

# The **GSE** REPORT™

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## *Major Events*

House Financial Services Committee passes GSE regulatory reform bill by vote of 45-19

- On March 29, the House Financial Services Committee passed GSE regulatory reform legislation (H.R. 1427) by a vote of 45 to 19, which would restructure the regulatory system for Fannie Mae, Freddie Mac, and the FHLBs. The bill is largely the product of careful negotiations between Committee chairman Barney Frank (D-MA) and senior Treasury officials which remained largely intact, despite the passage of multiple amendments to the bill during markup.
- Throughout the committee hearings and markup of H.R. 1427, Republican members voiced concerns that the affordable housing provision in the bill was a digression from the primary focus of providing improved regulatory supervision for the housing GSEs. During the March 28<sup>th</sup> markup, minority leader Spencer Bachus (R-AL) said, “I have said all along ... that I felt like the affordable housing fund was superfluous to this bill and was not a part of what we are trying to accomplish in stronger regulation of the GSEs.” Frank easily defeated Republican efforts to remove or alter the affordable housing provision. Bachus proposed an amendment which would give the FHLBs control over the affordable housing fund proceeds. Frank said he was not willing to support the amendment during the day’s vote, but appeared willing to consider it at a later date. “I do say that it is a very reasonable way to look at possibly doing this in the future,” Frank added. Later this year, Frank said, the Committee will take up legislation on how best to administer the affordable housing fund after the first year, which will be dedicated rebuilding efforts in Gulf Coast communities devastated by Hurricanes Katrina and Rita.
- By a vote of 34-27, Representative Maxine Waters (D-CA) succeeded in attaching an amendment to the bill that would require the regulated entities to set up offices of Minority and Women Inclusion and to develop procedures for including minorities and women in the companies’ operations.
- Democrats defeated an amendment proposed by Representative Scott Garrett (R-NJ) which would restrict Fannie Mae’s and Freddie Mac’s mortgage portfolio holdings to mortgages and MBSs that support affordable housing. Arguing that such a provision would limit the GSEs liquidity and their ability to support affordable housing, the Committee voted down the provision by a vote of 15-48. Frank and Representative Gary Miller (R-CA) won committee approval by voice vote for an amendment requiring the new regulator when it writes rules related to control of the GSEs’ portfolio growth, to limit the facts to be considered to those affecting the “mission and safe and sound operations of the enterprises.” Another GSE-friendly amendment, approved by the Committee, would require the GSE regulator to “rescind” temporary capital increases “if the director determines that the circumstances or facts justifying the temporary increase are no longer present.” The Committee also approved by

voice vote an amendment proposed by Representative Patrick McHenry (R-NC) calling for GAO to determine the effects that a prospective affordable housing fund would have on the availability and affordability of mortgage credit.

- By a vote of 10-51, Democrats also defeated an amendment proposed by Representative Jeb Hensarlin (R-TX), which would have removed the provision to increase conforming loan limits in high-cost real estate markets from the bill.
- After the Committee vote, Frank said support from the Treasury Department and Democratic control of Congress boost the chances that H.R. 1427 won't meet the same fate as earlier proposals. "There's been a change in control of the Senate and at the Treasury Department," said Frank, noting two obstacles to legislation the House passed last year. This year could be different, Frank argued, because of the extensive negotiations he conducted with senior Treasury officials in 2006. "Something very close to this bill is likely to become law," said Frank. Representative Richard Baker (R-AL), a senior member of the panel and co-sponsor of H.R. 1427, called the bill a "good one, certainly from a safety and soundness perspective." He added, "I believe the bill is within the framework or expectations of the [Bush] administration. I don't expect Treasury to have significant objections to the bill in its current form."
- Following the Committee's passage of H.R. 1427, Treasury Under Secretary for Domestic Finance Robert K. Steel said, "The swift action of House Financial Services Committee this year has demonstrated that reforming the oversight of the government sponsored enterprises is a priority. The legislation passed today creates a strengthened GSE regulator with the necessary tools to ensure that the GSEs operate in a safe and sound manner and support their housing mission. We commend Chairman Frank for leading the Committee toward a well-crafted, bipartisan bill. This bill is the result of considerable cooperation and the sum of its parts is a sound step toward reform. We look forward to continuing to work in a constructive manner as the bill moves forward."
- OFHEO Director James B. Lockhart, III, said, "I appreciate the efforts of the Committee to pass a balanced bill that will strengthen the nation's housing finance system by strengthening oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks. This bill ensures the GSEs fulfill their congressionally-established mission of supporting the housing finance market, especially affordable housing. I look forward to continuing our work with the Congress and the Administration to create a new, stronger GSE regulator."
- "I congratulate Barney Frank and [ranking member] Spencer Bachus for their action today," said Senate Banking Committee Chairman Christopher Dodd (D-CT). "I continue to believe that GSE reform is appropriate and necessary. There is a consensus that we need a stronger, more independent regulator with a deeper commitment to affordable housing. I look forward to working with Senator [Richard]

Shelby (R-AL) and other members of the Committee to move this important issue forward.”

- The Committee’s passage of H.R. 1427 also drew praise from members of the housing finance industry. Diane Casey-Landry, president and chief executive officer of America’s Community Bankers, said, “We are particularly pleased that an independent regulator will be established [in H.R. 1427] for the secondary market GSEs with powers similar to those of the banking agencies. Equally important, the unique cooperative structure of the Federal Home Loan Bank System will be preserved, along with its strong, existing regulatory framework.” Camden Fine, president and CEO of the Independent Community Banker’s of America, said his group was pleased that the bill would not impose too many restrictions on the GSEs portfolios. “Had the committee placed artificial limits on portfolio growth, Fannie Mae and Freddie Mac would be compelled by business reasons to give preference to their large volume customers, a scenario that could shut out community banks from the significant sources of housing funds in the secondary mortgage market,” said Fine. FM Policy Focus, a frequent GSE critic, issued a statement saying, “The Committee has produced bi-partisan legislation that not only establishes a strong, single regulator for the GSEs, but also provides that regulator with the necessary authority to oversee complex financial institutions that play such an important role in the housing market and the economy overall. Despite differences on a number of complex issues, Chairman Frank worked to bring Democrats and Republicans together and crafted legislation that will prevent GSE misbehavior while providing the financing and stability the housing market requires.”
- The National Association of Realtors announced support of H.R. 1427, as approved by the House Financial Services Committee. In a statement, NAR president Pat Vredevogd Combs said, “The bill strikes an appropriate balance that creates a world-class regulator while not imposing statutory limitations on the GSEs’ portfolios, which could hurt the housing finance market and limit funds available for affordable housing. As the nation’s leading advocate for homeownership, we are also pleased that the bill provides for regional adjustment to the cap on mortgages in high-cost areas. That authority will help more working families in high-cost areas qualify for safer GSE loans, and for FHA and VA loans as well.”
- In a written statement, Fannie Mae spokesman Brian Faith said that H.R. 1427 was a step forward even “if there are important aspects of the legislation that we would hope to see improved.” Freddie Mac spokeswoman Sharon McHale called it “a very very tough bill.” McHale said her company is particularly concerned about provisions that require the GSEs to hold more capital.
- Industry representatives noted that while the Committee’s vote was bipartisan, the bill faced more dissent than the 2005 version, which was passed by a vote of 65 to 5. The dissent likely portends a more contentious vote on the House floor, they added.

- “[Committee passage] is the easiest step of all of them,” said Keefe, Bruyette & Woods’ analyst Brian Gardner. “There’s a sense in the House that they just want to be done with this.” The Senate is unlikely to use the House bill as a starting point, as Banking Committee Chairman Chris Dodd pursues his own legislation. “We may start the whole process anew in the Senate,” said Howard Glaser, a mortgage industry consultant and senior HUD official in the Clinton administration. “This is a compromise agreement that was reached with the House, and the Senate will start from the ground up. Really, I think that’s where the focus is going to shift next.” (*Dow Jones Newswires*, Damian Paletta, 03/29/07; *American Banker*, Steven Sloan and Stacy Kaper, 03/30/07; *Washington Post*, David S. Hilzenrath, 03/30/07; *Bureau of National Affairs*, Richard Cowden, 03/30/07; *CQ Today*, Michael Crittenden, 03/29/07; PR Newswire, 03/29/07; *Dow Jones Newswires*, Damian Paletta, 03/30/07; *U.S. Treasury Department Press Release*, 03/29/07; *OFHEO Press Release*, 03/29/07; *Dow Jones International News*, Damian Paletta, 03/28/07)
- According to *Affordable Housing Finance*, “The GSEs are at a critical point in their respective evolutions, and as Congress plays tug-of-war with their business plans, the organizations are waiting like everybody else to see what the outcome will be. Some call the GSEs’ privileges anti-competitive, and would like to see them either privatized or limited only to those segments of the mortgage market inherent in their missions—the affordable housing markets. They also believe that the GSEs pose a systemic risk to the economy due to the size of their businesses. Should the GSEs ever go under, the economic ripples would cause a tsunami, they argue. Others believe that a government has a responsibility to house its people, and that the creation and preservation of affordable housing is one of the nation’s most critical needs. All you need to do is look in the poorest corners of any major U.S. city to get the sense that you’re living in a third-world country. The world’s richest nation can do better, they argue. It’s precisely these two forces that made the GSEs what they are today—part industry, part government—reflecting the split personality of a nation that worships at the altar of profits while feeling the pull of a social conscience.” (*Affordable Housing Finance*, Jerry Ascierio and Andre Shashaty, April 2007)

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| Freddie Mac reports \$480 million loss for fourth quarter |
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- Freddie Mac reported a \$480 million loss in the fourth quarter of 2006 which the company attributed to “realized losses and mark-to-market impacts on the company’s credit guarantee portfolio, derivatives and administrative expenses which more than offset net interest income and management and guarantee income.” The company’s loss compares to a \$685 million profit in the fourth quarter of 2005. For fiscal year 2006, Freddie Mac reported net income of \$2.2 billion or \$2.84 a share, up from \$2.1 billion or \$2.75 a share for 2005. The company’s 2006 profits were largely generated by increases in the value of derivatives during the first half of the year. Freddie Mac’s revenues declined to \$5.2 billion in FY2006, from \$5.6 billion in FY2005. While the company’s guarantee business generated \$1.6 billion in guarantee fees in 2006 versus \$1.4 billion in 2005, Freddie Mac’s overall fee rate slipped to 15.4 basis

points, from 15.7 basis points in 2005. In a research note, Jim Vogel, head of research for FTN Financial, wrote that Freddie's results reflect that the company "is becoming a lower margin, lower volume, lower risk and higher capitalized [business]." He added, "That formula means it is going to have to streamline costs and become still more aggressive when odds are in its favor."

