

The **GSE** REPORT™

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Contents of GSE Report™

Major Events

- [Fannie Mae CEO Mudd's compensation increases 25% to \\$14.4 million \(p. 3\)](#)

Fannie Mae and Freddie Mac

- [House Financial Services Committee Ranking Member Bachus voices opposition to the affordable housing fund in GSE legislation \(p. 5\)](#)
- [OFHEO director Lockhart reiterates the need for passage of GSE regulatory reform bill \(p. 7\)](#)
- [Federal Reserve should eliminate Fannie's and Freddie's special privileges, which reinforces the federal government's implied guarantee of the GSEs \(p. 9\)](#)
- [OFHEO director Lockhart is reluctant to give GSEs relief from the capital surplus requirements after the companies return to timely financial filings \(p. 11\)](#)
- [OFHEO releases 120-page regulatory guide to improve the transparency of the agency's supervisory program \(p. 11\)](#)
- [Capitol Hill notes \(p. 12\)](#)
- [Securities Industry and Financial Markets Association releases draft revised guidelines for electronic delivery of offering materials related to GSE securities \(p. 13\)](#)
- [SEC proposes rules to implement regime for oversight of credit rating agencies \(p. 13\)](#)
- [Financial Accounting Foundation reappoints Robert Hertz as FASB chairman \(p. 13\)](#)
- [E-Loan news \(p. 14\)](#)

Fannie Mae

- [Fannie Mae's portfolio grows at a 12.3% annualized rate in December \(p. 15\)](#)
- [Fannie Mae CEO Mudd said the company will cut its operating expenses to less than \\$2 billion in 2007 \(p. 15\)](#)
- [Former Fannie Mae CEO Raines requests hearing on OFHEO's administrative charges by February 16th \(p. 15\)](#)
- [Former CEO Raines alleges that OFHEO drove down Fannie Mae's stock price \(p. 16\)](#)
- [Senator Baucus \(D-MT\) announces Fannie Mae's \\$75,000 housing assistance program to boost housing in Libby, MT \(p. 16\)](#)

Freddie Mac

- [In 2006, Freddie Mac intentionally shrank its portfolio to position itself "opportunistically" \(p. 17\)](#)
- [Freddie Mac sets June 8th as date of its next annual stockholders' meeting \(p. 17\)](#)

Federal Home Loan Banks

- [Finance Board plans to update the FHLBs' risk-based capital rule this summer \(p.19\)](#)
- [In surprise move, the FHLB-Atlanta President and CEO steps down \(p.20\)](#)

- [The FHLB-New York announces its \(unaudited\) financial results and a 7.0% annualized dividend rate for the fourth quarter \(p. 21\)](#)
- [FHLB-San Francisco selects John Robinson to fill vacant seat on the board of directors \(p. 21\)](#)
- [FHLBs begin adopting Fannie and Freddie's marketing tactics \(p. 22\)](#)
- [The FHLBanks' Office of Finance names John F. Fisk to be COO \(p. 22\)](#)

Farm Credit System / Farmer Mac

- [FCA president Pellet discusses the outlook for the Farm Credit System \(p. 23\)](#)

Postal Service

- [Postal Service begins the implementation of the Postal Accountability Act of 2006 \(p. 26\)](#)
- [Solving the Postal Service's problems at Davos \(p. 26\)](#)
- [U.S. Postmaster General re-elected vice chair of the International Post Corporation board \(p. 27\)](#)
- [National Postal Mail Handlers Union ratify USPS contract \(p. 27\)](#)
- [Return to Sender: \\$78,818 \(p. 27\)](#)

TVA

- [Former TVA chairman Bill Baxter resigns from the utility's board of directors \(p. 28\)](#)
- [TVA's revenues off \\$95 million in fourth quarter due to warm weather \(p. 28\)](#)
- [The debate over nuclear energy continues \(p. 28\)](#)
- [TVA settles industrial customers' pricing lawsuit for \\$18 million \(p. 29\)](#)

Major Events

Fannie Mae CEO Mudd's compensation increases 25% to \$14.4 million
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- Fannie Mae's board of directors approved a 25% pay raise for CEO Daniel Mudd, bringing his annual compensation to more than \$14.4 million in salary, stock and bonuses in 2006. According to the company's SEC filing, Mudd received \$950,000 in salary, a cash bonus of \$3.5 million, and restricted shares of Fannie Mae stock worth nearly \$10 million in 2006. The GSE's board of directors also approved a salary of \$990,000 for Mudd in 2007, an increase of 4.2% over his 2006 salary level. "The management team led by Dan Mudd made significant strides in 2006 in getting the company back on track by completing the restatement," said Fannie Mae chairman Stephen Ashley. "The compensation figures are reflective of the progress the company has made." [Mudd's 2006 compensation package remains below the \$19.8 million that Fannie Mae paid former chairman and CEO Franklin D. Raines in 2003.]
- In a January 31 statement, Senate Banking Committee members Mel Martinez (R-FL), Chuck Hagel (R-NE) and John Sununu (R-NH) said, "We are quite surprised that the Board of Fannie Mae would sign off on this compensation package [for Mudd] at a time when they have paid almost \$1.4 billion in accounting and consulting fees to clean up their financial mess, and they are still two years behind on their financial reporting. In fact, it was only last month that Fannie reported its financial numbers through 2004. They still have not reported their financials for 2005 and 2006. We are equally surprised that [OFHEO] approved this pay raise. OFHEO's own investigation of Fannie Mae states that Dan Mudd worked against OFHEO's corporate governance regulations for Fannie in 2003 and tried to get other government agencies to side with Fannie in order to undermine OFHEO's effort. We will be requesting from OFHEO an explanation as to why OFHEO signed off on this astounding development."
- The Senators concluded, "A central focus of this Congress must be robust oversight. We intend to ensure that this extends to both the GSEs and their regulators. This includes the NYSE and SEC who continue to bend the rules and allow Fannie Mae to remain listed on the stock exchange without producing annual financial reports. The American taxpayer and the safety and soundness of our nation's financial system and housing market require nothing less."
- During a question and answer session with reporters on January 30, OFHEO director James B. Lockhart, III defended his agency's decision to approve Mudd's compensation package for 2006. "If you compare Dan Mudd's salary to other comparable institution CEOs, it's still less, said Lockhart. "[This is a concern] because excessive compensation can lead to excessive risk-taking, and excessive risk-

taking can lead to the kinds of problems that [Fannie Mae and Freddie Mac] have had in the past.” (*Washington Post*, David S. Hilzenrath, 01/30/07; *Washington Business Journal*, Neil Adler, 01/30/07; *Senator Mel Martinez Press Release*, 01/31/07; *Los Angeles Times*, 02/01/07; *Market News International*, Margaret Chadbourn, 02/01/07)

- On January 31, President George W. Bush called on corporate boards to hold their CEOs more accountable by tying their compensation to performance in a speech addressing business leaders on Wall Street. “America’s corporate board rooms must step up their responsibilities,” said Bush. “You need to pay attention to the executive packages that you approve.” White House spokesmen said that Bush decided to raise the issue out of his own sense of outrage over deals in which executives [such as Fannie’s former CEO Franklin Raines] have left flagging or failed companies with huge compensation packages, as workers and lower-level executives have been left far behind. (*New York Times*, Jim Rutenberg, 02/01/07)
- CNBC’s *Squawk Box* co-host Joe Kernan reported, “...[S]everal of the leading Republicans plan to question Fannie Mae’s regulator about approving about \$14 million in pay for the company’s CEO. The lawmakers call the pay astounding given the company has not emerged from an accounting scandal. Franklin Raines actually just kind of snickered at the 14. ...Senators Chuck Hagel [R-NE], John Sununu [R-RI] and Mel Martinez [R-FL] want ... [OFHEO] to clarify the compensation. Fourteen million. Sounds clear.” Co-host Carl Quintanilla interjected, “Want to break this down into six.” Kernan added, “14, plus six zeros. Is that clear enough?” Amid laughter, Quintanilla said “...They’re lawmakers.” (*CNBC Squawk Box*, 02/01/07; 06:10:55)

Fannie Mae and Freddie Mac

House Financial Services Committee Ranking Member Bachus voices opposition to the affordable housing fund in GSE legislation

