

# The **GSE** REPORT™

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## ***Major Events***

*Reforming mortgage lending... and its (unintended) consequences:*

House Financial Services Committee passes wide-ranging mortgage reform legislation

H.R. 3915 will hurt—more than help—consumers

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A Sarbox for Housing

Freedom *works*

House Financial Services Committee passes wide-ranging mortgage reform legislation

- By a vote of 45-19, the House Financial Services Committee passed a wide-ranging bill (H.R. 3915) which will reform the way in which mortgage loans are offered, securitized and regulated. The legislation would set minimum standards for all mortgage loans, which require lenders to ensure that the borrowers have a “reasonable ability to repay” their loans and receive a “net tangible benefit” from refinanced mortgages. The bill would [allegedly] provide certain safe harbor protections for lenders who meet certain underwriting standards when making subprime loans. H.R. 3915 also would require mortgage brokers be licensed and registered in the Nationwide Mortgage Licensing System and Registry, prohibit lenders from being compensated for steering borrowers toward certain high-cost products, and assign some limited liability to secondary market investors that finance certain subprime loans.
- Chairman Barney Frank (D-MA) secured the support of ranking member Spencer Bachus (R-AL) and Representative Judy Biggert (R-IL) through [alleged] compromises made in the 121-page manager’s amendment to H.R. 3915. Provisions in the manager’s amendment which attracted Republican support included (1) the establishment of liability standards for mortgage securitizers on a national basis, thus pre-empting state laws; (2) the creation of safe-harbor provisions to protect mortgage securitizers from liability if they meet certain due diligence requirements; (3) a limitation on the amount of time that a borrower would have to bring a liability claim against a securitizer or lender; and (4) the establishment of a regulatory role for federal regulators, including the Federal Reserve, to revise some of the safe harbor provisions dealing with minimum standards for mortgages.
- The panel rejected an amendment proposed by Representative Richard H. Baker (R-LA) and supported by the lending industry, which would have made the bill’s

provisions pre-empt tougher state mortgage laws for seven years. Instead, H.R. 3915 provides a federal “floor” for mortgage requirements and allows states to establish more stringent regulations, which may result in a patchwork of regulations that will be difficult for lenders to cope with. Amendments by Representative Steve Pearce (R-NM), which would have removed a section barring payment of incentives based on the type of loan a subprime borrower chose, and by Representative John Campbell (R-CA), which would have remove language establishing liability for mortgage securitizers, were defeated by the panel.

- H.R. 3915 leaves unresolved the following issues of (1) to what extent the legislation would pre-empt state consumer laws; (2) how far the bill would go in restricting incentive compensation; (3) how lenders would have to treat occupied rental properties that are foreclosed; (4) and what additional loans would be included under the Home Ownership and Equity Protection Act’s high-cost protections. These issues will likely be addressed during a floor debate of the bill in the House, which may occur as early as November 14. The issue of pre-emption is of prime concern to the financial services industry. H.R. 3915 [allegedly] only establishes pre-emption in a section that creates limited liability for securitizers that package loans in the secondary market. During the committee markup, Baker argued that the bill should go further to create a national standard for all provisions. “I believe that the reforms with regard to origination and lending are quite appropriate, worthwhile, and strong enough in reform to be the law of the land,” Baker argued. In response, Frank countered, “The preemption issue is a very difficult issue. There are arguments for strong national standards in some instances, but there are other instances where it would be a mistake to announce that we would take away the powers of the states.” While Baker’s amendment failed on a voice vote, it was clear that lawmakers expected the issue to be subject to further debate.
- Chairman Frank said, “It is important that this bill come to the floor. We have a national crisis to which we have to respond.” While significant Republican support in the House should build support for the bill in the Senate, Frank acknowledged that it was unlikely that the Senate would act on the measure before year-end. While Senate Banking Committee Chairman Christopher Dodd (D-CT) has said he is working on a similar bill, to date Dodd has only submitted a statement of principles on anti-predatory lending. It is unclear if Chairman Dodd is prepared to move legislative package during the remaining weeks of the 2007 legislative calendar.
- H.R. 3915 received qualified support from consumer advocates, who argued that the states be given greater flexibility to provide enhanced consumer protections. The mortgage finance industry expressed great disappointment that H.R. 3915 would not establish a single national subprime lending standard. The Mortgage Bankers Association has said it favors legislation that would not require lenders to observe different consumer protection standards in each state. MBA Chairman Kieran Quinn said, “We cannot support a bill which does not provide broad national uniformity in the fight against predatory lending. We want a clear, national standard for lenders to adhere to and for consumers to hold lenders accountable to.” Floyd E. Stoner,

executive director of congressional relations and public policy at the American Bankers Association, said, “[The ABA] neither supported nor opposed the bill.” He added, “[His organization would] continue to work with the committee as the legislation goes to the floor. . . . We hope to see some additional modifications.”

- At a joint news conference, New York governor Eliot Spitzer and state attorney general Andrew Cuomo harshly criticized the federal government for its inaction to combat mortgage loan abuses and said they plan to oppose federal preemption concerning the supervision of the mortgage industry. Como said, “Federal preemption is a battle that we have to win. It is an absurd position for the federal government to stand up and say, ‘We don’t need the states participating in this issue,’ when the federal inaction . . . created the problem in the first place. We must step in.” In letters to leaders of the House of Representatives and Senate, Spitzer and Cuomo said that any laws adopted to change the mortgage lending process must “preserve the role of states and state law.” (*Bureau of National Affairs*, Stephen Joyce, 11/09/07; *Bureau of National Affairs*, Richard Cowden, 11/08/07; *American Banker*, Stacy Kaper, 11/07/07; *Wall Street Journal*, Damian Paletta, 11/07/07; *CQ Today*, Benton Ives, 11/06/07; *Dow Jones International News*, Damian Paletta, 11/05/07; *Dow Jones Newswires*, Chad Bray, 11/08/07)

#### H.R. 3915 will hurt—more than help—consumers

- In dissenting views filed in the House Committee on Financial Services’ Committee Report on H.R. 3915, certain Republican members of the House Financial Services Committee wrote, “. . . [W]e continue to have very serious concerns about the bill, even as revised, and believe that it will hurt rather than help the consumers for which it is intended to provide relief. Never before have we adopted such far-reaching government restrictions and limitations on loan terms and products and underwriting decisions in the private market, that affect the ability of thousands of this country’s borrowers to obtain a mortgage loan to finance or refinance their home. While the bill’s breadth will affect the mortgage markets serving all segments of our society, its negative impact on the availability and affordability of credit to those borrowers, including minority borrowers, with blemished credit histories, will be most dire. . . . H.R. 3915 will drastically limit options for consumers, precisely at a time when the markets are already tightening, by imposing stringent restrictions, many of which are subjective, on loans that may be made, and creating severe liability for any lender that makes a loan that might be viewed as outside of those restrictions.”
- "Among our major specific concerns with H.R. 3915 are the following:"
  - **“Highly Subjective Duties and Standards.** The bill creates federal duties for loan originators that are highly subjective, and thus difficult to define for purposes of compliance and potential liability. We remain concerned that any federal duty requiring a loan originator to identify loan products that are ‘appropriate’ for the consumer, including those having a ‘net tangible benefit’ necessitate a determination whether the loan is suitable for the borrower. This type of standard

can always be second-guessed, and should be determined by the borrower, after disclosure of the loan terms, not by the originator who is not the agent of the borrower...”

- **“Rebuttable Presumption.** The bill creates a presumption that qualified safe harbor loans (those that meet a number of restrictions) will have a ‘reasonable ability to repay’ and a ‘net tangible benefit,’ but that presumption is rebuttable. As a result, there are no safe harbors to ensure lenders in advance of making a loan that the loan is compliant and thus insulated from challenge...”
- **“Excessive Potential Liability.** The bill creates excessive potential liability for creditors for compliance with the bill’s numerous requirements. In addition to a potential liability of three times the total amount ‘of direct and indirect compensation or gain accruing’ in connection with the violation, which arguably includes all interest and fees, the bill creates an extended rescission right for up to 6 years for certain adjustable rate loans, and potentially allows class action rescission claims against creditors for vague and subjective standards.”
- **“Other Restrictions on Loan Terms,** The bill contains various provisions that prohibit or severely restrict loan terms that consumers today use to their benefit, including: arbitration, which is often fast, fair and affordable relief to consumers, who choose not to go to court; and yield spread premiums, on higher cost loans, which has been a valuable mechanism for borrowers to finance upfront broker compensation rather than pay it at closing. While these mechanisms clearly must be fully disclosed and chosen by a consumer, outlawing them simply restricts the potential pricing package that consumers may choose.”
- **“Intrusion into Internal Company Compensation Structures.** The bill’s prohibition on all types of ‘incentive compensation’ is overbroad, pushing government regulation into companies’ internal operations and incentives. We are not aware that the federal government has attempted previously to regulate that intrusively in American business, whether in the financial industry or in any other industry. This unprecedented incursion into the internal operations and incentives of companies is a major departure from U.S. law, both as traditionally applied to lenders and as currently applied to every other industry. Lenders use incentive compensation for numerous legitimate purposes, including aligning employees’ incentives with their company’s incentives, ensuring that the company can obtain specific products when necessary to meet the terms of required loan sale commitments, when the company wants to readjust its portfolio to meet new strategic or risk objectives, and other purposes.”
- **“Expansion of HOEPA.** Title III’s lowering of the HOEPA thresholds, and including many additional items in the ‘points and fees’ calculation, would result in far too many loans falling under HOEPA restrictions. Very few lenders have any appetite for making HOEPA loans, so in effect this would result in the

establishment of a low usury ceiling and one that would unintentionally cause many loans to be unsaleable.”

- “The combination of the bill's expansion of HOEPA, the subjective standards applicable to the loan origination and underwriting process, and the vastly increased liability will greatly reduce mortgage lending, other than to those borrowers with pristine credit records and substantial downpayments. ...The Federal Reserve Board issued a credit scoring study in August that indicated that members of certain minority groups have, on average, substantially below-average credit scores. If that study is an accurate reflection of the credit scores of the overall population, we are very concerned that the reduction of lending that we foresee as a result of the bill will have particularly negative effects on minority applicants and communities. It would be a true shame if this bill, meant to protect American consumers, were to have the effect of making mortgage credit unavailable to many deserving borrowers who want a piece of the American dream.” (*Dissenting Republican Views on H.R. 3915*, Filed in the Committee on Financial Services’ Committee Report on H.R. 3915, November 9, 2007)

#### Regulatory over-reaction—again

- On *TCS Daily*, Desmond Lachman wrote, “Barney Frank’s ...mortgage reform bill demonstrates yet again Congress’ penchant for indulging in regulatory over-reaction to crises without addressing their underlying causes. Sadly, it also underlines how little Congress seems to have learned about the costs of past excessive market regulation. This is particularly disappointing coming as soon as it does after the Sarbanes-Oxley fiasco, which was Congress’ costly knee jerk reaction to the WorldCom and Enron crises.”
- “One can hardly take issue with the stated motivation of Mr. Frank’s mortgage reform proposal. After all, who could seriously object to legislation that purportedly aims ‘to combat abuses in the mortgage lending market and to provide basic protection to mortgage consumers and investors’? This is especially the case against the backdrop of US foreclosures now set to top a staggering 2 million homes in 2008. It is also the case considering that global financial markets are still reeling as a result of ever-mounting losses on a mountain of ill-advised sub-prime lending.”
- “One must take issue, however, with Congressman Frank’s fundamental approach to averting any recurrence of the sub-prime mortgage debacle. For rather than seeking to harness market forces and correct market failures, he chooses to rely exclusively on a regulatory approach to the problem. He does so seemingly disregarding the dismal record of past efforts down this well trodden path. Mr. Frank plans to rely on regulation in three distinct areas. First, he proposes the establishment of a federal duty of care aimed at prohibiting steering and at requiring the registration and licensing of all mortgage originators, including brokers and bank loan officers. Second, he advocates the setting of a minimum standard for all mortgages, which would require that borrowers must have a reasonable ability to repay. And third, he

seeks to attach limited liability to secondary market securitizers, who package and sell interest in home mortgage loans outside of these standards.”

