating in the American dream.”
- “Should we increase protections and safeguards for the new homeowners? Absolutely. The key is stopping the shortcuts taken in the recent go-go subprime market. Lenders should scrutinize borrowers’ ability to repay the loan, using the maximum rate on adjustable-rate mortgages—not the initial low rate. Lenders should escrow property taxes and insurance payments. Independent subprime lenders should be as carefully supervised as banks and thrifts making prime loans are.”
- “Congress can get going, too. The 1994 Homeowner Equity Protection Act imposed controls on predatory lending by preventing balloon payments on high-priced mortgages, outlawing long-term prepayment penalties, and forcing lenders to evaluate borrowers’ creditworthiness. HOPEA’s rate thresholds could be tightened up, and strictures on balloon payments could be applied to rate hikes on adjustable-rate mortgages and other payment shocks. If both lenders and borrowers had to confront the long-term costs of a mortgage, fewer households would lose their homes.”
- “The clock cannot be turned back on the subprime mortgage industry. But financial regulators and legislators could look forward by promoting less risky

homeownership.” (*It’s Not Your Parents’ Mortgage Market Anymore*, Edward Gramlich, PhD; 04/06/07)

Bush administration notes

- In a recess appointment, President Bush has named Susan E. Dudley, a former adjunct professor of George Mason University’s School of Law to serve as administrator of the Office of Information and Regulatory Affairs. (*CQ Today*, Jeff Tollefson, 04/04/07)
- The Federal Reserve appointed Laricke D. Blanchard to lead its congressional affairs team . Before joining the Fed’s congressional affairs team in April 2002, he worked as vice president and counsel at Citigroup, Inc. As the “assistant to the board,” Blanchard replaces Winthrop P. Hambley, who will now serve as a senior adviser to the Fed’s board. (*Dow Jones International*, Damian Paletta, 04/05/07)

Make mortgage insurance premiums fully tax-deductible

- In an April 13<sup>th</sup> editorial in the *American Banker*, Steve Smith, CEO of PMI Group, urged Congress to pass recently introduced legislation that would make permanent new federal tax deductions for mortgage insurance premiums (H.R. 1813). Smith argues, “Affordability will continue to be a challenge this year, and sustainability will become a bigger concern, as the industry focuses not just on getting people into homes, but also on keeping them there. This means recognizing that loans that transfer significant risk to the borrower are not the only way, nor necessarily the best way, to serve high-loan-to-value borrowers. It also means renewing our commitment to helping borrowers select a product they can manage successfully over the entire period they own their homes. Finding ways to provide [mortgage] products that offer affordable payments without transferring undue risk to borrowers will ensure that we continue to enjoy a stable, thriving mortgage market.” (*American Banker*, Steve Smith, 04/13/07)

## ***Fannie Mae***

### Fannie's continued listing on NYSE a "concern," Senators say

- In an April 2<sup>nd</sup> letter to Fannie Mae CEO Daniel Mudd, Senators Chuck Hagel (R-NE), Elizabeth Dole (R-NC) and John Sununu (NH) questioned why the company holds its NYSE listing even though it does not file timely financial statements. "We understand that Fannie Mae's special exemption from having to delist from the stock exchange will end this year," wrote the Senators. "We are very concerned that this exemption sends the wrong message to our capital markets." The Senators requested details on when Fannie Mae would return to a timely filing of earning statements with the SEC. (Correspondence to *Fannie Mae CEO Daniel Mudd*, Senators Chuck Hagel, Elizabeth Dole, and John Sununu, 04/02/07)

### Fannie Mae to buy tax-exempts following 2 year suspension

- On March 30<sup>th</sup>, Fannie Mae announced that it will soon resume purchases of tax-exempt bonds from state and local housing agencies, ending a two-year suspension of its tax-exempt debt purchases. Under its new rules, Fannie Mae will begin investing in "traditional" mortgage revenue bonds, which will be limited to fixed-rate bonds with double-A ratings or higher. According to the company, "Housing-related bond offerings, such as military housing and student housing, will require bond insurance from an AAA-rated, mono-line bond insurer at the time of purchase. Additionally, housing-related bond offerings, such as bonds issued by public housing authorities and secured by capital program funds, must include at least two AA-credit ratings or one credit rating and AAA-rated, mono-line insurance." (*The Bond Buyer*, Andrew Ackerman, 04/02/07)

### Fannie Mae provides \$1.3 million to help 250 Washington, D.C. teachers to become certified

- Fannie Mae has provided \$1.3 million to help as many as 250 public school teachers (\$5,200 per teacher) in the District of Columbia to earn certification from the National Board for Professional Standards. These teachers will also be eligible for down-payment assistance of \$10,000 from Fannie Mae to assist them in purchasing a home. A Fannie Mae spokeswoman told Education Week that she didn't know how the money targeted for certification would be spend by the D.C. School System. Fannie Mae's contribution to this effort is part of the company's \$10 million in new contributions it will be making in the Washington, D.C. area. (*Education Week*, Bess Keller, 04/11/07)

## ***Freddie Mac***

### Freddie Mac prices a \$500 million preferred stock offering

- On April 10<sup>th</sup>, Freddie Mac priced its \$500 million offering of fixed-rate, non-cumulative perpetual preferred stock at \$25 a share and a 5.66% dividend. The company expects to issue the shares on April 16<sup>th</sup>, subject to the satisfaction of customary closing conditions. Fitch Ratings has assigned an 'AA-' rating to Freddie Mac's new preferred stock issue, which will be used to repurchase the company's common stock. The preferred stock was offered via a syndicate of dealers headed by Banc of America Securities LLC and Morgan Stanley. Co-managers of the offering include Bear Sterns & Co., FTN Financial Capital Markets, Goldman Sachs Group, Lehman Brothers, and Merrill Lynch. (*Freddie Mac Press Release*, 04/10/07; *BusinessWire*, 04/12/07)

### Freddie Mac Foundation awards nearly \$11 million during the second half of 2006 to improve the lives of children and families in the Washington, DC area

