

The **GSE** REPORT™

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Major Events

Congress proposes legislative remedies for subprime crisis

House of Representatives passes FHA reform legislation

Senate Banking Committee passes FHA reform bill

America's newest and largest subprime lender: Uncle Sam

OFHEO temporarily eases restrictions on the GSEs' mortgage portfolios

Bush administration shares frank assessment
of subprime mortgage market fallout with Congress

Chairman Frank and Treasury Secretary Paulson urge the Senate to pass GSE reform

Keep Fannie and Freddie *out* of the mortgage mess

Other legislative "solutions" from Capitol Hill

Credit rating agencies: "They're central to this whole [subprime] debacle

Economic outlook more uncertain than ever

House of Representatives passes FHA reform legislation

- On September 18th, the House of Representatives passed an FHA reform bill by a vote of 348-72 that would raise the FHA loan limit to over \$700,000 in high-cost areas and allow the agency to lend to more subprime borrowers by charging risk-based premiums. House Financial Services Committee chairman Barney Frank (D-MA) said, "The bill we passed will help people all across America because we have enacted provisions to allow FHA to insure loans in high-cost areas." The House adopted by voice vote an amendment sponsored by Representatives Barney Frank (D-MA), Gary Miller (R-CA) and Dennis Cardoza (D-CA), which would allow the FHA to insure loans at the lower of 125% of the local median home price or 175% of the conforming loan limit. The provision would also provide the HUD Secretary the authority to raise the new insurance limit by as much as \$100,000 "if market conditions warrant." Under this provision, FHA would be allowed to insure jumbo loans of up to \$730,000 in California, Massachusetts, and the New York and Washington, D.C. metropolitan areas. While the bill would authorize the FHA to charge risk-based mortgage insurance premiums, Frank wants premium rebates for borrowers who make their payments on time. The Bush administration opposed rebates, arguing that it "undercuts the insurance principal on which FHA is based."

- By a vote of 148-280, the House turned back an attempt by Representative Jeb Hensarling (R-TX) to strike a provision in the bill which diverts FHA funds to an affordable housing trust fund. Lawmakers narrowly rejected by a vote of 209-216 a motion to recommit by Representative Tom Price (R-GA) that would have required those benefiting from the trust fund to prove their legal residency in the United States. Members adopted an amendment by Representative Gary G. Miller (R-CA) which would allow qualified down-payment assistance providers, such as nonprofits and government entities, to participate in FHA programs under certain conditions. Specifically, the amendment would allow FHA to consider any amounts gifted by family members, employers, labor unions, or qualified homeownership assistance entities as cash, if there is no obligation to repay. The House also adopted an amendment by Representative Pat Tiberi (R-OH) that would require borrowers seeking an FHA-insured mortgage to receive financial counseling at the time of application.
- In a statement of administration policy, the White House said that while it supports the House version of FHA reform, it “strongly opposes” any amendment increasing FHA’s insurance limit above the GSE’s conforming loan limit. “The program should remain targeted to traditionally underserved homebuyers, such as low- and moderate-income families,” said the White House. The statement also noted that the House bill does not “provide FHA with the necessary flexibility to implement risk-based pricing, thereby limiting consumer choices as well as FHA’s ability to help additional borrowers.” The Bush administration expressed its concerns about the affordable housing features in the bill, but did not issue a veto threat if the provision remains in the final draft. (*National Mortgage News*, 09/24/07; *Bureau of National Affairs*, Richard Cowden, 09/19/07; *American Banker*, 09/18/07; *Congressional Quarterly*, Libby George, 09/18/07)

Senate Banking Committee passes FHA reform bill

- On September 19th, the Senate Committee on Banking, Housing & Urban Affairs passed the Federal Housing Administration Modernization Act of 2007, which seeks to stem the surge in home foreclosures and prevent future buyers from resorting to risky mortgages. Committee chairman Chris Dodd (D-CT) called the legislation “vitaly important to helping working families find safe, fair, and affordable mortgages.” Dodd added, “This legislation can help generate quality mortgage credit for working families and help them avoid the wave of foreclosures that is expected to sweep through the communities and neighborhoods of our country in the coming 18 months. This legislation will be a source of affordable, wealth-building credit, both for new homeowners and for people who are seeking a way out of the abusive loans in which they are currently trapped.”
- By a vote of 20-1, the Committee approved the FHA reform bill, which would increase the size of mortgages that the FHA could insure to \$417,000, reduce the down-payments that home owners must pay to 1.5% from the current 3%, lift the cap

on FHA reverse mortgages, and increase civil and criminal penalties for fraud. At the insistence of ranking member Richard A. Shelby (R-AL), Dodd included a provision that would review the effectiveness of pre-purchase counseling programs for high risk borrowers and language that would increase civil and criminal penalties for fraud against the program. During the vote, Shelby made it clear that he still has reservations about the expansion of the FHA program. “It is ... worth noting that the program does not insure the success of borrowers. It only insures the risk of loss to lenders. I am greatly concerned that many FHA borrowers will quickly find themselves with negative equity in the near future.”

- Dodd was successful in preventing any amendments –particularly those related to Fannie Mae and Freddie Mac—which could have derailed the bill. “I wasn’t going to entertain amendments to the GSE on this bill,” said Dodd. “I will resist them on the floor of the Senate. I am going to stay away from them.” The chairman intends to seek quick action on the Senate floor on his bill and “speedy” negotiations on compromise legislation.
- The Senate bill differs in significant ways from the House version (H.R. 1852), which boosts the size of mortgages that the FHA can insure and allows for a portion of FHA revenues to be diverted to an affordable housing fund. Dodd said he would be open to increasing FHA’s loan limits in order to strike a deal with House Financial Services chairman Barney Frank (D-MA). The Senate version also is “short” of the Bush administration’s proposed reforms, which called for establishing a risk-based pricing system and allowing for zero down payments. The House bill contains a variation on risk-based premiums and also would allow zero down payments.
- After the committee’s markup, Senator Mel Martinez (R-FL.) was asked by the press about the omission of a risk-based premium pricing feature from the bill. Martinez said, “I would have favored [risk-based premiums]. It’s a compromise. Overall, I think it’s good that we got something done. ... It didn’t have everything in it the way I would have had it. I would have had it the way HUD proposed it in that regard.” Dodd said, “This step this morning, we felt, is a ... it’s important to get it done. I thank Senator Shelby as well for working this out over the weekend. It’s hopefully not only a substantive step, but a confidence-building step as well, and my hope is that Senator [Harry] Reid (D-NV) and Senator [Mitch] McConnell (R-KY) will find the time for us to move it quickly on the Senate floor so that we can also send the additional signal that the Senate as a body cares about this.”
- Although FHA reform legislation appears to be on the fast track to enactment in Congress, a number of analysts and consumer advocates question if the bill would accomplish the President’s and lawmakers’ primary goal of stemming a wave of foreclosures in the subprime market. “The number of people that get affected by this — most of the estimates I’ve seen are fairly limited,” said Keefe, Bruyette & Woods analyst Brian Gardner. “There’s tremendous political pressure on Washington to be seen as doing something, but actually doing something and solving something are different issues.” Several analysts pointed out that it will time for the FHA to

implement reforms. “FHA may not be able to scale up quickly,” said Mark Zandi, the chief economist of Moody’s Economy.com Inc. “It takes time to put together the personnel and the infrastructure to originate more loans, to underwrite more loans.”

- While a number of consumer groups said that they are happy with the bill, they call on Congress to do more. “These changes to FHA have some potential to improve the program, said National Consumer Law Center’s Alys Cohen. “[B]ut the only way to stop another round of extreme predatory lending is to have legislation that goes to the heart of the problem, which is to have substantive prohibitions on abusive behavior.”
- Other mortgage analysts and industry representatives hailed the FHA reform bill as a critical first step, which would help solve some problems in the market. “The floodgates are going to open for FHA borrowers and lenders,” said mortgage industry consultant Howard Glaser. “FHA is the only game in town.” American Bankers Association lobbyist James Ballentine said, “[The bill helps] put FHA back on lenders’ screen as an alternative to helping out low-income and middle-income borrowers.” (*American Banker*, Stacy Kaper, 09/20/07; *Bureau of National Affairs*, Richard Cowden, 09/20/07; *Congressional Quarterly Today*, Libby George, 09/19/07; *National Journal’s CongressDaily*, Bill Swindell, 09/19/07; *CQ Today Midday Update*, 09/19/07; *US Fed News*, 09/19/07)

America’s newest and largest subprime lender: Uncle Sam

- In a September 22nd editorial, the *Wall Street Journal* wrote, “...[T]he House of Representatives overwhelmingly approved a plan to erase billions of dollars of subprime loan defaults in the private mortgage industry. How? By making taxpayers responsible for future losses. The Bush Administration recently announced support for a similar plan, and the housing industry is in full lobbying mode. One of the lone skeptics is Alabama Senator Richard Shelby, who warns that this could be one of the most expensive federal bailouts since the savings and loan crisis of the late 1980s. He’s onto something.”
- “The goal of these bailout plans is at least admirable -- to ensure that subprime borrowers don’t lose their homes to foreclosure, which is a clear and present danger given that some two million adjustable rate mortgages will roll over at higher interest rates in the months ahead. The Bush plan would give the Federal Housing Administration (FHA) ...the authority to help as many as 80,000 subprime borrowers refinance mortgages at lower interest rates by insuring those loans against default.”
- “No one wants to see borrowers lose their homes, and the good news is that private lenders are already working with late-payment borrowers to refinance the terms of these subprime loans. What’s troubling about the FHA expansion plan is that the insurance guarantee places taxpayers atop the housing bubble. Uncle Sam would insure tens of billions of dollars in new mortgage liabilities, and just when default levels are cascading.”

- “Worse, both the White House and Congress want to suspend the FHA’s downpayment requirements to insure even zero-equity loans. They should read a new study by ...[OFHEO], which reviewed 5,000 FHA loans and found that borrowers ‘who make no downpayment at all have the highest default rates.’ Sometimes these default rates were three times higher than high downpayment loans. In the latest ‘FHA modernization’ bill, some borrowers would have no equity in their home. In some cases, those getting this federal guarantee would have a mortgage larger even than the value of the home. That’s because the FHA traditionally allows home borrowers to finance closing costs and the insurance premiums. If housing prices keep falling, home owners would have a financial incentive to walk away from the loan and leave it to taxpayers to pay off the balance.”
- “FHA’s supporters claim this insurance can be expanded at no cost to taxpayers because FHA premiums more than cover annual losses from defaults. But this is like arguing that Social Security is solvent because it is running a ‘surplus’ this year. According to the Bush Administration’s own actuarial projections, FHA already lacks the revenue stream to pay the expected claims on loans that go sour, though it claims expanding its loan portfolio will put it in the black.”
- “In recent years, the [GAO] and [HUD’s] Inspector General have issued reports scoring the FHA for fraud, lax financial standards, and mission failure. The Inspector General reported in 2006 that ‘because of adverse loan performance,’ the FHA’s ‘total costs exceed receipts on a present value basis.’ It also noted that FHA has consistently underestimated default rates on its new loans. Also in 2006, the [CBO] confirmed that ‘FHA’s insurance program imposes costs on the government and taxpayers’ and ‘the subsidy cost of the FHA insurance is between 2 and 5 percent of the amount of the insured loans.’ These subsidies are ‘free’ to taxpayers only in the sense that Beltway accounting rules record future liabilities in invisible ink.”
- “It’s a testament to the FHA’s underwriting ineptitude that, even during the biggest housing boom in a generation, the agency’s delinquency rate has somehow doubled over the last 10 years. In 2004, 2005 and 2006, the FHA’s delinquency rate was five times higher than the rate on conventional prime mortgage loans, double the rate on loans with private mortgage insurance, and even slightly higher than the rate on subprime loans...”
- “One recent FHA innovation was the ‘downpayment assistance program’ in which a third party (sometimes the bank or the home seller) is permitted to fund the downpayment for the borrower. That program has suffered default rates as high as 20% -- five times higher than on the typical mortgage.”
- “FHA’s market share fell to an all-time low of 4% of all loans in 2006, down from 19% a decade ago. The Bush Administration should have worked to get that percentage to zero and mothballed an obsolete New Deal agency. Instead, HUD bureaucrats and the housing industry keep inventing new missions for the agency,

such as the ‘zero downpayment’ program. FHA now wants to elbow its way into the upscale market by expanding the size of a loan it can insure to as much as \$417,000 -- which would make subsidized mortgage insurance a kind of universal entitlement.”