- In a January 24th letter to Representative Barney Frank (D-MA), Chairman of the House Financial Services Committee, Ranking Member Spencer Bachus (R-AL) expressed his opposition to the creation of an affordable housing fund in GSE regulatory reform legislation “It is well known that you hold a long-standing belief in the importance of such a fund,” wrote Bachus. “While I respect your view, I do not share it. In my opinion, this fund represents, in essence, a tax on lower and middle class homeowners to finance a government housing program, the need for which is debatable. ...Accordingly, I am unable to support legislation that includes provisions that impose additional costs on low and middle-class homeowners, and are, I believe extraneous to the critical mission of creating a world-class safety-and-soundness regulator for the GSEs. Removal of these provisions, on the other hand, would result in legislation that an overwhelming majority of Republicans and I could enthusiastically support...” (*Correspondence to the Honorable Barney Frank, Representative Spencer Bachus, 01/24/07*)
- In the 109th Congress, Bachus voted against the AH provision in the H.R. 1461, but later voted for the bill containing the provision. Bachus spokesman Richard Cross said, “On final passage of the bill [last year], he supported it to move the bill forward because there was a sense that the issue will be addressed in conference.” He added, “Keep in mind back then, he was a chairman of a subcommittee that wasn’t involved. Now, he is the ranking member. His situation has changed.” While Baucus’ position might not stop the passage of GSE legislation in the House, it does suggest that crafting a bipartisan bill in that chamber might be more difficult than some had expected.
- On January 29, Frank reiterated that the affordable housing fund was a key part of his GSE regulatory reform bill, which he expects the Financial Services Committee to pass, despite Bachus’ opposition. “The provision passed when we [Democrats] were in the minority,” Frank added. He also said that there is some support for the AH fund in the Senate. “[Senator Mel] Martinez said in Switzerland that it was a good idea,” said Frank, where both were attending the World Economic Forum in Davos. (*Reuters, 01/30/07; Dow Jones Newswires, Damian Paletta, 01/30/07*)
- A housing lobbyist said that Bachus’ position was a nod to the conservative Republican Study Committee, whose chairman [Representative Jeb Hensarling (R-TX) is on the Financial Services Committee. Bachus’ position also reflects the more aggressive stance that GOP members adopted as the minority party, said the lobbyist. “He had to do it,” the lobbyist added. Judy Kennedy, president and CEO of the National Association of Affordable Housing, said “I don’t think Bachus has the votes

to stop it in the House. Frank is a master legislator and worked for months on this. I think he will win approval by the House.”

- Kennedy believes that the larger problem for passage of the AH program will come in the Senate. When Chairman Christopher Dodd (D-CT) moves the GSE legislation in the Senate Banking Committee, Senator Robert Bennett (R-UT) will likely actively oppose the AH provision, she added. If the bill faces opposition from a powerful Republican such as Bennett, the Democrats with their one-seat majority could find it difficult to reach the 60 votes needed to cut off debate on a bill. Other industry sources argue if Frank and Treasury see eye-to-eye on that matter, the bill is unlikely to become stranded in either chamber over the affordable housing fund issue. (*National Journal's CongressDaily*, 01/30/07; *Bureau of National Affairs*, Richard Cowden, 01/31/07)
- At the National Association of Affordable Housing Lenders (NAAHL) meeting on February 1, Representative Maxine Waters (D-CA) said she favors establishing an affordable housing fund from Fannie Mae and Freddie Mac, which would be part of a National Housing Trust Fund (NHTF) that would draw on other sources. She told NAAHL that House Financial Services chairman Barney Frank (D-MA) is reworking the GSE affordable housing fund so that companies' annual contributions would go into the NHTF, which would distribute grants to states, cities, and local nonprofits that put up matching funds to build and preserve affordable rental housing. Waters said, “[It’s] Barney’s idea,” which she supports. A source told *MortgageWire* that the NHTF would be on a “separate track” from GSE regulatory reform legislation. In an address to the NAAHL meeting, Senator Jack Reed (D-RI) said that he hope for an AH provision in the GSE legislation. “We’ve worked closely with Congressman Frank, and I would assume that the starting point would be the version that we were promoting in the Senate and the version that was in the [House] bill last year,” said Reed. One of the issues being debated at the time was what mechanism should be used to administer and distribute the funds, said Reed, including “formulas, grants, state housing agencies, non-profits, etc.” He added, “I don’t sense that there’s a final template, definite template.” Reed said he is “somewhat confident” that GSE legislation will be passed in the 110th Congress. (*Bureau of National Affairs*, Richard Cowden, 02/02/07; *MortgageWire*, 02/01/07)
- On January 31st, OFHEO director James B. Lockhart, III said that lawmakers have addressed the White House’s key concerns about the affordable housing fund, which include provisions that GSEs’ not have control of the fund; that the financing not come solely from GSEs profits; and that a sunset provision for the fund be included in bill. “If one aim is to generate a fairly stable source of funds, using new business purchases as a fee base is certainly better than profits, but it is still volatile,” said Lockhart. “Perhaps a fee on total book of business or outstanding liabilities would be even better.” (*Dow Jones Newswires*, Damian Paletta, 02/01/07)
- During a question-and-answer session before the Senate Banking Committee on January 31st, U.S. Treasury Secretary Henry Paulson said, “We in the administration,

and I personally, feel strongly that we do need a strong independent [GSE] regulator. So far the conversations have been very constructive, but we have a lot further to go.”
(*Dow Jones Newswires*, Elizabeth Price, 01/31/07)

- Senate Banking Committee Chris Dodd (D-CT) plans to meet with fellow Democrats and ranking member Senator Richard Shelby (R-AL) to discuss GSE legislation soon. “My goal is to move quickly on this,” Dodd told reporters. In a question and answer session with reporters, he declined to support a proposal that would raise Fannie Mae’s and Freddie Mac’s conforming loan limit. “We may have a little different approach on all of that, and so I’m going to reserve any judgment as to where that’ll end up,” said Dodd. He indicated that he supports the affordable housing fund that was a part of the House bill in 2006. While the bill passed by the House last year was “a pretty good bill,” Dodd, who has announced his intention to run for president, expects the Senate bill will be “different.” He added, “We want to do our thing. And it may be a little different from what the House has done. ...I want to get that bill done. I’m interested in getting something done in the next couple of months.”
- A recent GAO analysis of Fannie Mae’s and Freddie Mac’s conforming loan limits noted that most higher-cost loans already are well served by the private secondary mortgage market. Increasing the size of the mortgages that can be purchased by Fannie and Freddie could increase the GSEs’ risks if they increase their mortgage holdings. (*Bureau of National Affairs*, R. Christian Bruce and Richard Cowden, 01/26/07)

OFHEO director Lockhart reiterates the need for passage of GSE regulatory reform bill

- In a January 31 speech at the Citizens against Government Waste, OFHEO director James B. Lockhart, III reiterated the need for GSE reform legislation and discussed the need to restrict the GSEs’ size. Lockhart said, “Legislation is still needed to give the new regulator the powers that it needs to prevent the Enterprises from growing out of control again. They continue to present large market, credit, and operational risks which could infect other financial institutions and markets. ...[T]hese Enterprises own or guarantee about 40 percent of [the] residential mortgages in the U.S. or approximately \$4.2 trillion dollars, comprised of two businesses: The largest and primary business is \$2.8 trillion of MBS. ...The second and more volatile business is the \$1.4 trillion mortgage portfolio holdings including their own and others’ MBS. They fund these investments by issuing bonds to investors.”
- “The FHLBanks, overseen by the Federal Housing Finance Board (FHFB), hold about \$800 billion in advances, mortgages, and MBS that support residential mortgage lending. Combined with Fannie Mae and Freddie Mac, the total is about 46 percent of mortgage debt outstanding at the end of the third quarter 2006. In 2003, the total market share peaked at nearly 54 percent. Despite the drop, which was caused by the Enterprises’ problems, the GSEs still dominate the U.S. mortgage market.”