- During the last six months of 2006, the Freddie Mac Foundation awarded nearly \$11 million to organizations whose innovative programs improve the lives of children and their families primarily in the Washington, D.C. area, bringing the organization's "giving" (including "all giving expenses, contributions, grants and matching of employee donations") to \$26.2 million in 2006. During the last half of the year, the Foundation approved 129 grants, which were primarily focused on strengthening families, foster care and adoption, youth development, and stable homes and families. (*PR Newswire*, 04/10/07)
- On April 5<sup>th</sup>, the Freddie Mac Foundation awarded \$750,000 to the Children's Defense Fund to help low income families file their tax returns, as part of the CDF's ongoing public education and financial literacy programs. (*PR Newswire*, 04/05/07)

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

AEI panel debates merits of the FHLBs' credit enhancement proposal
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- Under current law, interest on tax-exempt municipal bonds becomes taxable if the bonds are credit enhanced by a Federal Government instrumentality, such as the FHLBs. The FHLBs are seeking a change in the law that would allow them to issue stand-by letters of credit (SLOCs) to credit enhance municipal bonds without causing the bonds to lose their tax-exempt status.
- On April 11, American Enterprise Institute conducted a panel discussion on the issue. John R. Price, president and CEO of the FHLB- Pittsburgh, argued that Congress should allow the FHLBs to provide credit enhancement to issuers of tax-exempt development bonds in order to provide access to capital for small issuers in a number of “underserved markets,” which the private insurance market “wouldn’t touch.” Moreover, such a change would enable community banks to gain access to international capital markets, which money center banks currently enjoy, said Price. Several bills proposing the tax-code change have previously been introduced in Congress, but none have been approved. Price said he expected Representative Paul E. Kanjorski (D-PA) would be a sponsor of such a measure in the 110<sup>th</sup> Congress.
- Speaking on behalf of the Association of Financial Guaranty Insurers, Gary C. Dunton, president and CEO of MBIA Inc., argued that the private market meets the needs of issuers and that the tax break sought by the FHLBs is not warranted. Moreover, giving this tax treatment to the FHLBs on top of the other advantages that the System enjoys as GSEs would give the Banks an unfair advantage in a very competitive market, argued Dunton. He contended that a number of unintended consequences would result from giving the FHLBs tax-free status for SLOCs. Under such a structure, private competitors could be displaced and issuers would face monopoly pricing. Fiscal discipline could be undermined, even for investment-grade issues. Moreover, the tax break would significantly reduce tax revenues currently paid to federal, state and local governments. According to Dunton, the private financial guaranty industry paid over \$1 billion in taxes last year to federal, state and local governments. If the FHLBs were to displace the private companies, the federal, state and local governments would lose a good portion of those revenues because the FHLBs are exempt from federal, state, and local income taxes. In addition, the premium taxes paid by the private companies to the states would be lost as well.
- AEI’s senior fellow Peter J. Wallison, who served as the panel’s moderator, asked if providing the FHLBs the tax break is good public policy. A related issue to be considered is how far GSEs should be allowed to intrude into the private financial markets. Given their inherent advantages, the GSEs can easily dominate any market that they enter. If market failure is not sufficiently clear, what standards should be used to determine if the markets are “underserved,” asked Wallison.

- AEI resident fellow Alex Pollock said that providing the FHLBs credit enhancement would be “very far from the ideas of the creators” of the FHLB System, which originally consisted of mutual thrifts dedicated to the housing system. Today, the borrowing advantages (i.e., government subsidy) are passed along to private shareholders of the FHLBs’ privately-owned members . As an example, said Pollock, the five largest members of the FHLB System represent 80% (or \$148 billion) of the FHLBs’ borrowings: Citi, Washington Mutual, Wachovia, IndyMac, and Bank of America. Thus, the “needy” shareholders get the value of the FHLBs’ government subsidy. None of the original circumstances of the FHLB System still exist and have changed beyond recognition. While serving as the president of the FHLB-Chicago, Pollock said he wanted to expand the liabilities of his Bank, as his fiduciary responsibility to his members. From outside the GSE system, Pollock said, it is debatable if there should be a deposit-based or bond-based mortgage financed system. Creating a risk-based pooling is good, said Pollock, but is questionable if it should be done by a GSE. Specifically, the FHLBs have “zero knowledge” about municipal finance, so the Banks will be relying on its member, but not on the underlying collateral. (*The Bond Buyer*, Andrew Ackerman, 04/12/07; *Presentation to the American Enterprise Institute*, Gary Dunton, 04/11/07)
- In a white paper provided at the session, W. Scott Frame, a financial economist and associate policy adviser on the financial team in the research department of the Federal Reserve Bank of Atlanta, and Lawrence J. White, the Arthur E. Imperatore Professor of Economics at New York University’s Stern School of Business identify the public policy issues related to the FHLBs’ tax exemption proposal. Specifically, the authors ask, “Since the U.S. today has well-developed financial markets (including mortgage markets) and there are also extensive tax advantages and other preferential policies for residential housing already in place, what legitimate purpose is currently served by the housing GSEs? Where are the market failures that housing GSEs are supposed to correct? This question takes special importance for the FHLB System since ...it appears that the FHLBs’ advances to their members are used for general lending purposes, rather than being particularly focused on housing finance. Further, it is clear that the larger FHLB members that are the largest users of advances are well able to access national capital markets on their own and do not need the FHLBs as intermediaries on their behalf. While smaller members might benefit from a FHLB-like wholesale funding intermediary, it is not clear that such an institution needs a Congressional charter.”
- “As a related matter, when a GSE enters a new activity, the presence of their underlying borrowing advantage makes it difficult to discern whether their expansion (if successful) is due to an inherent efficiency or synergy or whether it is simply a ‘leveraging’ of their borrowing advantage to the new activity. This issue is particularly troublesome when private firms are already serving the market that the GSE is entering. Moreover, if the new activity should prove to be a major problem for the GSE, could the adverse financial consequences be large enough to place taxpayers at risk?”

