

# The **GSE** REPORT™

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## ***Major Events***

*Subprime market fallout continues...*

Big banks discuss \$100 billion SIV to avoid global credit crisis

Hope NOW is launched to help subprime borrowers keep their homes

Democrats announce initiative to stem subprime mortgage foreclosures

Chairman Frank and Senator Schumer craft compromise bill to lift GSEs' mortgage caps

Letting Fannie and Freddie grow is no solution—and could even be dangerous

Follow the money

Would *you* hire a con man to help you avoid foreclosure on your mortgage?

House passes bankruptcy relief for distressed subprime borrowers

Subprime mortgage crisis hasn't "peaked" yet

No new lessons learned

Subprime mortgages still needed by borrowers with "dinged" credit

### Big banks discuss \$100 billion SIV to avoid global credit crisis

- In hopes of avoiding the danger of a massive global fire sale of mortgage-backed securities, collateralized debt obligations, and other distressed assets, Citigroup, Inc. and other big banks are discussing a plan to pool together as much as \$100 billion in a structured investment vehicle (SIV) to buy distressed assets from participating banks. Over the past three weeks, leading U.S. banks have been meeting with Treasury Department officials to discuss the creation of a superfund, tentatively named Master-Liquidity Enhancement Conduit (M-LEC), which would act as a "super [SIV] conduit" backed by some of the world's largest banks to act as a buyer of last resort for distressed assets. According to one source, "each SIV in the market could pledge up to one-third of its assets and get financing" through M-LEC. Citicorp, J.P. Morgan Chase, Bank of America, Goldman Sachs, and HSBC are among the participants in the discussions. According to *Wall Street Journal*, sources say that the Financial Services Authority, the United Kingdom's markets regulator, has suggested

that U.K. banks also consider participating in M-LEC. The talks represent the Bush administration's latest efforts to restore liquidity to credit markets.

- “Treasury is very serious about getting some solution in place to take away the fear hanging over the markets,” said Alex Roever, a JPMorgan Chase credit analyst. “It is a very challenging thing to do. There are so many parties involved and they all don’t agree.” [Roever has followed the banks’ discussions of M-LEC, but has not participated in the negotiations.] M-LEC would provide Citigroup and other banks a way to “outlast the current market conditions that are so dry right now,” said Morningstar analyst Jaime Peters. The proposal mirrors that of the 1998 bailout of the hedge fund Long Term Capital Management, in which a group of big banks stepped in to prevent the fund from collapsing. The collaboration of the banks on M-LEC reflects the concern by both government officials and large financial players that a fire-sale of distressed mortgage assets and other assets could trigger a second wave of credit crunch which could adversely impact the broader economy. (*Wall Street Journal*, Carrick Mollenkamp, Ian McDonald, Deborah Solomon, Robin Sidel, and David Reilly, 10/13/07; *New York Times*, Eric Dash, 10/14/07; *Reuters*, Neil Shah and Patrick Rucker, 10/13/07; *Forbes*, 10/13/07)
- In the *Naked Capitalism* blog, Yves Smith wrote, “...[W]ill this approach work? The problem started because money market investors didn’t want to buy paper that was exposed to subprime risk, and the SIVs were opaque, so they couldn’t readily ascertain what they held (and even if they did, some of this paper, like collateralized debt obligations, is sufficiently arcane that it isn’t worth the investment of time to verify its creditworthiness. It’s easier simply to buy something else). Remember that money market players are not in the business of taking big risks. They are looking for a safe place to park short-term dough. For the most part, this crowd isn’t paid to speculate... So how is this proposal an improvement over the status quo? At least as described in the [*Wall Street Journal*], the new vehicle is guaranteed by a consortium of banks who are contributing assets. That ought to succeed unless [investors] have gotten nervous about the creditworthiness of big banks. If that turns out to be the case, we really have a mess on our hands.” (*Naked Capitalism*, Yves Smith, 10/13/07)

#### HOPE NOW is launched to help subprime borrowers keep their homes

- On October 10<sup>th</sup>, Treasury Secretary Henry Paulson and HUD Secretary Alphonso Jackson announced the creation of HOPE NOW, an alliance more than 30 mortgage servicers, major banks, mortgage companies, the government-sponsored entities, mortgage counselors, investors and trade organizations, which plans an “aggressive plan” of reaching out to homeowners to help them find a way to stay in their homes. “The earlier a troubled borrower reaches out to explore financial options, the more likely he or she will be able to find an affordable mortgage solution,” said Paulson. “...Although the servicers here represent 60 percent of the mortgages outstanding, we need greater participation if we are going to get to all those that need help as quickly

as possible. Others have good reason to join this alliance, because minimizing foreclosures benefits lenders and investors as well as homeowners.”

- In late November, HOPE NOW will conduct a direct mail campaign to at-risk borrowers, advising them to contact their lenders or credit counselors about their mortgages. The campaign maybe supplemented by a national advertising campaign if funding becomes available, said Michael Heid with Wells Fargo Home Mortgage. The alliance has adopted a standardized process model to speed work flow and improve communication among servicers and providers. “[T]he model requires that each servicer provide a dedicated team of loss mitigation experts to act as a central point of contact for counselors working with their customers, a toll-free dedicated phone number, a dedicated e-mail address, and dedicated fax lines to facilitate communication,” said Heid. The alliance has agreed to expand the existing national network, which manages 1,500 calls per day and operates around the clock, seven days per week. The alliance is also developing communications guidelines to offer customized mortgage solutions for each borrower. Heid stressed the need for funding to ensure the program’s longevity and added that public funding for the nonprofit counseling services “will be required.”
- Representative Barney Frank (D-Mass.), chairman of the House Committee on Financial Services, released a statement saying, “I applaud today’s announcement led by the Secretaries of Treasury and HUD. This will help coordinate efforts and reach more at risk homeowners through the HOPE NOW alliance. I was planning a similar effort to bring together lenders, servicers, counselors, and other nonprofits, but since Treasury and HUD are better positioned operationally to do this, I now plan to join with their efforts rather than duplicate them. The Members and staff of the Financial Services Committee will be cooperating with the Secretaries of Treasury and HUD in promoting this important effort.” Other Democratic lawmakers reacted more skeptically to the announcement of HOPE NOW. “Unfortunately, the bottom is falling out of our housing market much more quickly than the Administration is willing to act to stem the tide of foreclosures,” said Senator Charles E. Schumer (D-NY), a member of the Senate Banking Committee. Nadeam Elshami, a spokesman for House Speaker Nancy Pelosi (D-CA), said, “Today’s announcement by the administration is a small step that should also serve as a wake up call for lenders to take concrete action to help families who are struggling to keep their homes.”
- Housing advocates also voiced skepticism about the alliance. “[It’s] a smokescreen for not doing anything. It’s a PR gimmick. Having a process without a realistic opportunity for results is setting the homeowner up for failure,” said Bruce Marks, founder and CEO of the Neighborhood Assistance Corporation of America. Marks and Michael Shea, housing director of the Association of Community Organizations for Reform Now (ACORN), said they are highly skeptical about HopeNow, because of the reluctance they’ve seen among many members of the alliance to modify loans to levels affordable to borrowers. Marks and Shea support a recent suggestion by FDIC Chairman Sheila Bair that servicers permanently freeze interest rates on subprime adjustable-rate mortgages (ARMs) for those homeowners who are current

on their payments and whose rates have yet to reset. Pointing to a Moody's Investor Service survey that found only 1% of subprime loans had been modified [for the loans resetting in January, April and July], Bair argued that evaluating loans on a case-by-case basis is taking too long and more must be done to help borrowers. While HopeNow's goal is to improve turnaround time on loan evaluations by streamlining the process, Secretary Paulson and the American Securitization Forum (ASF), an alliance member which represents mortgage investors, stated that the alliance doesn't support across-the-board modifications. Paulson said, "The idea of across-the-board modifications is not something that this group is looking to do... and it's not something [that] we in this administration are advocating," He added that it's important that any efforts to work with distressed borrowers not harm lenders' willingness to make more home loans in the future. "How do we do things to help as many people as possible staying in their homes without shutting off future financing?" asked Paulson. Senate Banking Committee chairman Chris Dodd (D-CT) agreed with Bair's suggestion that a formula be used to restructure subprime mortgages into fixed rate loans "because the numbers [of loans] are so large." Dodd added, "Without that, I fear that too many borrowers may slip through the cracks and simply lose their homes." (*Bureau of National Affairs*, Len Bracken, 10/11/07; *Associated Press*, Martin Crutsinger, 10/10/07; *CNNMoney.com*, Jeanne Sahadi, 10/12/07; *Washington Post*, Allan Lengel, 10/11/07; *American Banker*, Cheyenne Hopkins, 10/10/07)

- In an October 6<sup>th</sup> letter to Bair, Anne Canfield, executive director of the Consumer Mortgage Coalition said that servicers of private-label mortgage-backed securities are concerned that some investors are planning to sue them for approving loan modifications. "We are aware of securities holders that have begun scrutinizing the actions of servicers and the ways the servicers' actions have allegedly improperly hurt the interests of the securities holders by insufficient adherence to the [servicing contract's] restrictions on modifications and related actions," wrote Canfield. "Global" remedies, such as forgoing interest rate increases on 2/28s and 3/27s, would violate servicing contracts, she added. "We believe that the 'loan by loan' methods we use are appropriate and allow all the stakeholders—the borrower, the investor and the servicer—to reach the correct outcome..." concluded Canfield. (*National Mortgage News Online*, 10/08/07)
- In reaction to Bair's suggested freeze on subprime mortgage rates, Mike Sheldlock wrote, "...It should not take a genius to figure out that if ARMs rates are 'frozen' at a point where the market does not think rates should be, there simply will be no more ARMs offered. Furthermore, to cover the cost of existing ARMS, prices would rise on new fixed rate mortgages. Oddly enough, price fixing ARMs would not even help the person most at risk because that person cannot afford the teaser rate, let alone the cost of a current ARMS rate. Thus price fixing ARMs is a sure fired guaranteed way to cause a continued weakness in home prices, if not an actual out and out crash. It's really hard to believe the FDIC is that incompetent..." (*Mish's Global Economic Trends*, Mike Sheldlock, 10/08/07)

