

The **GSE** REPORT™

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Contents of GSE Report™

Major Events

- [House Financial Services Committee members spar over aggressive housing aid bill \(p. 3\)](#)
 - [White House voices strong objections to Chairman Frank's proposed bailout \(p. 6\)](#)
 - [There's no guarantee that a government bailout will stem the decline in home prices \(p. 8\)](#)
 - [Chairman Frank's bailout bill: "Risky as hell" \(p. 9\)](#)
- [A chance for GSE regulatory reform \(p.10\)](#)
- [OFHEO has "significant supervisory concerns" about Fannie and Freddie \(p. 12\)](#)
- [Cost of propping up Fannie and Freddie could exceed 10% of GDP during a deep and prolonged recession \(p. 14\)](#)
- [OFHEO puts Fannie and Freddie on notice about the application of fair value accounting in a sound and consistent manner \(p. 15\)](#)
- ["GSE capitalism means never having to say you're sorry" \(p. 16\)](#)
- [President Bush nominates Steve Preston to serve as HUD Secretary \(p. 18\)](#)

Fannie Mae and Freddie Mac

- [Fannie Mae and Freddie Mac kick-start their jumbo conforming loan programs \(p. 19\)](#)
- [Fannie Mae and Freddie Mac slow to ramp up their purchases of mortgage loans \(p. 19\)](#)
- [The creation of an affirmative statutory duty on loss mitigation activities for the entire mortgage market will be costly and add complexity to the process \(p. 20\)](#)
- [Senators Landrieu and Vitter question the GSEs' higher credit score requirements \(p. 21\)](#)
- [GSEs' higher pricing structure is "tantamount to both ethnic and gender discrimination" \(p. 21\)](#)
- [Fannie Mae and Freddie Mac receive regulatory relief from certain affordable housing quotas for 2007 \(p. 22\)](#)
- [Fannie Mae wins two-year battle with IRS over losses in the company's loan portfolio \(p. 22\)](#)
- [The GSEs' appraisal standards agreement with NY AG Cuomo draws criticism \(p. 22\)](#)
- [State AGs conclude that foreclosure prevention initiative are falling short of need \(p. 23\)](#)
- [Subprime and beyond \(p. 24\)](#)
- [Unintended consequences... \(p. 28\)](#)

Fannie Mae

- [Fannie Mae announces second quarter dividends \(p. 30\)](#)
- [Fannie to announce its first quarter results on May 6th \(p. 30\)](#)
- [Fannie Mae's HomeStay results \(p. 31\)](#)
- [Fannie Mae's investment in Gulf Coast region tops \\$40 billion \(p. 31\)](#)
- [Fannie Mae alumni news \(p. 32\)](#)

Freddie Mac

- [Shaun O'Malley, Freddie's lead director, to retire in June \(p. 32\)](#)

- [Freddie Mac to announce its first quarter results on May 14th \(p. 32\)](#)
- [Freddie Mac requires loan servicers to diversify their foreclosure and bankruptcy referrals \(p. 32\)](#)
- [ICBA and Freddie Mac renew and enhance their Alliance Agreement \(p. 33\)](#)
- [Freddie Mac awards \\$10.5 million in grants for foreclosure prevention \(p. 33\)](#)

Federal Home Loan Banks

- [FHLB-Chicago discontinues purchase of mortgages in its Mortgage Partnership Finance Program \(p. 34\)](#)
- [The FHLB-Dallas ratings unaffected by termination of merger, says S&P \(p. 34\)](#)
- [Credit crisis in mortgage market “affirms” the integral role of the FHLB System in the nation's financial system \(p. 35\)](#)
- [Unrestrained growth of FHLB advances raises moral hazard risks \(p. 35\)](#)
- [FHLB-Cincinnati reports a 23% decline in net income for the first quarter 2008 \(p. 36\)](#)
- [FHLB-New York declares first quarter dividend of 7.8% \(p. 36\)](#)

International Mortgage Market

- [Bank of England announces \\$100 billion liquidity injection to cushion the UK's credit squeeze \(p. 36\)](#)
- [Canada's housing boom “officially over” \(p. 37\)](#)

Farm Credit System / Farmer Mac

- [Tentative agreement reached on the 2008 Farm Bill \(p. 38\)](#)
- [Ethanol's failed promise \(p. 39\)](#)
- [Are American farmers edging toward a financial crisis? \(p. 41\)](#)
- [FCA's debt increased 6% in first quarter of 2008 to meet seasonal demand caused by higher commodity and input prices \(p. 42\)](#)
- [Vagueness of the FCA lending authority rule draws ire of the commercial bankers \(p. 42\)](#)

Postal Service

- [House bill introduced to ensure continued availability of stamp vending machines to underserved communities \(p. 44\)](#)
- [Private contractors are the best antidote to the USPS's billion-dollar losses \(p. 44\)](#)
- [The PRC requests public comments on the postal monopoly in the U.S. \(p. 45\)](#)
- [USPS introduces on-line, customized greeting cards and documents \(p. 45\)](#)
- [USPS's “Stamp Out Hunger” drive to be held May 10th \(p. 45\)](#)

TVA

- [Five shutdowns of Browns Ferry nuclear unit causes NRC to require new round of inspections \(p. 46\)](#)

Major Events

House Financial Services Committee members spar over aggressive housing aid bill

White House voices strong objections to Chairman Frank's proposed bailout

There's no guarantee that a government bailout of subprime borrowers will stem the decline in home prices

Chairman Frank's bailout bill : "Risky as hell"

