

The **GSE** REPORT™

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Major Events

Amendment stripping GSE regulator of authority to restrict
The GSEs' mortgage portfolios "likely to pass" in the House

- Representatives Melissa Bean (D-IL) and Randy Neugebauer (R-TX) are expected to introduce an amendment during House floor debate of GSE regulatory reform legislation (H.R. 1427), which would narrow the authority of the GSE regulator to restrict the size of the GSEs' mortgage portfolio. Under a carefully worded compromise reached by House Financial Services Committee chairman Barney Frank (D-MA) and Treasury representatives, a provision in H.R. 1427 would give the new regulator the authority to monitor the safety and soundness of the mortgage portfolios based on "any potential risks posed by the nature of the portfolio holdings." Under the amendment proposed by Bean and Neugebauer, the provision would require the regulator to monitor the portfolios based on safety and soundness risks posed to Fannie Mae and Freddie Mac, not to the broader economy. This change would benefit Fannie and Freddie because it would provide the regulator less discretion over the GSEs' assets and eliminate the regulator's consideration of "systemic risk" as a factor in evaluating the GSEs' portfolios. [Other signatories to the amendment include Representatives Dennis Moore (D-KS) and Gary Miller (R-CA).]
- "One of the concerns I have ... is getting into the micromanagement business by Congress of private entities," said Neugebauer. "I think the new regulator ought to look at the financial condition of that entity and that ought to be their primary focus, and not what's going on and what impact it might have. You get very hypothetical at that point." Neugebauer has discussed his amendment with Treasury officials, who said they don't support the change. "We had a discussion about that," he said. "We just agreed that we don't agree."
- While many amendments are expected to be introduced during the May 17 debate in the House of Representatives on GSE regulatory reform, the Neugebauer/Bean proposal likely poses the highest risk of scuttling the compromise reached by Frank and Treasury because it could attract much support. In an interview with *Bloomberg News*, Frank said, "The votes are there to change [H.R.1427]. I did try to hold the deal [with Treasury], but it is a bipartisan thing."
- Treasury said it may withdraw its endorsement of the legislation if the amendment is passed. Treasury spokeswoman Jennifer Zuccarelli said, "Given the history of these enterprises, it is critical that the new GSE regulator has the necessary authority to oversee their portfolios. Treasury will not support efforts that would weaken the regulatory oversight in the bill passed by the Financial Services Committee." Two people familiar with the issue said Treasury has expressed major misgivings about passage of such an amendment, which could ultimately endanger broader Republican support of the bill.

- In a letter to Treasury Secretary Henry Paulson, Representative Richard Baker (R-LA) called on the Bush administration to oppose efforts to weaken GSE regulatory reform legislation. “Authority [for the GSE regulator] to mitigate [systemic] risk is imperative,” Baker wrote. “I strongly encourage the administration to oppose any degradation of regulatory authority [in the GSE regulatory reform bill].”
- In a letter to House members, the National Alliance of Independent Mortgage Bankers (NAIMB) urged Congress to strike language that would give a new GSE regulator the power to cut the GSEs’ mortgage portfolios. According to a draft of the letter [as reported by *Reuters*], “Independent mortgage bankers oppose efforts to arbitrarily restrict or diminish GSE portfolios, or to impose a 'systemic risk' or market size test on the portfolios. Such limitations introduce a significant risk of uncertainty into the housing finance system,” wrote NAIMB.
- House lawmakers are considering ways to retain Bush administration support of H.R. 1427 through possible amendments to the bill. Atop the list under consideration is an amendment that would reduce from five to three presidential nominees to the GSEs’ boards of directors. [During markup, the House Financial Services Committee passed an amendment sponsored by Representative Maxine Waters (D-CA) which increased the number of presidential appointees from three to five.] Some lawmakers hope that such a change could “offset” the administration’s displeasure with the bipartisan support of the Neugebauer/Bean amendment, which guts the Frank/Treasury compromise. A Treasury aide said his agency would rather not have any political appointees on the GSEs’ board, but reducing the number would move the legislation in the “right direction.”
- While Frank’s GSE reform legislation is virtually certain to pass the House, its prospects in the Senate are uncertain. If Treasury withdraws its endorsement of the bill containing the Neugebauer/Bean amendment, the legislation could lose momentum as it moves to the Senate for consideration. Senate Banking Committee chairman Christopher Dodd (D-CT) has said he is interested in addressing GSE regulatory reform, but has not yet set a legislative timeframe for the issue in the Senate. (*Reuters*, 05/10/07; *Bloomberg*, James Tyson, 05/08/07; *Bloomberg*, James Tyson, 05/10/07; *Wall Street Journal*, Damian Paletta, 05/08/07; *Dow Jones Newswires*, Damian Paletta, 05/08/07; *CQ Today*, Michael R. Crittenden, 05/10/07; *Dow Jones International News*, Damian Paletta, 05/03/07)
- In a May 10th editorial, the *Wall Street Journal* (*WSJ*) weighed in on the Bean/Neugebauer amendment. The *WSJ* wrote, “Just when you think they're defeated, Fannie Mae and Freddie Mac arise in Congress to kill any attempt to clean up their dangerous habits. This week's scary movie comes as an attempt by four Members to blow up a carefully negotiated deal between Treasury Secretary Hank Paulson and House Financial Services Chairman Barney Frank. Their deal would give Fan and Fred's regulator the power to limit the size of the companies' portfolios of

mortgage-backed securities (MBSs) -- currently \$1.4 trillion combined -- in the interests of safety and soundness.”

- “The four Congresspersons from Fan and Fred plan to offer an amendment to specify that portfolio limits could only be imposed if the two companies were in business jeopardy. In other words, they propose to gut the reform. To have the clout to take on Freddie and Fannie, a regulator needs the broadest possible authority to protect the financial system from packing so much housing risk in just two companies. Fan and Fred's friends on the Hill know this, and the game they're playing is to make it all but impossible for a regulator to limit the MBSs that are the source of most of their growth and profits -- and systemic financial risk.”
- “The four Members fronting for the scandal-plagued companies are Democrats Melissa Bean (Illinois) and Dennis Moore (Kansas) and Republicans Gary Miller (California) and Randy Neugebauer (Texas). They prove that corporate socialism isn't partisan, and no doubt they'll be handsomely rewarded with campaign contributions if their amendment succeeds.”
- “This will be a fascinating test of Mr. Frank's leadership, because a defeat would mean he can't deliver on the House floor. As for Mr. Paulson, we trust he realizes that Fan and Fred have smiled sweet cooperation even as they're mauling him in the backrooms of Capitol Hill.” (*Wall Street Journal*, 05/10/07)

Subprime mortgage market developments:

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Senator Dodd's principles for working with subprime borrowers

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which doesn't pose a "big" threat to the national economy

Subprime mortgage market developments:

- After weeks of finger-pointing and blame-laying, Congress and federal regulators are moving forward to implement some "fixes" to growing problems in the subprime mortgage market. After months of hearings, it is clear that lenders are going to get explicit federal guidance on riskier home loans from federal regulators. And, congressional Democrats appear to be ready to place mortgage brokers and non-bank lenders—many of whom are at the heart of the subprime mortgage crisis—under some form of federal regulation. "We have to put limits on what kinds of loans people make. They shouldn't be lending people a lot more money than they can pay back," said Representative Barney Frank, (D-MA), the chairman of the House Financial Services Committee. In an interview with *McClatchy Newspapers*, Frank said he expects Congress to pass comprehensive housing legislation "probably this calendar year." Frank believes that once housing legislation begins moving forward in Congress, Republicans, who today prefer industry solutions rather than federal legislation, will have a change of heart. "They may not be vulnerable in the abstract

[if they do not support such legislation], but I think they would be if they voted against it.” (*McClatchy Newspapers*, Kevin G. Hall, 05/10/07)

- Meanwhile, consumer advocates voice frustration at the lack of legislative action by Congress on issues such as predatory lending. “They’ve done a good job so far. They’ve set the table, but now it’s time for them to serve the food and eat the meal,” said Travis Plunkett, legislative director for the Consumer Federation of America. Linda Sherry, a director of Consumer Action, said consumer advocates have been “a bit disappointed” by the lack of consumer protection legislation originating from the Senate Banking Committee, chaired by Christopher J. Dodd, (D-CT), an aspirant for the Democratic presidential nomination. “We would like to see something concrete,” said Sherry. (*CQ Today*, Michael R. Crittenden, 05/09/07)
- Common Cause, an organization that tracks lobbying activities on Capitol Hill, reported that 10 of the largest mortgage companies and two trade groups contributed \$22.2 million to federal candidates over the past decade, as lawmakers considered tightening the oversight of the mortgage industry [and GSEs]. (*Dow Jones Newswires*, Damian Paletta, 05/08/07)

Coalition of lenders, servicers and consumer groups adopt Senator Dodd’s principles for working with subprime borrowers

- Two weeks after Senate Banking Committee Chairman Chris Dodd held a summit with mortgage industry leaders on the problems in the subprime mortgage market, the lenders, GSEs, and consumer trade groups agreed to Dodd’s foreclosure principles that were presented at the summit. Those voicing support of the principles include Mortgage Bankers Association, Citigroup, JPMorgan Chase, Litton Loan Servicing, HSBC, Freddie Mac, Fannie Mae, Self-Help Credit Union, the Leadership Conference on Civil Rights, the American Association of Retired People, and the Association of Community Organizations for Reform Now. In general, the principles call on loan servicers to warn borrowers facing interest rate adjustments that they can’t afford and to modify loans (before interest rates reset) to make them affordable for the borrower over the long term. “These principles represent a critical step in preserving homeownership and economic opportunity,” said Dodd. “Each party needs to do its part in helping to address this problem. The companies and organizations that endorse these principles demonstrate their commitment to being part of finding solutions to foreclosures.” (*Associated Press*, Marcy Gordon, 05/02/07; *Bureau of National Affairs*, R. Christian Bruce, 05/03/07; *American Banker*, Stacy Kaper, 05/03/07)
- During a hearing on subprime issues, Representative Carolyn Maloney (D-NY) said that Democrats on the House Financial Services Committee would not wait for the marketplace to resolve subprime mortgage problems before the panel advanced legislation to curtail industry practices. Maloney, chairwoman of the House Financial Services Financial Institutions Subcommittee, warned of a more aggressive legislative approach than that adopted by Senate Banking Committee chairman Christopher

Dodd (D-CT). "This committee is by no means waiting for the private sector to do what it thinks is right to solve this rapidly growing crisis," said Maloney. "Market-based solutions sometimes don't provide sufficient protections to those with little market power - in this case, our constituents who face the loss of their homes." (*Dow Jones Newswires*, Damian Paletta, 05/08/07)

Senator Chuck Schumer (D-NY) announces legislative proposals to address subprime mortgage market turmoil