## Democrats announce initiative to stem subprime mortgage foreclosures

- On October 3, the Democratic leadership of the House and Senate announced legislative and regulatory initiatives to stem the tide of subprime mortgage foreclosures. In a joint press conference, the Democratic leadership charged that the Bush administration has been too slow in responding to mounting crisis in the housing and mortgage markets. The Democrats outlined a series of steps, most of which had been previously proposed, which would help prevent subprime borrowers from losing their homes. Senate Banking Committee chairman Chris Dodd (D-CT) said the “meltdown” in the subprime market would effect “as many as 2.2 million families in this country, as a result of a failure of this administration to pay attention to this issue as it was emerging more than three years ago...”
- Senator Chuck Schumer (D-NY) called on the administration to “remove its ideological blinders and temporarily lift the portfolio caps imposed on Fannie Mae and Freddie Mac.” He added, “The GSEs are the best hope for liquidity.” Although OFHEO recently agreed to raise the GSEs’ mortgage asset caps by 2 percent over the coming year, Schumer insisted the regulator’s action was an insufficient response. The Senator reiterated his call for legislation that would temporarily raise both the asset limits by 10% and increase the conforming loan limit, which would free up \$145 billion that could be targeted by the legislation to helping subprime borrowers refinance their loans. Another legislative answer proposed by the Democrats would be to substantially increase funding for nonprofit groups to provide counseling for delinquent borrowers. The Senate has approved an appropriation of \$200 million next year for home counseling and the House lawmakers are seeking to increase that sum, said Schumer. The lawmakers called on the Bush administration to approve at least \$200 million for foreclosure prevention counseling. The Democrats other legislative efforts to address the subprime mortgage crisis include passage of reform legislation for FHA and the GSEs.
- The Democrats pointed to inaction on the part of the Federal Reserve Board to enforce rules under the Home Ownership and Equity Protection Act to protect borrowers from abusive lending practices. “The Federal Reserve has had more than 15 years to see a problem developing and essentially didn’t react when they should have,” said Senate Majority Leader Harry Reid (D-NV). In a statement released by Democratic leaders, the lawmakers called on President George W. Bush to appoint a “Special Advisor whose full-time job ... will be to aggressively work with lenders, services and the GSEs to modify or refinance troubled homebuyers so that they keep their homes.” After the press conference, House Financial Services Committee chairman Barney Frank suggested that former Representative Jack Kemp (R-NY), who previously served as HUD Secretary and has a “great populist streak and a real understanding of this” to serve as the administration’s “mortgage czar.” Senator Richard Shelby, ranking member on the Senate Banking Committee, criticized the Democrats’ suggestion of appointing a mortgage czar, saying that Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke already are responding to the subprime mortgage crisis. “I believe that their efforts should continue

unimpeded by another layer of bureaucracy,” said Shelby. He added that the legislative proposals promoted by the Democrats were already under consideration in Congress.

- During the press conference, Frank indicated he would support a temporary increase in the size of the Fannie Mae’s and Freddie Mac’s loan portfolio as well as an increase in their conforming loan limit. “As soon as the Senate does it, we would be ready to do it,” said Frank. “The phrase, ‘as soon as the Senate does it,’ does not come trippingly to the tongue,” he added. His position reversed his comments made several weeks ago, in which Frank said he would only support such changes as part of broader regulatory reform for the GSEs and set off a “firestorm” on Capitol Hill. In response to Frank’s comments, Treasury spokeswoman Jennifer Zuccarelli said, “Treasury has agreed that the GSEs temporarily may play an expanded role, as part of a number of efforts [to help distressed subprime borrowers]. But as responsible policymakers, we only can consider an expanded role in the context of comprehensive GSE reform.” (*Congressional Quarterly*, Benton Ives, 10/11/07; *Dow Jones International*, Damian Paletta, 10/11/07; *CQ Today*, Benton Ives, 10/03/07; *Bloomberg News*, Alison Vekshin and James Tyson, 10/03/07; *Bureau of National Affairs*, 10/04/07)
- In the *New York Sun*, Amity Shlaes observed, “...Democratic lawmakers are already calling on the White House to Katrina-ize the mortgage problem by appointing a special housing adviser to coordinate a federal response to mortgage problems. Republicans are almost as ready to see Washington jump. The decision by the [FHA] to rescue troubled subprime borrowers demonstrated that. The [FDIC] is already pulling its hair and imploring lenders to freeze ARM rates. If Fannie Mae and Freddie Mac founder, as they well might, they would give new meaning to the phrase too big to fail. All this might mean a much larger bailout for borrowers than we saw this summer, or even during the savings and loan crisis, is possible. Volckeresque rate increases would follow...” (*New York Sun*, Amity Shlaes, 10/12/07)

#### Chairman Frank and Senator Schumer craft compromise bill to lift GSEs’ mortgage caps

- On October 4, House Financial Services Committee chairman Barney Frank (D-MA) sought to “clarify” his comments made during the Democrats’ October 3<sup>rd</sup> press conference on the subprime market crisis. Frank said, “I continue strongly to oppose any partial legislation regarding Fannie Mae and Freddie Mac that would in any way diminish the interest of various parties in the adoption of comprehensive GSE legislation. Specifically, I have opposed and continue to oppose any legislation that would deal only with raising the jumbo loan limit, or generally increasing the portfolio cap, or any combination of those. I believe a six month extension [of the GSEs’ mortgage caps] would meet the needs that we have for a temporary accommodation in the purchase of refinanced subprime loans, but would expire quickly enough so that it could not come even close to being an obstacle to the push for a broader bill.”

- On October 11<sup>th</sup>, Frank later released statement saying, “I will introduce a very limited bill that mandates that the portfolio caps imposed by the regulator on Fannie Mae and Freddie Mac be temporarily increased [10% or nearly \$150 billion]—for six months—with 85 percent of the increase required to be used for purchasing refinanced subprime mortgages.” Frank added that Senator Charles Schumer (D-N.Y.) would introduce similar legislation in the near future. Frank added, “I continue to believe that it is very important that we pass a comprehensive GSE bill, and I hope that the Senate will soon be able to act on this matter,” Frank’s statement said. “For this reason, I have refused to support a bill that would provide an unrestricted 10 percent increase in the portfolios for one year, because I believe that could be seen as lessening the need for overall legislation in the minds of some.”
- On October 12<sup>th</sup>, Schumer introduced his bill which would allow the GSEs to expand their mortgage portfolios. Schumer said he plans to attach the bill to the “first available legislative vehicle” and, as a last resort, would attach it to the omnibus appropriations bill. (*Market News International*, John Shaw, 10/11/07; *Bureau of National Affairs*, Richard Cowden, 10/05/07; *Bureau of National Affairs*, Richard Cowden, 10/12/07; *Financial Times*, Jeremy Grant, 10/12/07; *Congress Daily*, Bill Swindell, 10/11/07; *American Banker*, Steven Sloan, 10/12/07)
- Treasury Secretary Henry Paulson reiterated the administration’s opposition to raising Fannie Mae’s and Freddie Mac’s portfolio limits, arguing that it would benefit the GSEs without necessarily helping the current market crisis. “The things that they could do that would be most helpful would require an expansion of their business model, taking on more risk, and I think we should do that where it makes sense,” said Paulson. “But we should do it in conjunction with a strong, independent regulator.” (*Dow Jones Newswires*, Tom Barkley, 10/10/07)
- In an interview with *Dow Jones Newswires*, OFHEO director James B. Lockhart, III said, “I think it’s a good idea to encourage both Freddie and Fannie to do more in the subprime space, and in particular rescue mortgages. But I don’t think increasing the cap is necessary to do that.” He added, “My concern would be if they are misleading Congress in any way. In this issue of portfolio caps, there is potentially a little of that going on in that they have not really told Congress that they could do what Congress wanted without an increase in the portfolios.” Lockhart also expressed concerns that temporary legislation could hurt the chances for passage of broader regulatory reform. “What’s happened in the market over the last two or three months really points to the need to have a strong Fannie and Freddie, but also a strong regulator,” he said. “And so anything that dilutes the possibility of getting that legislation through, I would be against.” (*Dow Jones Newswires*, Damian Paletta, 10/10/07)
- Analysts doubt that raising Fannie Mae’s and Freddie Mac’s investment caps would have much impact, because the companies’ charters limit their ability to finance riskier home loans. To refinance these subprime loans, Fannie and Freddie would have to charge high-risk borrowers a hefty premium, said Paul Miller, an analyst with

Friedman, Billings, Ramsey & Co. “It makes great headlines, but a lot of these loans will not fit into Fannie and Freddie’s criteria,” said Miller. “Some of these subprime loans are not fixable.” Pressure from Democrat lawmakers is unlikely to affect OFHEO’s plans for lifting the caps, said Brian Gardner, a Keefe, Bruyette & Woods research analyst. “[The caps are] probably coming off, but I don’t think this is going to speed up the timeline at all,” added Gardner. Mortgage industry consultant Howard Glaser, a federal housing official in the Clinton Administration, argues that a larger increase in Fannie’s and Freddie’s investment portfolio caps is inevitable and believes that the GSEs’ infusion of money would provide meaningful stability and added liquidity in the mortgage market. “Fannie and Freddie are the major tools for returning stability to the mortgage markets,” said Glaser. “They can’t be kept on the sidelines forever.” (*Associated Press*, Alan Zibel, 10/03/07)

### Letting Fannie and Freddie grow is no solution—and could even be dangerous

- In its October 4<sup>th</sup> issue, *The Economist* wrote, “The news from America’s housing market is getting no better. What should [U.S.] policymakers do? An expansion of the Federal Housing Administration, which guarantees mortgages to iffy borrowers, is in the cards. But Congress is itching to do more: hence the calls to expand the role of Fannie Mae and Freddie Mac, the giant ...[GSEs] that tower over America’s mortgage market. Fannie’s and Freddie’s political allies want two things. The first is the raising of the \$417,000 limit on the size of loans that the pair may handle. This would allow the GSEs into the “jumbo” mortgage market, where interest rates jumped in August. The second demand is the lifting of caps on the amount of mortgages they may buy and hold for themselves, put in place after accounting scandals a few years ago. Fannie and Freddie could then, as they portray it, ride to the rescue of struggling borrowers, injecting liquidity into parts of the market that have seized up. ...Unfortunately, the ideas are likely to do more for Fannie and Freddie than for the mortgage market.”
- “Start with the \$417,000 limit. Lifting this—Freddie Mac suggests \$650,000—could help if Fannie and Freddie scoured the upper bracket for borrowers who were struggling but viable. But their history suggests that they would cherry-pick those who could get refinanced elsewhere. And the jumbo-mortgage market may be correcting itself anyway: spreads over GSE-backed loans, though still unusually high, are falling.”
- “There are two reasons not to let the GSEs’ portfolios expand. First, it would be redundant. Whatever good Fannie and Freddie can do with bigger portfolios, they can already do through their other main business, guaranteeing and securitizing others’ mortgages, on which there are no limits. Fannie and Freddie would prefer to hold mortgages rather than guaranteeing them for a simple reason: it is more profitable. It is also riskier. When they hold a mortgage, they take on not only credit risk but also interest-rate and prepayment risk. The loans they guarantee, in contrast, carry only credit risk (the other risks are borne by the investor in the securities). So

as well as being just as effective, the guarantee business is also safer—and thus better for the taxpayer who unwittingly stands behind the GSEs. It is worth recalling that when Fannie and Freddie were caught misstating earnings by a combined \$11 billion a little while ago, the mismanagement of interest-rate risk, not credit risk, caused their problems.”

