

The **GSE** REPORT™

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Major Events

Subprime mortgage market takes center stage on Capitol Hill:

House Financial Services Committee holds September 5th hearing
on the subprime mortgage credit problems

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scheduled for floor vote the week of September 17th

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Senator Chuck Schumer introduces bill to temporarily increase the size and scope of
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“The Senate has more work to do... “

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Reaction to President Bush's proposal to revitalize the FHA

Chairman Frank's lessons of the subprime crisis

Fannie Mae and Freddie Mac adopt rules to discourage funding subprime mortgages

New IRS ruling on loan losses may add to mortgage market woes

Other subprime news and notes

House Financial Services Committee holds September 5th hearing on the subprime
mortgage credit problems

- Congress is gearing up for a broad review of financial markets regulations in response to the recent meltdown in the subprime mortgage market, which triggered a liquidity crunch that roiled credit markets last month. “It is clear that financial innovation

outstripped regulation,” said Representative Barney Frank (D-MA), chairman of the House Financial Services Committee, at a September 5th panel hearing. The chairman said lawmakers and regulators need to consider whether advances in technology and globalization require Congress to update the authority of financial regulators. “It’s not increasing regulation,” he argued. “It’s have the markets now come up with new things that we don’t have the regulatory tools for?” Representative Paul E. Kanjorski (D-PA), chairman of the Financial Services subcommittee with oversight over capital markets, said, “It’s going to be a long-term evaluation, not just over the next few months but through the rest of this Congress.”

- At the hearing, neither lawmaker talked of specific legislation, although Kanjorski said a starting point would be a Treasury report on market regulation due in early 2008. As part of Treasury Secretary Henry Paulson’s efforts to improve the effectiveness of the U.S. capital markets, his agency is preparing a series of recommendations on how to simplify the domestic financial regulatory scheme that the Paulson argues is too complex, burdensome, and expensive. Robert K. Steel, Treasury’s undersecretary for domestic finance, said, “Under Secretary Paulson’s leadership, the President’s Working Group on Financial Markets will examine some of the broader market issues underlying the recent market events, including the impact of securitization and the role of rating agencies in the credit and mortgage markets. The Treasury Department will also be releasing early next year a blueprint of structural reforms to make financial services industry regulation more effective, taking into account consumer and investor protection and the need to maintain U.S. capital markets competitiveness.” Steel added, “I don’t view a review of the status quo to mean necessarily less regulation. I think the issue is appropriate regulation. Our goal is to look at this fresh and focus on these issues.”
- Steel warned the panel that the market uncertainty is likely to continue. “The ultimate impact of these events on the economy has yet to play out,” said Steel. “These events have occurred during a time of solid domestic and global growth, helping to mute some of the impact of this turbulence. I do want to caution policy makers that this process is far from over. It will take more time to play out and certain segments of the capital markets are stressed. Risk is being repriced. This repricing will lead to a reevaluation of assets. This reevaluation will inevitably impact the balance sheets of financial market participants.” John C. Dugan, the Comptroller of the Currency, agreed with Steel’s comments, saying “[It] may take some time until markets fully stabilize.”
- “What we have is a severe lack of investor confidence,” said Chairman Frank. He said he hopes that Congress and the administration would work together to find solutions for the mortgage market. While Frank said he agrees with elements of the White House’s proposals to reform to FHA to help troubled subprime borrowers, he believes added measures should be taken. Representative Carolyn Maloney (D-NY) said the administration plan is “an important first step” [but] “it is not enough.”

- Steel told lawmakers that the Treasury Department has approached Fannie Mae and Freddie Mac about possibly developing new market products that could help address problems in the mortgage market. Steel stressed that such products would be market based and not providing a subsidy. Steel stressed that the Treasury Department's goal of retaining and preserving home ownership during this period of market turmoil is the agency's highest priority. "[The] first and foremost thing to focus on is how to have the most successful efforts to keep American homeowners in their homes," said Steel. He reiterated that Treasury officials oppose "any rescue or bailout," particularly for lenders who made these loans that contributed to the market turmoil, or investors who purchased these loans. "Investors basically were on the scene of the situation," said Steel. "And maybe they should have asked for some more information."
- Kanjorski said he is particularly concerned about "the transparency of our capital markets related to subprime mortgage-backed securities, [collateralized] debt obligations, credit default swaps, and the parties that package and hold these increasingly sophisticated financial products. From what I have read, it appears that participants in our capital markets, as well as their regulators, have had significant difficulties in determining exposures to subprime mortgages that have defaulted or will likely default."
- Erik Sirri, the SEC's director of market regulation, told the panel that his agency is looking into contingencies that could put strains on the investment banks' balance sheets. "These include the potential unwinding of off-balance sheet funding structures, such as conduit structures," said Sirri. "We also are monitoring the potential funding requirements for certain leveraged lending commitments made by the (certain) firms, typically to fund corporate acquisitions or restructurings." The SEC's focus is centered on the "big five" investment banking firms—Lehman Brothers, Goldman Sachs, Merrill Lynch, Morgan Stanley, and Bear Stearns—which the agency supervises on a consolidated basis. Sirri also said that recent events in the subprime mortgage and credit markets have prompted the SEC to begin a review of the credit rating agencies' services, potential conflicts of interests, disclosures, and rating performance.
- Representative Richard Baker (R-LA) said the recent market turmoil is an expected result of a period of overaggressive lending, fueled by low interest rates and rapidly appreciating house prices. For borrowers who were sold inappropriate mortgages, the system should discipline dishonest brokers, lenders, or other participants who have engaged in predatory practices, said Baker. "But I suggest most of the tools to respond to these crises or problems are well within the hands of the Treasury or the Federal Reserve," he said. "And so I urge great caution in having the Congress ham-handedly interject more risk in the American taxpayer pocketbook or constructing more constrictive rules that will in essence preclude a more logical, market-based recovery." Representative Jeb Hensarling (R-TX) warned about the "unintended consequences" of enacting legislation in response to problems in the subprime mortgage market, which accounts for only 13% to 15% percent of the mortgage

market. Moreover, 83% of subprime borrowers are making their payments on time, said Hensarling. He noted that much of the rise in foreclosures is attributable to factors such as illness, death, divorce, and job loss. Another factor, Hensarling noted, was that some borrowers acted foolishly. “[T]he question is: did some borrowers in the appreciation of their houses use their houses as a personal [automatic teller machine] and what does it mean for national policy for us to go and bail these people out? Will we incentive even more bad behavior?”

- Chairman Frank said that the committee will hold a second hearing on September 20th to review the Bush administration’s proposal to expand FHA programs and other options to deal more directly with specific subprime issues. Federal Reserve Chairman Ben Bernanke, Treasury Secretary Henry Paulson, HUD Secretary Alphonso Johnson will testify before the committee. The hearing will also include testimony from consumer advocates and financial services. An earlier list of witness provided by the Committee included Fannie Mae CEO Daniel Mudd and Freddie Mac CEO Richard Syron. The House Financial Services’ Subcommittee on Capital Markets, Insurance, and Government Sponsored Entities has also scheduled a September 27th hearing on “The Role of Credit Rating Agencies in the Structured Finance Market.”
- In a September 7th letter to Federal Reserve Chairman Ben Bernanke, House Financial Services Committee Chairman Frank said the central bank’s opposition to Democrats’ calls for an increase Fannie Mae’s portfolio limits is “an example of the triumph of a fairly rigid ideology,” which overlooks “the facts” of the housing slump. In an August speech, Bernanke said that lifting Fannie Mae’s and Freddie Mac’s mortgage portfolio caps would be unnecessary, because the GSEs could make room for new purchases by selling their holdings to the private secondary market. Rep. Frank disagreed with Bernanke’s argument by writing, “The unpersuasive nature of this argument against raising the portfolio caps leads me to believe that the objection to an increase in the cap is ideological, not driven by safety and soundness. Clearly, if safety and soundness was the concern that led you to object to any increase in portfolio, you would hardly be supportive of substituting within the overall portfolio cap riskier mortgages for those that are ‘easily placed’ in the market, presumably because they are of a higher credit quality.” (*Market News International*, Chris Middleton and John Shaw, 09/05/07; *Bureau of National Affairs*, Richard Cowden, 09/06/07; *Wall Street Journal*, Damian Paletta and Siobhan Hughes, 09/06/07; *Dow Jones Newswires*, Damian Paletta, 09/05/07; *Associated Press*, 09/05/07; *CQ Today*, Michael R. Crittenden and Benton Ives, 09/05/07; *Market News International*, John Shaw, 09/13/07; *American Banker*, Steven Sloan, 09/11/07; *Bureau of National Affairs*, 9/14/07; *Bloomberg News*, James Tyson, 09/10/07; http://www.house.gov/apps/list/hearing/financialsvcs_dem/ht092707.shtml)

Chairman Frank plans amendment to raise FHA's lending limits for FHA reform bill, scheduled for floor vote the week of September 17th

- The House of Representatives will consider this week FHA reform legislation (H.R. 1852), which would modernize the FHA's mortgage insurance system and raise the loan limits for FHA-insured mortgages. House Financial Services Chairman Barney Frank said he plans to introduce an amendment to H.R. 1852, which would allow FHA to insure loans up to \$700,000 in high costs markets. Frank told reporters [on September 12] that the amendment would raise the size of loans that could be insured by FHA "to \$500,000—that would be the base, and in addition to that it would give the HUD secretary the ability to raise it" if market conditions warranted such a change. The House Rules Committee will meet on September 17th to determine how many amendments may be made, when the legislation reaches the floor later in the week. (*CQ Today Midday Update*, 09/14/07; *Wall Street Journal*, Damian Paletta, 09/12/07; *National Mortgage News Online*, 09/11/07)

Senate Banking Chairman Dodd announces plans to introduce legislation to protect homeownership

- On September 5, Senate Banking Committee Chairman Chris Dodd (D-CT) announced plans to introduce legislation which would reform mortgage lending practices and allow borrowers who entered into predatory subprime loans to refinance their loans and avoid foreclosure. "Let me be clear: affordable home loans are a good thing; predatory lending is not. 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. "My bill will end prepayment penalties—which only exist in the subprime market, and which penalize homeowners for trying to do the right thing by refinancing their mortgage. It will prohibit brokers and lenders from 'steering' homebuyers to a more costly loan. And it will make brokers responsible to the people who pay them - and ban them from acting as free agents who play lenders and borrowers off against each other. Most importantly, my bill will help keep Americans in their homes while also helping to restore public confidence in our mortgage and capital markets."
- Dodd's bill would expand the number of high-cost loans covered by the Home Ownership and Equity Protection Act (HOEPA) and would hold lenders liable for brokers' actions. The bill would "strictly limit" fees associated with high-cost mortgages and would prohibit balloon payments, prepayment penalties, and yield-spread premiums for such mortgages. The bill also would impose new good faith and fair-dealing standards for all lenders and brokers and clarify "the fiduciary duty" of mortgage brokers towards the borrowers. The bill would also require escrows for taxes and insurance, an analysis of the borrower's ability to repay a loan after rate

resets, and documentation of borrowers' income [except in unusual circumstances]. It would provide the FDIC and the OCC rulemaking authority under the Federal Trade Commission Act's unfair and deceptive acts or practices provision. The bill also would authorize appropriations to fund foreclosure prevention counseling.