House Financial Services Committee members spar over aggressive housing aid bill

- Members of the House Financial Services Committee began debate over FHA Housing Stabilization and Homeownership Retention Act of 2008 (H.R. 5830), sponsored by Chairman Barney Frank (D-MA), which would federally guarantee up to \$300 billion in mortgages used to refinance struggling borrowers into affordable loans. Supporters argued that Congress must act to address the spiraling housing crisis and illiquid credit markets, which appears to be dragging the economy into a recession. "We're in a situation in which we have a serious economic problem, I believe a recession," said Frank. "What we hope to do today is diminish the cascade of foreclosures." The voluntary program, proposed by Frank, would require lenders to agree to reduce the principal value of the loan in exchange for a short payment from loan proceeds from a new FHA-guaranteed loan to the borrower. This affordable loan would require the borrower to share any future appreciation in the home's value with the government to help pay for the program. The program would be limited to loans made before January 1, 2008, which are collateralized by owner-occupied homes. The borrowers would be required to certify that they have not committed mortgage fraud and have not intentionally defaulted on their loans. Frank estimates that the program will cost taxpayers between \$3 billion and \$6 billion, half of which would be offset by FHA reform legislation currently being considered by lawmakers. The chairman also argued that the ultimate cost to taxpayers by not acting to help stem the tide of foreclosures would be much greater than the cost of implementing his proposed program. "The problem is that foreclosure causes concentric circles of damage," said Frank. "Everyone in the neighborhood where there is a foreclosure is victimized."
- During the April 23rd markup, the committee approved by voice vote the Emergency Loan Modification Act of 2008 [H.R. 5579], designed to protect servicers who modify mortgage loans from investor lawsuits, and the Neighborhood Stabilization Act of 2008 [H.R. 5818], which would provide \$15 billion—half in federal loans and half in grants—to states with high foreclosure rates for cities and counties to use to purchase and renovate foreclosed properties. [H.R. 5579 and H.R. 5818 are scheduled to go to the House floor for a vote the first week of May]. Committee

members are expected to offer a number of amendments to Frank's bill designed to stabilize the housing market (H.R. 5830) before a final committee vote on the measure expected on April 30 or May 1. Senate Banking Committee chairman Chris Dodd (D-CT) expects to begin work on a similar measure by May 6. Frank said that the final housing package will likely include an overhaul of the FHA and the long-stalled GSE regulatory reform legislation. In May and June, the chairman indicated that he will hold a series of hearings on financial risk, which would focus on the "lack of regulation on risk" and how government can write better rules to avoid major failures in the future.

- Representative Spencer Bachus (R-AL), ranking member on the Committee, raised concerns about the potential cost of the proposal to taxpayers. "It will require American taxpayers to assume risks incurred imprudently by mortgage lenders and now-over-extended borrowers during the run-up in housing prices earlier this decade. ...For me and for many of my colleagues on this side of the aisle, the fundamental issue remains one of fairness. I believe it will unfairly benefit a few homeowners, many investors and speculators, at the expense of millions of careful borrowers and renters." Representative Randy Neugebauer (R-TX) said, "Markets go up, they go down, and the government should not be involved in determining which way they go." By a vote of 27 to 32, the committee defeated a 445-page Republican amendment, in the form of a substitute proposal, sponsored by Representatives Bachus (R-AL), Judy Biggert (R-IL) and Shelley Moore Capito (R-WV). The Republican proposal included steps to protect consumers from fraudulent or unscrupulous lending practices, an overhaul of FHA, and stiffer regulation for Fannie Mae and Freddie Mac.
- As the House Financial Services Committee begins its votes on a bill designed to stabilize the housing market (H.R. 5830), supporters concede that two key issues remain unsettled, including how many borrowers would qualify for help and how many lenders would participate. Under Frank's bill, only borrowers who cannot afford their loans are eligible, while the bill proposed by Senate Banking Committee chairman Chris Dodd (D-CT) left the determination of eligibility to the regulators. While Frank's bill also would give regulators some discretion, it would require borrowers to occupy their homes, have a mortgage debt-to-income ratio above 35%, and have a mortgage originated prior to January 1, 2008. Frank estimates that his bill would help between 1 million and 2 million homeowners. In contrast, the Bush administration estimated the number to be between 500,000 and 1 million, while some private industry estimates put it between 300,000 and 500,000.
- Another key issue is would the lender or investor that owns the mortgage be willing to participate. Paul Leonard, a lobbyist for the Financial Services Roundtable, said, "The general feeling that we're getting from our companies is that it's a worthwhile program, but they can't guarantee how much it would be used, because it is contingent upon the investor accepting the writedown of the existing mortgage." He added, "We can't predict how broad the use would be. It's still dependent upon conditions in the market and what the final parameters [are in the bill]." Some

industry representatives argue that Congress should enhance incentives for lenders and investors, proposing that they be given a percentage of the gain if the targeted home appreciates in value. Under Frank's proposal, borrowers are forced to share any appreciation in their home with the government, which is phased out over a five-year period, after which the borrower pays a 3% exit fee to sell or refinance the home. [Dodd's proposal would split the home's appreciation evenly between the government and borrower.] Laurence Platt, a lawyer for Kirkpatrick & Lockhart Preston Gates Ellis LLP, said, "The fundamental flaw in all of these proposals is the notion that investors will unilaterally act against their self-interest for the greater community good ... and that's just not likely to occur."

- Operational issues also remain, including how to treat second liens and how house market values would be established. Second mortgages, a prevalent feature among mortgages which might qualify for Frank's proposed program, often are held by different investors than the holders of the first mortgage and must be extinguished to allow a refinancing to occur. "Communication with the second liens is still one of the biggest issues to addressing the problem," said Scott DeFife, a lobbyist for the Securities Industry and Financial Markets Association. "Everyone recognizes that it's a big problem, but no one has any idea what to do about it," said a representative of a large bank. Frank proposes to set up an oversight board, comprised of the heads of the Fed, the Treasury Department, and HUD, which would address this issue by setting a pricing formula for establishing an amount for the primary lien holder to pay to subordinate lenders or to allow subordinate liens to be compensated through sharing a limited portion of the writtendown loan's appreciation.
- Establishing accurate appraisals for properties is another big stumbling block in the process. Frank's bill requires lenders to hire appraisers, who are independent and certified by HUD. In recent testimony before the Senate Banking Committee, former Treasury Secretary Larry Summers pointed out that conducting appraisals in an illiquid market is difficult, and, if they were done incorrectly, the government would bear the cost if a home's value continued to deteriorate. "The people who are going to bear the burden if there are misappraisals are going to be the taxpayers," said Summers. American Enterprise Institute fellow Peter Wallison said, "In a market where values are falling and nobody actually knows how far values will fall, this is a very, very difficult process. The appraiser doesn't know whether the bottom has been reached. It's another one of the technical problems ...that's very easy for Congress to gloss over when they are passing legislation but which become serious obstacles to implementation."
- Some economists warn that if loan workout agreements fail, which could result merely in postponing foreclosures rather than preventing them, then the FHA insurance fund will lose even more down the road. Christopher Mayer, a real estate professor at Columbia Business School, said, "It may well have been true that this was a very good strategy between 2001 and 2006 [when real estate values were rising], [but] there's some reason to believe that the strategy of working loans out in a falling housing market ...just leaves lenders in worse shape than they were before."