- “...Absence of market discipline has clearly contributed to unconstrained growth of both Enterprises’ portfolios. Over the past 15 years, mortgages outstanding tripled and the Enterprises’ portfolios ...[grew] ten-fold. The \$1.4 trillion size of their portfolios is not based on their mission as less than 30 percent of their portfolios contribute to meeting their affordable housing goals and over half their portfolios are in their own MBS. If growth is unconstrained, the portfolios could pose increasing risk to financial markets.”
- “Legislation in 2006 addressed the portfolio issue, but the Senate Bill was too restrictive and the House Bill could be subject to very wide interpretations. What is needed is more flexibility, with clear guidance. While not perfect, I believe the compromise achieved near the end of the 2006 congressional session achieved those objectives. We believe this language is a major improvement over the House-passed bill of last year. The proposed language does not have ‘hard caps,’ but neither did the Senate bill. Both the compromise and Senate Bills required regulations. The compromise language ties the portfolios tightly to their missions which include: affordable housing and stability and liquidity of the secondary market for residential mortgages. It also states that potential risks posed by their holdings should be considered. Even with the broadest interpretations it would be hard to justify them holding over \$750 billion (54 percent of their total portfolios) in their own MBS. These holdings, which are 26 percent of their total MBS, could easily be sold to investors, and as previously noted, do nothing to increase affordable housing. ...[T]he recent shrinkage of almost \$300 billion of their portfolios, which was necessitated by their problems, was achieved by the run-off and sale of their MBS. Despite this reduction, the MBS market has continued to strengthen. After rightsizing, the portfolios could be allowed to grow with the housing market.”
- “Limiting Enterprise portfolios would do nothing to impede their ability to support the mortgage markets by guaranteeing MBS packages. The Enterprises’ ability to fulfill their important public mission of providing liquidity and stability to the market, and supporting affordable housing would be enhanced over time as investors purchase more agency MBS and less Enterprise debt. The Enterprises would retain an active trading capacity that allows them to expand rapidly to ensure market liquidity especially in emergencies. They could also return to their shareholders some of the excess capital generated by reducing their portfolios.”
- “...As you all know, an affordable housing fund is a priority issue for House Financial Services Chairman Frank. While managing the Fund is not a responsibility that OFHEO seeks, if it is in the legislation that passes, we will certainly do our best to implement the statute quickly. Issues of concern to the Administration – that the Fund not be controlled by the Enterprises, that it not be based directly on profits, and that there is a sunset – have moved in the right direction. I believe that one open question is whether there will be a cap on annual contributions. If one aim is to generate a fairly stable source of funds, using new business purchases as a fee base is

certainly better than profits, but it is still volatile. Perhaps a fee on total book of business or outstanding liabilities would be even better.”

- “... I believe the [GSE] bills proposed last year and the compromise offered near the end of the 2006 congressional session would give a new regulator the necessary powers. I am encouraged by the bipartisan statements supporting GSE reform, including Chairmen Dodd and Frank and Ranking Members Senator Shelby and Congressman Bachus. Certainly, there is strong support in the Administration, including President Bush and Secretaries Paulson and Jackson. Fannie Mae and Freddie Mac have also repeatedly said that they support reform legislation as it will strengthen them. They have a very important public mission of supporting affordable housing and helping to ensure the liquidity and stability of the nation’s housing finance system. The proposed legislation should ensure that they remain safe and sound and that the system remains strong.”
- During a question and answer session, Lockhart said he would envision that the new GSE regulator would slow the growth of the GSE’s portfolios to a certain level and then tie future growth to the overall growth of the mortgage market. He said he is hopeful that a compromise will eventually be worked out on the affordable housing fund, as long as the GSEs are not allowed to control the AH fund and the fund’s fee is not structured in a manner to that would encourage the GSEs to grow their portfolios or expand into new business lines unrelated to their mission. Lockhart also said that OFHEO agency has not taken a formal position on the issue of increasing conforming loan limits, but that his agency is preparing an analysis of the impact such a provision would have in high costs markets, which will be provided to the White House and Congress upon completion. Lockhart reminded the audience that OFHEO has advised the GSEs that they need to be in compliance with the non-traditional mortgage guidance issued by the federal banking regulators by the end of February. He also indicated that OFHEO is looking into Fannie Mae’s and Freddie Mac’s practice of one GSE funding the first mortgage up to the conforming limit and the other GSE funding the second mortgage, which takes combined loan exposure above the conforming loan limit. Lockhart said that his agency’s initial legal interpretation is that this practice is not legal. (*Prepared remarks of James B. Lockhart, III, Presentation to the Citizens Against Government Waste, 01/31/07*)

Federal Reserve should eliminate Fannie’s and Freddie’s special privileges, which reinforces the federal government’s implied guarantee of the GSEs

- In the January 30 issue of *The National Law Journal*, David J. Reiss, associate professor of law at Brooklyn Law School, wrote, “With each new month, more bad news piles up about Freddie Mac and Fannie Mae, the two government-chartered, but publicly traded, mortgage finance companies. In January, Freddie reported that it expects a more than \$1 billion loss in the second half of 2006. In a December filing with the [SEC], Fannie Mae released its final report of after-tax loss in earnings in the amount of \$7.9 billion for fiscal year 2002 through fiscal year 2004. And,

notwithstanding the progress that Fannie has made in filing its financial statements, Standard & Poor's has recently found pervasive deficiencies in Fannie's internal controls. If Fannie or Freddie were to become insolvent, the American taxpayer would be on the hook for the cost of making good on the implied guarantee that the federal government gives to investors who have purchased the many hundreds of billions of dollars of Fannie and Freddie securities that are currently outstanding."

- "But the chances are slim that Congress will meaningfully reform the regulation of these two scandal-ridden companies. This is notwithstanding the fact that House Financial Services Chairman Barney Frank, D-Mass., now believes that the House will pass a reform bill in April. The bill now being considered by Frank's committee, in consultation with the Treasury Department, would slightly increase the funding and supervisory power of Fannie and Freddie's federal regulator, [OFHEO]. But the bill would leave OFHEO far weaker than necessary to supervise these two financial behemoths. And of greatest importance, the bill would not address the really bad news about Fannie and Freddie: the federal government's implied guaranty of their tremendous financial obligations."
- "The Federal Reserve should therefore act independently to limit that exposure as much as possible until Congress is able to come up with a proportionate response to this latent crisis. Alan Greenspan and Benjamin Bernanke, the past and current chairmen of the Federal Reserve Board, have both recognized this precise risk. So the good news is that the Federal Reserve can start taking actions independently that would reduce the magnitude of the threat that these companies pose to the international financial system and the American taxpayer. (Yes, these companies are so large that the failure of either one would present a serious risk to the entire international financial system.) The Federal Reserve Board grants Fannie and Freddie significant privileges that treat them as instrumentalities of the federal government. First, the Federal Reserve regards Fannie and Freddie's obligations as the equivalent of explicitly guaranteed government securities. Second, Federal Reserve banks act as fiscal agents for Fannie and Freddie, a role that they primarily play for the federal government. Finally and most importantly, Fannie and Freddie's securities are eligible for unlimited investment by state banks that are Federal Reserve members, a policy which signifies that those securities are no-risk investments on par with Treasury securities. These special privileges reinforce the implied guarantee that has allowed Fannie and Freddie to issue such extraordinarily large amounts of securities and thus become such risky ventures for the entire financial system."
- "The Federal Reserve should stop granting privileges to Fannie and Freddie that exceed those required by statute. This will work to reduce the amount of Fannie and Freddie securities that are outstanding by making them less attractive investments. It will also signal to investors that the federal government will not necessarily guarantee those securities. Such a course will have the short-term benefit of reducing the risk that such debt poses as well as the long-term benefit of putting pressure on Congress and Fannie and Freddie themselves to hammer out a solution that meaningfully protects the American taxpayer."