- Noticeably absent from Dodd's proposal was any assignee liability, which House Financial Services Chairman Barney Frank (D-MA) has said is crucial for instituting market responsibility [by removing incentives for the secondary market to finance poorly underwritten loans]. The banking industry has fought any efforts to hold buyers of MBS liable for defunct loans, arguing it could destroy the secondary market. Marc Lackritz, president and CEO of the Securities Industry and Financial Markets Association, said he was "pleased" that Dodd's proposal "would not impose unlimited assignee liability, which has historically erased credit availability for subprime borrowers when implemented at the state level."
- "The Dodd proposal reflects the testimony that has been presented by many of the consumer groups that have testified before the committee," said James Ballentine, the American Bankers Association's director of grassroots and community outreach. "At the end of the day, should a legislative solution be crafted, neither the industry nor community groups will be entirely pleased." (*Press Release from Senator Chris Dodd, 09/05/07; Bureau of National Affairs, Thecla Fabian, 09/06/07; American Banker, Stacy Kaper and Steven Sloan, 09/06/07*)
- In a September 7th telephone briefing with the press, Dodd provided a partial outline of the Senate Banking Committee's fall legislative agenda. The chairman said his top priorities included passage of FHA reform legislation and a bill to curb predatory mortgage lending practices. Dodd said an FHA reform bill would be introduced in the Committee in September. "This is a bill that is supported by the administration, consumer groups, everyone involved," said Dodd. "I had hoped to get that done in July. We weren't able to get it done in July for reasons I won't go into here, but my hope is we can get this marked up and moving pretty quickly. Many people feel it would be a good signal to get that done and I agree with them."
- Passage of GSE regulatory reform legislation was not among Dodd's legislative priorities. When asked by the press if he planned to move GSE legislation this fall, Dodd said, "...[W]e would like to. [But] [w]e have several other items on the agenda." Instead, Dodd called on the Bush administration to lift restrictions on Fannie Mae's and Freddie Mac's mortgage portfolios as a means of improving the liquidity of the secondary mortgage market. "What we're suggesting today is at the very least the regulator [OFHEO], through the president, in my view, and the secretary of the Treasury ought to be lifting those caps to some degree to allow greater liquidity in this marketplace," said Dodd. (*Bureau of National Affairs, Richard Cowden, 09/07/07*)
- On September 13, Senators Chris Dodd (D-CT) and Christopher S. 'Kit' Bond (R-MO) successfully won Senate approval for a measure to provide an additional \$100

million to help homeowners facing foreclosure to remain in their homes, as an amendment to the 2008 Transportation and Housing and Urban Development and Related Appropriations Bill (H.R. 3074). [This appropriation supplements the original \$150 million in home mortgage foreclosure prevention programs approved by the Senate Appropriations Committee in July.] The measure would require the Secretary of HUD to provide grants for mitigation assistance to public, private and non-profit entities to assist borrowers. The grants can be used for both conventional and subprime mortgages and can be used to help homeowners modify or refinance their mortgages, or to obtain counseling to examine other options to keep them in their homes. Prospects for the appropriations bill are uncertain, after the White House threatened to veto the bill, calling it too costly. (*US Fed News*, 09/13/07; *Bureau of National Affairs*, Thecla Fabian, 09/13/07; *Dow Jones Newswires*, Damian Paletta, 09/13/07)

Senator Chuck Schumer introduces bills to temporarily increase the size and scope of Fannie Mae's and Freddie Mac's investments in the mortgage market

- With GSE regulatory reform legislation “pretty much deadlocked” in the Senate, Senator Chuck Schumer (D-NY) introduced the “Protecting Access to Safe Mortgages” bill to temporarily allow Fannie Mae and Freddie Mac to increase their mortgage portfolios by 10% to provide market liquidity, which would “free up” \$145 billion towards to purchase of new mortgages. The bill would require the GSEs’ to dedicate half of the portfolio growth to support financing of adjustable rate mortgages whose rates reset between June 2005 and December 2009. Schumer’s bill would also allow the GSEs to purchase loans of up to \$625,000 in high-cost markets for one year. “It’s a measure that will directly address the root of the problems in our broader credit market, which is the fallout from subprime mortgages,” said Schumer. “Fannie and Freddie are the missing link to stem the tide of foreclosures.” He added, “In the Senate, it’s going to be very difficult to pass a general GSE reform bill. Right now it’s pretty much deadlocked. ...We have a crisis. That’s why we’ve done this for only one year.” (*The Bond Buyer*, Peter Schroeder, 09/11/07; *Wall Street Journal*, Damian Paletta, 09/10/07; *American Banker*, Steven Sloan, 09/11/07; *Dow Jones Newswires*, Damian Paletta, 09/10/07)

“The Senate has more work to do...”

- In a September 12th breakfast meeting with media, Treasury Secretary Henry M. Paulson, Jr. acknowledged that the turbulence in the subprime mortgage market won’t end anytime soon. “We expect this turbulence to go on for a while,” said Paulson, arguing for patience. “There’s no quick fix,” he added. Despite pressure from the Democrats to raise Fannie Mae’s and Freddie Mac’s portfolio caps, Paulson said the Bush administration is reluctant to take such steps, saying it wants the two GSEs to show more stability. He called the Democrats demands a “red herring,” which would do nothing to ease the turmoil in the credit markets or help borrowers at risk of losing their homes. “We don’t have a problem in the prime market,” he added. Instead,

Paulson argued that it's the Senate's responsibility to act in different ways to ease the mortgage crisis—noting that the House passed GSE regulatory reform four months ago. “The Senate has more work to do,” Paulson said. “I think the Senate can get this done, and do it quickly, and we can all work together. I can't say it any plainer than that.”

- When asked by the media whether part of the Senate's slowness is attributable to Senate Banking Committee Chairman Chris Dodd, who is seeking the 2008 Democratic presidential nomination and trying to draw sharp differences between himself and the White House, Paulson responded, “I have a very high regard for Chris Cox,” confusing Dodd with the SEC chairman. After laughing and correcting himself, Paulson said, “You have someone very knowledgeable [in Chairman Dodd]. I said, and I chose my words carefully, that there's work that needs to be done in the Senate. ... I'm confident the Senate can get there, and that's all I want to say.” (*Hartford Courant*, David Lightman, 09/12/07; *The Hill*, Jessica Holzer, 09/12/07)

OFHEO Director Lockhart responds to the Democrats' demands to raise the GSEs' mortgage caps

- In a September 6th letter to Senator Chuck Schumer (D-NY), OFHEO Director James B. Lockhart, III said that the Fannie Mae and Freddie Mac have continued to serve their secondary market mission during despite their extended remediation, which is ongoing . Lockhart noted that GSE securitization programs, which totaled almost \$100 billion in July, “have continued to provide an attractive outlet for the Enterprises traditional mortgage products.”
- “In addition to their guarantee business, the Enterprises also contribute to market liquidity by buying and selling mortgages and mortgage securities,” wrote the Director. “Significant safety and soundness concerns required us last year to establish caps on each Enterprise's mortgage asset portfolio. We continue to have safety and soundness concerns with both Enterprises that lead us to conclude that the caps should remain. Despite those caps, normal runoff from loan prepayments and amortization give the Enterprises the continued ability to make new asset purchase of \$20 to \$30 billion each month, a sizeable amount. They also have the ability to sell securities to allow them to purchase new mortgages. Almost half their combined portfolios [\$642.8 million] are invested in Fannie Mae, Freddie Mac, and Ginnie Mae MBS.”
- “We recognize the uncertainty of current market conditions and the Enterprises' public mission of promoting a stable and liquid secondary market in a safe and sound manner. ... We will continue to follow developments quite closely and reevaluate circumstances, including the caps on mortgage portfolios, as necessary.” (*Correspondence to the Honorable Charles S. Schumer*, James B. Lockhart, III, 09/06/07; *OFHEO Mortgage Market Note*, 09/06/07)

Fannie Mae continues to lobby for increase its mortgage cap

- In a September 12th speech to the National Association of Federal Credit Unions, Fannie Mae CEO Daniel Mudd said, "...Financial crises generally have a long gestation period—market expansion leads to share growth which leads to pricing pressure which leads to poor credit allocation. But ultimately, the crisis is manifested in a liquidity event. This crisis is no different: Hot money, fast money, other people's money, loose money—all that easy liquidity is gone. Now we need to maximize liquidity from stable sources of long-term capital. What's happening is that as investors fled the mortgage market, they took away hundreds of billions of dollars in funding for mortgages. ...That's where the GSEs really come in. Congress chartered us to provide liquidity, stability and affordability to the mortgage market, in good times and in tough times like these. Right now, Fannie Mae is constrained in our response [due to the company's Consent Agreement, which froze Fannie's portfolio level]."
- "...[I]n response [market's liquidity crisis], we have asked our regulator for flexibility to exceed the portfolio cap so we can fulfill our stabilizing role in housing. Our request has not been granted, but we continue to work with our regulator to monitor and address the market situation. Some believe the GSE conforming loan limit should be raised above the current \$417,000. We leave it to Congress to decide, but I want to be clear—we would support such an increase, and we are prepared to act if Congress so decides..." (*Remarks Prepared for Delivery by Daniel H. Mudd, 09/12/07*)

Community banks don't need GSE competition

- In a September 7th article appearing in the *American Banker*, Alfred A. Dellibovi, president of the FHLB-New York, wrote, "I have read with interest recent news accounts that suggest there is a scarcity of home mortgage financing available in some markets. These accounts are untrue. There are, in fact, community bankers in virtually every city, hamlet, and village in our nation that are open for business. They can and do responsibly underwrite mortgages for families at all levels of income, including jumbo and nonconforming loans."
- "Calls to extend the reach and authority of Fannie Mae and Freddie Mac into the healthy and functioning primary mortgage market provided by community lenders appear unjustified. The poorly capitalized, often unlicensed broker distribution network effectively created by Fannie and Freddie may have actually caused the current problems in the subprime market. And as an interested observer of and customer in the mortgage markets for nearly 40 years, I have learned that nothing drives innovation in mortgage products like other people's money. And no one can deny that Fannie and Freddie are trailblazers in demonstrating how securitization can make use of other people's money."