- Ultimately, the program’s effectiveness in stemming the housing crisis could depend as much on market psychology as anything else—a factor outside the control of lawmakers, said Steve O’Connor, head of government relations with the Mortgage Bankers Association. “There’s the question of how many borrowers would be helped, and then the question of investor and homebuyer psychology,” said O’Connor. “At some point what you need to do is restore the investor and homebuyer confidence that prices aren’t going to continue to drop. ...So even if the number of borrowers isn’t large, is it enough to kind of change the psychology? Can these rescue plans be a catalyst?” No one knows the answer, said O’Connor. “It’s too early to tell.” (*Bureau of National Affairs*, Thecla Fabian, 04/25/08; *CQ Today*, Benton Ives, 04/23/08; *Associated Press*, 04/24/08; *Bureau of National Affairs*, Thecla Fabian, 04/24/08; *Dow Jones Newswires*, Michael R. Crittenden, 04/24/08; *American Banker*, Stacy Kaper, 04/24/08; *Bureau of National Affairs*, Thecla Fabian, 04/25/08; *Wall Street Journal*, Louise Radnofsky and Michael R. Crittenden, 04/25/08; *Washington Post*, Lori Montgomery, 04/25/08; *Associated Press*, 14/25/08)

White House voices strong objections to Chairman Frank’s proposed bailout

- In a letter to the House Financial Services Committee’s leadership, HUD deputy secretary Roy Bernardi stated that the Bush administration was “strongly opposed” the Democrats’ foreclosure relief bill, but did not threaten a presidential veto. Bernardi said the bill was unnecessary and irresponsible, because it may ultimately saddle the taxpayers with thousands of failing loans. “This legislation may come at a cost to taxpayers who are not participating in the new program. An attempt to shift costs to taxpayers would constitute a bailout,” said Bernardi. “We believe there are simpler and more targeted ways to accomplish the goals of the bill by relying on existing market forces and FHA practices.” His letter suggests that there is little room for compromise. Bernardi notes that the Democrats want to sharply relax the eligibility standards for FHA loans, which “would force the agency and taxpayers to take on excessive risk and would jeopardize its stability.” Democrats also want a new oversight board that could adjust FHA’s policies to respond the housing crisis. Such a board would “unnecessarily expand the role of government in the market [and] make the FHA program cumbersome and inefficient.” He also questioned if lenders would participate in a program which requires them to reduce the size of the mortgage principle and forgive fees and penalties.
- Treasury Secretary Henry Paulson, who has been negotiating with the management of Fannie Mae and Freddie Mac on the terms of GSE regulatory reform legislation, appeared to strike a more positive tone toward the bill during an interview with Reuters. Paulson said, “We are behind the objectives. We like some parts of it better than others and we have not issued a veto threat.”
- “I thought we were moving together,” said Chairman Barney Frank (D-MA). “Now I don’t know where we are.” He added, “I’m a little more discouraged because of [Bernardi’s letter]. I think there’s been an internal struggle within the administration.

They're now saying they're against it." Frank was later told by Treasury that it was not an explicit veto threat. He said the administration might reconsider once the bill is packaged with legislation that they support, including measures to modernize FHA and to reform the GSEs' regulatory structure. In reaction to Bernardi's letter, Frank said, "I was surprised. I thought I was hearing veto, but apparently they just say 'strongly object,' ... which means that when we get into a situation where we got the FHA and the GSEs that have been amended some, we may get closer." Frank noted that by moving a broader housing package forward, you weaken the ability of a single lawmaker to block a bill. "As the stakes get higher and as the package gets broader, your leverage diminishes," said Frank in answering a reporter's question about the ability of Senator Richard Shelby (R-AL) to block passage of the legislation. "It's one thing if it's got to come out of your committee. It's another if both Houses have acted and the leadership puts together a package. Senator Shelby (R-AL) will be in a position to shape some of that, but given the kind of grand approach I'm talking about, I don't think any one individual will be able to stop it."

- Frank also said that higher loan limits for Fannie Mae and Freddie Mac will need to be including in the housing bill being considered by Congress. "The increased loan limits are very much part of this," Frank told reporters. "I think there's going to be a very strong argument to keep them up there." He indicated that the more limited conforming loan limit increases being sought by Republicans are "not high enough" and signaled that the temporary increases could become permanent, because lowering them could cause problems for homeowners. "What about people who finance at this level, what happens when they go to refinance and are in a different category?" Frank asked.
- Senate Banking Committee chairman Christopher Dodd (D-CT) said it's do-or-die time for GSE regulatory reform, which Treasury Secretary Henry Paulson desperately wants to get passed before his tenure ends. "You only get one bite at this," said Dodd, whose first task is to either appease Shelby, the committee's ranking minority member, or get around him. Shelby said he doesn't know if he'll be able to come to an agreement on the GSE reform bill, but did stress that an important issue for him is raising the capital standards for Fannie and Freddie. "I don't know what will happen," said Shelby. "We're just interested in a strong regulator, with substance and will address some of the problems such as lack of capital [and] the portfolio."
- A final deal could involve a package containing an overhaul of the FHA insurance program, GSE regulatory reform, targeted tax breaks and new provisions allowing FHA to refinance subprime loans, said Frank. "They are mutually reinforcing," he added. Additional funding for states to purchase and rehabilitate repossessed property may be attached to another measure, such as a war supplemental appropriations bill, he added. Negotiating appears to also be taking place on other levels. House Speaker Nancy Pelosi (D-CA) said that passage of a controversial Columbia free trade agreement would not be considered unless the administration yielded on issues such as housing legislation. (*Financial Times*, James Politi and Krishna Guha, 04/25/08; *Washington Post*, Lori Montgomery, 04/25/08; *American*