- “Note that the perceived implied guarantee provides excessive risk-taking incentives to GSE shareholders and allows these institutions to grow almost without limit since their debt funding costs are seemingly invariant to risk. Such concerns about moral hazard and the potential scale of taxpayer liability have been primarily discussed in the context of the large mortgage portfolios retained by Fannie Mae and Freddie Mac and the interest-rate risk that is embedded in those portfolios; but they apply as a general matter to any GSE, where taxpayer support may ultimately be called upon. With respect to the FHLB System..., the cooperative ownership structure does not mitigate the dangers of deliberate or inadvertent risk-taking by the FHLBs. The extremely high leverage of the FHLB System (a ratio of assets to capital of over twenty-to-one) and the fact that the debt is held by outsiders who are lulled into slack monitoring (and the acceptance of that high leverage) because of the System’s GSE status mean that FHLB member/owners can still gain (in an expected value sense) from risk-taking. Similarly, the joint-and-several-liability structure of their consolidated obligations serves as only a modest restraint on risk-taking. Though the eleven other FHLBs may be liable for the misdeeds or errors of any single FHLB, a free rider problem among those eleven could well mute their efforts to control risk-taking among the twelve. ...[T]he safety-and-soundness issue re-raises the question of what are the public purpose benefits of the FHLB System and whether those benefits are worth the risks.”
- “...The FHLBs’ expansion of their SLOC activities poses the kinds of questions that we [previously] raised...: Is the FHLBs’ expansion here part of an inherent efficiency or synergy? Or is it just a leveraging of their special GSE borrowing advantage into an already competitive market? As a related point, how well does the offering of SLOCs fit with the FHLBs’ current expertise? Does it raise safety and soundness concerns? ...Is there a market failure in the area of bond guarantees that would justify the FHLBs’ expanded SLOC authority? It seems unlikely that the market for third-party credit enhancements for municipalities is inefficient or underserved. We are unaware of any barriers to entry. And, at the same time, the FHLBs may have two important GSE-related advantages that could help them underprice private-sector SLOC competitors: The first is that the FHLB System, like Fannie Mae and Freddie Mac, maintains a AAA rating despite holding much less equity/capital than similarly rated private financial firms. The second is the previously mentioned ability of the FHLB to lay to claim to marketable collateral as well having as a “super lien” for the repayment of advances, which include those advances created by a SLOC. The SLOC debate thus represents an interesting question as to the extent to which public policy should encourage the leveraging of the FHLBs’ GSE advantage into areas that are increasingly distant from the original housing mission of the System...” (*The Federal Home Loan Bank System: Current Issues in Perspectives*, W. Scott Frame and Lawrence J. White, PhD, 04/11/07)

FHLB System reports rising profits for FY2006, while advances decline at six banks

- The FHLB System reported a 4% increase in aggregate profits to \$2.6 billion, attributable to profit growth at eight of the 12 FHLBs. Profits declined at the Des Moines Bank (61%), followed by the Dallas Bank (50%), Chicago Bank (23%) and Indianapolis Bank (23%). According to the Banks' SEC filings, advance volumes grew at six of the 12 FHLBs. All of the FHLBs continued to build their retained earnings during 2006; as a result, only three FHLBs raised their dividend payments to members, while five kept their dividends unchanged and one Bank cut its dividend rate. [Three FHLBs have not announced their dividend payments for FY2007].
- Brian Harris, an analyst at Moody's Investors Service Corp, said, "[The FHLBs] are currently working their way through a number of issues related to cost structures," particularly those related to the Sarbanes-Oxley Act. He added, "Those issues all address profitability." Harris said, the FHLBs spent much of 2005 and 2006 adjusting to costs associated with becoming SEC registrants, and are working on implementing the Sarbanes-Oxley requirements. (*American Banker*, Steven Sloan, 04/03/07)
- On April 11, the Federal Housing Finance Board passed a resolution waiving some requirements dealing with the FHLBs' combined financial reports for prior periods. By regulation, the FHLBs' Office of Finance must prepare and distribute both annual and quarterly combined financial reports, which must generally be consistent with the requirements of the SEC Regulations S-K and S-X. As a result of the FHLBs' financial restatements, the Office of Finance determined that the agency's previously published combined financial reports from 2001 to the second quarter of 2004 could not be relied upon. Further, the Office of Finance determined that it would not provide any combined financial statements until all FHLBs became SEC registrants as the agency could not be sure that any financial statement information provided by the FHLBs would not be subject to subsequent restatement. In granting the waiver, the Finance Board considered the fact that each FHLB and the Office of Finance is providing current financial information to members, investors, and the public. As a result of the Finance Board's waiver, the Office of Finance (1) must place on its web site restated core financial statements for 2001, 2002, and 2003, and return to its web site the previously issued combined financial reports for those years with an appropriate disclaimer; (2) must place on its web site core financial statements for 2004 with an abbreviated financial discussion and analysis; and (3) will not have to re-issue quarterly financial reports for periods up through the second quarter of 2004 or issue quarterly financial reports for periods up through the third quarter of 2006. On balance, the waivers mandate that the Office of Finance post to its web site a full annual series of correct core financial statements for the FHLB System. (*Federal Housing Finance Board Press Release*, 04/11/07)

Housing Finance Board appoints Charles A. Bowsheer to serve as a private-citizen director of the FHLBs' Office of Finance

- On April 11, the Federal Housing Finance board of directors appointed Charles A. Bowsheer to serve as a private-citizen director of the FHLBs' Office of Finance for a three year term that expires on March 31, 2010. Bowsheer served a 15-year term as the Comptroller General of the United States and head of GAO. Previously, he was associated with Arthur Anderson for 25-years and served as Assistant Secretary of the Navy for Financial Management (1967 to 1971). Currently, Bowsheer serves on the Public Company Board of Accounting Oversight Board and Glass Lewis & Co. (*Federal Housing Finance Board Press Release, 04/11/07*)

FHLBs announce changes to their boards of directors

- On March 30<sup>th</sup>, the Federal Housing Finance Board approved the appointment of John Goldsmith and Dr. Helen F. Peters to serve as directors of the FHLB-Boston for the remainder of a three year term that commenced on January 1, 2007. The Finance Board also approved the appointment of Andrew J. Calamare, Cornelius Hurley, and Jay F. Malcynsky as directors of the FHLB-Boston to fill the remainder of a three year term beginning on January 1, 2006 and Patrick Clancy to fill the remainder of a three year term that commenced on January 1, 2005. Goldsmith is a partner with The Roseview Group, a Boston-based banking and advisory firm. Previously, he served as chairman and CEO of Tucker, Anthony, Sutro, a 2,500-person financial services firm which was acquired by the Royal Bank of Canada in 2001. Dr. Peters is a professor of finance at Boston College (BC) and former dean of the Carroll School of Management at BC. Calamare is the president and CEO of the Life Insurance Association of Massachusetts, a trade organization of 14 leading commercial life, health, disability and long-term care insurers in the state. Previously, he served as the Commissioner of Banks for the Commonwealth of Massachusetts, overseeing the state-chartered banking system. Hurley is the director of the Morin Center for Banking and Financial Law at Boston University School of Law. Previously, he served as a managing director of the Secura Group, a Washington-based bank consultancy. Malcynsky serves as the president and managing partner of the law firm Gaffney, Bennet and Associates, which specializes in government and administrative law. Clancy is the president and CEO of The Community Builders, a Boston-based non-profit housing and development organization that is active in 15 states. (*Federal Housing Finance Board Press Release, 03/30/07; PR Newswire, 04/05/07*)
- On April 11<sup>th</sup>, the Federal Housing Finance Board approved the appointment of C. Kent Conine, William L. Jackson, Jr. and James Wynford Pate, II to serve as directors of the FHLB-Dallas for the remainder of a three year term that began on January 1, 2007. The Finance Board also approved the appointment of Margo S. Scholin and Clarence G. Simmons, III to serve as directors for the remainder of a three year term that began on January 1, 2006. Conine is the President of Conine Residential Group