- “But while the government-sponsored entities have standards and regulators, their Wall Street imitators know no bounds. During the last few years Wall Street promoted ‘innovative’ subprime products without regard to the ability of the homeowner to meet the monthly payment. Now that bill is coming due, and the markets are sorting out the bad from the good.”
- “In contrast, the regulated network of community-based lenders is subject to the anti-predatory standards recently promulgated by banking regulators. Community bankers have solid experience in avoiding the kind of subprime products that are creating pain and problems for some homebuyers. And the community banks now have access to GSE funding of the mortgages they originate through sales to Fannie Mae and Freddie Mac, as well as advances collateralized by those loans from the Federal Home Loan Bank System. Congress created the Federal Home Loan Bank System in 1932 to support the nation’s housing finance system. It is largely the Federal Home Loan banks’ ability to raise long-term debt in the capital markets and pass that triple-A funding along to their community member lenders that encouraged the development of the 30-year fixed-rate mortgage that is the predominant financing tool. This source of housing finance liquidity is deep. For as long as a member lender can pledge a loan for a collateralized advance, this lender will then have the needed funding to make a new, responsible loan for the American homebuyer. Simply put, the problem is not about availability of mortgages for creditworthy borrowers. The problem is the unsuitable loans that have already been made to borrowers that may need to be modified or recast.”
- “If there is a role for Fannie and Freddie in this process, I would suggest that it be based on enabling them to purchase in the secondary market those loans that community lenders do not choose to retain in portfolio. In order to minimize risk, only the purchase of loans originated by those regulated by the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corp., the National Credit Union Administration, or a state banking department should be permitted.”
- “Our system of mortgage origination, on the whole, works exceedingly well. Parts of the system have recently failed because clarity, full understanding, and solid underwriting were missing. We can only hope to correct this problem by excluding the swindlers and con artists who created the mess. We have a network of regulated, established community lenders who have a proven track record of making good mortgages that millions of people live with every day. We do not need more ‘innovation.’ What we need is the encouragement of responsible and rational underwriting and lending for the economic security and benefit of every American homeowner.” (*American Banker*, Alfred A. Dellibovi, 09/07/07)

Reactions to President Bush's proposal to revitalize FHA

- In a September 8th editorial, the *Washington Post* wrote, "...Now that the subprime market has collapsed, Washington has rediscovered the FHA. FHA-backed refinancing of defaulted subprime loans is the centerpiece of President Bush's plan to deal with the [subprime] crisis, and the president is calling for a broader 'modernization' of the FHA. House and Senate Democratic leaders also are promising an overhaul. Senate Banking Committee Chairman Christopher J. Dodd (D-CT) says it is one of his priorities this fall. The administration, House and Senate proposals differ in their particulars, but they share at least two goals: to reduce or eliminate the FHA's down-payment requirement and to allow the FHA to insure larger loans, especially in expensive housing markets. A House bill that passed the Financial Services Committee in June would also permit the FHA to charge borrowers based on their credit scores, an idea that the administration supports but that Mr. Dodd does not."
- "The risk, of course, is that these proposals would put the government into the subprime lending business now that the private-sector version has failed. But even though the proposals would allow the FHA to compete with subprime lenders by slashing down-payment requirements, they would not allow the FHA to adopt the most suspect and dangerous practices of that troubled industry, such as no-doc lending. If prudently designed and administered, FHA modernization would permit the agency to play a useful role in the post-subprime housing market. Congress should approve a bill as soon as possible." (*Washington Post*, 09/08/07)
- In a September 6th editorial, *The Los Angeles Times* wrote, "...In weighing the policy options [to address the subprime crisis], Washington must perform a delicate balancing act. Politicians want to help constituents in need. At the same time, no one wants a 'bailout' that would reward the financial irresponsibility of borrowers who couldn't afford the homes they bought, of mortgage brokers and lenders who peddled onerous loans and of Wall Street investors who bankrolled the whole operation."
- "But where to draw the line between useful assistance and a bailout? It's easy to see how raising investment limits for Fannie and Freddie might constitute a boondoggle for Wall Street, or why using tax dollars to pay off bad loans is something virtually no one advocates. But does Bush's FHA proposal, which would help just 80,000 homeowners, constitute a bailout? Does funding mortgage counseling, which, far from keeping undeserving borrowers in overpriced homes, often advises them to sell, allowing local real estate prices to readjust in a rational way? Although it's not the government's job to prop up markets, letting neighborhoods and the economy spiral into foreclosure chaos isn't thoughtful public policy either." (*Los Angeles Times*, 09/06/07)
- In a September 10th editorial, the *New York Times* wrote, "When President Bush recently announced a plan to help beleaguered homeowners avoid foreclosure, one of his aides made a point of saying, 'We are not using the b-word' -- bailout. But a

bailout it is. A government bailout is aid to people or industries in financial distress. It shields them from the full losses they would incur if left entirely to the vagaries of the market. A bailout is justified when remedial assistance averts even greater harm to the economy.”

- “Mr. Bush’s plan meets those criteria. Its most direct relief measure would allow an additional 80,000 at-risk homeowners to refinance their loans through the Federal Housing Administration, on top of 160,000 already eligible. Though not likely to be aggressive enough -- some two million homeowners are now headed for default -- the refinancing effort is a good first step. Properly executed, it would help families and communities that could otherwise be ruined, with devastating effects on consumer spending, tax revenues and state and local governments. Also important, Mr. Bush’s plan shows a rare willingness to work with Congress on getting more help to people who need it.”
- “Similarly, the Federal Reserve’s recent efforts to grease the financial markets, a k a Wall Street, also amount to a bailout. The meltdown in the market for subprime-mortgage-related debt -- a market fostered by Wall Street -- has sharply curtailed lending, threatening a cascade of business and financial failures. To parry the threat, the Fed has lowered its lending rate, injected tens of billions of dollars into the markets, and also allowed banks to funnel extra billions to clients who presumably would otherwise fail and in the process wreak havoc on the markets and the economy.”
- “Indeed, the Fed’s ongoing bailout of Wall Street added to the political pressure to help ailing homeowners. It was simply too unseemly for the government to take steps that aid Wall Street bankers without aiding the far more vulnerable people caught up in the same crisis. Now, policy makers from Mr. Bush on down must acknowledge the bailouts for what they are -- government interventions in private markets to correct for something that has gone very wrong. They may be squeamish about using the ‘b-word’ because of its negative connotations. They can call their actions ‘responses’ if that makes them and edgy markets feel better.”
- “But if, deep down, there is no acknowledgment of a bailout -- no ‘b-word’ -- there will be no grappling with the ‘c-word,’ complicity. The White House is complicit in the current mess for advancing an absolutist notion that self-policed markets self-correct, and therefore require little or no regulation. The Federal Reserve and other regulators are complicit because they failed to rein in clearly reckless lending. The Congress of the bubble years is complicit for failing to oversee the derelict regulators. For the current bailouts to ultimately do more good than harm, those failings must be vetted and corrected via stronger laws, regulation and oversight.” (*New York Times*, 09/10/07)
- In response to the *New York Times*’ September 10th editorial, HUD Secretary Alphonso Johnson responded in a *Letter to the Editor*: “When is the definition of a bailout not a definition of a bailout? When your editorial defines the term. Our

efforts to help homeowners in trouble through the [FHA] are financed by insurance premiums that borrowers themselves pay. This is not a bailout, nor a handout. The new FHA Secure product is designed for the homeowners who were steered into exotic mortgages they couldn't afford when their original rates doubled or tripled. To qualify for the product, borrowers must have a strong credit history, and have made on-time mortgage payments before their loans suddenly reset. We also require that they be capable of repaying: no 'no-doc' or 'liar loans' here. The premiums that FHA-backed homeowners pay go directly into our insurance fund, which allows us to be self-sustaining. This ensures that borrowers, not the government, remain responsible for the loans that they sign." (*New York Times*, Alphonso Johnson, 09/14/07)

- In a September 10th *WebMemo* published by the Heritage Foundation, Ronald D. Utt, Ph.D., and John C. David wrote, "Any federal intervention in the [subprime] mortgage market must meet several strict criteria: be carefully targeted to those who need help most; utilize to the greatest extent possible existing programs; be strictly limited in duration; not increase the taxpayers' exposure to risks that should be held by the private sector; and not unintentionally make the current problem worse. As described by the White House, FHA/Secure—with a few key modifications— would meet most of those tests. The program will need to be closely monitored, and the White House must be willing to make rapid changes if it is used by lenders and/or borrowers to dump onto taxpayers loans that should never have been given in the first place. Also, the program must end on time."
- "However, there is the possibility that Congress may enact legislation that further broadens FHA and/or FHA/Secure eligibility. ...[T]he President's plan appears to cover only one of the many types of subprime mortgages and does nothing to alleviate the default problems confronting borrowers with other types of loans. Some loans were given under deceptive circumstances to unqualified buyers, many of whom have low-to-moderate incomes and now risk losing their house."
- "Furthermore, with the advent of the FHA/Secure program, it will be even more difficult for Congress to avoid extending the same type of relief to borrowers with better credit records who are now squeezed by increasing loan payments. These borrowers are even more likely to benefit from the financial regulators' guidance, and Congress should resist any impulse to include them in an FHA/Secure-type program. Legislators—even with the best of intentions— have a tendency to produce massive permanent responses to temporary problems. Often, other program expansions are attached. In addition, because of the inevitable delays in passing a new law and then starting a new program, they often become available only well after the current crisis has ended. The current mortgage problems should not become an excuse to enact housing program expansions that would not be approved in normal circumstances and could even further destabilize the housing market." (*WebMemo No. 1604: The Subprime Mortgage Situation—Bailout Not the Right Solution*, Ronald D. Utt, Ph.D., and John C. David, 09/10/07)

- In *The Australian*, Stephen Ellis wrote, "...In reality, of course, most of the solution to flaws exposed by the sub-prime crisis will not come from Washington—it will arise from the current crisis itself. Investors will no longer take at face value AAA ratings granted by agencies paid to bestow them. Banks will no longer buy and securitize mortgages from persistently fraudulent originators. Mortgage firms will dig deeper to find out if information from borrowers is true. And borrowers will presumably be more realistic and delve deeper into what happens when those low introductory rates end. Anything that Washington's finest do on top of that—beyond providing limited short-term help in cases where the market is overreacting, closing loopholes, and making sure existing rules are enforced—is likely to hurt more than it helps. But history suggests that won't stop them doing it. (*The Australian*, Stephen Ellis, 09/14/07)

Chairman Frank's lessons of the subprime crisis

- In the September edition of the *Boston Globe*, House Financial Services Committee Chairman Barney Frank (D-MA) wrote, "One aspect of the subprime mortgage crisis that deserves special attention is that it was in large part a natural experiment on the role of regulation. And the results are clear: Reasonable regulation of mortgages by the bank and credit union regulators allowed the market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis."
- "At every step in the process, from loan origination through the use of exotic unsuitable mortgages to the sale of securities backed by those mortgages, the largely unregulated uninsured firms have created problems, while the regulated and FDIC-insured banks and savings institutions have not. To the extent that the system did work, it is because of prudential regulation and oversight. Where it was absent, the result was tragedy for hundreds of thousands of families who have lost, or soon will lose, their homes and for those who invested in shaky and untested, even though highly rated, securities, and have been forced to take large losses and, in many cases, shut their doors."
- "In the coming months, Congress needs to apply that lesson - to adopt for all of the mortgage industry, both origination and secondary market sales, the sort of rules that served us well in the regulated sector. Beyond that, a second major aspect of the subprime crisis demands attention: the unanticipated impact it had on financial markets in general. Indeed, that lack of anticipation is a danger sign: None of the entities charged with supervision of the economy predicted that the crisis would have broader negative effects. And this leads to a second and more difficult task that the Financial Services Committee must undertake: examining whether or not in the broader financial markets we have the same pattern that we saw in the subprime market; namely, a massive increase in innovative financial activity that brings a good deal of benefit to society, but also poses serious dangers."