- Management also acknowledged "slight credit deterioration" of Freddie Mac's mortgage holdings last year, resulting from the deteriorating market for subprime mortgages. As a result, the company increased its reserves for potential loan losses to \$420 million on December 31, 2006 from \$414 million the year before. Freddie's credit-related expenses of \$275 million in 2006 were down slightly from the prior year (\$291 million), largely because of Freddie Mac reduced its reserves for losses related to Katrina by \$82 million in 2006. The company also lost \$126 million last year on loans that it had to repurchase from other investors which were delinquent 120 days or more. At year-end, Freddie Mac held \$124 billion of mortgage-backed securities backed by subprime loans, which comprised 18% of Freddie Mac's \$714 billion retained portfolio; virtually all of these holdings were triple-A tranches. In a conference call with investors, Syron said troubles in the subprime mortgage market are expected to spread only marginally into segments of the broader mortgage market. "I think that there may be some slight bleedover, but we really haven't seen very much," said Syron. "In the prime space, I think things are pretty good." However, he acknowledged, "I think that some of this will overflow into the broader economy as many consumers become more concerned about their debt burdens,"
- During 2006, Freddie Mac's common-dividend payout rose 22% or \$2.00 a share, up from \$2.13 billion in 2005. The company also announced plans to buy back \$1 billion in stock through the issuance of \$1 billion in preferred stock, market conditions permitting.
- Freddie Mac, which hasn't released timely financial reports since disclosing accounting irregularities in 2003, plans to provide first quarter results "sometime after" the May 28<sup>th</sup> Memorial Day holiday, said Eugene M. McQuade, the company's president and COO. Freddie Mac chairman and CEO Richard Syron conceded to shareholders that the company had fallen short of its goals for improving internal controls and financial reporting systems in 2006. Syron wrote in a letter to shareholders, "There's no question this has taken longer than any of us expected." In a research note, Credit Suisse analyst Moshe Orenbuch wrote, "Freddie provided no update to its 2007 reporting schedule. While it has made some incremental progress ..., we were disappointed that a more definitive timeline was not released. It does not appear that Freddie will return to timely financial reporting in 2007." (*Wall Street Journal*, Damian Paletta and James R. Hagerty, 03/24/07; *Dow Jones Newswires*, Damian Paletta, 03/23/07; *American Banker*, Harry Terris, 03/26/07; *Washington Post*, David S. Hilzenrath, 03/24/07; *Associated Press*, Marcy Gordon 03/23/07; *Baltimore Sun*, 03/24/07; *National Mortgage News' MortgageWire*, 03/23/07)

- In *The Motley Fool*, S. J. Caplan wrote, “One step forward, one step back, and one silent shuffle made for a clumsy performance from mortgage finance company Freddie Mac ...when it reported annual earnings [for 2006]... The positive step: a 4% increase in annual net profits to \$2.2 billion. ...Uneven earnings were its backwards step, though. ...The sideways shuffle remains Freddie’s lack of progress in its financial reporting. ...Although the company disclosed a boost in spending to upgrade internal controls, it disappointed by failing once more to articulate a definitive timeline for its return to quarterly reporting. Besides detracting from investor confidence, this reporting absence has a quantifiable financial impact; Freddie must carry a 30% surplus capital level, which drags on growth and earnings. At the end of 2006, Freddie’s core capital was estimated at \$36.2 billion, including an estimated \$2.6 billion in excess of the required amount. ...While Freddie also announced plans to repurchase an additional \$1 billion in common shares, and issue as much as \$1 billion in preferred stock, you may not want to choose Freddie as your dance partner just yet. Let the company first continue to clean up its own act, issue regular quarterly reports, and maintain its capacity to adequately manage risk. Then wait to decipher any regulatory changes before you engage in any investment tango.” (*The Motley Fool*, S. J. Caplan, 03/26/07)

***Subprime mortgage “tsunami” takes center stage on Capitol Hill:***

Congress holds hearings on subprime industry crisis

CRS outlines the public policy issues facing Congress in the subprime crisis

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Hope springs eternal...

**Subprime mortgage “tsunami” takes center stage on Capitol Hill**

- With the subprime mortgage crisis making headlines in the media, Congress has begun its examination of this “tsunami” in an effort to identify who can be blamed for this crisis and what steps—legislative and otherwise—need to be taken to resolve this

crisis. A brief examination of how the subprime mortgage crisis evolved, provides a useful framework in sorting through today's media frenzy on this issue.

- According to *Knowledge@Wharton*, several factors were responsible for the boom and bust of the subprime mortgage market. The magazine wrote, “Several factors were responsible. One was the Community Reinvestment Act of 1977, which made redlining illegal and pushed lenders to make loans in poorer communities they previously had avoided, says Kenneth Thomas, adjunct professor at Wharton. In the 1990s, Congress and the Clinton administration pushed policies to encourage wider home ownership, which today is at the highest level in U.S. history, nearly 69% of households. ‘A regulatory climate developed—which still exists today—that favored these loans.’ There is a distinction, he notes, between subprime loans for people who deserve mortgages and otherwise could not get them, and predatory lending, which is pushing people into loans they cannot afford. ‘Subprime is good, predatory is bad.’”
- “Another factor was work by academics and lenders who found that people with low credit scores were not as risky as previously thought. In the 1980s and 1990s, lenders ‘began to learn how to trade off one risk factor against another risk factor,’ [said Jack M.] Guttentag [emeritus finance professor at Wharton]... ‘A bunch of guys realized there was a lot of money to be made for delivering loans to a category of buyers who had never qualified for loans. They found that they could charge very high rates to cover their risk and make large profits.’ According to [Susan M.] Wachter [Wharton real estate professor], her research showed that many people deemed not creditworthy actually were paying more in rent than they would if they could get mortgages. For many renters, the obstacle to home ownership was not the size of the monthly payment, but the need for a down payment of 10% to 20% of a home's cost. In the 1990s, lenders began addressing the problem with low- and no-down payment loans, and with computerized loan approvals that used a more scientific approach to judging applicants' credit worthiness, she says.”
- “The final factor was the mushrooming in the 1990s of ‘securitization,’ the bundling of home loans into bond-like securities that could be bought and sold on the secondary market. This allows lenders to get loans off their books so they can lend more.” ([Knowledge@Emory.com](http://Knowledge@Emory.com), March 14-April 10, 2007)
- These factors, coupled with declining global interest rates led to the boom in the subprime market, which evidenced the fastest growth in the mortgage market over the past decade. According to *Time Magazine*, “Declining global interest rates left investors searching for anything that would pay higher yields. Eager to oblige, Wall Street investment bankers devised ever cleverer ways to package ever riskier loans into high-yield securities. And mortgage lenders came up with ever more creative loan terms to attract customers. This lured ‘unsophisticated borrowers’ who had difficulty fully understanding how these products would affect them when interest rates rose and housing prices edged off,” says Eugene Ludwig, a former top banking regulator.... The boom in risky mortgage lending was driven ...by firms beyond the reach of the [federal banking regulators]. ...As a result, the subprime lenders made

all manner of dodgy loans, and that could go on only for so long. This is the way of financial innovations, which tend to be used to excess at least once until people figure out what the true risks are.” (*Time Magazine*, Justin Fox, 04/02/07)

- The subprime market boomed, until the Federal Reserve began its string of 17 interest rate hikes in the summer of 2005, setting the stage for a market correction. Wharton real estate professor Todd Sinai describes the situation as a "perfect storm," given that three things had to happen for the subprime market to tank: Borrowers' incomes had to drop, interest rates had to rise and housing prices had to fall. "It is extremely rare that all three things happen," he says. As the delinquency rates of subprime mortgage escalated in 2006, consumer advocacy groups touted new studies, claiming that more than 2 million subprime borrowers face foreclosure and the loss of more than \$184 billion of home equity. Activists and Democratic candidates for President for 2008 were quick to call on the government to bail-out these subprime borrowers, who they claim, were victims of predatory lending practices. More recently, the economic research firm FirstAmerican CoreLogic determined in a new study that the vast majority of subprime borrowers will escape foreclosure. Their study forecasts that 1.1 million subprime mortgages totaling approximately \$326 billion are heading to foreclosure through the year 2010—"just a flea on the nation's \$10 trillion elephant," writes *Business Week*. Ken Thomas, a lecturer on finance at Wharton noted that most subprime mortgages are not in trouble and many were able to buy homes only because subprime mortgages are available. "The fact that some of these same groups that are pushing [for restrictions on the issuance of subprime loans] are the same groups that pushed banks to make more loans to the poor," said Thomas. (*Knowledge@Wharton*, 03/21/07; *Business Week*, Mara Der Hovanesian, Peter Coy, Matthew Goldstein, and David Henry, 03/26/07)

#### Congress holds hearings on subprime industry crisis

- Pressure is mounting in Congress to "right the wrongs" of victimized subprime borrowers—real or perceived. Hearings were held on Capitol Hill to examine the subprime mortgage crisis and identify those parties responsible for it occurring. Senate Banking Committee Chairman Christopher Dodd (D-CT) was quick to lay out a "chronology of regulatory neglect" for failure by financial regulators to stop the lending abuses in the subprime market and putting more than 2 million homeowners at risk of losing their homes. "Our nation's financial regulators were supposed to be the cops on the beat, protecting hardworking Americans from unscrupulous financial actors," said Dodd. "Yet they were spectators for far too long." The chairman repeatedly blamed the Federal Reserve and former chairman Allan Greenspan for failing to prevent a rash of subprime mortgage delinquencies and foreclosures and accused former Fed chairman Alan Greenspan for encouraging the public to use alternative mortgages in his testimony before Congress three years ago. During the five hour committee hearing, Dodd said, "These actions set the conditions for a perfect storm that is sweeping over millions of American homeowners today. The obvious question here is why hasn't the Fed acted."