Banker, Stacy Kaper, 04/25/08; *CQ Today*, Liriel Higa and Benton Ives, 04/24/08; *Politico.com*, 04/24/08; *Bureau of National Affairs*, Bill Swindell, 04/25/08; *Dow Jones Newswires*, Michael R. Crittenden, 04/23/08)

- Ronald D. Utt, Ph.D., a fellow at The Heritage Foundation, warns, “Among the many risks confronting the United States is that many of the proposed relief measures [to address the subprime crisis] would substantially and permanently expand the scope of the federal government while doing little to address the current financial crisis.” He notes that increasing the GSEs’ conforming loan limit and reducing their excess capital requirements will do little to address the problem at hand and ultimately may hinder the recovery of struggling, but still viable, lenders. With no restrictions on how Fannie and Freddie invest their expanding portfolio limits and any debt they issued being perceived by the marketplace as government-guaranteed, the GSEs will be positioned to cherry-pick among the 5.5 million homes that will be bought, sold and financed in 2008 by qualified buyers. As GSEs, Fannie and Freddie will be competing unfairly with private lenders and investors, putting more pressure on the private sector’s profitability. Utt adds, “Regrettably, by raising the loan caps on GSE lending and FHA mortgages, Congress and the Administration are accommodating and encouraging these land-use abuses, which will continue to make homeownership unaffordable for many moderate-income families. An important first step would be to rescind the loan cap increases and make their restoration contingent on reform of a region’s land regulations.” (*Executive Summary Backgrounder: The Subprime Mortgage Market Collapse: A Primer on the Causes and Possible Solutions*, Ronald D. Utt, Ph.D., 04/22/08)

There’s no guarantee that a government bailout of subprime borrowers will stem the decline in home prices

- In an April 12th editorial, the *Washington Post* wrote, “...[W]hat’s the moral argument for a bailout? For every troubled subprime borrower, there are several struggling but paid-up homeowners wondering why they should foot the bill—in higher taxes, increased government financial risk, eventual inflation, or all three—to rescue those who took on more debt than they could handle. In a recent interview on public radio in Boston, Rep. Barney Frank (D-MA), who is sponsoring a leading mortgage-relief bill, said this: ‘There are people who are working and have their jobs, and then there are other people who’ve lost their jobs and we pay them unemployment compensation. There are people who buy all their own food, but there are other people for whom we buy food stamps. We have said, I think correctly, in this society, that if you find yourself in economic distress, within reason, we’ll try to help you out.’”
- “Fair enough. But unemployment insurance is a time-limited benefit, paid for through a dedicated employer payroll tax. Food stamps go only to the verifiably poor. Except for during the Great Depression—and we’re not back there yet—American society has never offered wholesale federal relief from unpayable home

loans. Before the recent crisis, hundreds of thousands of people went into foreclosure each year and got no help from Uncle Sam.”

- “The clearest moral argument is that made on behalf of subprime borrowers who were sold those loans without being told about alternatives that were more affordable. But however large that group is—and no one can specify its size—such deception probably accounts for a minority of mortgages in which the homeowner could actually keep up a federally fixed mortgage. The fact is that any program, Republican or Democratic, that mobilizes any amount of federal resources to save distressed homeowners will create perverse incentives and arguable inequities, one of which is that it may take from some people who are less well-off than those to whom it gives. Subprime-heavy states such as California, Florida and Nevada would be subsidized by the rest of the country. And so on.”
- “However unevenly distributed the costs and benefits of a housing bailout, they might be smaller, and more equitably distributed, than would be the costs of mass unemployment and hollowed-out neighborhoods. This is an argument about ‘systemic risk’—similar to Federal Reserve Board Chairman Ben S. Bernanke’s defense of his decision to help J.P. Morgan Chase buy Bear Stearns. And it’s the strongest point in favor of a government housing rescue. But, just as the Bear Stearns bailout can ultimately be justified only if it helps restore lasting confidence in financial institutions, so must the various housing plans stem the decline in home prices. And that is something for which there can be no government guarantee.” (Washington *Post*, 04/12/08)

Chairman Frank’s bailout bill : “Risky as hell”

- In the April 15th edition of the *Boston Herald*, Michael Graham wrote, “Risky as hell.” That’s how the Heritage Foundation’s David John describes Rep. Barney Frank’s mortgage bailout program. He’s an economist who takes the consequences of this taxpayer-backed bailout seriously. Unlike, oddly enough, Frank himself.”
- “*The Hill* recently quoted Frank as saying [that] it’s ‘irrelevant’ how many people are actually helped by his \$300 billion plan. ‘I would hope a million would benefit. There’s no downside. Why not try?’ Only a Bay State pol could hand out \$300 billion in taxpayer promissory notes and then say ‘What’s the downside?’ It’s like Tip O’Neill getting the go-ahead on the Big Dig and asking, ‘What could possibly go wrong?’ Well, at least Barney’s bailout won’t get anybody killed. Probably.”
- “Frank’s proposal is that bad borrowers should have their bad loans written down by irresponsible lenders to 85 percent of the current value of their home. The borrower—you know, the guy who showed lousy judgment and had to default in the first place—will then borrow 90 percent of the home’s value. The problem is that the lousier risk you are, the more likely the person holding your loan will be to stick you in the government-backed program. Remember, these loans aren’t being written

down by 85 percent—the lenders are agreeing to eat everything they’re owed down to 85 percent of the home’s current value.”