- “We wonder if either end of Pennsylvania Avenue grasps the irony of what they are proposing. At the very moment when private mortgage lenders are under pressure from regulators, rating agencies and shareholders to tighten underwriting to avoid another mortgage meltdown, the FHA is relaxing its standards so it can insure more questionable mortgages. If that is permitted to happen, America’s newest and largest subprime lender will be Uncle Sam. Don’t expect this story to have a happy taxpayer ending.” (*Wall Street Journal*, 09/22/07)
- During the September 20th House Financial Services hearing, Representative Paul E. Kanjorski (D-PA) said, “...I [have been] here long enough—I think there are about five of us left on the committee [who] remember the S&L crisis. And I remember the pre-S&L crisis of the late 80s, when the regulators, with the assent of Congress—if not by activity but at least we were happy to see them clean up the problems that appeared to be out there—invented a new terminology, ‘supervisory goodwill.’ Do you all remember that great methodology of getting out of the S&L crisis, when, if we had acted at the time, would have cost us about \$15 billion? In a short period of two to three years, because we contaminated the good S&Ls and caused them to collapse also, it became a \$200 billion problem... But having watched what we’re doing, it seems to me I’m hearing shallow echoes in the administration, in the regulatory community, that we can find another easy fix and not necessarily have to face the consequences. And I happen to agree that that’s possible, probably more than 50 percent likely, except if we hit a recession ...or something occurs that we’re not prepared to meet within the formula...” (*Federal Service News*, 09/20/07)

OFHEO temporarily eases restrictions on the GSEs’ mortgage portfolios

- In response to the deepening U.S. housing slump, OFHEO director James B. Lockhart, III announced on September 19th that his agency has adjusted the restraints placed on Fannie Mae and Freddie Mac to make it easier for the GSEs to address problems in the subprime market and help borrowers avoid foreclosure. Specifically, OFHEO changed how the cap is calculated based upon unpaid the principal balance of the loans, rather than its prior use of GAAP numbers, which varied widely. In addition, the regulator will no longer use closing values at the end of a quarter to determine the portfolio size; instead, the agency will use an average of monthly closing values. OFHEO has temporarily doubled the GSEs’ quarterly growth limit to 1% during the fourth quarter, but said that Fannie and Freddie will remain under the 2% annual growth limit. The agency said that this added flexibility to the GSEs’ portfolio cap will enhance each GSEs’ ability to purchase or securitize over the next six months up to \$20 billion or more of subprime mortgages, which should assist lenders in helping some subprime borrowers avoid foreclosure during the upcoming wave of subprime resets. OFHEO is requiring Fannie Mae and Freddie Mac to

provide the agency frequent reporting on market conditions, portfolio sizes and new loan purchases, including monthly reports of the Enterprises' purchases of subprime and other mortgages to borrowers with lower credit scores and multi-family housing mortgages in relationship to the \$20 billion level.

- Fannie Mae and Freddie Mac criticized OFHEO's actions, arguing that the small increase in the GSEs' portfolios would be insufficient to help revive the \$11.5 trillion mortgage market. "The more effective response, given the extent of the market disruption, would be to raise our portfolio cap by at least 10% so that we can more fully address the ongoing turmoil and bring much-needed liquidity to the mortgage market," said Fannie Mae spokesman Brian Faith. "More should be done" to help alleviate the credit crunch, said Freddie Mac spokesman David Palombi. OFHEO's decision "timid and inadequate," said Senate Banking Committee chairman Chris Dodd (D-CT), who urged OFHEO to increase the GSEs' portfolio constraints by 5% in August. Senator Richard Shelby (R-AL), ranking member of the Committee, supported OFHEO's move, saying it "will enable Fannie and Freddie to grow some in a dire time." Josh Rosner, a managing director at Graham Fisher & Company, added, "I actually think this was a smart way of giving the enterprises an opportunity to prove themselves." (*Market News International*, 09/19/07; *US Fed News*, 09/19/07; *New York Times*, Eric Dash, 09/20/07; *Washington Post*, David S. Hilzenrath, 09/19/07; *American Banker*, Rob Blackwell, 09/20/07; *Bloomberg*, James Tyson and Jody Shenn, 09/19/07)
- Days after OFHEO's moved to raise the GSEs' mortgage caps, Fannie Mae and Freddie Mac said that they were considering issuing preferred stock. On September 25th, Freddie Mac issued \$500 million of perpetual preferred stock at \$25 a share. Company spokeswoman Sharon McHale said the capital offering would provide Freddie Mac additional sources of financing for lender customers hurt by a "liquidity crunch." Using preferred stock to raise money also would increase the company's capital levels, giving it room to operate, said McHale. "This gives us flexibility to take advantage of growth opportunities as they arrive," she said. "We want to continue to play as large a role as possible in the markets." On September 25th, Fannie Mae priced 40 million shares of non-cumulative preferred stock at a stated value of \$25 a share for a gross offering of \$1 billion. [On September 24th, Fannie released the company's core capital data, apparently in an effort to dispel market concerns that its preferred stock sale was tied to its current capital levels.] (*Reuters*, Al Yoon, 09/24/07; *Reuters*, 09/25/07; *Fannie Mae Press Release*, 09/25/07; *Freddie Mac Press Release*, 09/25/07; *Reuters*, 09/24/07)
- On the same day [September 19th] that Lockhart announced the modification in the GSEs' mortgage caps, CIT Group said it would sell between \$3.5 and \$4.2 billion in 'AAA'-rated subprime MBS to Freddie Mac. Freddie Mac's Sharon McHale said the purchase of top-rated mortgage bonds was not an unusual move. "We have been investors in the triple-A tranches of mortgage-backed securities for quite some time," said McHale. "It's one of the ways we've been bringing liquidity to the market, and we will continue to do so." In related news, Jeffrey Peek, CIT's chairman and chief

executive, resigned on September 17th from Freddie Mac's board in order to avoid the appearance of a conflict of interest in connection with his company's proposed loan sale to the GSE. (*Financial Times*, Stacy-Marke Ishmael, 09/20/07; *Asset Securitization Report*, 09/24/07; *Washington Business Journal*, Neil Adler, 09/24/07)

- In a September 21st interview with *Dow Jones Newswire*, Lockhart said that the portfolio limits on Fannie Mae and Freddie Mac could be lifted or altered significantly in February, if the GSEs return to timely financial reporting with a clean audit opinion and no material weaknesses. "They both could be [lifted around February], and they are both planning to be," said Lockhart. "And I hope they are right... Obviously current financials with no material weaknesses is a key test. Until you have an audited account, you can't tell if there are no material weaknesses." While noting it was possible that the GSEs' caps could be removed in February, Lockhart would not give a timeframe for when the GSEs' high capital requirements might be eased. "There will be a point where there will be a lot of pressure to remove those [higher capital requirements]," he said. "I would certainly like to have some powers [through the passage of GSE regulatory reform legislation] that say that part of [the higher capital requirements] should be removed but not necessarily all of it." (*Dow Jones Capital Markets Report*, Damian Paletta, 09/21/07)

Bush administration shares frank assessment of subprime mortgage market fallout with Congress

- In testimony before the House Financial Services Committee, Federal Reserve chairman Ben Bernanke told the panel that the central bank was trying to "get out ahead" of financial markets with its larger-than-expected 50 basis points cut in interest rates in September, but offered few signals about the path of the central bank's future policy. "We took that action [rate cut] to try to get out ahead of the situation and try to forestall potential effects of tighter credit conditions on the broader economy," said Bernanke. "There's quite a bit of uncertainty, so we're going to have to continue to monitor how the financial markets evolve ... and try to keep reassessing our outlook and adjusting policy." He promised lawmakers that the Fed will take steps to crack down on abusive and bad lending practices. Bernanke said, "We are committed to preventing problems from recurring, while still preserving responsible subprime lending."
- In his prepared statement, Bernanke also warned Congress to exercise caution in expanding the role of the GSEs to prop up the subprime market. The Fed chairman said, "...Fannie Mae and Freddie Mac are, to a limited extent, assisting in subprime refinancings and should be encouraged to provide products for subprime borrowers to the extent permitted by their charters. However, the GSE charters are likely to limit the ability of the GSEs to serve any but the most creditworthy subprime borrowers. Indeed, if GSE programs remove the strongest borrowers from the pool, the risks faced by other programs—such as a modernized FHA program—could be increased."

- He continued, “Some have suggested that the GSEs could help restore functioning in the secondary markets for non-conforming mortgages (specifically jumbo mortgages, those with principal value greater than \$417,000) if the conforming-loan limits were raised. However, in my view, the reason that GSE securitizations are well-accepted in the secondary market is because they come with GSE-provided guarantees of financial performance, which market participants appear to treat as backed by the full faith and credit of the U.S. government, even though this federal guarantee does not exist. Evidently, market participants believe that, in the event of the failure of a GSE, the government would have no alternative but to come to the rescue. The perception, however inaccurate, that the GSEs are fully government-backed implies that investors have few incentives in their role as counterparties or creditors to act to constrain GSE risk-taking. **Raising the conforming-loan limit would expand this implied guarantee to another portion of the mortgage market, reducing market discipline further.** [Emphasis added]. If, despite these considerations, the Congress were inclined to move in this direction, it should assess whether such action could be taken in a way that is both explicitly temporary and able to be implemented sufficiently promptly to serve its intended purpose. Any benefits that might conceivably accrue to this action would likely be lost if implementation were significantly delayed, as private securitization activity would likely be inhibited in the interim.” (*Federal News Service*, Prepared Testimony of Federal Reserve Chairman Ben Bernanke, 09/20/07; *USA Today*, Sue Kirchoff, 09/20/07; *Associated Press*, Jeannine Aversa, 09/20/07)
- Bernanke’s call for caution in expanding the role of the GSEs was echoed by Treasury Secretary Henry M. Paulson, Jr. In his written statement, Paulson said, “[C]onsideration of [expanding the GSE presence in the jumbo mortgage market] should be limited to a provision that is temporary and is part of legislation strengthening the [GSEs’] regulatory structure. If it goes beyond that, it raises difficult public policy issues and could be seen as detracting from the GSEs’ affordable housing mission and displacing private sector participation, which the Administration does not support.”
- “The borrowers who are facing the greatest stress today are those who have less-than-perfect credit, and also those who have little equity in their homes, due to a decline in house price appreciation or a depreciation in home values. These difficulties are not limited solely to subprime mortgages, but are also surfacing among some prime jumbo mortgage holders. Anything the GSEs do to provide liquidity in this area, then, would mean taking on more risk. Therefore, such steps, and any additional authority permitting such steps, must be contemplated only in conjunction with legislation that addresses the inadequate regulatory structure of the GSEs.”
- “The current GSE regulator has less authority than a federal bank regulator. ...[I]n our view, the GSE regulator should have more tools available than does a bank regulator to take into account the unique characteristics and tensions of the GSEs. ... This Committee and the House of Representatives worked very hard to pass a meaningful GSE regulatory reform bill. In our view, the House bill is not perfect, but

it goes a long way in addressing the issues that must be considered. The Senate now must act. The case cannot be stronger for the Senate to take up GSE reform legislation. It would be unreasonable and irresponsible to expand the GSEs' businesses without addressing the fundamental problems of their regulatory structure. I would welcome this debate and repeat our request for the Congress to send the President a strong GSE reform bill. I frankly am disappointed that we have not had further engagement on these important issues."

- Paulson also addressed Democrats' demands that the GSEs' portfolio cap be lifted. Noting that there is ample liquidity in the conforming loan market, Paulson argued that a more efficient use of the GSEs' capital was in their securitization efforts, where "each dollar of capital goes further in adding liquidity." Given OFHEO's recent steps to give Fannie Mae and Freddie Mac more flexibility in managing their retained portfolios, he added, "I hope that both GSEs will use this new flexibility to provide liquidity to parts of the market experiencing the most strain." Paulson concluded that he sees no reason for legislative intervention on this issue, since "both enterprises likely will complete their [financial] restatements some time in 2008" and OFHEO will lift the caps. (*Federal News Service*, Prepared Testimony of Treasury Secretary Henry Paulson, 09/20/07)
- During a question and answer session with the panel, Bernanke reiterated his concern about raising the GSEs' conforming loan limit in a September 17th letter to Chairman Frank, Bernanke stated that such an increase should be explicitly temporary and promptly implemented. Bernanke added, "There are several concerns that I describe in my letter—expanding the implicit government guarantee into a new area of the mortgage market and so on. But I think the primary concern I have is that if this goes ahead without any reform, that somehow reform may not ever happen or be effective. So I do believe it's important that this be done, if it is done, in the context of meaningful GSE reform. If it is done, as I indicated, I think it needs to be temporary, and if it's not prompt, it's not going to be productive because these markets will recover over the next few months. And if this comes on-line in March, it'll be counterproductive." (*Federal News Service Hearing Transcript*, 09/20/07)
- When asked about the issue of assignee liability, Paulson said, "I do believe that, in terms of assigning liability to those investors that purchase the mortgage, that that might have the negative [effect], being a very big damper on securitization and thereby curtailing product to those who need it." Later in the hearing, Bernanke signed that a limited and carefully crafted assignee liability clause could be appropriate. He told lawmakers, "There may be circumstances where it might be proven a useful adjunct to some of these other methods, but I think it is extraordinarily important that we make sure... that if assignee liability exists, that the ... responsibilities of the investors be very, very clearly delineated, and that it not be some uncapped damages or unspecified damages that you would be liable for. If you do that, then the investors will simply consider it too risky, and they will pull out, and you will simply not have any investment in this whole sector."