- On May 3, Senators Chuck Schumer (D-NY), Sherrod Brown (D-OH) and Robert Casey (D-PA) announced S. 1299, the Borrower's Protection Act of 2007, a two-part legislative proposal that would tighten regulation of the mortgage industry and request \$300 million in appropriations to non-profit groups certified by HUD to provide counseling and legal services to borrowers who want to modify their mortgage terms. Schumer said he has written mortgage lenders and asked them to contribute at least \$600 million to this effort and to make their personnel available for to help borrowers. The legislation that the Senators are introducing will address current regulatory shortfalls by making all brokers and lenders subject to federal laws governing lending practices, in place of the current patchwork of state and federal oversight in place today, said Schumer.
- Specifically, the measure would (1) establish a fiduciary responsibility for mortgage brokers and other non-bank mortgage originators; (2) create a good faith and fair dealing standard for all originators; (3) required originators to establish escrow accounts for borrowers to pay taxes and insurance; (4) prohibit brokers from directing or counseling a consumer to "rates, charges and principal amount or prepayment terms that are not appropriate or suitable" for the borrower; (5) hold lenders responsible for "policing their associated appraisers and brokers;" and (6) bar originators from influencing the appraisal process. While Schumer called Senate Banking Committee chairman Chris Dodd's efforts to negotiate a non-legislative solution "terrific," he said that his bill is aimed at companies not "susceptible" to moral persuasion. Although Dodd has not committed to support his bill, Schumer said he's optimistic about its prospects. "We're going to try to work through the Committee to get this done," he said.
- In a May 3rd statement, the Mortgage Bankers Association criticized Schumer's bill and stated that lenders are already working with non-profit groups to help borrowers. "The legislative remedies that Senator Schumer presents ... will have the unfortunate effect of limiting choice and restricting mortgage credit to the neediest borrowers, thereby hurting those people it is ostensibly designed to help," said MBA Chairman John M. Robbins. (*Bureau of National Affairs*, R. Christian Bruce, 05/04/07; *CQ Today*, Michael R. Crittenden, 05/03/07; *Marketwatch*, Robert Schroeder, 05/03/07)
- Schumer's bill, as currently proposed, would dramatically change the face of the mortgage market, say industry observers. The legislation has alarmed many industry participants, who fear that it would force banks to stop doing business with brokers

and create rigid underwriting standards, which would reduce market liquidity. "On a ranking of 1 to 10, where 1 is bad and 10 is good, this is probably a minus-1," said Gil Schwartz, a partner with Schwartz & Ballen LLP, a Washington, DC law firm. Although many observers believe that the bill faces long odds against enactment into law, Charles Gabriel, SVP at Prudential Equity Group, said that the Schumer bill will have an effect. "You have an important open debate on this, and what Senator Schumer does will help to frame that debate," he said. "Just because legislation doesn't move towards enactment doesn't mean that it hasn't had an impact... The Democratic Congress is going to continue to beat the drum about these problems."

- Industry participants are particularly concerned about the bill's provision to hold lenders liable for any wrongdoing by a broker that they employ. "If you were liable for every action of a broker, you would totally revamp your relationship with the broker and might just use loan officers. ... You can't have a casual, arm's-length relationship with that person," said MBA lobbyist Erick Gustafson. Roy DeLoach, the EVP of the National Association of Mortgage Brokers, said "The way the mortgage broker's business model is, we have a contractual relationship with many lenders. That provision would change the relationships of all the parties in the mortgage system today."
- Bankers also voiced concerns about the steering provision in the bill, which would in effect impose a suitability standard for lenders. "The steering provision "is essentially where you get into suitability," said Wright Andrews, the executive director for the Coalition for Fair and Affordable Lending. "A loan that's not 'reasonably advantageous' in light of all the circumstances. ...What does that mean? I don't think you really have a definition of what's reasonably advantageous. It just opens up an issue that would have to be litigated." Another potential for lender liability in the bill is a provision that says borrowers must have an ability to repay the loan, said Swartz. "It imposes a higher standard of care for mortgage originators in that they have to act with reasonable skill, care, and diligence and act in good faith and fair dealing," he said. (*American Banker*, Stacy Kaper, 05/08/07)

Federal Reserve to hold hearing on curbing mortgage market abuses and conduct study of adjustable rate mortgages

- The Federal Reserve has scheduled a public hearing on June 14th to hear testimony concerning the possible adoption of rules under the Home Ownership and Equity Protection Act (HOEPA) to "curb abusive lending practices" in the mortgage market, particularly in the subprime market. "The goal is to find ways to promote sustainable homeownership through responsible lending, informed consumer choice, and effective guidance and regulation," said Federal Reserve Governor Randall S. Kroszner, who will chair the hearing. "We want to encourage, not limit, mortgage lending by responsible lenders, so it is crucial that any actions the Board might take are well calibrated and do not have unintended consequences." The Fed will invite lenders, consumer advocacy groups, and other interested parties for the day-long hearing. The hearing will mark the Fed's fifth in a series of hearings on HOEPA

issues in the mortgage market, which examined predatory lending practices, the subprime mortgage market, and nontraditional mortgage products. The announcement followed sustained calls for Fed action on abusive lending practices by House Financial Services Committee chairman Barney Frank (D-MA), Senate Banking Committee chairman Christopher Dodd (D-CT), and many members of Congress. (*American Banker*, Steven Sloan, 05/03/07; *Dow Jones Newswire*, Benton Ives-Halperin, 05/04/07; *Reuters*, 05/03/07; *Bureau of National Affairs*, R. Christian Bruce, 05/04/07)

Chairmen Dingell and Frank call on federal financial regulators and FTC to strengthen federal consumer protection

- On May 11th, Representative Barney Frank (D-MA), chairman of the House Financial Services Committee, and Representative John Dingell, chairman of the House Energy and Commerce Committee, sent a joint letter to federal financial services regulators and the Federal Trade Commission, calling for the strengthening of protections for financial consumers against unfair and deceptive trade practices. The letter was sent to Ben S. Bernanke, Chairman of the Federal Reserve Board, John M. Reich, Director of the OTS, Deborah Platt Majoras, Chairman of the Federal Trade Commission, John C. Dugan, Comptroller of the Office of the Comptroller of the Currency, and Sheila Bair, Chairman of the FDIC.
- The lawmakers wrote, “We are concerned that recent developments are leaving American consumers vulnerable in the financial services marketplace, and seek your cooperation in strengthening federal-level consumer protections and enforcement. Over the last several years the states, in the absence of strong federal action to enhance consumers' rights, have implemented a host of important specific protections for consumers. Among these are laws on transaction fees and surcharges, protections for gift cards, check cashing fees, certain credit card disclosures, payday lending, and high-cost mortgage lending. In addition, state regulatory and enforcement agencies have had the authority to address a wide array of abusive practices under state unfair and deceptive practices laws.”
- “A series of regulatory actions, ratified by the recent Supreme Court decision in *Watters v. Wachovia*, has significantly reduced the application of state laws and enforcement over a large part of the financial sector. These developments bring into sharp relief an urgent need to rethink the way in which our financial regulators approach consumer protection going forward.”
- “...Clear authority exists under the Federal Trade Commission Act and the Home Ownership and Equity Protection Act with regard to unfair and deceptive trade practices on the part of financial institutions. ... It is imperative that the agencies work together to develop a meaningful strategy for improving federal consumer protection for all financial consumers.” (*House Financial Services Press Release*, 05/11/07)

The Shadow Financial Regulatory Committee issues statement on concerns about the subprime mortgage market

- On May 7, AEI's Shadow Regulatory Committee rejected most government "solutions" to the subprime mortgage crisis that have been offered to date and argued that careless lenders will be punished more heavily in the marketplace than overburdened borrowers. The Committee endorsed only efforts to improve and simplify mortgage disclosures, arguing that borrowers would receive clear notification about how much and when initial teaser rates can rise. Lenders also should provide clear information on how much of the borrower's monthly income would go to initial and maximum mortgage payments under the terms of the loan, said the Committee. Moreover, new disclosures should include warnings above the signature line indicating that borrowers should not sign the closing document unless they fully understand the level of payment adjustments and the time frame for those adjustments. (*Bureau of National Affairs, Richard Cowden, 05/8/07*)

Conflicts of interest lead credit rating agencies to downplay risks in subprime mortgage market

- Bond rating agencies are unable to adequately assess the risk of residential mortgage-backed securities due to the agencies' conflicts of interest and the complexities of the MBS themselves, concluded Joshua Rosner, managing director for Graham Risher and Co., and Joseph Mason, associate professor of finance at Drexel University, in a new research report presented at a Hudson Institute event. The authors concluded that the rating agencies have an economic disincentive to fine-tune their bond rating because the issuers of the bonds provide the majority of the agency's revenues. During his presentation, Rosner raised the question of whether rating agencies have ceased to be impartial publishers of opinions on bonds and have become a part of the bond underwriting team. "Unlike the traditional ratings process, in which a company can do little to change its risk characteristics in anticipation of issuance, in structured finance, the rating agency is often an active part of structuring the deal," wrote the authors. Rosner and Mason conclude that the ratings agencies' cooperation with deal underwriters, who pay for the ratings, could lead courts to consider the agencies as underwriters under U.S. securities law. [In the past, the agencies have responded to shareholder lawsuits with the claim that they are publishers of opinion, which is protected by the First Amendment of the U.S. Constitution.]
- The "big three" ratings agencies were quick to dismiss the study's findings. Ratings agencies argue that there is a clear line between their role and that of an underwriter. "When we're asked to rate an MBS or a CDO our role is to analyze [and provide an opinion of the relative creditworthiness of a given security]," said Anthony Mirenda, a Moody's spokesman. "We do not participate in the design and construction [of the securities and] our [ratings] methodologies are published on our web site and are fully transparent."

- The study also finds that residential mortgage bonds are inherently more complex than corporate bonds, since they are affected by constant changes in home price appreciation, interest rates, mortgage underwriting, and refinancings, which complicate the picture for both rating agencies and investors trying to analyze the bonds. Subprime bonds, particularly those backed by loans originated in 2006, have experienced a surge in early borrower defaults that have caused ratings agencies to adjust their loss expectations upward in recent months. "We know now that we really don't fully understand default risk in subprime bonds," said Mason.
- The Rosner and Mason conclude, "Perhaps of greater concern [about the implosion of the subprime mortgage market] is the reputational risk posed to the U.S. capital markets—markets that have historically been viewed as among the most transparent, efficient, and well regulated in the world. The economic value of mortgage securitization and the risk transfer value of CDO issuance support their further use. However, there should be significant resources allocated to building the regulatory framework surrounding their structuring, issuance, ratings, sales, and valuation. We believe that efforts to provide transparency to these new product areas can foster stability while maintaining liquidity to the underlying collateral sectors and supporting further meaningful financial innovation and capital deepening." (*Dow Jones Newswires*, Danielle Reed, 05/03/07; *Financial Times*, Saskia Scholtesin, 05/11/07; [Draft] *Where Did the Risk Go? How Misapplied Bond Ratings Cause Mortgage-Backed Securities and Collateralized Debt Obligation Market Disruptions*, Joseph R. Mason and Joshua Rosner, 05/03/07)
- Recent downgrades of bonds collateralized by subprime mortgages has highlighted the role that credit ratings agencies have played in the collapse of subprime market. Since mid-April, Moody's Investor Service has cut credit ratings on more than 30 bond issues, collateralized with subprime mortgages and issued in 2006. More than half of the bond issues downgraded were originally rated "investment grade" but have since been downgraded to "junk" status. Moody's Investor Service is reviewing 81 bond issues for downgrade, including a few "AA" and "AAA" ratings. Standard & Poor's has downgraded 43 bond issues backed by subprime mortgages, issued in 2006, and is reviewing an additional 60 bonds for downgrades.
- "It's unusual to see downgrades in subprime deals so soon after they were issued," said Jay Guo, a director of asset-backed securities research at Credit Suisse Group. "This is not a normal phenomenon and is a cause of concern." Paul Ullman, chief executive of HFH Group, a New York hedge fund active in the mortgage market, said, "It's embarrassing for a ratings company to downgrade bonds so quickly [after the bonds were issued]. It reflects poorly on all parties in the underwriting process and their judgment of the credit-worthiness of the bonds." (*Wall Street Journal*, Serena Ng, 05/03/07)