- “Moreover, even if they grow no more, the mortgage giants pose a clear systemic threat. Their portfolios of retained mortgages and mortgage-backed securities add up to no less than \$1.4 trillion. It is bad enough that this is concentrated in two institutions. Worse, they lack discipline because of the implicit guarantee. No matter how much risk they take or how they manage it, they can borrow at rock-bottom interest rates. If they got into trouble, banks as well as taxpayers would be on the hook. Banks may hold as much GSE debt as they want. Many have amounts that exceed their regulatory capital.”
- “It would be better if instead of letting Fannie and Freddie become even more bloated, politicians saw the GSEs for the anachronism they are. They were set up decades ago to help banks pool concentrated regional mortgage risk and to make housing more affordable. But as the market has grown deeper and more sophisticated, history has left them behind—hence their desire to get into any bit of the business that will turn a profit. The eventual aim should be to turn them into normal private-sector companies, by stripping them of the charters that give rise to the implicit government guarantees, and break them into smaller pieces. Encouraging another growth spurt, even in today’s sagging market, is asking for trouble.” (*The Economist*, 10/04/07)
- At the *Street.com*, Nat Worden added, “While Fannie and Freddie have so far avoided the sort of massive asset writedowns that have recently hit other financial institutions in the mortgage market, like Countrywide Financial, their financial performance is suffering from the same issues. ‘People are saying the problem is just in the subprime market and Fannie and Freddie are doing great, but look at recent results from Freddie,’ says Josh Rosner, an independent financial services analyst with Graham Fisher & Co. ‘We may not have audited and full statements from them, but we certainly have a clear sense that they have not been doing well and their credit quality is deteriorating.’ Freddie said its second-quarter net income dropped 45% to \$764 million. Fannie didn’t report its second-quarter results, but CEOs from both companies recently told Congress that their default rates were rising and adjustable rate mortgages with resets peaking in 2008 make up roughly one-fifth of their mortgage portfolios. ‘I expect to see considerable and surprising levels of defaults and some problems with the valuation of their portfolios ultimately,’ says Rosner. ‘It’s a dangerous game to allow them to claim a victory at this point and give them more power to expand their portfolio when the reality is, they’re perfectly capable of securitizing now. I’m not sure what expanding their portfolio does other than drive more revenue to them.’” (*TheStreet.com*, Nat Worden, 10/09/07)

## Follow the money

- In an October 5<sup>th</sup> editorial, the *Milwaukee Journal Sentinel* wrote, “The collapse of the subprime housing market is like a bad Halloween movie. Thousands of homeowners who had hoped for the American dream are instead living an American horror story. With 2.5 million more loans resetting to higher rates over the next two years, that story is still playing out. Even so, Congress must be wary of allowing Freddie Mac and Fannie Mae to play leading roles, as some congressional Democrats are suggesting.”
- “Fannie and Freddie provide a secondary market in home mortgages by purchasing them from lenders. They hold some of these mortgages and sell others as mortgage-backed securities. Because of their unique position, they can borrow at rates that their top private competitors can’t touch. The debt is backed, at least implicitly, by the U.S. Treasury, which means taxpayers could be on the hook if they fail. Fannie and Freddie want the caps lifted on the size of their portfolios of mortgage-backed securities. And they want the ability to purchase jumbo mortgages, those larger than their current \$417,000 limit.”
- “Neither does much to help subprime borrowers. Freddie and Fannie are unlikely to buy troubled loans, and it’s debatable whether these agencies actually add capital to the market or just move it around.”
- “There are also those nettlesome accounting scandals. Freddie Mac recently agreed to pay a \$50 million penalty as part of a settlement with the [SEC] over allegations it misstated earnings. It admitted no wrongdoing. Last year, Fannie Mae was fined \$400 million in its own accounting fraud case.”
- “Any loosening of restrictions on Fannie and Freddie must include stronger regulation.”
- “But it’s worth asking why congressional patrons believe giving this duo more latitude is a good idea at all. We suspect the answer can be found in the donors’ logs of those congressmen.”
- “Fannie and Freddie are government-sponsored enterprises and are supposed to help with low-income housing. They should stick to that. Their presence in this story won’t make for a happy ending.” (*Milwaukee Journal Sentinel*, 10/05/07)

## Would you hire a con man to help you avoid foreclosure on your mortgage?

- In an October 11<sup>th</sup> article, *Bloomberg* columnist David Pauley wrote, “Would you hire a con man to help you avoid foreclosure on your mortgage? That’s more or less what Democrats who control the U.S. Congress have proposed in order to ease the

crisis in the housing market. Party leaders [have] suggested lifting the current caps on mortgage holdings of Fannie Mae and Freddie Mac, the country's biggest buyers of home loans. They would direct the bulk of the money—about \$120 billion—into the purchase of risky home loans that have set the markets aflutter and are now hard to sell. Instead of allowing scandal-torn Fannie Mae and Freddie Mac to harvest profit from the proposed overall 10 percent increase in their mortgage investments, Congress should break up the companies and end their dominance of the mortgage business.”

- “Fannie and Freddie’s mortgage holdings are limited for good reason: Both companies made a habit of issuing fraudulent earnings reports, giving investors the impression of steady profit increases. The misstatements totaled \$11 billion and the companies paid \$525 million in fines, \$400 million by Fannie Mae. The books of both companies are still being straightened out. In September, ...[OFHEO] said it might lift the mortgage caps as early as February—if the companies’ 2007 earnings reports are clean. The limit on mortgage holdings at both companies is \$735 billion.”
- “Even so, Fannie and Freddie—both creatures of the government with public shareholders—rule the market. They own or guarantee about 40 percent of the \$11 trillion in U.S. home mortgages outstanding. It’s time for the government to divide the companies at least in two. In other words, better to have four companies with 10 percent market shares rather than two with 20 percent each. That would reduce the risk of one company failing and looking for a bailout by the taxpayers. ...Fannie Mae and Freddie Mac have proved to be anything but the cuddly protectors of home ownership that their names and promotion might suggest. Throw them out into a cold, competitive marketplace and see if they can redeem themselves.” (*Bloomberg News*, David Pauly, 10/11/07)

#### House passes tax relief for distressed subprime borrowers

- On October 4<sup>th</sup>, the House of Representatives passed a bill (H.R. 3648) by a vote of 386-to-27 which would permanently exclude from taxable income any debt that was forgiven as a result of mortgage foreclosure or renegotiation retroactively up to \$2 million. The bill also would extend the deduction for private mortgage insurance, scheduled to expire on December 31<sup>st</sup>, to the end of 2014 and slightly broaden the definition of a housing cooperatives to enable a taxpayer to deduct payments to the co-op as mortgage interest. The bill’s cost is offset by adjustments to corporate estimated tax payments and by a provision providing new restrictions the capital-gains-exclusion tax benefits available to taxpayers who buy vacation and rental homes. Senator Debbie Stabenow (D-MI) has introduced a similar bill (S. 1394), which has been referred to the Finance Committee. (*Washington Post*, Kenneth R. Harney, 10/06/07; *CQ Today*, Richard Rubin, 10/04/07; *Bureau of National Affairs*, Heather M. Rothman, 10/05/07)

- According to the White House’s Statement of Administrative Policy, “The Administration supports House passage of H.R. 3648, which advances the President’s proposal to help financially troubled homeowners by shielding mortgage write-offs from taxation. While the House should be commended for its efforts to protect these homeowners from an unexpected tax bill, the Administration strongly believes this relief should be temporary to assist homeowners during the current mortgage market transition period and to avoid distorting consumer and lender decisions on new mortgage loans. The tax code already protects people who are insolvent or whose debt has been discharged in bankruptcy from having to pay tax when debt is cancelled; therefore, the most financially stressed mortgage borrowers are already protected under current law. The Administration looks forward to working with Congress to narrow the scope of the bill and ensure that it addresses current difficulties without the potential for influencing future behavior. Also, the Administration does not think it is necessary for this tax relief to be offset by revenue increases.” (*Bureau of National Affairs*, 10/04/07)
- By a vote of 5 to 4 along party lines, a House Judiciary subcommittee to report H.R. 3609 which would revise certain provisions of the Bankruptcy Code related to residential mortgage loans to the full committee. Subcommittee chairwoman Linda T. Sanchez (D-CA) said that the bill would allow “a debtor in Chapter 13 to reorganize his or her home mortgage obligations just like any other debt” and “provides guidance to the courts in terms of how this restructuring may be done.” The bill would also provide an exception for certain homeowners to the mandatory requirement that consumers receive credit counseling before they file for bankruptcy relief.
- Republicans argued that the bill could have unintended consequences in the real estate market. “I fear that it will immediately trigger a restriction of capital, a rise in mortgage rates, and a resulting drop in the numbers of those who can buy homes, said Representative Chris Cannon (R-UT), ranking member of the subcommittee. Industry groups voiced similar concern. “This bill is a first-class example of where Congress will overreach and make the situation worse rather than making it better,” said Kurt Pfothauer, senior vice president for government affairs and public policy at the Mortgage Bankers Association. By allowing bankruptcy judges to change the terms of a home loan after it has been originated, lenders would likely view mortgage loans as relatively riskier investments and could end up charging higher rates and requiring higher downpayments to offset those risks, MBA argued. Housing advocates argue that this “tweak” to the bankruptcy code could help up to 600,000 homeowners avoid foreclosure. (*Bureau of National Affairs*, Eileen J. Williams, 10/05/07; *CNNMoney.com*, Jeanne Sahadi, 10/01/07; *CQ Today*, Benton Ives, 10/04/07; *American Banker*, Steven Sloan, 10/05/07)
- According to *BusinessWeek*, “A \$20 billion hedge fund may have hit on a unique investment strategy for playing the subprime mortgage bust: fund a consumer-protection group. Paulson & Co., which has seen its assets under management soar this year through fortuitous bets in the subprime market, has given \$15 million to the