- In testimony before the committee, Fannie Mae president Daniel Mudd and Freddie Mac chairman and CEO Richard Syron argued that their companies should be able to grow their portfolios and purchase jumbo mortgages to address liquidity problems in the mortgage market. Mudd told the panel that while OFHEO's change in the formula for the portfolio cap was "directionally helpful, ...we believe having the flexibility to increase our portfolio by at least 10% will would make a meaningful difference [in the mortgage market]." Syron added, "A temporary lifting of the conforming loan limit would enable us to provide needed liquidity to a segment of the jumbo market." (*Fannie Mae Press Release*, 09/20/07; *Dow Jones International News*, Damian Paletta, 09/19/07; *American Banker*, Stacy Kaper and Steven Sloan, 09/21/07)
- In testimony before the panel, American Enterprise Institute resident fellow Alex J. Pollock told the panel that he does not support increasing the GSEs' conforming loan limit, arguing that it would "principally ...expand the government's credit into the prime jumbo mortgage market" which he believes "will fairly quickly recover from panic on their own." Pollock added, "Relaxing the portfolio caps is more interesting and capable of being focused on the key issue of refinancing subprime ARMs. As odd as it may seem coming from an AEI fellow, I do favor granting Fannie and Freddie a special increased mortgage portfolio authorization, strictly limited, however, to a segregated portfolio solely devoted to refinancing subprime ARMs. Such a special authorization might be for \$100 billion each, and include the ability to purchase FHA-insured subprime ARM refinancings. FHA loans would then have both a Ginnie Mae and a Fannie-Freddie funding channel."
- Pollock also said that the loan disclosure process is a "fundamental failure of the American mortgage finance system" and argued that lenders should provide borrowers a one-page, easily understood loan disclosure form, well before closing, to enable the borrower to make informed decisions. Pollock suggested that the mortgage industry adopt the "Basic Facts About Your Mortgage" form, which has been incorporated in H.R. 3012. Pollock said, "I believe this requirement would help achieve the required clarity, make borrowers better able to protect themselves by understanding what the mortgage really means to them, and at the same time would promote a more efficient mortgage finance system. This seems to me a completely bipartisan idea, which should be implemented as a fundamental reform, whatever else is done or not done." (*Testimony of Alex J. Pollock, Resident Fellow American Enterprise Institute to the Committee on Financial Services*, 09/20/07)
- Before adjourning the hearing, Chairman Frank said, "I just want to close by saying I think the elements [to address the subprime mortgage problems] are here. ...I think one clear message ...is we need the lenders to understand that foreclosure is bad for everybody and it's bad for the whole society, and that they need to be willing allow people to restructure. We will be working—and I'm glad to see what Senator Dodd has said. I hope within a month or six weeks, we'll have an FHA that's fully able to ensure the mortgages of people who are subprime. We'll have Fannie Mae and Freddie Mac able to buy more of those refinanced mortgages, and it is certainly the

case that the financial institutions—and we can't order anybody to abrogate a contract, but what we can say is this. Institutions that will be from time to time coming before this committee and asking us to do things that are in their interests will have a likelier chance of a yes if they have done this. I mean, we cannot legally compel them to do things. But on the other hand, they cannot legally compel us to do other things that they would like. And I would just urge them to remember the absolutely most important principle of legislating—the ankle bone is connected to the shoulder bone. (*Federal News Service Hearing Transcript*, 09/20/07)

Chairman Frank and Treasury Secretary Paulson urge the Senate to pass GSE reform

- In a September 20th letter to Senate Banking Committee chairman Chris Dodd (D-CT), Treasury Secretary Henry M. Paulson, Jr. asked for a meeting “to discuss the urgency of passing a GSE reform bill in the Senate.” He continued, “...The strains in the mortgage market and capital markets require our considered attention and vigilance. Time is of the essence. Finding common ground on comprehensive GSE reform legislation is a difficult task, however, I am confident that it can be done.” (*Correspondence to the Honorable Christopher Dodd*, Treasury Secretary Henry M. Paulson, Jr., 09/20/07)
- House Financial Services Committee chairman Barney Frank (D-MA) urged his Senate counterparts to move quickly so legislation can pass soon. “Within a few weeks we could have a package [of legislation]” that would help borrowers, said Frank. “The single most important thing is for the United States Senate to take up and act on ...[FHA] and GSE legislation.” If the Senate would advance legislative proposals, the Bush administration could negotiate with House and Senate lawmakers on compromise legislation, said Frank. He added that he's not interested in passing legislation that would narrowly raise regulatory limits for Fannie and Freddie. Instead, Frank said he wants to consider such changes in the context of broader regulatory reform for Fannie Mae and Freddie Mac. “If the Senate were to send us a cherry-picked bill, dealing only with the [portfolio] caps and only with the jumbo mortgages, we would not go along with that,” said Frank.
- Following the Senate Banking Committee passage of a bill to reform FHA, Dodd told reporters that a GSE regulatory reform bill would be considered soon. “I hope to announce markup dates fairly soon [for the GSE regulatory reform bill]” said Dodd. “There's a lot that needs to be done there.” (*American Banker*, Stacy Kaper and Steven Sloan, 09/21/07; *Congressional Quarterly Today*, 09/20/07; *Congressional Quarterly Today*, Libby George, 09/19/07; *Dow Jones Newswires*, Damian Paletta, 09/20/07)

Keep Fannie and Freddie out of the mortgage mess

- In a September 30th editorial, the *Kansas City Star* wrote, “Federal Reserve Chairman Ben Bernanke has rightly warned Congress against allowing a significant expansion of the two mortgage giants, Fannie Mae and Freddie Mac. Nevertheless, some in Congress are pressing hard to let the two agencies grow as a way to help deal with the subprime mortgage crisis. Some lawmakers even say Fannie and Freddie should be permitted to buy mortgages above the current \$417,000 cap, an unwise move that would allow the two to enter the ‘jumbo’ mortgage market. ...But Bernanke is right to advise caution. The two agencies still haven’t finished cleaning up after their massive accounting and management scandals. Thursday, for example, the Securities and Exchange Commission said Freddie had agreed to pay \$50 million to settle charges that over a four-year period it had fraudulently misstated earnings.”
- “Fannie and Freddie should not become deeply involved in bailing out problem mortgages. In some cases, that would mean bailing out investors and speculators. In Nevada, for example, loans on non-owner-occupied homes account for nearly a third of serious delinquencies. In Florida, the proportion is 25 percent.”
- “Meanwhile, Congress has yet to complete work on an overhaul of the regulatory structure that supervises Fannie and Freddie. Any significant expansion by the two agencies would be a bad idea until they are supervised by a properly empowered regulator.” (*Kansas City Star*, 09/30/07)

Other legislative “solutions” from Capitol Hill

- On September 26th, the House Ways and Means Committee marked up a bill designed to help homeowners facing foreclosure. H.R. 3648, estimated to cost \$2 billion, would declare that a debt forgiven as part of a renegotiated mortgage is not income subject to tax and extend for seven years the deduction for private mortgage insurance. “Families dealing with the pain of foreclosure should not have the double-whammy of a large tax bill for terminating their mortgage through no fault of their own,” said Representative Charles B. Rangel (D-NY), the committee chairman. Although the Bush administration proposed temporary relief from paying taxes on the forgiveness of debt, H.R. 3648 provides a permanent exclusion. To comply with congressional budget rules, Rangel included a provision that would tighten the requirements taxpayers must meet to exclude gain from the sale of residences, such as vacation homes and rental properties. (*National Mortgage News Online*, 09/27/07; *Bureau of National Affairs*, Heather M. Rothman, 09/27/07)
- Representatives Linda Sanchez (D-CA), Brad Miller (D-NC), Barney Frank (D-MA) Carolyn Maloney (D-NY) and Melvin Watt (D-NC) are sponsoring The Emergency Homeownership and Mortgage Equity Protection Act of 2007 (H.R. 3609) to provide homeowners relief from the subprime mortgage crisis. The bill would allow bankruptcy judges to modify mortgages on principal residences of Chapter 13

debtors, by waiving prepayment penalties and spreading the principal payments over 30 years. The bill also would allow the amortization for home mortgages to exceed five-year life of the Chapter 13 plan; permit bankruptcy judges to waive pre-filing credit counseling requirement when foreclosure is imminent; and require creditors to provide timely notice of fees assessed to debtors to the trustee and the debtors during a pending bankruptcy case. Sanchez, who chairs the House Judiciary commercial and administrative law subcommittee, said she is working on a vote for H.R. 3609 during the first or second week of October. “Right now if you’re in bankruptcy and own a vacation home or investment property, the bankruptcy judge can modify the mortgages on those properties and give you relief,” said Sanchez. “But if you’re like most Americans and only have one property, your home, you don’t get the same privilege.” She added, “If we can move this bill swiftly, we can bring relief to approximately 600,000 people who are in dire risk of losing their homes.” Miller said, “What we’re trying to do is respond to a crisis for millions of Americans and try to ... not to fix every wrong in the bankruptcy laws, but do what we need to do to give them relief as quickly as we can.” (*American Banker*, Steven Sloan, 09/28/07; *Bureau of National Affairs*, Jay Horowitz, 09/28/07; *National Mortgage News Online*, 09/24/07)

- A group of lenders and servicers have asked Senate Judiciary Committee chairman Patrick Leahy (D-VT) to join them in opposing certain proposed changes in bankruptcy laws. The group is particularly concerned about H.R. 3609’s proposed changes to the bankruptcy code. (*Bureau of National Affairs*, Jay Horowitz, 09/28/07)
- In written testimony provided to the House Judiciary Committee’s Subcommittee on Commercial and Administrative Law, the Consumer Mortgage Coalition said, “The CMC and its members strongly oppose proposals to subject mortgage loans to the cramdown provision of Chapter 13 of the bankruptcy code. In particular, the CMC and its members strongly oppose H.R. 3609. While well-meaning, H.R. 3609 would wreak havoc on the capital markets—markets already jittery from the problems arising from the difficulties associated with subprime loans. Further harming the capital markets will only increase the cost and decrease the availability of mortgage credit. In the long term, this will make the dream of homeownership less attainable for many would-be homebuyers, including many minority consumers. If Congress wishes to foster homeownership, it should seek to strengthen the capital markets. H.R. 3609 would do just the opposite... The Committee should consider carefully whether it wishes to take a chance that the bill will precipitate further turmoil in the secondary market as banks and investors are forced to re-price both the risks they have already taken on as well as for mortgage credit on a going forward basis. The reduction in confidence that investors will have could create considerable fallout on the national economy.” (*Testimony submitted by the Consumer Mortgage Coalition before the House Judiciary Commercial and Administrative Law Subcommittee*, 09/25/07)
- House Financial Services Committee chairman Barney Frank plans to introduce and mark-up legislation to enhance consumer protection from predatory mortgage lending practices by the end of October, according to Frank’s spokeswoman Heather Wong.

The committee staff has developed a two page summary of the bill, which is currently being used as a basis of discussion and consultation with representatives of the banking industry, trade groups, academics, other members of Congress and advocates, said Wong. *American Banker* reports that according to sources “[Frank’s proposal would] ...create securitizer liability that would not hold the end investor accountable, but would apply in certain circumstances to the company that bundles the loans for securitization. In concept, borrowers who were given loans they could not afford would have the right to cure or rescind a loan, according to the summary. ‘In addition to specific lender liability ... a limited liability would extend to assignees (acting in good faith) of the loan to the ‘securitizers’ for loans (liability would not extend to bondholders/investors) that violate these standards if the securitizer has failed to take sufficient steps to not purchase non-safe harbor loans,’ the [Committee’s] summary said.”

- Frank’s bill could be the latest legislation introduced in the 110th Congress that would statutorily revise mortgage lending practices. On July 12th, Committee ranking member Spencer Bachus (R-AL) introduced legislation that addressed a range of subprime lending practices and would create a nationwide mortgage industry licensing system. On September 5th, Senate Banking Committee chairman Chris Dodd announced plans to introduce sweeping legislation to reform mortgage lending practices. According to Dodd’s spokeswoman Justine Sessoins, the chairman’s legislation is “being drafted right now” and will be completed no later than December 31st. Senators Richard Durbin (D-IL), Barack Obama (D-IL), and Charles Schumer (D-NY) have also introduced bills concerning subprime lending. (*Bureau of National Affairs*, Stephen Joyce, 09/28/07; *American Banker*, Stacey Kaper, 09/27/07)
- Senator Hillary Clinton (D-NY) introduced S. 2114, which tightens mortgage lending standards, enhances broker regulation, and sets aside more than \$2 billion toward foreclosure prevention, affordable housing, and mortgage fraud prosecution. According to the *American Banker*, Clinton’s bill would (1) require that property taxes, adjustments in interest rates, and property insurance be accounted when determining a borrower’s ability to pay a loan; (2) call for a national broker registry and requires brokers to enhance disclosures; (3) ban prepayment penalties; (4) encourage the GSEs to “identify homeowners at risk of default” and stabilize the borrowers situation by recasting the loan in a 30- or 40-year, fixed rate mortgage—but establishes no enforcement mechanism for this “goal;” (5) establish a \$1 billion foreclosure prevention and mortgage finance fund through HUD; (6) establish a \$1 billion grant fund to assist affordable housing trust funds to support low- and moderate-income housing; and (7) set aside \$20 million to support FBI agents and Department of Justice prosecutors to co-ordinate mortgage fraud prosecutions with state attorney generals. (*American Banker*, Stacy Kaper, 09/28/07)

Credit rating agencies: “They’re central to this whole [subprime] debacle”