- Roger Cole, director of the Fed's division of banking supervision, faced aggressive questioning by members of the panel. Dodd pressed Cole on why the Fed has not used its authority under the Home Ownership and Equity Protection Act (HOEPA) and the Federal Trade Commission Act to prohibit unfair and deceptive practices by federally- and state-regulated mortgage lenders and brokers. While the Fed writes the HOEPA regulations that cover all lenders, the agency's officials said they have enforcement power only over the banks that they regulate, but not over state-licensed mortgage brokers and lenders. Cole defended the federal regulators' efforts to address this issue and provided the panel a three-page, detailed outline of the regulatory agencies' regulations and other initiatives [by agency] through the years. Dodd complained that the federal agencies had not done enough by soon enough to avoid this crisis. When asked if the Fed planned to write new lending standards anytime soon, Cole responded, "I will go back to the Federal Reserve Board, talk to the governors. We will have discussions." Dodd responded, "It is not a request—it is a demand." Senator Robert Menendez (D-NJ) asked Cole, "The size of this problem ... leads me to the question: regardless of everything you are telling me, how can it be this big and you have done your job?" Cole conceded, "I will say that given what we know now—yes, we could have done more sooner."
- In separate testimony before a House panel, Sandra Braunstein, director of the Federal Reserve Board's Division of Consumer and Community Affairs, said that her agency is reviewing the closed end loan products provision in the Truth in Lending Act, including HOEPA provisions, and is seeking to address many issues presented by subprime mortgages in revisions to its regulations. "It is not an easy process," she said. "We need to make sure that whatever rules are written, are well calibrated and are very thoughtful and are done in such a way as to... take care of the bad actors but [do] not overly constrict the market." She added, "[Because HOEPA] does carry with it the right for people to file private lawsuits... we have to be even more careful about what we write. ...It's not a matter of banks being sued as much as... there is threat of lawsuits taking place... And it carries with it assignee liability, which means anybody who touches the loan could potentially be sued [including the secondary market]."
- Ranking member Richard Shelby (R-AL) urged Dodd to schedule hearings on "other actors" in the mortgage process, including mortgage brokers and rating agencies. Dodd responded that he hopes to schedule such a hearing "rather soon." In *National Mortgage News*, Paul Muolo noted, "...[I]f senators on the committee knew anything about the mortgage industry they would realize that many of the biggest players in AMPs/subprime are non depositories that are beyond the reach of the Fed and FDIC. The Senate panel might want to investigate Wall Street's role in the crisis but that might cast many of their largest donors in a bad light and we wouldn't want to see that happen."
- In a media interview after the hearing, Greenspan took issue with Dodd's characterization of his comments on the subject of adjustable-rate loans, which he intended only for a specific type of consumer. "There was a Fed staff study that indicated a small number of consumers could do better in the mortgage market by

taking out something other than a 30-year mortgage,” he said. “I was merely identifying an arithmetically obvious issue, that some mortgage borrowers, admittedly a very small segment, would do better with a different [mortgage] product...” Greenspan added, “To generalize the way the Senator does is really doing violence to what I said and certainly what I had in mind.”

- After the hearing, Federal Reserve Governor Susan Bies said, “What is really frustrating about this is [federal regulators] don’t have enforcement authority to do anything with these state-licensed, stand-alone mortgage lenders.” [In 2005, 52% of subprime mortgages were originated by companies with no federal supervision—largely mortgage brokers and stand-alone finance companies—while another 25% of loan originations were made by finance companies that are units of banking holding companies and only indirectly supervised by the Federal Reserve.] There is widespread agreement that the biggest shortcoming in the regulation of the mortgage industry is the patchwork of state and federal regulation, which leaves many market segments “barely supervised” by state regulators, many of whom lack the financial resources and mandates of their federal counterparts. While concurring with FDIC chairman Sheila Blair’s recommendation that Congress “seriously needs to consider a national anti-predatory lending law” that would apply to all mortgage lenders, Bies warns that enforcement powers are also needed. “If a federal statute is put out there with little inspection, it’s only going to fall on the regulated entities,” said Bies. “At the unregulated entities, where there’s a problem, there will be little enforcement.” (*Associated Press*, Greg Ip, 03/22/07; *Dow Jones Newswires*, Damian Paletta, 03/22/07; *Washington Post*, David Cho and Nell Henderson, 03/23/07; *Bureau of National Affairs*, R. Christian Bruce, 03/23/07; *American Banker*, Stacy Kaper, 03/21/07; *Associated Press*, 03/23/07; *American Banker*, Stacy Kaper, 03/23/07; *Bureau of National Affairs*, Richard Cowden, 03/28/07; *American Banker*, Stacy Kaper, 03/28/07; *National Mortgage News Daily Briefing*, Paul Muolo, 03/26/07)

#### CRS outlines the public policy issues facing Congress in the subprime crisis

- In a March 19<sup>th</sup> CRS Report to Congress on subprime mortgages, Congressional Research Service identified the policy issues facing lawmakers. CRS wrote, “Subprime loans, which are extended to borrowers with weaker credit conditions, have higher delinquency and foreclosure rates. Policies that facilitate subprime lending have to balance the benefits of homeownership against the risks of increased debt. More complex mortgage products may facilitate homeownership under some conditions but may be more difficult for consumers to understand. Restrictions on mortgage products may insulate credit-impaired borrowers from default risk but may make it more difficult for these potential borrowers to own a home. Federal and state authorities also protect consumers through anti-predatory lending initiatives. The recent rise in subprime delinquencies illustrates the trade-off between encouraging greater access to credit markets and risking increased defaults and foreclosures.”
- “Policymakers decide the role of government agencies and government sponsored enterprises (GSEs) in the subprime sector. Some argue that greater GSE presence in

the subprime market could help reduce instability in that market by helping to standardize underwriting procedures. Raising the GSEs' housing goals may direct their programs to lower-income households but may increase the flow of funds to risky mortgages. Reforming the loan programs of the Federal Housing Administration ...could provide lower-income borrowers with an alternative to subprime lenders but may be less flexible in changing market conditions. FHA makes it easier for borrowers to obtain loans by insuring the loan payments. On the other hand, some argue that granting FHA greater flexibility could increase the amount of risky mortgages." (*CRS Report for Congress: Subprime Mortgages [RL33903]*, Edward Vincent Murphy, 03/19/07)

#### Chairman Dodd calls for an "all parties" conference to address the subprime crisis

- Senate Banking Committee chairman Christopher Dodd (D-CT) said that he will soon convene a "summit of regulators, lenders and consumer advocates to identify ways to help minimize the damage from pending foreclosures. "A lot can be done –can be done under existing authority, in my view, by the federal regulators—and the fact that they haven't acted really does anger me in many ways." Dodd emphasized that he wants market-based solutions, but has not ruled out passage of legislation, if needed. Echoing Dodd's position, Democratic presidential contender Barack Obama (D-IL) called on Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson to convene a "homeownership preservation summit" to bring together the major players in the mortgage market for purposes of stemming the tide of mortgage foreclosures. "We cannot sit on the sidelines, while increasing numbers of American families face the risk of losing their homes," wrote Obama in a letter to Bernanke and Paulson.

#### Senator Schumer and Chairman Frank outline legislative solutions

- Senator Chuck Schumer (D-NY) announced plans to introduce legislation "very shortly" which will outlaw several alternative mortgage products and create a national regulatory system for all mortgage brokers. Schumer said, "The subprime market is the Wild West of mortgage loans, and it's time we finally bring a sheriff to town. The first step is making sure that borrowers are protected from these usurious lenders. ...These mortgage brokers are just the underbelly of society and these liar loans are despicable. They prey on people. They're rapacious. They're vultures." To address these problems, Schumer said, "I'm planning on introducing a bill that would establish a national regulatory system for all mortgage brokers, including those at non-bank companies, and establish a suitability standard for borrowers..." His bill would also prohibit prepayment penalties, stated-income or low-documentation loans, and "pick a payment" plans, said Israel Klein, Schumer's spokesman. Schumer also proposes setting up a Foreclosure Prevention Task Force in his home state of New York, which would include non-profit groups such as ACORN, which focus on housing issues.

- Consumer advocates hope that the attention on rising defaults on subprime loans will result in Congress passing comprehensive anti-predator legislation. Allen Fishbein, director of housing and credit policy at the Consumer Federation of America said, “There is going to be tremendous pressure on Congress to do something, and I think the industry would be wise to get behind responsible legislation and support it.” Greenling, of San Francisco, is advocating that Congress federalize the home mortgage origination system and “hold the investment bankers and mortgage brokers ... just as liable as the banks.”
- House Financial Services Committee Chairman Barney Frank (D-MA) said he is working on a bill which will “break down” the concept of suitability standard. “We are going to pass a bill that will substantially diminish the likelihood of people getting loans that they should not be given. ... There used to be a debate about lender liability; I hope that debate is broadly over. There is now a recognition of the problems these loans are causing through the financial system, and it is clear that the securitization of these loans—the sale of these mortgage into the secondary market—has caused a number of problems. [Lenders] should not be held accountable to things they could not have known. [But] lender liability going all the way up the scale appropriately done is the best enforcement mechanism we could have.” Frank’s proposal would give borrowers and others the ability to sue the Wall Street firms that securitize the subprime mortgages, as well as purchasers of the MBSs in the secondary market. In an interview with the *Wall Street Journal*, Frank said that a key goal for this bill will be to establish liability for investors that buy securities backed by “ill-conceived” mortgages. “If you buy a loan that should never have been made, you shouldn’t totally be free from someone’s right to sue,” said Frank. The bill should also crack down on compensation methods that reward loan officers for selling borrowers higher-cost mortgages or ones with prepayment penalties, said Frank. (*American Banker*, Stacy Kaper, 03/21/07; *American Banker*, Stacy Kaper, 03/29/07; *Rochester Business Journal*, Tom Adams, 03/28/07; *Buffalo News*, Jonathan D. Epstein, 03/29/07; *Dow Jones Newswires*, 03/25/07; *New York Times*, Stephen Labaton, 03/16/07)
- In a March 29<sup>th</sup> letter to lawmakers, Frank outlined the key components he intends to include in anti-predatory lending legislation to be introduced “later this session.” Frank said this legislation will insure that (1) all Americans be protected from predatory lenders; (2) consumers get “good credit” by getting “good loans;” (3) credit availability is preserved, especially in a troubled market; (4) lenders not make loans that they know the consumer can not pay back or exceeds the value of the home; (5) consumers get simple, understandable, meaningful disclosures of their loan terms; (6) mortgage originators not receive financial incentives to steer consumers into bad loans; and (7) the market does not return to redlining. Frank wrote, “The Committee is intently focused on these issues and is working on a balanced solution that stops abuses, preserves access to credit, and aids stable homeownership.” (*Correspondence from Representative Barney Frank*, 03/29/07)

Chairman Frank schedules April 17<sup>th</sup> hearing on how the resources of Fannie, Freddie and FHA can be used to help subprime borrowers in trouble

- House Financial Services Committee chairman Barney Frank (D-MA) has scheduled an April 17 hearing with executives from Fannie Mae, Freddie Mac and the FHA to discuss ways to address rising foreclosure rates on subprime mortgages. Frank said, “Fannie and Freddie, in a stable situation, should help us, because when we get back [from April Recess], one of the things we are going to be doing is meeting with them, the FHA and the regulators to try and see how we can use their resources to help the people who are currently in trouble with subprime mortgages, what kinds of workouts and things we can do for them.” (*Dow Jones Newswires*, Damian Paletta, 03/30/07)

Political risk and danger of unintended consequences is high in subprime meltdown