Center for Responsible Lending, a Washington nonprofit that has been lobbying on Capitol Hill for passage of bankruptcy legislation. Paulson, run by former Bear Stearns (BSC) investment banker John Paulson, stands to rake in a windfall if the measure passes.” “The hedge funds and equity firms have bet that Americans will lose their homes. If the bankruptcy bill is enacted, they stand to make considerable profits,” said Scott Talbott, a lobbyist with the Financial Services Roundtable. (*BusinessWeek*, Eamon Javers and Dawn Kopecki, 10/12/07; *American Banker*, Stacy Kaper, 10/12/07)

- The subcommittee’s vote on H.R. 3609 came on the day that Senator Arlen Specter, ranking member on the Senate Judiciary Committee, introduced a bill that would allow bankruptcy judges to delay, ban, or change rate increases on mortgages and waive early repayment penalties. On October 4, Senator Richard Durbin (D-IL) introduced a bill that would allow a bankruptcy judge to modify the terms of a debtor’s primary mortgage, which largely mirrors H.R. 3609. In some areas, Durbin’s bill would go further than the House version, giving more specifics on time frames and interest rates for mortgages restructured under Chapter 13 of the federal Bankruptcy Code. (*American Banker*, Steven Sloan, 10/05/07; *American Banker*, Steven Sloan, 10/04/07)
- At a press conference, Treasury Secretary Henry Paulson was critical of Democrats’ efforts to modify bankruptcy laws to help homeowners avoid foreclosure. “When you’re talking about bankruptcy and modifying contracts, then you’re dealing with something that may ... very much impede future financing and a mortgage work that has been the envy of the rest of the world,” said Paulson. “So again we need to be careful in trying to help so we don’t end up doing something that’s counterproductive.” (*American Banker*, Cheyenne Hopkins, 10/10/07)

#### Subprime mortgage crisis hasn’t “peaked” yet

- The U.S. subprime crisis is likely to get worse and dampen U.S. economic growth through 2008, said David Wyss, the chief economist of Standard & Poor’s. “The panic has subsided but the housing market has not hit bottom yet. It will not hit bottom until winter. Housing prices won’t hit bottom until next summer and the losses won’t peak for another two years, until 2009,” said Wyss. “We are not halfway through this crisis yet.” According to S&P forecasts, the U.S. economy is expected to grow 2% in 2007 and in 2008, while the global economy is projected to grow 3.6% and 3.5% for these two years. “We are looking at another year of sluggish growth and that’s consistent with an uptick in the unemployment rate to 5%,” said Wyss. To date, the credit losses resulting from the U.S. subprime crisis have not been that great—only about \$150 billion, representing less than 1% of the \$16 trillion U.S. mortgage market, he said. (*Dow Jones Newswires*, Subhadip Sircar, 10/09/07)
- In the wake of specialty mortgage companies faltering in the face of tougher secondary market conditions, the balance sheet strength of the five largest U.S.

banking companies should likely push their combined retail mortgage business to nearly 50% by the end of 2008, according to Howard K. Mason with Sanford C. Bernstein & Co. Over the last five years, Citigroup Inc., JPMorgan Chase & Co., Bank of America Corp., Wachovia Corp., and Wells Fargo & Co. lost an aggregate 5 percentage points of their share of the mortgage origination and servicing market and currently account for 31% of the market, said Mason. “With the capital markets more restrictive, the mortgage specialists can no longer fund the growth rates of recent years, and aggressive underwriting is likely to be constrained by regulatory tests around ‘suitability,’ “ wrote Mason in a research note on September 27<sup>th</sup>. “There is an increasing advantage to banks that can defray mortgage origination costs across a broader array and use their balance sheets to mitigate the funding constraints of the capital markets.” (*American Banker*, Tim Mazzucca, 10/01/07)

### No new lessons learned

- In an October 9<sup>th</sup> speech, William Poole, the president of the Federal Reserve Bank of St. Louis, said that while the financial turmoil of the subprime mortgage crisis is still unfolding, his preliminary judgment that there are no new lessons” to be learned. Poole said, “Weak underwriting practices put far too many borrowers into unsuitable mortgages. As borrowers default, they suffer the consequences of foreclosure and loss of whatever equity they had in their homes. It is painful to have to move, especially under such forced circumstances. Investors are suffering heavy losses. There is no new lesson here: Sound mortgage underwriting should always be based on analysis of the borrower’s capacity to repay and not on the assumption that a bad loan can be recovered through foreclosure without loss because of rising property values.”
- “The other aspect of the current financial turmoil that reaffirms an old lesson is that it is risky to finance long-term assets with short-term liabilities. Consider a portfolio of any sort of long-term assets or assets carrying substantial credit risk, such as securities collateralized with subprime mortgages. Financing such a portfolio with commercial paper makes the firm vulnerable to the risk that holders of the commercial paper will refuse to roll over maturing issues. Over the past few months, firms that structured their portfolios this way found themselves faced with exactly this problem. No manufacturing firm would ever finance a portfolio of fixed assets with commercial paper; once market sentiment became distrustful of subprime assets, these assets lost value and became no more marketable than investments in factory buildings.”
- “The Federal Reserve has neither the power nor the desire to bail out bad investments. We do have the responsibility to do what we can to maintain normal financial market processes. What that means, in my view, is that we want to see restoration of active trading in assets of all sorts and in all risk classes. It is for the market to judge whether securities backed by subprime mortgages are worth 20 cents on the dollar, or 50 cents, or 100 cents. Obviously, the market will judge different

subprime assets differently, based on careful analysis of the underlying mortgages. That process will take time, as it is expensive to conduct the analysis that good mortgage underwriting would have conducted in the first place. Although there is a substantial distance to go, restoration of normal spreads and trading activity appears to be under way, and we can be confident that in time the market will straighten out the problems. We do not know, however, how much time will be required for us to be able to say that the current episode is over.” (*Prepared Remarks by William Poole, President of the Federal Reserve Bank of St. Louis, 10/09/07*)

#### Subprime mortgages still needed by borrowers with spotty credit

- In an interview with *Associated Press*, former chairman Alan Greenspan said that there remains a place in the market for borrowers without stellar credit. “Subprime mortgages were and are risky, but they are worth it,” Greenspan said, arguing that it’s better to have a larger property owning class with a vested interest in the system. “I’m terribly concerned that we would cut back on the availability of subprime that has enabled a very significant increase in mortgages among minorities in the United States,” he added. (*Associated Press, Jane Wardell, 10/02/07*)
- In an October 10<sup>th</sup> speech, Eric S. Rosengren, president and CEO of the Federal Reserve Bank of Boston said that is “critical” that subprime lending continue. He acknowledged that the securitization process that ensured a steady stream of funding for subprime mortgages has tightened, as a result of many brokers who arranged financing have gone out of business. “Since the broker channel has been disrupted, ...I believe there is an opportunity for commercial and savings banks to help provide liquidity in this market,” said Rosengren. “Most commercial and savings banks were not involved in originating subprime mortgages and are well capitalized, and may have profitable opportunities to explore in this market.” (*Bureau of National Affairs, R. Christian Bruce, 10/11/07; Wall Street Journal, Greg Ip, 10/10/07*)

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

House of Representatives passes housing trust fund bill
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- By a vote of 264 to 148, the House of Representatives passed legislation on October 10<sup>th</sup> that would create one of the biggest expansions of federal housing programs in decades through an affordable housing fund. The bill (H.R. 2895) would allocate from \$800 million to \$1 billion annually through separate measures that overhaul the FHA insurance program and the regulatory structure of Fannie Mae and Freddie Mac. By a voice vote, the House also adopted an amendment that would allow grantees to give preference in the program to public employees such as police officers and teachers who live in high-cost areas. (*National Journal*, Jill Smallen and Jason Dick, 10/13/07 *National Journal's CongressDaily*, 10/11/07)
- In a statement of administration policy issued by OMB, the White House said the trust fund legislation would create a “duplicative program” and instead urged Congress to “fully fund the president’s request for the high-performing, flexible Home Program, which has an effective track record for producing affordable housing for low-income families.” OMB said that the bill’s reliance on Fannie Mae and Freddie Mac for funding would “create an undue and counterproductive reliance” on the GSEs. The agency also raised concerns that the fund could be “susceptible to political influences that could compromise the goals of assisting as many low income families in need as possible. If H.R. 2895 was passed and sent to the White House for signing, OMB said that administration advisors would advise the President to veto the legislation. (*Dow Jones International News*, Damian Paletta, 10/09/07; *National Journal's CongressDaily*, 10/11/07))
- The bill faces an uncertain future in the Senate. While noting his support of this bill, Senate Banking chairman Christopher Dodd (D-CT) has not introduced a comparable version, nor has he held any hearings on this issue. In a statement, Dodd said, “There is a critical shortage of affordable housing in many areas around the country. Incomes have not kept up with rising rents, leaving many working families with a large gap between what they make and the cost of housing their family.” (*National Journal*, Jill Smallen and Jason Dick, 10/13/07; *National Journal's CongressDaily*, 10/11/07)

Details on Chairman Frank’s mortgage overhaul emerge, but status of similar legislation in the Senate is “murky”
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- The latest iteration of a bill by House Financial Services Committee Chairman Barney Frank to overhaul the mortgage market would call for more specific underwriting requirements and more qualifications on a provision that would offer lenders a safe harbor exemption for secondary market liability. The outline is the

third to surface in recent weeks, provides details on three key sections of the bill. According to a previous outline, the bill would ban any lender from making a residential mortgage loan to a consumer who has no reasonable ability to repay or refinancing a loan that does not have a “net tangible benefit” to the consumer. The revised bill outline provides more details on how the bill would define such conditions. Under the bill, lenders would be required to make a “reasonable and good faith determination based on verified and documented information” that a borrower can repay the loan based on the fully indexed and fully amortized rate, after factoring in all loan terms, taxes, insurance, and assessments when qualifying a borrower.