- “The proposed heavy reliance on regulation to prevent any future recurrence of the sub-prime problem is curious to say the least. Was not a principal cause of today’s sub-prime lending crisis precisely the fact that the regulators in general, and the Federal Reserve in particular, were fast asleep at the wheel as no less than US\$1.3 trillion in sub-prime loans were made between 2004 and 2006[?] Does it now really make sense to put one’s faith in the same regulators who, for whatever reason, chose to ignore blatantly abusive lending practices and the creation of a ticking time bomb for the financial system of grossly sub-standard loans that had little chance of being repaid?”
- “It might well be recalled that under the Home Ownership and Equity Protection Act, the Federal Reserve already had the authority to reign in the non-bank mortgage originators, who were the most culpable of bad lending practices. Yet, under Mr. Greenspan’s leadership, the Federal Reserve chose not to exercise that authority as mortgage lending standards progressively deteriorated. Can we have any assurance that regulators will be any better at implementing Mr. Frank’s proposed reforms?”
- “Reliance on regulation to address the sub-prime problem would seem to be particularly misguided when a more effective and market based remedy is readily at hand. Might not a more straightforward approach to mortgage reform be to harness market forces by aligning the incentives of mortgage originators with the promotion of the public good? One could do so by requiring that all mortgage originators be adequately capitalized and be forced to hold until maturity a significant portion of all mortgages that they originate.”
- “In recent years, poorly capitalized non-bank institutions originated almost 50 percent of U.S. home mortgages. Typically they sold in short order their full stake in the mortgages they originated for securitization purposes. In this originate-to-distribute model, they had little incentive to determine whether the loans they originated might perform well over the life of the loan. Rather, their sole concern was to be sure that the loan would not default during the short period that they held the loan before distribution and before they were paid their fees.”
- “By requiring mortgage originators to hold at least part of the mortgages they originate, one would be establishing powerful incentives for all originators to exercise better due diligence in making loans and to refrain from making loans to those borrowers who are most unlikely to meet the loan’s terms. Such an approach would have the distinct advantage of obviating the need for the Mr. Frank’s cumbersome regulatory approach to the problem. It would also be very much more transparent and very much less likely to interfere with the proper functioning of the US mortgage market than would Mr. Frank’s proposed remedy.” (*TCS Daily*, Desmond Lachman, 11/08/07)

## A Sarbox for Housing

- In a November 6 editorial, the *Wall Street Journal* wrote, “Throughout the 1980s and ‘90s, Congress prodded, even strong-armed, banks into making more mortgage loans to low-income and minority families. Washington enacted anti-discrimination and community lending laws with penalties against lenders for failing to issue riskier mortgages to homebuyers living in poor neighborhoods or with low down payments and subpar credit ratings. And so it was that the modern subprime mortgage market was born.”
- “Now, and for a variety of reasons, some two million of those loans have gone sour, and the same politicians are searching for villains. Leading the charge is House Financial Services Chairman Barney Frank, who is accusing banks of ‘predatory lending’ --by which he means making loans to the very group of borrowers that Mr. Frank and his colleagues urged banks to serve. [On November 6] ...Mr. Frank ...[held] a committee vote on his Mortgage Reform and Anti-Predatory Lending Act of 2007, which would impose new rules and financial penalties on subprime lenders, while providing new lawsuit opportunities for distressed borrowers. ‘People should not be lent money that’s beyond what they can be expected to pay back,’ Mr. Frank says. Now, there’s an idea. Why didn’t the bankers think of that?”
- “Mr. Frank’s proposal is a trial lawyer’s dream. It would forbid banks from signing up borrowers for ‘overly expensive loans’; require banks to make sure that the consumer has a ‘reasonable ability to repay the loan’; and insist that loans must be ‘solely in the best interest of the consumer.’ This kind of murky language would invite litigation from every borrower who misses a payment. If it becomes law we can expect to see billboards reading: ‘Behind on your mortgage? For relief, call 1-800-Sue-Your-Banker.’”
- “Also for the first time, banks that securitize mortgages would be made ‘explicitly liable for violations of lending laws.’ This is a version of secondary liability that holds the bundlers and resellers of mortgages responsible for the sins of the original lenders. The reselling of mortgages has been a boon both to housing liquidity and risk diversification. So to the extent the Frank bill adds a new risk element to securitizing subprime loans—and it surely will—the main losers will be subprime borrowers who will pay higher rates if they can get a loan at all.”
- “No one disputes that there were lending excesses during this decade’s housing revels. The Federal Reserve’s easy money policy created a subsidy for debt and fed an asset bubble that made borrowers and lenders alike think prices would rise forever. If companies or individuals committed fraud, they should be punished. Meanwhile, federal regulators have been rewriting rules to outlaw the most abusive practices, such as onerous prepayment penalties and disguised balloon interest payments.”

- “But for all the demonizing, about 80% of even subprime loans are being repaid on time and another 10% are only 30 days behind. Most of these new homeowners are low-income families, often minorities, who would otherwise not have qualified for a mortgage. In the name of consumer protection, Mr. Frank’s legislation will ensure that far fewer of these loans are issued in the future.”
- “All of this would also hit banks when they and their shareholders are already being punished in the marketplace. The stock values of financial companies have taken a beating and executives are losing their jobs. Lenders are fleeing the subprime market, and the pendulum has swung to the opposite extreme as banks have tightened credit, which is contributing to the mortgage meltdown.”
- “The latest housing data indicate that new home sales are down 23% from a year ago, with the biggest retrenchment in the subprime market. The volume of subprime securities was down a whopping 70% to \$15 billion in the third quarter from \$62 billion one year ago. Originations of the controversial subprime ARMs are down by 50% so far this year compared to 2006. Mr. Frank’s bill couldn’t come at a worse time, as it will further shrink credit to marginal borrowers, which will mean fewer buyers and extend the housing downturn.”
- “The Frank bill is essentially a Sarbanes-Oxley for housing, an attempt to punish business in general for the excesses of an unscrupulous few and the perverse incentives created by Washington policy.” (*Wall Street Journal*, 11/06/07)

### Freedom works

- In a November 12th opinion editorial, Star Parker wrote, “The Mortgage Reform and Anti-Predatory Lending Act of 2007 has passed out of Chairman Barney Frank’s House Financial Services Committee. It’s now headed to the full House for a vote. In the name of protecting the poor from market predators it will in actuality protect the poor from wealth. This is yet a new chapter in the grand liberal tradition that advances the illusion that government micromanagement of private lives and markets will make us better off. We already have laws against fraud and theft. But for liberals, government isn’t there to enforce the law. It’s there to run our lives.”
- “The legislation assumes that when private individuals make mistakes they can’t figure out what they did wrong and make adjustments and that even if they could they wouldn’t. We’re going to wind up with new and onerous regulations in the business of making loans to consumers for purchasing homes, and as a result, fewer loans will be made and we’ll all be worse off. Those who will be penalized the most will be the low-income families who the new regulations will supposedly protect.”
- “Should fraud be permitted in our society? No. Should government interfere with private individuals’ latitude to determine on their own what risks they wish to take and the willingness of others to finance those risks? Absolutely not. Frank’s bill

crosses far over the line into regulating private lives and behavior where he and government have no business.”

- “Why will this hurt the very low-income families it purports to protect? We already have plenty of experience with the costs of so-called consumer protection laws in general and those designed to regulate mortgage lending in particular.”
- “In a recently published article in the *Cato Supreme Court Review*, Professor Marcus Cole of the Stanford University Law School discusses the fallout of lending laws in Illinois. The Illinois Fairness in Lending Act passed in 2005 gives the state oversight authority on loans made in nine designated zip codes in the state. These zip codes are, of course, areas in which residents are mostly lower-income households. The law places authority in a state bureaucracy to review all applications for mortgages in these designated zip codes. The bureaucrats who review these applications determine if the borrower needs credit counseling and requires the lender to pay for it if required. The costs of the counseling are estimated to be as high as \$700 and can delay the processing of the loan up to a month. The borrower has no option to forego this counseling, whose objective is ‘to protect homebuyers from predatory lending in Cook County’s at-risk communities and reduce the incidence of foreclosures.’”
- “What’s the result? Cole reports the following: ‘Instead of protecting hardworking would-be homeowners from predatory lending, the new law protected them from credit. Within just a few months more than 30 mortgage lenders refused to lend on homes purchased in the targeted zip codes. Those lenders determined to service these communities saw a rise in their costs, which translated into higher interest rates on their loans.’ The purported cure was worse than the disease. Cole goes on to note that, “home sales in the designated zip codes dropped an average of 45 percent in just one month after the bill took effect. Home prices plummeted, draining relatively poor but hardworking people of what little equity they had in their homes. The experience is similar in other states where governments have authorized bureaucrats to insert themselves between lenders and borrowers. Yes, the number of defaults have declined. They have declined because the number of loans have declined.’”
- “The *Wall Street Journal* reports that currently ‘80 percent of subprime loans are being repaid on time and another 10 percent are only 30 days behind.’ These are overwhelmingly loans to low-income families. Probably, under Barney Frank’s new regulatory regime, many of these loans would not have been made and the families in these homes would be renting and considerably less wealthy than they are today.”
- “To quote former Texas Rep. Dick Armey, ‘freedom works.’ But it can only work if we let it. Many have paid and are paying a great price for the errors and excesses of recent years. We now should allow private individuals and private markets the opportunity to self correct, which is what will happen. If government steps in to preempt the market and Barney Frank is the one to decide who gets loans, the rich will stay rich, the poor will stay poor, and we’ll have one more reason for already skeptical Americans to question the American dream.” (*Townhall*, Star Parker, 11/12/07)

- On November 7, New York Attorney General Andrew Cuomo expanded his investigation of mortgage lending practices of what he calls “widespread” collusion between the real estate appraisers and lenders, by issuing subpoenas to Fannie Mae and Freddie Mac in a quest of learning how mortgage loans are securitized and sold to the public. “Today, we follow the mortgage from the primary market to the secondary market,” Cuomo told reporters. Fannie and Freddie have agreed with the attorney general’s request to appoint an independent, examination team, approved by Cuomo, to monitor the GSEs’ purchase of loans originated by Washington Mutual and The First American Corp. He told reporters that his investigation is also targeting certain investment banks, but declined to name them.
- “In order to fulfill their duty to consumers and investors, Fannie Mae and Freddie Mac must ensure that Washington Mutual’s mortgages have not been corrupted by inflated appraisals,” Cuomo said. “Our expanding investigation into the mortgage industry has uncovered that Washington Mutual improperly pressured appraisers to provide inflated values that best served the lender’s interest. Knowing this, Fannie Mae and Freddie Mac cannot afford to continue buying Washington Mutual mortgages unless they are sure these loans are based on reliable and independent appraisals.”
- Cuomo’s subpoenas will attempt to gain information about loans that Fannie and Freddie have purchased, by examining the GSEs’ due diligence process used in making loan purchases, obtaining information about originating lenders and their policies related to valuing properties, and reviewing appraisals. In his letter to Fannie and Freddie, Cuomo made it clear that his concerns extended to the GSEs. “The investment banks and GSEs may also have an interest in inflating (or at least in not questioning) the value of pooled loans,” he wrote. “The value[s] of these loans serve as a basis for the value of their securities. As such, the higher value of the loans closed, the greater the value for which the securities are sold on the secondary market.” Although the AG did not accuse the GSEs of wrongdoing, Fannie’s stock dropped 10% and Freddie’s stock slid 8.6% on the day of the announcement.
- Cuomo’s statements about the mortgage lending industry have become increasingly more “bold.” On November 7, he said there is a national “housing crisis,” in which fraudulent mortgages are “the rule and not the exception.” Cuomo has repeatedly argued that a chief component of mortgage problems is inflated appraisals of property, resulting from banks’ pressure on appraisers to inflate valuations in order for real estate deals to close. “We believe this is not a new situation. We believe people in the mortgage business knew very well that the appraisers were being pressured ... There is plenty of evidence where the appraisers have spoken up and said ‘You have to understand, we’re supposed to be independent but we’re being pressured by everyone,’ [including banks].” said Cuomo. Cleaning up the problem now will benefit the housing market over the longer term, he added. (*The Main Wire*, Margaret Chadbourn, 11/08/07; *Associated Press*, 11/07/07; *American Banker*,

Steven Sloan, 11/08/07; *Bloomberg News*, 11/08/07; *Wall Street Journal*, James R. Hagerty and Ann Carrns, 11/08/07; *Bureau of National Affairs*, Stephen Joyce, R. Christian Bruce, and Richard Cowden, 11/08/07)