in Frisco, TX, which has been responsible for the construction, management and development of more than 4,500 apartment units and the development of several residential communities. Conine also serves as vice chairman of the board of the Texas Department of Housing and Community Affairs and is a member of the National Conference of State Housing Boards. Jackson is the founder and CEO of Metroplex Industries in Houston, TX. Pate is the Executive Director for the New Orleans Area Habitat for Humanity. Scholin is a partner at Baker Botts L.L.P. in Houston, Texas, where she has practiced corporate, transactional and securities law at the firm since 1983. Scholin also is a board member for the Houston Area Women's Center and Neighborhood Centers Inc., and is a past member of the Texas Board of Health. Simmons is senior executive vice president and CFO at Thornburg Mortgage Inc. in Santa Fe, NM.

- On April 11<sup>th</sup>, the Federal Housing Finance Board approved the appointment of Grady P. Appleton and Donald R. Ball to serve as directors of the FHLB-Cincinnati for the remainder of a three year term that began on January 1, 2007. The Finance Board also approved the appointment of Charles Ruma to serve as the Bank's director for the remainder of a three year term that began on January 1, 2006. For 25 years, Appleton has served as Executive Director of East Akron Neighborhood Development Corporation, Ohio, which under his leadership has built or rehabilitated more than 2,000 affordable homes, created more than 400 jobs and facilitated more than 100 new businesses. His housing finance leadership experience includes current board service with Ohio Capital Corporation, Ohio Equity Fund, Ohio Housing Council and Ohio Housing Trust Fund. Ball is co-founder of Ball Homes, Lexington, Kentucky, and creator of Barkham Inc. and LexLinc. Barkham is a nonprofit building/general contractor organization which donates all revenue to affordable housing activity. LexLinc is a private, nonprofit organization that works with welfare recipients to obtain employment. Ball is currently Chairman of Kentucky Housing Corp., the state's housing finance agency. Ruma is President and CEO, Virginia Homes Ltd., Columbus, OH. He also serves on the Ohio Housing Finance Agency, the state's housing agency, where he chairs the Single Family Committee. He is also a former president of the National Association of Homebuilders.
- On April 12<sup>th</sup>, The Federal Housing Finance Board approved the appointment of C. Cathleen Raffaelli and Edwin C. Reed to serve as directors of the FHLB-New York to serve the remainder of a three-year term that began on January 1, 2006. The Finance Board also approved the appointment of Joseph Melone and Michael M. Horn to serve as directors for the remainder of a 3-year term that began on January 1, 2007. (*Federal Housing Finance Board Press Release, 04/12/07*)
- On April 12<sup>th</sup>, The Federal Housing Finance Board approved the appointment of Thomas Edward Henning and Neil F. M. McKay to serve as directors of the FHLB-Topeka to serve the remainder of a three-year term that began on January 1, 2006. The Finance Board also approved the appointment of Andrew C. Hove, Jr. and Richard S. Masinton to serve as directors for the remainder of a 3-year term that

began on January 1, 2007. (*Federal Housing Finance Board Press Release, 04/12/07*)

- The FHLB-Indianapolis announced that director Ronald G. Seals, president and CEO of Springs Valley Bank and Trust, Jasper, IN, passed away on March 31, 2007. (*FHLB-Indianapolis Press Release, 04/05/07*).

Representative Chaka Fattah (D-PA) announces FHLB-Pittsburgh housing grants

- Representative Chaka Fattah (D-PA) announced that the FHLB-Pittsburgh has awarded \$2.62 million in grant money to 11 affordable housing projects in the Philadelphia region, helping to create 314 units of clean, safe housing for individuals and families of modest means. (*FHLB-Pittsburgh Press Release, 04/13/07*)

## ***Ginnie Mae***

Two FHA reform bills introduced in the House to modernize the agency  
in wake of subprime mortgage market turmoil

- On March 29, Representative Judy Biggert (R-IL) introduced H.R. 1752 to reform FHA, an identical bill to legislation (H.R. 5121) that passed the House 415-7 in 2006. H.R. 1752 provides FHA wider discretion in charging risk-based premiums to borrowers. On the same day, Representatives Barney Frank (D-MA), chairman of the House Financial Services Committee, and Maxine Waters (D-CA), chairman of the Subcommittee on Housing and Community Opportunity, introduced the Expanding Homeownership Act of 2007 (H.R. 1852), which would reform the FHA and “generate” revenues that would be “available for use only for grants to provide affordable rental housing and affordable homeownership opportunities for low-income families, an amount equal to the net increase for such fiscal year in negative credit subsidy for the mortgage insurance programs.” According to CBO’s scoring of H.R. 5121 last year, the bill was projected to earn \$247 million in negative credit subsidies of FHA’s insurance program in fiscal year 2007 and \$2.1 billion over five years. Frank said he is still considering how the AH fund would work in the FHA bill. The FHA legislation in concert with GSE reforms and the federal regulators’ lending guidance can begin to resolve some of the problems in the subprime mortgage market, said Frank.
- In contrast to H.R. 5121, the Expanding Home Ownership Act would also eliminate fee increases for borrowers who make down payments, a reduction in the maximum initial fee from 3% of loan value to 2.25%, and a reduction of the annual fee from 2%

to 0.55%. According to the Committee's statement on this bill, these three changes "would reduce FHA closing cost premiums for a hypothetical family buying a \$300,000 house by \$2,250 and annual fees over a five year period by over \$20,000 compared to the bill enacted last year." The Frank-Waters bill also would add a new feature providing authority to HUD to require pre-purchase counseling for riskier borrowers.