- “Many financial crises have their Cassandras, vainly attempting to warn a heedless public of impending ruin. The Savings & Loan fiasco of the 1980s as well as the more recent Internet bust come to mind. The magnitude of the crisis posed by the more than \$1.5 trillion of outstanding Fannie and Freddie debt could easily dwarf those earlier ones. Unlike Cassandra herself, the chairman of the Federal Reserve has the power to prevent the crisis that he himself has predicted. It remains to be seen whether he in fact will do so. The stakes may be hundreds of billions of dollars from the public’s purse. So let’s hope he does.” (*National Law Journal*, David J. Reiss, 01/30/07)

OFHEO director Lockhart is reluctant to give GSEs relief from the capital surplus requirements after the companies return to timely financial filings

- OFHEO director James B. Lockhart, III said that while Fannie and Freddie will be taking a major step forward” when the file timely financial statements, he is going to be very reluctant to remove the capital surplus requirements for the companies. Lockhart stressed that Fannie and Freddie “have very, very large problems” and “have made some progress on remediation, but much less than we or they expected.” Wall Street analysts had hoped that the GSEs would be able to reduce their capital levels, but their hopes have been fading. “Another piece of the puzzle is the extent of their material weaknesses,” said Lockhart. “Both of them have well over 10 significant material weaknesses and a whole series of significant weaknesses. So that will also be a key issue.” Lockhart acknowledged that Freddie Mac’s regulatory agreement is voluntary. “They could decide at some point that they’ve fulfilled it,” he said. “We will be in discussions about that.” (*National Mortgage News*, Brian Collins, 01/29/07)
- OFHEO is on target to complete its annual review of Fannie Mae and Freddie Mac for 2006 in late March or early April. “We’re in the process of finalizing our annual review of the two companies,” said James Lockhart. His agency’s findings will show both Fannie and Freddie are “making progress,” even though “they do have a long way to go” on remediation efforts to recover from accounting and management errors. “Things are changing,” Lockhart added. (*Market News International*, Margaret Chadbourn, 02/02/07)

OFHEO releases 120-page regulatory guide to improve the transparency of the agency’s supervisory program

- On January 26, OFHEO released the agency’s Supervision Handbook, which outlines its supervisory program to examine Fannie Mae and Freddie Mac. “This is an important step in improving the scope and transparency of our supervisory program,” said OFHEO director James B. Lockhart, III. “This handbook documents our current supervisory approach.” Leonard Reid, director of OFHEO’s Office of Supervision, said, “We will continue to identify ways to enhance our overall supervision program

and further improve oversight of the Enterprises. The handbook will be amended over time as enhancements are made.” The handbook is available in its entirety at <http://www.ofheo.gov/media/pdf/SupervisionHandbookJanuary262007.pdf>. (OFHEO Press Release, 01/26/07)

Capitol Hill notes

- In a January 23rd press release, Barney Frank, chairman of the House Financial Services Committee, said the Democratic members of the Committee include Paul E. Kanjorski (PA), Maxine Waters (CA), Carolyn B. Maloney (NY), Luis V. Gutierrez (IL), Nydia M. Velázquez (NY), Melvin L. Watt (NC), Gary L. Ackerman (NY), Julia Carson (IN), Brad Sherman (CA), Gregory W. Meeks (NY), Dennis Moore (KS), Michael E. Capuano (MA), Rubén Hinojosa (TX), William Lacy Clay (MO), Carolyn McCarthy (NY), Joe Baca (CA), Stephen F. Lynch (MA), Brad Miller (NC), David Scott (GA), Al Green (TX), Emanuel Cleaver (MO), Melissa L. Bean (IL), Gwen Moore (WI), Lincoln Davis (TN), Albio Sires (NJ), Paul W. Hodes (NH), Keith Ellison (MN), Ron Klein (FL), Tim Mahoney (FL), Charles Wilson (OH), Ed Perlmutter (CO), Christopher S. Murphy (CT), Joe Donnelly (IN), Robert Wexler, (FL), Jim Marshall (GA), and Dan Boren (OK). (*House Financial Services Press Release*, 01/23/07)
- On January 30, House Financial Services Committee chairman Barney Frank announced the Committee’s five subcommittee chairs, including Representative Paul E. Kanjorski (D-PA) for the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises; Representative Maxine Waters (D-CA) for the Subcommittee on Housing and Community Opportunity; Representative Carolyn B. Maloney (D-NY) for the Subcommittee on Financial Institutions and Consumer Credit; Representative Luis V. Gutierrez (D-IL) for the Subcommittee on Domestic & International Monetary Policy, Trade and Technology; and Representative Melvin L. Watt (D-NC) for the Subcommittee on Oversight and Investigations. (*House Financial Services Press Release*, 01/30/07)
- In the January 27-28 edition of *National Mortgage News Online*, Paul Muolo reported, “We’re hearing that Senator Chuck Schumer (D-NY) may wind up with the chairmanship of the Senate Housing Subcommittee. Senator Schumer was a guest on “*The Daily Show with Jon Stewart*” Thursday night [January 25th]. He did not bring up the matter on the show.” (*National Mortgage News Online*, Paul Muolo, January 27-28, 2007)
- The *Times Picayune* reports that Representative Richard Banker (R-LA) isn’t ruling out a run against Senator Mary Landrieu (D-LA) in 2008. “Folks in D.C. have talked to him about it. Folks in Louisiana have talked to him about it,” said Baker’s spokesman Michael DiResto. “He’s thinking about it.” (*Times-Picayune*, Bruce Alpert and Bill Walsh, 01/28/07)

Securities Industry and Financial Markets Association releases draft revised guidelines for electronic delivery of offering materials related to GSE securities

- The Securities Industry and Financial Markets Association has released a draft of revised guidelines for offering materials related to GSE securities, which permits electronic delivery of documentation for the securities. “Allowing for electronic delivery will make important information related to GSE securities available in a timely manner while also resulting in significant dollar savings for both GSEs and dealers,” said Robert Toomey, SIFMA’s vice president and assistant general counsel. (*National Mortgage News*, 01/22/07)

SEC proposes rules to implement regime for oversight of credit rating agencies

- On January 31, the Securities and Exchange Commission agreed unanimously to propose rules to implement the new regime for regulating credit-rating agencies, mandated by Congress in the Credit Rating Agency Reform Act of 2006. The commission is proposing six new rules under the CRA Reform Act including: (1) Rule 17g-1, which requires an initial application for registration on new Form NRSO and updated information submitted annually by approved NRSROs; (2) Rule 17g-2, which sets forth recordkeeping requirements by NRSROs; (3) Rule 17g-3, which mandates that NRSROs provide the SEC (confidential) audited financial statements; (4) Rule 17g-4, which require NRSROs to develop procedures to prevent misuses of material nonpublic information; (5) Rule 17g-5, which requires an NRSRO to disclose and manage six specified conflicts of interest; and (6) Rule 17g-6, which prohibits NRSROs from engaging in five specific acts or practices that the SEC deems to be unfair, coercive or abusive. Given the statutory deadline (June 26, 2007) for the adoption of these rules, the commission set a 30-day comment period for the proposal. (*Bureau of National Affairs*, Rachel McTague, 02/01/07)

Financial Accounting Foundation reappoints Robert Hertz as FASB chairman

- On January 23, the Financial Accounting Foundation reappointed Robert Hertz to serve a second five-year term as chairman of the Financial Accounting Standards Board. Originally appointed FASB chairman in July 2002, Hertz was a long-time partner with PricewaterhouseCoopers and part-time member of the International Accounting Standards Board. (*Bureau of National Affairs*, 01/24/07)

- The Mortgage Industry Standards Maintenance Organization (MISMO) has formed an alliance with FHA for the development and publication of government standards for data and electronic mortgage transaction involving government entities within MISMO's framework and infrastructure. FHA is joining MISMO's Government Housing Workgroups, which are being developed with the help of Ginnie Mae. (*MortgageWire*, 01/26/07)
- E-Loan.com is launching electronic signing of mortgage loans in the first quarter of 2007. According to E-Loan SVP Pete Bonnikson, the company's back office is "all but paperless." He said the key to online lending is to give the borrower an instant decision by a live loan consultant and have the borrower lock in the rate and submit a credit card for credit report and appraisal costs at that time. E-Loan consultants succeed at this goal 25% of the time, he added. Since its launch in 1997, E-Loan has closed \$32 billion in consumer loans, according to the company's website. (*MortgageWire*, 01/29/07)

Fannie Mae

Fannie Mae's portfolio grows at a 12.3% annualized rate in December

- In December, Fannie Mae's mortgage portfolio increased by \$6.97 billion for an annualized increase of 12.3%. According to the company, the portfolio growth was "due to a high volume of year-end transactions and a drop in sales." In December, Fannie Mae's purchase of mortgages bonds rose to \$19.6 billion from \$13.9 billion in November, while its sales declined sharply to \$1.9 billion in December from \$6.3 billion the prior month. The volume of securities maturing or paying off early slipped to \$10.9 billion in December versus \$11.2 billion in November. Fannie Mae's retained commitments, an indicator of future growth, increased to \$15.2 billion, a 76% increase from November commitments of \$8.6 billion. The company's duration gap averaged zero months in December, unchanged from the prior month. (*Associated Press*, 01/25/07)