Fannie and Freddie pose as “subprime heros”

- “Talk about impeccable timing. As Fannie Mae and Freddie Mac face the prospect of Congress passing ‘stringent’ GSE regulatory reform bill in the aftermath of their accounting scandals, the GSEs ‘ride to the rescue’ of the imploding subprime market—or at least hope that’s the image they’re hoping to cast. ‘It’s undoubtedly terrific publicity for them,’ said Keefe Bruyette & Woods analyst Brian Gardner. Fannie and Freddie, who largely avoided the subprime market in the past, publicly committed to commit ‘\$20 billion’ (Freddie Mac) and ‘tens of billions’ (Fannie Mae) of additional investments in the subprime space –literally a drop in the bucket of the \$600 billion market. ‘The practical impact of their initiatives is going to be pretty limited,’ said Bert Ely, an Alexandria, VA consultant and longtime GSE critic. ‘They’re going to go into the market and skim off the best credit risks to refinance. I don’t give them a lot of credit for acting in a charitable fashion. They have stockholders to take care of, and what they’re doing is good business.’” (*Financial Week*, Andrew Osterland, 05/07/07)

Say it isn’t so, John...

- The subprime mortgage market collapse is already casting its shadow on the 2008 presidential campaign. On *Fox News*, John Gibson reported, “The John Edwards campaign took a huge hit today, and it was delivered by *The Washington Post*. In a long piece today [May 11th], *The Post* reports that Edwards, whose 28,000-square-foot home has not kept him from a campaign based on advocacy for the poor, worked at a major hedge fund whose main business was the subprime loan market that has exploited the poor. The subprime mortgage market is how credit-risky homebuyers get a loan. Often these are people close to poor or actually defined as poor.”
- “Edwards has repeatedly bashed the subprime loan business as exploiting the poor. Now he says when he went to work for the hedge fund it was to learn about poverty and he didn’t know the fund was involved in the subprime business. This is as laughable as the idea that a \$400 haircut shows the poor you are on their side. Edwards has been caught in a major league act of presidential hopeful hypocrisy. Why? Because the hedge fund he went to work for was in the business of selling loans that could hurt the borrower later. In this case, those borrowers were the people Edwards says he’s running to help.”
- “By definition, the subprime business exists to help poor people who are credit risks to get loans. Many of them will end up going broke because they cannot afford those loans when interest rates rise. Proof of that are the new figures on foreclosures among subprime customers, now running 42 percent higher than last year. 1.2 million subprime borrowers lost their homes in '06, and one of the companies up to its armpits in that action was the fund Edwards was involved in.”
- “Worse, this wasn’t when Edwards was a mere callow youth. It was recent history, only a year after he lost the election as John Kerry’s running mate, when he’d been

campaigning on the ‘two Americas’ theme, as the man fighting for the poor. Edwards says he just remembers being told the company he went to work for did lending to start-up businesses. No mention of a multi-billion dollar stake in mortgage companies issuing high-risk loans to poor people. ‘Those are the things I remember,’ Edwards told *The Post*. ‘They may have told me more.’”

- “‘They may have told me more’ gives him a lot of wiggle room, obviously. Let's now watch the advocate of the poor who spends \$400 on one haircut wiggle out of this one.” (*Fox News*, John Gibson, 05/11/07)

Investor Warren Buffet sees “sick” housing market, which doesn’t pose a “big” threat to national economy

- During Berkshire Hathaway’s annual shareholders meeting, long known as “Woodstock for Capitalists,” Warren Buffet shared his pessimistic outlook for the housing market. He told shareholders that too many homes were bought by people carrying mortgages with little or no money down, who hoped to sell the properties quickly for a profit. “The housing market is sick and it’s going to stay sick for a couple of years,” Buffet concluded. Nevertheless, Buffet remains bullish about the stock market with Dow at 13,000. “I don’t think there’s going to be any huge danger [posed by the subprime mortgage market collapse] to the economy”—although the crisis is a “very big problem” to many participants in the housing industry. So long as unemployment and interest rates don’t rise significantly, “it’s unlikely that that factor triggers anything of a massive nature in the general economy,” said Buffet. (*CNN Money*, Susan Lisovicz, 05/06/07; *Reuters*, 05/05/07)
- Luxury home builder Toll Brothers Inc. reports that the problems in the subprime mortgage market are beginning to reverberate in the marketplace, making it more difficult for potential homebuyers to get a mortgage. While fewer than 2% of its buyers use subprime loans, the builder said that stricter lending standards were hurting the affordability at lower price points. “This, in turn, can impact the entire ‘housing food chain,’ including some of our potential customers’ ability to sell their existing homes, said Toll. As a result, the company’s total contracts [signed during the quarter less cancellations] fell 24% to 1,647 homes, while the value of contracts fell 25% to \$1.17 billion and its backlog of homes on order for the second quarter fell 32% to \$4.15 billion. The company’s weakest markets included Massachusetts, Rhode Island, Las Vegas, Chicago and much of Florida. In a research note, Bank of America securities analyst Daniel Oppenheim wrote, “Our sense is that the decline in March/April was more severe than the decline for the quarter since the negative impact of the mortgage environment did not begin until March.” (*Reuters*, 05/09/07; *Wall Street Journal*, John Spence and Michael Corkery, 05/10/07)

- On May 2, Fannie Mae released its audited financial results for fiscal year 2005, reporting net income of \$6.3 billion, a 26% increase over FY2004 results. The company's earnings per share was \$6.01 for 2005, up from \$4.94 in 2004. In the 2005 Annual Report, Fannie Mae reported a sharp increase in losses from investments to \$1.3 billion, up from \$362 million in 2004. The company attributed to this sharp increase in its investment losses to "impairments on mortgage-related securities" which increased to \$1.2 billion in 2005, up from \$285 million in 2004. Fannie Mae said that it "expects high levels of period-to-period volatility in [its] financial results as changes in market conditions cause periodic fluctuations in the estimated fair value of derivative instruments used by the company." The company's net interest income fell 36% to \$11.5 billion, due in part to a 10% decline in its average earning assets and 30% decline in Fannie's net interest yield. The company said that its income from guaranty fees increased 5% in 2005 to \$3.8 billion, "primarily due to an increase in average outstanding [Fannie Mae MBS and other guaranties]." Fannie's administrative expenses totaled \$2.1 billion in 2005, up 23.5% from the firm's expenses of \$1.7 billion in FY2004. Much of the increase in Fannie Mae's admin expenses were related to "restatement and related regulatory examinations, investigations, and litigation expenses, which totaled roughly \$570 million in 2005," said the company. Fannie said that it is on track to reduce administrative expenses by \$200 million in 2007, through a cut in its 6,500-person workforce by several hundred employees by year-end. While fiscal year 2005 was a strong year, the company said that it expects profits to decline in 2006, due to reductions in interest income, ballooning costs from the restatement process, and increased credit losses as "serious [mortgage] delinquencies may trend upward." Fannie Mae's board of directors increased the company's quarterly common stock dividend for the second quarter by 25% (or \$0.10 a share) to \$0.50 per share.
- Fannie Mae also provided more detailed information on the company's exposure to non-traditional mortgage products in its mortgage portfolio. Over 2005 and 2006, negative-amortizing adjustable rate mortgages (or ARMs) made up close to 3% of Fannie Mae's single-family business volume and interest-only ARMs comprised roughly 9% of its single-family business volume. Combined, Fannie Mae estimated that the negative-amortizing ARMs and interest-only ARMs accounted for approximately 6% of its credit book of business at the end of 2005 and 2006.
- The company also announced that CFO Robert T. Blakely as resigned and will be succeeded by Stephen M. Swad, the former executive vice president and chief financial officer of AOL. Previously, Swad was a deputy chief accountant at the SEC, where he helped develop the accounting and disclosure rules governing derivatives. Blakely will continue serving as the Company's EVP through the end of 2007 and will focus on completing Fannie Mae's 2006 10K, the company's last remaining historical filing. "It has been challenging and rewarding to be given this opportunity at Fannie Mae by helping to complete the restatement and to work toward timely filings," said Blakely. "This has been a dream job for me, someone who likes

large, complex tasks and helping people take on great challenges, particularly at organizations with a distinct public mission like Fannie Mae. The company has accomplished a great deal over the past several years, and as it moves forward on stronger financial footing, Fannie Mae's future will be well served by Steve Swad as its next chief financial officer.” (*Washington Post*, Howard Schneider, 05/02/07; *American Banker*, William Launder, 05/03/07; *Associated Press*, Marcy Gordon, 05/02/07; *Dow Jones Newswires*, Damian Paletta, 05/02/07; *Fannie Mae Press Release*, 05/02/07)

Freddie Mac COO McQuade turns down the company's offer to serve as CEO
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- On May 2, Freddie Mac announced that COO Eugene McQuade has rejected the company's offer to become its chief executive officer. McQuade, who plans to resign with his contract ends on September 1st, is leaving after three years as the heir apparent at Freddie Mac. In interviews, he denied rumors of a personal rift with chairman and CEO Richard Syron and expressed frustration with the political environment surrounding Fannie Mae and Freddie Mac. “I would say there is a significant amount of frustration that a CEO does feel with the government in these roles,” said McQuade. “It's an element of the job that doesn't exist in most jobs in the country. ... I'd say it was one of the less appealing aspects of the job.” Rumors of a conflict with Syron “couldn't be more off,” he said. “He and I are not only good business associates, but I'd say we're better friends. I have terrific respect for him.” McQuade acknowledged that he made the decision to leave Freddie, when the board offered him a contract to serve as CEO. “That really forced me to focus on what I would have to do to be successful in the CEO role, and it was a time commitment and a commitment to Washington that I just didn't think I was able to promise to the board,” said McQuade. “The company couldn't have been better to me.” He still has a good relationship with the board and received no pressure to turn down the promotion, McQuade said. “In fact ... I think the board was still trying to talk me into it.”
- Although there was no clear successor in place, McQuade insisted his departure would not hurt the company. “We've put together a really strong management team here that is very capable of leading the place whether I'm here or not,” he said. “I think clearly there are holes that will be created over the next year and a half that the board will have to address, but I don't see anything worrisome at this point.” McQuade, 58, hopes to ensure a smooth management transition by standing for re-election to Freddie Mac's board in June. He added that he will likely return to the private market to run a more “traditional” financial institution in the near future. A Freddie Mac spokesperson said that the McQuade's severance package is still being determined. Under his contract, McQuade would have walked away with a lucrative severance package if Freddie Mac had not offered him the CEO position by the end of his contract. Since McQuade actually turned down the promotion, his severance package likely will be substantially reduced.