- In a September 26th Senate Banking Committee hearing, lawmakers grilled credit rating agency executives about their role in the subprime mortgage meltdown, particularly their business relationship with issuers of CDOs that have soured during the summer’s market crisis. Ranking minority member Richard Shelby (R-AL) bluntly stated, “[The rating agencies are] central to this whole debacle. They’re conflicted. It’s driven by money, not responsibility and ethics....It seems to me that money’s trumping ethics”
- Vickie Tillman, executive vice president for credit market services at Standard and Poor’s, told the panel, “We understand that certain things did not work and we are looking at root causes.” Michael Kanef, managing director of Moody’s asset finance group, said his firm was in discussions with issuers about potential reforms to the process. “We believe that these discussions help enhance overall market transparency and stability in that both issuers and investors have a better understanding of our analytical thinking and the ratings that result,” said Kanef. The executives argued that while their agencies may have miscalculated the quantity of low-quality loans, these mistakes were unintentional and not the result of conflicts of interest. Tillman said, “We have learned hard lessons from the recent difficulties in the subprime mortgage area. Some have questioned whether the ‘issuer pays’ model has led S&P and others to issue higher, or less rigorously analyzed, ratings so as to garner more business. There is no evidence — none at all — to support this contention with respect to S&P.” Kanef added, “The integrity and objectivity of our rating processes is of utmost importance to us. Our continued reputation for objective and independent ratings is essential to our role in the marketplace.”
- In testimony before the Senate Banking Committee, SEC chairman Christopher Cox said his agency is focusing on whether the fees that big Wall Street bond issuers pay Moody’s Investors Service, Standard & Poor’s and Fitch Rating to grade their securities have “unduly influenced” those ratings. “There’s a mismatch between the ratings and the results,” Cox said, but added that his agency “has yet formed no firm views” on the issue. He admitted that the SEC has the power to inspect the nationally recognized statistical rating organizations (NRSRO), but does not have the power to police the accuracy of the ratings firms. The SEC is considering whether to require the NRSROs to disclose more information about their performance, such as credit rating downgrades which occur long after the security being rated has lost value, said Cox. He added that President Bush has asked an interagency committee, headed by Treasury Secretary Henry Paulson, to examine the role credit rating agencies play in mortgage industry. Separately, Cox and Shelby argued that it would be premature for Congress to consider new legislation to reform the credit rating industry, while the 2006 reform bill is just being implemented by the SEC.
- John Coffee, law professor at Columbia University, suggested that the SEC publish the credit rating agencies’ real-time default rates, which would shine the light on the agencies’ track record. Coffee also suggested that that rating agencies should sell

subscriptions to their ratings information to free them of potential conflicts by taking payment from debt underwriters.

- Lawmakers remain skeptical about the performance of the credit rating agencies and are debating if the SEC needs more power to crack down on the industry. Several attorneys general, including Ohio's Mark Dann, are working together, as part of several broader mortgage fraud investigations. In an interview with *BusinessWeek's* Dawn Kopecki, Dann said "[The credit rating agencies] are one cog in the machinery. They've developed more of a collaborative relationship with the investment banks that are their customers. They get paid for every rating they give. At some point in time, everybody in the country knew or should have known that many of these loans were being fraudulently obtained. They knew or should have known that the loans they were endorsing were fraudulently obtained."
- In response to public criticism, Moody's Investors Service named three new ratings executives on September 26th and proposed changes in the subprime rating industry. In the future, Moody's will have information for non-prime loans that get bundled into bonds verified by third parties. Separately, the Teamsters Local 282 Pension Fund Trust has filed a shareholder lawsuit against Moody's, claiming the agency's ratings of subprime-mortgage bonds were materially misleading to investors concerning both the quality and relative risk of the bonds. The suit is seeking class-action status for purchasers Moody's shares from October 25, 2006 through July 10, 2007. (*Wall Street Journal*, Robert Schroeder and Aaron Lucchetti, 09/27/07; *Reuters*, 09/26/07; *BusinessWeek Online*, Dawn Kopecki, 09/28/07; *New York Times*, Stephen Labaton, 09/27/07; *CNNMoney.com*, Grace Wong and David Ellis, 09/26/07; *CNNMoney.com*, 09/26/07; *Bureau of National Affairs*, Rachel McTague, 09/27/07)

Economic outlook more uncertain than ever

- In the September 28th issue of the *Frontline Weekly Newsletter*, John Mauldin wrote, "Let's slice and dice the latest housing data and see just how bad it is if you are trying to sell a home. (Most of the data is from data-maven Greg Weldon at www.weldononline.com...) First the inventory of existing homes rose yet again to 4,581,000, which is an increase of more than 1,000,000 since March alone. It is more than double the supply since the beginning of 2005. In January there was a 6.6 months supply of homes for sale. Now it is 10 months. Over 500,000 homes are in the process of foreclosure and will soon come onto the market. I think that means in the near future we will see a 12 month supply of existing homes for sale. Remember, that is an average. In some markets, that means there may be a two year supply and a three month supply in areas of higher demand..."
- "Want to buy a condo? Existing condos for sale have risen by 35% since January to 661,000. That is almost 12 months of supply, and there are a lot of new condos coming onto the market as there are a lot of construction projects that are just now nearing completion. New home sales in August saw the largest decline in three

decades, down 8.3%. Mean new home prices are down 11% in the last five months. The inventory of new homes for sale is up to 8.2 months and rising. ...The number of homes above \$750,000 which are selling is down by over 35% from last year. Sales of home from \$500,000 to \$749,000 is down by 25%. Jumbo mortgages are just hard to find at rates that make sense. I think it is likely that Congress will allow Fannie and Freddie to take larger loans onto their books. I would not be shocked to see the number at \$600,000, at least temporarily. Right now they are limited to taking \$417,000 loans. With a 20% down payment that means about \$525,000 for the sales price of the home.”

- “All this means that the fall-out from the housing recession is still in our future. ...Again, recessions and the bursting of bubbles are profoundly deflationary.”
(*Frontline Weekly Newsletter*, John Mauldin, 09/28/07)
- In a September 27th interview, Fannie Mae president Daniel Mudd said the housing slump will last through 2008, which will drag down housing prices and increase credit losses. “We don’t think we hit a bottom until the end of ‘08 and then we have some period of time to work our way back up again,” said Mudd. Housing prices will fall 2% to 4% this year—and “more next year,” he added. (*Bloomberg News*, Peter Cook and James Tyson, 09/27/07)
- Freddie Mac’s president and CEO Richard Syron said that the U.S. economy faces a 40% to 45% risk of recession induced by the housing market downturn. In an interview with BBC, former Federal Reserve chairman Alan Greenspan said “The danger of a recession has obviously risen, but in my judgment, and I suspect looking at the forecasts of most American economists, is that it is still at less than 50-50. It’s less optimistic than one would like.” (*CNN Money.com*, 09/28/07; *Financial Times*, Saskia Scholtes, 09/28/07)
- In the September 28th global credit crisis weekly wrap-up, Mike Shedlock provided a summary of the current economic conditions:
 - “Public spending is out of control in the US and UK;
 - Banana Republic charges are being leveled at the US and UK;
 - Runs on the bank occurred in the US [Countrywide] and UK [Northern Rock];
 - The Fed is accepting mortgages as collateral in the US for the first time;
 - Foreclosures are at all time high in the US;
 - The US dollar is at all time lows;
 - Japan is still struggling with deflation;
 - Two failed banks in Germany were bailed out by the ECB;
 - There are U.S. Congressional threats of tariffs against China;
 - There is a proposal to freeze short-term commercial paper for up to 7 years in Canada;
 - Housing bubbles in the US, Spain, and Australia are deflating;
 - Housing bubble in Canada is still inflating;

- China refuses to float the RMB and sterilize US dollars flooding in. That in turn is fueling Chinese inflation;
 - Price controls that can't possibly work were implemented in China in response to aforementioned Chinese inflation;
 - Commodity prices are soaring;
 - Oil is at record high prices;
 - A massive carry trade in Japan is fueling a plethora of asset bubbles around the globe;
 - \$500 Trillion in derivatives are floating around dwarfing the size of the global economy; and
 - The global credit bubble dwarfs by orders of magnitude the credit bubble preceding the great depression.”
- “Other than the above, the global economy seem[s] pretty normal and rather well balanced, wrote Shedlock. “It’s a tribute to just how well central bankers have done their jobs.” (*Mish’s Global Economic Trend Analysis*, Mick Shedlock, 09/28/07)

Fannie Mae and Freddie Mac

Securitization and lax regulatory framework contributed to
the perfect storm in the subprime mortgage market

- In a September 17th report released by the Congressional Research Service, analyst Edward V. Murphy concluded that securitization allowed non-bank lenders, which operate outside the safety and soundness regulation of federal examiners, to offer subprime mortgages which borrowers have been unable to afford following rate resets. Murphy wrote, “There is some evidence that the underwriting standards of non-banks that chose to securitize loans outside of Fannie Mae and Freddie Mac became weaker as the housing boom progressed. Indicators of excessive debt appear to have weakened more than indicators of weaker borrower payment history.”
- CSR outlined six options that Congress can consider to prevent similar recurrences of a meltdown in the subprime mortgage market:
 - (1) Congress could extend the coverage of agency loan guidance to non-banks institutions. If such a step is taken, Congress would have to determine if existing federal banking agencies and their personnel could regulate non-bank, or whether such an expansion would require more significant changes.
 - (2) Congress could do nothing and allow the marketplace to improve underwriting standards and punish the riskiest lenders with bankruptcy and investors in the riskiest securities with significant losses.
 - (3) Congress could assign originator liability to mortgage originators, including brokers and lenders, whereby they are held liable for defaults if underwriting standards were not suitable for the borrower’s circumstances.
 - (4) Alternatively, Congress could hold secondary purchasers of mortgages liable for unfair, deceptive or unsuitable mortgage originations. Assignee liability would encourage secondary market participants to be more vigilant in monitoring the practices of mortgage brokers and lenders and provide aggrieved borrowers potential. If liability is unclear, however, investors will not be able to quantify and price risk, and cause the secondary market for mortgages to shut down.
 - (5) Congress could establish national underwriting guidelines by statute or authorize an agency to establish national underwriting guidelines by regulation. Official standards for debt-to-income ratios, FICO scores and other risk indicators could be set, making all banks, non-banks, and borrowers aware of the single set of prudential limits on loan terms. However, national mortgage standards would make mortgage markets less flexible and borrowers with nontraditional sources of income or other characteristics could have difficulty qualifying for mortgages.

- (6) Congress could take action to improve mortgage disclosures to aid the borrower's decision making process and minimize deceptive and misleading marketing by lenders. Congress could also require counseling and financial literacy training to help improve the borrower's financial sophistication, which might minimize the chances of default by making more prudent mortgage decisions. (*CRS Report to Congress: Securitization and Federal Regulation of Mortgages for Safety and Soundness*, Edward V. Murphy, 09/17/07; *Bureau of National Affairs*, Thecla Fabian, 09/21/07)

Is the media's template for the subprime crisis accurate?

- In the September 29 edition of the *Washington Post*, Kenneth R. Harney wrote, "The term 'mortgage meltdown' has become so common—on TV, in headlines and in casual conversations—that you might assume that this is a tough time to get a mortgage. But the reality is starkly different: Mortgage money is plentiful; the majority of mortgage products remain relatively unaffected by troubles in the subprime segment; and interest rates for 30-year, fixed-rate loans remain in the low 6 percent range for people with reasonably good—not necessarily perfect—credit records. Even interest rates on jumbo loans—those for more than \$417,000—have fallen after spiking this summer."
- "The main change over the past several months is that 'the products and underwriting that allowed people to buy houses they couldn't afford have disappeared,' said Ted Grose, president of 1st Mortgage Advisors in Los Angeles. Nonetheless, lenders and brokers say, there is a widespread and persistent belief by consumers that the entire mortgage market is in crisis. ...In Everett, [WA], Jim Brown, chief executive of Veteran Mortgage, agreed that 'the "mortgage meltdown" idea is way overstated.' Even in his part of the country, where home prices are rising, 'a lot of people think that the mortgage market is in much worse shape' than it actually is. 'Other than subprime and high-LTV [loan-to-value ratio] stated-income' programs, he said, 'we've got pretty much everything now that we did before. We've got a lot of outlets...' (*Washington Post*, Kenneth R. Harney, 09/29/07)

Economic terrorists, cockroaches, and greed

- In testimony before the House Financial Services Committee, Bruce Marks, CEO of Neighborhood Assistance Corporation of America, said, "There is a solution out there [for subprime borrowers facing the threat of foreclosure]. The solution is not a taxpayer bailout. It's not even some of the things we heard about today. It's around restructuring loans. The lenders created the problem. The brokers also created the problem, but the problem is you can't find it. They're like roaches. Once you step on one there's about five more. But the lenders are out there and they created the problem. They need to fix it. So what's the answer? Take what people can afford.