Fannie Mae CEO Mudd said the company will cut its operating expenses to less than \$2 billion in 2007

- In a speech at a Citigroup investor conference, Fannie Mae CEO Daniel Mudd said that the company expects to realize \$200 million in costs savings this year, which will reduce its operating expenses to less than \$2 billion annually. "The costs of running the business rose as we focused on restatement, remediation and growing the business," said Mudd. "The emphasis was speed, but not efficiency. We need to operate smarter and cheaper, and we can." Mike Williams, the company's COO, is leading the effort to "drive out inefficiency in our company operations, with a real emphasis on reengineering how we do business," said Mudd. To reach its cost-saving goal in 2007, Fannie Mae began by freezing headcount and space and conducting line-by-line reviews of every business and staff-function budget. "These are brute-force cost measures, taken in real time," said Mudd. (*Dow Jones Newswires*, Lingling Wei, 01/31/07)

Former Fannie Mae CEO Raines requests hearing on OFHEO's administrative charges by February 16th

- Former Fannie Mae chairman and CEO Franklin Raines has asked that a hearing of OFHEO's administrative charges against him be held by February 16. On December 18, OFHEO filed 101 charges against Raines, former CFO Timothy Howard and former controller Leanne Spencer, alleging that their actions contributed to Fannie Mae's \$6.3 billion accounting restatement and asked for fines of up to \$100 million and disgorgement of more than \$115 million in bonuses. In a recent filing, Kevin Downey, Raines' attorney, said that such charges must be followed by a hearing

within 60 days unless a later date is requested. Downey said in the filing with the case's administrative law judge William B. Moran that his client wouldn't request such a delay. (*Dow Jones Newswires*, Damian Paletta, 01/22/07)

Former CEO Raines alleges that OFHEO drove down Fannie Mae's stock price

- In court papers filed in the shareholders' class action suit against Fannie Mae and the company former management, Franklin D. Raines' lawyers allege that OFHEO leaked negative, confidential, and occasionally erroneous information to media outlets such as the *Wall Street Journal* and *Dow Jones Newswires* to drive down Fannie Mae's stock price and exert greater control over the GSE. According to the filing, "OFHEO had decided, at least as early as February 2004, to use its regulatory power to drive down the price of Fannie Mae stock so as to gain greater control over Fannie Mae." The filing references an October 2004 HUD inspector general report, which alleges that OFHEO deputy director Stephen Blumenthal told the agency's staff that public statements regarding Fannie Mae could negatively impact the company's stock price. However, the political nature of the HUD IG report has been called into question, since a senior Fannie Mae lobbyist has acknowledged that the company had generated the request for the HUD report through political connections. (*Dow Jones Newswires*, Damian Paletta, 01/24/07)

Senator Baucus (D-MT) announces Fannie Mae's \$75,000 housing assistance program to boost housing in Libby, MT

- On January 26, Senator Baucus announced that Fannie Mae will give \$75,000 to "help people pay for their homes" in Libby, MT. The grant includes \$50,000 to support Montana's Homeownership Network's foreclosure prevention and owner-occupied rehabilitation programs; \$10,000 for Home Counselor Online programs; and \$15,000 to support the development of Lincoln County's growth program. Baucus said that the project is one way to help the some of the people of Libby, who have been sickened by asbestos fibers released from the now-closed W. R. Grace and Co. Vermiculite mine. Some health officials blamed the deaths of more than 200 residents and sickening of one of every eight Libby residents to asbestos contamination by the mine. After the EPA declared the area a Superfund site, many area houses have been cleaned or destroyed due to lingering asbestos fibers.
- "Let me emphasize, this is all just a start," said Fannie Mae CEO Daniel Mudd. "Be assured that I'm going to keep my eye on this because helping communities like Libby is exactly why Fannie Mae exists. And I'm sure that Senator Baucus will keep an eye on me too, which I appreciate." (*Baucus E-Newsletter*, 01/25/07; *Associated Press*, 01/26/07)

Freddie Mac

Freddie Mac's portfolio shrank 1.2% in December

- In December, Freddie Mac's retained portfolio shrank by an annualized 1.2% in to \$703.6 billion. During the month, the company sold \$2.6 billion of loans and received \$15.5 billion in loans pay-offs, which offset loan purchases of \$17.4 billion. "For the month, sales and liquidations just offset purchases, leading to a net decrease of \$705 million in the retained portfolio," said Freddie Mac spokesman Michael Cosgrove. "Sales, net of other activity, continued to be depressed as the market has slowed for structured product, while the purchases during December fell as mortgage-to-debt spreads continued to tighten." Freddie Mac's duration gap remained at zero months in December, unchanged from November.
- In 2006, the company's portfolio contracted 0.9%, after rising 8.7% in 2005. Freddie Mac's mortgage bonds held by investors rose 15.2% to \$1.22 trillion during 2006, while the company's mortgage acquisitions fell 14% to \$502 billion for the year. (*Bloomberg News*, 01/24/07; *Reuters*, Julie Haviv, 01/23/07; *National Mortgage News*, 01/29/07)

In 2006, Freddie Mac intentionally shrank its portfolio to position itself "opportunistically"

- Patricia Cook, Freddie Mac's EVP of investments and capital markets, said the company has intentionally been shrinking its mortgage portfolio in recent months to allow room for future growth if interest rate spreads widen. "It was a conscious business decision when the [mortgage] cap was put into place in July, that we wanted to create some room, if you will, below the cap in the event that spreads were to be wider and provide a better opportunity than they were at the time," said Cook at Citigroup's 2007 Financial Services Conference in New York. "As we look at going into 2007, with another 2% the size of the retained portfolio could grow to be \$730-odd billion. We're currently at about \$700 (billion). We can use that \$30 billion opportunistically as we see investment opportunities."
- Without the regulatory cap, Freddie Mac's portfolio growth would have been only "modest" said Cook, given today's interest rate environment. "Even absent the cap, growth would have been modest," she said. "It wouldn't have been negative. Growth could have been mid-single digits. ...[F]rom the political pressures associated with the retained portfolio, there is no way we could grow the retained portfolio over the next five years at the rate that portfolio grew from - let's say - '97 to '02," Cook said. "Capital markets, there just isn't the depth and liquidity in terms of the hedging products we would need to be able to grow the portfolio at that level. [This is] kind of the irony, right, because it looks as if the reason the portfolio has

come down is just because of - let's say - the regulatory environment. When the truth is from a market perspective, there were going to be limits on the growth of the retained portfolio anyway." (*Dow Jones Newswires*, Damian Paletta, 01/30/07)

- In her prepared remarks at the Citigroup conference, Cook also discussed Freddie Mac's efforts to expand its participation in the "alternative" mortgage markets, as a means of meeting its their "mission of providing affordability, liquidity and stability" to the mortgage market. Cook said, "Industry research forecasts that the majority of home ownership growth in the U.S. over the next ten to twenty years will come from currently under-served demographic groups. Here is where striving to achieve our goals can make a difference. By working to improve access to mortgage credit for very low-income families and underserved areas, we can also enhance our future growth potential. During 2006, success in our mission contributed directly to success in our single-family securitization business. As we have discussed in the past, a large part of our future success hinges on expanding our credit guarantee capabilities."
- "One recent example of these efforts is our growth in IO and Option ARM products in 2006. As you can see these accounted for approximately 17 percent of our total mortgage purchases for the first nine months of 2006, and about 6 percent of our total portfolio balance as of the end of September 2006. By guaranteeing these and other mortgage products, we have provided liquidity where customers have demanded it. Meeting this customer need has helped us stabilize our GSE market share from its low point in 2003. In a market characterized by competition from both GSE and private label players, the continued strength of our guarantee business and originator relationships are strategic imperatives for Freddie. The importance of this last point is obvious when you realize that over the past five years, our credit guarantee portfolio has accounted for the lion's share of our total growth, and that this trend is expected to continue into the future."
- "...A lot of media attention and research notes have focused in on the deteriorating credit, particularly as it is related to alternative products such as IO and Option ARM loans. All I would say here is that we are very conscious of the risk/reward trade offs that we are making, and that historically, Freddie has been very good at making disciplined risk management decisions. Going forward, this will remain a core competency as we continue to 'touch more loans.' Improving our understanding of the market's view on credit risk is one area where we made significant progress in 2006. Through our work on marking the guarantee obligation to market, we have begun to see the key differences in how we view future credit risk relative to the [Wall] Street. (*Prepared remarks of Patti Cook, EVP of Investments & Capital Markets*, Citigroup Financial Services Conference, 01/30/07)