- "There is a growing sense of urgency in Congress that something needs to be done," said Kurt Pfothenauer, the chief lobbyist for the Mortgage Bankers Association. "To the degree that Congress ... legislates only to the headline or an anecdote, it will almost certainly multiply the unintended consequences of its legislation." (*American Banker*, Stacy Kaper, 03/21/07)
- In the *American Banker*, AEI senior fellow Alex J. Pollock wrote, “If history is any guide, we can expect the same from the implosion of the subprime mortgage boom. On the same basis, we can also expect the usual political overreaction, which may result in the Sarbanes-Oxley Act of mortgage lending, or some similar mistake.” Unfortunately, the mortgage industry’s claims that they system is working appears to be falling on deaf ears in Congress. MBA’s chief economist Doug Duncan said, “Market discipline in this industry is swift, can be severe, and is more effective in changing lending practices than any potential regulation.” (*American Banker*, Alex J. Pollock, 03/30/07; *Wall Street Journal*, Greg Ip and Damian Paletta, 03/22/07)
- Harvey S. Rosen, a professor of economics at Princeton and former economic adviser to President Bush, concluded, “Ultimately the public policy choice is going to be whether to make it harder for people to get these loans, and just shut people out, or let people make the choice and know that sometimes they will make mistakes.” (*New York Times*, Eduardo Porter and Vikas Bajaj, 03/17/07)
- “Few doubt that the subprime mess was, in part, a regulatory failure. But now the mistakes have been made, the biggest risk is that populist politicians rewrite the rules hamfistedly. Fraudulent activity should be punished. The vulnerable need protection from predatory lenders. But an ill-conceived swathe of new ‘consumer protection’ could easily make matters worse. If restrictive regulation scared investors away from the subprime market for good, that really would hurt the poor.” (*EIU ViewsWire Select*, 03/23/07)
- In the *Washington Post*, Sebastian Mallaby wrote, “It may be tempting ... to turn to Fannie and Freddie to help stabilize the mortgage market in its time of need. But

these institutions are a potential source of instability themselves; they have used their government link to grow so big that a collapse would cause chaos. The policy debate needs to stay focused on cutting Fannie and Freddie down to *size, not on giving them a white-knight role in the mortgage debacle.*” [Emphasis added] (*Washington Post*, Sebastian Mallaby, 03/19/07)

#### The subprime mortgage crisis impact (thus far) on the national economy

- In March 28<sup>th</sup> testimony before the Joint Economic Committee, Federal Reserve Chairman Ben Bernanke said, “...Developments in subprime mortgage markets raise some additional questions about the housing sector. ...Although the turmoil in the subprime mortgage market has created severe financial problems for many individuals and families, the implications of these developments for the housing market as a whole are less clear. The ongoing tightening of lending standards, although an appropriate market response, will reduce somewhat the effective demand for housing, and foreclosed properties will add to the inventories of unsold homes. At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency. We will continue to monitor this situation closely.” (*Testimony of Federal Reserve Chairman Ben S. Bernanke*, 03/2/07)
- In testimony before the House Appropriations Subcommittee on Financial Services and General Government, Treasury Secretary Henry Paulson told lawmakers that the U.S. housing market appears to be near its bottom and any systemic fallout from the subprime mortgage market likely to be contained. Paulson said, “Systemically, it looks like it’s going to be contained. We have to watch it closely... we believe it’s going to be contained.” (*Dow Jones Newswires*, 03/28/07)
- In a worst case scenario, Wall Street economists fear that the subprime mortgage crisis could ultimately push the economy into a recession. According to the *Wall Street Journal*, “Credit Suisse estimates that mortgage originations could drop 21% during the next year or two because of tighter credit standards. Coupled with high inventories of unsold homes and the additional supply likely from distressed sellers, this drop in demand could produce an unprecedented nationwide decline in home prices. Merrill Lynch estimates prices could drop as much as 10% this year. A price drop of this magnitude would lead to a vicious cycle in the housing market and pose a major risk to economic growth. And, of course, it would create a raging political firestorm [in time for the 2008 presidential election].” (*Wall Street Journal*, Andy Laperriere, 03/21/07)

## Hope springs eternal

- On *Kudlow and Company*, host Larry Kudlow asked Chris Whalen, SVP and managing director at Institutional Risk Analytic, “What is Washington going to do about [the subprime mortgage crisis]?” Whalen responded, “Well, hopefully they won't do anything. You know, Larry, this is one of those cases where government creates a problem, the Fed with their monetary policy, the markets have underpriced risk for the last five, six years, both in terms of retail mortgage originations and the institutional securitization market, where these mortgages went. And now the home owner and the buy-side investor have the same problem, which is that they own an asset that they bought a year or two years ago that they can't liquefy at anywhere near the price they paid for it. So Congress can't fix this. If anything, you know, harkening back to Milton Friedman, what we need is less variability in monetary policy.” (*Kudlow and Company*, 03/20/07)

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

OFHEO announces 4<sup>th</sup> quarter capital classifications for Fannie Mae and Freddie Mac

- OFHEO director James B. Lockhart, III announced that Fannie Mae and Freddie Mac were adequately capitalized as of December 31, 2006. On that date, Fannie Mae's adjusted core capital of \$34.4 billion exceeded the adjusted OFHEO-directed capital requirement by \$4.2 billion and exceeded its adjusted critical capital requirement by \$27.1 billion. OFHEO also provided public notification of its reclassification of Fannie Mae from adequately capitalized to significantly undercapitalized for the interim 2002, 2003, and 2004 quarters. According to the OFHEO press release, "While progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the fourth quarter of 2006, significant work remains before Fannie Mae becomes a timely financial filer and corrects its internal control and operational weaknesses. It continues to remain prudent for Fannie Mae to hold capital in excess of the OFHEO-directed requirement to compensate for these uncertainties."
- On December 31, 2006, Freddie Mac's reported core capital of \$36.2 billion exceeded the OFHEO-directed minimum capital requirement by \$2.6 billion and its statutory critical capital requirement by \$22.9 billion. OFHEO wrote, "While filing the 2006 information statement and annual report is a significant move forward for Freddie Mac, internal control and operational weaknesses remain evident. Significant work remains before Freddie Mac becomes a timely filer and SEC registrant. It continues to remain prudent for Freddie Mac to hold capital in excess of the OFHEO-directed requirement to compensate for these uncertainties." (*OFHEO Press Release*, 03/30/07)

Representative Kanjorski "recovering well" following heart bypass surgery

- Representative Paul Kanjorski (D-PA), chairman of the House Financial Services Committee's capital markets subcommittee, is recovering from heart bypass surgery performed on March 20<sup>th</sup>. "Congressman Kanjorski is recovering well," said Dr. Lawrence Cohn, who performed his surgery. "There were no complications. ...[W]e have every expectation that he will recover fully." (*American Banker*, Rob Blackwell, 03/21/07)

IBM to automate "every step of the lending process"

- IBM has created IBM Lender Business Process Services, Inc. (LBPS), a mortgage lending services unit that the company claims can automate every step of the lending process. The Armonk, NY-based unit, which will be operational in the third quarter, will handle loan applications, underwriting process, third-party vendor management,

document preparation, and closing. Greg A. Sullins, the executive director of LBPS, said that the unit will offer a “private-label mortgage loan originations and outsourcing service” using technology that had been acquired from FileNet Corp, a content management company, and Palisades Technology Partners, a provider of services and technology for the mortgage industry. Sullins said, “[Lenders are] always going to determine how to underwrite loans. We’re acting as an agent of the lender.” He stressed that IBM is ahead of the curve on mortgage automation because it has both an electronic core origination platform and an enterprise content management platform, which can convert paper applications to electronic ones. (*American Banker*, David Breitkopf, 03/28/07)

#### Electronic mortgage standards for government loans set for MISMO publication

- Electronic mortgage standards for government loans are slated to be published through the MBA’s Mortgage Industry Standards Maintenance Organization (MISMO) subsidiary and paired with a single Ginnie Mae automated underwriting system. The standards are scheduled to be set for FHA, VA, and rural development products. (*National Mortgage News’ MortgageWire*, 03/27/07)

#### Hedge fund notes

- According to an *Institutional Investors News* survey, the hedge fund industry had assets of \$1.89 trillion at year-end 2006, up 24% from 2005. At least 83 U.S. hedge funds, managing approximately \$35 billion, shut down during 2006. The largest category of closings (27) was U.S. equity long/short funds, which comprises the largest percentage of the hedge fund industry. (*Reuters*, 03/19/07)

## ***Fannie Mae***

Fannie Mae's retained portfolio down an annualized 14.4% in February

- In February, Fannie Mae's retained portfolio fell by a 14.4% annual rate to \$712.4 billion, after shrinking by an annualized 4.8% in January and declining at a 0.4% annual rate in 2006. During February, Fannie Mae issued \$41.7 billion of MBS, compared to \$44.0 billion in January, while the GSE's commitments to purchase mortgages ballooned to \$10 billion from \$1.1 billion the prior month. In February, the company's duration gap stood at zero months, unchanged from the previous month. (*Reuters*, Julie Haviv, 03/22/07)

Fannie Mae expects to lay-off "several hundred" employees and contract workers

- Fannie Mae plans to lay-off several hundred workers by the end of the year in order to meet its goal of reducing its operating expenses by \$200 million. According to a March 19<sup>th</sup> internal memorandum obtained by *The Examiner*, Fannie Mae CEO Daniel Mudd said, "Even as we continue to hire for critical positions in areas such as finance, risk, and internal audit, we will be looking to become yet more efficient. Thus, it is likely that we will end the year with several hundred fewer employees than we have today." In a March 19<sup>th</sup> statement, communications manager Brian Faith said Fannie Mae will eliminate some full-time positions, but did not specify what positions or when and where the layoffs would take place. "Our objective is to bring costs in line following a period of significant increases in overall administrative expenses as the company completed its restatement and made critical investments in financial systems, risk management, and internal controls," said Fannie Mae. (*The Examiner*, David Francis and William C. Flook, 03/27/07)

Fannie Mae Foundation is under scrutiny from the IRS

- In the March 23<sup>rd</sup> issue of *BusinessWeek*, Dawn Kopecki reported, "[T]he Internal Revenue Service is looking into Fannie's charitable work and related tax deductions over the years. According to former executives at Fannie and documents reviewed by *BusinessWeek*, the IRS is trying to determine whether the company used the foundation and other charities to curry favor with members of Congress and whether it improperly wrote off those costs."
- "...Created in 1979, the Fannie Mae Foundation has given out more than \$1 billion. In 2006 it awarded \$34.5 million in grants to 300 nonprofit groups, money welcomed by small charities that often operate on a shoestring. ... Yet [Fannie's] generosity came with strings attached, say some former Fannie executives, grant recipients, and nonprofit advocates. In applications for funding, nonprofits were asked to list their

political contacts in a section labeled ‘franchise value.’ Those so-called affinity contacts—a former congressional aide, a lawmaker’s barber, a senator’s pastor—helped populate a database at Fannie that at one point had roughly 4,000 people with a direct connection to a member of Congress. ‘They were using charitable grants to strengthen, advance, and carry out the political and lobbying agenda,’ says Fred Wertheimer, president and CEO of campaign finance watchdog Democracy 21. ‘It was the political equivalent of a quid pro quo.’ Says Bruce Marks, CEO of the Neighborhood Assistance Corp. of America, a low-income housing advocate: ‘Many institutions rely on Fannie Mae and understand those funds are contingent on public support for its policies. Fannie Mae has intimidated virtually all of them into remaining silent.’”