- In a statement, Brian Faith, Fannie Mae managing director of communications, said, "...We are concerned about the allegations in the complaint. If true, the appraisal practices described in the complaint would violate Fannie Mae's requirements for loans we purchase from lenders or securitize. It is against our interest to purchase or guarantee mortgages with inflated appraisals, and so it is in Fannie Mae's interest that these appraisal practices be investigated. The Attorney General has indicated that he also plans to subpoena Fannie Mae for documents and testimony related to the appraisal process. We intend to cooperate fully with the Attorney General. We also will appoint, with the Attorney General's approval, an independent examiner to review the appraisal practices cited in the complaint. If the examiner determines we own or guarantee mortgages with inflated appraisals, our guide states that the lender must buy back the loans that do not meet our standards and requirements. We look forward to working with the New York State Attorney General and other regulators to support the highest lending standards for the market and homebuyers." (*Fannie Mae Press Release*, 11/07/07)
- In a statement, Freddie Mac said, "Accurate appraisals are fundamental to our effective credit risk management as well as to the long-term success of the homebuyers we are chartered to serve. In fact, Freddie Mac has no incentive to accept inflated appraisals on the loans we purchase and guarantee. Indeed, Freddie Mac has a long-standing commitment to fighting mortgage fraud, as evidenced by its leadership role in the industry through our active internal fraud investigations, quality control activities, Freddie Mac-instituted remedial steps, and assistance with criminal prosecutions. We look forward to cooperating fully with the New York Attorney General's investigation and have agreed to appoint an Independent Examiner, as requested, to review the appraisal practices cited in the Attorney General's complaint." (*Freddie Mac Press Release*, 11/07/07)
- In a November 8 letter to New York Attorney General Andrew Cuomo, OFHEO director James B. Lockhart, III expressed concern about the AG's investigation and the fact that his agency was not consulted. He also noted that Cuomo has not formally charged Washington Mutual with any wrongdoing. "I am disappointed that your office did not contact OFHEO before or even after subpoenaing the GSEs and issuing certain threats regarding their future business activity [with Washington Mutual]," wrote Lockhart. "...I feel that you and your staff may not fully understand the differences between the mortgage-backs issued by the GSEs and those issued by other entities. In particular, unlike the issuers of private label MBS, when Fannie Mae or Freddie Mac issues an MBS, they retain the credit risk on the underlying mortgages by guaranteeing repayment to MBS holders. Consequently, they have no economic incentive to knowingly purchase or guarantee mortgages with inflated appraisals. The two firms already have programs in place to prevent this and other types of mortgage fraud as well as contract terms to put back mortgages in such

situations to the primary lender.” In closing, the director wrote, “...OFHEO shares your concern that mortgage fraud, including fraudulent appraisals, be eliminated. I also recognize that the mortgage market in recent months has been subject to much turmoil. I believe that all relevant government agencies shoulder a responsibility to eliminate fraudulent and otherwise bad actors from the market while also respecting the many legitimate parties—borrowers, appraisers, lenders, and investors—trying to participate in this market during this uncertain period. We need not aggravate the latter in pursuit of the former.” (*Market News International*, 11/08/07)

- Cuomo’s office has agreed to a meeting with Lockhart, but did not signal that the Attorney General would cede any turf in his investigation. “We are well aware of OFHEO’s jurisdiction, and we are also well aware of the significant financial and fraud issues that the GSEs have faced in the recent past,” said Cuomo’s spokesman Jeffrey Lerner. “As OFHEO recognizes, our office has a legal duty and unquestioned jurisdiction to protect New York consumers and investors. Our investigation will continue to root out fraud in the industry, which we believe is in the best interests of consumers, investors, and the market.” (*Dow Jones International News*, Damian Paletta, 11/08/07)
- In *Naked Capitalist*, Yves Smith notes, “...A new front was opened [November 8] between the Office of Federal Housing Enterprise Oversight today, the body that supervises Fannie and Freddie, and Cuomo... What makes this development noteworthy is that Freddie Mac had initially signaled its intention to cooperate with Cuomo, but yesterday, the director of OFHEO, James Lockhart, issued what by bureaucratic standards is a stinging letter to Cuomo. And to add another twist, Lockhart may be the only guy in the Administration who is perceived to be highly competent, tough, and just about immune to pressure. So it’s reasonable to assume that he has legitimate grounds for going after Cuomo.”
- “... Now at first, I thought this might be mainly about Cuomo following in Spitzer’s footsteps and playing the possible fraud for maximum media effect, rather than involving OFHEO and coming up with a joint approach. OFHEO has every reason to want to get to the bottom of this, but the public at large is likely not to understand that the GSEs don’t do due diligence, and may damage OFHEO’s and/or Freddie’s and Fannie’s’ reputation unfairly. I viewed this as a concern about institutional reputation (remember, Lockhart was brought in to clean up the GSEs). But then I happened to see a *Bloomberg* story about a press conference Cuomo had on Wednesday, and now have another theory. While Lockhart may want to save OFHEO’s and the GSEs’ image, this motivation is likely secondary to a bigger and more pressing concern. Consider Lockhart’s statement: Cuomo’s office ‘may not fully understand the difference between mortgages issued by government sponsored enterprises (GSEs) and those issued by other entities.’
- “Now ponder this excerpt from the *Bloomberg* article: ‘New York Attorney General Andrew Cuomo subpoenaed Fannie Mae and Freddie Mac as he expanded his investigation into “widespread” collusion between real estate appraisers and lenders

including Washington Mutual Inc... The attorney general's investigation calls into question the value of securities Fannie Mae and Freddie Mac have guaranteed from mortgages provided by lenders. Cuomo said he discovered a "pattern of collusion" between lenders and appraisers and that he's targeting banks beyond Seattle-based Washington Mutual for potentially pressuring appraisers. "I don't believe it's just about Washington Mutual," Cuomo said at a press conference in Manhattan today. "I believe it's widespread. I believe it's the rule not the exception. And we're investigating Fannie Mae and Freddie Mac and other investment banks as to the underlying practices that have allowed this to go on for so long."

- "No wonder Lockhart is [ripped]. I would be too. Cuomo astoundingly called the GSEs investment banks, and as the article points out, raises doubts about the value of their even though they are government backed. Huh? That is likely the basis for Lockhart's 'you may not understand remark.' The last thing the securities market needs is doubts being cast on the creditworthiness of Freddie's and Fannies' paper. ... While investors have legitimate reasons to worry, the fear is becoming indiscriminate. The last thing that we need now is for relatively sound mortgage paper to become tainted in investors' eyes. That is likely the reason for Lockhart's salvo." (*Naked Capitalist*, Yves Smith, 11/09/07)
- Never one to mince his words, CNBC commentator Jim Cramer called New York Attorney General Andrew Cuomo a "communist [who] wants to shut down the mortgage market," following the AG's announcement that he was subpoenaing Fannie Mae and Freddie Mac in his expanded investigation of the mortgage market. "[W]itness the fact that right now, the most important man in America for the stock market—the most important man and I mean it negatively is this guy Andrew Cuomo, the New York State Attorney General," Cramer said. "I'm getting tired of the New York State Attorney General being the most important man in America." He added, "Cuomo's about confiscation – genuine communist. The Chinese are capitalists, we got a communist. ... Why doesn't he just destroy any opportunity we have to move the \$1.25 trillion in houses that are just sitting on the market right now? ... Can I give you the real headline? Cuomo says let's make it harder to get a mortgage, let's make it harder to lend. Is that really the intent of this Democrat who wants to be president of the universe?" (*Business & Media Institute*, Jeff Poor, 11/07/07)
- Mike Shedlock observes, "... This is why the whole flap [over Cuomo's investigation] is scaring the panties off everyone in the mortgage industry—far, far beyond any worry over stiffer appraisal regulation. The core issue here is a cornerstone of the whole 'originate and sell' model that has created such a crisis. If Cuomo's suit makes any headway at all, it will put eAppraiseIT out of business one way or the other. That's because if appraisal management companies are no longer willing or able to write these liability swaps into their contracts, they won't be able to offer what the lenders really want from them. The advantage of doing business this way isn't really about saving a few dollars on outsourcing administrative work for the lenders, it's about getting out from under a huge expensive compliance and legal risk. No wonder [Jim] Cramer's head is exploding again. This thing really isn't about appraisals, it's

about stopping the game of risk-layoff. Yes, WaMu will collapse if it has to take back those loans [sold to Fannie, Freddie and other investors], but the bigger picture is the entire 'originate and sell' model might collapse along with it. Won't that be fun?" (*Mish's Global Economic Trend Analysis*, Mike Shedlock, 11/08/07)

Fannie Mae reports \$1.4 billion loss for the third quarter and warns about FY2008
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- Fannie Mae reported a loss of \$1.4 billion for the third quarter compared to a loss of \$629 million for the year-earlier quarter. For the first nine months of 2007, Fannie Mae's net income was \$1.5 billion [\$1.17 a share], down from \$3.46 billion [\$3.16 a share] for the nine months ended September 30, 2006. On November 9, the company published 10Qs for the first, second and third quarters of 2007, returning the GSE to timely filing of its financial statements for the first time since 2004.
- Although Fannie Mae has avoided investing in many of the riskier mortgage loans made in recent years and has a modest exposure to subprime loans, company CEO Daniel Mudd said, "Fannie Mae is not immune to the challenges facing the mortgage markets." Credit expenses, related to overdue or defaulted loans, increased to \$2 billion for the nine months ended September 30 versus \$400 million for a year earlier. The company's losses were driven by declines in home prices nationwide and continued economic weakness in the Midwest. During the period, Fannie Mae also recorded \$400 million of losses on the AAA-rated securities collateralized by subprime mortgage which it held in its trading account and unrealized losses of \$900 million of its subprime and Alt-A holdings classified "available for sale." The company's expenses for foreclosed property totaled \$260 million for the nine month period ended September 30, more than triple its expense level [\$89 million] a year earlier. Fannie Mae also noted that during October and through November 8, seven of its AAA-rated subprime private-label securities with an unpaid principal balance of \$1.3 billion were put on review for possible credit downgrade or on negative watch by the rating agencies. None of the company's 300+ private-label securities backed by subprime loans are also backed by collateralized debt obligations.
- Fannie Mae says that it expects the housing market downturn to continue through 2007 and 2008, which will lead to further declines in home values and mortgage originations, as well as "pockets of disruption" in the credit markets. As of July 31, Fannie Mae estimated it had \$185 billion in adjustable-rate mortgages tied to high-risk, subprime securities scheduled to reset next year. "These resets could result in a further sharp increase in delinquency and foreclosure rates," said Fannie Mae. In a conference call to investors, Mudd added, "We expect additional foreclosures this year and next. ... We previously said that our credit loss ratio would be in the range of 4 to 6 basis points this year. That is still what we expect. Going forward, projecting a 4 percent national decline in home prices and a scenario where there is not a nationwide recession, we can see our credit loss ratio move into the range of 8 to 10 basis points next year." (*Reuters*, Patrick Rucker, 11/09/07; *Associated Press*,

Marcy Gordon, 11/09/07; *Dow Jones Newswires*, Damian Paletta, 11/09/07; *Wall Street Journal Online*, James R. Hagerty, 11/09/07)

- On November 2, Fannie Mae also published its 2006 Annual Report and began mailing its “Notice of Internet Availability of Proxy Materials” for its 2007 annual meeting of shareholders scheduled for December 14. According to the company’s SEC filing, Daniel Mudd, president and CEO of Fannie Mae, was paid \$14.4 million in 2006, roughly the same compensation paid in 2005. He received a salary of \$950,000, a \$3.5 million bonus, and restricted stock valued at \$9.9 million in 2006. Robin Levin, EVP and chief business officer, was the second highest paid officer in 2006, receiving a salary of \$750,000, a \$2 million cash bonus, and restricted stock valued at \$6.6 million. Beth A. Wilkinson, EVP and general counsel, was paid an \$800,000 signing bonus in 2006, when she joined the GSE from the law firm Latham & Watkins, LLP. (*American Banker*, Kate Berry, 11/05/07; *PRNewswire*, 11/02/07)
- During his November 5<sup>th</sup> appearance on CNBC’s *Mad Money Round*, Jim Cramer said, “I am so concerned about Fannie Mae. ...I believe the problem with Fannie Mae is ... the mortgage insurance problem. ... Basically, what I am saying is I wish Fannie Mae was able to get some of those bad loans off its balance sheet, but it can’t. ...I cannot get behind Fannie Mae right here.” During a November 2<sup>nd</sup> appearance on CNBC’s *Fast Money*, Doug Kass, founder and president of Seabreeze Partners, said he thinks private market insurance companies, like Ambac, PMI Group and MBIA, simply don’t have enough capital to keep running and reminded viewers that these firms aren’t banks and they have no access to the discount window. If the market takes out the private market insurance business, it will crush others—including Fannie Mae, Freddie Mac, and Washington Mutual. (*TheStreet.com*, Jim Cramer, 11/05/07; *TheStreet.com*, 11/02/07)

OFHEO enters into consent agreement with former Freddie Mac CEO Brendsel
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- OFHEO has entered into a consent agreement with Freddie Mac’s former chairman and CEO Leland C. Brendsel, in which the former executive agreed to pay penalties of \$13 million and to waive his claim to an additional \$3.4 million in settlement of the agency’s enforcement action against him. Under the agreement, Brendsel is required to pay a \$2.5 million fine and to disgorge previously paid salary and bonuses totaling \$10.5 million to Freddie Mac. The disgorged funds will be used “to support initiatives and programs that seek to keep distressed homeowners in their homes, subject to OFHEO approval.”
- Kevin M. Downey, Brendsel’s lead attorney, said, “Although Mr. Brendsel and OFHEO disagree strongly about what happened in the past at Freddie Mac, Mr. Brendsel agreed to a settlement because it requires that most of the money paid will be used to assist families who are threatened with the loss of their homes in the current mortgage credit crisis. ...[Brendsel] did not admit and specifically denies any liability in connection with the matters alleged by OFHEO.” OFHEO director James

B. Lockhart III, issued a statement saying the settlement “represents a satisfactory conclusion to the enforcement actions.”