- “In part because of massive intervention by central banks the crisis that caused global capital markets to seize up in the first three weeks of August appears to have moderated - at least temporarily. However, it did not work as expected, and we must retool regulatory and oversight apparatus to ensure that we are not caught so woefully unprepared again. Balance sheets are still full of lightly or never traded asset-based securities and derivatives that are difficult to value and have many of the same characteristics of the subprime based securities that plummeted in value when the real estate market turned lower.”
- “Well-functioning financial markets depend on transparency and confidence that institutions are playing by clearly defined rules. Both were in short supply in the months leading up to the August meltdown and remain so today. Large pools of unregulated capital, often highly leveraged, especially in hedge and private equity funds remain opaque and have been joined by massive sovereign investment funds to transform the financial landscape in ways that are out of reach of regulators here at home and in other wealthy countries. We lack the information that we need to ensure safety and soundness as well as the confidence that comes from the requirements mandating governance and reporting standards that apply to publicly traded companies.”
- “To an important extent these new pools of capital are structured in a fashion that allows them to avoid the scrutiny that is required of firms and financial institutions in the regulated sectors. We should not be surprised. It is a fact of life that investors and firms will seek to innovate their way around whatever regulatory strictures apply, whether they deal with health and safety, labor protections, or reporting obligations. This tendency has been exacerbated by a 30-year attack on the very notion of a regulatory role for governments and loud professions that the market not only knows best, but knows everything.”
- “Our job is to understand the changes in the financial marketplace and consider what we must do to ensure that our regulatory system is able to keep up with those changes. Innovation is as important in financial markets as it is in product markets, but it would be foolish to act as if regulatory structures, designed for a different world, do not have to be as nimble and innovative as those they regulate.”
- “As capital markets continue to become more globally integrated and complex, we must modernize our own regulatory tools; but it is certain that a truly 21st-century regulatory structure must include sophisticated multilateral initiatives as well. We must join with other countries to craft oversight and regulatory responses that are as global as the financial marketplace. A new race to the bottom by firms seeking to escape national regulation would not be good for any of us. An innovative global financial economy requires internationally coordinated financial regulation. We may have dodged a bullet earlier this year, but that should cause us to redouble our efforts, not rest on our unearned laurels while the next crisis builds.” (*Boston Globe*, Representative Barney Frank, 09/14/07)

Fannie Mae and Freddie Mac adopt rules to discourage funding subprime mortgages

- OFHEO announced that Fannie Mae and Freddie Mac have adopted the new federal standards intended to discourage funding of subprime mortgages. The new rules, announced by the Federal Reserve and four other regulators on June 29, apply to mortgage applications dated on or after September 12th. “These actions represent another significant step in promoting sound underwriting practices, enabling homeowners to select from prudent mortgage vehicles, and restoring confidence in the mortgage finance system,” said OFHEO director James Lockhart. The GSEs hold roughly \$170 billion in private-label securities backed by subprime mortgages, said OFHEO. “Since these securities were acquired before the implementation date [September 13th], they will not be affected by the guidance,” said OFHEO. (*Washington Post*, 09/11/07; *Dow Jones Newswires*, Damian Paletta, 09/10/07)

New IRS ruling on loan losses may add to mortgage market woes

- *Financial Week* reports, “[In late August], the IRS held a second round of hearings on a rule it proposed in August of last year that could significantly change the tax treatment of assets held by non-bank lenders, including the decimated subprime mortgage shops. The rule would ban the recognition of losses on assets like mortgage loans or credit card debt as regular losses that can be deducted from a company’s taxable income. Instead, those loans—subprime or not, would be considered capital assets, and any losses on them would be considered capital losses for tax purposes. The IRS has given no indication of when it may enact the proposed rule.”
- “‘It would be a lot better for these mortgage companies if their losses are deemed operating and not capital losses,’ said Bob Willens, a tax analyst with investment bank Lehman Brothers. For the time being, they are. Current tax practice allows such losses to be deducted directly from income. If they are large enough to create a net operating loss (NOL)—such as the \$206 million loss recently reported by Accredited Home Lenders for fiscal 2006—it can be carried back two years to recover taxes paid in earlier years and carried forward as many as 20 years to offset future income. The potential liquidity could keep distressed lenders afloat or make them more attractive takeover targets.”
- “The IRS, however, appears determined to correct a tax practice it says is ‘inconsistent with congressional intent and is unsound as a matter of tax policy.’ If the loans are deemed to be capital assets, then the losses on them could offset only capital gains, and on much less favorable terms for the lenders. And given the size of the losses being incurred and likely yet to come in the subprime sector, the change in tax treatment would be another major blow to mortgage lenders.” (*FinancialWeek*, Andrew Osterland, 09/10/07)

Other subprime news and notes

- According to a national survey, approximately 57% of mortgage broker customers were unable to finance their adjustable rate loans in August, portending that the U.S. housing slump may worsen in future months. In a poll of 1,744 brokers the last week of August conducted by Campbell Communications, subprime borrowers had trouble refinancing their mortgages because many loan programs were no longer available. “The question is not what home sales are doing now, but what will happen three to four months from now” as lack of mortgage funding in August trickles down into foreclosures, said Thomas Popik, author of the Campbell Communications survey. The survey also found that a third of home purchase closings were canceled in August, which included cancellation of 56% of subprime borrowers’ closings and 21% of prime borrowers’ closings. According to Lehman Brothers, 5 million adjustable-rate mortgages will reset at higher rates over the next 18 months. (*Reuters*, Al Yoon, 09/11/07)
- Among the many programs that lenders and mortgage insurers are offering to distressed subprime borrowers is Genworth Financial’s Home Owner Assistance Program (HOA). Through the HOA Program, Genworth Mortgage Insurance works directly with lenders to offer borrowers options such as repayment plans, loan modifications, presale or deed-in-lieu of foreclosure. To date, the HOA program has successfully helped more than 3,400 homeowners. Ninety-three percent of those homeowners were able to keep their homes. (*The Genworth Informer*, 08/28/07)
- While regulators want to help subprime borrowers to avert foreclosure by renegotiating their loan terms, bond investors [who own the subprime mortgages] fear that the cure may not be any better than the disease. Specifically, investors are wary of loan modifications that have never been applied on a grand scale or at a time when home prices were falling around the country. “Even in the best of times, [many of] these modifications just served to push off foreclosures for a later period when home prices were increasing,” said James Grady, a structured finance portfolio manager for Deutsche Asset Management. “Now with home prices declining, you’re arguably just increasing your loss severity.” Given the lower yield and likely longer holding period for the renegotiated loans, “you’re extending the time over which you have credit risk” to bear as an investor, said Grady. “You may find investors no longer willing to buy future or similar securities on the same terms,” he added. Gary Greenberg, senior vice president and mortgage strategist for Payden & Rygel Investment Management, said investors’ reaction to loan modification “depends on where you are in the capital structure.” For holders of the investment-grade classes of bonds [AAA to BBB -] it’s most likely a net negative based on altered expectations of cash flows, said Greenberg. For the lowest-rated classes of bonds, it’s probably a net positive, if the modifications really improve the performance of the loans, he added. Loan modifications are “not the unequivocal positive” for investors, concludes Grady. (*Dow Jones Newswires*, Danielle Reed, 09/11/07)

- Attorneys general and banking regulators from 10 states have formed a task force in an effort to persuade investors in mortgage-backed securities and mortgage-servicing companies to work with borrowers on the restructuring subprime mortgages. The task force, comprised of the attorneys general of California, Arizona, Texas, Illinois, Ohio, North Carolina, Colorado and Massachusetts, banking regulators from North Carolina and New York, and a representative from the Conference of State Banking Supervisors, will meet with a dozen of the nation's largest subprime mortgage servicing companies later in September. The group will meet separately with investors who own mortgage-backed securities in October. (*Wall Street Journal*, Ruth Simon, 09/08/07)
- The SEC has expanded its probe of the subprime mortgage sector to examine all of the players involved—from the subprime lenders to the investors in mortgage-backed securities and everyone in between. “Our team is focusing on whether any improper accounting, disclosure, or insider sales occurred,” says Walter G. Ricciardi, deputy director of the SEC’s enforcement division. “We will look for any potential fraud, by management, auditors, lawyers, credit-rating agencies, or others.” The agency’s biggest area of concern appears to be whether the lenders and big investors who hold the mortgage-backed securities, collateralized by poorly performing loans, are accurately marking down the value of those assets. (*BusinessWeek*, Dawn Kopecki and Christopher Palmeri, 09/10/07)
- The International Organization of Securities Commissions (IOSCO), the umbrella body for the world’s securities regulators, has called a special meeting with the credit rating agencies to review how they rate structured financial products, collateralized with mortgage assets. Philippe Richard, IOSCO’s secretary-general, said, “We will have a meeting some time [this month] with the credit ratings agencies to understand whether there are specific issues in relation to these structured financial products, whether there is a risk of potential conflicts of interest in these very complex financial products and in what way, for instance, the frequency of reviews of the ratings of these products differ from that of other products.” (*Financial Times*, Jeremy Grantin, 09/12/07)
- The Federal Trade Commission has sent warning letters to over 200 mortgage lenders and brokers, and the media outlets that carry their mortgage advertising, that their ads contain potentially deceptive claims that could violate federal laws. While the commission has not yet determined whether the companies were in violation of the law, the agency urged the recipients of the September 10th letter “to review your practices to ensure that they comply with the law.” The FTC said that it has not waived the right to take legal action based on “past or future law violations” and would keep the offending ads on file. (*Bureau of National Affairs*, Thecla Fabian, 09/12/07)
- “The combination of rising delinquencies, higher foreclosures, more housing inventories, increasing interest rates on many mortgages and greatly reduced

availability of mortgages due to limited liquidity is creating what we call a near-perfect storm for housing,” said Washington Mutual CEO Kerry Killinger on September 10th. (*Seeking Alpha*, Susan Lerner, 09/11/07)