- “The foundation appears to have walked a fine line in its dealings with politicians. It regularly hosted regional housing fairs and paid for politicians to attend a three-week management program at Harvard University’s John F. Kennedy School of Government. It has also spent millions supporting politically aligned groups such as the Congressional Black Caucus Foundation, Congressional Hispanic Caucus Institute, Metropolitan Mayors Caucus, and National Conference of State Legislatures. The Fannie Mae Foundation has, according to tax filings, donated at least \$600,000 to the Congressional Black Caucus Foundation since 1989, money used in part to sponsor events like the CBCF’s golf and tennis tournament. ‘They’ve been an important player,’ says Representative Mel Watt (D-NC), the past chairman of the Congressional Black Caucus and a current member of the CBCF. “[We] have worked closely with Fannie Mae or the foundation periodically to do things, sponsor housing fairs, [and] press Fannie Mae to provide support for housing initiatives in [members’] districts.’ The concern is whether such efforts were made to bolster Fannie’s business more than to advance philanthropic goals. Critics say the foundation helped to reinforce ties with various congressional groups forged by Fannie’s in-house lobbyists...”
- “...The Fannie Foundation in some cases played an overt marketing role. During much of the 1990s it covered the bulk of Fannie’s estimated \$50 million annual advertising budget. That was possible because the foundation received a series of IRS exemptions from the usual restrictions on nonprofit ad campaigns that promote the corporate parent. Most of the ads highlighted how Fannie made homeownership possible. But after TV spots, featuring a minority couple worried that a Senate bill would prevent them from getting a mortgage, ran the week before votes were scheduled on the legislation, lawmakers accused Fannie and the foundation of coordinating the marketing in an effort to derail the bill. Although Fannie said it paid for those ads, they were eventually pulled; since then, Fannie and the foundation have discontinued almost all national TV advertising. For years, Fannie’s special status as a government-sponsored entity made it seem untouchable. ...That perception changed three years ago as allegations of accounting irregularities, aggressive lobbying, and management missteps surfaced. ...Now, as the company fights to rebuild its damaged reputation, the foundation may have become another headache Fannie just didn’t need.” (*BusinessWeek*, Dawn Kopecki and Adrian Reeves,

03/23/07)

Al Gore promotes creation of “Connie Mae,”  
which would use Fannie Mae’s patent to sell carbon credits

- In an encore performance on Capital Hill, former Vice President Al Gore provided a Congressional panel a ten-point plan to combat the dangers of global warming. In the *American Thinker*, Christopher Alleva wrote, “Perhaps the boldest [proposal] of them all, was [Gore’s] call for the creation of a new government agency ‘Connie Mae’ to create and trade ‘carbon credits’ a la Fannie Mae. Helpfully, he fantasized out loud about a future in which consumers would get out their checkbooks and write checks to Connie Mae right along with paying their mortgages. ..So where did this come from? ...[T]his has been in the works for a very long time. Back in November 2006, Fannie Mae was granted a patent for a system to trade greenhouse gas-reduction credits paid by homeowners. The application was filed in April 2005. Fannie is just now getting out from under a huge scandal that threatened the safety and soundness of the housing finance system. In the wake of this, it is unlikely Congress and the regulators will go along with this scheme. Although, I wouldn’t make book on it.”
- “Ousted Chief Executive Franklin Raines is listed in the patent as an inventor of a system for verifying cuts in household emissions of carbon dioxide and other greenhouse gases. The patent, granted on Nov. 7 and held jointly with a subsidiary of New York-based Cantor Fitzgerald LP, gives Fannie Mae proprietary control over a method for pooling and selling credits to companies that can’t meet emission reduction targets. According to *Bloomberg*, Connie Russell, a spokeswoman for the Office of Federal Housing Enterprise Oversight that regulates Fannie Mae, said the agency is reviewing the patent and wouldn’t comment further...”
- “I have not examined the patent award closely but the Patent Office has a lot problems, granting patents when they shouldn’t and denying patents they should grant. This is a patent that should not have been granted. Its utility is entirely dependent on a government regulation. Where’s the invention in that?”
- “Al Gore and his guys have been very busy laying the groundwork for sweeping policy changes that they can profit from. There is no real value being created here, just a host for a rapacious nest of parasites.” (*American Thinker*, Christopher Alleva, 03/23/07)

Another Fannie Mae “alumni” in the news

- Lawrence M. Small has resigned under pressure as Secretary of the Smithsonian Institute, following revelations regarding his housing allowance and lavish office and travel expenditures of more than \$2 million. The Institute’s 17-member Board of

Regents voted unanimously to accept his resignation and elected not to provide Small a severance package. Before joining the Smithsonian in January 2000, Small served as president and chief operating officer of Fannie Mae for eight years. (*Washington Post*, Jacqueline Trescott and James V. Grimaldi, 03/27/07)

- In a March 29<sup>th</sup> editorial, the *Houston Chronicle* wrote, “Former Fannie Mae banker Lawrence M. Small lived large after he took over the national museum and zoo system known as the Smithsonian in Washington, D.C., in 2000. While Small proved to be a prodigious fund-raiser, his skyrocketing salary and lavish personal expenses billed to the taxpayers proved too much for lawmakers to swallow. ... The failure [by the Board of Regents] to oversee Small’s budget and rein in his taste for high living indicates the need for tighter oversight of the world’s largest network of museums and a rejection of costly pomp and inappropriate privilege at a tax-supported educational institution. The Smithsonian received more than \$600 million in federal dollars last year. With that magnitude of public support, taxpayers deserve better leadership and more responsible management of this national treasure.” (*The Houston Chronicle*, 03/29/07)

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| Fannie Mae’s LIBOR indices to be dropped on June 28 <sup>th</sup> |
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- Fannie Mae announced that it will no longer post new values for its five Fannie Mae London Inter-Bank Offered Rate (LIBOR) indices, beginning the third quarter of 2007. The indices affected by this action are 1-, 3-, 6-, and 12-month LIBOR Rates and the 12-month monthly average. The final values for Fannie Mae LIBOR indices will be posted by June 28, 2007. Fannie Mae will not accept delivery of any mortgage loans tied to any Fannie Mae LIBOR index that are originated after June 28, 2007.
- Anyone using the Fannie Mae LIBOR index data to adjust mortgage loan interest rates should consult their own counsel regarding the appropriate replacement index for Fannie Mae LIBOR. Fannie Mae has recommended to its lender and servicer customers that subject to language in the related note, LIBOR values published in the *Wall Street Journal* are comparable replacement indices in most cases. (*WebWire*, 03/30/07)

## ***Freddie Mac***

### Republican Senators press Freddie Mac on timing of SEC registration

- Senators Chuck Hagel (R-NE), John Sununu (R-RI), Elizabeth Dole (R-NC) and Mel Martinez (R-FL) are pressing Freddie Mac to provide them details on when the company plans to register with the SEC. In a March 2 letter to Freddie Mac's chairman and CEO Richard F. Syron, the Senators wrote, "Despite the passage of almost five years and your repeated public promises [to register its common stock and file financial reports with the SEC], Freddie Mac has not complied... What is the reason for this noncompliance?" (*Correspondence from Senators Chuck Hagel, John Sununu, Elizabeth Dole, and Mel Martinez, 03/02/07*)
- In a March 16<sup>th</sup> letter, Syron responded, "[L]et me assure you that Freddie Mac remains committed to fulfilling our pledge [to register its common stock with the SEC]. ...[W]e plan to return to quarterly reporting in the second half of this year. Once we have become timely in our reporting, we will then be eligible under the SEC's rule to become a registrant, and we will move forward expeditiously to fulfill our pledge." (*Correspondence from Richard F. Syron, 03/16/07*)
- In a follow-up letter dated March 23<sup>rd</sup>, the Senators pressed Syron for a specific timeline for Freddie Mac registering with the SEC. They also asked for a "detailed list of actions the board [of directors] has taken in response to this failure" and description of disciplinary actions taken by the board. (*Correspondence from Senators Chuck Hagel, John Sununu, Elizabeth Dole, and Mel Martinez, 03/23/07*)
- During an interview with *Knowledge@Wharton*, Freddie Mac chairman Richard F. Syron said his company is still in the midst of spending about \$1 billion to fix problems with its accounting and other financial reporting systems, which still aren't ready for prime time. "It was a supertanker on the chassis of a '49 Ford," said Syron, referring to the company's old accounting system and its inability to cope with the GSE's rapid growth. "Think of a 7-Eleven that became a Wal-Mart," he added. (*Knowledge@Wharton, 01/10/07*)

### Freddie Mac's retained portfolio rises at an annualized rate of 5.1% in February

- Freddie Mac's retained portfolio grew at an annualized rate of 5.1% in February to \$709.2 billion. This increase followed a 4.4% growth in the portfolio in January, versus a 0.9% decline for fiscal year 2006. To date, the GSE's portfolio has expanded an annual rate of 4.7%. According to FNT Financial analyst Jim Vogel, Freddie Mac's retained portfolio is "growing exactly in line with overall growth in fixed rate-conforming [MBS]" over the past three months. During February, Freddie Mac's net outstanding commitments to buy mortgage assets fell 17% from the prior

month to \$14.9 billion. Freddie Mac's duration gap was at zero months in February, unchanged from January. (*Reuters*, 03/21/07; *Bloomberg News*, 03/22/07)

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

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| Federal Housing Finance Board approves final rule allowing the FHLBs to name candidates to serve as public members |
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- On March 27, the Federal Housing Finance Board approved a final rule, allowing the FHLBs to nominate candidates to serve as their public members, subject to board approval. In response to comments from member, the Board approved a rule which goes into effect immediately, allowing the Banks to nominate “up to two individuals per vacancy” for public members [rather than a strict requirement for two nominees per vacancy]. The FHLBs had asked for this change to avoid nominating candidates for positions that did not exist. “It seems to be acknowledging... that by requiring two nominations you were going to have a 50% disappointment rate,” said Joe Pigg, senior counsel at the American Bankers Association. “This seems like a more straightforward approach.” However, senior lawmakers will likely not be pleased with the Finance Board's actions. House Financial Services Committee chairman Barney Frank (D-MA) and subcommittee chairman with oversight of the FHLB system Paul Kanjorski (D-PA) have argued that the Finance Board should not give the FHLBs the power to nominate their own public interest members. In a December 15<sup>th</sup> letter to the Finance Board, Frank and Kanjorski wrote, “The nomination and appointment authority remain entirely with the Finance Board. ...The Finance Board should continue to consider qualified individuals from a number of sources. It should not ignore the statute and simply permit the Federal Home Loan Banks to essentially pick their own public interest directors.” In an interview with *American Banker*, Finance Board director Geoff Bacino said, “The original intent with the provision was a concern on our part that someone doesn't just send one name expecting that person to get on. We still maintain control over picking the directors. We can send them back or we can pick our own people -- we still have that option.”
- The Finance Board also voted to approve for public comment a proposed rule, establishing the permissible financial interests that may be held by an appointed director. The proposal includes provisions related to acceptable contractual relationships between an appointed director and a member of an FHLBank. The Finance Board will accept public comments on the proposal for 45 days following the rule's publication in the *Federal Register*. (*Federal Housing Finance Board Press Release*, 03/27/07; *American Banker*, Steven Sloan, 03/28/07)