Freddie Mac sets June 8th as date of its next annual stockholders' meeting

- On June 8, Freddie Mac will hold its next annual stockholders' meeting, where shareholders of record as of March 30th will elect 13 board members. The company will mail to shareholders proxy materials and Freddie Mac's 2006 annual report in accordance with the GSE's bylaws and NYSE requirements. To be considered for inclusion in the company's proxy statement, stockholder proposals must be submitted in writing to Freddie Mac by March 5. (*Freddie Mac Press Release*, 01/02/07)

Federal Home Loan Banks

Finance Board plans to update the FHLBs' risk-based capital rule this summer

- According to agency sources, the Federal Housing Finance Board plans to draft an updated risk-based capital requirement, which will require the FHLBs to boost their retained earnings. The rule will likely target the FHLBs' holdings of mortgages and mortgage-backed securities, which comprise nearly 20% of the FHLB System's assets. In an interview with *American Banker*, Finance Board chairman Ronald Rosenfeld said "In relation to advances, clearly... [mortgages and mortgage-backed securities] have a higher degree of risk and should have more capital. The goal is that the banks in the system have adequate retained earnings." Rosenfeld said that the FHLBs will probably be given several options for complying with the new risk-based capital rule." "Whatever the numbers ultimately come out, there are interesting ways to deal with it," said Rosenfeld. "One of which is simply putting more retained earnings away. Somebody may create some capital instruments that turn out to be an appropriate substitute for retained earnings. The banks conceivably may at some point create a mutual defense pact—a catastrophic insurance kind of thing" Regardless of what the final rule looks like, Rosenfeld said it would be clear how it was developed. "Whatever the analytics are --[they] have to be defensible," he added.
- As the Finance Board moves forward with its proposal, the debate will likely focus on how much risk mortgages and MBSs actually pose. According to sources, the Board itself appears to be divided on this subject with some members viewing mortgages as the riskiest assets a FHLB can hold, while others disagree and are concerned that the agency has been too quick to reach that conclusion. "We want to be careful that we don't continue a built-in bias against mortgages," said a board official.
- A source of contention within the FHLBs continues to be the role that mortgage programs should play in their business. Before his retirement in December, FHLB-Indianapolis president Martin Heger argued that the FHLBs could not survive solely

on advances and should expand their mortgage purchase programs. However, Rosenfeld said that while mortgages can play a positive role for the FHLBs, they should be treated with caution. “The mortgage business is a perfectly appropriate, legitimate business—providing you know what you’re doing,” he said. “And the providing you know what you’re doing is the critical amplifier of the statement.” Rosenfeld also warned that the FHLBs should be leery of relying too heavily on large banks for the program, because they can seek alternative sources of funding. Rosenfeld added, “I think the [FHLBs], when they buy mortgages from smaller members, are performing a very valuable service and one that should be encouraged. There’s nothing wrong with dealing with large banks either, but you’ve got to deal with them on an intelligent basis.” As the Finance Board updates its risk-based capital proposal, the role of the mortgage programs at the FHLBs will be at the heart of the industry’s debate.

- Specific details about the proposal have not been finalized and may change before being unveiled later this summer. According to sources, the Board plans to release its new proposal this summer in an advance notice of proposed rulemaking and allow three months for comments, before crafting a more specific plan.
- Industry representatives are hopeful that the rule would not force broadly applied capital increases by the FHLBs. Robert Davis, EVP and manager of America’s Community Bankers, said, “If there’s a presumption that everyone has to have more capital than they do, I would say that presumption doesn’t seem appropriate.” (*American Banker*, Steven Sloan, 01/24/07; *American Banker*, Steven Sloan, 01/31/07)
- The Finance Board ended its January 18 meeting with a send-off for John Kennedy, who is retiring as the agency’s general counsel. Kennedy joined the Finance Board in May 2005 after spending 35 years as legal counsel at HUD. (*American Banker*, Steven Sloan and Stacy Kaper, 01/22/07)

In surprise move, the FHLB-Atlanta President and CEO steps down

- On January 25th, Raymond Christman, the president of the FHLB-Atlanta, unexpectedly offered his resignation to the Bank’s board of directors, effective January 31. Christman, 56, has served as president of the Bank for eight years. According to his statement, Christman said, “The time is right for me to explore other opportunities in banking, housing and community development.” According to the *American Banker*, the Bank’s spokesman refused to comment on Christman’s reason for leaving and would not make him available for comment. The Bank’s chairman would not comment on the matter and other board members refused to return the reporter’s calls. Under Christman’s leadership, the FHLB-Atlanta has grown from \$50 billion to \$144 billion

- Several observers said that Christman is leaving amid frustration about the FHLBs having to register with the SEC in 2005. Some insiders said that Christman was unhappy that the FHLBs were being transformed from essentially nonprofit entities to a more corporate type business. ABA senior counsel Joe Pigg said, “With the increased pressures of SEC registration, I think the Bank is being forced to go in a somewhat different direction, and he might feel he can use his talents elsewhere.” (*American Banker*, Steven Sloan, 01/26/07; *PR Newswire*, 01/25/07)
- On February 1, William Ott, president of PEAC Ventures [a firm that advises corporate boards and executive management teams], will become the Bank’s interim president and CEO. [Ott currently serves as a Director and Chairman of the Audit Committee of E*TRADE Bank.] During the management transition, Christman will serve as an advisor to the Bank. FHLB-Atlanta spokesman Chris McEntee said that the Bank will probably disclose the financial arrangements for Christman’s advisory services soon. (*PR Newswire*, 01/25/07; *American Banker*, Steven Sloan, 01/26/07)
- On January 19, Scott C. Harvard was elected the chairman of the board of directors of the FHLB-Atlanta. Harvard is the president and CEO of Shore Bank, headquartered in Onley, VA. In addition, the board elected Jerry Williams, chairman, president and CEO of Orion Bancorp, Inc., headquartered in Naples, FL, to serve as vice chair. (*PR Newswire*, 01/23/07; *FHLB-Atlanta Press Release*, 01/19/07)

<p>The FHLB-New York announces its (unaudited) financial results and a 7.0% annualized dividend for the fourth quarter</p>
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- In the January 30th President’s Report to Members, FHLB-New York president and CEO Alfred A. DelliBovi announced that the Bank reported net income for the fourth quarter of \$70.3 million, an increase of 25% for the corresponding period in 2005. At December 31, the Bank had total assets of \$81.7 billion, down 3.9% from yearend 2005, and total advances of \$59 billion, down 4.7% from December 31, 2005. The FHLB-New York’s board of directors declared a 7.0% (annualized) cash dividend for the fourth quarter, payable to members on January 31. The Bank’s average rate for (cash) dividends paid in 2006 was 6.06%. (*FHLB-New York Press Release*, 01/30/07)

<p>FHLB-San Francisco selects John Robinson to fill vacant seat on the board of directors</p>

- The FHLB-San Francisco’s board of directors has selected John F. Robinson to fill a vacant seat on the board for a term ending December 31, 2009. Robinson replaces J. Benson Porter, who resigned from the board effective January 25. Robinson is EVP of Washington Mutual Bank in Henderson, NV. (*FHLB-San Francisco Press Release*, 01/26/07)

FHLBs begin adopting Fannie's and Freddie's marketing tactics

- In a page from Fannie Mae's public relations playbook, Representative Paul Kanjorski (D-MA), the newly-elected chairman of the Subcommittee on Capital Markets, announced a \$120,000 Affordable Housing Grant from the FHLB-Pittsburgh for creating "transitional housing for homeless veterans and young adults" in Wilkes-Barre and Plains Township, PA. [Editor's Note: This is one of the first FHLB Affordable Housing Grants that a member of Congress has "announced."] (*FHLB-Pittsburg Press Release*, 01/24/07).
- In press releases, several of the FHLBs also have begun redefining their mission as providers of affordable housing. In the FHLB-Pittsburgh's [January 24th] press release spotlighting Representative Kanjorski, the Bank's position statement read, "[The] FHLBank, a wholesale bank using private capital, not taxpayer funds, distributes AHP dollars through its member financial institutions to community sponsors and project developers, empowering individuals and families and improving neighborhoods." And in the FHLB-Seattle's January 29th press release, the Bank's position statement read, "The [FHLB-Seattle] is a financial cooperative that ...support[s] the availability of affordable homes..." (*FHLB-Pittsburg Press Release*, 01/24/07; *BusinessWire*, 01/29/07)