- The subprime contagion, which has resulted in 156 major lenders and 30 distinct hedge funds imploding, is far from over, said Kal Das, head of the global bank and institutional finance and restructuring practice group at law firm Seward & Kissel. “This isn’t the last of it,” said Das. “Many more mortgage lenders will go down in the coming months.” The pain has spread beyond subprime mortgages to Alt-A mortgages and the commercial paper market “is non-existent right now,” he said. “Lenders are getting jittery and people are thinking twice before lending money,” which is stalling commercial real estate deals, said Das. Banks are feeling the mortgage pinch in off-balance-sheet “conduits” and structured investment vehicles (SIVs). “No one wants to liquidate collateral in the asset-backed market because of the huge losses they would face,” said Das. “The collateral isn’t always bad, but when you use mark-to-market, it gets hit.” (*Marketwatch*, John Spence, 09/14/07; www.ml-implode.com, 09/16/07; www.hf-implode.com, 09/16/07)
- Freddie Mac has asked a bankruptcy court to order the swift transfer of paperwork for 4,547 mortgages totaling \$769.8 million to the GSE from bankrupt lender American Home Mortgage. According to Freddie Mac’s filing, “[There is] imminent risk that borrowers’ insurance policies may lapse from non-payment, and real property tax bills will go unpaid, resulting in increased tax liabilities and possible tax foreclosure sales.” Although the GSE was successful in capturing about \$7 million in “custodial account funds for these loans, Freddie Mac has not obtained the loan files, which the lender has refused to hand over. “Without the mortgage loan files... neither Freddie Mac nor its designee will be able to pay Freddie Mac’s borrowers’ insurance premiums or periodic real property tax liabilities,” said the filing. Without access to the custodial accounts, American Home will be unable to pay the borrowers’ insurance premiums or property taxes. A September 20th hearing has been scheduled to determine whether Freddie Mac would assume servicing the loans. (*Washington Post*, Thomas Heath, 09/13/07; *Newsday*, Daniel Wagner, 09/12/07)
- In a recent research note, Friedman Billings Ramsey (FBR) estimates that \$150 billion to \$250 billion of “permanent capital” is needed to “normalize” pricing in the mortgage market. This capital is needed because many firms are trying to de-leverage at the same time, said FBR. The firm predicts it will take six to 12 months for the prices “of mortgage assets to adjust and for capital to flow back into the space.” FBR concludes, “The big question is who will supply this permanent capital when many investors believe that housing assets are impaired?” (*Mortgage Line*, 09/12/07)
- World-wide central banks injected \$383 billion in credit to world banks just in August. According to *Minanyville.com*, “That is just an amazing number. It’s unprecedented.” (www.minanyville.com, 09/13/07)

Fannie Mae and Freddie Mac

Congress questions Fed nominee's "involvement" in subprime mortgage market

- Capital One Financial executive Larry A. Klane, who has been nominated by President Bush to serve on the Federal Reserve Board, faces questions from Democrats, concerning Kane's supervision of a bank subsidiary which originated and sold subprime mortgages. Capital One Home Loans, a unit of Klane's Global Financial Services division, originated "2/28s" and "3/27s," exotic subprime adjustable-rate loans with low introductory rates that increase after two or three years. These types of loans [approximately \$15 million] account for only 1% of the unit's \$1.5 billion mortgage portfolio, said Capital One. "Mr. Klane's involvement in subprimes raises questions, but we'll withhold judgment until we get answers," said Senator Charles Schumer (D-NY), who is a member of the Senate Banking Committee which held an August 2nd hearing on Klane nomination but has not scheduled a vote. (*Dow Jones International News*, Damian Paletta, 09/07/07)

Senator Tim Johnson (D-SD) returns to the Senate

- On September 5th, Senator Tim Johnson (D-SD) returned to the Senate, after an eight month recovery following stroke like symptoms in December and emergency brain surgery for arteriovenous malformation. "It must already be clear to you that my speech is not 100 percent," said Johnson. "My doctors tell me that it will get there. But my thoughts are clear and my mind is sharp, and I'm here to be a voice for South Dakota in the Senate." Senate colleagues from both parties gave their colleague two standing ovations during his appearance on the floor of the Senate. Johnson said he will decide this fall if he will run for re-election. His decision will be based in part on the progress he's able to make in recovering his speech and improving his mobility. "I anticipate it will be good, but you never know," he said. Johnson said he expects to hear from Senate Majority Leader Reid (D-NV) soon about resuming his role as chairman of the Senate Ethics Committee. "I'm in no hurry," he said. "It's a thankless job." Senator Barbara Boxer (D-CA.) has been led the panel in Johnson's absence. Johnson is also the second ranking Democrat on the Banking Committee. (*Bureau of National Affairs*, Ralph Lindeman, 09/06/07)

Retirement announcements

- Senator Chuck Hagel (R-NE), one of the Senate's most outspoken critics of Fannie Mae and Freddie Mac, has announced he will not run for re-election in 2008. Hagel, 60, has been considering whether to seek a third term in the Senate, run for President or retire. Previously, Senator Wayne Allard (R-CO), also a member of the Senate

Banking Committee, had announced he will not seek re-election. Committee members John Sununu (R-NH), Elizabeth Dole (R-NC), also face reelection next year. (*Dow Jones Newswires*, Damian Paletta, 09/10/07; *World-Herald*, Jake Thompson, 09/07/07)

- On September 10th, the Federal Reserve Bank of St. Louis president William Poole announced his plans to retire in March 2008, in accordance with the Fed's retirement policies. The Bank has named a search committee, headed by its chairman Irl F. Engelhardt, to begin the selection process for Poole's successor. (*Bureau of National Affairs*, Len Bracken, 09/11/07)
- OFHEO Director James B. Lockhart, III announced that Leonard Reid, Director of the Office of Supervision, will be retiring on December 31st after six years with the agency. During his tenure at OFHEO, Reid was responsible for monitoring capital adequacy at Fannie Mae and Freddie Mac and played a key role in the implementation of OFHEO's risk-based capital requirement. In March 2006, Reid became the agency's first Director of Office of Supervision, in which he managed the work of the examination teams, the Office of Capital Supervision, the Office of the Chief Accountant, the Office of Policy Analysis and Research, and other supervisory offices to ensure the GSEs' safety and soundness. "Len Reid has done an outstanding job as OFHEO's first Director of the Office of Supervision," said Lockhart. "I am very grateful for his stewardship during the completion of the Special Examination of Fannie Mae and his leadership in overseeing the remediation efforts underway at Fannie Mae and Freddie Mac." (*OFHEO Press Release*, 09/11/07)

<i>In memoriam</i>

- Representative Paul Gillmor (R-OH) passed away unexpectedly on September 5, 2007. Gilmore, 68, was first elected to Congress in 1988, after serving in the Ohio State Senate for 22 years. House Minority Leader John Boehner (R-OH) told fellow congressmen on the floor of the House that their colleague died "suddenly overnight." Gillmor was a member of the House Committee on Financial Services and ranking Republican on the Subcommittee on Financial Institutions and Consumer Credit. Gillmor also served on the Subcommittee on Capital Markets, Insurance and Government Sponsored-Enterprises and the Subcommittee on Housing and Community Opportunity. He is survived by his wife, Karen Gillmor, two daughters, Linda and Julie, and three sons, Paul and twins Connor and Adam. (*CNN*, 09/06/07)
- On September 12th, Representative Judy Biggert (R-IL) accepted the position of ranking member of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit, filling the vacancy created by Gillmor's death. (*Press Release from the Office of Representative Judy Biggert*, 09/12/07)
- Edward "Ned" M. Gramlich, former governor of the Federal Reserve, passed away on September 5 at the age of 68 following a battle with acute myeloid leukemia. In

1997, Gramlich, who was named to the Federal Reserve by President Bill Clinton and served until 2005, was known as a pragmatic economist who lightened the seriousness of board discussions with humor and common sense. He was also known as a policy activist who piloted two measures to enhance disclosures and protections on high cost home loans. “His contributions to the Federal Reserve were broad and significant,” said Federal Reserve Bank Chairman Ben S. Bernanke.

- After leaving the Fed, Gramlich served as a senior fellow of the Urban Institute, which published his book, *Subprime Mortgages: America’s Latest Boom and Bust*, in June. In a July interview with *Chicago Sun Times*, Gramlich said that given the fall-out in the subprime lending market he would like to see an even playing field as far as regulatory oversight. “Where we don’t need the safeguards so much, we have a lot. Where we need safeguards a lot, we have nothing. My main push is a plea, ‘Let’s supervise the subprime lenders.’ We have a lot of mortgage laws. But we do not have any police on the beat,” said Gramlich. Although he was too ill to travel to the Federal Reserve Bank of Kansas City’s annual symposium in August, Gramlich prepared a paper on subprime mortgages which was delivered in his name at the session. In this paper, he wrote that the subprime market had been a force for good, “a valid innovation” that enabled “12 million households to become homeowners, a large majority of these who would have been denied mortgage credit in the early nineties,” despite the problems experienced in the market. Gramlich called the subprime market of lending to riskier homeowners a classic boom-bust cycle in which “[t]he predictable result was carnage.” However, abandoning the subprime market would, he wrote, be “exactly the wrong message to take from the experience.” (*Chicago Sun Times*, Craig Torres, 09/09/07; *New York Times*, Micheline Maynard, 09/06/07; *Wall Street Journal*, Greg Ip and Stephen Miller, 09/08/07)

HUD plans to propose new RESPA rules in early 2008
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- In early 2008, HUD plans to propose rules under the Real Estate Settlement Procedures Act (RESPA) to ease the home mortgage and settlement process. In a September 12th statement, Federal Housing Commissioner Brian Montgomery said, “While it is too early to discuss the substance of a new RESPA rule, our driving force will be to provide consumers with the tools they need to shop for the best loan for them.” HUD’s proposal is expected to be submitted soon to OMB for review, which could last up to 90 days. After Congress reviews the proposal, the rule would be released for public comment. (*Bureau of National Affairs*, R. Christian Bruce, 09/13/07)

Wachovia was largest commercial and multi-family mortgage servicer on June 30th

- On June 30, Wachovia Securities was the largest commercial and multi-family mortgage servicer with \$356.6 billion in primary and master servicing volume, followed by CapMark Finance (\$252.3 billion), Midland Loan Services (\$245.5 billion), Wells Fargo (\$153.2 billion) and KeyBank Real Estate Capital (\$133.2 billion), according to the Mortgage Bankers Association. The largest Fannie Mae/Freddie Mac servicers at midyear were Midland, Deutsche Bank Commercial Real Estate, Capmark, Wachovia and Centerline. MBA also reported that Capmark was the top FHA and Ginnie Mae servicer. (*MortgageLine*, 09/07/07)