- Noting that partisan politics got in the way of passage of FHA reform legislation, Federal Housing Commissioner Brian D. Montgomery said that the Bush administration may craft its own reform bill. "[There are] broad swaths of agreement on this bill and on the need. We're now just working out some minor differences of opinion," said Montgomery.
- In a recent report, HUD's inspector general Kenneth Donohue cautioned that the Bush administration's plan to offer low- and middle-income home buyers an alternative to subprime loans may be susceptible to fraud. The proposal, incorporated in H.R. 1752, would make it easier for borrowers to get mortgage insurance from the FHA but would do little to assure adequate oversight of lenders, appraisers and lawyers, said Donohue. FHA reviews only 6% to 7% of its loans each year to ensure that its portfolio is properly administered, he added. "The FHA has to go back and make sure the same thing that has happened with subprime loans doesn't happen with its program," said Donahue. "The FHA has to make sure it doesn't get taken by the lenders, and it has to make better reviews of loan portfolios." FHA will need more resources to review loans and to try to recover losses, he added. (*Washington Post*, Neil Roland, 04/13/07)
- Although the outlook for passage of FHA reform is uncertain, observers agree that the current surge in foreclosures in the subprime mortgage market may spur lawmakers to find common ground on FHA reform legislation. Industry representatives and consumer groups say that they support FHA reform because it offers subprime borrowers a means to avoid foreclosure. John Taylor, the president and CEO of the National Community Reinvestment Coalition, said his group supports adding a provision in an FHA bill to assist subprime borrowers facing foreclosures to get into "fairer loans that more accurately reflect the borrowers' ability to repay." Robert Davis, EVP and the managing director of government relations at America's Community Bankers, agreed, saying, "It's logical to ... get them a mortgage that is more likely to keep them in the home through FHA." Stanford Washington Research Group analyst Jaret Seiberg, said, "As we move through the spring there is going to be enormous pressure for there to be a political compromise on FHA reform." (*Bureau of National Affairs*, Richard Cowden, 04/03/07; *American Banker*, Joe Adler and Stacy Kaper, 04/05/07; *National Mortgage News*, 04/09/07)

## FHA helps borrowers avoid foreclosure

- According to HUD, FHA lender/servicers helped 36,500 thousand families who were behind in their mortgage payments keep their homes during the first half of fiscal year 2007. “FHA lending relief measures continue to help families around the nation work through difficult times, stay in their homes, and avoid foreclosure,” said HUD Secretary Alphonso Jackson said. “Modernizing the FHA would provide more hard-working families with a strong alternative to risky mortgages.” During fiscal year 2006, FHA’s loss mitigation program helped 75,000 delinquent borrowers keep their homes. In FY2006, FHA foreclosed 51,600 loans, while 4,900 defaults resulted in pre-foreclosure sales. (*National Mortgage News*, 04/09/07)

## ***Postal Service***

Postal reform legislation’s intent was to provide the USPS with significant flexibility to price their products, so long as rate changes stay within the CPI cap

- In a April 6<sup>th</sup> letter to Postal Regulatory Commission chairman Dan C. Blair, Senators Thomas Caper (D-DE) and Susan Collins (R-ME) wrote: “The section of the Postal Accountability and Enhancement Act (the Act) calling for the creation of a new system for regulating the Postal Service’s Market Dominant products lays out the nine major objectives of the new system. It also lists fourteen factors that the Commission should consider when developing the new system. The primary requirement, however, is the requirement that, for at least ten years, the system ‘include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers.’ We intended the objectives to supersede the factors in issues affecting the system’s design.”
- “In drafting the rate-setting section of the bill, we did choose to allow the Postal Service to carry unused rate authority over into future years, even if using such authority may result in a breach of the Consumer Price Index cap. We also chose to call for the development of a mechanism whereby the Postal Service may raise rates above the cap under ‘extraordinary or exceptional circumstances’ that may hinder the Postal Service’s ability to fulfill its universal service obligation or its ability to provide high quality service standards. We intended for this mechanism to be used sparingly, however.”
- “In our view, the ‘extraordinary or exceptional circumstances’ referenced in the language may include terrorist attacks, natural disasters, and other events that may cause significant and substantial declines in mail volume or increases in operating costs that the Postal Service cannot reasonably be expected to adjust to in the normal

course of business. We expect that, in accordance with the requirement written into the bill, the Commission will closely examine any request from the Postal Service for permission to raise rates above the cap and hold public hearings in which the public may comment.”

- “So long as a rate change put forward by the Postal Service is within the Consumer Price Index cap, it was our intention that the Postal Service should have significant flexibility to price their products in the manner they deem most appropriate to meet their needs and the needs of the mailing public. The 45-day period that the Act gives the Commission to review rate filing is largely intended to be used to determine whether or not a rate filing is within the rate cap.” (*Correspondence to Postal Regulatory Commission chairman Dan C. Blair*, Senators Thomas Caper and Susan Collins, 04/06/07)

What was the Postal Rate Commission thinking?
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- In the April 1<sup>st</sup> issue of *Direct*, Charley Howard analyzed the changes that the Postal Rate Commission made to the Postal Service’s last request for a postal rate increase. Howard wrote, “First, the [PRC] made several major changes, including cutting revenue to be generated by the rate case. This helped all mailers, and mainly was accomplished by reducing the first class stamp price increase from 3 cents to 2, or 41 cents per piece. To help make up for some of this lost revenue, the PRC raised first class rates for automated letters and flats somewhat, thereby shifting impact from consumers to commercial mailers. Second, the PRC took the step the USPS seemed to hold back on — that is, pushing the vision of shape-based rates to its logical and cost-based end. In standard mail, the PRC lowered the increase for automated letter mail and boosted the earned drop-ship discounts to full cost coverage. Flat mail took a further huge hit across the board, and the hike for non-machinable letters went up as well. The case in standard mail subcategories, though, is not straightforward. Winners and losers appear in niches and nuances. Each mailing has to be analyzed with an eye on the impact imparted by the PRC’s actions. The key to the increases and their impact appears to hinge on mailing density — both in presort and drop ship. In short, the higher the carrier route penetration and sectional center facility (SCF) drop-ship entry point, the softer the impact of the PRC’s recommendations.”
- “The letter rates seem to be about 5% to 8% less than those requested by the USPS (now an increase of 2% to 3.5%) while flat rates as it now stands are running 5% to 8% higher (17.5% to 19%). From a budget perspective, the PRC’s recommendations amount to a wash if a mail mix is roughly half letters and half flats. The more automated letter mail there is, the better a mailer fares — the more flats, the worse. On the downside, for those with lower density and less carrier route and SCF drop-ship entry mail, the flat mail charges are staggering. It’s not uncommon to see 23% to 28% rate hikes as normal. And non-machinable letters are the worst of all, at 55.6% to 88.1%!”