- “So let’s say that Steve and Sue bought a \$500,000 house at the peak of the housing bubble. They padded their financial resume, found an aggressive broker and got their subprime loan. Then the housing slide began, their plan to refinance using their equity went bust and now they’ve got a huge monthly payment on a house that’s worth just \$400,000. That’s bad enough. But under Frank’s plan, the lender would eat all but \$340,000. That’s a \$160,000 hit—some ‘bailout.’ The commonsense question is: Why would the lender ever make such a deal? Answer: Only if the borrower was such a high risk or the original deal was so bad that losing \$160k is the best deal around.”
- “In other words, if Sue and Steve are solid citizens, they don’t need Frank. As the Heritage Foundation points out, more than 1 million loans have already been renegotiated under the [Treasury Department’s] watchful eye in the ‘Hope Now’ program, without Barney’s bailout. But if Sue and Steve are deadbeats, the lender will take the \$160,000 writedown and consider itself lucky. Extra lucky, in fact, because Frank put the taxpayer on the hook for the entire loan. So we’re putting 300 billion tax dollars on the table to cover loans to the riskiest borrowers on the worst deals. Oh, and which borrowers are most likely to default? Why, the ones with the riskiest credit and the worst deal. Oops.”
- “This isn’t just an economic mistake, but a moral one, too. Responsible home buyers will be on the hook for the loans of their risky and irresponsible neighbors. It’s like the Massachusetts auto insurance system: The worse you behave, the bigger the subsidy.”
- “Nobody likes to see people evicted, but **53 percent of Americans oppose a federal bailout for overextended homeowners, according to Rasmussen Research.**” [Emphasis added.]
- “When it comes to the mortgage mess, doing the right thing means doing nothing. It means letting dumb borrowers and greedy lenders suffer. It means letting prices fall so a new generation of responsible buyers can afford their first home. It means someone will have to explain the free market system to Frank. Don’t hold your breath.” (*Boston Herald*, Michael Graham, 04/15/08)

A chance for GSE regulatory reform

- In an April 28th editorial, the *Washington Post* wrote, “The cause of reforming government-sponsored enterprises (GSEs) may not be a lost one after all. Last week, a meeting involving Treasury Secretary Henry M. Paulson Jr., Senate Banking Committee leaders and the heads of the GSEs—Fannie Mae and Freddie Mac—ended with all sides pronouncing themselves ready to settle the issue at last. The House

passed a bill to tighten regulation of the mammoth mortgage companies almost a year ago, but the effort stalled in the Senate. Sen. Richard C. Shelby (Ala.), the ranking Republican on the Banking Committee, had well-founded concerns that a new law might be too weak. Now he appears willing to deal.”

- “Since another opportunity to craft a good law may not come around soon, it is essential that Congress get it right this time. If the lawmakers achieve nothing else, they must at least provide solid assurances that the GSEs maintain a sufficient capital base. Under current law, Fannie and Freddie are required to hold a reserve fund equal to 2.5 percent of their assets—only half the ratio required of commercial banks. That thin layer of protection reflects the implicit guarantee of a federal bailout that the GSEs enjoy. (The GSEs have held somewhat more in reserve in recent months due to a temporary agreement with their regulator.) But given the immense size of the GSEs—they currently hold or guarantee \$5 trillion worth of mortgages, about 80 percent of the market—everyone would be better off if they could rely more on their own resources. At the moment, the firms' losses are significant: \$3.6 billion in the fourth quarter of 2007 for Fannie and \$2.5 billion for Freddie. Losses could grow as Fannie and Freddie take on more risk to help prop up the housing market. And if you think the economy looks shaky now, just watch what happens if a GSE goes belly up.”
- “Fannie and Freddie have recently promised to raise more capital in the financial markets, though it remains to be seen how well they'll do, given that selling more stock is not in the short-term interests of current shareholders. And they have long resisted tighter statutory capital requirements because shareholders wanted the companies' spare cash to be spent on dividends. The House bill originally permitted a proposed new GSE regulatory body to adjust capital requirements to reflect not only the safety and soundness of the firms but also the ‘systemic risk’ posed by their activities—i.e., the threat that their collapse might pose to the economy as a whole. In the end, however, that provision was removed. It should be restored by the Senate. With great wealth and power come great responsibility. The GSEs must be more closely supervised, because the national interest comes first.” (*Washington Post*, 04/28/08)
- In an April 28th editorial, *USA Today* wrote, “...Fannie Mae and Freddie Mac, the two publicly traded corporations created by the federal government to promote homeownership, are capturing a rapidly growing share of the housing finance market. In the final three months of last year, Fannie and Freddie were involved in \$450 billion in new home loans, or about 76% of the mortgage business, up from just 37% as recently as two years ago. This year, that figure might top 80%. While it is beneficial that someone is still pouring money into the troubled housing market, this concentration poses great risks to taxpayers that need to be addressed.”
- “Fannie and Freddie have guaranteed \$3.6 trillion in loans and mortgage-backed securities that they have sold to other institutions. They hold an additional \$1.6 trillion themselves, bringing their total exposure to the housing market to \$5.2 trillion.

That, incredibly, is larger than the \$4.5 trillion portion of the national debt that's held by private investors. Should Fannie or Freddie run into trouble, the federal government would have little choice but to bail them out. With the government already sodden in debt, that is a risk to which every American is exposed.”

- “If that is not cause enough for concern, consider this: These two companies are subject to almost no government oversight to ensure they don't engage in reckless behavior. Their one overseer is an obscure, understaffed and hamstrung agency within the Department of Housing and Urban Development that has less control over these financial behemoths than U.S. Treasury has over conventional banks. ...[OFHEO] ...has minimal powers to impose and adjust capital reserve requirements — the cash cushions Fannie and Freddie must set aside to absorb potential loan losses. The agency has little say over their business practices. And, in a crisis, it has no authority to restructure their debts and would have little recourse but to ask Congress to put the full faith and credit of the government behind them.”
- “Efforts to bring tighter controls over these companies have gone nowhere. For years, Fannie and Freddie deployed armies of politically connected lobbyists to deflect them. Accounting scandals at both companies, uncovered in 2004, convinced many of their staunchest defenders that they need tighter oversight.”
- “Sensible legislation is supported by President Bush and has passed the House of Representatives. Yet it has been stuck in the Senate, caught between Fannie's and Freddie's efforts to water it down and objections from some of their harshest critics, who want more dramatic reforms. It is time to end this senseless maneuvering. Congress needs to realize that Fannie's and Freddie's upside of supporting the mortgage market comes with a potential downside that needs to be taken seriously. If they were to falter, the federal rescue of Bear Stearns would look like peanuts.” (*USA Today*, 04/28/08)

OFHEO has “significant supervisory concerns” about Fannie and Freddie and Standard & Poor’s concurs

- In its annual report to Congress, OFHEO said that it has “significant supervisory concerns” about both Fannie Mae and Freddie Mac, which have suffered losses totaling \$5.1 billion in fiscal year 2007 in the meltdown of the housing market and remain vulnerable to further declines. While Fannie and Freddie have made progress in addressing the accounting concerns that were at the center of the companies’ financial scandals, the extraordinary declines in the U.S. housing market have greatly increased the enterprises’ credit and interest rate risk, placing additional pressure on their credit management, interest rate risk management, and financial modeling processes.
- OFHEO noted that Freddie Mac still has some ineffective internal controls, has invested in poorly underwritten loans, and lacks “sufficient management depth.”