- OFHEO director James B. Lockhart, III said, “President and COO Gene McQuade has played a key role over the last three years in leading the financial remediation process at Freddie Mac. As our recently released Report to Congress stated, while there has been significant progress at the Enterprise, much work remains to be done. OFHEO will continue its active oversight of Freddie Mac and expects the Board of Directors and Chairman Syron to address leadership succession with due deliberation and in a timely manner.”
- Industry observers said that they were somewhat surprised by McQuade’s decision, but were confident that Freddie Mac can attract new leadership. "Freddie is past the point where adding or subtracting one person has a substantial impact," said Howard Glaser, a mortgage industry consultant and former member of the Clinton administration. "Gene McQuade's extensive banking experience helped to guide Freddie Mac out of a difficult situation and put the company back on track," said ABA president and CEO Ed Yingling.
- Freddie Mac’s board of directors has named a special committee to review management succession and to determine the appropriate next steps. After he leaves Freddie Mac this fall, Some of McQuade’s responsibilities may fall to Patricia Cook, Freddie Mac’s EVP, investments and capital markets. “Patti is very, very capable,” said Freddie Mac chairman and CEO Richard Syron, but added he didn’t want to preempt the board in discussing if she is a possible candidate for CEO.
- Freddie Mac also announced that Ronald Poe, the company’s longest serving director, will retire from the board at next month’s annual meeting of shareholders. Freddie’s board of directors has nominated Nicolas Retsinas, director of Harvard University’s Joint Center for Housing Studies, to succeed Poe. Retsinas is a lecturer in Housing Studies at the Graduate School of Design and the Kennedy School of Government, as well as in Business Administration at Harvard Business School. Previously, he served as Assistant Secretary for Housing-Federal Housing Commissioner at HUD and as the Director of the Office of Thrift Supervision. (*Freddie Mac Press Release*, 05/01/07; *OFHEO Press Release*, 05/01/07; *Wall Street Journal*, Damian Paletta and James R. Hagerty, 05/02/07; *Dow Jones International News*, Damian Paletta, 05/01/07; *American Banker*, Steven Sloan, 05/02/07)
- Representative Richard Baker (R-LA) said the announcements of the resignations of two top executives at Fannie Mae and Freddie Mac could be a sign of the changed regulatory and legislative environments in which the GSEs operate today. “It might be more of an outlook as to where these enterprises are headed, which may mean a longer period of recovery than some would have expected," said Baker. "It may mean that with the continued scrutiny of the Congress, and I think an enhanced likelihood of the passage of the regulatory reform piece, people are looking at alternatives.” Neither Fannie Mae nor Freddie Mac have begun to file timely financial reports and both GSEs continue to have insufficient operational controls, according to OFHEO’s Annual Report to Congress for 2007. Baker told reporters that the GSEs’ tougher regulatory environment is not going to disappear. “It’s not

something likely to lessen in intensity," he said. "It's not the good-old days of the 1990s when double-digit rates of return were coming with a Congress standing ready to defend every action. So it's a troubling political environment at this point." (*Dow Jones International Report*, Damian Paletta, 05/02/07)

Fannie Mae and Freddie Mac

OFHEO director Lockhart remains an optimist about passage of GSE reform legislation

- In an interview with The Hill, OFHEO director James B. Lockhart, III was asked what is preventing Fannie and Freddie from making faster progress on their problems with financial controls and risk management. Lockhart responded, "It is a good question. They are spending billions of dollars to fix them, and they almost have as many consultants now as employees. I think the genesis of the problem is they were so mismanaged and they under-spent in systems and internal controls for many years, and it's just taking a long time and in many cases they're almost starting from scratch in some of their systems." With regard to surprises on the job, Lockhart said, "Well, it's probably how big a hole these two companies dug for themselves. It is also very hard for me to believe that it is taking so long to remediate these problems. So that's probably been the biggest surprise. The best surprise is the team at OFHEO. A very strong team has been put together over the last few years and they're very dedicated to helping these companies recover."
- When asked his feelings about Congress's progress on GSE reform, the director said, "Nothing goes as quickly as I would like in Washington. This is my third job here, and in every one of them I had to work on creating legislation. But I think we are making good progress. Chairman Frank's bill that was just passed out of committee is a very balanced and strong bill and a good improvement over the last House bill."
- With regard to the GSE reform bill sponsored by Senator Chuck Hagel (R-NE), Lockhart said, "My belief is that [Hagel's bill] is probably a little too restrictive compared to the House bill. Certainly, affordable housing is a key issue and certainly that should be a key component of their portfolio. But they also need the capability to support their other missions, the stability and liquidity of the mortgage market, which the House bill does provide. ... I think both [Hagel's and Frank's bills] give a future regulator the ability to ensure future safety and soundness. I think in many ways, as I have said, the House bill is better balanced but without removing the power the regulator needs."
- When asked if the subprime mortgage crisis would slow down passage of GSE reform, Lockhart said, "It shouldn't. It's again an example of why these companies

should be remediated, why they should have a strong regulator, so they can react better to these kinds of crises.” He added that he’s “certainly very hopeful” a GSE bill will pass this year. “All signs are that it will get out of the House and that it will go to the Senate,” said Lockhart. “And certainly there have been comments on both sides of the aisle of the need for reform in the Senate. I just hope they get a good compromise.” (*The Hill*, Jessica Holzer, 05/03/07)

OFHEO plans to propose a rule establishing a policy
for placing a GSE into conservatorship

- In November, OFHEO plans to propose a rule that would establish a policy for putting Fannie Mae or Freddie Mac into conservatorship if circumstances warranted such action, according to the agency’s semi-annual agenda published on May 30th in the *Federal Register*. Few details were provided in the notice. OFHEO also said that it plans to propose amendments to its minimum capital rule that would incorporate changes in GAAP and clarify reporting requirements. Such action would make more transparent how the agency supervises the GSEs’ capital, said OFHEO. The agency also plans to “strengthen the risk sensitivity of the [Enterprises’] risk-based capital requirements,” by changing the “loss severity equations” which “currently understate losses on certain defaulted single-family [loans].” OFHEO also plans to propose clarifying the limits on indemnification payments made by the GSEs to their executives in an effort to make this policy more comparable to policies of other federal bank regulators. (*Dow Jones Newswires*, Damian Paletta, 04/30/07)

Capital One executive being considered for appointment to the Federal Reserve Board

- According to two people “familiar with the matter,” *Dow Jones Newswires* reports that Larry A. Klane, the president Capital One Global Financial Services is to become a board member of the Federal Reserve. Klane, who would fill one of two vacancies on the Fed board, would bring banking expertise to a board heavily weighed with economists. The White House is also considering Elizabeth A. Duke, a former EVP of Wachovia Bank and former chairman of the American Bankers Association, to fill the other open seat at the Fed. (*Dow Jones Newswires*, Damian Paletta, 05/10/07)

Commercial and multi-family mortgage debt approaches \$3 trillion

- According to the Mortgage Bankers Association, commercial and multi-family mortgage debt outstanding increased 12.7% in 2006 to \$2.95 trillion on December 31st. In the fourth quarter alone, commercial and multifamily mortgage debt outstanding increased \$99 billion or 3.5%. On December 31, 2006, multifamily debt outstanding totaled \$731 billion, an increase 7.5% for the year and 2.1% in the fourth quarter alone. (*Mortgage Servicing News*, May 2007)

Bank of America eliminates closing costs for some home mortgages

- In mid-April, Bank of America began offering “No Fee Mortgage Plus” home mortgage product nationally, following an initial offering of the product in the State of Washington and subsequent offering of the product in an eight state region in February. In this program, borrowers have to make a minimum 5% downpayment on home purchase, which eliminates the requirement for private mortgage insurance typically paid by borrowers whose downpayment is less than 20%. The borrower may choose to pay interest and principal, or make interest only payments. The loan program is not available to subprime mortgage holders, who have blemished credit records or low income. Bank of America is guaranteeing customers that they will receive the best deal on the mortgage and be provided an “on-time” closing. According to the Bank, the loan will eliminate on average \$3,350 in closing costs on a \$200,000 loan. (*Associated Press*, 05/07/07)

Pilot mortgage products for illegal immigrants being offered
by J.P. Morgan Chase, Citigroup, Wells Fargo and Fifth Third Bankcorp

- J.P. Morgan Chase & Co. is developing a pilot program to market home mortgages to illegal immigrants in Maricopa County, Arizona. If the program is successful, the Bank could roll-out the program nationally this summer. The New York bank joins Citigroup Inc., Wells Fargo & Co., and Fifth Third Bankcorp, which are also experimenting with this loan product. Meanwhile, Deutsche Bank AG has teamed up with the Hispanic National Mortgage Association to develop a secondary market in which these loans can be sold and traded. "Whoever hits the street first with these loans will be the winner," says Timothy Sandos, president of the National Association of Hispanic Real Estate Professionals (NAHREP). According to NAHREP, at least \$85 billion of mortgages could be originated from 375,000 households occupied by undocumented renters, up 93% from an estimated \$44 billion from 216,000 households several years ago. (*Wall Street Journal*, Robin Sidel, 05/03/07)

FASB considers simplifying its derivative accounting rule

- On May 16, the Financial Accounting Standards Board plans to consider starting an effort to change its nine-year old standard on derivatives and hedge accounting (FAS 133) to make it less complex. Initially, the Board plans to focus on what is known- as the standard’s “bifurcation-by-risk” approach in hedge accounting which some FASB members would like to eliminate. While exact scope of the potential project remains uncertain, the primary object would be to simplify the use of hedge accounting, said FASB member Thomas Linsmeier. Some board members favor cutting documentation and monitoring requirements for FAS 133, while others advocate

changing how companies assess the relationship between financial instruments that is being used to hedge against changes in the value of another item. It remains an open question as to how deep and broad the FASB project on this issue may be. (*Bureau of National Affairs*, Steve Burkholder, 05/11/07; *Wall Street Journal*, David Reilly, 05/10/07)

Fannie Mae

Former Fannie Mae CEO Franklin Raines loses bid to move OFHEO's lawsuit against the company's former executives to federal court

- Former Fannie Mae chairman and CEO Franklin D. Raines has lost another legal battle over OFHEO's lawsuit against Raines' role in the company's accounting troubles, when a federal appeals court refused to move the action out of the hands of the regulator. A three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit ruled, "[Raines] has not shown a clear and indisputable right to the requested relief," and refused to move Raines's request that the case be moved from the administrative law arena to a federal trial court. The court also rejected a similar petition filed by Leanne G. Spencer, a former Fannie Mae controller and co-defendant. OFHEO's lawsuit against Raines, Spencer, and former Fannie Mae CEO J. Timothy Howard. Howard has filed a similar request to move the proceedings to federal court with the federal trial court now handling Fannie Mae's investor litigation. OFHEO's lawsuit is scheduled to be heard in a trial-like proceeding before an administrative law judge, beginning in March 2008. (*Washington Post*, David S. Hilzenrath, 05/01/07)