FHLBs submit 10Ks to the SEC and declare dividends

- In its 10K filing with the SEC, the FHLB-San Francisco reported net income of \$542 million for fiscal year 2006, 46.9% higher than its FY2005 earnings of \$369 million. During the year, the Bank's total assets grew 4.8% to \$244.9 billion. Members increased their outstanding advances at the Bank by \$20.8 billion (12.8%) to \$183.7 billion. At December 31, 2006, the Bank reported total capital of \$10.8 billion, representing 4.44% of total assets. On that date, the Bank's duration gap was positive one month, unchanged from the prior year. Based upon information available to date, the FHLB-San Francisco has projected a 5.18% dividend for the first quarter of 2007, which will be finalized at the end of April when the Bank's financial results are available. (*BusinessWire*, 03/29/07; *Form 10K*, Federal Home Loan Bank of San Francisco, 03/30/07)
- The FHLB-Des Moines reported net income of \$89.4 million for fiscal year 2006, down more than 59% from \$221.2 million in 2005. On December 31, 2006, the Bank's assets totaled \$42 billion, down approximately 8.1% from Bank's total assets (\$45.7 billion) at year-end 2005. The Bank's advance portfolio decreased 2.0% to \$21.9 billion at year-end 2006. On March 26<sup>th</sup>, the board approved a cash dividend of 4.25% per annum for the three month period ended November 30, 2006, payable March 28<sup>th</sup>. (*FHLB-Des Moines E-Newsletter*, March 2007, Volume 1; *FHLB-Des Moines Press Release*, 03/26/07)
- The FHLB-Atlanta's board of directors has approved an annualized dividend rate of 5.90% for the first quarter, payable to members at the close of business on April 2<sup>nd</sup>. (*FHLB-Atlanta Press Release*, 03/22/07)
- The board of directors of the FHLB-Dallas has declared a stock dividend for the first quarter of 2007 at an annualized rate of 5.25 percent, payable March 30<sup>th</sup>. On April 30, 2007, the Bank will repurchase the portion of members' excess stock identified as surplus stock as of that date. Surplus stock is currently defined as the amount of capital stock held by a member that exceeds 105 percent of its minimum investment requirement. (*Prime Newswire*, 03/29/07)

Representative Tim Holden (D-PA) announces FHLB-Pittsburgh's housing grants

- Representative Tim Holden (D-PA) announced that the FHLB-Pittsburgh has awarded \$370,000 in grants through the Bank's Affordable Housing Program for new housing for the elderly, very-low income individuals with disabilities, and a low-income Habitat for Humanity homeowner. (*FHLB-Pittsburgh Press Release*, 03/19/07)

## *Ginnie Mae*

“End the mortgage fine-print horror” by passing FHA reform,  
argues HUD secretary Alphonso Jackson

- In a March 18<sup>th</sup> editorial in the *Wilkes Barre Times Leader* [PA], HUD Secretary Alphonso Jackson wrote, “There is a worrisome trend affecting the housing market nationwide - one that has rightfully garnered the attention of lawmakers, regulators, real estate professionals and, most important, homebuyers. Too frequently families with less than perfect credit are resorting to high-priced, high-risk exotic mortgage loans to purchase a home. These risky mortgages carry extraordinarily high interest rates, and in many cases, hidden payments. More important, these risky mortgages illustrate a famous saying similar to caveat emptor (Let the buyer beware): Read the fine print. ...Families who want to share in the dream of homeownership, but have less than perfect credit, need and deserve a safer alternative [to subprime mortgages]. Fortunately, help might soon be on the way. [HUD] is working to modernize the Federal Housing Administration to meet the needs of today’s homebuyers.”
- “With bipartisan congressional support, the FHA can regain its stature as a stabilizing force for homeowners. I am hopeful Congress will soon reintroduce legislation that modernizes the FHA by updating FHA’s products to meet the needs of today’s homebuyers. With this legislation, no longer will Americans with less than perfect credit think the subprime market is their only choice for obtaining a mortgage. FHA modernization legislation will increase homeownership opportunities for millions of Americans by offering them safe homeownership options at a fair price.”
- “For buyers with sufficient income to make mortgage payments but without the funds for a down payment, FHA-backed mortgages would eliminate the current 3 percent down requirement and instead offer flexible low downpayment options. For borrowers with impaired credit, but with funds for a substantial down payment, FHA would offer fair mortgages products at more affordable rates. And for borrowers who live in high-cost real estate markets, the FHA would increase its loan limits.”
- “Minority Americans, who tend to have a much lower homeownership rate than other groups, would benefit the most from our efforts to modernize the FHA. The minority homeownership rate is at a historic high of 51 percent, and it could grow even higher if Congress passes our proposal. Studies show 40 percent of blacks and 23 percent of Hispanic homeowners pay interest rates 3 percent above market. This legislation would give these groups a new layer of protection.”
- “...By modernizing the FHA, we can help millions of Americans share in the dream of homeownership and prevent millions more from falling victim to predatory lenders who hide important details in the fine print. The new FHA will ensure homeownership is accessible, affordable, and safe for all.” (*Wilkes Barre Times Leader* [PA], Alphonso Jackson, 03/26/07)

- In a March 26<sup>th</sup> editorial, *National Mortgage News* wrote, “When one door shuts, another one opens, and the woes of the subprime mortgage industry mean a shot at new life for the Federal Housing Administration. ... Last year, an FHA reform package passed the House of Representatives overwhelmingly but failed to move through the Senate and so expired at the end of the last Congress. A new Congress should move quickly to send the same or similar legislation through to the president’s desk, and he should sign it. An improved FHA will help cushion the market from some of the sting of the imploding subprime sector. (*National Mortgage News*, 03/26/07)

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| <p>Democrats propose comprehensive FHA reform bill</p> |
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- Representatives Maxine Waters (D-CA), Chairwoman of the Subcommittee on Housing and Community Opportunity, and Barney Frank (D-MA), Chairman of the Financial Services Committee have introduced the “Expanding Homeownership Act of 2007” to revitalize and modernize the FHA. Specifically, the bill would (1) increase loan limits in high cost areas of the country like California, New York, and Massachusetts, where FHA has been driven from the market; (2) authorize zero down and lower down payment FHA loans for homebuyers who could not otherwise make the down payment required under current FHA rules, to make FHA more consistent with other private sector loan products; (3) direct FHA to underwrite to borrowers with higher credit risk than FHA currently serves that are still creditworthy to take out a mortgage loan, but are otherwise now being driven into the subprime loan market, with higher mortgage rates; and (4) permanently eliminate the current statutory volume cap on FHA reverse mortgage loans to permit this program to meet the growing needs of home equity-rich and cash-poor senior citizens that need help paying bills or needed home costs.
- In addition, the bill includes a number of important changes to the reform bill passed by the House last year. First, it eliminates the fee hikes from last year’s bill for borrowers that continue to make a down payment, scaling back the maximum upfront fee from 3% to 2.25%, and the maximum annual fee from 2% to 0.55%. These reductions would reduce FHA closing cost premiums for the purchase of a \$300,000 home by \$2,250, and annual fees over a five year period by over \$20,000, compared to the bill enacted last year. The bill also adds a number of homebuyer protections for families taking out riskier zero down payment loans, and for borrowers who represent a higher credit risk. Specifically, the bill gives HUD authority to require pre-purchase counseling for riskier borrowers, requires a number of disclosures spelling out the costs and risks of zero down and lower down payment loans, and provides a borrower “opt-in” to receive notice of availability of counseling in the event a borrower falls behind in their loan payments. Finally, the bill includes a provision authorizing loan limit increases for FHA rental housing loans in high cost areas, where current FHA loan limits do not keep pace with local construction costs.

- Waters said, “There is growing evidence about the perils of the subprime lending market and the rise in foreclosures, with estimates as high as 2 million mortgage loan defaults predicted by year’s end. Without a viable FHA, many low and moderate income borrowers are left with few safe and viable mortgage options.” (House Financial Services Press Release, 03/29/07)
- Affordable housing advocates are demanding that Congress do more to help subprime borrowers. “As this crisis worsens, mortgage tsunamis will ravage working class neighborhoods across this country,” said John Taylor, president of the National Community Reinvestment Coalition. Taylor advocates having FHA intervene with these endangered homeowners through the use of a “national rescue fund.” Senator Christopher Dodd (D-CT), chairman of the Senate Banking Committee, told *Bloomberg News* that Congress providing a few billion dollars to help address this problem “may be a lot less costly” than the \$164 billion in lost wealth to foreclosures on subprime mortgages. However, Rondal Utt, a senior research fellow at the Heritage Foundation, argues that an expanded role for FHA is unwarranted. “One could only marvel [when Congress] sees a disaster sweeping through financial markets and tries to figure out how to be a part of it,” said Utt. Lowering the FHA’s minimal down-payment requirements would attract borrowers “who are living on the edge” which would put the entire program at risk, Utt added. (*Investor’s Business Daily*, Jed Graham, 03/20/07)
- House Financial Services Committee chairman Barney Frank (D-MA) opposes the Bush administration’s proposal to charge risk-based premiums as part of the FHA reform bill. Instead, Frank wants to cross-subsidize mortgage insurance premiums so everyone pays the same premium. Arguing such a system is unfair, Frank proposes tapping into \$400 million in annual revenue generated by changes to the profitable FHA reverse mortgage program to subsidize the single-family premiums. “We will take a piece of that revenue, we hope, to subsidize higher loan losses for less creditworthy borrowers,” said Frank, who plans to start work on the FHA reform bill soon. At a recent meeting of the National Association of Mortgage Brokers, Senator Mike Capro (R-ID) said that he supports reforms to the FHA single-family and HECM programs, which could be a “relief valve” for the correction in the subprime mortgage market and “fill a void” in the marketplace. (*National Mortgage News*, 03/26/07)

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

FCA president and chairman Pellett tells Congress that  
FCS “is fundamentally sound in all material respects”