- Brendsel’s case is a forerunner to a similar proceeding pending against Fannie Mae’s former chairman and CEO Franklin D. Raines, who is represented by the Brendsel’s lawyer [Kevin M. Downey] and whose case will be heard by the same administrative law judge [William B. Moran], who heard Brendsel’s case. The administrative charges against Raines are expected to go to trial in 2008. (*Washington Post*, David S. Hitzentrath, 11/07/07; *Associated Press*, Alan Zibel, 11/06/07; *Bureau of National Affairs*, 11/07/07)

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

*Capitol Hill addresses subprime mortgage crisis:*

House Financial Services Committee holds hearing on preventing mortgage foreclosures

Federal Reserve Chairman Bernanke floats a proposal  
for GSEs to play role in jumbo mortgage market

House Financial Services Committee approves bill to  
change escrow and mortgage servicing rules

Deal on mortgage bankruptcy bill “blew up”

The right long-term solution is passage of GSE reform legislation

Calls for special fund to bail out subprime borrowers continue

Concerns over the subprime fallout grow, along with fears of U.S. recession

### House Financial Services Committee holds hearing on preventing mortgage foreclosures

- House Financial Services chairman Barney Frank (D-MA) urged the Bush administration and mortgage servicing industry to accelerate efforts to stem the tide of rising home foreclosures during a November 2 hearing. “Speed is important,” said Frank. “Time is of the essence.” The chairman questioned why the administration is not backing a proposal made by FDIC chairman Shelia Bair, who urged mortgage companies to consider implementing broad based conversions of adjustable rate loans to fixed rate mortgages. Treasury Undersecretary Robert K. Steel said the administration could see benefits to a broader approach to speeding up refinancings and that the proposal was under review, but stopped short of endorsing Bair’s approach. “I think chairman Bair has provided a very good perspective on this issue,” said Steel. “I believe that she’s exactly right, that... a more systemic and standardized approach is needed.” In response to a question from the committee, Steel warned against any broad moratorium on foreclosures, saying that some expected foreclosures are “inevitable.” He added, “The reality is that there is some level of foreclosure that seems to be consistent in a normal marketplace. I think the idea of a freeze is not right at this time.”
- Steel and HUD assistant secretary Brian D. Montgomery, who heads the FHA, said the government and industry groups have stepped up efforts to contact borrowers through mass mailings, increased advertising and expanded toll-free hotlines. The

HOPE NOW alliance is mailing 200,000 letters this month to borrowers in jeopardy of foreclosure, as an initial step in an aggressive outreach effort. Steel concluded his testimony by highlighting three initiatives that the administration has asked Congress to put on the fast track, which includes (1) FHA reform; (2) a temporary elimination of taxes on mortgage debt forgiven on a primary residence; and (3) GSE reform.

- “You’re not doing enough,” said Representative Ruben Hinajosa (D-TX). “There needs to be some improvement in getting the information out.” Lawmakers agreed and pressured Steel and Montgomery to do more to help struggling borrowers. Representative Al Green (D-TX) argued that HOPE NOW needs more flexibility and chided Steel and Montgomery for being too quick to write-off homeowners who have already gone into the foreclosure process. Green said, “[The alliance] needs to find more flexibility [to work with these homeowners].” Representative Gwen Moore (D-WI) said she wanted to see fewer studies and less emphasis on the development of metrics—and more concrete results. The results I’m interested in is the number of people able to keep their homes, said Moore. After the hearing, Frank told reporters, “We need to push them to do more. There’s too much process and not enough being done. We’re just pushing people to do it, do it, do it.” (*Dow Jones Newswires*, Michael R. Crittenden, 11/02/07; *Associated Press*, Martin Crutsinger, 11/02/07; *Bureau of National Affairs*, Thecla Fabian, 11/05/07)
- Following a November 1<sup>st</sup> meeting with HOPE NOW participants, Treasury Secretary Henry Paulson told reporters that the alliance is considering a process to speed up loan modifications for some borrowers who are current on their payment at the low introductory rate. “Members of the alliance told me they are developing methods, criteria, and metrics that any industry participant can use to systematically evaluate borrowers’ ability to pay resetting adjustable-rate mortgages,” said Paulson. “For example, borrowers who are current on payments at the lower rate might be candidates for fast tracking into a refinance or a loan modification. Others who struggled even with payments at the teaser rate may not have these options.” He called on other industry participants to review their existing procedures and adopt a process to quickly identify borrowers for refinancing or modification. “Developing clear criteria now will allow us to gauge the success of these efforts in avoiding preventable foreclosures,” said Paulson. (*American Banker*, Cheyenne Hopkins, 11/01/07)
- In an interview with *Financial Times*, FDIC chairman Sheila Bair said there is a gathering political momentum for a more -radical approach than the investment and home loans industries had so far countenanced. Bair reiterated that it is in the best interest of investors and mortgage service companies that collect debt payments to adopt a wholesale approach to loan modifications before the rising social and economic costs of foreclosure compelled Congress to intervene. “The political pressure is going to mount for Congress to step in and dictate how these loans should be modified,” said Bair. “We’re asking the industry to do this voluntarily to avoid unnecessary foreclosures.” (*Financial Times*, Eoin Callan, 11/09/07)

## Federal Reserve Chairman Bernanke floats proposal for GSEs to play role in jumbo mortgage market

- During testimony before the Joint Economic Committee, Federal Reserve chairman Ben Bernanke floated an idea to help improve the market liquidity of jumbo mortgages by allowing Fannie Mae and Freddie Mac to securitize the mortgages and then have the federal government act as a “guarantor” for these products. “For example, if the GSEs were to pay their usual mortgage insurance credit fee to the federal government, which then acted as guarantor” [it could transfer the credit risk from Fannie Mae and Freddie Mac to the federal government], he said. “Then they could process these jumbo loans and sell them to the secondary market, and that would be, I think, of some assistance to the mortgage market. From the federal government’s point of view, it would be taking on some credit risk, which you may or may not be willing to do.” He added that under this scenario, “It would be a good idea to make the GSEs ultimately responsible for some, any excess losses, or some part of excess losses, relative to the premiums that are paid.” Bernanke said, “If we do that, I think it ought to be *a very temporary measure* [emphasis added] and be done in a way that assures us that doing so doesn’t risk the underlying safety and soundness of the underlying institutions.” In follow-up questions, Bernanke suggested placing a \$1 million cap on the size of the jumbo loans for such a program. If implemented, the program could potentially create an “explicit” government guarantee on certain mortgage products securitized by the GSEs.
- Democrats quickly embraced Bernanke’s suggestion. Senator Chuck Schumer (D-NY) said he would craft a bill very soon to implement a GSE securitization program for jumbo loans. Representative Carolyn Maloney (D-NY), who chairs the House Subcommittee on Financial Institutions, said Bernanke’s idea has “significant potential to help our struggling markets” and could be added to a broader legislative effort to reform GSE oversight. Spokesmen for the Treasury Department and OFHEO declined to comment.
- Lawmakers also pressed Bernanke on the Federal Reserve’s response to the subprime mortgage crisis and asked the chairman if he endorsed FDIC chairman Bair’s suggestion that widespread modifications of mortgages be made for loans whose rates were resetting. Bernanke responded, “We do support scaling up these efforts, and the best way to do that is by creating more systematic approaches.” (*Dow Jones Capital Markets Report*, Damian Paletta and Brian Blackstone, 11/08/07; *Bureau of National Affairs*, R. Christian Bruce, 11/09/07; *American Banker*, Steven Sloan and Stacy Kaper, 11/09/07)
- Separately, Federal Reserve Governor Randall Kroszner added his support to those seeking more systematic ways to help modify loans of struggling subprime borrowers. In an speech to the Consumer Bankers Association, Kroszner said, “Given the substantial number of resets from now through the end of 2008, however, I believe it would behoove the industry to join together and explore collaborative, creative efforts to develop prudent loan modification programs and other assistance to

help large groups of borrower systematically. He also told the audience that the Fed was nearing the release of a proposal under the Home Ownership and Equity Protection Act to address unfair mortgage practices. Kroszner indicated that the proposal would require subprime lenders to escrow funds for taxes and insurance. “It is common practice for these payments to be escrowed in the prime markets, and I see no reason that escrows should not be standard practice in the subprime markets too.” (*American Banker*, Cheyenne Hopkins, 11/07/07)

#### House Financial Services Committee approves bill to change escrow and mortgage servicing rules

- The House Financial Services Committee passed H.R. 3837, which would require some homeowners to open escrow accounts with their mortgages to protect the borrowers from “unexpected” taxes and insurance premiums. The costs of escrows would have to be included in mortgage quotes provided to prospective borrowers. The bill also would create federal appraisal standards, which would allow consumers to obtain copies of all appraisals to determine if others are lower and would create a statutory requirement that appraisers have no financial interest in the property. “The bill’s reforms are part of a complete solution to abusive lending” said Representative Paul E. Kanjorski (D-PA), who sponsored this bill. The bill is expected to be incorporated into H.R. 3915, a broader bill on reforming mortgage lending practices (*CQ Today*, Timothy R. Homan, 11/05/07; *US Fed News*, 11/08/07)

#### Deal on mortgage bankruptcy bill “blew up”

- Representative Steve Chabot (R-OH) told reporters that a deal with Democrats over legislation (H.R. 3609) that would allow bankruptcy judges to alter mortgage terms for borrowers in the foreclosure process “blew up” several hours before the House Judiciary Committee was set to vote on the measure. “It blew up somewhere between last night and this morning,” said Chabot. Ranking member Lamar Smith (R-TX) said that the panel was ignoring evidence that H.R. 3609 “would only hurt consumers by pushing up mortgage rates for everyone, restricting capital, and pushing middle- and low-income families on the verge of homeownership back down the slope of scrimping, saving, and renting that they had laboriously climbed towards a home.” The compromise unraveled after lawmakers failed to reach an agreement over which borrowers should qualify to have their mortgages modified during the bankruptcy. Capitol Hill aides said the agreement appeared to break down over a means test, which would dictate how many borrowers would be eligible under the bill. Chabot was seeking to allow only borrowers who make 150% or less of their home state’s median income be eligible for loan modifications during bankruptcy proceedings. Democratic lawmakers from California insisted that the threshold was too low. Negotiations on the issue continue.
- On the day of markup, major financial industry and builder groups sent a joint letter to the committee, outlining their criticisms of the measure and urging members to vote against the bill. They wrote, “[The bill] remains overly broad, encompassing

prime, conventional, and home-only mortgages, as well as all subprime mortgages, and not just those—such as hybrid ARMs—that are causing most of the problems,” the letter states.” The groups expressed concern that the bill would allow bankruptcy judges “to cram-down the value of the remaining principal balance on a mortgage loan without the consent of the lender,” and allow judges to extend a mortgage beyond its original termination date. They added, “[The bill] will inject massive risk into the secured lending process and the secondary markets that will decrease liquidity in the markets and increase the cost of owning a home, through a higher downpayment, a higher interest rate, or both. In the end, it will thereby prevent many low and moderate-income Americans from owning homes.” The letter was sent by American Bankers Association, America’s Community Bankers, American Financial Services Association, Consumer Bankers Association, Consumer Mortgage Coalition, The Financial Services Roundtable, The Housing Policy Council, Independent Community Bankers of America, Manufactured Housing Institute, Mortgage Bankers Association, National Association of Home Builders, Securities Industry and Financial Markets Association, and the U.S. Chamber of Commerce.