Take their net income, their required liabilities they have to pay every month -- their required expenses -- determine what they can afford and say to lenders, restructure the loans. ... Well, I know it might be a little controversial to say and it might get people a little angry, but I'm not sure what else to call that except economic terrorism, because that's what's going on in this country. Hardworking people ...they're losing their homes. And these lenders and services—and the largest one in the country, Countrywide—well, they're engaged, as are others, in economic terrorism..." (*Federal News Service*, 09/20/07)

- In *National Mortgage News Online*, Paul Muolo wrote, "...I received a ton of e-mails, several with epithets aimed at consumer advocate Bruce Marks of Neighborhood Assistance Corp. of America who before Congress likened brokers to a pest commonly found in several Jersey City apartments that I rented in my youth. Let's just say many brokers were offended by Mr. Marks' comments. And, Mr. Marks, if you're thinking of attending any broker shows over the next few weeks, I wouldn't. Anyhow, this e-mail response from 'Lennie' shall serve as a rebuttal to Mr. Marks' comments: 'In 14 years I never, nor anyone that has worked for me, crossed the line of illegal activities to get a paycheck and when those crazy ass investors came out with things like the stupid interest-only (loan) I refused to sell them and anyone that wanted one I told them no and if they went elsewhere to get it I'd say call me when you see what you got into. This type of program was stupid and greedy created by investors not brokers.' Thanks, Lennie..." (*National Mortgage News Online*, Paul Muolo, September 29-30, 2007)

The Age of Turbulence

- In *The Age of Turbulence: Adventures in the New World*, former Federal Reserve Chairman Alan Greenspan wrote, "[T]he benefits of broadened home ownership are worth the risk. Protection of property rights, so critical to a market economy, requires a critical mass of owners to sustain political support." (*Wall Street Journal*, Greg Ip and Emily Steel, 09/17/07)
- Greenspan also discussed the Bush administration's GSE policy. He wrote, "The [Bush] administration also took the Fed's advice on policies we thought were essential for the health of the financial markets. Most important was an effort that began in 2003 to curb the excesses at Fannie Mae and Freddie Mac... They are granted a de facto subsidy by financial markets in the form of interest rates with very low credit-risk premiums on their debt--the markets presume that Uncle Sam will bail them out in the event of default. Fannie and Freddie had been using their subsidy to pad their profits and grow. But their dealings had begun to distort and endanger the markets and seemed likely to become a bigger and bigger problem. The companies employed skillful lobbyists and had powerful advocates in Congress. President Bush had very little to gain politically by supporting a crackdown. Yet he backed the Fed through a two-year struggle that resulted in crucial reforms..." (*The Age of Turbulence: Adventures in the New World*, Alan Greenspan, page 242)

OFHEO announces the GSEs' minimum and risked-based capital classifications
for the second quarter

- On September 27th, OFHEO director James B. Lockhart, III announced that Fannie Mae and Freddie Mac were adequately capitalized as of June 30, 2007. The agency's classification is based up on Fannie Mae's estimated numbers as of June 30 and on Freddie Mac's second quarter financial statements released on August 30, 2007.
- On June 30, 2007, Fannie Mae had an estimated core capital of \$42.375 billion, which exceeded the company's adjusted OFHEO-directed capital (\$39.416 billion) by \$2.959 billion. The company's surplus, expressed as a percentage of the OFHEO-directed capital, was 7.5%. From the prior quarter, Fannie Mae's surplus decreased significantly from 10.2% on March 31st to 7.5% on June 30, which was mainly due to growth in the GSE's MBS outstanding and the retained portfolio growth. According to the agency, "Although progress is evident and OFHEO is classifying Fannie Mae as adequately capitalized for the second quarter 2007, the company's remediation process is not finished, a number of safety and soundness issues are not yet resolved, and the company is not yet a current and timely financial filer."
- On June 30, 2007, Freddie Mac had core capital of \$36.334 billion, which exceeded the company's adjusted OFHEO-directed capital (\$34.555 billion) by \$1.779 billion. The company's surplus, expressed as a percentage of the OFHEO-directed capital, was 5.1%. Freddie Mac's surplus decreased from 5.9% on March 31st to 5.1% on June 30 due primarily to growth in its guaranteed MBS. OFHEO wrote, "Although the filing of the Second Quarter 2007 Financial Statements and Information Statement Supplement continues to demonstrate progress for Freddie Mac in returning to timely and accurate financial reporting, internal control and operational weaknesses remain evident. Significant work remains before Freddie Mac becomes a timely filer and SEC registrant." (*OFHEO Press Release, 09/27/07*)

Fannie Mae and Freddie Mac met their affordable housing goals for 2006

- The Department of Housing and Urban Development has determined that Fannie Mae and Freddie Mac met or exceeded their affordable housing goals for 2006, although Freddie Mac missed one of its home purchase subgoals by 0.07%. According to Freddie's annual AH report to HUD, the GSE purchased 179,145 mortgages that qualified for the special affordable purchase subgoal, but "missed by 634 loans."
- Under the 2006 housing goals, Fannie Mae and Freddie Mac purchased mortgages that financed 3,669,950 owner and rental housing units occupied by low- and moderate-income families; 1,768,667 housing units occupied by special affordable families (i.e., very-low-income families or low-income families living in low-income neighborhoods); and 2,901,547 housing units located in underserved areas. Together,

the GSEs' purchases under the housing goals totaled \$370 billion for low- and moderate-income loans, \$133 billion for special affordable loans, and \$376 billion for underserved area loans. (*HUD Press Release*, 09/18/07; *National Mortgage News Online*, Brian Collins, 09/24/07)

Federal Reserve nominees are “not quite as pressing,” so committee vote may be delayed until after the first of the year, says Chairman Dodd

- Earlier this year, the White House nominated bankers Larry Kane and Elizabeth Duke and re-nominated Fed Governor Randall Kroszener to serve on the Federal Reserve's seven member board. On August 2, the Senate Banking Committee held a hearing on the Fed nominees. Now, Chairman Chris Dodd (D-CT) suggests that a vote on the three nominations may not come by the end of the year. “We've got a lot of these other matters before us right now,” said Dodd. “[The Fed nominees] are important, but they are not quite as pressing as these other matters. I intend—at some point—to get to them, but I've got to get to these other matters first. ...I'm not opposed to doing it, but these other matters have a priority for me.” (*Dow Jones International News*, Damian Paletta, 09/19/07)

More good news from Congress

- Dealing with global warming will be painful, said Representative John Dingell (D-MI), who has offered a “discussion draft” outlining tax proposals to deal with the problem which includes a 50-cent gasoline tax, a carbon tax and scaling back mortgage deductions for some home owners. “I'm trying to have everybody understand that this is going to cost and that it's going to have a measure of pain that you're not going to like,” said Dingell, chairman of the House Energy and Commerce Committee. “This is going to cause pain—[which needs to be] shared in a way that is fair, proper, acceptable and accomplishes the basic purpose [of reducing greenhouse gases],” he added.
- In addition to a (new) 50-cent-a-gallon tax on gasoline and jet fuel (phased in over five years) and a tax on carbon of \$50 a ton, Dingle also proposes a phase-out of the interest tax deduction on home mortgages for homes over 3,000 square feet. Under the proposal, owners would keep most of the deduction for homes at the lower end of the scale, but the deduction would be eliminated entirely for homes of 4,200 feet or more. Dingle estimates that this provision would affect 10% of homeowners. He claimed it was “only fair” to tax those who buy large suburban homes, which create urban sprawl. Historic homes and farm houses would be exempted, he added.
- The revenue generated by Dingle's proposal would be used, first and foremost, to expand the Earned Income Tax Credit to help lower income people who don't pay taxes compensate them for increased taxes on food. Revenues will also be used for highway construction, mass transit, paying social security and health programs [i.e.,

“universal healthcare—upon passage,” clarified Dingell in a media interview], help the poor pay energy bills, and help reduce payroll taxes. “All my friends tell me you can’t do this, it’s going to be political poison,” said Dingell, 81, who argued that he’s trying to trigger “an intelligent discussion of the whole question.” (*Associated Press*, J. Josef Hebert, 09/26/07; *CNSNews.com*, Susan Jones, 09/27/07)

- In response to Dingle’s proposals, syndicated columnist and professor of Economics at George Mason University Walter Williams wrote, “Despite increasing evidence that man-made carbon dioxide (CO₂) is not a significant greenhouse gas and contributor to climate change, politicians and others who wish to control our lives must maintain that it is. According to the *Detroit Free Press*, Rep. John Dingell, Michigan Democrat, wants a 50-cents-a-gallon tax on gasoline. We’ve heard such calls before, but there’s a new twist. Mr. Dingell also wants to eliminate the mortgage tax deduction on what he calls ‘McMansions,’ homes that are 3,000 square feet and larger. That’s because larger homes use more energy.”
- “One might wonder about Mr. Dingell’s magnanimity in increasing taxes for only homes 3,000 feet or larger. The average U.S. home is around 2,300 square feet, compared with Europe’s average of 1,000 square feet. So why doesn’t Mr. Dingell call for disallowing mortgage deductions on houses more than 1,000 square feet? The reason is there would be too much political resistance, since more Americans own homes under 3,000 square feet than larger than 3,000. The full agenda is to start out with 3,000 square feet and later lower it in increments.”
- “Our buying into global warming hysteria will allow politicians to do just about anything, upon which they can muster a majority vote, in the name of fighting climate change as a means to raise taxes. ... There are many ways to reduce CO₂ emissions, and being 71 years of age I know many of them. Al Gore might even consider me carbon neutral and possibly having carbon credits because my carbon offsets were made in advance. For example, for the first 15 years of my life, I didn’t use energy-consuming refrigerators; we had an icebox. For two decades, I listened to radio instead of watching television and walked or used public transportation to most places. And for more than half my life I didn’t use energy-consuming things such as computers, clothes dryers, air conditioning and microwave ovens. Of course, my standard of living was much lower. The bottom line is, serious efforts to reduce CO₂ will lead to lower living standards through higher costs of living. And it will be all for naught because there is little or no relationship between man-made CO₂ emissions and climate change.” (*Washington Times*, Dr. Walter E. Williams, 09/27/07)
- This summer, Moveon.org began running radio ads in Michigan “targeting Representative Dingell for blocking progress in the fight against global warming,” according to the group’s website. The ad portrays Dingell as a dinosaur for blocking new Washington fuel economy rules. Activists also have worn dinosaur costumes and picketed the congressman’s office with “Dingellsaurus” signs. Moveon.org notes on its website that Dingell [age 81] has been a Congressman since 1955 [52 years], representing Michigan’s 15th district which includes Monroe, Wayne and Washtenaw

Counties. Since 1989, Dingell has accepted \$840,865 in campaign contributions from the automotive industry. (planetgore.nationalreview.com, Henry Payne, 06/28/07; <http://www.house.gov/dingell/>; <http://pol.moveon.org/dingellsaurus.html>)

- In the September 30th edition of the Detroit Free Press, Brian Dickerson writes, “There is an affluent segment of the environmentally conscious set that takes pride in its bulging recycling bins, cheerfully shells out the premium for a hybrid SUV and watches documentaries about sustainable manufacturing in the home theaters of its 5,000-square-foot houses. Now the nation's longest-serving congressman has these greener-than-thou types squarely in his rifle scope, and all Washington is wondering whether he means to pull the trigger or merely to enjoy watching them squirm.”
- “...Dingell turned 81 this summer, and not a few Washington cynics doubt the sincerity of his 11th-hour conversion. The carbon and gas tax proposals, they note, are at once enticing enough to divert environmentalists' attention from auto emissions and ambitious enough to render their success unlikely. But former state legislator and environmental activist Lana Pollack, who was sitting behind Dingell when former Vice President Al Gore brought his global warming slideshow to Ann Arbor a couple of years ago, believes Dingell's concern about greenhouse gases is genuine. The carbon and gas tax initiatives may have sprung from Dingell's anger that the auto industry has been unfairly singled out, Pollack says, ‘but I think that once these ideas were in his hand, he said, “Hey -- why not?”’ Pollack says she thinks Dingell's proposal to exempt diesel fuels and large farmhouses from any new taxes are further evidence of his seriousness. Both exemptions are calculated to avoid fights with powerful lobbies that could KO his carbon tax package – ‘a sign,’ says Pollack, ‘that he's thinking politically and not just going through the motions.’” (Detroit Free Press, Brian Dickerson, 09/30/07)

Senator Johnson signals his interest in running for re-election

- According to the *Sioux Falls Argus Leader* (*Leader*), Senator Tim Johnson (D-SD) sent an email, seeking donations for a re-election bid. In the solicitation, Johnson wrote, “I am more determined than ever to run for re-election and continue serving the people of South Dakota.” Johnson, who suffered a life-threatening brain hemorrhage on December 13th, returned in early September to the Senate, where he serves on the Senate Banking Committee. Johnson has not yet set a date to announce his plans for re-election, the Senator’s spokeswoman Julianne Fisher told the *Leader*. University of South Dakota political science professor William Richardson suggested that Johnson’s postponement of the announcement might “tie down” potential rivals to entering the race. (*Sioux Falls Argus Leader*, 09/27/07)

ABA and ACB boards support the trade groups' merger

- On September 5th the American Bankers Association board of directors voted to approve a merger with America's Community Bankers. In turn, ACB's board voted to approve the merger on September 14th. The final decision rests with the two organizations' members; ABA members scheduled to cast their votes on October 9th at their annual convention and ACB's membership scheduled to vote by phone or written proxy October 15th. If the merger is approved, the trade groups will complete their merger on December 1st. (*Bureau of National Affairs*, Tecla Fabian, 09/17/07)

Green mortgages coming into vogue

- Increasingly, lenders are offering incentives to borrowers to buy energy-efficient homes. These "green mortgages"—otherwise known as energy efficient mortgages—feature discounts on closing costs, factor in energy savings as additional income to qualify for loans, and factor in the purchase of energy saving features into the loan amount.
- "You're going to buy a house but you want to add \$20,000 worth of energy improvements," said Freddie Mac spokesman Brad German. "That \$20,000 or whatever it is would be treated as part of the total purchase price for the purposes of calculating the mortgage. ...At the end of the day, we're allowing a greater flexibility in the amount to support energy-efficient retrofitting." Fannie Mae has offered energy-efficient incentives for at least 15 years, well before green mortgages became popular. The FHA backed 441 energy-efficient loans in 2005, which jumped 125% to 994 loans in 2006 and 805 loans this fiscal year. (*Newsday*, Ellen Yan, 09/24/07)