- “...The USPS’ next rate case would be subject to postal reform rules, with CPI-tied rate caps and expedited proceedings. In the end, that may be some consolation to all.” (*Direct*, Charley Howard, 04/01/07)

PRC suspends the deadline for comments  
on proposed rate increase for Standard Mail flats

- The Alliance for Nonprofit Mailers reports, “The Chairman of the Postal Regulatory Commission has granted a Coalition of Catalog Mailers its request for more time since the motion included ‘persuasive justification for extending the deadline for submission of its Motion to Reopen and Supplement the Record for Reconsideration.’ This extension results in a suspension of the April 12 deadline for comments about the reconsideration of recommended rates for Standard Mail flats.” (*Alliance for Nonprofit Mailers*, 04/06/07)

NALC wants Congress to get “involved”  
in the Postal Service’s outsourcing jobs to contract labor

- Concerned that the Postal Service plans to increase its use of contractors to deliver mail in cities and suburban areas, the National Association of Letter Carriers (NALC) is lobbying Congress to get involved and study the agency’s use of contract delivery services. To draw attention to the issue, NALC plans to picket Postal Service’s headquarters on L’Enfant Plaza on April 16<sup>th</sup>. “I can’t believe the American public wants private contractors delivering their mail,” said NALC president William H. Young, the union’s president. “[The issue] “is a public policy matter. This is not about jobs for my members.” National Rural Letter Carriers, lead by President Donnie Pitts, will join the NALC picket to demand a halt of the Postal Service’s practice of contract delivery.
- Thomas G. Day, a senior vice president at the Postal Service, agrees that his agency has been part of the post office’s operations since mail was carried by stage coaches and the Pony Express. “There’s nothing dramatic, nothing new, not some sudden policy change,” said Day. Through the agency’s history, the Postal Service has turned to contractors to haul mail long distances or deliver mail on highway routes in sparsely populated areas. However, the unions believe that the Postal Service has decided to expand that policy to cover new residential and business developments, inside cities and in the suburbs. With the USPS adding about 3,000 delivery routes each year to keep up with the nation’s growing population, Day said the agency makes “a prudent decision” on how to provide mail service to new households and businesses and “by no means does every new extension of delivery service go to contractors.” The Postal Service has 7,612 contract routes, up by 297 routes from 2005, said Day said. “The idea that management and the postal board have deemed all new deliveries will go to contractors -- the data doesn’t bear that out,” he said.

Day and Young agree that contract delivery is less expensive for the USPS. “They are bound and determined that this is the way to hold down costs,” said Young.

- In reaction to NALC’s April 16<sup>th</sup> demonstration, the Association for Postal Commerce wrote, “Wait a minute....Unions are asking Congress to get involved in an issue that was the result of prior collective bargaining? What ever happened to the union demand that Congress stay out of business that’s the subject to collective bargaining?”
- NALC’s demonstration appears to be tied to the union’s impasse in its contract negotiations with the Postal Service. In an April 6<sup>th</sup> message to members, Young told his members, “I truly regret to inform the membership that the top leadership of the United States Postal Service has flatly rejected NALC’s offer of a strategic partnership to protect the future of the Postal Service. We are shocked by their refusal to work jointly, and now have no choice but to pursue our bargaining goals through interest arbitration. The Postal Service power brokers have thrown down the gauntlet. They apparently don’t believe NALC is militant enough to fight them on these issues. They are sadly mistaken and will rue the day they so misjudged us....The current chairman of the USPS Board of Governors, James Miller III, earned his right-wing reputation as budget director during the Reagan administration, and is now trying to ram that ideology down the throats of all at the USPS. The Board of Governors believes it should risk the trust of the public and threaten the long-term viability of the United States Postal Service for quick and ultimately illusory savings offered by contracting out....Although NALC has no quarrel with traditional Highway Contract Routes, it will seek a legislative prohibition on expanded outsourcing. ...The lawmakers who worked side by side with us to implement postal reform will not sit by and see all that good work undone by ideologues at L’Enfant Plaza.”
- Association for Postal Commerce notes, “In recent months, President Burrus has felt the need to criticize the NALC and other postal unions over postal reform, branding their leaders as ‘fools’ for working to shape ‘bad’ legislation. He routinely demonizes the nation’s major mailers. Indeed, he once famously referred to the customers who generate the majority of the Postal Service’s volume—and revenue—as ‘vermin.’ ...[A]ll the chest pounding in the world doesn’t change one simple fact. Postal reform was finally passed by the Senate unanimous consent rules—an objection from just one out of the 100 senators would have killed it. President Burrus either did not have the courage of his convictions or he lacked the clout to find a single member of the Senate to stand up for him.” (*Washington Post*, Stephen Barr, 04/13/07; *Rural Mail Carrier Postal News*, 04/13/07; *Postcom.org*, 04/13/07; *NALC Bulletin*, 04/06/07; *Postcom.org*, 04/08/07)

The world keeps changing for the USPS

- According to a new study conducted the Harris Interactive and the Marketing Workshop, consumers in Internet-connected households are paying more of their bills

online than by paper check. The 2007 Consumer Bill Payment Survey showed that, for the first time, online bill payments exceeded bill payments made by paper check among online households. Online payments made up 39% of the total volume of bill payments among online households, an increase of 4% over the previous December 2005 survey. In contrast, the volume of checks sent through the mail fell 4% to 34% of the overall volume. The survey concluded: (1) A growing number of consumers are turning to their computers, rather than their checkbooks, to pay household bills; (2) Paying bills online has become a mainstream activity among U.S. households; (3) Western states, followed by the South, have embraced online bill payment faster than other regions, which may be driven in part by higher broadband penetration rates and online banking use in these regions; and (4) Paperless bills appear to be catching on as consumers recognize their convenience, security and environmental benefits. (*PR Newswire*, 04/12/07)