Fannie Mae

Fannie Mae “not actively” seeking to buy a loan servicing platform

- Fannie Mae CEO Daniel Mudd said that while Fannie Mae is “not actively” seeking to buy a servicing platform, the company is concerned about a shortage in servicing capacity due to the growing number of troubled loans and the number of loan servicers going out of business. (*National Mortgage News Online*, 09/11/07)

Fannie Mae to close more than 40 regional offices as part of its cost-cutting efforts

- Fannie Mae has announced plans to cut more than 40 of its 55 regional offices, known as community business centers, as part of its efforts to reduce operating expenses by \$200 million. To date, the company has closed its West Virginia office and begun the closure of its business center in Pittsburgh. A Fannie Mae spokesman declined to say how many offices will be closed or how much money the closings will save the company. “Fannie Mae is realigning our community development group, including the community business centers, to better achieve our objective of bringing capital to partners to build thriving communities,” said Jon Searles, a Fannie Mae account director for housing and community development. (*Dow Jones Newswires*, Damian Paletta, 09/07/07; *Pittsburgh Tribune-Review*, Sam Spatter, 09/06/07)

Fannie Mae renews its lease at its Washington, DC headquarters

- Fannie Mae has expanded and renewed its lease to occupy all of the office space at its Washington, D.C. headquarters at 4000 Wisconsin Avenue, NW. Under the new lease, the company will acquire an additional 53,158 square feet, increasing Fannie’s total occupancy to 417,000 square feet in the three five-story office buildings. The

Fannie Mae complex, developed in 1988 by Donohoe Cos., sits on 4.1 acres in the Washington's uptown market. (www.costar.com, David C. Burr, 09/05/07)

Freddie Mac

Freddie Mac's credit position "is near the very best in the industry"

- In a September 10th speech at Lehman Brothers' Financial Services Conference, Freddie Mac's Chief Business Officer and EVP, said, "...Freddie Mac has very low exposures to Alt-A and risk layered mortgage products. When taken together, these represent about 8 percent of our total single-family guarantee portfolio. On the Alt-A side, as of the end of June, we guaranteed \$120 billion of loans that were either identified by the originator as Alt-A or had reduced levels of documentation. ...[M]any of these loans were sourced through our bulk channel, and so were priced considering their increased risk. In addition, for the Alt-A book, we have significant credit enhancement, strong average current LTVs of 71% and FICO scores of 715. These attributes should limit the credit impact from these loans."
- "As to risk layered products with low FICOs and high LTVs, at the end of the second quarter, we had total guarantees of about \$10 billion, or less than 1 percent of our portfolio. Moreover, 94 percent of these loans had credit enhancements. So while we are not totally immune to these risks, when compared to other participants, I think you'll find them to be very low."
- "So again, whether you view our overall portfolio, or look to our Alt-A book, layered products, total single-family delinquencies [42 basis points], or charge-offs [expected to be 3 basis points in 2007], we feel our credit position is near the very best in the industry." (*Prepared Remarks of Patti Cook, 09/10/07*)

Freddie Mac declares its third quarter dividends

- The Freddie Mac board of directors declared a \$0.50 share dividend for the company's common stock for the third quarter, payable on September 28th to stockholders of record as of September 17th. The board also declared third quarter dividends on the corporation's preferred stock in accordance with the terms of each issue. (*Freddie Mac Press Release, 09/07/07*)

Freddie Mac cancels REMIC issue citing insufficient demand

- On September 4, Freddie Mac said that “market demand does not appear sufficient” to issue a Reference Real Estate Mortgage Investment Conduit [REMIC] in September. “We and the dealers that we work with are seeing a market with considerable supply with all fixed-income programs” said Freddie Mac spokesman Michael Cosgrove. “At this time it doesn’t make sense to provide more supply to the market.” (*Reuters*, Al Yoon, 09/04/07)

Lobbyist disclosure for Freddie Mac

- During the first six months of 2007, Freddie Mac paid Porterfield & Lowenthal LLC \$140,000 to lobby the federal government on mortgage finance reform, according to a recently filed disclosure form. (*Associated Press*, 09/12/07)

Freddie Mac names new vice president of multifamily sourcing’s offering

- Freddie Mac announced that Patti Saylor has joined the company as vice president of multi-family sourcing’s offerings and customer management department, responsible for multifamily customer and product strategy. Previously, Saylor was managing director of national due diligence, managing director of originations, corporate managing director of development and strategy, and senior vice president of east coast originations for Centerline Capital [formerly CharterMac and Capri]. (*Multi-Housing News*, Kelly Sheehan, 09/10/07)

Freddie Mac participates in the “Hope and Recovery Summit” in New Orleans

- At the Hope and Recovery Summit sponsored by Senator Mary Landrieu (D-LA), Ralph E. Boyd, Jr., Freddie Mac’s EVP of community relations, discussed his company’s commitment to housing and sustainable community recovery in New Orleans. Boyd addressed Freddie Mac’s commitment to recovering New Orleans, specifically through (1) linking employment with housing through Freddie’s workforce home benefit initiative; (2) purchasing tax credits and loans which totaled \$88 billion of loans in New Orleans (90% of the company’s total of \$97 billion for Louisiana); and (3) committing millions to provide residential services [by Freddie Mac Foundation] for basic health and transportation services, getting children enrolled back in school and tutoring programs, and coordinating job training and access to employment opportunities. At the session, Landrieu said, “The intent is not to revisit old debates over fault and failure in the days and months after the hurricanes – that is a road well tread. This summit is a forum for fresh ideas and new paths forward for a great city and region.” (*Freddie Mac Press Release*, 09/04/07)

- As the Gulf Region commemorated the second anniversary of Hurricane Katrina, syndicated columnist Lawrence Kudlow posed the question: “How much money has Uncle Sam spent on New Orleans and the Gulf region since Hurricane Katrina ripped the place apart?” Kudlow continued, “I’ll give you the answer because you’ll never guess it. The grand total is \$127 billion (including tax relief). That’s right: a monstrous \$127 billion. ...This is an outrage. The entire GDP of the state of Louisiana is only \$141 billion, according to the U.S. Commerce Department. So the cash spent there nearly matches the entire state gross GDP. That’s simply unbelievable. And to make matters worse, by all accounts New Orleans ain’t even fixed. ...Perhaps all this money should have been directly deposited in the bank accounts of the 300,000 people living in New Orleans. All divvied up, that \$127 billion would come to \$425,000 per person. ...”
- “... The idea of using federal money to rebuild cities is the quintessential liberal vision. Given the dreadful results in New Orleans, we can say the government’s \$127 billion check represents the quintessential failure of that liberal vision. Hillary Clinton calls this sort of reckless spending ‘government investment.’ That’s what’s in store for America if she wins the White House next year...”
- “...Right from the start, New Orleans should have been turned into a tax-free enterprise zone. No income taxes, no corporate taxes, no capital-gains taxes. The only tax would have been a sales tax paid on direct transactions. A tax-free New Orleans would have attracted tens of billions of dollars in business and real-estate investment. This in turn would have helped rebuild the cities, schools and hospitals. Private-sector entrepreneurs would have succeeded where big-government bureaucrats and regulators have so abysmally failed. This is the real New Orleans Katrina story...” (*Washington Times*, Lawrence Kudlow, 09/02/07)
- Columnist Mona Charen wrote, “ **...[T]he federal spending on the Gulf Coast in the past two years (\$127 billion) has exceeded total spending on the Marshall Plan to rebuild Europe after World War II (in inflation-adjusted dollars).** [Emphasis added.] ...If there is to be any hope for New Orleans it must rest upon reality: build on higher ground; reform the justice system to truly punish violent crime; reform welfare to discourage illegitimacy as most other cities and states have done; and permit choice in education. Instead, we are being urged, in the name of compassion and justice, to throw good people back into a terrible situation and to invite another catastrophe.” (*Columbus Daily Tribune* [MO], Mona Charen, 09/05/07)

Federal Home Loan Banks

FHLBs provide \$110 billion of advances to members in August

- During the month of August, the FHLB System's advances increased \$110 billion to \$769 billion, while the Banks' consolidated obligations grew \$110 billion to \$1.087 trillion. Mike Thomas, President of the FHLB-Chicago, said, "Members can be comfortable that the triple-A rated Home Loan Bank System is able to efficiently access capital markets to fund advance demand during periods of stress." (*FHLB Office of Finance*, 09/04/07)

FHLB-Des Moines receives regulatory approval to accept ADC loans as collateral for advances

- The Federal Housing Finance Board has approved the FHLB-Des Moines' request to accept one-to-four-family construction loans as collateral for advances. (*National Mortgage News Online*, 09/11/07)

Charter One will leave the FHLB-Cincinnati

- The FHLB-Cincinnati will lose its second-largest member, after Charter One transfers its membership to a different district. Charter One has already begun reducing its reliance on the Bank's advances, which fell from \$11.6 billion on June 30 to \$7.4 billion on August 31st. To date, Charter One has not sold its \$527 million of the FHLB-Cincinnati's stock [representing 14% of the Bank's stock]. In a filing with the SEC, the FHLB-Cincinnati wrote, "It will not materially affect the adequacy of our liquidity, our profitability in terms of the dividend rates available to pay remaining stockholders ... and the ability to continue providing sufficient membership value to our members. Absent replacing the volume of business, we expect that our annual net income will decrease." (*American Banker*, Steven Sloan, 09/06/07)

A successful merger of the FHLBs of Dallas and Chicago could clear the way for more mergers in the FHLB System

- According to *Mergers & Acquisitions Report (MAR)*, consolidation across the banking industry has greatly reduced the number of the large banks that are member institutions within the FHLB System, as their local charters are dissolved following a takeover. "This industry is driven by mergers and acquisitions," an advisory source told *MAR*. "In Chicago, Wisconsin and Illinois, there are not many large banks remaining." The source said, "There is pressure to consolidate," adding that the 12

FHLBs issue non-tradable stock to their members which does not appreciate in value and typically yields about 5%. While the FHLBs would gain economies of scale and improved operating efficiencies through consolidation, completing a merger of the Banks may be easier said than done. “There are no regulatory rules on the books about merging the banks,” said the advisory source. “The banks themselves don’t know the approval process. It’s easy to talk about, but difficult to do.”