In memoriam

- On September 27th, the National Taxpayers Union announced the passing of John Berthoud, the organization's president for the past 11 years. Colleagues described John, 45, as a strong leader, compassionate friend and fierce fighter for freedom. Pete Stepp, NTU's vice president of communications, said, "John Berthoud's death ... was as sudden as it was shocking and saddening to all who knew him. ...All of our staff, just as the entire policy community in Washington, are doing the best they can to cope with an irreplaceable loss." "We fought a number of important battles side by side with John over the years," said former House Majority Leader Dick Armey (R-TX), chairman of FreedomWorks. "Freedom has lost a champion." Grover Norquist, president of Americans for Tax Reform, called Berthoud a "great guy [who] stood up for taxpayers in a town that views taxpayers as chumps." (*National Taxpayers Union Press Release*, 09/27/07; *Washington Times*, Robert Stacy McCain and Ralph Z. Hallow, 09/28/07)

Fannie Mae

Fannie Mae's retained portfolio declined at annualized rate of 1.6% in August

- In August, Fannie Mae's retained mortgage declined 1.6% (annualized) to \$728.9 billion. For the eight months ended August 31st, the GSE reported a 0.9% annualized growth in its mortgage portfolio. Fannie reported that its single-family serious delinquency rate rose four basis points in July to 0.68% (latest data available), while its multi-family serious delinquency rate rose one basis point to 0.10% in July. The GSE's effective duration GAP of its mortgage portfolio averaged plus one month in August, unchanged from July. (*Fannie Mae Monthly Summary*, August, 2007)

Fannie Mae director Joe Pickett will resign from the board when his term expires in December

- Joe K. Pickett, a mortgage banker who has served as a Fannie Mae director since 1996, announced plans to resign from the board when his term expires in December. Pickett has also served as a member of the board's audit committee.
- Fannie Mae chairman Stephen B. Ashley said, "Joe Pickett brought a career's worth of mortgage industry leadership and experience into the Fannie Mae Board room. That experience—as a mortgage banker, corporate executive, and past President of the Mortgage Banker's Association—brought enormous value to Fannie Mae for over a decade. Joe's deep understanding of the company and the industry were especially valuable as the company worked through the process of restatement and remediation. He will be greatly missed." (*Fannie Mae Press Release*, 09/21/07; *Associated Press*, 09/21/07)

Former Fannie Mae CEO Franklin Raines attempts to clear his name

- Former Fannie Mae chairman and CEO Franklin D. Raines has escalating his campaign to clear his name by trying to draw the White House into his defense against a shareholder lawsuit alleging that he and the company misled investors when Fannie Mae overstated earnings by billions of dollars. Raines has subpoenaed the White House for any records that would show it was behind a regulatory investigation that found problems with Fannie Mae's accounting and gave rise to the shareholder claims.
- In response, the White House said Raines was on "a fishing expedition through the files of the President," and asked the court to quash the subpoenas. In July, Raines subpoenaed the White House and served a second subpoena on OMB, to seek information Raines could use to challenge OFHEO's impartiality. The White House

made the subpoenas public through a recent court filing, in which it suggested that Raines was trying to show that the administration was out to get Fannie Mae. “Mr. Raines believes the Executive Office of the President forced the special examination and coerced OFHEO into producing a critical report,” said the White House. Even if true, that is irrelevant to Raines’s defense against investors’ claims, because Raines’s liability will hinge on the facts about Fannie Mae’s accounting, argued the White House.

- Recently, Raines also asked a federal judge to hold OFHEO in contempt of court for allegedly failing to search its records thoroughly enough for documents that might be useful in his defense. OFHEO argued that Raines was asking it to undertake “a costly ‘fishing expedition’ into ever vaster stretches of sterile sea.” The agency said part of the disputed search process—looking for e-mails on backup tapes dating to 2002—would cost more than \$9 million, which would represent more than 13% of its annual budget of \$66.1 million. Raines alleged that OFHEO falsely assured the court that it had turned over all relevant records when the agency had not searched certain backup tapes. In response, OFHEO told the court that it had told Raines the parameters of its search and Raines did not object. (*Washington Post*, David S. Hilzenrath, 09/17/07)
- AOL co-founder Steve Chase is starting Revolution Money, an on-line credit card company that will provide a PayPal-type of money transfer service which will be linked with a bank account. Jason Hogg, the company’s CEO has signed up a number of big names for his board of directors, including Case, former Fannie Mae chief executive Franklin D. Raines, former Treasury Secretary Lawrence H. Summers, former Charles Schwab chief executive David S. Pottruck and Russell Hogg, former president of MasterCard [and Jason Hogg’s father]. (*Washington Post*, Thomas Heath, 09/25/07)

Alumni news

- The PMI Group has appointed David W. Berson to serve as the company’s chief economist and strategist. Berson will be responsible for PMI’s domestic and global market research and planning and will support the company’s government relations, public policy, and strategic environmental planning. Previously, Berson served as Vice President and Chief Economist for Fannie Mae since 1989. He also served a senior member of Fannie’s corporate strategy group, where he provided alternative views and risk analyses based on economic and market changes. (*PRNewswire-FirstCall*, 09/28/07)

Freddie Mac

Freddie Mac's mortgage holdings surge 19.3% in August

- In August, Freddie Mac's mortgage holdings rose 19.3% to \$732.2 billion, the fastest pace since December 2005. The company's retained mortgage portfolio rose for the straight sixth month, bringing the GSE's year-to-date growth to an annualized 6%. **In August, Freddie Mac's growth was primarily in its own mortgage-backed securities, while its holdings of private label securities declined. The company's holding of "agency" MBS, not guaranteed by Freddie Mac, also increased.** [Emphasis added.] Freddie Mac's duration gap remained at zero months, unchanged from the previous month. (*Reuters*, Julie Haviv and Albert Yoon, 09/25/07)

Freddie Mac pays \$50 million settlement to the SEC and four of its former executives agree to pay the agency \$790,548 in fines and restitutions

- On September 27th, Freddie Mac announced that it had reached an agreement with the SEC to settle the agency's investigation related to the company's restatement of financial results for fiscal years 2000 through 2002, subject to court approval. Under the terms of the proposed settlement, Freddie Mac neither admits nor denies allegations of federal securities law violations and agrees to a payment of \$50 million. "We take these charges seriously, and that's why the Freddie Mac of today is a very different company than the Freddie Mac of the past," said Freddie Mac's chairman and CEO Richard F. Syron. "Today's agreement would resolve the last investigation related to the company's legacy restatement issues. This is another milestone enabling us to focus entirely on those things that are most important – further advancing our housing mission, effectively serving our customers and building our business for the future." SEC Enforcement Director Linda Thomsen said, "As has been seen in so many cases, Freddie Mac's departure from proper accounting practices was the result of a corporate culture that sought stable earnings growth at any cost. Investors do not benefit when good corporate governance takes a back seat to a single-minded drive to achieve earnings targets." (*Freddie Mac Press Release*, 09/27/07; *Associated Press*, Marcy Gordon, 09/28/07)
- On September 27th, OFHEO Director James B. Lockhart, III announced the issuance of a Consent Order against former Freddie Mac EVP and CFO Vaughn A. Clarke. Clarke consented to the Order in settlement of the agency's December 17, 2003 administrative notice of charges filed against him, which included allegations of misconduct and unsafe and unsound practices involving, among other things, misapplication of applicable accounting principles in connection with improper earnings management. According to the terms of the Order, Clarke has agreed to cooperate with OFHEO in any administrative proceedings against other individuals and payment of a \$125,000 civil money penalty to be satisfied when paid to the SEC

connection with a settlement reached with that agency. Clarke also agreed to forego any bonus not yet paid to him by Freddie Mac. In addition, Clarke may not accept employment with Freddie Mac and Fannie Mae without the Director's written permission or accept employment with any federally-regulated financial institution without providing notice of the consent order to the institution and its regulators. (OFHEO Press Release, 09/27/07)

- The SEC has also reached a settlement with three (additional) former Freddie Mac executives in the agency's civil lawsuit, alleging negligent conduct with regard to the handling the company's accounting. The SEC said that former president, COO and vice chairman David Glenn has agreed to pay a \$250,000 penalty and return \$150,000 of allegedly ill-gotten gains. In addition, former senior vice president Tobert Dean has agreed to pay the SEC a \$75,000 penalty and return \$61,663, while former senior vice president Nazir Dossani has agreed to pay a \$65,000 penalty and return \$34,658. (Wall Street Journal, Judith Burns, 09/28/07)
- OFHEO's enforcement action against former Freddie Mac CEO Leland Brendsel continues before an administrative law judge William B. Moran, who has scheduled a trial-like hearing October 15th. In July, Moran denied Brendsel's motion to throw out the case and rejected potentially important defenses, including the fact that, before Freddie Mac's accounting issues came to light, OFHEO conducted examinations of the company and gave it favorable reports. "A defense of finger-pointing at OFHEO will not do," wrote Moran. "It is a mirror that the Respondent must face." (OFHEO Press Release, 09/27/07; Washington Post, David S. Hilzenrath, 09/28/07)

Freddie Mac settles dispute with American Home Mortgage

- On September 20th, Freddie Mac settled its dispute with bankrupt loan servicer American Home Mortgage Corp (AHMC), clearing the way for the GSE to pay \$2.4 million in delayed property taxes on behalf of 4,547 loans (totaling \$769.8 million). "The money was wired [Tuesday] night so all tax and insurance payments should be up to date," said Freddie Mac spokesman Brad German.
- In a previous court filing, Freddie said when it fired American Home on August 1st, the GSE was able to seize the \$5.5 million in principal, property tax, and insurance payments held by AHMC, but the servicer refused to release the associated loan files. On August 24th, American Home stopped making tax and insurance payments on all the loans it serviced, according to Freddie's court filing. (Associated Press, 09/20/07)

Freddie Mac names Ed Hussey to be vice president
of Multifamily Sourcing Terms of Business

- Ed Hussey has joined Freddie Mac as vice president of Multifamily Sourcing's Terms of Business, responsible for establishing and overseeing credit risk and credit policy for the Multifamily Division. Previously, Hussey was senior vice president/chief underwriter for Wells Fargo Multifamily Capital/Reilly Mortgage Group Inc., where he developed and implemented new credit policy for all company lending platforms. (*Freddie Mac Press Release, 09/24/07*)

Freddie Mac delegates full underwriting authority of multi-family mortgages
to Centerline Capital Group of New York

- Following a three year period of sharing the risk of multi-family mortgages with a seven lenders, Freddie Mac is delegating full underwriting authority to one of these lenders—Centerline Capital Group of New York. Kim Griffin, the GSE's vice president of multifamily affordable sales and investments, said that Freddie Mac gave Centerline Capital Group of New York the authority to write loans for sale to the GSE without its prior approval in August. Centerline Capital has "originated quality business consistently [for Freddie with] the kind of underwriting we wanted to see," Griffin added. Centerline is one of seven lenders in Freddie's Targeted Affordable Housing Seller/Service program. Freddie's program has "made the process more efficient by allowing the lender to underwrite on our own behalf," Mr. Griffin said. Lenders in the program's "initial phase" must submit each loan to a "prescreening" process. The "fully delegated" status allows Centerline to act more like the lenders in Fannie's program. The GSE plans to elevate other lenders to fully-delegated status and to expand the program by adding three or four partners to the program in 2008.
- Freddie Mac's delegation of the underwriting process brings the company a step closer to the direction that its competitor, Fannie Mae, has taken for nearly 20 years. In Fannie's comparable Delegated Underwriting and Servicing program, 26 lenders participate in the program which was started in 1988. (*American Banker, William Launder, 09/25/07*)

Freddie Mac announces completion of its largest student housing transaction

- Freddie Mac has completed its largest student housing transaction through the purchase of a \$154 million fixed-rate, cross-collateralized pool of mortgages from Deutsche Bank Berkshire Mortgage. The transaction enabled the borrower, Campus Apartments, to acquire 10 student housing properties (1,799 units and 4,605 bedrooms) located at six universities. "The Campus Apartments portfolio is our first large-scale entrance into the student housing market," said Mitchell Kiffe, Freddie Mac vice president of Production and Sales. "We were very pleased to provide this

financing package to enable Campus Apartments to acquire this quality portfolio. We hope this is the first of many student housing deals as we expand our student housing lending activities.” (*Freddie Mac Press Release, 09/25/07*)

Freddie Mac’s \$600,000 investment helps fund the James E. Clyburn Community Empowerment Center in Orangeburg, S.C. a reality

- Through a partnership with HOPE worldwide, the Orangeburg [S.C.] Consolidated School District 5, the South Carolina Department of Commerce and Freddie Mac, the James E. Clyburn Community Empowerment Center in Orangeburg, S.C. opened on September 21st. Representative James E. Clyburn (D-SC) was on hand for the formal opening of the center, which will serve as a one-stop facility for area youth and adults to access technology and education resources, to improve their academic performance, and to prepare them for transitioning into the job market. [Clyburn represents the sixth district of South Carolina and serves as the Majority Whip for the 110th Congress.] The Center is being funded by the South Carolina Department of Commerce, along with a \$600,000 investment from Freddie Mac. (*Freddie Mac Press Release, 09/21/07*)

Federal Home Loan Banks

Federal Housing Finance Board sends FHLB-Chicago a draft cease and desist order

- According to the Bank’s SEC 8K filing, the FHLB-Chicago received a Consent Cease and Desist Order (Order) from the Federal Housing Finance Board on September 24, 2007. Under the terms of the draft order, the Bank’s capital stock repurchases and redemptions would be prohibited until such time as may be determined by the Finance Board, unless the repurchase or redemption is approved by the Director of the Office of Supervision of the Finance Board. The draft also proposes that dividend declarations would be subject to the prior written approval of the Director. The Bank is currently in discussions with the Finance Board regarding the terms of a consensual cease and desist order. The Bank’s management believes that the requirements under a final cease and desist order could result in delays or denials of capital stock redemptions in connection with membership withdrawal or termination and significantly reduce dividend levels compared to recent period dividends.
- In a letter to its members, Mike Thomas, the Bank’s president, wrote, “Our consideration of strategic options for the FHLB-[Chicago], including the possibility of a merger with the [FHLB-Dallas], continues. Although we have not reached an agreement and it is possible that we will not finalize any agreement to combine the

banks, our priority in the analysis of all options is evaluating the possible benefit to ...our members.”