- Postal rate increases, declining prospecting, talent absorption, the failure of net neutrality, online intensity and new systems are a few of the major trends “shaking the world of direct markets,” said direct mail guru Don Libey, which will ultimately lead to a smaller direct mail industry, generating dramatically lower mail volumes in the future. (*DMNews.com*, Melissa Campanelli, 04/13/07)

## **TVA**

### Supreme Court rules unanimously to reinstate EPA lawsuit against utility companies

- On April 3, the Supreme Court ruled that lower courts had misread the Clean Air Act when they threw out an EPA lawsuit charging Duke Energy Corp. with skirting provisions governing coal-burning plants. The unanimous ruling will likely affect cases pending in Alabama and Ohio, which have been on hold pending the Supreme Court’s ruling. The lawsuits, which were filed by the Clinton administration in 1999, accused Duke Energy, Atlanta-based Southern Co., and eight other power companies, along with TVA, of skirting provisions in the Clean Air Act, which required them to install new pollution controls on old, coal-burning power plants. “The decision is going to reverberate throughout the electric utility industry and have a major impact on the air quality in dozens of states,” said John Walker, a lawyer with the Natural Resources Defense Council.
- The impact of the Supreme Court’s ruling is uncertain with regard to North Carolina’s lawsuit against the TVA regarding its air emissions. According to James Staudt, a consultant on utility air pollution controls, the estimated costs to retrofit TVA plants with air pollution controls between 2008 and 2012 would be \$3 billion, plus \$220 million a year in operating costs. In testimony on behalf of the State of

North Carolina, David Freeman, a former chairman of the TVA board of directors, concurred with Staudt's cost estimates, which are in line with TVA's estimates of \$3 billion to \$5 billion in its 2005 annual report. Freeman, who said that the control measures are "commonplace" and "clearly doable by TVA," argued that keeping utility rates low at the expense of human health and the environment is unacceptable. "I testify with sadness and regret that the current TVA management needs a nudge from its neighbors in order to do what clearly is required for environmental stewardship," said Freeman. The State is asking the court to mandate that TVA cut emissions to levels near those that are required for North Carolina plants under the State's Clean Smokestacks Act by 2013. In response, TVA said it is taking a broad approach to improving air quality and plans to make its air emissions cleaner than those of North Carolina, but most reductions aren't expected until 2015.

- "There is no evidence that TVA's emissions are having any kind of adverse health effects on people in Tennessee or North Carolina," argued TVA spokesman John Moulton. "The air quality in Tennessee, North Carolina and the entire region is a lot better than any time in the past three decades and continues to improve." However, according to the EPA, the State of Tennessee ranks fifth in the nation in releasing more toxic chemicals than other states. Each year, the EPA requires manufacturing plants and industries to report levels of chemicals released during operations. Out of the State's top 10 plants that generate the most toxins, two are located in East Tennessee, including TVA's Kingston Power Plant which released 3,285 tons of toxic chemicals and TVA's Bull Run Power Plant, which released an estimated 2,727 tons of toxins. In the utility's public statement, Moulton argued, "Even though collective amounts appear to be large, it poses no significant health risk to TVA employees or the public."
- TVA has asked a federal court to dismiss North Carolina's lawsuit, arguing that its status as a federal agency makes it immune from nuisance lawsuits. A lower court has rejected TVA's dismissal motion. Nineteen states have supported North Carolina in opposing an TVA's appeal of the lower court ruling. Although TVA says it will improve air quality and will even surpass North Carolina's emissions requirements, Cooper and others want pollution reductions sooner than the agency has promised. (*WATE-Channel 6*, Catharyn Campbell, 04/06/07; *Associated Press*, 04/10/07; *News & Observer* [Raleigh, NC], Wade Rawlins, 04/07/07; *Atlanta Journal-Constitution*, Jeff Newsmith and Stacy Shelton, 04/03/07; *Associated Press*, 04/09/07)

"TVA's charter at risk," opines *The Chattanooga Times Free Press*

- In an April 6<sup>th</sup> editorial, *The Chattanooga Times Free Press* wrote, "Congressional Republicans over the years have regularly introduced bills designed to undermine or privatize [TVA]. Fortunately, the TVA caucus has regularly beaten back such selfish and misguided efforts. Senator Bob Corker's assessment of the latest anti-TVA bill, however, is not encouraging. He seems to believe that the bill being pushed by Kentucky's GOP senators may yet pass in the Senate. That is not a good omen."

- “Kentucky Senators Mitch McConnell, the Republican minority leader, and Jim Bunning are sponsoring a bill that would give several Kentucky distributors of TVA power pricing deals and access to outside power supplies that would undermine TVA’s control of its power grid and break down the so-called TVA fence. That is the territorial boundary beyond which TVA cannot expand, and which restricts intrusion of adjacent power systems. Their legislative proposal also calls for a study on privatizing TVA.”
- “The Kentuckians’ ‘Access to Competitive Power Act of 2007’ must be taken as a serious threat to TVA’s structural integrity. The most immediate threat is the proposal to put TVA’s power grid -- the transmission lines financed by TVA ratepayers and operated for their benefit -- under the control of the Federal Energy Regulatory Commission.”
- “Under Republican-appointed directors in recent years, FERC wants to require open access to the transmission grids of electric utilities nationwide to permit wheeling of power from distant locations to utilities elsewhere that want to purchase imported power. Such access is now permitted, but not uniformly required. FERC’s goal, promoted by merchant power plants that want to sell and wheel power at expensive peak hours, goes on the misguided assumption that utilities ought to be required to fund and operate such transmission systems, or required to sell their transmission systems to independent operators that would meet that goal.”
- “That may sound efficient in theory, but it wouldn’t work without huge investments to build a national interstate power grid. In reality, such a grid doesn’t exist. Utility grids are built mainly to meet their individual capacity needs. They are more akin to a local street system than a national interstate system. Loading them with transferred power often causes sagging lines, brownouts and blackouts.”
- “Moreover, distant imported power is, in a sense, perishable. Electricity sent from, say, an Oregon distributor to a Florida customer is not the voltage received at the other end. Rather, electricity, like money, is fungible. It may be used and replaced a dozen times along the way -- if the intermediary utilities have the capacity to absorb and replace the imported power supposedly sent along their lines by and to other utilities.”
- “That’s why local power distributors in the TVA system, and TVA as the wholesale producer, want to -- and should -- protect their investment in the systems their ratepayers have built over the last 60-plus years. That unique investment is also why it would be unfair for FERC to require local customers of any utility anywhere in the nation to pay to supersize their local power grids to accommodate a power transfer scheme designed mainly to help mercenary, merchant power plants maximize their profits at local ratepayers’ expense.”
- “The Kentucky senators’ bill is rooted in selfishness. The several power distributors that want out of TVA’s system simply want to be able to use TVA transmission lines

to buy and import power from Kentucky's uniquely cheap power system -- a system whose marginally lower prices derive from power plants positioned nearly adjacent to Kentucky's coal mines."