- The summary adds specific criteria for assessing the borrower’s ability to repay adjustable-rate mortgages with deferred payment on principle and/or interest. For interest-only loans, lenders are required to consider the “payment amount required to amortize the loan by its final maturity.” Lenders must consider “any balance increase that may accrue from any negative amortization provision.” According to the summary, refinancing loans would be deemed to have no net tangible benefit “if the costs of the refinanced loan including points, fees, and other credit organization charges, exceeds the amount of any newly advanced principal” under the bill.
- The summary provides additional details on a controversial assignee liability provision. According to *American Banker*, “Under the new version, a ‘lender/assignee’ would be protected from liability for loans within a yet-to-be-defined range of interest rates close to the Federal Reserve Board rate, or if it meets several other criteria. That criteria includes loans with a debt-to-income ratio that does not exceed 50% and includes documentation verifying the income of a borrower and underwritten at the fully indexed rate.” (*American Banker*, Stacy Kaper, 10/12/07)
- On September 5<sup>th</sup>, Senate Banking chairman Chris Dodd issued a press release, detailing his plans for comprehensive mortgage reform legislation. “Predatory lending needs to be stopped, which is why I intend to introduce legislation that will put an end to the practices that have forced thousands of Americans into foreclosure and put thousands more in danger of losing their homes,” said Dodd in the press release. In the month after Dodd’s office provided a laundry list outline of the bill’s features, little evidence has emerged to suggest that that the Senator is doing the bipartisan coalition-building that it would take to pass such legislation. Instead, Dodd has been busy campaigning for president, which appears to rankle fellow lawmakers, members of the financial services industry, and consumer activists. “Senator Dodd’s preoccupation with some other things such as running for president has not put him here on a timely basis, and so ... even though there was a comprehensive bill [summary] written, there’s been no one pushing it and there’s been not much coordination between staffs,” said Senator Jim Bunning (R-KY) in a recent interview with *American Banker*.
- Senator Robert Menendez (D-NJ), who has repeatedly called for action to stem foreclosures, recently announced that he would introduce his own bill package of

bills. “We have always said to Senator Dodd that we are happy to work in collaboration with him, but we may have some issues that we believe we might be ready to go on before he comes to those conclusions,” said Menendez. “We’re trying to think strategically what’s best to do.”

- “For the Banking Committee in the face of this [subprime] crisis ... to not have a response would be — to say it would be ill-advised would be an understatement,” said Senator Robert Casey (D-PA). “We’ve got to have a response.” Casey hopes that the committee can come to a consensus quickly and vote on a bill this fall “to prevent this stuff from happening again.” He added, “Dodd has been very responsive ... and the fact that our committee has had hearings that deal with this I think speaks volumes about his concern about it, but we’ve got a lot more work to do.”
- While committee members all agree that there is much work to do on the mortgage issue and hope it will be done soon, some Senate aides say there are no serious negotiations taking place in the committee largely because of Dodd’s attention to his presidential campaign. “He obviously has his presidential campaign and he’s working on that, so there may be things that he does as chairman of the Senate Banking Committee that are good for the presidential campaign. ... If it’s one of those issues that he’s ready to mark up, then his staff will come around and we’ll have a meeting and we’ll take this seriously and see what we can do to help out,” said one aide.
- At a recent panel hearing, Dodd’s absenteeism was the butt of a joke after three different members rotated into the chairman’s seat in place of the Chairman in one week. “So many different senators have chaired meetings this week, I am wondering when it will be my turn,” said Bunning. Ranking member Richard Shelby (R-AL), who is typically reticent to criticize, noted that Dodd’s time on the campaign trail puts a big question mark over what the committee will complete this year. “He seems to be busy. ... He’s running for president,” said Shelby. “That’s very important, and if he’s running for president it’s hard for him to be here every day. ... This is the first year of a two-year Congress, and there’s plenty of time.”
- According to industry observers, Dodd’s strategy will likely depend on whether his goal is to enact legislation or just use subprime mortgage reform as a political issue. “If he wants a bill, then this is a starting point. Then he’ll negotiate with Republicans to get some kind of consensus compromise,” said Keefe, Bruyette’s political analyst Brian Gardner. “If he doesn’t want a bill and he just wants the issue, then I think he’ll try and push this through the committee with few changes.” It “won’t get a lot of Republican support and dies on the Senate floor. That’s an election-year tactic. Both sides have used it.” (*American Banker*, Stacy Kaper, 10/12/07)
- Dodd’s busy schedule has also precluded the Committee from moving the President’s three pending nominations to the Federal Reserve Board to the Senate floor for a vote. “The Fed nominations are not a high priority at this point,” said Dodd. “We’ve got some legislative stuff to get out.” With just five governors, the Fed can still do

business. The loss of one more governor would make it difficult for the central bank to authorize lending from its discount window to non-banks, which requires the approval of five governors. (*Wall Street Journal's Real Time Economics Blog*, 10/03/07)

- During the third quarter of 2007, Senator Christopher Dodd (D-MA) raised \$1.5 million for his presidential campaign, placing him well behind front-runners Senators Hillary Rodham Clinton (who raised \$27 million in the quarter) and Barack Obama (“close to” \$20 million) and second-tier candidates former Senator John Edwards (\$7 million) and New Mexico Governor Bill Richardson (\$5.2 million). Campaign spokeswoman Colleen Flanagan said, “No campaign can buy voters or votes in these early states. Voters are going to respond to which candidate they believe will deliver results about the issues they care about the most...We are confident that that candidate is going to be Chris Dodd.” (*Dow Jones Newswires*, Damian Paletta, 10/02/07)

Treasury Department wants to expand its oversight over Fannie Mae's and Freddie Mac's debt growth
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- According to a document obtained by Reuters, the Treasury Department wants to expand its power to regulate how Fannie Mae and Freddie Mac access the debt market, which could “stifle” the GSEs’ ability to grow its investment portfolio. According to Treasury’s outline, the agency would require Fannie and Freddie to “estimate total debt outstanding (with high and low range) during the upcoming six months period.” The plan envisions requiring the GSEs to obtain Treasury approval of any debt issuance that “may materially change the risk profile of the enterprises” or “may have significant spillover effects” and assessing penalties if either GSE exceeds its debt ceiling. According to sources “close to the GSEs,” Treasury’s language could be construed as a test to gauge if the GSEs’ debt might imperil the broader economy. Sources also said that the months-long talks between Treasury, Fannie Mae and Freddie Mac have broken down over the GSEs’ officials concern that the agency’s new debt protocol could be used as a tool to disrupt their business. On October 5<sup>th</sup>, Fannie and Freddie sent a letter to the Treasury Department, suggesting that the agency’s current debt oversight process is sufficient, according to sources familiar with the correspondence. Senator Charles Schumer (D-NY) said, “In this critical time of mortgage market turmoil, the administration should refrain from doing anything that would handicap Fannie and Freddie’s ability to provide much-needed relief to subprime borrowers.” (*Reuters*, Patrick Rucker, 10/05/07)

OFHEO announces a proposed rule for loss severity calculations under the risk-based capital regulation for Fannie and Freddie
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- OFHEO has proposed a new formula to determine how much capital Fannie Mae and Freddie Mac must hold against potential losses, which could force the GSEs to boost their capital reserves. In a notice proposed rulemaking, OFHEO said that Fannie and

Freddie may not be correctly tallying the amount of money recovered from failing loans and therefore underestimate the wealth they need to protect against losses. “The current loss severity equations overestimate Enterprise recoveries for defaulted government-guaranteed and low loan-to-value (LTV) loans,” said OFHEO. “The results generated by the current loss severity equations are not consistent with the Risk-Based Capital Regulation and result in significant reductions in the risk-based capital requirements of the Enterprises.” (*Reuters*, 10/11/07)

- On the *New York Times Blogs*, Floyd Norris wrote, “Do you ever get the feeling that regulatory rules are manipulated by the regulated? ...[OFHEO] said today that it was amending the rules on how much capital its regulatees — Fannie Mae and Freddie Mac — must have. Before your eyes glaze over, consider OFHEO’s explanation. ‘The first change is proposed because certain loss severity equations *result in the Enterprises recording profits instead of losses* on foreclosed mortgages during the calculation of the risk-based capital requirement.’ (emphasis added) You got that? The more their loans go bad, the less capital the current rules say they need. If anybody knows how that was justified in the first place, please let me know.” (*New York Times Blogs*, Floyd Norris, 10/12/07)

HUD releases the 2006 public-use database for Fannie and Freddie
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- On October 11<sup>th</sup>, HUD announced the release of the GSE Public Database of single-family mortgage acquisitions for 2006. This data on mortgages purchased by Fannie Mae and Freddie Mac supplies mortgage lenders, planners, researchers and housing advocates with information on the flow of mortgage credit in America’s communities. The database can be accessed at [www.huduser.org/datasets/gse.html](http://www.huduser.org/datasets/gse.html). (*HUD Press Release*, 10/11/07)

IRS audits dozens of market participants in REMIC market
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- The IRS is in its early stages of reviewing 20 to 30 participants in the REMIC market to determine if they are underreporting income on the mortgage-backed securities and reaping illegal tax benefits. The IRS is looking into companies, such as Fannie Mae, Freddie Mac, along with large Wall Street investment firms, commercial banks and other mortgage originators, who set up REMICs. IRS official Barry Schott said the agency is looking specifically into whether these firms have undervalued the interest earned on these securities and underpaid their federal taxes. (*New York Times*, Lynnley Browning, 10/13/07)

Commissioner Nazareth to leave the SEC,  
leaving agency with only three Republican members

- In early October, SEC commissioner Annette Nazareth, the sole Democratic member of the agency announced that she is stepping down and has told the President that she does not wish to be re-nominated to the board. Nazareth's term expired on June 5<sup>th</sup>. Senate Banking Committee chairman Christopher Dodd told reporters, "Frankly, I don't think they [the SEC] ought to be making any decisions until we have someone there." Then Dodd told reporters, however, that he didn't have any recommendations for a Democrat to replace Nazareth. (*Dow Jones Newswires*, Damian Paletta, 10/03/07; *Bureau of National Affairs*, 10/03/07)