- On August 8th, the FHLBs of Dallas and Chicago announced that they are currently discussing a combination of their two banking organizations. A spokesman for the Chicago Bank said that the talks were only preliminary and described the process as “uncharted territory.” The FHLB-Dallas lost a number of large members, including World Savings Bank (2006), Hibernia National Bank (2005) and Bank United Corp (2001). The FHLB-Chicago reported a 50% decline in its second quarter earnings (in part due to problems in its mortgage programs), while the FHLB-Dallas reported only a 2.9% increase in its second quarter earnings relative to the same period last year. Rusty Cloutier, CEO of MidSouth Bancorp Inc. [a member institution of the FHLB-Dallas], said “The big question is whether or not Dallas and Chicago could survive individually.” Cloutier added that the recent slowdown in the mortgage market also may have triggered the Banks’ merger discussions.
- The FHLB-Cincinnati and FHLB-Indianapolis are experiencing similar loss of members resulting from mergers. The Cincinnati Bank is losing its largest member, Charter One Bank, which owns 24% of the Bank’s outstanding advances and 14% of its stock. The termination of Charter One’s membership is expected to occur next month. Similarly, the FHLB-Indianapolis faces the loss of LaSalle Bank Corp.’s membership, as a result of its recently announced agreement to merge with Bank of America. Sources believe that a possible joining of the FHLB-Cincinnati and FHLB-Indianapolis would be a likely, given the membership trends of both banks and geographic fit of their franchises. (*Mergers & Acquisition Report*, Ernest Loesser, 09/10/07)

Federal Housing Finance Board approves its \$38.7 billion budget for 2008

- The Federal Housing Finance Board unanimously approved a \$38.7 billion fiscal year 2008 budget, a \$2.9 billion increase [8%] over the agency’s 2007 budget. Approximately 90% of the agency’s spending increase is allocated to the FHLBs’ examination and supervision. (*American Banker*, Steven Sloan, 09/13/07)

Banking trade groups urge Senator Baucus to co-sponsor bill that would allow FHLBs to back tax-exempt bonds

- More than a dozen trade groups are urging Senate Finance Committee Chairman Max Baucus (D-MT) to cosponsor legislation that would allow the FHLBs to back tax-exempt bonds. In a letter to Baucus, the groups wrote that allowing such use of the

FHLBs' letters of credit "will provide an additional credit enhancement option as issuers work to structure cost-effective financing on projects like water treatment facilities, fire stations, long-term care facilities for the elderly, medical clinics, school buses, bridges, and other infrastructure improvements. ...[The letters] will provide an additional opportunity for these institutions to serve the communities they call home while also keeping the LOC fees in the local and regional economy." The American Bankers Association and the Independent Community Bankers of America were among the letter's signatories. (*American Banker*, Steven Sloan, 09/14/07)

Farm Credit System / Farmer Mac

Brazil will ask the World Trade Organization to investigate U.S. ethanol subsidies
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- Brazil plans to ask the World Trade Organization for a formal investigation of U.S. farm subsidy programs, which it says includes payments for ethanol production, according to Roberto Azevedo, the Brazilian Foreign Ministry's trade chief. The country, which has already won a series of WTO rulings over U.S. cotton subsidies, is a major ethanol producer. After consultations with Washington officials in August, Brazil accused the U.S. of exceeding the \$19.1 billion that it is permitted under WTO rules to spend on the most controversial forms of farm subsidies in six of the past eight years. While most of the measures mentioned concerned farm produce, Brazil included in its complaint what it called "energy subsidies," which included tax exemptions on diesel fuel and gasoline. "Ethanol results from agricultural subsidies," said Azevedo. "You don't produce ethanol from rocks or underground. It's derived from agricultural commodities." Azevedo isn't sure when Brazil would formally ask the WTO to launch an investigation. [The next meeting of the WTO's dispute settlement body is September 25.]
- Brazil, which touts its sugarcane-based ethanol as a cheap, eco-friendly alternative to fossil fuels, says its exports have been depressed by high U.S. and European tariffs. Brazilian President Luiz Inacio Lula da Silva, who has argued that the EU's tariffs on ethanol were unfair, is seeking support from Nordic countries to slash them; such moves would likely meet fierce resistance from the larger European countries, which are determined to protect their fledgling biofuels industries. Brazil also is concerned about U.S. subsidies to corn growers, who are devoting more than a quarter of their crop this year to ethanol, according to U.S. Agriculture Department. The U.S. is the world's leading ethanol producer, while Brazil, the top sugar producer and exporter, is second. Experts believe that Brazil could become the world's undisputed ethanol superpower, because its sugarcane is more efficient for ethanol production than the corn used to make ethanol in the United States, if related tariffs were lifted. [On December 31, 2006, the Farm Credit System's loan exposure to the ethanol plants

was \$2.6 billion, representing 10.5% of the system's capital and 2.1% of its gross loans, according to FCA's 2006 annual report.] (*Associated Press*, Bradley S. Klapper, 09/11/07; *2006 Farm Credit Administration Annual Report on the Farm Credit System*, June 2007)

FCA board adopts rules to amend regulations governing liquidation of FCS institutions

- The Farm Credit Administration (FCA) board of directors has adopted two final rules to amend its regulations on the priority of claims payments to holders of obligations of a Farm Credit System institution in liquidation. One final rule provides the same priority of claims rights for payments made by FCS banks under an agreement to pay a defaulting bank's consolidated and Systemwide obligations as the banks have for payments made under a statutory joint and several call. While no agreement exists at this time, the rule applies to any future agreement among System banks to make payments for such purpose, provided the agreement is in writing and approved by FCA. This rule will be effective 30 days after publication in the *Federal Register* during which either body of Congress is in session.
- The second rule deals with claims of holders of obligations in a defaulting System institution that are subordinated to the claims of general creditors. The rule clarifies that the subordinated claims are to be paid after the claims of general creditors are paid in full. 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*. (*States News Service*, 09/13/07)

Postal Service

Vice Chairman Tisdale to leave the Postal Regulatory Commission in November

- Dawn A. Tisdale, vice chairman of the Postal Regulatory Commission has advised President Bush that he will not seek re-nomination to the PRC and will leave the Commission on November 22, 2007. (*Association of Postal Commerce*, 09/14/07)

Postal Service's workforce has declined 1% over the last two decades

- According to an August 20th CRS Report for Congress on the USPS work force, the Postal Service's work force has declined 1% over the past two decades [1986-2006] and nearly 12% over the past five years. According to CRS, "The number of career employees declined over 6% since 1986, and the number of non-career employees increased more than 62%. Clerks, who staff retail counters at post offices and manually sort mail, dropped about 26%. Rural mail delivery employees, however, grew more than 84%, and three categories of employees directly involved in the transportation of mail prior to its delivery grew between 8.9% and 26.9%." (*CRS Report to Congress: U.S. Postal Service Work Force Size and Employment Categories, 1986-2006*, Kevin R. Kosar, 08/29/07)

NALC endorses Senator Hillary Clinton for president

- The National Association of Letter Carriers has endorsed Senator Hillary Rodham Clinton (D-NY) for president, saying she has the strength and experience to bring change to the White House. "She's ready to lead this country from her first day in the White House," said NALC president William H. Young, who called Clinton the "runaway winner" in the union's survey of their members on the presidential primary candidates. "In the primary elections next year, you can count on letter carriers to deliver for Senator Clinton, and I am confident that in the years to come, President Hillary Clinton will deliver for every citizen throughout America," said Young. (*Associated Press*, Jesse H. Holland, 09/12/07)

Mass mailers form Mail Moves America to lobby against "Do Not Mail" laws

- Worried that "Do Not Mail" laws will catch on the way "Do Not Call" legislation did, the Direct Marketing Association (DMA) and other mass mailing and fulfillment businesses are fighting back through the formation of Mail Moves America (MMA). The new lobbying group, comprised of 50 associations and businesses, plans to head off at the pass the growing number of bills introduced in state legislatures that would permit residents to opt out of receiving "marketing or advertising mail." In 2006,

“Do Not Mail” proposals have been introduced in four state legislatures and 18 bills have been introduced in 15 states to date in 2007. DMA president and CEO John A. Greco, Jr. said his organization sees “stirrings at the state level of what we believe is a long-term, concerted national effort to limit advertising mail.” He added, the “well financed” opposition to unsolicited mail “is being driven by environmental, privacy and consumer groups who often distort the facts in their efforts to eliminate advertising mail to consumers.” Greco said, “[T]he best response to the growing threat posed by the state ‘Do Not Mail’ legislation, is one that is aggressive, coherent, and equipped with complete and convincing information about the consumer benefits of advertising mail.” According to DMA, marketing mail currently provides more than half the revenue of the USPS. If this mail were curtailed or eliminated, postal rates would soar and delivery may be “shortened,” argues MMA. (*Editor & Publisher*, Mark Fitzgerald, 09/12/07)

Timing of the Postal Service’s filing of its next omnibus rate case is uncertain
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- In its September 5th issue, *eNAPUS Legislative & Political Bulletin* wrote, “While Congress was on break [in August], the Postal Regulatory Commission (PRC) proposed new rules for the postal ratemaking system under Public Law 109-435, the Postal Accountability and Enhancement Act. The PRC had until June 2008 to propose the new system, but unveiled the proposed rules on August 15, 10 months early. Postal stakeholders, including the USPS, have until September 24th to comment on the rules. After the comments are published in the *Federal Register*, stakeholders have until October 9th to submit ‘reply comments’ to the PRC. Based upon these comments and reply comments, the PRC may revise their August rules. It is anticipated that final regulations will be published in the *Federal Register* by mid-to-late October. Subsequently, the Board of Governors has until December 19 to decide whether to go with the new rules, or file a rate case under the pre-existing rules.”
- “Interestingly, stretching the Congressional Calendar beyond Thanksgiving, to accommodate unfinished budget business, may have political implications for the Postal Service decision regarding a possible omnibus rate case. House and Senate postal overseers have expressed their strong preference for the new inflation-adjusted rate process. As previously stated, under PL 109-435, the USPS Board of Governors has until December 19 to decide what rate-setting process they will use for the next rate adjustment. The new law provides that the default adjustment for market-dominant postal products is based on the consumer price index (CPI) and could take effect as early as spring 2009. The timing depends on when the ...[PRC] publishes final regulations on the rate process. The PRC is expected to unveil these regulations in mid-to-late October. However, if the Board of Governors elects to employ the old rules and file an omnibus rate case, a protracted process would commence that could extend to late summer or early fall next year. This would result in rate increase being pushed until FY 2010. Postal stakeholders are anxious about the decision.” (*eNAPUS Legislative & Political Bulletin*, 09/05/07)

Japan's government gives final endorsement for the 10-year privatization of Japan Post

- The Japanese government has approved a blueprint submitted in April by Japan Post Corp. for privatizing postal services. The 10-year privatization process will begin on October 1st, when postal services will be split into four stock firms — savings, insurance, mail and over-the-counter services — under Japan Post, which will turn into their holding company. The blueprint provides a list of assets and employees Japan Post will take over from the public postal corporation that currently runs postal operations and outlines some new businesses planned for the privatized entities. In a September 10th statement, Masayuki Oku, chairman of the Japanese Bankers Association, said that he regrets the final blueprint “fails to contain any specific plan for scaling down postal savings.” As a result, the planned savings bank “will expand operations while the government’s capital subscription in it is maintained,” Oku added. Kunie Okamoto, chairman of the Life Insurance Association of Japan, said the government should consider allowing the postal life insurance company to undertake new operations, only after ensuring conditions for fair competition in the market. (*The Japan Times*, 09/12/07)

TVA

The nuclear debate continues:

Nuclear power can help meet our energy needs and preserve the Earth's climate

S. David Freeman, former TVA chairman during the Carter administration, argues to dismantle all of the existing power plants in the U.S.