District Court dismisses Fannie Mae shareholders' lawsuit against Goldman, Sachs

- U.S. District Judge Richard J. Leon has dismissed the Fannie Mae's shareholder lawsuit against Goldman Sachs, alleging that the investment banking firm had arranged deals for the GSE that allow it to shift more than \$107 million of earnings into future years without properly informing investors. Leon ruled that there is no evidence that Goldman Sachs prepared any of Fannie Mae's misleading financial statements or knew about them in advance. Thus, the investment banking firm did not violate any duty to Fannie Mae shareholders, Leon concluded. Goldman Sachs had already been dropped as a defendant in a shareholder derivative lawsuit. (*Associated Press*, 05/08/07)

SEC announces the beginning of the distribution of Fannie Mae settlement

- On May 1, the SEC announced the beginning of the distribution process for a \$357 million Fair Fund, created as part of the agency's settlement in 2006 with Fannie Mae on charges of fraud in connection with the preparation of the company's financial statements. Eligible claimants include any person or entity that purchased Fannie Mae common stock between January 14, 1999 and December 22, 2004 or Fannie Mae Class N preferred stock between September 25, 2003 and December 22, 2004. On April 16, the U.S. District Court of the District of Columbia approved the Fair Fund and its distribution plan and appointed Jeffrey D. Dahl, with Rust Consulting, Minneapolis, MN, as distribution agent. The funds are expected to be distributed by October. (*Associated Press*, 04/30/07; *Southwest Nebraska News*, 05/01/07)

Fannie Mae finances \$34.3 billion in multi-family rental housing in 2006

- In 2006, Fannie Mae financed \$34.3 billion in multifamily rental housing, an increase of nearly 34% above the \$25.6 billion the company financed in 2005. In comparison, Freddie Mac closed \$28.8 billion in new multi-family transactions in 2006, a 10% increase over the company's \$26.2 billion in 2005.
- Fannie Mae invested \$2.2 billion in seniors' housing in 2006, a 29% increase over the prior year's level. "We think as part of our mission responsibility that having a strong interest and presence in the seniors space is critical," said Phil Weber, senior vice president of Fannie Mae's multifamily division. "And we think that if you look at the demographics, it's a market that's going to continue to grow."
- In 2006, Fannie Mae's multifamily production included of \$6 billion in large loans (defined as loans \$25 million or greater), up 17% from \$5.1 billion in 2005, and \$2 billion in equity investments that qualify for low-income housing tax credits (LIHTCs), up 11% from \$1.8 billion in 2005. The company's gains in large loans and LIHTC volume were offset by a few losses in the affordable housing sector. Fewer small loans were administered by Fannie Mae last year, \$3.9 billion, a 25% drop from the \$5.2 billion that Fannie Mae closed in 2005.
- Overall, Fannie Mae's multifamily affordable housing efforts totaled \$2.6 billion in 2006, down 13% from 2005's \$3 billion. Bond credit enhancements also declined 10% percent to \$1.9 billion, from \$2.1 billion in 2005. Fannie Mae's loans for manufactured housing communities also declined 26% to \$306 million in 2006, from \$414.6 million in 2005. These volumes aren't reflective of any change in philosophy, said Webber, who expects Fannie Mae to follow a "similar script" this year. "We think that 2006 is going to be reflective of 2007," Weber said. "We don't see any asset mix change that would be very dramatic from 2006 to 2007." (*Affordable Housing Finance*, Jerry Ascierio, May 2007)

Fannie Mae enters into \$500 million joint venture with Mid-America Apartments L.P.

- On May 9, Fannie Mae entered into a \$500 million apartment joint venture fund with Mid-America Apartments, LP, an REIT subsidiary of the Mid-America Apartments Community Inc, a Memphis-based real estate investment trust. Mid-America will make a \$60 million total equity contribution in the joint venture and will own 33% of the venture. Fannie Mae will own 66% the joint venture, which will “allow for the acquisition of \$500 million of multi-family apartment communities over a three year period,” according to a Mid-America press release. The fund “will focus on acquiring properties with redevelopment offering upside value creation through capital improvements, operating enhancements, and restructuring in-place financing,” The REIT subsidiary will receive a management fee of 4% of revenue from the joint venture; an asset management fee of 1% on equity invested; and a “promote fee” for investment returns above 10%. [Mission creep?] (*Dow Jones Newswires*, Greg Wright, 05/09/07; *PR Newswire US*, 05/09/07)

Fannie Mae announces fulfillment of pledge to provide 1,500 homes for temporary housing along the Gulf Coast

- On May 3, Fannie Mae announced it had fulfilled its pledge to provide 1,500 single-family properties from its real estate owned portfolio for temporary housing to individuals and families displaced by Hurricane Katrina. In addition, Fannie Mae has donated \$9 million, in what is expected to be a \$25 million total commitment to house evacuees in its REO properties, according to a company press release. The GSE has also worked with housing counselors, such as United Way and the National Urban League affiliates, to begin working with families six months before their rent-free leases expire to help them prepare for the transition. Assistance can include, but is not limited to, homeownership counseling, helping families to find a new place to live, and job training. (*Fannie Mae Press Release*, 05/03/07)

Freddie Mac

Freddie Mac sued over patent

- Graff/Ross Holdings, a Chicago-based real estate investment firm, has filed suit against Freddie Mac, alleging that the GSE violates the company's patent with the way in which Freddie sells bonds. According to the lawsuit filed on May 1st in a Washington, D.C. federal court, Freddie Mac infringes on the patents "by using computer systems and methods to conduct its electronic bond auctions of fixed income instruments and will continue to do so unless enjoined by this court." (*Washington Post*, 05/05/07)

Freddie Mac announces mortgage relief for Kansas tornado victims

- Freddie Mac has reminded loan servicers that they have the discretion to provide up to a year's worth of mortgage relief to borrowers with homes damaged by tornadoes in Kansas. Freddie's disaster relief policies are available in major disaster areas designated by FEMA, in which the agency's assistance is available. (*PR Newswire*, 05/09/07)

Freddie Mac and the American Bankers Association renew their alliance

- Freddie Mac and the American Bankers Association have extended and enhanced their alliance agreement, providing community banks with a wide array of mortgage products, technology tools, and critical services designed to help ABA members compete in the mortgage market. Mary Bruce Batte, co-president of Mortgage Dynamics Inc., said, "Our goal for the 2007 Alliance package was to contribute services that are critical to maintaining favorable ratings with investors and regulators. These services also include special audits (such as ARMs and fraud), investor accounting, quality control, performing FAS 140 tasks and post closing." (*Freddie Mac Press Release*, 05/09/07)

Freddie Mac's milestone: Making 50 million homes possible

- Freddie Mac announced that it has financed more than 50 million homes since its founding in 1970. According to the company's press release, "We've done a lot in 37 years and will continue to do more in the years ahead to make housing more affordable, accessible, and stable. ...We currently support \$1.3 trillion in home loans." [...However, Freddie Mac *still* doesn't have adequate internal controls, according to OFHEO's 2007 Annual Report to Congress, or a management succession team in place.] (*Freddie Mac Press Release*, 05/10/07)

Federal Home Loan Banks

Finance Board narrowly approves FHLB-Atlanta proposal to serve as intermediary for third party that purchases and securitizes loans from members

- The Federal Housing Finance Board narrowly blessed a proposal that would allow the FHLB-Atlanta to serve as a conduit between its 1,200 members and Hildabrand Capital, a private investment firm that plans to buy and pool traditional fixed rate mortgages and package them into mortgage-backed securities. The FHLB-Atlanta would earn a fee for transactions made through its new "Global Mortgage Alliance Program," but the Bank's spokesman declined to say how much the FHLB planned to earn from the relationship. If the program is successful, it could serve as a model for the other FHLBs.
- During public debate, the Finance Board was split over whether to approve the program, an unprecedented service not offered by any of the 12 FHLBs. Finance Board Chairman Ronald A. Rosenfeld praised the program, which would offer FHLB members another option as they determine where to sell their loans in the secondary market, but would not expose the FHLB-Atlanta's balance sheet to any credit or interest rate risk posed by any loans sold by members. "It seems to me that it is just another source of opportunity for the small and medium-sized banks to sell their mortgages on whatever basis they deem most favorable," said Rosenfeld. "Whether this process actually works or not, I don't know. That's for the marketplace." Two of the five directors on the Finance Board raised concerns about the program and tried unsuccessfully to table the proposal. Brian Montgomery, assistant secretary at HUD, questioned why the Finance Board was debating the plan if Stephen Cross, the Finance Board's director of the Office of Supervision, was empowered to approve the plan. He asked Cross if he was privately concerned about the new policy and was looking for guidance from the board. "I'm trying to read between the lines here," Montgomery said. "I'm not a between-the-lines kind of guy, really," Cross responded. "I'd say the answer is 'No, I am not particularly concerned about the policy.'" When Montgomery asked Cross if he was "100% in support of the policy," Cross said no, although his support was "certainly well over 50%."
- Director Alicia R. Castaneda said the program appeared to be an inappropriate use of the FHLB's GSE charter and could lead to reputational risk and other problems. "If we approve this, we would be letting a Home Loan Bank get into what I would call the 'outsourcing business' for the primary benefit of a single private entity," said Castaneda. "I don't think it's appropriate to exploit the GSE charter in this way." Montgomery and Castaneda were the only two board members who voted to table the proposal. Eventually, the Finance Board passed a motion providing Steve Cross, the

Finance Board's supervision director, the authority to determine if the plan should ultimately be approved. Three members voted for the motion, while Castaneda voted against it and Montgomery abstained.

- The FHLB-Atlanta now must receive final approval from the Finance Board staff before it can proceed with marketing the new program. "We're pleased with the Finance Board's consideration," a FHLB-Atlanta spokesman said. "We look forward to hearing from the staff its recommendation." The Bank, which currently participates in the Mortgage Partnership Finance Program and the Mortgage Partnership Program, has a mortgage portfolio of \$3 billion at year end 2006. While the Bank said it would continue to offer those programs, officials at the FHLB-Atlanta said privately that they expect to steer members toward participation in just one program. Officials insist that they will not be diverting members from the current programs, arguing that each program has different benefits. (*American Banker*, Steven Sloan, 05/10/07; *Dow Jones Newswires*, Damian Paletta, 05/09/07)
- Also at the meeting, the Finance Board voted to allocate the elective directorships at each FHLB among the states in that Bank's district. The Banks' directorships are allocated initially on the amount of Bank stock owned by the members in each state. However, under a "grandfather provision," which requires each state to have at least as many directorships as it had in 1960, additional directorships may have to be allocated to certain states. In addition, the Federal Home Loan Bank Act authorizes the Finance Board, at its discretion, to increase the size of the board for any Bank district comprising five or more states. The Finance Board approved an allocation, which will preserve the current number of directorships at eight of the FHLBs. At one of those Banks, the allocation of directorships among states will change. The boards at the FHLB-Boston, FHLB-New York, and FHLB-Pittsburgh each will decrease by one elective directorship, while the FHLB-Indianapolis board will increase by one elective directorship. (*Federal Housing Finance Board Press Release*, 05/09/07)

FHLB-Chicago plans layoffs to improve the Bank's profitability

- In an 8K filing with the SEC, the FHLB-Chicago said it "conducted a reduction in force" on May 1st and plans to conduct additional reductions through the remainder of the year to achieve a net reduction in compensation and other expenses of approximately \$13.5 million on an annualized basis. In connection with the RIF, the Bank "anticipates a charge to the second quarter's earnings of approximately \$4.2 million." (*Form 8K*, Federal Home Loan Bank of Chicago, 05/01/07)

Bill introduced to allow FHLBs to issue standby letters of credit for tax-exempt bonds

- Representative Sander Levin (D-MI) introduced legislation that would allow the FHLB System to provide credit enhancements to tax-exempt economic development

bond transactions. Levins said, "This legislation will help provide our communities with access to capital at the lowest possible costs. The needs are almost limitless, but resources unfortunately are not, and this legislation will help those scarce resources go farther." As with previous bills on this issue, Levin's proposal would apply to bonds sold after enactment, leaving previously issued debt uncovered and still open to IRS scrutiny. The bill is co-sponsored by Representative Paul E. Kanjorski (D-PA), chairman of the House Financial Services subcommittee on capital markets, insurance, and government-sponsored entities, along with Representatives Phil English (R-PA) and Deborah Pryce (R-OH).