Freddie Mac is facing a deterioration in asset quality and resulting increase in credit risk, because of the company's "strategic decision" to buy and guarantee higher-risk loans issued over the past two years [including loans with limited documentation and loans with low downpayments], said OFHEO. The regulator suggested that Freddie create a credit committee and designate a chief credit officer. "Concerted efforts by the Board and management will be necessary to improve financial performance, mitigate credit weaknesses and complete the internal controls remediation effort," said OFHEO. The agency also raised questions about some of Freddie's accounting decisions, including the company's approach to calculating the amount of money it should hold in reserve and other accounting treatments which enabled the GSE to report a one-time gain of approximately \$1 billion. OFHEO director James B. Lockhart, III said that the agency is not challenging Freddie's accounting judgments, but would be monitoring its accounting process going forward "to make sure there's a logical and ongoing methodology." Lockhart added that the Securities and Exchange Commission may look at the accounting issues then Freddie Mac seeks to register with the SEC later this year.

- OFHEO said that while Fannie Mae's controls range from "satisfactory to adequate," many of its controls "remain manually intensive," creating a potential for error. According to the report, Fannie Mae's interest-rate risk program is in the "low range of satisfactory," because its portfolios and related funding that aren't hedged by derivatives represents a high level of risk. While Fannie Mae has made a number of changes to manage its credit risk, OFHEO said losses may "significantly increase" because of market conditions.
- OFHEO also highlighted in the report its concerns over Fannie's and Freddie's management of counterparty risk. "Counterparties, which represent a significant exposure to Fannie Mae, may be unable or unwilling to honor obligations should their financial strength continue to decline," said OFHEO. At Freddie, the regulator said counterparty exposures were "material" and that "significant deterioration in the financial condition of a top counterparty could adversely impact [the company]." OFHEO's report highlighted the concentration of servicing of the GSEs' mortgages in the hands of a small number of servicing companies. According to the regulator, the top 10 servicers processed 74% of Fannie's single-family mortgage book of business and 80% of Freddie's servicing book. "Mortgage insurers also represent significant levels of counterparty risk to [Fannie and Freddie] and are facing financial difficulties," said OFHEO. "Risk from servicers and mortgage and bond insurers increased because of recent market events that have contributed to bankruptcies for some industry players and an overall deterioration of counterparty financial strength."
- Lockhart reiterated his plea for Congress to pass GSE regulatory reform legislation. "...[L]ast month both GSEs agreed that a 'world-class regulatory structure' is needed and they renewed their commitment to work for comprehensive GSE reform legislation," said Lockhart. "The time to act on the legislation is now." (*Financial Times*, Saskia Scholtes, 04/15/08; *Bureau of National Affairs*, Thecla Fabian,

04/16/08; *Wall Street Journal*, Michael R. Crittenden, 04/16/08; *Washington Post*, David S. Hilzenrath, 04/16/08; *HousingWire*, Paul Jackson, 04/15/08)

- Fannie Mae and Freddie Mac ranked in the top 10 of the Fortune 500's biggest losers. Freddie Mac ranked as the fifth biggest loser in the Fortune 500, after reporting a \$3.09 billion loss for FY2007, while Fannie Mae ranked as tenth biggest loser based upon its \$2.05 billion loss for FY2007. (*Fortune*, 04/25/08)

Cost of propping up Fannie and Freddie could exceed 10% of GDP during a deep and prolonged recession

- The possible need for the federal government to provide Fannie Mae and Freddie Mac financial support could pose a risk to the United State's AAA credit rating, said Standard & Poor's. In the event of a deep and prolonged recession, S&P estimates the costs of propping up the GSEs to approximate \$420 billion to \$1.1 trillion of taxpayers' money – roughly 10% of GDP. “The size of GSEs, coupled with their current level of common equity, could create a material fiscal burden to the government that would lead to downward pressure on its rating,” said John B. Chambers, chairman of S&P's sovereign rating committee.
- “The mortgage GSEs face heightened demand to provide mortgage financing, which comes at a time when their need to raise capital and improve earnings has placed them under extreme pressure against the backdrop of historically weak housing markets and seized securitization markets,” said S&P's credit analyst Victoria Wagner. “We expect the mortgage GSEs to raise substantial amounts of equity to meet their capital adequacy needs. We will be looking closely at their forthcoming plans to shore up their common equity base as they attempt to preserve the ‘AA-’ rating and limit the risk they present to the ‘AAA’ rating on the U.S. government.”
- Decisions by Congress and OFHEO to allow the GSEs to buy larger mortgages and to reduce the GSEs' excess capital requirements “reinforces these institutions' key public policy roles and their implicit government support,” said S&P. “The tide has definitely changed [for Fannie and Freddie],” said Wagner in a telephone interview with *Bloomberg News*. “I don't think the message is a bailout is necessary or imminent. But they're facing this increased role at a time that their own credit performance is suffering from the rifts in the housing and mortgage markets. They're both projecting much higher losses than we've seen in some time.” However, the GSEs' increased role in the mortgage market is not without risks for the companies or the U.S. taxpayer, warned S&P.
- S&P's analysis of Fannie Mae and Freddie Mac in setting their ratings suggests “we may as well just give AAA ratings out to any firms that have become too large to fail without regard to their risk of failure,” said Joshua Rosner, managing director at Graham Fisher & Co. “I have to bet that if our sovereign rating became at risk due to the GSEs, bondholders would lose out.” Robert Shiller, a Yale University economist

who has argued for years that a bubble was forming in real estate prices, said, “The real fundamental problem is real estate prices have been falling and they might fall substantially more. OFHEO and Fannie and Freddie never considered the possibility of a massive real estate correction.” (*Associated Press*, 04/14/08; *CNNMoney.com*, Chris Isidore, 04/21/08; *Bloomberg News*, Jody Shenn, 04/14/08; *Financial Times*, Aline van Duyn, 04/15/08; *Standard & Poor’s Press Release*, 04/14/08; *Standard & Poor’s Commentary Report*, Victoria Wagner and Xavier Chavee, 04/14/08)