Nuclear power can help meet our energy needs and preserve the Earth's climate

- In a September 17th article in *Business Week*, Christine Todd Whitman, the former administrator of the EPA for the Bush administration, wrote, “...[F]orecasts that we’ll need 40% more electricity by 2030, [determine] how we can realistically feed our energy addiction without ruining our environment is the critical challenge of the new century. Of course, we could buy energy-saving appliances or drive fuel-efficient cars. We can recycle cans, bottles, and newspapers. We can even plant carbon-absorbing trees. But, no matter how much we may wish they would, these acts by

themselves won't satisfy our energy demands. To do that, we need a diverse energy mix that takes a practical, rather than emotional, approach.”

- “Enter nuclear energy. Nuclear alone won't get us to where we need to be, but we won't get there without it. Despite its controversial reputation, nuclear is efficient and reliable. It's also clean, emitting no greenhouse gases or regulated air pollutants while generating electricity. And with nuclear power, we get the chance to preserve the Earth's climate while at the same time meeting our future energy needs.”
- “The cost of failing to meet these needs will be steep. The global economy relies on world-class power grids to trade stocks, to communicate instantly, and to buy and sell around the clock. If anything points to the frustrating effect that a failed power grid can have on profits, it's the San Francisco power outage that took down Silicon Valley enterprises like Craigslist and Netflix (NFLX) in July. Although it only cost them two hours of online business, that minor power blip illustrates how a lack of electricity can render even a tech-savvy company impotent.”
- “Nuclear power also provides a valuable tool for businesses: cost stability. Unlike other power suppliers, nuclear plants buy their uranium at set prices three years in advance. And uranium prices comprise just 26% of production costs at nuclear plants; by comparison, coal accounts for 78% of costs at coal-fired plants. So despite big increases in uranium prices over the past three years, industry production costs have remained low, at less than 2 cents per kilowatt-hour (a quarter of those at gas-fired plants).”
- “Moreover, many of the management woes that gave the early nuclear business a black eye have finally been overcome. [TVA] recently demonstrated the industry's ability to manage large capital projects by successfully refurbishing the Browns Ferry 1 reactor in Alabama and returning it to commercial operation. The five-year project was completed on time and very close to budget. Also, U.S.-designed reactors have been built in about four years in Asia, and new nuclear plants (*BusinessWeek*, 6/26/07) on the drawing board for installation here in America will be licensed by the Nuclear Regulatory Commission under a speedier process that should be far more efficient than the one in place when the 104 nuclear facilities operating today were licensed.”
- “But this streamlined process will not compromise nuclear safety and security. The NRC holds nuclear reactors to the highest safety and security standards of any American industry. (The Bureau of Labor Statistics finds that accident rates at nuclear plants are lower than in the manufacturing, real estate, or finance industries.) A two-day national security simulation in Washington, D.C., in 2002—conducted by the Center for Strategic & International Studies—concluded nuclear plants ‘are probably our best defended targets.’ And because of their advanced design and sophisticated containment structures, U.S. nuclear plants emit a negligible amount of radiation. Even if you lived next door to a nuclear power plant, you would still be

exposed to less radiation each year than you would receive in just one round-trip flight from New York to Los Angeles.”

- “Here’s the reality: The U.S. needs more energy, and we need to get it without further harming our environment. Everything is a trade-off. Nothing is free, and nuclear plants are not cheap to build (although costs should drop as we build more of them). But we have a choice to make: We can either continue the 30-year debate about whether we should embrace nuclear energy, or we can accept its practical advantages. Love it or not, expanding nuclear energy makes both environmental and business sense.” (*BusinessWeek*, Christine Todd Whitman, 09/17/07)

S. David Freeman, former TVA Chairman during the Carter administration, argues to dismantle all of the existing power plants in the U.S.

- S. David Freeman, who was appointed by former President Jimmy Carter to serve as TVA’s chairman, argues that the next president of the United States should adopt a bold “First 100 Days agenda” which would outlaw the construction of new coal-fired plants and nuclear power plants in the U.S. Freeman urges the next president to then set in motion a fixed time table to dismantle existing power plants and replace them with comparable renewable energy systems, which include massive solar and wind installations. In *EVWorld*, reporter Bill Moore wrote, “...[I]t’s [Moore’s] view that this is the only sane, logical, economic and environmentally-viable course we—and the rest of the nations on the planet—can take. He spells out how we accomplish this goal in his soon-to-be-released (Oct. 2007) book, *Winning Our Energy Independence: An Energy Insider Shows How*.” Some of his prescriptions include the following:
 - Existing coal and nuclear plants should be retired in harmony with renewable replacement, with older plants shutting down first;
 - No new fossil fuel or nuclear plants should be built;
 - The nation should adopt a portfolio standard that requires every publicly and privately owned utility to meet the following standards: (1) 20 percent renewable by 2017; (2) 40 percent renewable by 2027; [and] (3) 60 percent renewable by 2037.”
- “In addition, he would require all utilities to submit to their Public Utility Commissions a 30-year plan to retire their coal and nuclear power plants. Natural gas plants—which are the lowest emitters of carbon dioxide and most efficient fossil fuel plants—can continue to operate largely as back-up power for wind and solar. Importantly from the perspective of *EV World*, the nation would encourage the development and deployment of plug-in hybrids and all-electric cars, the acquisition of which is encouraged by offering owners low-cost, off-peak power rates, along with tax credits...” (*EV World*, Bill Moore, 09/09/07)

TVA takes steps to expand its nuclear power production capacity

- In October, TVA will resume construction of its Watts Bar Unit 2 reactor and submit an application for a new type of reactor to be built at its Bellefonte Nuclear Plant. According to Ashok Bhatnagar, TVA's senior vice president for new power generation, the utility is in the final stages of selecting a contractor, which will complete construction of the reactor. Contractor groups, led by Bechtel Corp. and Stone & Webster Engineering Corp., are competing for an estimated \$1 billion contract. "That selection process is going on right now," said Bhatnagar. "We would anticipate making a decision in the next month." TVA estimates the total expenses to finish the second reactor will be approximately \$2.49 billion.
- Separately, the Nuclear Regulatory Commission held a public meeting on September 11th to hear the stakeholders' comments on a proposed nuclear plant in Jackson County, AL. On October 31st, NuStart, a group of power utilities, is expected to submit an application to the NRC for a 40-year license to build and run two reactors at the TVA's Bellefonte Nuclear Plant. TVA spokesman John Moulton said his agency, which is a member of the NuStart consortium, would be the licensee because it owns the site. Over the next three to four years, NRC officials expect to spend an estimated 100,000 hours reviewing TVA's application, which will include an evaluation of the reactor's design, the site's security and emergency preparedness, and the potential for impact on the environment. "If we grant the license, if, it will be for safe designs that we believe will protect the environment," said Thomas Bergman, deputy director for licensing operations in NRC's office of new reactors to about 200 people attending the September 11th public hearing. If NRC grants a license, TVA would then decide whether to build the plant with an estimated cost of up to \$5 billion. (*Birmingham News*, Kent Faulk, 09/12/07; *Associated Press*, 09/09/07; *Chattanooga Times Free Press*, Dave Flessner, 09/07/07)

185,000 skilled workers (or more) needed by 2015
to expand the nation's nuclear industry

- TVA says that it likely needs to bring on thousands of employees to construct and operate a slew of nuclear power plants that may get built in the Southeast. Locating skilled employees will be a challenge. "Currently, the (south) lacks enough skilled craft workers to build the infrastructure, install equipment, operate the facilities and make repairs," says the U.S. Department of Labor.
- According to a recent study by the Department of Labor, a third of the workers in the nuclear industry are eligible to retire in the next five years, which equates to more than 19,000 people on all levels. [The average age of TVA's workforce is 47 years; the utility sees many of its employees retire at age 55.] Construction of a nuclear plant requires at least 1,500 hands. And with the proposed construction of up to 30 nuclear facilities, the potential shortfall for skilled workers is evident. To accommodate that

growth, about 3,500 miles of transmission lines would also have to be constructed, necessitating an even larger workforce of trained workers. “Our growing need for labor isn’t incremental,” says Anthony Topazi, CEO of Mississippi Power. “It is exponential. We must meet this demand if we are going to satisfy the needs of this economy and this country’s national security.” An estimated 185,000 utility construction workers are needed by 2015, said Topazi. “Where are we going to get the educated and skilled workers to safely run the current fleet over extended lifetimes and the potential nuclear plants of the future?” asked Dale Klein, chairman of the Nuclear Regulatory Commission, at an industry conference. “Where are they being educated? Where are they being trained?”

- To address the need for skilled workers, the utility industry has been actively pursuing solutions through collaborations with colleges and universities to establish innovative programs, consisting of internships, scholarships and grants. In recent years, TVA said it has been internally training all kinds of workers for wide array of positions. The utility has been working closely with the University of Tennessee at Knoxville in the development of its nuclear engineering program. (*EnergyCentral.com*, Ken Silverstein, 09/14/07)

TVA distributors offer pilot program, allowing customers to generate “green” power and sell the electricity to the power system

- TVA’s 40 power distributors are offering a pilot program to its commercial and residential customers called Green Power Switch-Generation Partners, which allows customers to generate power from solar and wind equipment and sell the electricity to the power system. Officials caution customers that the program is not a means to make money, since it took take up to 20 years to pay-off the cost of the equipment through green power sales. Instead, customers’ primary motivation should be the opportunity the program provides to produce renewable energy which reduces carbon emissions. “TVA needs additional green power generation,” said Huntsville Utilities spokesman Bill Yell. “This is one way to do it. TVA will look at the pilot to see if there’s enough interest to offer it to the entire TVA area.”
- According to the pilot program, qualifying generation sources for the residential program are solar cells and wind turbine systems with a minimum output of 500 watts of alternating current and a maximum of 50 kilowatts, while commercial generation sources are restricted to solar cells. Equipment installations must comply with local codes and adhere to electrical system interface guidelines. Participants will be required to sign a 10-year agreement to participate in the program. (*Huntsville Times [AL]*, John Peck, 09/07/07)

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