- Supporters argue that the bill is crucial for local projects financed by small issuers that have trouble accessing capital markets and would put the FHLB system on the same level as Fannie Mae and Freddie Mac, who are permitted to issue letters of credit in support of tax-exempt bonds. Bond insurers oppose the legislation, arguing that it would permit the FHLBs to enter into a market that is already well served by private companies. Moreover, they argue that this bill would reduce the fiscal discipline that the capital markets currently imposes on issues and would significantly limit tax revenues currently paid to the federal, state, and local governments, assuming that private credit enhancers are displaced by the FHLBs. CBO estimates that \$6 million would be diverted from federal coffers, if the FHLBs are allowed to provide letters of credit for tax-exempt economic development bonds. Other observers say they are weary of letting another GSE grow beyond its original housing mission focus. "It gets to the question of should the GSEs be granted additional power," said Bert Ely, an Alexandria, VA bank consultant and a frequent GSE critic. "There are more important fish for the [FHLBs] to fry. ...They just don't need it." (*Bond Buyer*, Andrew Ackerman, 05/03/07; *American Banker*, Steven Sloan, 05/07/07)

FHLBs' Office of Finance announces first quarter operating results of FHLB System

- On March 31st, the FHLB System's combined assets were \$1.02 trillion, a 0.4% increase from the System's total assets of \$1.016 trillion at yearend 2006. FHLB advances decreased 2.5% to \$624 billion, representing 61.2% of the System's total assets. During the first quarter, the System's investments rose 8.0% to \$292 billion, while member mortgage assets declined 1.7% to \$96 billion. The System's combined net income for the first quarter was \$621 million, a 0.3% increase from the System's net income of \$619 million for the first quarter of 2006. Total combined capital declined 0.5% to \$45 billion on March 31, 2007. The FHLB Affordable Housing Program contributions of \$70 million during the first quarter were consistent with the same period a year ago. (*FHLBanks Office of Finance Press Release*, 04/30/07)

FHLB-Seattle declares first quarter dividends

- The FHLB-Seattle's board of directors has declared cash dividends of \$0.15 per share (for a total of \$3.2 million) on outstanding Class B stock, representing a 50% increase over the previous year's Class B dividend. The Bank will also pay \$1.29 per share dividend on the Bank's Class A outstanding stock. The Bank's president and CEO Richard M. Riccobono, said, "The Board of Directors elected to pay a market-rate dividend on Class A stock to encourage new capital investment in the Seattle Bank cooperative, promote the growth of its advance business, and enhance overall earnings. We also expect that the growth in advances supported by Class A stock will improve the mix of advances at the Seattle Bank and, eventually, better position the cooperative to repurchase excess Class B stock." The dividends, which are based on first quarter 2007 earnings of \$10.6 million, will be paid in May 2007. (*Business Wire*, 05/02/07)

FHLB-Seattle announces new appointments to its board of directors

- The Federal Housing Finance Board has appointed to the FHLB-Seattle's board of directors Les AuCoin and Michael W. McGowan to serve the remainder of three years terms beginning on January 1, 2006 and Frederick C. Kiga and Cynthia A. Parker to serve the remainder of three-year terms that began on January 1, 2007. AuCoin is a visiting professor at Southern Oregon University and a retired U.S. Congressman from Oregon. During his 18-year tenure in Congress, he served on the House Appropriations Committee, the House Banking Committee, and the Housing and Community Development and International Institutions subcommittees. McGowan is president and chairman of Daniel Management Capital Ltd., a business consulting and investor relations services firm located in Missoula, MT. He also co-manages U.S.A. Capital LLC, a hedge fund domiciled in Virginia. Kiga is director of corporate and government relations for the Russell Investment Group in Seattle, WA and serves as chair of the University of Washington's Board of Regents. Parker is vice president of Seattle-Northwest Securities' affordable housing and real estate group. Previously, she was director of the City of Seattle's Office of Housing and served as executive director of Anchorage Neighborhood Housing Services, Inc. Parker is a former director of the Federal Reserve Bank of San Francisco, a past president of National Neighborhood Housing Network, and member of the Seattle Bank's Affordable Housing Advisory Council. (*Business Wire*, 04/30/07)

FHLB-Des Moines expands management team

- Effective May 1st, Nicholas J. Spaeth will join the FHLB-Des Moines as general counsel and risk officer. He will have the overall responsibility for the Bank's enterprise risk management framework and will assume responsibility for the Bank's legal department. Previously, Spaeth was a partner at Kirkpatrick & Lockhart Preston Gates Ellis LLP in Washington, DC. Before joining Kirkpatrick & Lockhart, he served as SVP law and public policy and chief legal counsel for H&R Block, Inc. (2004-2007); general counsel and secretary of Intuit, Inc. (2003-2004); and SVP and

general counsel of General Electric's Employers Reinsurance Corporation (2003-2004). Spaeth has strong government and regulatory background, having served as an elected State Attorney General in North Dakota for eight years. (*FHLB-Des Moines Press Release*, 04/30/07)

FHLB-New York renews its \$250 million commitment for disaster recovery relief

- The FHLB-New York has renewed its previous commitment of up to \$250 million in disaster recovery relief funds to provide immediate gap financing to begin the process of rebuilding while insurance settlements are being worked out. The funds are made available through the Bank's Community Lending Programs to meet the short, medium and long-term funding needs of communities designated as FEMA disaster areas. The Bank's CLP commitment can specifically be used for housing, small business and economic development lending needs. (*PR Newswire*, 05/02/07)

Ginnie Mae

House Financial Services Committee passes comprehensive FHA reform

- On May 3, the House Financial Services Committee passed the Expanding American Homeownership Act (H.R. 1852), introduced by Representative Maxine Waters (D-CA) and actively promoted by Committee Chairman Barney Frank (D-MA). The bill is a variation on the FHA reform bill (H.R. 5121) passed by the House in 2006, by a vote of 415-7. H.R. 1852 would increase the ceiling on loans that the FHA can insure and use the additional revenues to support a national affordable housing trust fund. Republicans, who backed an identical version (H.R. 1752) of H.R. 5121, argued that the committee should advance bipartisan legislation, rather than advance a bill that contained a controversial AH program that would divert FHA resources to purposes that are not directly related to the FHA's mission. Minority leader Spencer Bachus (R-AL) argued that the AH program, which would be funded by FHA premiums, would divert money away from the agency and threaten its solvency. "This could not come at a worst time," said Representative Ed Royce (R-CA). "This fund, in my view, will decrease [FHA] resources and drive false hope." Frank objected to the Republicans' characterizations of the program as a "slush fund," calling the remarks "wholeheartedly inappropriate." He added, "We are not interfering with the current flow of funds."
- Frank argued that building new affordable housing was in line with the FHA's mission and noted that past surpluses generated by FHA were simply returned to the Treasury, where they funded many other functions not related to housing. Under H.R. 1852, increased FHA revenues of approximately \$247 million, resulting from

measures such as increasing the limits on the size of mortgages that the agency can insure, would be directed to fund affordable housing. Frank also introduced a successful amendment that would give priority to funding \$100 million in surplus FHA funds to borrower counseling, before earmarking funds for the AH fund. Republican members introduced a series of unsuccessful amendments that could have effectively crippled the affordable housing fund proposal, which were largely defeated along party lines.

- Representative Scott Garrett (R-NJ) proposed an amendment that would suspend funding of the AH fund if GAO determined that actions of the FHA in conjunction with the activities proposed under H.R. 1852 caused the agency's mortgage insurance program to be designated as a high-risk program. In 1994, FHA's mortgage insurance program was included on the GAO's high-risk list and was removed in January 2007, said Garrett. Frank argued that such a provision would be unfair in the event actions taken by FHA were considered risky but the affordable housing fund itself was not considered to be a high-risk initiative. Frank said other measures were added to the legislation to assure the solvency of the affordable housing fund and that such a provision would be unnecessary. "Let's be clear," said Frank. "The gentleman doesn't like the [affordable housing] program and is trying every way to put obstacles in its path," Garrett responded, "Don't attack my motives." The sharp exchange among panel members illustrated the highly partisan undercurrent of the markup session in which the committee approved H.R. 1852 by a 45-19 vote.
- The Committee approved an amendment offered by Frank, and Representative Gary Miller (R-CA), David Scott (D-GA), and Randy Neugebauer (R-TX) that would allow FHA-qualified mortgage brokers and correspondent lenders to post a \$75,000 surety bond as an alternative to an audited financial statement or meet a minimum net worth requirement. [Under current FHA rules all mortgagees that are not federally supervised must submit annual statements and maintain a net worth of \$250,000, while loan correspondents must maintain a net worth of \$63,000.] The amendment provides for GAO to study the change and sets a five-year sunset for the provision. Banking and accounting groups warned the panel in a May 2 letter that the surety bond option would provide inadequate protection, noting that it "would barely cover the cost of repurchasing a single average FHA loan." The amendment passed on a voice vote.
- Other amendments passed by the Committee included:
 - An amendment by Waters (D-CA) to set upfront premiums on FHA single-family loans at levels commensurate with risk, so that HUD can afford to insure loans for such borrowers;
 - An amendment by Neugebauer to require HUD to conduct a study on its Information Technology needs with respect to FHA.;