- On March 27, FCA president and chairman Nancy C. Pellett told a House Agriculture Subcommittee, “The FCS is fundamentally sound in all material respects, and it continues to be a financially strong, reliable source of affordable credit to agriculture and to rural America. The quality of loan assets, risk-bearing capacity, stable earnings, and capital levels collectively reflect a healthy Farm Credit System. Capital levels continued to be strong, especially when compared with the System’s risk profile. Asset quality remained high, loan volume growth was strong, and favorable credit conditions enabled the System to achieve nearly \$2.4 billion in earnings for the 12 months ended December 31, 2006. ...As of December 31, 2006, Farmer Mac’s portfolio of loans, guarantees, and standbys totaled \$7.3 billion. During 2006, Farmer Mac experienced significant growth in its outstanding portfolio of program assets.”
- “...One of the ways we have encouraged System institutions to continue their service to underserved groups and rural communities is to use the broad investment authority provided in the Farm Credit Act. FCA issued guidance in January 2005 that gave System institutions a provisional opportunity to make mission-related investments through pilot programs supporting investments in rural America. Many of the investments are made in the form of a bond or other security instrument. The pilot programs are intended to strengthen the System’s mission to provide for an adequate and flexible flow of funds, under specified conditions, to agriculture and to rural communities across the country. Further, the pilot investment programs are intended to provide FCS institutions with greater flexibility to partner with Government agencies and with other agricultural and rural lenders in fulfilling their mission objectives. Through these programs, the Agency is looking to gain a better understanding of the diverse financing needs of agriculture and rural communities and how FCS institution investments could help increase the availability and efficiency of funds to these markets.”
- “These investments include rural housing mortgage securities; bonds that provide funding for economic development; infrastructure; essential community facilities; and revitalization and stabilization projects. One program that I was particularly pleased to see is aimed at helping starter farmers or cooperatives obtain greater access to funds needed to begin or continue operations. Through a subordinated debt arrangement, the program provides investments for working capital purposes of up to \$50,000 for young and/or beginning farmers for terms of up to five years. Thus far, the program has funded a goat cheese operation, an apple orchard, and a vegetable operation. While we believe these programs are important for agriculture and rural America, I do want to make it clear that FCA is cognizant that safety and soundness must come first. We place appropriate conditions on each pilot program to limit risk

exposures, and we can revise our approval any time safety or soundness becomes an issue.” (*Statement of Nancy C. Pellett, chairman and CEO of Farm Credit Administration before the House Agriculture Subcommittee on Conservation, Credit, Energy, and Research, 03/27/07*)

FCC calls on Congress to pass legislative proposals  
allowing FCS to better serve rural American

- In testimony before the House Agriculture Committee’s Subcommittee on Conservation, Energy and Research, the Farm Credit Council proposed three “modest” legislative proposals to improve service to rural America. The group’s three point plan includes (1) providing more financing options for farm business, primarily those businesses directly dealing with producer’s needs; (2) making competitive home mortgage loans available to more rural families; and (3) modernizing Farm Credit’s ability to set cooperative stock requirements. Doug Stark, president and CEO of Farm Credit Services of America, told the panel, “For nearly 90 years, the Farm Credit System has been rural America’s customer-owned partner. Tomorrow’s agriculture – more complex, more diverse and more consumer-driven than ever before – requires more industry cooperation, community collaboration, financial support and investment, dependable infrastructure and updated public policy, in order to ensure continued success and a bright future for rural America.” (*Farm Credit Council Press Release, 03/27/07*)
- Noting that the Farm Credit Act has not had a major overhaul in 30 years, FCA president and CEO Nancy Pellett urged the panel to update the legislation to meet the changing conditions of America’s agricultural industry. Pellett told the panel that allowing the Farm Credit System to lend in larger communities would promote competition and help ensure that rural homebuyers always have access to credit. She also said that the Farm Credit Act needs to be updated to allow the FCS to do business with ag-related companies that have adopted new ownership structures, including ones that transfer control to farmers’ children. (*American Banker, Ben Jackson, 03/29/07*)
- In testimony before the panel, Jeff Greenlee, vice chairman of ABA’s agricultural and rural bankers committee, said, “The Horizons Project is really just about expanding the System. It is not sound policy, and it would set the FCS on a path that would take them further than they are today from financing agricultural producers. ... We urge Congress to reject Farm Credit’s expansion plan. ... The Farm Credit System was created to serve the credit needs of farmers, ranchers, rural home owners, farmer-owned service businesses and farmer-owned cooperatives. They should not be allowed to abandon their mission to serve such borrowers while retaining the tax, regulatory, and other special benefits. ... Congress has wisely chosen to restrict the role played by government-backed retail lenders that compete directly with the private sector, and we urge you to continue this policy.” (*The Main Wire, 03/27/07*)

Farm Credit System's loan portfolio grows 16% in 2006  
with large loans accounting for 80% of the System's growth

- In the March issue of *Farm Credit Watch*, Bert Ely wrote, “The FCS’s 2006 financial statements provide fresh insights into the competitive edge the FCS enjoys over its tax-paying, unsubsidized competitors that undermine the FCS’s arguments for its HORIZONS Project.” According to Ely, key issues and concerns about the FCS’s 2006 financial statements include (1) the System’s rapid growth in loans and assets; (2) FCS’s increased focus on large borrowers; (3) the System’s falling tax rate; and (4) the lack of ownership of the System’s retained earnings and capital.
- “...In sharp contrast with the FCS’s slow growth when it was recovering from its lending debacle in the 1970s and early 1980s, FCS growth has accelerated in recent years, especially since 2004 -- FCS’s total assets grew 30.4% in 2005 and 2006, including 16.4% last year, compared with 32.8% asset growth in the 2001-2004 period. Loans grew 28.1% in the 2005-2006 period, including 16.2% loan growth last year, reaching \$123.4 billion. Rapid growth will stress any lender, which is why the Farm Credit Administration (FCA) expressed grave concerns about that growth in a February 9 Informational Memorandum titled ‘Significant Asset Growth and Its Implications.’ The FCA noted that it had ‘observed that loan spreads and net interest margins have steadily declined in recent years’ and that ‘narrowing spreads have started to cause a decline in overall [FCS] capital ratios.’”
- ...’[M]ost of [the System’s] loan growth occurred among its larger borrowers. Last year, loans under \$1 million increased 5.7%, slightly less than the U.S. economy’s growth rate in 2006. Loans over \$1 million grew 30.5% and accounted for 80% of total FCS loan growth in 2006; those loans accounted for almost one-half (47.3%) of total FCS loans outstanding at the end of 2006. Almost half (48.9%) of FCS’s 2006 loan growth was in loans over \$5 million; they equaled 24.1% of the FCS’s outstanding loans at year-end 2006. Because many FCS borrowers, particularly larger borrowers, may have several or many FCS loans outstanding, the above data understate the FCS’s increasing focus on supplying taxpayer-subsidized credit to very large borrowers. Despite numerous FCW comments on this point, the FCS still does not report data on the size range of the amounts lent to borrowers even though it tracks this data internally. However, the AIS does report a few snippets about its largest borrowers. At end of 2006, the ten largest borrowers accounted for 2.29% of FCS’s outstanding loans, compared to 1.95% twelve months earlier. As of December 31, five FCS borrowers had outstanding loans and loan commitments falling between \$563 million and \$750 million, compared to two borrowers in this size range the year before. One FCS borrower, ‘through an acquisition,’ burst through the FCS’s voluntary \$750 million loan-limit early this year. The FCS ‘expects to reduce its exposure [to this customer] during the second quarter of 2007.’”
- “The FCS dropped its combined federal-state-local income tax rate to an all-time low of 3.37% in 2006, from 4.34% in 2005 and 5.19% in 2004 (excluding the effect of a

large loan-loss reversal in 2004). As recently as 1999, FCS's tax rate was 12.24%. Amazingly, the FCS's tax rate has declined even though its gross interest income from its tax-exempt real-estate lending dropped from 50.5% of total interest income in 2004 to 39.2% in 2006. That is, had interest, operating expense, and patronage dividends been allocated proportionally across FCS's taxable and non-taxable loans and investments, its tax percentage should have risen, not declined. Assuming those proportional allocations, the FCS's 2006 tax percentage should have been at least 13.3%, if not a few percentage points higher. The FCS's declining tax percentage reflects the increasing efficiency with which the FCS's Agricultural Credit Associations shift income into tax-exempt real-estate lending subsidiaries while shifting tax-deductible expenses and patronage dividends into taxable non-real-estate lending subsidiaries."

- "Unlike the Federal Home Loan Banks, with member-owned capital stock accounting for most of their capitalization, the FCS largely capitalizes itself with retained earnings, which have no ownership attribution. This unallocated surplus equaled 83.6% of FCS capital at the end of 2006, excluding capitalization of the FCS Insurance Fund. This unallocated capital effectively parks control of the FCS with its directors and management; many borrowers probably do not understand that they are FCS stockholders." (*Bert Ely's Farm Credit Watch*, Bert Ely, March 2007)

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| Farm Credit members provide \$50 million credit facility<br>for construction of ethanol plant |
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- On March 23<sup>rd</sup>, Green Plains Renewable Energy closed a \$50 million credit facility that the company will use to complete construction of its second 50 million gallon ethanol plant being built near Superior, IA. Farm Credit Services of American, FLCA and CoBank, along with other participating lenders, provided the credit facility to Green Plains. (*MarketWire*, 03/23/07)

## *Postal Service*

Postal reform “may impact the market in ways we have yet to fully grasp”

- In a March 28<sup>th</sup> research note, Morgan Stanley Research analysts William Green and Heeten Doshi wrote, “We attended the National Postal Forum this week and came away with the view that in the wake of postal reform legislation, the USPS may become a greater competitive threat to FedEx and UPS, especially in the rapidly growing B2C market. Longer-term, a more nimble, profit-motivated Postal Service is probably not a bad development for the marketplace. However, a Postal Service unshackled from its more restrictive regulations of the past may impact the market in ways we have yet to fully grasp. What’s New: In this report, we discuss a number of initiatives the USPS currently has underway to improve customer service and reliability. In addition, we discuss the new postal reform law which can change the way the USPS competes in the US domestic parcel segment. Implications: We see the risks from the USPS as bigger for UPS.” (*Morgan Stanley Research*, William Green and Heeten Doshi, 03/28/07)

*Nothing* lasts forever

- In a March 30 editorial, the *Midland Daily News* [Midland, MI] wrote, “Tired of rising prices for stamps? The ...Postal Service claims it has a solution. First-class postage rises to 41 cents on May 14. A month earlier, on April 12, the same price will buy a ‘forever’ stamp emblazoned with the Liberty Bell. It is supposed to remain valid for sending a letter, well, forever, regardless of how much rates go up in the future. It is a lovely idea in theory. Some of us still have 1-cent and 2-cent stamps from one of the last go-rounds. It’s not the buying of the odd-price stamps to make up the difference that is the real grind, though. It’s that postage keeps going up, like gas and milk and virtually everything else we buy. It’s an unfortunate fact of life. This is what makes us suspicious of ‘forever.’ You only have to be in your 40s to remember when stamps were 10 cents. Decades from now when first-class postage costs 75 cents, will these ‘forever’ stamps still be accepted? According to the postal service, they will be. If you have the inclination to lay in a large supply, go ahead and take that bet. We’re not buying. (*Midland Daily News*, 03/30/07)