OFHEO puts Fannie and Freddie on notice about the application of fair value accounting in a sound and consistent manner

- Separately, OFHEO said that some of the accounting methods used by Fannie Mae and Freddie Mac could overstate their financial strength. In some cases, “fair value” accounting could lead to an “inappropriate” adjustment in core capital, which is used to assess the GSEs’ capital adequacy, said OFHEO in a new guidance on FASB 159, governing the election to carry almost any financial instrument at “fair market value.” The GSEs may be required to provide OFHEO information on how they apply the fair value option, which may go beyond FASB’s disclosure requirements. The additional information “may include, but is not limited to, accounting, risk management and valuation policies necessary for regulatory assessment of the [fair value option] implementation.” OFHEO expects Fannie and Freddie to provide it with a “full fair value balance sheet [quarterly] at a minimum, and to continue to provide public disclosure of a full fair value balance sheet quarterly.” According to the guidance, “OFHEO must consider whether financial statement information is suitable for regulatory purposes, and when it is not, must take this into consideration when assessing safety and soundness, including capital adequacy [guidelines]. ...[I]f OFHEO detects patterns of use of the fair value option that impair transparency or distort earnings or capital, OFHEO will evaluate whether such an application of the [rule] is unsafe and unsound.” OFHEO Director James Lockhart said, “It is important that Fannie Mae and Freddie Mac apply fair value in a sound and consistent manner.” OFHEO’s new guidance was issued less than a week after the agency said that it found “certain issues” in Freddie Mac’s implementation of accounting standards which “raised concerns” about its capital levels. (*Washington Post*, David S. Hilzenrath, 04/22/08; *Bureau of National Affairs*, 04/22/08; *Reuters*, Al Yoon, 04/21/08)
- OFHEO choosing to issue guidance on FASB 159 at this time — ahead of each GSE’s first quarter earnings report— raised more than a few eyebrows among industry sources, according to *Housing Wire*. “It reads like a warning,” said one source. “There isn’t anything in the guidance that makes you say wow, this is really new,” said another source. “So the question becomes whether OFHEO has some reason for concern.” (*HousingWire*, Paul Jackson, 04/21/08)

- Former Fannie Mae chairman and CEO Franklin Raines, CFO Timothy J. Howard and controller Leanne Spencer, have agreed to a \$31.4 million settlement with OFHEO over allegations that they improperly manipulated the company’s earnings to maximize their bonuses. Raines has agreed to pay \$24.7 million, including a \$2 million fine to the government, relinquish claims on stock options [ranging from \$69.43 to \$80.95 per share] valued at \$15.6 million at the date of issuance, \$1.8 million in proceeds from the sale of Fannie Mae stock [which will be contributed to charitable programs to help struggling homeowners] and \$5.3 million in “other benefits.” Howard agreed to pay a \$750,000 fine; surrender \$5.2 million in stock options, donate \$200,000 from stock sales to charity, and forfeit other benefits [related to pension and foregone bonuses] totaling \$240,000. According to sources, Raines and Howard are not paying anything out-of-pocket, since all cash payments that they have agreed to pay are covered by insurance, while all but \$25,000 of Spencer’s settlement is covered by insurance. In December 2006, OFHEO sued the three former Fannie officials, seeking damages of \$215 million. The litigation has been a burden for OFHEO, which has spent millions of dollars just responding to vast document requests from the defendants. According to OFHEO director James B. Lockhart’s testimony before Congress, his agency’s enforcement actions against the former management of Fannie and Freddie could eat up as much as 20% of his agency’s budget—or approximately \$13.4 million. The litigation has also been a burden for Fannie Mae, which has been obligated to pay for the company’s former management team’s defense. In a statement, Lockhart said that the agreements reached with Fannie Mae’s former management “represent a satisfactory conclusion to the enforcement actions against these individuals.”
- In a statement, Raines said that the consent order “is consistent with my acceptance of accountability as leader of Fannie Mae and my strong denial of the allegations against me. This settlement is not an acknowledgement of wrongdoing on my part, because I did not break any laws or rules while leading Fannie Mae. At most, this is an agreement to disagree.” Steven Salky, Howard’s attorney, said, “The settlement is a capitulation by OFHEO, reflecting that its concocted claims never had an ounce of merit.” Salky added that Howard remains “justifiably proud” of his 23-year career at Fannie Mae. Spence also maintains that she acted properly while working for Fannie Mae, said her lawyer David Krakoff. Nevertheless, the careers of Raines and Howard were shattered and shareholders, whose stock has swooned 62% from \$75.06 on December 31, 2003 to \$28.55 on April 18th, have paid a huge price. (*Washington Post*, David S. Hilzenrath, 04/19/08; *Bloomberg News*, James Tyson, 04/18/08; *Washington Post*, David S. Hilzenrath, 04/19/08; *Bloomberg News*, James Tyson, 04/18/08; *GSE Report*, 02/19/07; *Wall Street Journal*, James R. Hagerty, 04/19/08; *Wall Street Journal*, James R. Hagerty, 04/21/08)
- In an April 21st editorial, the *Wall Street Journal* wrote, “Standard & Poor’s issued a report last week concluding that Fannie Mae and Freddie Mac are the biggest financial threat to the U.S. government’s AAA credit rating. And on Friday, we

found out once again why this is so: The two ‘government-sponsored’ mortgage giants aren’t held to the same standards of accountability as everyone else in American business. A group of former Fannie executives settled with federal regulators Friday, ending a two-year legal battle over the inflated pay and bonuses they received as a result of fraudulent accounting at the firm. The upshot is that former CEO Franklin Raines will forfeit some underwater stock options, make a donation to charity and pay \$2 million to the government, although that last sum will be covered by Fannie’s officers-and-directors insurance. The lawyer for former CFO Timothy Howard called it a ‘capitulation’ by the government, and it’s hard to disagree.”