- An amendment by Representatives Jim Marshall (D-GA) and Ginny Brown-Waite (R-VA) to cap loan origination fees on FHA reverse mortgage loans at 2% of the amount that can be borrowed upfront, which would reduce costs for seniors citizens compared to the current 2% cap on a much higher baseline, the maximum mortgage amount;
 - Two amendments by Representative Margaret Donnelly (D-MO) to provide for more flexibility for FHA to insure manufactured housing loans;
 - An amendment by Representative Paul Hodes (D-NH) to ensure that FHA escrow agents bear the cost of any financial penalty based on any failure on their part to make timely payments of taxes and insurance out of an escrow account;
 - An amendment by Rep. Maloney to increase the maximum FHA loan amount when the home is also being used to operate a licensed day care facility;
 - An amendment by Representative Dennis Moore (D-KS) to prohibit FHA from unnecessarily raising loan fees, by conditioning any fee increase on a need to keep that particular FHA program from running a deficit;
 - An amendment by Representative Carolyn McCarthy (D-NY) requiring borrowers who are late on their loan payments from receiving notice of the availability of foreclosure prevention counseling;
 - An amendment by Representative Gene Green (D-TX) to require HUD to create a pilot program for an automated process for borrowers without sufficient credit history; and
 - An amendment by Representative Shelly Moore Capito (R-WV) to require a some form of government identification to qualify for an FHA loan.
- Green (D-TX) also introduced an amendment to the amendment on surety bonds that would require additional duties by mortgage brokers to assure that they safeguard funds held on borrowers' behalf. Green's proposal was approved by the Committee after he agreed to drop a measure that would have allowed legal actions by borrowers against brokers who were in violation of the requirements. Republicans also objected to a provision in Green's amendment that required brokers to "make reasonable efforts to secure a mortgage loan with rates, charges, and repayment terms that are advantageous to the borrower." Neugebauer argued that the language would amount to a "suitability" standard, requiring that brokers assure that they offer the borrower a loan with the lowest possible available interest rate or face sanctions. He said it would be dangerous to impose a mandate that brokers "determine what is a suitable mortgage for their client." Minority leader Spencer Bachus (R-AL) said the proposal "appears to give an affirmative duty to the broker to find the best available loan out there, and I'm not sure that that's a reasonable expectation." Neugebauer contended

that the thrust of the provision may be more appropriate in the context of future legislative action concerning predatory lending. Green said that his amendment "is the genesis of what we may move to; it is not the end game." Green withdrew that section of his amendment, which passed on a voice vote, along with underlying amendment permitting the use of surety bonds as an alternative for audited financial statements by mortgage brokers and correspondent lenders. (*Bureau of National Affairs*, Richard Cowden, 05/04/07; *House Financial Services Committee Press Release*, 05/03/07; *American Banker*, Cheyenne Hopkins, 05/04/07)

Farm Credit System / Farmer Mac

Farm Credit System reports solid growth and profitability for first quarter

- For the first quarter 2007, the Farm Credit System reported combined net income of \$654 million, an 18.1% increase over the System's combined net income of \$554 million for the first quarter of 2006. The FCS's gross loans increased \$3.747 billion or 3% to \$127.183 billion for the quarter, reflecting continued demand for real estate mortgages, the System's marketing efforts, and increased seasonal agribusiness demand due to commodity prices that remain at relatively high levels. "The System continued to generate strong earnings during the first quarter of 2007," said Jamie B. Stewart, Jr., president and CEO of the Federal Farm Credit Banks Funding Corporation. "Continued growth in the System's loan and investment portfolios, while maintaining a high level of credit quality, has favorably affected the System's earnings."
- At March 31, the FCS reported total capital of \$25.24 (in millions), representing 15.1% of the System's total assets of \$167.1 billion. According to the FDIC's latest available financial data (as of December 31, 2006), the Farm Credit System's total assets place it tenth among the nation's largest banks. [The Farm Credit System—the tenth largest financial institution in the country based upon total assets—tells Congress that it needs *expanded* lending powers to better serve rural America? And, *when* will the FCS register with the SEC?] (*Business Wire*, 05/01/07; www.FDIC.gov, 05/10/04)

United FCS board reaches unanimous approval of governance issues

- At a recent board meeting, the Board of Directors of United FCS, ACA (the Association), reached unanimous agreement on various issues related to the Association's governance and organizational structure. United FCS Board members agreed to the appointment of an Outside Director who will serve as Board Chair and

Chair of the Executive Committee. Effective May 2, Jerold Harris will assume this Outside Director position. Harris has more than 40 years of Farm Credit System experience. The Board also agreed to (1) the continuation past and current practice of patronage allocation to shareholders based on the financial performance of the Association; (2) the affirmation of United FCS's commitment to maintaining all branch offices in Wisconsin and Minnesota with high-quality staff able to quickly and effectively respond to local customers' needs; (3) the implementation of a new Executive Committee structure, consisting of three members from Wisconsin, three from Minnesota and the new Outside Director; and (4) the designation of one Association President and CEO, Marc Knisely, with Regional Chief Operating Officers managing day-to-day retail operations in each region.

- "The actions taken at the April meeting reflect unanimous support from all Board members, speaking as one organization for the benefit of all United FCS shareholders," says Marc Knisely, CEO of United FCS, ACA. "As a local farmer-owned cooperative, we remain highly committed to our shareholders' current and future needs." Incoming board chairman Harris said, "Based on my experience with a number of Farm Credit System entities, it's clear that the United FCS Board has been diligent in its efforts to create a solid plan for its shareholders. I'm pleased to be joining a financially strong organization and I look forward to helping lead United FCS as we move forward."
- The Boards' actions were taken in response to their February 8 meeting, in which the 12 Minnesota board members of United FCS outvoted their nine Wisconsin counterparts on provisions which transferred decision making authority from their regional offices to the full board and subsequent protest by FCS Financial Services, which closed its six Wisconsin offices. [In 2002, Farm Credit Services of Minnesota Valley and FCS Financial Services in Wisconsin merged to form United FCS, under an agreement by which each state's organization would operate independently, maintain separate names and executives.] A day after the offices were closed, the Marathon County Circuit Court issued a restraining order against the parent association, which restored the rules that applied before the resolutions were passed on February 8. The board's recent actions supersede their actions taken on February 8th. (*Associated Press*, Dinesh Ramde, 02/22/07; *Associated Press*, 02/21/07; *Brownfield Ag News for America*, Bob Meyer, 02/21/07; *Wisconsin Agriculturalist*, 05/09/07)

Has the drive for "clean" ethanol been driven on false hopes?

- In a May 2nd editorial, *Investor Business Daily* wrote, "In the U.S., the alternative fuel du jour is ethanol. It can be made from corn or sugar or perhaps even wood chips and leftover copies of the *New York Times*. But here too there are consequences to its use that may exceed any benefits. We already know that ethanol consumes more energy in its manufacture than it produces when consumed, that it is difficult to transport and evaporates easily."

- “We also know that using virtually all available land to produce an ethanol crop like corn would make only a small dent in our energy mix, and that by competing with crops grown for food, raises food costs.” [Adding insult to injury, the U.S. taxpayer is subsidizing the development of ethanol to the tune of \$1.50 a gallon, including \$0.51 per gallon federal blenders credit (totaling \$2.5 billion), \$0.9 billion in corn subsidies for ethanol corn, and \$3.6 billion extra paid at the pump. The Farm Credit System has helped lead the ethanol charge, though its financing of new ethanol production plants, providing an indirect subsidy for the ethanol industry.]
- “A study just published by Mark Jacobson, a Stanford University civil and environmental engineering professor, in the peer-reviewed journal *Environmental Science and Technology*, adds another consequence — that 200 more people would die each year from respiratory problems if all U.S. cars ran on ethanol. Most of these additional deaths would occur in, surprise, Los Angeles. According to Jacobson, ethanol actually produces more hydrocarbons than gasoline and less nitrogen oxide. Ethanol produces longer-lasting chemicals that eventually turn into hydrocarbons spread over a larger area. The actual science is complicated but in an area like L.A. when nitrogen oxide levels reach a certain level, it actually begins eating up some of the ozone. So less is bad, not good.”
- “The first rule of environmentalism, like medicine, should be to do no harm. Or to put it in terms the greenies understand, are they destroying the earth in order to save it?” (*Investor Business Daily*, 05/02/07; <http://zfacts.com/p/63.html>)

Postal Service

USPS on the road to oblivion?

- In the May 12th issue of *American Chronicle*, Dale Netherton wrote, “In true government fashion the U.S. Post Office with monopoly power, without a worry about competition, is on the road to oblivion. Cost control by an arrogant subsidized protected organization is a feeble gesture that only is used for propaganda and has no baseline to relate to. Without having to demonstrate a bottom line and meeting the competition, the lumbering Post Office blatantly raises its rates and changes its way of charging for postage with no regard to the consequences to businesses and consumers. Meanwhile as they ignore the market changes in moving messages and literature, the demise rears its head for those who are looking to the future.”
- On the eve of yet another hike in postal rates, businesses and retail customers are looking for alternatives to the USPS. Some believe that online banking and bill paying systems have reached the tipping point, now that some 74% of households pay

at least one bill on line. With banks going paperless with their customers to save postal costs, many financial institutions have lowered and often eliminated their online banking charges, often through bundling of banking products. Many businesses are looking for ways to save on their mailing costs, largely by switching to email and abandoning high-cost, low margin parts of their business. In short, as postal rates go up, customer behaviors change and mail volumes will likely decline. (*Dow Jones Newswires*, Jennifer Openshaw, 05/09/07; *Associated Press*, Joyce Rosenberg, 05/04/07)

- "If the Postal Service does not address its ballooning costs, stamp-price increases could become regular events," said Charles Guy, the former director of the USPS Office of Economics and Strategic Planning and now an adjunct scholar with the Lexington Institute. "Although the Postal Service is now required by law to keep price increases under the inflationary cap, it will not succeed in doing so unless management can find new ways to rein in labor costs." Approximately 80% of USPS spending goes to labor costs, compared to about 50% for private firms, he added. [And, Postal Service employees enjoy a 20% to 30% wage premium over their private sector counterparts.] "Any effort to cut costs must take into account the significant resources devoted to labor."
- Possible ways to reduce labor costs at the Postal Service include greater labor flexibility for postal managers; the phasing out of contractual no-layoff provisions; greater pay flexibility, including the introduction of market wages rather than premium wages for new hires; and pay scales that take into account regional differences in the cost of living, said Guy. "Unless the Postal Service launches real labor reforms, stamp-price increases will continue to be an all-too-common occurrence," said Guy. In fact, Postmaster General John Potter has hinted that USPS will now begin increasing rates annually. (*Daily Globe* [Ironwood, MI], 05/11/07; *The Examiner*, Robert R. Schrum, 04/30/07)

NALC continues its protest against private contractors handling the U.S. mail

- "I can't believe the American public wants private contractors delivering their mail," said William Young, president of the National Association of Letter Carriers (NALC), who recently broke off contract negotiations on behalf of the union with the Postal Service. Joined by members of other postal workers unions, NALC organized a Washington, D.C. protest to oppose the USPS's contracting of mail delivery to private firms. Mailmen from 18 different states attended the protest.
- Robert Schrum, research fellow at the Lexington Institute, said that the Postal Service's management would be wise to take advantage of the cost-cutting opportunities that private contractors provide. [Private contracting of mail delivery can cost half as much as delivery of federal postal employees, says Schrum.] Otherwise, consumers will face the burden of ever-rising postage rates, leading, in all likelihood, to less mail for postmen to deliver.