- Sources familiar with the draft order insist that it was not triggered by a particular event, but instead underscores the Finance Board’s concerns over the Bank’s capital position, as well as its unique capital structure. The FHLB-Chicago is the only member of the FHLB System which offers its members stock that can be redeemed in six months. Under the draft Order, members who wish to leave the Bank will have to wait five years before they can redeem their stock—the same standard to which the other FHLBs’ members are held. “It appears as though what the Finance Board has done is put the Federal Home Loan Bank of Chicago’s stock in the same status as all the other Home Loan bank stock,” said John von Seggern, the president of the Council of Federal Home Loan Banks. Some observers believe that the Finance Board’s draft order could be a blessing in disguise, which would allow the Bank to work on its merger negotiations and ongoing earnings problems without worrying about members leaving and redeeming their stock.
- On September 26th, Standard & Poor’s Corp. left its debt ratings for the FHLB-Chicago unchanged. (*Form 8-K*, Federal Home Loan Bank of Chicago, 09/26/07; *American Banker*, Steven Sloan, 09/27/07)

<p>Merger of FHLBs of Chicago and Dallas will “set the stage for the future” of the FHLB System</p>

- All eyes are turned to the on-going merger negotiations between the FHLBs of Chicago and Dallas, which have now moved beyond the theoretical realm and whose outcome could dictate whether a downsized FHLB System will become a reality. “It sets the stage for the future,” said Alfred DelliBovi, the president and CEO of the FHLB-NY. “When that evaluation is over, we’ll know more than what they concluded, but why they reached that conclusion, and other banks will certainly take notice.”
- A successful merger between the two Banks would be the first among the FHLBs since 1946, which would prove to naysayers that the obstacles can be overcome and offer other Banks a blueprint for how a merger can be pulled off. “Clearly, if a merger were to occur, that would provide a road map, if you will, for further mergers,” said Moody’s analyst Brian Harris. “That makes anything after the fact easier.” Further consolidation could be spurred depending on how the Federal Housing Finance Board interprets a provision of the Federal Home Loan Bank Act of 1932 that requires the FHLB System to include at least eight banks. Some observers have argued that the clause is flexible and refers only to the minimum needed at that time. However, if the Finance Board concludes that at least eight Banks are needed in the System, then the FHLBs which are considering merger could feel renewed pressure to consolidate before the System reaches the minimum membership. “If the better legal interpretation is you always have to have at least eight banks, the banks

may feel the impetus to merge, because they don't want to be left at the altar without a bride," said Finance Board director Allan Mendelowitz.

- Industry observers say the FHLBs' executives face challenges in serving a diverse membership base with competing interests and differing responses to merger prospects. "The group that wants good dividends probably favor mergers," said Jim Vogel, the head of fixed-income research at FTN Financial Capital Markets. "The group that wants a responsive, service-based Home Loan bank probably doesn't want it. The bank that wants an aggressive system to provide leadership in terms of funding strategy does want it, and the bank that wants mortgage funding probably doesn't want it." Vogel added that the timing could be challenging for other FHLBs, because uncertainty surrounds the GSEs regarding future regulation and reform legislation before Congress. "You don't know who the regulator is going to be," said Vogel. "You don't know precisely what the risk-based capital scheme is going to be. You don't know precisely what's happening with the membership pool."
- Continued instability in the credit market which has led to robust growth in FHLB advances will likely result in robust profit growth in the third quarter for the FHLBs, leaving many of them with a stronger footing and possibly diminishing the sense of urgency the Banks may have felt about mergers. "The pressure on earnings that might have created an appetite to do a transaction will probably be less," said DelliBovi. "If the [FHLBs] are getting more business—and I believe that's what we'll see—then they should be more profitable, and the pressure I referred to would be lessened." (*American Banker*, Steven Sloan, 09/18/07)

Third quarter dividend announcements

- The board of directors of FHLB-Atlanta has approved an annualized dividend rate for the third quarter of 6.0% for the Bank's capital stock held during the period from July 1st to September 30th. The Bank will credit this dividend to members' daily investment accounts at close of business on October 1, 2007. (*PRNewswire*, 09/27/07)
- The FHLB-Dallas's board of directors has declared a dividend in the form of capital stock for the third quarter at an annualized rate of 5.25%, which equates to the average effective federal funds rate for the second quarter of 2007. The third quarter dividend, applied to average capital stock held during the period from April 1st through June 30th, will be paid on September 28, 2007. On October 31st, the Bank will repurchase the portion of members' excess stock identified as surplus stock as of that date. (*PrimeNewswire*, 09/27/07)
- The FHLB-San Francisco's board of directors projects a dividend of 5.21% (annualized) for the third quarter, based upon the financial information available to date. The Bank expects to announce its third quarter operating results on or about

October 25, 2007, and will include the dividend rate in that announcement. (*FHLB-San Francisco Press Release, 09/28/07*)

Public interest director appointment to FHLB-Des Moines

- Labh S. Hira has been appointed to serve as a public interest director of the FHLB-Des Moines. From 2002 to 2005, Dr. Hira served as the dean of the College of Business at Iowa State University. Prior to his appointment as the dean, he served as department chair for Accounting and Finance. (*Accounting Today, 09/24/07*)

FHLB-Indianapolis announces promotions

- The Board of Directors of the FHLB-Indianapolis have promoted Cindy Konich to serve as senior vice president and chief financial officer. Previously, Konich served as the Bank's acting chief capital markets officer during its recent reorganization. The board also promoted Paul J. Weaver to serve as senior vice president and chief accounting officer. (*FHLB-Indianapolis Press Release, 09/27/07*)

Council of Federal Home Loan Banks spent \$360,000 lobbying Congress during first six months of 2007

- During the first six months of 2007, the Council of Federal Home Loan Banks spent \$360,000 lobbying Congress on proposed reforms to GSEs and on a proposal to allow bonds guaranteed by the FHLBs to be exempt from taxes. In addition to Congressional lawmakers, the Council lobbied the FDIC, Federal Reserve, Federal Housing Finance Board, the GAO, the OTS, the OCC, and departments of Treasury, HUD, and the White House. (*Associated Press, 09/17/07*)

Ginnie Mae

Ginnie Mae officials consider using customized pools for multiple users

- *National Mortgage News* reports, “Bond market traders don’t want the new FHASecure mortgages for subprime borrowers placed in Ginnie Mae I mortgage-backed securities, so Ginnie officials are considering using customized pools with multiple issuers. ...The [FHA] estimates that the new FHASecure program could help 60,000 subprime borrowers that are delinquent because of the reset of their mortgage to avoid foreclosure. But bond traders expect investors to react negatively, so they are urging Ginnie officials to look for alternatives, such as limiting FHASecure loans to 5% or 10% of a Ginnie Mae II pool. Meanwhile, FHA issuers are divided on the issue and many are skeptical that the FHA will achieve anything near the loan volume it expects. (*National Mortgage News Online*, 09/26/07)

Farm Credit System / Farmer Mac

Former FCA chairman urges Senate Ag Committee leadership not to include HORIZONS provisions in the 2007 Farm Bill

- In *Farm Credit Watch*, Bert Ely reports that the Farm Credit System is “desperately trying to resurrect HORIZONS in the Senate Agriculture Committee as it seeks to find a sponsor for a HORIZONS amendment to the Senate version of the Farm Bill,” following a decisive loss in the House when the provisions were stripped by a voice vote by the full chamber. Ely wrote, “Despite their crushing loss in the House, the FCS appears to be continuing to push its fatally flawed HORIZONS agenda. Hopefully, members of the Senate Ag Committee will follow the recommendation of former Farm Credit Administration Chairman Mike Reyna, in a September 10 statement he sent to Senator Tom Harkin, Chairman of Senate Ag, and the committee’s top Republican, Senator Saxby Chambliss, that ‘the Senate Agriculture Committee should not include any HORIZONS provisions in the 2007 Farm Bill.’ This statement closely parallels the statement Reyna sent to the House in July.”
- “Reyna’s statement made important points everyone should keep foremost in their minds as the FCS continues to push its HORIZONS agenda. Reyna noted that ‘striking a delicate balance, Congress wrote, and has amended, the Farm Credit Act with an eye towards focusing the public benefits [of the FCS] by limiting the types of loans that the System can make as well as where and to whom these loans can be made.’ Reyna went on to observe that ‘the System’s proposed changes to the Farm Credit Act are an outgrowth of its HORIZONS Project, a multi-year effort designed

to justify an expansion of the System's off-farm lending powers. And therein lies its primary flaw—the System's efforts are more about the System's growth and profitability rather than the credit needs of agriculture and rural America.' Continuing, Reyna stated that 'the bulk of the System's public benefit goes to commercial agriculture—those farmers with retail sales in excess of one million dollars annually. This fact alone suggests a through review of whether the System is achieving its public policy purpose is in order.'”

- “...Reyna [added] ...[R]ather than responding to the System's relentless desire to finance corporate agriculture and main-street businesses, Congress should undertake a comprehensive examination of the System's future role in financing agriculture and rural America. Only after such an examination should the Congress consider any expansion of the System's off-farm lending authority.” Ely concluded, “Not only should there be such an examination, but Congress should go even further and consider privatizing the FCS.” (*Farm Credit Watch*, Bert Ely, September 2007)

FCS consolidation news

- In *Farm Credit Watch*, Bert Ely reports, “After a few quiet years, consolidation has resumed within the FCS. On August 29, the directors of two large California associations, Farm Credit West and Sacramento Valley Farm Credit, voted to merge, subject to 60 days' due diligence. If it goes through, the merger would form the fourth-largest FCS association, with approximately \$4.5 billion of assets. Farm Credit West is four times the size of Sacramento Valley; the merged association will carry the Farm Credit West name. Two aspects of the proposed merger are most intriguing.”
- “First, the Farm Credit West CEO, Ken Graff, will serve as the CEO of the merged association while Ernie Hodges, Sacramento Valley's CEO, will serve as the new association's president. Both men reportedly have strong personalities. If one of them does not retire soon after the merger, there could be a struggle for management control, a struggle compounded by the fact that the merged association will be headquartered in the Sacramento area.”
- “Second, for no apparent reason there has been no public announcement about this merger... Perhaps the directors of the two associations do not want to give their members any more time than necessary to oppose the merger. Perhaps, too, the directors are worried about employee morale, since an email reporting on the boards' decision to merge cited 'projected costs and cost savings' as one reason for the merger. Anticipating staff cutbacks and dislocations, association management has been authorized 'to develop an Employee Security Plan ...to provide transitional support for those employees who might be displaced solely as a result of the potential merger.'”