Fannie Mae and Freddie Mac: The new LBO backers

- In a just completed \$13.6 billion Archstone-Smith buyout by Lehman Brothers and Tishman-Speyer, Fannie Mae purchased a \$7.1 billion credit facility secured by 105 apartment buildings. Freddie Mac bought \$1.8 billion of loans secured by new financing on 32 properties and assumed existing loans on 15 properties. On *Wall Street Journal's Deals Blog*, Dennis Berman writes, "We're still not sure how and why Fannie and Freddie got involved, but it's clear from reading executive comments that they stepped in to stanch a bad situation. David Worley, Fannie's senior vice president of risk management put it like this: 'Fannie Mae is pleased to serve as a constant and reliable source of liquidity in today's ever-changing [we read this as 'crummy'] capital markets.' We can't imagine Fannie and Freddie participating in too many other LBO deals, but we will do more reporting on their involvement and write more about it soon." (*Wall Street Journal's Deals Blog*, Dennis Berman, 10/05/07)

## ***Fannie Mae***

### An unusual changing of the guard

- For more than two years, Berman DeValerio Pease Tabacco Burt & Pucillo of Boston has served as lead counsel in a class action lawsuit against Fannie Mae. On August 3<sup>rd</sup>, a New York firm, previously uninvolved in the case, replaced the Berman firm as lead counsel. Observers say it is rare for a lead plaintiffs' counsel to get changed this far into litigation and some question if political contributions to the Ohio attorney general's race may have precipitated this change. The Berman law firm contributed \$5,000 to the campaign of Ohio Attorney General Marc Dann, a Democrat who is overseeing the case, but gave more [\$18,000] to his Republican opponent, Betty Montgomery and the firm's lead partner gave \$21,900 to the Ohio Republican Party. In June, the Berman firm contributed \$12,000 to the Ohio Democratic Party. Eight months after taking office, Dann dumped the Berman firm.
- The attorney general's spokesman told reporters that campaign giving wasn't involved in the decision to switch law firms. "There was a professional difference on strategy and tactics, so the attorney general made a decision that it was in the best interests of the case that a change needed to be made," said the spokesman. However, the Berman firm said, "We were in regular contact with the attorney general's office. At no time did anyone indicate there was a disagreement over strategy or tactics."
- Dann has retained William Titelman, a partner at New York's Bernstein Liebhard & Lifshitz LLP, a firm that has taken the lead in many securities class-action cases, to serve as lead counsel. Titelman has long been active in Democratic politics and has donated hundreds of thousands of dollars to Democratic causes. A Dann spokesman said attorneys have the right to contribute to candidates. (*Wall Street Journal*, Nathan Koppel and Aaron Lucchetti, 10/08/07)

### Former Fannie Mae chairman and CEO Raines claims the White House and Treasury "conspired" to undermine the GSE's investor and political support

- In an effort to obtain Bush administration emails, memos and other documents, Fannie Mae's former chairman and CEO Franklin Raines has argued in a court filing that the White House and Treasury Department conspired to undermine the company's stock price and damage its political support. According to Raines' filing, the Executive Office of the President "formed a task force, nicknamed 'Operation Noriega,' which collaborated with officials from Treasury to rein in Fannie Mae and Freddie Mac by attacking the companies in the press, in speeches and through other pressure." Raines argued that White House and Treasury officials pursued "a coordinated effort to communicate with stock analysts covering Fannie Mae and to convey negative information about Fannie Mae that would depress the price of the

company's stock." Raines asked the court to deny the Bush administration's request to throw out his subpoenas, which seek documents from 14 officials, including former chief of staff Andrew Card, director of the Economic Counsel Al Hubbard, the council's deputy director Keith Hennessey, deputy director of OMB Stephen McMillin and Treasury's assistant secretary for financial institutions [from 2002-2005] Wayne Abernathy. (*Bloomberg News*, James Tyson, 10/11/07)

#### Fannie Mae reinstates \$79.6 million of loans to Tarragon Corporation

- Tarragon Corporation has entered into an agreement with Fannie Mae to reinstate \$79.6 million of loans the GSE made to the corporation and its subsidiaries. In addition, the corporation has reached an agreement with five other lenders to restore loans totaling \$56.6 million to good standing and reached an agreement with another lender to reinstate an additional \$73.2 million in loans in connection with the proposed sale of the collateral property. Tarragon's agreements with its lenders are part of an overall plan designed to restore the company's liquidity and improve its financial condition. (*Marketwire*, 10/01/07)

#### Alumni news

- On October 3, PMI Mortgage Insurance Co. announced the appointment of Dan Nicoll as vice president of government sponsored entities, responsible for relationship management with the GSEs and their structured finance, credit risk management, and marketing teams. Nicoll will report to Jim Wagner, the company's senior vice president of government sponsored entities. Nicoll joins PMI from Fannie Mae, where he began his career in 1989 as Director of Product Development and subsequently managed Fannie Mae's mortgage insurance affiliations. (*PR Newswire*, 10/03/07)
- The Bill & Melinda Gates Foundation has named David Bley to serve as director of its Pacific Northwest programs, effective November 12<sup>th</sup>. Bley currently serves as vice president of strategic initiatives at the Seattle office of nonprofit Enterprise Community Partners, and is chairman of the Seattle Housing Authority's Board of Commissioners. Previously, Bley was executive vice president and chief operating officer at the FHLB-Seattle and a former director with the Seattle Fannie Mae Partnership Office. (*Business Journal of Portland [OR]*, 10/09/07)

## ***Freddie Mac***

Freddie Mac's former chairman and CEO Brendsel finally gets his day in court

- Four years after losing his job as chairman and CEO of Freddie Mac, Leland C. Brendsel will get his day in court beginning on October 15<sup>th</sup> before administrative law judge William B. Moran. The legal proceeding is scheduled to continue through the end of February. Dozens of witnesses are slated to testify in the proceeding, including billionaire investor Warren E. Buffett, C.E. Andrews, the chief executive of Sallie Mae who helped lead audits of Freddie Mac during his days as a partner at Arthur Andersen and Freddie Mac senior executives who served under Brendsel and have agreed to testify against him. In addition to seeking hundreds of million of dollars in potential fines and penalties, the government also wants Brendsel to repay Freddie Mac any compensation he received unjustly.
- According to court filings, the government is arguing that Brendsel “directed, was aware of, and participated in the unsafe and unsound financial transactions and manipulations. Any attempts by him to place blame for his unsafe and unsound conduct on others, or claim that Arthur Andersen’s audits shield him from culpability and liability should be summarily rejected.” In court filings, Brendsel has argued that he “was not making detailed decisions about the daily operations of Freddie Mac during the period in question and could not, even by exercising ‘reasonable supervision,’ be aware of each of the hundreds of activities, projects and trades that Freddie Mac’s 4,500 employees were pursuing at any given moment.” His legal counsel has also argued that the financial stability of Freddie Mac was never compromised.
- Following a months-long hearing, the administrative judge will make a recommendation to the OFHEO director, who will decide the case. The director’s findings can then be challenged in a federal appeals court. (*Washington Post*, David S. Hilzenrath, 10/11/07)

Freddie Mac's legal staff “partners” with clients  
to help them achieve their business objectives

- In an interview with *The Metropolitan Corporate Counsel*, Freddie Mac executive vice president, general counsel, and corporate secretary Robert E. Bostrom said, “[Freddie Mac’s Legal Division has] a total staff of 175 people, including approximately 95 attorneys. They all report to me on a solid line basis. The issues we face and the transactions we handle frequently require the involvement of attorneys from different practice areas. By organizing around areas of expertise rather than functional lines or business units, the Legal Division is able to develop great expertise in a variety of legal disciplines, which enables the Division to provide

a high level of legal service in a fast-changing business environment. In the event of a corporate or divisional reorganization, the Legal Division can address new legal issues and products immediately without having to reorganize to follow the organizational structure. We actively partner with our clients to help them achieve their business objectives. Freddie Mac's business fundamentally involves transactions in legal instruments, including debt securities, mortgages, mortgage-related securities, equity securities, hedging instruments, servicing rights and guarantees."

- "We are involved in virtually all aspects of the company's daily operations by assisting our business clients in structuring and negotiating transactions, advising on charter, regulatory and governance issues, and drafting and interpreting complicated contracts. In 2006, we provided legal support for almost 2,000 single-family and multifamily mortgage transactions, almost 1,200 debt offerings, over 1,000 swap transactions, over 190 mortgage securities offerings, a common stock repurchase and two preferred stock offerings. We do the bulk of this work in-house, including all our securitizations. We send little work to outside law firms relative to the scope and nature of our business."
- "... On an ongoing basis, we consult with Corporate Compliance and the business units about the effectiveness of the implementation of policies and procedures designed to ensure compliance with law. Because the effectiveness for compliance purposes of such policies and procedures involves a legal judgment, the board and the CEO expect me not only to be thoroughly familiar with such policies and procedures, but also to let them know if improvements are required. In practice, if the need for a control improvement is discovered and after the CCO or I have briefed the CEO, we will design and launch implementation of an appropriate remediation plan, and inform the board as appropriate. It is a seamless relationship." (*The Metropolitan Corporate Counsel*. October 2007)

Freddie Mac rolls out a new streamlined acquisition-financing product
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- Freddie Mae recently rolled out new streamlined acquisition-financing product, in an effort to retain properties already in portfolio by offering advantages to new borrowers. Benefits to new borrowers include reduced documentation requirements, including appraisals, engineering reports, or environmental reports, which will lower the cost of the transaction and reduce the closing cycle from 45 to 60 days to a three- or four-week execution. "Since [Freddie Mac is] already familiar with the property, the costs go down because you don't have to order some of the reports and you don't have to wait for them, either," said Todd Rodenberg, senior vice president and agency lending director for KeyBank Real Estate Capital. "The acquisition can happen a lot faster this way." Freddie Mac is also offering an economic incentive of up to 1% of the unpaid principal balance, which the borrower can elect to receive in cash or through a lower cost on the new loan. "I'd equate that 1 percent savings to 10 to 15 basis points on the rate side. That's pretty sizable," said Rodenberg. "I've seen deals

move from one source to another for a lot less than that.” Eligible collateral properties include garden, mid-rise, and high-rise apartments and cooperatives with a minimum occupancy rate of 90% for 90 consecutive days. Freddie’s program also features a minimum debt service ratio of 1.25x and a maximum loan-to-value ratio of 80%. (*Affordable Housing Finance*, Jerry Ascierio, October 2007)

Freddie Mac issues \$7.6 million unfunded forward commitment for use in rehabing a New Orleans brewery into 147 apartment units