- "The precedent would essentially break up TVA's control of its grid, and that would be its undoing. The follow-on privatization study would then set the formula for breaking up the TVA system completely. That would ill serve TVA customers, who benefit from one of the nation's least expensive, most reliable power systems. In fact, privatization of public utilities and deregulation have yet to produce cheaper power; almost everywhere, the result has been higher costs to consumers."
- "With such a bill on the table, members of TVA's congressional caucus should gird themselves for the work necessary to defeat it. Ratepayers here will bear the burden if [Senators] Corker and Alexander -- and the TVA caucus in the House -- take a defeatist attitude and let it pass." (*The Chattanooga Times Free Press*, 04/06/07)

TVA projects lower earnings for 2007  
due to warm weather and resulting lower power demand

- TVA projects its net income to be \$53 million lower than budgeted for 2007, due to mild, dry winter weather which reduced hydroelectric power production by 25%. As a result, the utility had to buy other, more expensive power in place of hydroelectric power, its cheapest source of power. TVA said that while power sales will be "well below normal," lower interest expenses for its FY2007, expected to be \$56 million less than planned, will help offset its lower revenues. In addition, the utility will slash operating and maintenance expenses by \$30 million during the remainder of the fiscal year, which ends September 30<sup>th</sup>. (*Memphis Business Journal*, 04/04/07; *Reuters*, 04/04/07)

TVA seeks NRC's final inspection before reactor startup

- TVA has asked the Nuclear Regulatory Commission to send its "operational readiness assessment team" to its Browns Ferry Nuclear Plant in Athens, AL for its final inspection on of the Unit 1 Reactor, slated to power up in May. The startup marks the completion of the utility's five year, \$1.8 billion restoration of the nuclear unit, following nearly a 22-year shutdown. Over the past five years, TVA has spent more than 15 million work hours modifying, refurbishing or replacing Browns Ferry Unit 1 systems and components and conducted more than 1,200 safety tests. All three Browns Ferry reactors were idled in 1985 due to management and operational concerns; Units 2 and 3 were returned to service in 1991 and 1995, respectively. Unit 1 is expected to generate more than 1,155 megawatts, enough power for 650,000 homes. (*Associated Press*, 04/12/07)

TVA takes first official step toward possibly finishing a second reactor  
at its Watts Bar Nuclear Power Plant

- TVA has completed a draft report on the environmental impact of adding another nuclear reactor at the Watts Bar plant, near Spring City, TN. The 132-page study, which concludes that the environment risks of another reactor are small, recommends that TVA complete the new unit to meet growing power demand. The agency is receiving public comments on its draft environmental assessment until May 14. TVA senior environmental specialist Ruth M. Horton said the utility “will not make a decision about whether to proceed” with the reactor until a \$20 million engineering study is completed. TVA expects to complete its detailed, scoping, estimating and planning study this summer and make a recommendation to TVA’s board of directors about building the second reactor as soon as August. (*Chattanooga Times Free Press*, Dave Flessner, 04/07/07)

TVA announces executive appointments

- TVA announced the appointment of William R. Campbell to serve as its chief nuclear officer, effective May 14<sup>th</sup>. Campbell will replace Karl Singer, who joined TVA in 1993 and announced his retirement effective this summer. Until his retirement, Singer will be concentrating on the \$1.8 billion restart of a mothballed reactor at the Browns Ferry nuclear station in Alabama, which is expected to come online in May. Campbell, who will be based in the utility’s Chattanooga headquarters, will be responsible for all nuclear power production and operations. Previously, Campbell oversaw the operating results of Entergy’s regulated nuclear assets in Mississippi, Texas, Louisiana, and Arkansas. He also has worked at Entergy Nuclear Generation Company, Duke Energy, Carolina Power and Light and Union Electric Company. (*Associated Press*, 04/10/07)
- TVA has also named Emily J. Reynolds, previously the chief of staff for former Senate Majority Leader Bill Frist (R-TN), as the utility’s top communications and government relations executive, effective April 23<sup>rd</sup>. Reynolds, 50, will serve as senior vice president of the newly-created department and earn an annual salary of \$250,000 plus bonuses. Reynolds will be based in her hometown of Nashville, where TVA maintains a small communications staff and economic development office. She replaces Peyton Hairston, who will serve as the senior vice president of diversity development, a newly-created position. Hairston, who served as interim director of the agency’s communication staff for the past couple of years, was formerly a labor attorney for TVA. (*Associated Press*, 04/04/07; *Chattanooga Times Free Press*, 04/05/07)

TVA certifies a 2,010-acre site in Northeast Alabama as “megasite”

- TVA has certified a 2,010-acre site, extending from U.S. 31 to Interstate 65 in Limestone County in Northeast Alabama, as a “megasite” which meets the needs for an automobile assembly plant. TVA designed the megasite to avoid disrupting wetlands on the property and harming the endangered spring pygmy sunfish near the property. According to the Alabama Department of Conservation and Natural Resources, the tiny fish is found only in Limestone County. (*Associated Press*, 04/10/07)

Senator Lamar Alexander (R-TN) announces plans to run for re-election in 2008

- Senator Lamar Alexander (R-TN), who serves as co-chair of the TVA caucus, has announced plans to run for re-election in 2008. Several months ago, Alexander considered not running for re-election, when he lost a bid to become the Senate Republican deputy whip to Senate Minority Leader Mitch McConnell (R-KY). To mitigate the Senator’s whip loss, McConnell appointed Alexander to the Senate Environment and Public Works Committee and the Appropriations Committee. (*Associated Press*, 04/03/07)

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