- After lengthy debate of the bill on November 7, the panel adjourned the markup to conduct votes on other, unrelated measures. A spokeswoman for Representative Linda Sanchez (D-CA) said markup is expected to resume on November 14. (*Bureau of National Affairs*, Eileen J. Williams, 11/09/07; *Dow Jones Newswires*, Damian Paletta, 11/07/07; *American Banker*, Stacy Kaper, 11/07/07)

The “right long term solution” is passage of GSE reform legislation

- Representative Paul E. Kanjorski (D-PA), chairman of the House Financial Services Capital Markets, Insurance, and Government-Sponsored Enterprises Subcommittee, released a letter from OFHEO director James B. Lockhart, III, responding to his inquiries about the raising the caps on the Fannie Mae’s and Freddie Mac’s retained mortgage portfolios. Lockhart wrote, “...it would not be in the best interest of the safety and soundness of the Enterprises to enact this legislation [which increases the GSEs’ caps].” He added that, “...legislation increasing the portfolio is unnecessary, unsafe and unsound, and could have the unfortunate effect of appearing to set a target for subprime purchases that the Enterprises may not be able to meet safely.”
- Kanjorski said, “Director Lockhart states that the ‘right long-term solution’ to these matters would result in the passage of a comprehensive government-sponsored enterprise reform bill, and I agree with his informed assessment. We should carefully consider the judgment of our safety-and-soundness regulators who have the capabilities to fully examine the risk involved. By doing so, we hope to avert the potential of repeating the mistakes of the savings-and-loan crisis.” (*Press Release from Representative Paul E. Kanjorski*, 11/01/07)

### Calls for special funds to bail out subprime borrowers continue

- At a joint appearance, New York Governor Eliot Spitzer (D) and state attorney general Andrew Cuomo (D) called on the mortgage lenders and the federal government to create a fund to stabilize the subprime mortgage market. Such a fund would allow lenders to rewrite the terms of many subprime borrowers and help homeowners avoid foreclosure, said Spitzer. The governor's proposal was announced in connection with a package of state incentives to help borrowers keep their home, including a loan modification program to help reduce mortgage payments, a \$2 million matching-grant program for counseling and advocacy groups to help homeowners facing foreclosure, and proposed state legislation making lenders and brokers more accountable. (*Dow Jones Newswire*, Chad Bray, 11/08/07; *Marketwatch*, Christopher Hinton, 11/08/07)
- Former President Jimmy Carter urged the federal government to set up a special fund to help subprime borrowers keep up their payments and avoid foreclosure. "A special program to help tide them over... would be a top priority among domestic affairs," said Carter. According to *Reuters*, "It is unclear how much money is needed for the program." (*Reuters*, 10/29/07)
- Countrywide CEO and chairman Angelo Mozilo said that it's long past time for the feds to ride to the rescue of the subprime mortgage market and blasted government leaders for their failure so far of doing anything meaningful to breathe life into the increasing moribund housing sector. "In terms of tangible effort from the federal government... there has been no program, no federal effort, no legislative assistance—zero," said Mozilo. (*Financial Times*, Matthew Garrahan, 10/29/07; *Salon.com*, Andrew Leonard, 10/30/07)

### Concerns over the subprime fallout grow, along with fears of U.S. recession

- According to Royal Bank of Scotland's chief credit strategist Bob Janjuah, "The credit crisis, when all is out, will see \$250 billion to \$500 billion of losses [worldwide]. The heat is on and it is inevitable that more players will have to revalue at least a decent portion of assets they currently value using 'market-to-make believe'" In the *Frontline Weekly Newsletter*, John Mauldin adds, "...[T]he majority of these assets are not in banks but in pension funds, insurance portfolios, hedge funds, etc. Those losses have yet to be accounted for." (*Frontline Weekly Newsletter*, John Mauldin, 11/09/07)
- "The global economy will be a very challenging one in the next couple of years," said Morgan Stanley Asia chairman Stephen Roach [on November 2]. "The subprime crisis is an early sign of a recession in the U.S. in 2008." "I think that the risk of a recession is greater than people realize," said James Dunne, CEO of Sandler O'Neil & Partners. Charles Peabody, partner at New York-based research firm Portales

Partners LLC, said “We’re moving into a recession, and over time—the length of which is difficult to predict—there is going to be a lot more credit problems.” When asked at a Reuters Finance Summit where the U.S. economy is headed over the next year or so, John Duffy, chairman of Keefe, Bruyette & Woods, said, “In the toilet.” (*Associated Press*, 11/02/07; *Reuters*, 11/05/07)

- Declining home sales, rising oil prices and the credit crunch has brought the nation to the brink of recession, said Ross DeVol, director of regional economics for the Milken Institute. “We’re right there,” said DeVol. “If anything else goes wrong, we’re probably in a recession.” (*CNNMoney*, 10/29/07)
- Bill Gross, managing director of PIMCO, said, “There are \$1 trillion worth of sub-primes, Alt-A’s [self-certified] and basically garbage loans,” adding that he expects some \$250 billion in defaults. “We’ve only begun to see the pain from rising mortgage payments,” he added. Brian Gendreau, an investment strategist at ING, said, “Financials are 20[%] of the S&P 500 and if that sector doesn’t do well all bets are off. People just don’t know what’s on the balance sheets.” (*The Independent*, Sean O’Grady, 11/06/07)
- Former Federal Reserve chairman Alan Greenspan said that cutting excess home inventories in the U.S. is the key to stabilizing the national and worldwide financial system. “The critical issue on the whole subprime, and by extension, the international financial system rests very narrowly on getting rid of probably 200,000-300,000 excess units in inventory,” said Greenspan. (*Associated Press*, 11/06/07)

Fannie Mae’s and Freddie Mac’s market share surges in the third quarter
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- Fannie Mae and Freddie Mac have regained their dominance in the mortgage market during the third quarter. According to *Inside Finance*, Fannie and Freddie purchased \$342.3 billion in mortgage and mortgage securities, up 3% from the second quarter. These purchases accounted for more than 60% of the \$570 billion in home mortgages originated during the three month period—up from the GSEs’ 37% market share last year. While the GSEs’ market share has rebounded, total mortgage loan originations plummeted 22% from the second quarter. “What the trend really highlights is the demise of...some of these nontraditional mortgage markets which rose to prominence starting in 2004,” said Guy Cecala, publisher of *Inside Mortgage Finance*. “It’s not really that Fannie and Freddie did anything to warrant this.” (*Associated Press*, Alan Zibel, 10/31/07)

How does the GSEs' purchase of loans secured by buildings in some of the country's toniest neighborhoods further their mission to promote affordable housing?

- In letters to Fannie Mae and Freddie Mac, Senators John Sununu (R-NH) and Chuck Hagel (R-NE) requested additional information on the GSEs roles in the recent \$15.2 billion sale of apartment-building owner Archstone-Smith Trust to Tishman Speyer Properties and Lehman Brothers Holdings Inc. According to news reports transaction, Fannie bought a \$7.1 billion loan backed by 105 apartment buildings, and Freddie purchased \$1.8 billion of loans backed by mortgages on 32 buildings. [Archstone has bragged that its buildings were concentrated in some of the U.S.'s toniest neighborhoods.] "Please explain how this transaction furthers your mission to promote affordable housing," wrote the senators
- Fannie said half the apartment units that serve as collateral for the loan will help the GSE meet rules requiring it to support housing for people with low or moderate incomes. Freddie said that their participation in the transaction helped bring "liquidity and stability" to the market. (*Wall Street Journal*, James R. Hagerty, Alex Frangos, and Michael Corkery, 11/07/07)

Senator Clinton proposes using the GSEs to help improve energy efficiency of homes

- In her presidential campaign's comprehensive energy plan aimed at reducing global warming and decreasing the country's dependence on foreign oil, Senator Hillary Clinton (D-NY) proposes developing a plan to help homeowners in making their homes more energy efficient. According to the plan, "This program would direct Fannie Mae and Freddie Mac to facilitate the origination of energy efficiency improvement loans in order to help homeowners with the additional costs of investing in energy efficiency. Individual loans will be capped at the greater of 5% of the property's value (up to \$10,000) or \$5,000, and tough efficiency standards will apply. An energy audit of the home will determine the size of the improvement loan needed, and the energy bill savings that will result. Borrowers will not be required to make down payments on the loans. And the energy bill savings will ultimately offset the cost of the loan. Hillary will commit up to \$1 billion per year to the program, assisting upwards of 100,000 homeowners. The program will target lower- and middle-income homebuyers." (*Targeted News Service*, 11/07/07)

Equifax introduces the ARM Predictor

- Equifax, Inc. has introduced the ARM Predictor, which alerts credit card, auto, and home lenders about pending resets on adjustable-rate mortgage loans their customers have with other lenders. The tools will help consumer finance companies identify customers with the highest risk of becoming delinquent, allowing them to customize

their loss-mitigation operations and loan loss reserves. (*American Banker*, William Launder, 10/29/07)

## ***Fannie Mae***

### Fitch Ratings downgrades three classes of Fannie Mae MBS

- On October 29, Fitch Ratings downgraded \$7.7 million in Fannie Mae mortgage-backed securities, after actual losses on the bonds exceeded the reserved excess spread. Of the three classes one MBS worth \$1.9 million was downgraded four notches from “BBB+” to speculative grade “BB, while the other two classes were downgraded two notches from “A-” to “AA-”. Fitch said that Fannie Mae’s corporate ratings of “AAA/F1” were not affected by their downgrades on the company’s MBS. (*Associated Press*, 10/29/07; *BusinessWire*, 10/31/07)

### Fannie Mae provides new incentives for attorneys to encourage loan workouts

- To stem the tide of foreclosures, Fannie Mae has begun paying incentive fees to foreclosure lawyers who restructure or modify loans for delinquent borrowers. The new program addresses a longstanding industry problem: foreclosure lawyers usually receive high fees and scorecard ratings for every loan in foreclosure, but generally earn nothing for loans that get restructured. “A foreclosure attorney makes the most money if a loan goes into foreclosure, so we’re trying to design something where they’re paid more if they do a workout,” said Michael A. Quinn, senior vice president and single-family risk officer for Fannie Mae. (*American Banker*, Kate Berry, 11/09/07)

### Fannie Mae releases new underwriting guidelines giving lenders more discretion in making lending decisions

- At the end of October, Fannie Mae released new DUS guidelines that will give its lending partners increased powers to make decisions. The new DUS guidelines, which apply to loans under \$25 million, cover most of Fannie Mae’s multifamily loan products, including affordable housing, seniors, student housing, military, cooperative, supplemental, and mezzanine products. Under these guidelines, lenders will be given greater discretion to set the DSC ratio if the property is located in certain top markets; the borrower is putting in at least 30% cash (for acquisition loan); or the LTV is less than 70%. “For the past few years, Fannie Mae wanted to restore delegation to lenders,” said Michele Evans, vice president of multifamily corporate affairs at Fannie Mae. “Given the amount of waivers that are coming in, the guide

needs to be written in a way that lenders are given more delegation.” She added, “Really, all multifamily lenders delivering individual loans to Fannie Mae will be able to access the guide for up to \$25 million.” (*Multi-Family Housing News*, Keat Foong, 11/05/07)

“Louisiana Speaks: Our Voice, Our Plan, Our Future” nominated for Emmy

- The hour-long documentary, “Louisiana Speaks: Our Voice, Our Plan, Our Future,” has been nominated for an Emmy award. The documentary, made possible by a grant from the Fannie Mae Foundation, was part of an outreach campaign to engage citizens across South Louisiana on their views for the region’s future. (*KnowledgePlex Week in Review*, 10/31/07)

Fannie Mae announces \$200,000 grant to Common Ground

- According to a new Gallup poll released by Fannie Mae, 24% of veterans are concerned that they may not have a place to live and 86% polled believe that homelessness among veterans is increasing or staying the same. In response to these findings, Fannie Mae announced a \$200,000 grant to Common Ground, which will enable the organization to build “more permanent supportive” housing units for veterans. “Those who have defended our homeland should have a home to call their own,” said Fannie Mae president and CEO Daniel Mudd. “Our veterans served America and America must serve them. Fannie Mae is committed to implementing programs to prevent and end homelessness in America. We are pleased to ramp up our partnerships with the National Alliance to End Homelessness, Common Ground and other leading organizations that share our commitment and will work toward real solutions.” (*Fannie Mae Press Release*, 10/08/07)

## ***Freddie Mac***

### Freddie Mac extends CEO Syron's employment contract through 2009

- Freddie Mac has amended its employment agreement with chairman and CEO Richard Syron, which extends extend his contract through December 31, 2009. Under the new agreement, Syron's base salary is increased from \$1.1 million to \$1.3 million, effective July 1, 2007, and provides for a special extension bonus of \$3.5 million, spread over several dates. "This special bonus is payable only if Mr. Syron remains employed by Freddie Mac as of each of these dates, and it is subject to repayment by Mr. Syron if he terminates his employment [before December 31, 2009]," other than for "good reason," said the company. Syron also would be entitled to an equity grant of up to \$9.4 million in 2008 and up to \$10 million in 2009.
- Freddie Mac plans to appoint a new CEO in mid- to late-2008, at which point Syron would serve as executive chairman of the board for the balance of his term. According to the company, "[Syron] will actively assist Freddie Mac in recruiting and retaining his successor as chief executive officer." In June, Syron had said he would keep an arm's distance during the process and would not promote one candidate over others. At the time, Syron said, "We're very cautious on this from a governance perspective, and I really have always believed that it doesn't work out well - CEOs should never choose their successors," said Syron. "It's just emotionally, every other way, there is too much potential for conflict." (*Dow Jones Newswire*, Damian Paletta, 11/09/07)