The FHLBanks' Office of Finance names John F. Fisk to be COO

- On January 25, the FHLBanks' Office of Finance named John F. Fisk to be its new Chief Operating Officer, responsible for managing the day-to-day functions of the Office. Previously, Fisk was Deputy Managing Director of the Office of Finance, in which he oversaw the issuance of debt, servicing, and strategic planning. Previously, Fisk was EVP of strategic planning at MGIC and worked for Freddie Mac over 17 years in capital markets and mortgage positions. (*The Main Wire*, 01/25/07)

Farm Credit System / Farmer Mac

FCA president Pellet discusses the outlook for the Farm Credit System

- In a January 15 speech at the Farm Credit Council Annual Meeting, FCA president Nancy C. Pellett reviewed the financial performance of the FCS and the future prospects of the System. In 2006, the FCS had “unprecedented” loan growth of \$19.3 billion (or 14.3%) to \$154.7 billion for the fiscal year ended September 30. The System’s capital grew \$1.5 billion to \$24.2 billion, representing 15.7% of total assets at September 30. The System’s credit quality remained strong with classified loans representing only 2% of total loans.
- Pellet applauded the System’s institutions’ request to participate in the Investments in Rural America pilot program. Pellet said, “It is encouraging to see the System use the investment authority of the Act to improve rural communities. ...Under these pilot programs, you are creating solutions for meeting the financing needs of agriculture, rural infrastructure, facilities, housing, businesses, renewable energy, supply systems, and value-added agribusiness. For example, several System institutions have created the ‘FarmStart’ program. This program provides investments for working capital purposes of up to \$50,000 for young and/or beginning farmers and start-up cooperatives. Other institutions have purchased debt securities that provide critical medical and sanitation services needed in rural communities. We continue to encourage System institutions to use these programs to make appropriate and helpful investments that support rural communities’ success in keeping agriculture vibrant and young, beginning, and small farmers involved.”
- Pellet also acknowledged the System’s “resolve to function and operate in the spirit of the cooperative body as a unified entity.” She continued, “I would suggest that through the Horizons project you have demonstrated your ability and intention to focus on shared goals and speak with a unified voice more than you ever have in the System’s 90-year history. The result of your internal communications and common objectives is obvious. As a matter of fact, I would offer that the criticism and concerns voiced by some of your competitors in the marketplace are more of a reaction to 95 associations and 5 banks with over \$150 billion in assets operating as a unified and effective financial entity rather than to possible small changes to the Farm Credit Act or changes in regulations. The real significance of the Horizons project is the realization of the potential for real cohesiveness within the Farm Credit System. ...The Horizons project has shown the value of a cooperative plan acting in the cooperative spirit, and I would encourage you to continue to work together in this manner so that the System can continue to thrive.”
- “...[A]s we at FCA look toward our 2007 policy agenda, we are committed to continue making sound policy decisions that address System mission accomplishment. This past year we have worked to provide appropriate flexibility while holding System institutions responsible for making the right decisions in

financing borrowers within the System's charter. You should use this flexibility with care to finance operations consistent with your GSE mission. Going forward, as we evaluate our regulations to make sure they are consistent with the System's mandate to serve the full range of agriculture in this country, it will require a continued dialogue with you as we keep the farmer, the all-important end user, in mind as policy decisions are made. But also, we must be mindful of the statutory and regulatory limitations; and as Congress begins reauthorization of the Farm Bill this year and considers possible changes to the Act, we look forward to participating in that process.

- "...[F]or a GSE and for the Farm Credit System in particular, the bottom line must always be mission accomplishment. We, as the regulator, must do our part to ensure that the System continues to accomplish the mission set out for it by Congress... I have been impressed as I have read the Horizons research and other reports from the Farm Bureau and the National Corn Growers on how agriculture and rural America are changing—this kind of self-evaluation is essential for staying relevant to your farmer-borrowers and staying true to your mission. Specifically, within proper safety and soundness limits, this means growth with a purpose and not just growth for growth's sake. It means using the authorities you have to serve all of agriculture, not just the most creditworthy or largest entities. Given the GSE stature and public policy focus of the System, you must continually push for balance in your mission accomplishment to ensure that all segments of the agricultural marketplace receive constructive and needed credit. Along those lines, I continue to encourage you to do all you can to reach minority, young, beginning, and small agricultural producers that have difficulty in obtaining credit. But I also want to commend your efforts to bring more diversity into the System—whether it is actively looking for more diversity on your boards, in your staff, or in how you are marketing yourselves to potential borrowers. I want to acknowledge your efforts on this and encourage you to continue to focus on this important issue..."
- "...As we at FCA look toward this new year, ...I see the opportunities out there for the Farm Credit System to continue to serve a changing agriculture and rural America. The importance of biofuels, including the growth of ethanol, cannot be underestimated. President Bush and Congress have focused significant attention on alternative energy sources as they begin to craft a new farm bill, and there is now emphasis on cellulose ethanol from switchgrass, wood, sorghum, and other farm products. These developments present new opportunities for the System but also opportunities that must be properly managed. 2007 promises to be an eventful and important year for FCA and the Farm Credit System. We at the Agency will continue our commitment to excellence as an arm's-length regulator and in keeping the System safe and sound. At the same time, the System has never been in better shape, and thus your responsibility to monitor your mission accomplishment has never been more important." (*Remarks by the Honorable Nancy C. Pellett, Farm Credit Annual Meeting, 01/15/07*)

- In the January issue of *Farm Credit Watch*, Bert Ely observed that in Pellet's speech, she "admitted that FCA is circumventing the Act's lending by authorizing a wider and wider range of FCS investments, often in illiquid bonds, that are merely loans by another name. The financing of a medical clinic in Minnesota, which *FCW* reported last month, is one of a growing number of examples where the FCA is bending the rules, and violating congressional intent, to expand the FCS's credit-granting abilities. These FCS investments go by a variety of names and acronyms, such as Rural America Bonds, or RABs; agriculture and rural community bonds, or ARCs; Rural Housing Mortgage-Backed Securities (RHMS); and mission-related investments, or MRIs. All have the same intent -- to turn a loan the FCS cannot make into an investment under one of these 'pilot' programs. ... What Pellett is advocating is classic 'mission creep,' the attempt by an obsolete GSE lender, and its regulator, to grow in power at a time when the FCS should be abolished or privatized. Hopefully, Congress will put the FCS on the road to privatization when it is presented with the HORIZONS proposals."
- Ely also noted that FCA's proposed regulation which would expand the FCS's ability to finance agricultural processing and marketing operations is another example of the agency's mission creep. Ely wrote, "This proposed regulatory watering down reflects the HORIZONS Project's objective of expanding FCS's lending authority to any activity taking place within a vastly expanded definition of rural America. An FCA memorandum, dated November 6, 2006, approved an FCS bank investing in debt securities of 'agribusinesses [which] enhance the value of agriculture by serving in the chain from the local agricultural producer to the end consumer' [emphasis supplied]. Those underlined words say it all as to where the FCA is willing to let the FCS go. Bankers and others concerned by FCS 'mission creep' need to tell the FCA that this proposed regulation is a no-go and that the FCA should kill it rather than 'complete a balanced final rule.'" (*Bert Ely's Farm Credit Watch*, Bert Ely, January 2007)

Postal Service

Postal Service begins the implementation of the Postal Accountability and Enhancement Act of 2006
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- On February 1, the Postal Regulatory Commission (PRC) established the Office of Inspector General, beginning the transformation of the USPS under the recently signed Postal Accountability and Enhancement Act. At the meeting, the PRC also adopted a resolution to establish an Office of Public and Congressional Relations and authorize a director to coordinate its activities. “There is a lot of interest in how we are moving to implement postal reform,” said Dan G. Blair, the newly-appointed chairman of the PRC. “I believe it is very important that the commission has staff dedicated to the important work of keeping interested segments of the government, legislature and public informed.” A PRC notice will appear soon in the *Federal Register*, inviting public comment on many topics facing the commission in fulfilling the new law’s requirements, said Blair said. Comments are due within 60 days of the date of publication of the notice. (*DMNews.com*, Melissa Campanelli, 02/02/07)
- As a result of the passage of postal reform legislation, the GAO has removed the Postal Service from “high risk” category of federal agencies. (*Association for Postal Commerce*, 01/31/07)