- Freddie Mac has issued a \$7.6 million 24-month unfunded forward commitment to enable Renaissance Property Group to proceed with its plans to gut and rehabilitate the former New Orleans Falstaff brewery into 147 apartment units. The transaction utilizes Freddie Mac’s Affordable Forward Commitment 9% Tax Credit product and also includes federal historic tax credits, local real estate abatement, and federal low-income housing tax credits, approved by the Louisiana Housing Authority. “Freddie Mac provided a 24-month unfunded forward commitment that allowed the borrower to rate-lock the permanent mortgage at the time we issued the commitment,” said Michael Meers, Freddie Mac Southeast Region managing director. “We were pleased to be able to contribute to the development of much-needed housing in greater New Orleans.” (*Freddie Mac Press Release*, 10/11/07)

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

### **FHLB-Chicago enters into Consent Degree**

- On October 10<sup>th</sup>, the Federal Housing Finance Board and FHLB-Chicago entered into a consent cease-and-desist order, which imposes capital requirements on the Bank and restricts its dividends. Under the order, the Bank must maintain a ratio of regulatory capital to total assets of at least 4.5% and keep at least \$3.6 billion in combined capital stock and subordinated debt. The order immediately bars the Bank from repurchasing or redeeming any capital stock from members or paying dividends without the written permission of Steve Cross, the director of supervision for the Finance Board. The order also requires the Bank to develop a plan for improving its capital structure, market risk management practices, and hedging policies. According to the Finance Board's press release, these changes are "necessary to improve the condition and practices of the bank, stabilize its capital, and provide the bank an opportunity to address the principal supervisory concerns identified by the Finance Board's Office of Supervision." In an October 10<sup>th</sup> letter to members, Mike Thomas, the Bank's president and chief executive, wrote, "As a result of this order, we do not expect that we will be able to conduct a broad redemption of voluntary stock in the fourth quarter of this year. With regard to dividends, the board will continue to assess our dividend capacity each quarter and make appropriate requests for approval." (*Associated Press*, 10/10/07; *American Banker*, Steven Sloan, 10/11/07; *Correspondence to Members*, Mike Thomas, 10/11/07)

### **FHLB advances increased 28% in third quarter**

- The FHLB System's advances increased 6.9% to \$822 billion in September, as member institutions increased their reliance on borrowings for liquidity. During the third quarter, FHLB advances increased \$182 billion (28%) as a result of turmoil in the credit markets. "The FHLBs have provided a massive liquidity injection into the banking system," said Portals Partners analyst Gary Gordon. "By anybody's standards, that increase was immense," said Richard A. Dorfman, president and CEO of the FHLB-Atlanta. "But, having said that, we are in business to respond to the funding needs of our member banks." (*American Banker*, Joe Adler, 10/03/07; *Fortune Magazine*, 10/04/07)

### **FHLB-Atlanta announced board election results**

- FHLB-Atlanta has announced the results of the 2007 election for two positions on the board of directors for three-year terms beginning January 1, 2008. The Bank's members in Maryland re-elected John M. Bond, Jr., chairman of The Columbia Bank. Member institutions in Florida elected Miriam Lopez, CEO of TransAtlantic Bank in Miami. She is a former president of the Florida Bankers Association and serves on

the American Bankers Association's Government Relations Council and Executive Committee. Bond and Lopez will serve a term of three years beginning on January 1, 2008.

- Brian Schmitt, chairman and CEO of The PrivateBank in Atlanta, was the sole nominee for the directorship that the Federal Housing Finance Board designated for the state of Georgia. On October 2, 2007, Schmitt informed the Bank that he would be unable to serve on the board of directors because of scheduling conflicts. In accordance with the Federal Home Loan Bank Act, the board of directors will elect a director to fill the vacancy as of January 1, 2008, for that directorship. (*FHLB-Atlanta Press Release, 10/04/07*)

Lisa MacMillen named COO at the FHLB-San Francisco
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- The FHLB-San Francisco's board of directors has appointed Lisa MacMillen as Executive Vice President and Chief Operating Officer, effective October 15, 2007. MacMillen will oversee the activities of the Bank's operational divisions, which include Finance, Financial Risk Management, Financial Services and Community Investment, Credit and Collateral Risk Management, Controller's Department, Information Services, and Enterprise Risk Management. Since 1998, MacMillen has served as the Bank's senior vice president and corporate secretary, responsible for corporate governance matters, policy issues and special projects for the Bank's management and Board of Directors. From 1998 to 2005, she also served as General Counsel. (*Business Wire, 10/03/07*)

Finance Board appoints two members to FICO
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- The Federal Housing Finance Board's board of directors has approved the appointment of the Richard A. Dorfman, president of the FHLB-Atlanta, and Richard S. Swanson, president of the FHLB-Des Moines, to serve on the directorate of the Financing Corporation (FICO). The FICO directorate consists of the managing director of the Office of Finance and two FHLB presidents, selected by the Finance Board. FICO's primary function is to service the debt on bonds that were issued to finance the resolution of the savings and loan crisis. (*Federal Housing Finance Board Press Release, 10/10/07*)

## *Ginnie Mae*

### HUD secretary Jackson urges passage of FHA reform

- In an October 5<sup>th</sup> speech before members of the FHLB-Dallas, HUD Secretary Alphonso Jackson said that the country’s goal of homeownership is “still sound and desirable,” but said steps must be taken to “smooth out the housing cycle.” Jackson told attendees, (1) predatory lending must end—“there is no place for it in American housing or lending practices;” (2) prospective homeowners, particularly members of our minority communities, must be encouraged to use housing counselors; (3) financial literacy must be increased, which will re-enforce the utilization of housing counseling; and (4) FHA reform legislation must be passed by Congress. Jackson said, “The President wants FHA to return to its original role, which was to help bring stability to the real estate market. This will help break the cycle of foreclosure and price depreciation, and bring much-needed liquidity to a mortgage market that has quickly become constricted. ...I urge you to speak loudly and often in demanding Congressional support for this Administration’s efforts to address the subprime crisis. And I ask you to demand that Congress pass FHA Modernization without any further delay...not one more day or one more week of excuses or finger-pointing...” (*US Fed News*, 10/05/07)

### FHA rule banning seller financing will go into effect in November

- On October 1<sup>st</sup>, the FHA published in the *Federal Register* a rule prohibiting borrowers from using seller-financed down payment assistance programs. The rule, which is little changed from the preliminary version published in May for comment, will go into effect 30 days after publication. In issuing the rule, HUD said that it was codifying its long-standing practice of allowing down payment assistance that is derived from gifts by family members and “certain organizations,” but prohibiting assistance from “the seller or any other person or entity that financially benefits from the transaction.” According to a 2005 GAO study, these programs allow home sellers to give money to charities, which in turn assist buyers with their down payments. The sellers often recoup the money by charging a higher price for the homes (usually 2% or 3% more). GAO also concluded that borrowers receiving assistance from those charities were more than twice as likely to default or become delinquent in making their mortgage payments than other FHA borrowers.
- In a conference call with reporters, FHA commissioner Brian Montgomery said, “These [down payment] contributions often function as an incentive to purchase the home. But these gifts are ultimately paid for by the borrower through a higher mortgage amount. The home buyers are often unaware that the ‘gift’ is something they end up paying for and is not a ‘gift’ at all.” In a September 28<sup>th</sup> statement, Montgomery said, “Nonprofits can still play a role in providing down payment

assistance in the form of a gift, so long as they don't collect 'donations' from sellers, who have a financial stake in the sales transactions." (*Washington Post*, Nancy Trejos, 09/29/07; *Bureau of National Affairs*, Richard Cowden, 10/02/07)

- Beazer Homes' internal investigation has determined that Beazer Mortgage Corp., its mortgage unit, violated FHA rules, "particularly in relation to downpayment assistance programs," for loans dating back to at least 2000. The Atlanta homebuilder said that a possible settlement with regulators could range from \$8 million to \$15 million. The company did not disclose how many loans were involved or the default rate for these loans. (*National Mortgage News Online*, 10/12/07)

AmeriDream and Nehemiah Corp. sue HUD over rule banning down payment assistance
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- AmeriDream and Nehemiah Corp. of America, two of the largest nonprofit organizations which provide seller-financed down payment assistance, are seeking injunctions to block HUD's rule that bans such down-payment assistance to some low- and moderate-income home buyers. The law suits called HUD's rule "arbitrary," "capricious" and contrary to the FHA's mission of insuring mortgages for borrowers who don't qualify for conventional loans. "The program is helping many minority, first-time, low-income, single-parent home buyers," said AmeriDream's chief executive Ann Ashburn. Nehemiah's CEO Scott Syphax, said, "The rule was an outrageously bad piece of public policy coming at exactly the wrong time in the economy and for low-income borrowers." Through a spokesman, HUD General Counsel Robert Couch said, "We will vigorously defend any lawsuit." (*Washington Post*, Nancy Trejos, 10/02/07)

President Bush to nominate Joseph Murin to be president of Ginnie Mae
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- President George W. Bush plans to nominate Joseph Murin as president of Ginnie Mae. Most recently, Murin served as president of the Mortgage Settlement Network, LLC, a provider of loan settlement services. Previously, he was chief executive officer of Basis100, a mortgage automation company acquired by the First American Corp. Murin will succeed Robert Couch, who was confirmed by the Senate in June to serve as HUD's general counsel. (*Reuters*, 10/11/07)

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

FCA adopts proposed rules for Farmer Mac and FCS's Funding Corporation
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- The FCA Board has adopted a proposed rule that would revise Farmer Mac's risk-based capital requirement. The proposed rule would add a component to recognize the risk-reducing characteristics of structures such as Off-Balance-Sheet AgVantage, a new loan product whose volume accounts for a growing percentage of Farmer Mac's program volume; add a component to recognize counterparty risk on non-program investments; and revise the estimated carrying costs of nonperforming loans. The proposed rule is open for public comment until October 29, 2007. (*Farm Credit Administration Press Release, 10/05/07*)
- FCA's board has also adopted a direct final rule requiring the external auditor of the Federal Farm Credit Banks Funding Corporation to express an opinion on the effectiveness of internal control over financial reporting (ICFR). Previously, the Funding Corporation's external auditor was required to report on management's assessment of ICFR. Under the new requirement, the external auditor must express an opinion directly on the effectiveness of ICFR, which will be included in the Funding Corporation's annual report. This change brings FCA's position on this matter in line with similar changes recently made to the regulations of the SEC and auditing standards of the Public Company Accounting Oversight Board. The FCA Board adopted this rule as a direct final rule with opportunity to comment. If no significant adverse comment is received on the direct final rule within 30 days after publication in the *Federal Register*, the rule will be effective 30 days after publication during which either body of Congress is in session. Notice of the effective date will be published in the *Federal Register*. (*Farm Credit Administration Press Release, 10/11/07*)