### "There's never just one cockroach in the kitchen"

- In testimony for the government against Freddie Mac's former CEO Leland C. Brendsel, billionaire investor Warren E. Buffett minced no words on why he chose to sell a huge stake in the GSE well before the company's accounting irregularities came to light. "I follow the old dictum: There's never just one cockroach in the kitchen," said Buffett. He said he was troubled by Brendsel's forecasts of double-digit earnings growth for Freddie Mac, saying that when a CEO make such promises and the company fails to achieve them in a given quarter, they sometimes "start making up the numbers." Trying to deliver smoothly increasing earnings "can lead to a lot of trouble in any company," and it is "unachievable" at a company like Freddie Mac, testified Buffett. When asked by Judge William B. Moran if he felt his concerns were vindicated, Buffett replied, "I think they were fully vindicated." Buffett bought stock in Freddie Mac during the 1980s and ultimately became one of the company's largest stockholders, before liquidating his stake in the GSE for an eventual profit of \$2.75 billion. (*Washington Post*, David S. Hilzenrath, 10/31/07)

Freddie Mac Foundation awards 74% of its \$35 million in philanthropic investments  
in 2006 to local organizations

- In an October 27<sup>th</sup> speech to the Human Service Coalition of Northern Virginia Annual Luncheon, Ralph F. Boyd, Jr., EVP of Freddie Mac and chairman of the Freddie Mac Foundation, said, “Last year, [the Freddie Mac Foundation] made about \$35 million in philanthropic investments – with \$26 million going to local organizations. ...At Freddie Mac, we make our philanthropic investments through two vehicles—one is our corporate giving and community investment program, and the other is through the Freddie Mac Foundation.”
- “In on the corporate philanthropy side, when deciding what investments to make, we ask ourselves several questions: First – does [the] proposed investment advance our mission affordable housing? In this context, we’re looking to support partnerships with high performing affordable housing nonprofits. For example, some of these partnerships are with larger organizations such as Habitat for Humanity, Enterprise Community Partners, NeighborWorks, and the National Alliance to End Homelessness.”
- “Second—does it help demonstrate and model good corporate citizenship? In other words, are we acting in a way that demonstrates leadership and corporate social responsibility in the communities that we work and live in?...Third—we ask ourselves whether a particular request helps us maintain, build and strengthen key business relationships? ...“And finally we also ask ourselves whether a particular request for support provides us with an opportunity to engage our employees in ways that bolster employee morale?...”
- “On then on the other side of the Enterprise, the Freddie Mac Foundation’s philanthropy focuses on working with nonprofits that make a measurable difference in the lives of vulnerable children and families. Our investment strategy focuses on several considerations. We partner with nonprofits that specialize in providing services in several key areas; including promoting adoption and foster care, enhancing youth development, and creating stable homes and families. We work with groups that have a proven track record. We use an outcomes based approach, where we closely monitor the results of our investments. This is an increasingly important consideration for us and other major funders as well.”
- “On the Foundation side, our investments are area specific, that is we work mainly with nonprofits dedicated to helping families and children in the National Capital Region.”
- “That said however, our investments are also based on meeting urgent, critical and immediate needs. They can be in director response to pressing national and urgent needs, such as providing emergency funds for local nonprofit agencies during the economic downturn that followed 9/11, or aiding Gulf South communities devastated

by Hurricanes Katrina and Rita in 2005.” (*Prepared Remarks of Ralph E. Boyd, Jr., 10/27/07*)

#### Freddie Mac unveils the Freddie Mac Foundation Family Home

- The Doorways for Women and Families, Congressman Jim Morgan (D-VA), and the Freddie Mac Foundation unveiled the newly built Freddie Mac Foundation Family Home, a 7,200 square-foot Arlington shelter that will provide temporary housing and intensive support services to homeless women and families within Arlington County and the D.C. region. (*PRNewswire, 10/07/07*)

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

#### FHLB System announces third quarter results

- The FHLBanks Office of Finance announced that the FHLB System’s assets totaled \$1.228 trillion on September 30, an increase of 20.8% from year-end 2006. As a result of “extraordinary events affecting the credit markets in the third quarter,” the FHLBs advances increased 28.6% to \$824 billion, representing 67.1% of total assets. The System’s consolidated obligations outstanding totaled \$1.134 trillion at September 30, an increase of 21.4% from year-end 2006. Total consolidated obligations outstanding consisted of \$309 billion of discounted notes and \$825 billion of bonds, an increase of 96% and 6.2%, respectively, from December 31<sup>st</sup>.
- More than 99% of the FHLBs’ investments, which include mortgage-backed securities, overnight and term Federal funds sold, commercial paper, and GSE securities, were rated ‘AAA/Aaa or the short-term equivalent at September 30, 2007. At the end of the third quarter, the weighted average FICO score and loan-to-value ratio of the loans held in portfolio by the FHLBs’ Mortgage Purchase Plan was 738 and 67%, respectively, and 749 and 71% LTV for the Mortgage Partnership Plan. Each Bank believes it has limited exposure to subprime loans due to the System’s conservative business model, conservative policies regarding collateral for advances and investments, and low credit risk associated with the mortgage loan programs.
- The FHLB System’s combined net income for the third quarter was \$719 million, a 7.7% increase over the prior year’s third quarter earnings. The System’s net income for the nine months ended September 30 was \$1.965 billion, a 1.8% increase over the prior year’s earnings for the corresponding period. At September 30, the FHLB System reported total capital of \$51 billion, a 14.3% increase from December 31, 2006. (*FHLBanks Office of Finance Press Release, 10/31/07*)

- Noting the FHLBs' 28% growth in advances during the third quarter, Peter Wallison, a fellow at the American Enterprise Institute, said "[Taxpayers are] taking a lot of risks through the [FHLBs] that are unnecessary." The FHLBs are increasing their risks by becoming a lender of last resort – a job of the Federal Reserve, he added. Wallison and Representative Richard Baker (R-LA) voiced concerned that a loss of confidence in one of the FHLBs could cause investors to dump FHLB debt, potentially triggered the collapse of one or more of the Banks. If the FHLBs were unable to meet their liabilities, taxpayers would be on the hook, they added. Congress needs to ensure that "these institutions don't blow up in the taxpayers face," said Representative Christopher Shays (R-CT). The failure to pass GSE regulatory reform legislation "is predicting disaster," said Baker. "[The FHLBs] have the potential for adverse economic impact if not properly administered." (*Bloomberg News*, James Tyson and Jody Shenn, 10/30/07)

As they said, "If it ain't broke don't fix it"
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- In a November 2<sup>nd</sup> article appearing in the *American Banker*, Federal Housing Finance director Geoff Bacino wrote, "...Over the last several years reforming the national housing mission, business activities, and regulatory regime of ...Fannie Mae, Freddie Mac, and the Home Loan banks has become a heated public policy issue. One proposed regulatory 'reform' would abolish the current regulator for Fannie and Freddie ...and ...Home Loan banks...and create a super regulator for all 'housing' GSEs."
- "Though the Home Loan Bank System often is considered a housing GSE, it has a vastly different mission, business strategy, and organizational structure than Fannie and Freddie. The reasons most often cited for creating a new regulator for Fannie and Freddie—the purported lack of bank-like regulatory and supervisory authority on the part of OFHEO—do not apply to the Federal Housing Finance Board. Moreover, even though in recent years several Home Loan banks have experienced some supervisory issues, the Finance Board has dealt with them swiftly and effectively, and they haven't even remotely approached in scale the accounting scandals that have bedeviled Fannie and Freddie and their regulator during the last several years."
- "This GSE regulatory reform proposal reminds me of that old maxim of public administration: 'When in doubt about how to resolve a policy issue, reorganize the affected agency.' During this current period of stress in our economic markets, when a key participant, the Home Loan Bank System, is performing superbly in its role as a primary provider of liquidity for mortgage lenders, does it make sense to risk any disruption of the Home Loan banks by destroying a well-run regulatory regime and imposing a new, and arguably unnecessary, regulatory structure? I think not. Hopefully, Congress will agree." (*American Banker*, Geoff Bacino, 11/02/07)

### FHLBs announce third quarter dividends

- The FHLB-Chicago announced that it will not pay a dividend for the third quarter, several weeks after entering a Cease and Desist Order with the Federal Housing Finance Board. Under the Order, the Bank must receive written permission from the Finance Board before declaring a dividend. In a letter to members, FHLB-Chicago president Mike Thomas said that the board of directors had decided on its own not to pay a dividend. While Thomas expects the Bank to report “positive earnings” for the third quarter, he said the board decided against a dividend in anticipation of earnings pressure in the fourth quarter and into next year. “The decision not to declare a dividend for the quarter was a difficult one, as we well understand that an adequate return on your investment in the bank is one element of the value of membership in the bank,” wrote Thomas. “You can depend on the fact that we will continue to price advances competitively.” (*American Banker*, Steven Sloan, 10/01/07)
- The FHLB-Pittsburgh’s board of directors declared a quarterly dividend of 6% annualized, payable on November 20. (*FHLB-Pittsburgh Press Release*, 11/07/07)
- The FHLB-Seattle declared a cash dividend of \$ 1.28 a share on Class A stock and \$0.20 a share on Class B for the third quarter, which will be paid in November. (*BusinessWire*, 10/30/07)

### FHLBs announce board election results and public interest director appointments

- The FHLB-Indianapolis announced the election of five directors to its Board of Directors for terms beginning on January 1, 2008 and ending December 31, 2010. The directors include (incumbent) Charles Crow, chairman, president and CEO of Community Bank, Noblesville, IN; (incumbent) Timothy P. Gaylord, president and CEO of Mason State Bank, Mason, MI; John L. Skibski, EVP and CFO of Monroe Bank & Trust, Monroe, MI; James D. MacPhee, CEO of Kalamazoo County State Banker, Schoolcraft, MI; and Mark A. Hoppe, CEO of LaSalle Bank Midwest N.A., Troy, MI. (*FHLB-Indianapolis Press Release*, 10/11/07)
- The FHLB-Des Moines announced the results of its recent board of elections and reappointments of directors by the Federal Housing Finance Board. The Bank’s members elected Michael J. Finley, president of Janesville Bank, Janesville, MN; Eric Harmeyer, president and CEO of the Bank of North Dakota, Bismarck, ND; and Joseph C. Stewart, III, CEO of Bank Star, Pacific, MO to three year terms beginning on January 1, 2008. The Finance Board reappointed Johnny A. Danos, president of the Greater Des Moines Community Foundation, Des Moines, IA; Geral D. Eid, CEO of Eid-Co Buildings, Fargo, ND; and David R. Frauenshuh, CEO and founder of Frauenshuh, Inc., Minneapolis, MN to three year terms as community directors beginning on January 1, 2008. The Bank’s board of directors elected Michael K. Gutttau, chairman and president of Treynor State Bank, Treynor, IA to serve as

chairman and Dale E. Oberkfell, president and COO of Reliance Bank, Frontenac, MO, to serve as vice chair. (*PrimeNewswire*, 11/02/07)

- The FHLB-Cincinnati announced the Finance Board's appointment of Carl Wick and Charles Koch to serve as public interest directors for a three-year term beginning on January 1, 2008. Wick, who currently serves as the Bank's chairman, is the principle and owner of Wick and Associates Business Consulting. In 1994, Wick retired from the NCR Corporation after 28 years of service. Kock, a long-time Ohio bank executive, also returns to the Bank's board of directors. He was elected to serve on the board six times [from 1990-1995 and 1998-2006]. In 2004, Kock retired as chairman of Charter One Bank, Cleveland, OH. He is a director of the Royal Bank of Scotland Plc and Assurant University, both in Cleveland, OH. (*FHLB-Cincinnati Press Release*, 10/29/07)
- The FHLB-New York announced that four directors were re-elected to serve three-year terms on the board of directors beginning on January 1, 2008. The four re-elected directors include Joseph R. Ficalora, chairman and CEO of New York Community Bank, Westbury, NY; Ronald E. Hermance, Jr., chairman, president, and CEO of Hudson City Savings Bank, Paramus, NJ, Kevin J. Lynch, chairman, president, and CEO of Oritani Savings Bank, Washington Township, NJ; and John M. Scarchilli, president and CEO of Pioneer Savings Bank, Troy, NJ. (*PRNewswire*, 11/06/07)

FHLB-Atlanta names new director of community investment services
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- The FHLB-Atlanta has named Arthur Fleming as first vice president and director of the Community Investment Services department effective November 1. Before joining the Bank, Fleming was EVP, chief lending and investment officer for Opportunity Finance Network, where he managed the financial services unit. Previously, he worked at Fannie Mae Foundation as senior director of the Southeast region and at GMAC Residential as senior vice president and managing director of the Housing Initiative Group. "Art Fleming's experience in using private capital to promote community development lending will be a tremendous asset," said Jill Spencer, FHLB-Atlanta's EVP and COO. "His leadership and management experience will help us better serve members and the development organizations that benefit from our programs." (*FHLB-Atlanta Press Release*, 11/02/07)