- "...[B]y leading the pickets earlier this month, Young and other union leaders weren't just protesting private contractors," said Schrum. "They were also protesting lower prices for consumers." (*The Examiner*, Robert R. Schrum, 04/30/07)

Representative Davis introduces bill to make absentee ballots postage-free
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- Representative Susan Davis has introduced a bill to make absentee ballots postage free for voters. "In our fast-paced hectic society, voting by mail is an option that works for many people," said Davis. "The price of a stamp is not a burden for many people, though it certainly is for some. For these people, adding a stamp to a ballot is a sort of poll tax and that is wrong." Davis estimates that the cost of instituting postage-free ballots would be about \$23 million, assuming the same number of people voted absentee as in the 2004 presidential election. This issue was last considered by Congress in 1979, when five similar bills were introduced on this issue. (*The Hill*, Aaron Blake, 05/02/07).

TVA

TVA is leader in the revival of America's nuclear energy program
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- America's nuclear energy program is being revived at TVA's Unit 1 reactor at the Browns Ferry Nuclear Plant in Athens, AL, the site of the one of the worst nuclear accidents in which a candle sparked a major fire in 1975. Unit 1 has been "reborn" as a modern 1,200 megawatt atomic generator, following a five year, 1.8 billion restoration project. Most recently, NRC inspectors deemed that TVA has "adequately prepared" Unit 1 to resume operations and the Nuclear Regulatory Commission recommended its restart, following a 22 year shut-down. The unit, which was designed in the 1960s, run in the 1970s, mothballed in the 1980s, and revived in the 1990s, will be the country's first nuclear generator of the 21st century and its 104th active commercial reactor. "You could almost point to Browns Ferry Unit 1 as really the beginning of nuclear energy's rejuvenation in the United States," said Scott Peterson, vice president of the industry's Nuclear Energy Institute. "If you care about global warming and clean air, it is hard not to be for nuclear power," said Senator Lamar Alexander (R-TN), co-chairman of the TVA congressional caucus. By 2009, the Nuclear Regulatory Commission expects to receive fast-track construction and operating license applications for 28 standard design reactors at 19 sites. Among the applicants is NuStart Energy Development LLC, a consortium of power companies such as TVA and equipment manufacturers, which is contemplating building two reactors at TVA's unfinished Bellefonte plant site in Hollywood, AL. TVA is also

expected to decide by late summer if it will complete a second reactor at its Watts Bar plant in Spring City, TN.

- "We are probably going to stay in the nuclear ballpark until the clean-air regulations clear up," TVA President and CEO Tom Kilgore told The Associated Press. "I think nuclear (projects are) going to be in our future for a decade." By the end of the decade, TVA will have spent nearly \$6 billion on emissions controls for its 11 coal-fired plants in Alabama, Tennessee and Kentucky under existing emissions control regulations. With the prospect of the enactment of tougher carbon standards on the horizon, the utility faces even higher costs for its coal-fired plants in the future. Today, TVA generates 64% of its power from coal, 29% from nuclear, 6% from hydroelectric, and 1% from natural gas and diesel. The agency's renewable energy program, which includes wind, solar and methane sources, contributes less than 1% of TVA's power. Assuming other generation sources remain constant, TVA could increase its nuclear generation from 29% to 41% of its energy portfolio within a decade, putting the utility on track to achieve its goal of having the largest nuclear generation capacity of any utility in the United States.
- Jerry Paul, an energy policy expert at the Howard Baker Center for Public Policy at the University of Tennessee, pointed to a "confluence of issues" that contributed to the "rebirth" of the country's nuclear program. "It is all about climate change and emissions. It is about economics and the recognition that nuclear power has the lowest operating cost for any form of baseload generation. It is about energy supply and security," said Paul. On balance, nuclear plants cost about half as much to operate as coal-fired power plants but cost twice as much to build, said TVA's Kilgore
- Critics are quick to point out TVA's troubled nuclear history, in which it scrapped a planned 17-reactor system when power supply quickly exceeded demand in the 1970s. Consumer advocates are also concerned that the utility is weighing all of its energy options. "I think it is shortsighted. Rushing back to nuclear power is a real mistake," said Steve Smith, director of the Southern Alliance for Clean Energy. S. David Freeman, a former TVA chairman who helped "kill" eight of the agency's 17-planned reactors between 1977 and 1984, said, "You know if anybody gave nuclear power 'the college try' it was the Tennessee Valley Authority. And I know because I had to suffer through it. It failed financially." Freeman, the outspoken opponent to nuclear energy added, "We don't even need to go to the new concerns about terrorism and nuclear proliferation and what to do with the waste and all of those issues. The pure economics of it killed it, and there is no reason to think that another round with the same technology is going to do any better." [...Unless the price of oil soars to over \$60 a barrel.] (*Business TN Magazine*, Allison Gorman, May 2007; *Birmingham News*, Kent Faulk, 05/02/07; *Montgomery Advisor*, 05/06/07; *Associated Press*, Duncan Mansfield, 05/04/07)
- In a May 10th editorial, the *Decatur Daily News* [Decatur, AL] wrote, "Nuclear may be solution, but waste still a problem. Browns Ferry in Limestone County is leading

an American revival in nuclear energy. While that is positive news for local residents and businesses that depend on low-cost electricity from the Tennessee Valley Authority, it adds to a problem that neither scientists nor politicians have been able to solve.”

- “What do we do with all of that nuclear waste? For now, Browns Ferry and other nuclear plants are postponing a solution by stockpiling radioactive waste for later disposal. The government solution is the Yucca Mountain nuclear landfill in Nevada, but it's a shortsighted fix. By the time the controversial dump opens, the accumulated nuclear waste will fill it immediately.”
- “Despite his wartime differences with France, President Bush points to that European ally for a solution. The French recycle their spent nuclear fuel and reuse it. This leaves less highly radioactive material to be sealed in caskets and buried deep underground. If we do reprocessing and recycle, we can increase the capacity of Yucca Mountain 100-fold,” Phillip Finck, a nuclear engineer, told the IEEE Spectrum, a trade magazine for electrical engineers. Until good science catches up with good intentions, however, recycling is not yet the perfect solution. So far, it's cheaper to use new fuel than recycled fuel and, in some forms, the recycled fuel leaves a waste problem that is more dangerous than the original form. But, President Bush is right in pushing our scientists and government leaders to perfect recycling. We can benefit from an alliance with the French when it comes to nuclear waste.”
(*Decatur Daily News*, 05/10/07)

Global warming concerns should renew interest in TVA's green power program
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- In an opinion editorial, *The Decatur Daily* [Decatur, AL] wrote, “With global warming now a worldwide concern, the federal government should take renewed interest in the Tennessee Valley Authority because of its green power program. TVA started the program seven years ago when skeptics said the federal agency was wasting money on a pipe dream. Still in its infancy, the Green Power Switch program is selling a record amount of renewable power and may soon reach its capacity again. That's because people in the Tennessee Valley are concerned about global warming, acid rain, rising fuel costs and having enough energy. And because green power is available.”
- “The program offers power in blocks of 150 kilowatt hours, which is about 12 percent of an average household's monthly usage. The cost is slightly higher than traditionally generated power. The program is small, generating only 37 megawatts of TVA's 35,000 megawatts. But it is significant because the program is demonstrating to the nation the practicality of green power. For instance, a TVA plant in Memphis burns methane from a sewage plant to create electricity. TVA has several solar power sites and 18 windmills on its wind farm on Buffalo Mountain in Tennessee. There was concern last week over a report that TVA is selling only 69

percent of its green power. That is misleading because of the windmills that came on line in recent months.”

- “As of March, TVA had 158 distributors participating in green power, sending this hope for the future to 10,000 residential customers and more than 650 businesses. ...Green power is working for TVA and is continuing to grow. Hopefully, Congress is watching. One way each of us can help with cleaning up the environment and stopping global warming is to join the Green Power Switch program.” (*The Decatur Daily*, 05/01/07)
- From March 2006 to February 2007, TVA sold only 69% of the green power it produced, said the utility’s spokesman Gil Francis. As of March, TVA had 9,845 residential customers and 654 businesses signed up for TVA’s green program, which is being offered by 98 of the agency’s 158 local power distributors. (*Knoxville News-Sentinel* [TN], Andrew Eder, 04/22/07)

Fallout from the FBI’s investigation of Memphis Light Gas & Water continues

- As noted in the July 18, 2005 edition of *GSE Report*, Larry Thompson, the former chief operating officer for Memphis Light Gas & Water (MLGW), alleged that Memphis Mayor Willie Herenton hand-picked Joseph Lee to serve as president and CEO of MLGW [at a salary of \$215,000] to benefit his banking friends and to siphon money from the utility to the city budget. In a lawsuit, Thompson alleged that Lee and Herenton conspired to eliminate his job because he cooperated with FBI agents looking into the mayor’s involvement in the public utility. According to Thompson’s suit, “The FBI had been investigating...the involvement of Herenton...to retain certain lawyers” in a “possible sale of MLGW.” Thompson alleged that talk of a sale was part of a plan “to steer [MLGW’s] bond issue to certain banking” friends of the mayor. According to public records, MLGW paid its underwriters \$6 million and attorney fees of \$500,000 for the \$1.5 billion municipal bond offering. Thompson said he “met with the FBI” and told agents that Herenton considered having “money transferred from MLGW ...to the city for budgetary purposes,” a violation of the utility’s contract with the TVA. (*GSE Report*, 07/18/05)
- The FBI’s investigation of the utility discovered that Memphis City Councilman Edmund Ford had been allowed to run up a \$16,000 debt for MLGW’s services at his business, E. H. Ford Mortuary Services. [Ford is the uncle of former U.S. Representative Harold Ford, Jr. (D-TN)]. According to the investigation, MLGW president Lee prevented the disconnection of councilman’s utilities at a time in which Ford served as chairman of the City Council committee that oversees the MLGW’s budget and spending. In December, Ford was removed from his post, when he and fellow councilman Ricky Peele were arrested on federal charges of accepting bribes for votes. [In April, Ford paid off his debt to MLGW, two days before the scheduled shut-off of utility services]. Subsequently, Lee and MGLW general counsel Odell Horton, Jr. have resigned from the agency and been denied severance packages, after

the *Commercial Appeal* reported that Lee had brokered a deal to have his nearly \$62,000 of legal bills concerning the utility's billing irregularities be paid by MLGW. [Lee and Horton had agreed to have the utility pay the legal bills in increments of \$24,999 or lower in order to avoid City Council oversight and approval.] Subsequently, the utility has reversed course and said Lee's personal legal bills will not be paid by MLGW.

- When MLGW contemplated implementing an income-based rate structure for its subscribers in 2004, TVA informed the utility that basing its rates on the customers' incomes could violate its electrical-supply contract with the TVA, which requires MLGW to sell power "without discrimination among consumers" and prohibits offering special rates or concessions to select customers. It appears that MLGW violated the terms of its agreement with TVA by providing Councilman Ford "special treatment" of his utility accounts. (*The Commercial Appeal*, Tom Charlier, 12/12/04; *Associated Press*, 05/03/07; *Commercial Appeal*, Michael Erskine and Trevor Aaronson, 05/03/07; *Commercial Appeal*, Trevor Aaronson, 05/04/07; *Associated Press*, 05/05/07)

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