- Ely also noted that in July FCA approved the merger of the two largest FCS associations headquartered in North Dakota—AgCountry FCS and FCS of Grand Forks. The merged association [AgCountry] will have approximately \$2.5 billion in assets, 50% more than the largest banking company headquartered in North Dakota. Ely concludes, “So much for the FCS being comprised of small associations controlled by local owner/borrowers.” “In fact, most FCS assets are now controlled by large, remote associations with little member influence.” (*Farm Credit Watch*, Bert Ely, September 2007)

United FCS board takes actions to “strengthen [its] governance”

- In response to recent controversies and at the request of FCA, the Board of United FCS ACA has adopted actions to eliminate the Association’s regional committee structure and streamline governance into the full United FCS Board. [In 2002, United FCS was created through the merger of Farm Credit Services of North Central Wisconsin and Farm Credit Services Minnesota Valley]. Over time, United FCS’s board will be reduced from 22 directors to 13 directors, comprised of six directors from Minnesota, four from Wisconsin [to align MN and WI representation to the shareholder base], and three independent, outside directors with no regional affiliation. To facilitate the reconstitution of the board, eight directors have submitted their resignations. The board has authorized the nominating committee to expedite the search process for candidates to fill the vacant Board positions.
- The Association also plans to distribute \$4.7 million to Wisconsin shareholders to equalize the percentage of cash paid out to Wisconsin and Minnesota shareholders since the merger. The board has asked management to develop a plan prior to year-end to equalize the remaining capital pools between the Minnesota and Wisconsin regions.
- “The regional governance structure was not working in the best interests of the Association and was creating regional biases, turf battles and unnecessary Board disruption,” said United FCS Board Chairman Jerold Harris. “In a September 10th letter to the United FCS Board, the Farm Credit Administration took note of these controversies and requested we take corrective action by October 15th. We are confident that these Board actions will satisfy our regulator by moving to a more simplified governance structure where each director will now have a clear fiduciary responsibility to all shareholders, regardless of location.” (*EarthTimes.org*, 09/20/07)

Postal Service

USPS projects \$600 million loss for fiscal year 2008

- The Postal Service projects a \$600 million loss for fiscal year 2008, due to a provision in last year's postal reform legislation which requires the agency to fully fund retiree health benefits out of its operating budget. The agency's budget which was approved by the Postal Board of Governors (BOG) on September 26th includes a 4.6% increase in operating revenue generated by the 2-cent postal rate hike that took effect in May. While no rate hikes are proposed in the budget, the BOG has not taken a formal position on any price changes for FY2008. The board also approved a capital budget of \$3 billion for FY2008, up from \$2.8 billion in FY2007. (*Associated Press*, 09/27/07; *Federal Times*, Tim Kauffman, 09/26/07)

Under postal reform, USPS must manage rates by class –something the agency has never done before

- At the Postal Service's National Postal Customer Council Day, Postmaster General John E. Potter talked about the new competitive environment created by postal reform legislation and the ways in which his agency have been working to understand and implement opportunities, such as setting service and measurement standards for every class of mail, becoming profit-driven and redefining the rate and pricing processes. "One of the biggest changes is keeping rates at or below inflation. We must manage rates by class and we've never done that before," he said. "The goal is to make a profit every year. We are more cognizant than ever of the bottom line. The goal is to make a profit every year. We are more cognizant than ever of the bottom line." (*DMNews.com*, Giselle Abramovich, 09/25/07; *USPS Press Release*, 09/19/07)

USPS opens the door to "far less accountable workforce" through outsourcing

- According to the AFL-CIO Transportation Trades Department, "The United States Postal Service is jumping on the outsourcing and privatizing bandwagon at the expense of good jobs, safety and security, and reliable delivery of basic services. According to a new USPS program, all new mail delivery locations will be considered for outsourcing to companies that often provide low wages, no benefits, and have no equivalent background check requirements. This program and other attempts to outsource core mail handling functions violate the spirit of the policy established by the Postal Accountability and Enhancement Act of 2006, which reinforced collective bargaining obligations. In its effort to employ fewer union workers, the USPS is opening its doors to a far less accountable workforce." (*Association of Postal Commerce*, 09/27/07)

Postal Service's largest customer is the newspaper industry

- According to a national survey by the Newspaper Association of America (NAA), the nation's daily newspapers spend nearly \$1 billion on postage services from the USPS. In 2006, the newspaper industry spent more than \$972 million, up more than 7% from its total expenditures of \$901 million in 2004. "Collectively, daily newspapers are a leading customer of the U.S. Postal Service and many of our member newspapers are the largest mailers in their local markets," said John F. Sturm, president and CEO of the Newspaper Association of America. (*Newspaper Association of America Press Release, 09/27/07*)

Only at the USPS

- According to the *Grand Rapids Press*, mail went undelivered on the northwest side of Grand Rapids, resulting in nearly half of the Postal Service's 59 letter carriers from the one postal station (1625 Walker Avenue NW) being suspended from two days to nine months. The last of the suspensions for 29 carriers ended in August. Through the efforts of the workers' unions and arbitrators, **all workers received back pay for their "time off,"** said Jim Mruk, a spokesman for the Postal Service Great Lakes Region in Chicago. [Emphasis added.] None of the carriers were fired and no criminal charges were brought, added Mruk. In another investigation at a station in Battle Creek, MI, 18 workers were suspended and two carriers resigned—one a career employee and the other a temp, according to Mruk. The matter took a while to resolve, he added, because of grievance arbitration, which handled each case individually. "We had to be fair to everyone." (*The Grand Rapids Press, Theresa D. McClellan, 09/17/07*)
- According to the *Marine Corps Times*, "...Richard Erickson of Fort Myers, [FL], was fired from the U.S. Postal Service for what his termination letter says was excessive use of military leave. ...A National Guard Special Forces sergeant major who already had served one tour in Afghanistan, Erikson was terminated because postal officials calculated he had missed more than five years of work since 1991 because of his military service and was about to be mobilized for another 18 months. " (*Marine Corps Times, Rick Maze, 09/20/07*)

Tip of the hat to Wayne Viger –our hero of the year

- The *Sun Journal* reports, "Mail carrier Wayne Viger remembers vividly the afternoon he stepped into the burning apartment on Knox Street in search of people. It was April 3, 2006, and he was at the end of his route. Smoke was pouring from the building and alarms were sounding inside. Viger believed an elderly woman was inside her first-floor apartment. 'I pushed open the door and I went in the kitchen,' he said. 'This woman came out of the living room. The living room was filled with

thick, thick smoke. It was like a dream. She came out of that thick smoke and she was on fire. Her clothes were on fire.’ Viger, 55, smothered the flames that were burning the woman’s clothing and got her outside. He told her to wait a safe distance from the burning building... He called the post office from a number he remembered easily from his 30 years as a postal carrier. The information was relayed to the fire station and Viger went back into the first-floor apartment.”

- “‘The smoke was so thick. I held my breath and thought, “I can’t suck any of that in”” he said. ‘I went in there and I started to disappear into the smoke.’ Viger was forced to flee the apartment after finding nobody inside. He checked on the second and third floors as well. After further chaos and encountering a stairwell full of smoke, Viger left the building and the Fire Department took over. Viger told his story Tuesday night [September 18] while awaiting a twilight tour of Washington, D.C., with some prominent politicians. He was there to accept an award: He’s been named National Hero of the Year by the National Association of Letter Carriers.” (*Sun Journal* [Maine], Mark LaFlamme, 09/20/07)

Regulators and lawmakers do not fully understand the economics of the international postal industry
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- *DM News* reports, “In recent years, the international postal market has undergone widespread change,” reports competition is increasing among different postal providers and mail order companies entering the postal market and has intensified through the growing developments in the electronic sector, logistics and publishing. On the political side, there are discussions and negotiations aimed at liberalizing postal markets and the introduction of new laws and regulations. However, regulators and lawmakers do not fully understand the economics of the postal industry, according to the International Post Corporation’s CEO, Herbert-Michael Zapf.”
- According to a new study produced by the IPC in cooperation with the German Institute for Economic Research entitled “How to Regulate the Postal Industry: An Economic Approach,” the liberalization of the postal market is being accompanied by new, complex and detailed regulations. However, the economics of the postal business and the dynamics of the postal market are either ignored or not understood. According to the study, the number of new entrants in the postal markets has made it possible to create an alternative postal infrastructure, clearly demonstrating that a monopoly does not exist. (Examples include parcel services, express services, newspaper delivery and international mail services.)
- According to the study, “The role of postal market regulation is not to create competition, but rather to create a framework that allows for competition. Regulators that today set out to create a high level of competition within a short period of time have failed to understand the postal market correctly.” The study argues that the objective of postal market regulation today is not to apportion the postal market;

instead its objective is to create an environment in which the market can grow.
(*DMNews*, Giselle Abramovich, 09/28/07)

TVA

Leading environmental activist concludes that nuclear power has “astronomical advantages” over other renewable energy sources

- In the July issue of *International Journal of Nuclear Governance, Economy, and Ecology*, Rockefeller University’s Jesse Ausubel, a prominent environmental advocate, stunned environmental activists by reporting that the use of renewable energy is wrecking the environment. “Renewables are not green,” wrote Ausubel. [according to his biography, Ausubel “was one of the main organizers of the first U.N. World Climate Conference (Geneva, 1979) which substantially elevated the global warming issue on scientific and political agendas [and] ...played major roles in the formulation of both U.S. and world climate-research programs.”] In the article, Ausubel calculated the amount of energy produced by various renewable energy sources in terms of power output per square meter of land disturbed and concluded that none of the renewable sources—hydroelectric, biomass, wind and solar—were efficient users of land.
- Ausubel also noted other undesirable consequences of renewable energy sources, such as wind power’s production of low-frequency noise and thumps, its blights on landscapes, interference with TV reception, and mutilation of birds and bats. Moreover, he noted that dams kill rivers and solar power require large areas of land be essentially “painted black” with photovoltaic cells. “Cheerful self-delusion about new solar and renewables since 1970 has yet to produce a single quad of the more than 90 quadrillion BTU of total energy the U.S. now yearly consumes,” wrote Ausubel. “...Let’s stop sanctifying false and minor gods and heretically chant ‘Renewables are not Green.’” He concluded, “Like computers, to grow larger, the energy system must now shrink in size and cost. Considered in watts per square meter, nuclear has astronomical advantages over its competitors.” (*Environment & Climate News*, Steven Milloy, 10/02/07)

Nuclear power: The zero-emission energy

- On *National Review Online*, Senator John McCain wrote, “...We have in use today, a zero-emission energy that could provide electricity for millions more homes and businesses than it currently does. Yet it has been over 25 years since a nuclear-power plant has been constructed. The barriers to nuclear energy are political not

technological. We've let the fears of 30 years ago, and an endless political squabble over the storage of nuclear spent fuel make it virtually impossible to build a single new plant that produces a form of energy that is safe and non-polluting. If France can produce 80-percent of its electricity with nuclear power, why can't we? Is France a more secure, advanced, and innovative country than we are? Are France's scientists and entrepreneurs more capable than we are? I need no answer to that rhetorical question. I know my country well enough to know otherwise..." (*National Review Online*, Senator John McCain, 09/27/07)

Representative Markey demands information
on NRC's outsourcing of nuclear reactor construction applications

- Representative Edward J. Markey (D-MA) sent a letter to Nuclear Regulatory Commission (NRC) Chairman Dale Klein seeking to know why the agency has outsourced the job of reviewing new nuclear reactor construction applications to three companies for three different plant designs. By October 5th, Markey has asked the NRC to provide him copies of all documents related to the contracts, including requests for proposals. Markey also wants to check any records of discussions related to compliance with the law governing "inherently governmental functions." NRC spokesman Scott Burnell said, "The NRC has not, and will not, delegate any decision-making authority in the licensing of potential new U.S. nuclear reactors," Markey appears to be "alarmed that this contract may violate the law and ... result in a danger to public health and safety." The NRC anticipates receiving license requests from TVA [in conjunction with a consortium of utility companies] to build a new nuclear power plant at its rural Bellefonte site on the Tennessee River in northeast Alabama and from NRG Energy Inc. and South Texas Project Nuclear Operating Company to build a nuclear power station site in South Texas. (*eFluxMedia*, Dan Kean, 09/27/07)

TVA board approves a \$9.7 billion budget for FY 2008,
along with \$2 billion capital expenditures

- TVA's board of directors approved a 2008 budget for \$9.7 billion to cover total expenses and \$2 billion in capital spending. The capital budget includes \$1 billion in spending on new power plants, including \$317 million to begin construction of a second unit at TVA's Watts Bar Nuclear Plant. The board directed staff to work with the agency's power distributors to develop a single-digit rate increase proposal [likely to range from 6% to 9%] which would generate additional revenue during the 2008 fiscal year to cover operating expenses and capital expenditures. That increase, likely to start in April, will be in addition to a quarterly fuel surcharge from the unusually hot, dry summer across much of TVA's coverage area.
- TVA's budget includes a projected \$122 million in productivity improvements during the year to help offset inflation and to hold non-fuel operating and maintenance costs and \$775 million to reduce existing debt and capital lease obligations. The capital

budget includes \$761 million of new debt to help finance new generation assets, \$423 million for investments in additional gas-fired generation, \$190 million for transmission system upgrades and \$383 million for clean-air initiatives. The budget includes \$22 million for the first phase of a new energy efficiency and peak power demand reduction program. The board also voted to hire Ernst & Young LLP as external auditors, replacing PricewaterhouseCoopers LLP. (*Memphis Business Journal*, 09/27/07; *Associated Press*, Bill Poovey, 09/27/07)

- TVA's board of directors also voted Thursday to seek a Nuclear Regulatory Commission license to build a two-reactor plant at TVA's rural Bellefonte site on the Tennessee River in northeast Alabama. The agency will apply for the license as a partner in a consortium of power companies and reactor manufacturers called NuStart Energy Development LLC, which will split the projected \$50 million initial design cost with the U.S. Department of Energy. (*Associated Press*, 09/27/07)

TVA recognized among the top utilities in North America for its economic development
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- *Site Selection Magazine* recognized TVA as one of the top utilities in North America for its economic development efforts, which resulted in corporate investments of \$4.2 billion in new projects in TVA's service area and the creation of approximately 53,000 jobs in 2006. The projects included Nissan's new North American headquarters in Nashville, TN (1,200 jobs, \$120 million); SeverCorr's steel plant in Mississippi (450 jobs, \$880 million); Bluegrass Bioenergy's project in Kentucky (50 jobs, \$96-million); and Verizon Wireless' project in Alabama (1,300 jobs). In 2006, TVA also inaugurated its Valley Targeted and Prepared Community Program, which assists communities in targeting and recruiting specific industry segments to site selectors. "It takes a tremendous team to achieve an honor like this one, and TVA could not have been named to this list two years in a row without close collaboration and support from our customers and economic development partners," said John Bradley, TVA senior vice president of economic development. (*Site Selection Magazine*, September 2007; *Memphis Business Journal*, 09/18/07)

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