FHLB-Pittsburgh enters into partnership with the University of Delaware's Center for Community Research in a revitalization initiative
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- The University of Delaware's Center for Community Research and Service and the FHLB-Pittsburgh have entered into a partnership to bring the Blueprint Communities revitalization initiative to Delaware. Blueprint Communities helps cities, towns and neighborhoods develop stronger leaders, a clear community vision and a detailed

strategic plan for sustainable community growth. In January 2008, up to ten Delaware communities will be the recipients of free community development training valued at \$25,000, a mini-grant for implementation and other program features designed to spur comprehensive community growth upon successful completion of the nearly year-long program. (*BusinessWire*, 11/05/07)

## ***Ginnie Mae***

### FHA reform bill falls off the radar screen in the Senate

- The FHA Modernization Act, which passed the full House and was voted out of Senate Banking Committee by a 20-1 bipartisan vote, has dropped off the radar screen—despite strong assurances by Senate Banking Committee chairman Christopher J. Dodd (D-CT) to rush the bill to the Senate floor for quick action. On September 19<sup>th</sup>, Dodd pledged to “fight for swift passage so that homeowners can get the relief they deserve.” More than a month after committee passage, the Senate FHA Modernization Act hasn’t been assigned a bill number, nor has it been sent to the majority leader’s office for scheduling a floor vote. Dodd spokesman Marvin Fast said committee staff’s work on the bill is underway. However, Fast didn’t have any explanations about what happened to Dodd’s earlier promises of quick action to aid homeowners in distress. (*Washington Post*, Kenneth R. Harney, 10/27/07)
- Meanwhile, Dodd continues his run for the Democratic nomination for president. The Senator, who is drawing 1% support in the polls, works hard on the campaign trail while some of the critical issues before the Senate Banking Committee remain stuck on hold. Dodd has filled his schedule for traveling across Iowa for most of November, rankling people with business before the committee. Murmurs of dissatisfaction have grown louder among lawyers, lobbyists, consumer advocates and even the Treasury Department, as the campaign season intensifies. (*Washington Post*, Carrie Johnson, 11/07/07)

### HUD urged to drop plans for risk-based FHA insurance premiums next year

- House Financial Services Chairman Barney Frank (D-MA) and Representative Maxine Waters (D-CA) are urging HUD to drop its plans to begin charging risk-based premiums on FHA-insured 1-4 family loans next year. In a November 2 letter to HUD secretary Alphonso Jackson, Frank and Waters wrote, “...We are particularly surprised to see HUD acting unilaterally to implement risk-based pricing before waiting for Congress to complete action on this [FHA reform] legislation—especially

since your proposal differs from the bill passed by the House.” (*Mortgagewire*, 11/05/07)

Court order blocks HUD rule on down-payment assistance programs

- U.S. District Court Judge Paul L. Friedman issued a temporary order blocking HUD from enforcing a rule that prohibits seller-funded down-payment gifts on loans insured by the FHA. Friedman ruled that the rule, set to take effect on October 31<sup>st</sup>, would put the nonprofit groups out of business. He added that HUD “failed to supply a reasoned analysis for its departure from its long-standing policy of approval [of the program].” HUD, the IRS and GAO have questioned the value of such programs, after studies show that borrowers who use them were twice as likely to default on their mortgages or become delinquent on their payments as borrowers on other mortgages backed by the FHA. (*American Banker*, Marc Hochstein, 11/01/07; *Washington Post*, Renae Merle, 11/01/07).

Ginnie Mae to roll-out first standardized bond issued backed by reverse mortgages

- Ginnie Mae plans to introduce its first “standardized” bond issue backed by reverse mortgages. The agency’s first issue, expected to total \$120 million, will be collateralized by more than 1,000 government-insured reverse mortgages. Ted Foster, senior vice president for mortgage-backed securities at Ginnie Mae, said, “Our objective is to get the best price for consumers by supporting the underlying product. Two years from now, the market [for reverse-mortgage-backed securities] will be there.” Fannie Mae has been the dominant purchaser of reverse mortgages for many years. Recently, financial firms, including Lehman Brothers and Bank of America, have securitized these loans through private-label MBS and sold the securities through private placements to a limited number of investors. Ginnie Mae’s development of the first standardized reverse mortgage security on the market should help “open up the universe” to more investors, particularly those with long-term investing horizons. (*Wall Street Journal*, Lingling Wei, 11/08/07)

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

### FCS reports 17% increase in third quarter earnings

- The Farm Credit System reported combined net income of \$727 million for the third quarter, a 17.1% increase over its third quarter earnings of last year. The System's earnings for the nine months ended September 30 totaled \$2.021 billion, 13.4% over the same period last year. The System's gross loans increased \$11.634 billion to \$134.601 billion at September 30, as compared to \$123.436 billion at year-end 2006. During the nine months ended September 30, the System's non-accrual loans decreased \$54 million to \$469 million, while its non-performing loans declined \$38 million to \$577 million. Non-performing assets represented 0.43% of the System's outstanding loans on September 30, down from 0.50% at year-end 2006. The allowance for loan losses totaled \$722 million at September 30, representing 0.57% of total loans outstanding. The System's total capital increased \$2.157 billion during the first nine months of 2007 to \$26.587 billion, representing 14.8% of total assets.
- "The favorable earnings of the first nine months of 2007 reflected the current robust agricultural economy in the United States," said Jamie B. Stewart, president and CEO of the Federal Farm Credit Banks Funding Corporation. "Growth in the loan portfolio continued to have a strong impact on the increase in earnings for 2007. The healthy credit quality of the loan portfolio and the sound capital levels of System institutions have contributed to the System's continued favorable access to the capital markets, which has allowed the System to continue to grow the loan portfolio." (*BusinessWire*, 10/31/07)

### Farmer Mac reports \$8.6 million loss for third quarter

- Farmer Mac reported a net loss of \$8.6 million or \$0.82 per diluted share for third quarter 2007, compared to a loss of \$6.3 million or \$0.58 per diluted share for third quarter 2006. The losses in both periods were attributable to market value changes on financial derivatives used to hedge interest rate risk on the agency's assets and liabilities. Farmer Mac's core earnings for third quarter 2007 increased 18% to \$7.6 million or \$0.71 per diluted share, compared to \$6.5 million or \$0.58 per diluted share for third quarter 2006. The agency's increase in core earnings was driven by an increase in net interest income attributable to Farmer Mac's significantly improved short-term funding costs, as compared to the rates on related investments, as well as ongoing fee income from the Corporation's guarantee portfolio. (*PRNewswire*, 11/08/07)

- In the October issue of Farm Credit Watch, Bert Ely reports, "...the FCS lost again when the Senate Agriculture Committee reported a 2007 Farm Bill to the Senate floor without a single HORIZONS provision in it. Worse for the FCS, no HORIZONS amendments to the bill were offered in committee. The full Senate is expected to take up the Farm Bill [The Farm Bill is currently on the Senate Floor]. FCS will now try to sneak a sliver of HORIZONS into the Senate version of the Farm Bill that could then be expanded greatly when a Senate-House conference committee reconciles the House and Senate versions of the Farm Bill. Bankers now need to express their concerns about HORIZONS to all senators."
- "Senate Ag Committee members clearly learned from bankers that HORIZONS would only serve to increase the FCS's off-farm lending activities since the FCS now can lend without limit on the farm. Perhaps the committee members also have learned that the FCS increasingly provides taxpayer-subsidized credit to large, well-capitalized corporations with no direct linkage to agriculture..."
- "Another important factor in the absence of any HORIZONS provision in the Farm Bill is the October 3 letter Senators Christopher Dodd [D-CT] and Richard Shelby [R-AL], Chairman and top-ranked Republican, respectively, on the Senate Banking Committee, sent to Senators Tom Harkin and Saxby Chambliss of the Senate Ag Committee. They wrote 'to express our jurisdictional interest in the policy implications of certain proposals by the FCS to expand its current lending authority beyond its statutory mission of providing credit to the agricultural sector.' Translation: We will look at any Farm Bill provision which expands the FCS's off-farm lending powers. The Dodd-Shelby letter parallels the earlier letter Reps. Barney Frank and Spencer Bachus of the House Financial Services Committee sent to the House Ag Committee about HORIZONS. These two letters clearly establish that the two committees responsible for banking issues and the credit sector of the U.S. economy will examine any future attempt to increase the FCS's off-farm lending powers. The Senate Ag Committee appears to have gotten the message, loud and clear."
- "There are three interesting provisions affecting the FCS in the Farm Bill on the Senate floor. First, the bill includes statutory changes which will boost the premiums the FCS pays to the FCS Insurance Corporation so as to bring its fund balance to 2% of outstanding FCS debt. Those premiums are estimated to cost the FCS another \$378 million over the next five years. Second, the Farm Credit Administration (FCA) board member the President designates to be the FCA Chairman will be subject to Senate confirmation; that is not now the case. Third, First South, ACA, which primarily serves Alabama, Mississippi, and Louisiana, would be authorized to compete against the Farm Credit Bank of Texas in doing real-estate lending in those three states. This amendment may set off a turf war within the FCS. Stay tuned." (*Bert Ely's Farm Credit Watch*, Bert Ely, October 2007)

- *National Journal's CongressDaily* reports that Senator Saxby Chambliss (R-GA), ranking member of the Agriculture Committee, plans to introduce an amendment to the 2007 Farm Bill which would allow the FCS to make loans to bio-refineries and to make more loans for rural housing, according do the Senator's spokeswoman. (*National Journal's CongressDaily*, Jerry Hagstrom, 10/26/07)

Ethanol “a classic farm program—a costly system of transfers looking for a rationale”
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- In the October 30 issue of *Financial Times*, columnist Martin Wolf wrote, “Energy security and climate change are two of the most significant challenges confronting humanity. What we see, in response, is the familiar capture of policymaking by well-organized special interests. A superb example is the flood of subsidies for biofuels. These are farm programs masquerading as answers to energy insecurity and climate change. Not surprisingly, they have the depressing characteristics of such programs: high protection, open-ended support to producers, and indifference to economic rationality.”
- “Already the support in members of the Organization for Economic Co-operation and Development costs about \$13 [billion] to \$15 [billion] a year. But this sum generates much less than 3 percent of the overall supply of liquid transport fuel. To bring the biofuel share to 30 percent, as some propose, would cost at least \$150 billion a year and probably more, as marginal costs rose. Someone needed to take a close look at the rationality of all these supports. An excellent report from the Global Subsidies Initiative of the International Institute for Sustainable Development does just that. [At [http://www.globalsubsidies.org/article.php3?id\\_article=37&var\\_mode=calcul](http://www.globalsubsidies.org/article.php3?id_article=37&var_mode=calcul), the report may be downloaded.] It does not tell a pretty story.”
- “Policy is extraordinarily complex. It can also be highly irrational. Brazil is, for example, the most efficient supplier of bioethanol, but confronts tariffs of at least 25 percent in the US and 50 percent in the European Union. A smaller example is the advantage given to production of ‘flexible-fuel vehicles’ in US corporate average fuel-efficiency standards. Because the fuel-economy credit is biggest for the least energy-efficient models, manufacturers concentrate on sport utility vehicles and light trucks. Yet almost all the drivers of these vehicles use ordinary petrol. The result is greater consumption of petrol, not less.”
- “The cost of support per liter of ethanol varies between \$0.29 and \$0.36 per liter in the US and \$1 in the EU... Support for biodiesel varies between \$0.2 per liter in Canada and \$1 in Switzerland. But the cost of petrol, in terms of equivalent energy units, is \$0.34 and of diesel is \$0.41. Thus, the subsidy to biofuels is often greater than the cost of the fossil fuel equivalent. Not surprisingly, the production costs of subsidized biofuels are also generally much higher...”
- “Does this costly shift to biofuels at least deliver reductions in net emissions of greenhouse gases? Not by as much as one might suppose, is the answer. The net

greenhouse gas emissions of expensive European rapeseed oil-based diesel are a mere 13 per cent less than those of conventional diesel. Similarly, net emissions from US corn-based ethanol are only 18 per cent less than conventional petrol.”