Latest postal rate increase may do “permanent damage” direct mail industry and USPS

- In *DM News*, postal commentator Cary Baer wrote, “The Governors of the U.S. Postal Service have approved the Postal Regulatory Commission’s proposed 7.6 percent average rate increase. The PRC’s recommendation was one of its first acts under its new mandate. However, the rate increase has the possibility of doing permanent damage to commercial postal users and therefore the U.S. Postal Service

itself. The commissioners and their staff just don't understand the damage they may have done to the postal service and the direct mail industry." (*DMNews.com*, Cary Baer, 03/30/07)

- Dan Blair, the new chairman of the Postal Rate Commission, said that the PRC hopes to expedite its reconsideration of certain rates based on the Postal Service's Board of Governors' rate decision announced March 19. Blair said, "The [USPS] will be filing a document outlining possible proposals for how they would like us to look at [the reconsidered rates], and from there we will establish a process. We expect that to happen soon -- even this week. This will be intended to make the process move quickly and efficiently so we can get back to what is on our plate, which is establishing a new system." (*DMNews.com*, Melissa Campanelli, 03/28/07)

#### The USPS does its part for the war on global warming

- According to an agency press release, the Postal Service, which has a "long history of exploring cleaner, more energy-efficient, and more cost-effective ways to deliver the nation's mail," has acquired the nation's largest fleet of alternate-fuel vehicles--some 38,000 cars, trucks and minivans--powered by electricity, compressed natural gas, liquid propane gas, ethanol (E85), biodiesel fuel, and hydrogen fuel cells. (*PR Newswire*, 03/28/07)

## TVA

#### S. 864 will protect consumers' rights from the monopolistic TVA

- In a March 25th editorial appearing in *The Tennessean*, Senator Jim Bunning (R-KY) said he was co-sponsoring The Access to Competitive Power Act of 2007 (S. 864) to preserve consumers' rights from TVA's monopoly over local communities. Bunning wrote, "My issue with TVA is fairness. TVA has served an important role in the Tennessee Valley. It brought electricity to the rural Southeast and for many folks it is a part of daily life. But somewhere in the last 75 years, TVA has changed from a public works project into a utility giant with a monopoly over our local communities."
- "Let me be clear: I do not want to dismantle the Tennessee Valley Authority. I simply want TVA to be an honest and fair company that is subject to similar rules as other utilities. Right now, if TVA wants to build a high-voltage power line through a community, there is no one to protect the rights of the consumers. Other utilities have to get permission from the Public Service Commission or Federal Energy Regulatory

Commission (FERC), which conduct an independent evaluation of the costs and benefits to local residents. While I rarely believe that more government regulation is a good thing, I believe that TVA can no longer be both judge and jury. The people of Kentucky, Tennessee and the rest of the valley deserve the right to appeal decisions they believe are unfair. That is why I introduced legislation with Senator Mitch McConnell.”

- “...There are three parts to my bill. First, it would provide FERC jurisdiction over TVA’s transmission services. This will have no impact on TVA’s power generation services. TVA will charge a fee to those who use this transmission service. This means existing customers will not have to pay for those who leave the system. My legislation does not set rates or terms of service; it simply provides distributors the right to appeal to FERC if they feel TVA is not negotiating fairly.”
- “Second, the bill would put into law the specific rights of TVA customers who choose to leave the TVA system. I initially believed that these customers’ contracts with TVA would be enough, but I have seen TVA negotiate firsthand. Unless a basic level of protection is written into law, TVA will use every maneuver it can think of to prevent customers from leaving its network. Local distributors should have the right to pay to use TVA power lines, to buy a portion of their power from TVA and to buy from the Southeastern Power Administration.”
- “Third, it requests the Government Accountability Office to conduct two studies on the TVA, one on the impact of privatizing the system and the other on the staggering \$25 billion debt level. As TVA moves forward in developing a strategic plan, I think it is important that we all have a complete picture of TVA. I believe TVA could turn its financial situation around, but it will first have to face the harsh reality of its out-of-control debt. I would think TVA would want this information, as it has previously discussed bringing down the fence and providing power to a larger area. These studies would help prepare for that possibility.”
- “The overall goal of my legislation is fairness. I believe the people of Kentucky, Tennessee and the rest of the valley should have fair access to TVA services and a reliable electric grid.” (*The Tennessean*, Senator Jim Bunning, 03/25/07)

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| S. 864 “would destroy the TVA we know” |
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- The Access to Competitive Power Act of 2007 (S. 864), introduced by Senators Jim Bunning (R-KY) and Mitch McConnell (R-KY), has caused a public furor, particularly in the neighboring state of Tennessee. In a March 25<sup>th</sup> editorial in *The Tennessean* [Knoxville, TN], Senator Lamar Alexander (R-TN) wrote, “I am disappointed that Kentucky’s two United States senators (with whom I usually agree) have introduced legislation that would destroy the Tennessee Valley Authority as we know it. Their bill ...would put TVA’s transmission lines on the chopping block and sell them, and put TVA on a path toward deregulation, privatization and sale of its

other assets. Specifically, the bill would require the TVA to allow its transmission system to be used by others at the expense of existing customers. It would also place the TVA under the jurisdiction of the Federal Energy Regulatory Commission, and require studies on its debt level and the potential for privatization or sale. Such deregulation is usually music to Republican ears, that is, until you take a look at what deregulation has been doing to electric rates across America. ... TVA's new board of directors is in the midst of developing a new strategic plan for its future. The most important decision will be whether there is good reason to change TVA's autonomy and its geographic service area. I hope my Kentucky colleagues will give the new board the opportunity to decide whether so-called 'deregulation' would result in unreliable power, higher electric rates and fewer good jobs. Doing so would be best for Tennesseans; and, in the long run, it might be for Kentuckians, too." (*The Tennessean*, Senator Lamar Alexander, 03/25/07)

- In an editorial addressing this issue, *The Tennessean* wrote, "The Tennessee Valley Authority was established to provide low-cost energy for a large region, and it has done exactly that. It would be senseless to undermine such a success story. ...TVA is operating with a new, nine-member board, which replaced its previous three-member format. It continues its mission of providing power and promoting economic development. TVA also has environmental and conservation responsibilities. Granting special provisions in Kentucky is a threat to the larger benefits of the system. The plan to study privatization is a clear indication of where TVA's critics think it should be going. The expressed intention of studying TVA's debt, currently \$25 billion, is a tip-off of the intent of the study. TVA, established in 1933, and currently serving about 8.6 million customers with 158 distributors, serves a valuable purpose. Any move that could signal the dismantling of that system would be bad for the many customers who have benefited so long from the system." (*The Tennessean*, 03/25/07)
- In a March 20<sup>th</sup> editorial, the *TimesDaily* [Florence, AL] wrote, "The latest attempt to dismantle the Tennessee Valley Authority is coming from within its borders -- and it's a deeply misguided attempt. ...Senators Jim Bunning (R-KY) and Mitch McConnell (R-KY) ...have introduced bills in Congress that would authorize a study to privatize the 8.6 million customer federal utility and establish the "Access to Competitive Power Act," which they say would give customers choices for cheaper electric power. Their bills are inherently flawed in that they would allow customers to buy power outside the TVA service area. TVA, however, is prohibited by federal law from selling power outside its seven-state service area in the Southeast. By allowing private companies to sell electricity inside TVA's territory, a 'cherry-picking' scenario would be created, undermining TVA's ability to compete. And experience suggests they are on the wrong track. So far, where electricity generation has been deregulated, rates have increased and reliability has not improved. There have been few bargains for customers in the hurly-burly of deregulated trade. ...Senator Lamar Alexander (R-TN) is chairman of the TVA Caucus, and he has signaled his intent to block the legislation. We support his efforts."

- “Bunning and McConnell appear to be working from local politics: two Kentucky power companies have given notice to TVA that they will be severing their ties to the agency and buying electricity elsewhere. One of the electric companies has invested in a private coal-burning power plant. Because TVA requires those leaving the system for private sources to build their own transmission systems, the cost can be hefty. It appears the Kentucky senators want to break TVA for two comparatively small power providers.”
- “TVA still has some of the cheapest electricity rates in the country, though it is burdened with a debt of \$25 billion. The senators’ bills do little to address the debt, which ultimately would be placed on the steps of the federal government if TVA is dismantled. The debt was incurred mostly from an overly ambitious nuclear plant construction program in the 1970s and from Congress’ decision in the 1950s to stop subsidizing power operations.”
- “TVA certainly has its faults, but selling it off to the highest bidders won’t improve the quality of life in its service area.” (*TimesDaily*, 03/25/07)
- In a Letter to the Editor, Matt Collins wrote, “Should Tennessee Valley Authority be studied for privatization? Absolutely. Private enterprise is more innovative and cost effective than government operations with few exceptions. Also private enterprise has incentive to generate a profit — not become a money pit. Non-governmental entities that run a continued deficit go out of business. They are also able to adapt to technological advances and market fluctuations quicker than the government. (*The Tennessean*, Matt Collins, 03/25/07)

#### TVA’s chief nuclear officer announces retirement

- Karl Singer, the chief nuclear officer and executive vice president for TVA, plans to retire from TVA in this summer. Singer says he will stay with TVA for an interim period to assist with the transition to a new chief nuclear officer. Preston Swafford, TVA’s current senior vice president for nuclear support will assume responsibility for nuclear operation, while Singer will concentrate on the restart of Browns Ferry Unit 1 scheduled for May 1st. Singer, who joined the agency in 1993, has served as TVA’s nuclear chief since 2004. (*WRCBTV News*, Chattanooga, TN, 03/30/07)

#### TVA makes headway in reducing pollution from its plants

- Over the past ten years, TVA has reduced its emissions of sulfur dioxide from its plants by more than 46% to 453,000 tons in 2006 and reduced its emissions of nitrogen oxides by 60% to 200,000 tons last year. As result of TVA’s installation of scrubbers and other pollution-control technology, the agency’s interim CEO Skip

Orser said, “Air quality has been improving in both states since the mid-1990s and will continue to improve.” (*Asheville Citizens-Times*, Clarke Morrison, 03/23/07)

TVA holds negotiations with its distributors on shared-ownership of a power station

- The TVA is holding discussions with its 159 power distributors regarding ways to share the cost of a gas-fired combustion turbine power plant in Gleason, TN. Through a partnership with its distributors, the agency is seeking ways to minimize its use of debt and provide its partners ownership in a TVA power station for the first time in the utility’s history. TVA also announced the introduction of a new summer pilot program called “time-of-day” pricing, which will provide residential customers a price break if they agree to let their utility remotely adjust their thermostat during peak hours. The five TVA distributors participating in the program will allow up to one thousand customers in each location to sign up for the program. (*Associated Press*, 03/30/07)

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