Solving the Postal Service’s problems at Davos
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- On the *Wall Street Journal Online*, Marc Champion wrote, “Where are some of the key issues facing the U.S. Postal Service sorted out? In Davos, Switzerland, of course. The mail carrier’s Chief Executive and U.S. Postmaster General John E. Potter, attending his fifth consecutive World Economic Forum, has key business to discuss at the mountaintop resort. Last night he was to meet with logistics and airline executives -- including FedEx Corp. Chairman Frederick W. Smith and DHL Express CEO John Mullen -- to discuss the stalled ‘open skies’ deal between the U.S. and the European Union, antiterrorism measures and other issues. Unfortunately for Mr. Potter, Massachusetts Democratic Rep. Edward J. Markey, a frequent Davos-goer, isn’t attending this year. ‘Markey’s been pushing to pull U.S. mail off of commercial flights,’ Mr. Potter said. ‘I cornered him about it last year.’ In Mr. Markey’s absence, Mr. Potter might try having a stern chat with leaders from the Organization of Petroleum Exporting Countries attending this year’s summit. ‘We’ll see what OPEC has to say. Every time oil goes up one cent, it costs us \$8 million,’ Mr. Potter said, shaking his head.” (*Wall Street Online*, Marc Champion, 01/25/07)

U.S. Postmaster General re-elected vice chair of the International Post Corporation board

- U.S. Postmaster General John E. Potter has been re-elected as vice chairman of the International Post Corporation (IPC) Board. The IPC, a cooperative association of 23 national postal operators in Europe, North America and Asia Pacific, accounts for 80 percent of the world's mail. "Being part of the IPC is an excellent way for international postal leaders to share best practices," said Potter. "Our cooperative efforts benefit postal customers in every country and help strengthen international trade and commerce." (*PRNewsWire*, 01/24/07)

National Postal Mail Handlers Union ratify USPS contract

- The members of the National Postal Mail Handlers Union (NPMHU) have voted to ratify a new five-year contract that will run through November 20, 2011, affecting approximately 55,000 career USPS employees who are engaged in bulk transfer, loading and unloading of mail. (USPS Press Release, 01/25/07)

Return to Sender: \$78,818

- According to *InForum News*, "James Chalupnik saw the bins full of undelivered CDs and DVDs inside Fargo's U.S. Post Office as trash. He took thousands of the discs during nearly five years of working inside the building as a janitor for a company with a federal contract to clean the building. And he wasn't alone. He claims that others inside the building, including postal employees, took discs, books and baby formula that were returned to the Post Office for various reasons and destined for the landfill. A federal judge saw it differently Friday, when he ordered Chalupnik, a 46-year-old Fargo man, to pay \$78,818 restitution to BMG Columbia House Inc., the company that sent the discs to customers." (*Inforum News*, Steven P. Wagner, 02/03/07)

TVA

Former TVA chairman Bill Baxter resigns from the utility's board of directors

- Bill Baxter, a former chairman of TVA's board of directors, announced his resignation from the board. "Today I have self-limited my term to five years in the spirit of the legislation modernizing the governance structure of TVA," said Baxter, who was nominated by President Bush in 2001 to the agency's previous three-member, full-time board in 2001 to a term expiring in 2011. In 2005, Baxter was elevated to chairman until an expanded nine-member, part-time board took office in 2006. "I am proud of the progress we have made at TVA over the last five years," said Baxter. "TVA is in significantly better financial shape than it has been in several years (and) the air in the Tennessee Valley is cleaner than at any time in the past half century." (*Associated Press*, 01/23/07)

TVA's revenues off \$95 million in fourth quarter due to warm weather

- In a briefing of TVA's directors, the utility's president and CEO Tom Kilgore said that the agency's operating revenues are about \$95 million lower than planned for the fourth quarter and its net income is expected to be \$46 million below budget due to mild winter weather. The utility's lower revenue was partially offset by \$20 million in lower-than-expected maintenance and operating expenses, along with \$31 million less in capital expenditures. TVA expects to provide its financial results for the quarter in mid-February. (*The Huntsville Times*, 01/27/07; *Associated Press*, 01/26/07)

The debate over nuclear energy continues

- As TVA pushes to expand its nuclear production capability, critics question the wisdom of the utility's strategic direction. "We need more power and, at this point, nuclear looks to be the best option," said TVA Chairman Bill Sansom. The agency projects that energy demand will grow 1.9% a year, requiring TVA to nearly double its nuclear generation over the next decade. The agency currently plans to submit applications for two new reactors, restart its oldest nuclear reactor after a 22-year shutdown, and complete the construction of the unfinished Unit 2 reactor at Watts Bar Nuclear Power plant for a total cost of about \$7 billion. Kilgore insists that TVA is taking a slower and more cost-effective approach to expanding its nuclear production, than it did in the 1970s when it attempted to open 17 reactors at one time. "If we do decide to proceed with more nuclear units, we're going to make sure they are well designed in advance and are built one at a time," said Kilgore.

- Critics question why the debt-burdened utility would again pursue an expansion of its nuclear power program, after scraping its original \$8 billion program nearly 30 years ago. “Of all the places on Earth that have given nuclear power a shot and failed, the Tennessee Valley has got to be No. 1,” said former TVA chairman S. David Freeman, who has also headed four other electric utilities across the country. “TVA’s electric rates would be a whole lot lower today if they wouldn’t have tried to build all those expensive nuclear plants. It’s just baffling to me that TVA would want to get into that business again.” Anti-nuclear activists also contend that additional nuclear power plants will create more terrorism targets, nuclear proliferation and radioactive wastes. “The nuclear industry thinks they are making a comeback and they can run over everybody to get these new plants licensed and built,” said Ann Harris, head of the Southeast office of the anti-nuclear group, We the People. “They still haven’t dealt with their wastes, their mismanagement or the risks to the public from these plants.” (TVA spokesman John Moulton said the agency is “safely” storing more than 2,500 metric tons of radioactive spent fuel waste onsite at TVA nuclear plants.)
- The Bush administration and Republican lawmakers such as Senator Lamar Alexander (R-TN) and Representative Zach Wamp (R-TN), are touting the resurgence of nuclear energy and the new reprocessing and recycling technology for highly radioactive spent fuel waste. “Nuclear power is almost the only answer for clean electricity to meet our growing needs,” said Alexander. “When I look at all of the options, I think nuclear is the leading technology.” Senator Bob Corker (R-TN), who is a member of the Senate Energy and Natural Resources Committee, said, “I think nuclear has to be a large portion of what we do in our country energy wise.”
- Adrian Heymer, senior director for new plant deployment at the Nuclear Energy Institute, said 2007 will be a pivotal year for developing new nuclear generation. “The industry has made significant improvements in the reliability, safety and productivity of our nuclear units, and with today’s volatile prices for natural gas and global warming concerns from coal, nuclear just makes a lot of sense,” said Heymer. The Nuclear Regulatory Commission expects a flood of applications for permission to build as many as 30 reactors, primarily in the South, which could boost the nation’s electric supply by more than 30,000 megawatts or 3%. In recent legislation, Congress provided more than \$8 billion worth of subsidies plus loan guarantees to encourage development of nuclear reactors. Nuclear power currently generates 20% of the nation’s power supply, while 104 coal powered plants produce 50% of the nation’s electricity. (*Chattanooga Times Free Press*, Dave Flessner, 01/28/07; *Associated Press*, 01/29/07)

TVA settles industrial customers’ pricing lawsuit for \$18 million
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- TVA has agreed to pay \$18 million to settle an 8-year old lawsuit over the rates it charges industrial customers during peak power demand. Under the agreement reached in mediation, the utility will provide payments to the 340 customers that

participated in TVA's Economy Surplus Power program in the summer of 1998. In 1999, Birmingham Steel Corp. filed the class action suit against TVA, seeking more than \$100 million that the company claimed was improperly calculated by the utility. A federal court ruled that TVA made mistakes in setting rates for approximately 500 hours of its Economy Surplus Power. (*Chattanooga Times Free Press*, 01/23/07)

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