- “This highly subsidized source of demand is also having a big impact on demand for foodstuffs. In 2007, for example, the increase in US demand for corn-based ethanol will account for more than half of the global increase in demand. Much the same is true for US and EU use of soyabeans and rapeseed in biodiesel. The rising price of food is good for producers. It is dreadful, however, for consumers, particularly for those in poor food-importing countries. Increased production of biofuels also adds stress on existing land and water supplies.”
- “Is it possible to justify this cornucopia of complex and expensive subsidies, mandates and protectionist measures? No. But that does not stop people from trying. Indeed, they point to a host of different (and often changing) justifications, as is too familiar from the history of farm policies. Here are just five of them.”
  - “Rationalization One: Biofuel subsidies reduce farm support payments. But, in fact, US evidence strongly suggests that these subsidies are being piled on top of existing farm subsidies, not replacing them.”
  - “Rationalization Two: Mandating biofuels will lower petrol prices. But it is obviously mad to try to lower the price of a commodity by subsidizing the production of more expensive alternatives.”
  - “Rationalization Three: Subsidizing biofuel is an efficient way to reduce reliance on risky fossil fuels. But biofuels are, under current technologies, complements to, rather than substitutes for, fossil fuels and are also vulnerable to their own risks of weather and disease.”
  - “Rationalization Four: Subsidizing biofuel is an efficient way to reduce greenhouse gas emissions. According to the report, the cost of eliminating a ton of carbon dioxide equivalent through biofuels varies from a low of about \$150 to as much as \$10,000. Even the lower of these figures exceeds almost all estimates of the marginal benefit of reducing a ton of emissions. It certainly much exceeds the cost of many alternative ways of doing so.”
  - “Rationalization Five: Subsidies are only needed to establish the infrastructure. But if biofuels are to be competitive, it will be unnecessary to subsidize the infrastructure. Investors can do that for themselves.”
- “This then is a classic farm program: A costly system of transfers looking for a rationale. Or, as the report puts it: ‘The bewildering array of incentives that have been created for biofuels in response to multiple (and sometimes contradictory) policy objectives bear all the hallmarks of a popular bandwagon aided and abetted by sectional vested interests.’”

- “So what should be done? Here are some simple negative suggestions: eliminate increasingly popular (because apparently costless) mandates to use specific quantities of biofuels, since these shift all the risk of fluctuations in demand and supply of foodstuffs on to their use as food; discipline the stacking of subsidies on one another; and eliminate all open-ended supports for production before these become impossible to reverse.”
- “Here, also, are some positive ideas: Define the objectives and instruments of policy precisely, in terms of the overall goals of energy security and reductions in emissions of greenhouse gases; create a single global price of carbon that governs all activities; make producers compete for any support that is offered; let the markets decide on sale of flexible-fuel vehicles (and indeed the energy efficiency of vehicles); and, above all, move to free trade in biofuels.” (*Financial Times*, Martin Wolf, 10/30/07)
- “We should at least try to learn from painful experience with a century of farm policies. I know that is naive. But is it impossible to respond to the big challenges of energy policy and climate change by applying a little intelligence, for a change?” (*Financial Times*, Martin Wolf, 10/30/07)
- The 2007 Farm Bill contains provisions for \$2.3 billion in federal support, half of which will develop cellulose as a companion to corn as a feedstock for fuel ethanol. Agriculture Committee chairman Tom Harkin (D-IA) said the bill contains a “very robust” program in biofuels, which “puts us on a path” to produce 60 billion gallons of biofuels by 2030, roughly 10 times current output. The package includes \$1.1 billion to encourage farmers to grow biomass crops and to construct ethanol plants using cellulose. An additional \$1.1 billion would provide tax credits for biofuels, including credits for cellulosic ethanol. Under the bill, Senator Democrat Ken Salazar (D-CO) said cellulosic ethanol would be eligible for up to \$1.28 a gallon in credits. The bill also includes a credit to small producers of 67 cents for cellulosic ethanol, the current 10-cent credit available to all small producers, and the long-standing 51-cent tax credit for blending ethanol into gasoline. A recent CBO report said the House farm bill authorized \$3.2 billion in mandatory spending on energy programs. (*Reuters*, Charles Abbott, 11/08/07)

## *Postal Service*

### Postal Regulatory Commission releases pricing regulations for USPS

- Eight months ahead of a Congressional deadline, the Postal Regulatory Commission release a regulation providing the USPS more leeway in setting prices and using contracts to customize rates for big mailers. Under this new system, postal rate adjustments should become more predictable for companies and the general public. The 173-page regulation will permit the Postal Service to adjust rates annually for first-class letters, magazines, advertising materials, and certain other kinds of mail at a rate not to exceed the CPI for the previous 12 months. Other types of mail, including Priority Mail and Express Mail, are treated as “competitive products,” which are not subject to the price cap. Within this category, the USPS is allowed to offer discounts based upon volume and negotiate special terms. (*Washington Post*, Stephen Barr, 10/30/07)

### APWU hires five grass-roots organizers to implement the union’s legislative program

- In a November 7th speech about the union’s future, the American Postal Workers Union President William Burrus announced plans to hire five grass-roots organizers to help implement the union’s legislative program and unveiled plans to better communicate with far-flung union members via the Internet. Burrus also announced that the union had prevailed in its efforts to gain admittance to the Mailers Technical Advisory Committee, a panel composed of large mailers that meets secretly with postal officials to develop long-term plans for the Postal Service. He called the agreement a “major accomplishment for the union.” (*Postcom.org*, 11/09/07)

### Privatization of the USPS is the *only* answer

- In the November 9<sup>th</sup> issue of the Statesman Journal, James A. Montanye wrote, “Congress has taken a tentative step toward bringing the nation’s postal services into the twenty-first century. Unfortunately, the reforms it enacted in 2006 fall conspicuously short of those already adopted by the European Union and other countries. More serious reform is needed.”
- “The United States Postal Service is an anachronism. Yale’s law and economics scholar George Priest has characterized it as ‘the most significant example of socialism in the United States ...[embracing] almost all the aspects of socialism rejected in Eastern Europe and in the privatized Western economies.’ It employs 30 percent of the nonmilitary federal workforce; pays wages and benefits 30 percent above competitive levels; and operates more than 60 percent of its offices at a loss.”

- “The Postal Service has survived—despite high costs, bland offerings, and comparatively middling service—by exploiting its two statutory monopolies: the carriage of First Class mail; and exclusive access to customer-owned mail boxes. Despite this economic leverage, its continued survival is being threatened by the Internet, which enables better, faster, and less costly alternatives to First Class mail. As a result, mail volume is declining, and at a faster pace than was predicted only a few years ago. This matters because First Class mail is the Postal Service’s cash cow. The General Accounting Office now warns that ‘comprehensive postal reform is urgently needed ... to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases.’”
- “Congress appears to have taken only minimal notice. The Postal Accountability and Enforcement Act of 2006 addresses the impending crisis merely by allowing the Postal Service to adjust prices more quickly and to close unprofitable post offices. The Act contemplates no bold measures, such as privatizing the Postal Service and limiting regulation to the maintenance of minimum service and delivery standards. The European Union, by contrast, already has done both. The Act also does not contemplate removing the statutory monopolies which shield the Postal Service against the beneficial discipline of full market competition.”
- “On a more encouraging note, the Act directs the Postal Regulatory Commission to undertake a variety of studies that conceivably represent a prelude to future legislative reform. This work, to be completed in just over one year, almost certainly will be evaluated by a Democrat-controlled Congress whose reform sensibilities differ from those of the Republican Congress which passed the underlying legislation. Rapidly changing market conditions nevertheless require that comprehensive and timely reform be enacted. Doing so would be prudent under any circumstances.”
- “The ongoing lesson from the telecommunications industry teaches that comprehensive reform is fraught with political pitfalls. Competing factions battle fiercely to shape legislative and regulatory outcomes in ways that benefit private interests at public expense. Where successful, the ineluctable result is a lawyer-driven industry hamstrung by administrative and judicial mischief. Equally concerning is the willingness of legislators and regulators to sustain moribund firms by imposing arbitrary restrictions, obligations, and taxes in order to fetter more efficient technologies and suppliers.”
- “The Postal Service’s annual revenue, at \$60 billion, is sufficiently large to attract predatory political interest. Ancillary taxation possibilities loom large. For example, all of today’s electronic messaging arguably violates the Private Express Statutes, whose prohibitions and draconian penalties have evolved to shield First Class mail against competition in all forms. Funding some sort of “universal” postal service through a tax on electronic messaging will become a legislative temptation that must be resisted.”

- “The Postal Service is an artifact from a time when Congress sought practical means for binding the nation together. Broadcasting, telephony, the Internet, and large-scale package delivery firms now obviate the need for a quasi-governmental postal authority operating under statutory monopoly protection.”
- “Congress must be encouraged to abjure postal monopolies, and to privatize the Postal Service.” (*Statesman Journal* [Salem, OR], James A. Montanye, 11/09/07)

## **TVA**

NuStart Energy and TVA file application to NRC for license to build a nuclear reactor
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- NuStart Energy, the nation’s largest consortium of nuclear energy companies, and TVA have filed an application with the Nuclear Regulatory Commission for a Construction and Operating License (COL) which would allow for the construction and operation of an advanced reactor design [using the Westinghouse dual-unit AP100] at TVA’s Bellefonte site in northern Alabama. TVA’s COL, which consists of 7,000 pages and required more than 100,000 work hours over a two-year period, will be processed by NRC over a four-year period. NuStart Energy’s goal is to pool the resources of the utilities, so that all 10 members can gain early benefits from the advantages of the new standardized licensing method. Currently, four NuStart members have chosen to use the Westinghouse design in their plans to build new nuclear reactors and have informed NRC that they will reference TVA’s application in their own COLs during the coming year. Bill McCollum, TVA’s chief operating officer said applying for a license as part of the NuStart consortium “is a cost effective way to preserve TVA’s nuclear power option.” Although TVA clearly plans to move ahead with the Bellefonte project, the actual decision to proceed will be made later by the utility’s board of directors after the COL has been obtained, he added. Deputy Energy Secretary Clay Sell called TVA’s application “a monumental step toward the rebirth of nuclear power in the United States.”
- Senator Pete Domenici (R-NM), said, “I am pleased that NuStart and TVA are moving forward with this historic license application. The NuStart consortium saw three big pluses for choosing the Bellefonte site in Alabama—TVA, an attractive pre-existing site, and a community that welcomes a future with nuclear energy. As a nation, we must commit ourselves to a greater usage of nuclear power, our best source of clean, reliable and safe energy. Applying for a new nuclear license puts TVA in a leadership position within the nuclear industry, and we’re proud that Alabama may be home to one of the first new plants in decades.” Senator Lamar Alexander (R-TN) said, “I applaud NuStarts and TVA’s decision to formally apply for a Combined Operating License for the Bellefonte Nuclear Facility. I have worked with Jackson County and TVA officials for years to complete Bellefonte. This is a major move in the right direction for North Alabama to utilize the next generation of

nuclear power technology. (*States News Service*, 10/30/07; *World Nuclear News*, 10/31/07; *Associated Press*, H. Joseph Hebert, 10/31/07; *World Nuclear News*, 10/29/07)

#### North Carolina will “invest” \$5 million in its lawsuit against TVA

- North Carolina Attorney General Roy Cooper said that the state’s lawsuit over TVA’s air pollution will likely cost more than \$5 million in legal expenses. To date, the has incurred \$3.5 million in legal expenses in its quest to get TVA to reduce the amount of pollutants its coal-fired power plants release into the air and Cooper anticipates he will spend an additional \$1.9 million if the case goes to court in the spring.
- Cooper has asked the 10 statewide elected officials serving on the Council of State, which consists of North Carolina’s 10 statewide elected officials to authorize \$250,000 toward the legal bill. He said the money spent so far is a “relatively small investment” for a significant public health threat and argued that the medical costs related to air pollution will exceed \$500 million. Labor Commissioner Cherie Berry was the only member attending the meeting, who voted against the authorization. Berry said she didn’t think the state would win the suit –and even if the state won, she didn’t see the legal action ending there. “How far west are we going to go?” asked Berry (R). “You’ve got Tennessee, and then you’ve got other states.” Governor Mike Easley (D), who supports the lawsuit, argued if North Carolina wins its case in federal court, other states will be reluctant to challenge the legal precedent. “If you have success in the courtroom, it makes it easier in the boardroom,” said Easley. (*News and Observer* [Raleigh, NC], Dan Kane, Barbara Barrett, Ryan Teague Beckwith and Jane Stancill, 11/07/07)

#### Drought in southeast brings pleas to divert water from TVA’s river basins

- With Atlanta’s water supply dwindling down to a 90-day supply, the City’s mayor, Shirley Franklin, has proposed diverting water from the Tennessee River to supply water to the area’s 4.5 million resident for help. Franklin’s recent pleas for help have raised concern in Alabama, which worries that a diversion of water from the Tennessee River could further exacerbate their water problems, caused by the drought. According to TVA officials, any attempt to divert water from the utility’s river basins requires lengthy environmental studies and federal permits. TVA spokesman Gil Francis said that river levels have been at minimum seasonal-water-flow levels since February because of the drought. With water systems, navigation and recreation concerns to consider in the seven states TVA serves, diversion would be complicated. Instead, Francis urged the local governments to develop regional plans for water use. Francis also noted that weather changes. “At some point, the rain will come again,” he said. (*Decatur Daily* [AL], M.J. Ellington, 11/04/07)

**Canfield & Associates, Inc.**  
101 Constitution Avenue, N.W.  
9th Floor West  
Washington, DC 20001  
Phone: (202) 742-4366  
Fax: (202) 403-3926  
[www.canfieldassoc.com](http://www.canfieldassoc.com)