## *Postal Service*

### Postal reform's silver lining

- *Multichannel Merchant* reports, "First, the bad news: You can expect a postal rate hike by next summer, according to Gene Del Polito, president of the Association for Postal Commerce. The good news? It's likely that the rate-making process will follow the Postal Reform Bill's new rules, meaning the increase will be subject to inflationary levels." (*Multichannel Merchant*, Melissa Dowling, 10/05/07)

The Postal Regulatory Commission warns that the Postal Service's NSA with Bank of America could cost the agency between \$25 million to \$45.8 million

- The Postal Regulatory Commission has warned the Postal Service's Board of Governors that the agency could lose between \$25 million to \$45.8 million, if a proposed Negotiated Service Agreement (NSA) between the USPS and Bank of America is implemented. PRC found that the \$5.5 million in savings claimed in the initial NSA filing was based upon 1999 read/accept rates. While the PRC has advanced the NSA to the next stage, the Commission has asked the BOG to seriously consider the costs before making its final decision on the proposed agreement, which would grant the bank discounted postal rates in exchange for its use of the Intelligent Mail Barcode. (*DMNews.com*, Cara Wood, 10/10/07)

Limit the role of GSEs to serving a compelling public policy need and filling a role not met by the private sector

- In an October 2<sup>nd</sup> IRET advisory on the postal service's productivity, Michael Schuyler wrote, "If not for the productivity turnaround of the last several years, the Postal Service would need about 9% more production inputs to handle its present workload. Instead of looking at a 41 cent first-class stamp, mail users would now be contemplating a 44 or 45 cent first-class stamp. Rates would need to rise correspondingly for other mail classes. Without the productivity advance, households and businesses would be paying more for each letter, sending less mail, complaining more about Postal Service inefficiency, and diverting more of the potential mail stream to electronic alternatives. Taxpayers would be at greater risk of having to bail out the government enterprise in the future. The nation's output would be slightly lower. In short, improved productivity has allowed the Postal Service better to carry out its government-assigned mission by moderating rate increases and keeping mail more affordable."
- "It is notable that the Service realized this improvement by focusing on its core market of hardcopy, non-urgent letter delivery. In the past, and certainly under the

two previous Postmasters General, the Service often regarded peripheral markets longingly and claimed it needed to branch out into other fields to offset problems it claimed it could not fix in its core market. In reality, the back-to-basics approach of the last several years makes much better business sense. It plays to the market in which the Service has its greatest expertise. It avoids distracting management and other employees from their primary job, which is also their government assigned mission. And it recognizes that the Service's non-core operations are too small in relative terms and face too much private-sector competition to be able to support the agency if the core business fails."

- "The productivity data also suggest a more general point about government enterprises. For the last several years, the Postal Service has set productivity records compared to its past performance. It is currently among the best run government enterprises. However, if the Service's recent productivity growth were judged by private sector standards, it would be average, that is to say, entirely respectable but not extraordinary. The message is that while government enterprises can sometimes deliver the efficiency of private-sector businesses, they more typically do not. Hence, if we are concerned about efficiency, which we should be, it is good public policy to limit the role of government businesses. They should only be authorized if they would serve a compelling public policy need and fill a role not met by the private sector. Moreover, to maintain a strong economy, care should be taken to guard against mission creep by existing government enterprises. (*IRET Congressional Advisory*, Michael Schuyler, 10/02/07)
- According to PostCom vice president Kate Muth, "The Postal Service has set as its total factor productivity (TFP) target for FY 2008 a growth of 1 percent. This would mark the ninth straight year of productivity growth for the organization. In its FY 2007 integrated financial plan, released last year at this time, the Postal Service set as its total factor productivity goal an increase of only 0.6%. Its final number for FY 2007 should surpass that target, which is a good thing. But the target needs to be much higher."
- "...But the challenge is greater as the Postal Service moves into the era of price-cap control on its prices. With its latitude to raise rates on its market-dominant products capped at inflation and volume increases remaining flat, the Postal Service will need to increase its productivity even more than it has in the past few years. It will have to set private-sector targets. The Postal Service faces competition and a price cap. It needs strong productivity to thwart both. I doubt anyone is suggesting that the Postal Service should set 5 percent as a TFP target in 2008. But 1 percent growth year-over-year won't be enough to keep the Postal Service under a price cap. Unless, of course, it has a wicked revenue-generation plan up its sleeve. Industry would love to see that as well." (*Postcom.org*, Kate Muth, 10/04/07)

Congressional Research Service's analysis of the Postal Service's work force

- According to CRS's analysis of the USPS workforce, the agency's workforce has declined about 1% during the past two decades and nearly 12% in the past five years. Since 1986, the number of career employees declined over 6%, while the number of non-career employees increased more than 62%. The number of clerks, who staff retail mail counters and manually sort mail, dropped 62%, while the number of rural mail delivery employees grew more than 84%. In 2006, the USPS had 684,774 employees of which 87.3% were career employees and 12.7% were non-career employees. (*Congressional Research Service Report to Congress: U.S. Postal Service Workforce Size and Employment Categories, 1986-2006*, Kevin R. Kosar, 08/29/07)

Without junk mail, the USPS wouldn't need to deliver mail more than once a week – perhaps a good thing?

- In the *Mitford Daily News*, Lee Ostaszewski wrote, "...There are some people who think we should take this Do Not Call List further and have a Do Not Send Junk Mail to My House List because they are sick and tired of all the junk mail they receive. I understand their frustration, but I have always defended junk mail for the simple reason that it is pretty easy to toss into the trash or recycle bin if you're not interested. Consider these advantages: junk mail doesn't show up demanding attention right away when we are relaxing in the evening; it rarely mispronounces your name, although your name might be misspelled; and most importantly, it subsidizes the few times each month when we actually need to mail something. Be realistic. Without junk mail the United States Postal Service would have no reason for coming around to everyone's house more than once a week. Once a month for some people. And it would probably cost \$100 or more to mail a letter." (*Mitford Daily News*, Lee Ostaszewski, 10/01/07)

Not a good day at the Post Office

- By the time Torrance, CA businessman Kenneth Dewayne Owen made his fifth visit to a Long Beach Post office in 2006, he had mailed more than one million letters and owed more than \$300,000 for the postage. Unfortunately when the USPS cashed Owen's five checks, they bounced. Now the 43-year old executive of Nova Net Media, Inc. is sitting in jail and refusing to answer investigators' questions. He faces up to 10 years in federal prison. (*Daily Breeze*, Larry Altman, 10/10/07)
- The Postal Service was fined \$10,000 for cutting down trees at its Coconut Grove [FL] post office to make way for improvements to the facility's parking lot. (*Miami Herald*, 10/06/07)

## TVA

### TVA nominee pledges to continue the utility's commitment to nuclear energy

- At an October 2<sup>nd</sup> hearing by the Committee on Senate Environment and Public Works, Thomas Gilliland pledged to continue the utility's commitment in nuclear energy, if confirmed by the Senate to serve on TVA's board of directors. Gilliland told the panel that while utility looks to increase its production of electricity from alternative energy sources, nuclear power gives the utility a reliable, clean means of meeting increasing electricity demand. "You've got to have nuclear to have the reliability to meet peak loads," he said. The agency currently generates 60% of its energy from fossil fuels, 30% from nuclear and 10% from alternative sources, he said.
- When asked by the panel about TVA's debt load, Gilliland said he would support the utility's focus on retiring debt. The agency has cut \$2.5 billion in debt over the past decade, but still carries about \$25 billion in obligations, more than any other investor-owned utility. "In 1997, 34% of the revenues generated by TVA went to pay interest. Now it's 13 %," said Gilliland. "That's significant improvement."
- Gilliland, the first Georgian nominated to serve on TVA's board, was recommended by Senators Saxby Chambliss (R-GA) and Johnny Isakson (R-GA), as well as Representative Nathan Deal (R-GA) to fill a term that expires May 18, 2011, replacing William Baxter, who resigned in January. Gilliland is executive vice president, secretary, and general counsel for United Community Banks Inc, the third largest bank holding company in Georgia. Also up for confirmation are the reappointments of William H. Greaves and Susan Richardson Williams to terms expiring May 18, 2012. The TVA nominees are scheduled for a full Senate vote alter this year.
- After the hearing, Senator Lamar Alexander (R-TN) issued a statement saying, "Tom Gilliland is a first class nominee and brings strong business credentials to the Board. His addition, along with the reappointments of Bishop Graves and Susan Williams, gives continuity to TVA's mission of providing clean, reliable electricity to the residents and businesses of the Tennessee Valley." (*Chattanooga Times Free Press*, Herman Wang, 10/03/07; *State News Service*, 10/02/07; *US Fed News*, 10/02/07)

### How will Tennessee dispose of its radioactive waste?

- At an October 2<sup>nd</sup> hearing of the Senate Environment and Public Works Subcommittee, Senator Lamar Alexander (R-TN) asked officials with the Nuclear Regulatory Committee how Tennessee might dispose of radioactive waste from the

state's hospitals and TVA's nuclear facilities after the State loses its access to the Class B and Class C low-level nuclear waste located in Barnwell, S.C on July 1, 2008. Since these facilities will have no disposal facility available for their use after July 1st, Alexander asked the NRC to examine recommendations for the State's disposal options. Dale E. Klein, the chairman of the NRC, responded, "Senator, you've touched on an issue that has serious consequences for the entire nation." ([www.Chattanooga.com](http://www.Chattanooga.com), 10/03/07)

TVA should be doing more to promote energy conservation
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- According to the agency's 2008 budget, TVA will spend \$22 million to encourage their customers to conserve energy. Environmental groups argue that the nation's largest utility should be doing more. Steven Smith, executive director of the Southern Alliance for Clean Energy, said that EPA has asked businesses to spend 1% of its revenues on conservation—which would represent \$97 million in expenditures by TVA. Utility president Tom Kilgore says that his agency's \$22 million for conservation is "just the beginning" and more money will likely be spent once TVA's conservation programs are up and running. (*Associated Press*, 09/30/07)

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