- “To be clear, Mr. Raines and the rest have never been charged with any crime, and we aren’t suggesting they should be. Our point is that we rather doubt the government would show similar restraint if Fannie were not a Washington favorite, and in fact it has thrown the book at executives at other scandal-tarred companies. We fear this settlement – which [OFHEO], the regulator, generously values at \$31 million for the three executives involved – is one more sign that Fannie Mae exists in a separate, politically protected universe.”
- “When Fannie went two years without filing financial reports, the New York Stock Exchange passed the ‘Fannie rule’ to avoid having to delist the stock. And now the three top executives during the height of Fannie’s accounting fraud have walked away with only a token acknowledgement of ‘managerial’ responsibility for a \$10 billion scandal. Recall that their huge bonuses depended on reported profits that were later determined to be fanciful. Recall, too, that Mr. Raines, other Fannie executives and their Wall Street retinue derided those of us who wrote critically about their derivatives accounting before it all blew up.”
- “Friday’s paltry settlement shows once again that Fannie and Freddie are dangerous because, as creatures of Congress, they can never be seen to have failed. So their accounting fraud is explained as merely a mistake, and their former executives keep the bulk of their riches. ‘Government-sponsored’ capitalism means never having to say you’re sorry.” (*Wall Street Journal*, 04/21/08)
- The *Washington Post*’s “Reliable Source” also notes: “Big changes for Franklin Raines. The former chief executive finally closed the book on his controversial stint at Fannie Mae ...and is selling his house, getting a divorce and has a new girlfriend. Last week, Raines settled a civil lawsuit with the feds by agreeing to pay \$24.7 million, ending more than three years of legal wrangling over accounting shenanigans at Fannie Mae. Raines admitted no wrongdoing; he now sits on the board of Steve Case’s Revolution Health company. He’s already moved on in his personal life, too. We’ve learned that Raines and his wife of more than 25 years, Wendy Farrow Raines, have been separated for more than a year. Beechwoods, the 1910 colonial they shared with their three daughters in Forest Hills—the site of their huge annual Christmas party—went on the market last month for \$8.25 million. The seven-bedroom, seven-bath property (movie theater, pool and cabana, tennis court) was

assessed at \$3.2 million last year. Raines, 59, is dating Denise Grant, a partner at the executive search firm Russell Reynolds Associates. The 43-year-old lawyer served with Raines as vice president and assistant to the chairman of the Fannie May [sic] Foundation..." Grant's resume at Russell Reynolds Associates states, "Prior to joining Russell Reynolds Associates, Denise was in management at Fannie Mae, where she served in a variety of leadership roles, most recently as Head of Mortgage-Backed Securities Issuance, where she led a cross-divisional team charged with securitizing mortgages and issuing securities." (*Washington Post*, Amy Argetsinger and Roxanne Roberts, 04/22/08; <http://www.russellreynolds.com/bio.asp?cid=&cname=Denise+Grant+>)

President Bush nominates Steve Preston to serve as HUD Secretary

- President George W. Bush has chosen SBA administrator Steven C. Preston to serve as HUD Secretary. If confirmed by the Senate, Preston would replace HUD Secretary Alphonso Jackson, who announced his resignation in March. Until the Senate confirms Preston's appointment, Roy A. Bernardi, the second-in-command at HUD, will serve as acting Secretary of the agency. President Bush said, "The department requires strong leadership at a time when our housing market is experiencing a period of challenge and uncertainty. He called Preston, "a reformer who would act to help Americans obtain affordable mortgages" and urged quick Senate confirmation of his nomination.
- In July 2006, Preston was sworn in as head of the Small Business Administration, after being confirmed unanimously by the Senate. At SBA, Preston was responsible for revamping his agency's Disaster Assistance Program, which was still reeling from the aftermath of the 2005 hurricanes which ravaged the Gulf Coast region. He was also responsible for supporting the nation's small business community with an \$80 billion portfolio of direct and guaranteed business loans, venture capital loans, and disaster loans. Preston, 47, has more than 25 years of financial and operational leadership positions, having served as EVP and CFO of The ServiceMaster Co, SVP and treasurer of First Data Corp., and an investment banker for Lehman Brothers.
- Senate Banking Committee Chairman Chris Dodd (D-CT) holds the key to Preston's confirmation, since his approval is necessary before any votes take place on the panel. Dodd said that Preston's lack of housing experience "raises questions." Over the past year, Dodd has stalled White House nominations by delaying votes on three nominations to the Federal Reserve. Senator John Kerry, who chairs the Small Business Committee, said he was "sorry to see him go" from SBA. "Mr. Preston inherited an agency in disarray, and he's worked hard to right its course," said Kerry. Senator Mel Martinez (R-FL), who served as HUD Secretary during President Bush's first term, said that Preston's lack of housing background wouldn't impair his ability to lead HUD. "It's a management job," said Martinez. "It's not like they are setting a broad agenda. It's about managing the very challenging housing situation we're in today." (*Bureau of National Affairs*, Marcia Kass, 04/21/08; *Washington Post*,

Michael Abranowitz and Carol Leonning, 04/19/08; *Wall Street Journal*, Damian Paletta and Henry J. Pulizzi, 04/21/08; *New York Times*, Rachel L. Swarns and David Stout, 04/19/08)

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac kick-start their jumbo conforming loan programs

- Fannie Mae and Freddie Mac have stepped up their efforts to revive the housing markets in high-cost areas with Freddie guaranteeing 90-day, forward delivery pricing in conforming jumbo loans in 2008 from Wells Fargo, JPMorgan Chase, Citigroup, and Washington Mutual. Bob Ryan, Freddie's vice president of mortgage credit pricing, said that Freddie Mac would finance \$10 billion to \$15 billion in jumbo conforming loans in 2008 and is in talks with other lenders about similar deals. Chairman and CEO Richard Syron said, "[Freddie's move] shows how we can bring new liquidity to markets other investors have all but abandoned and make full use of the new tools Congress gave us to help restore stability during the current housing crisis."
- Since April 1st, Fannie Mae has offered similar purchase programs to "lenders large and small," providing price quotes on jumbo conforming loans at rates approximately 40 basis points higher than conforming mortgages.
- The GSEs' jumbo conforming loan programs have numerous barriers, including steep fees and qualifications which limit their availability. Freddie Mac requires borrowers to have a 720 credit score versus a 680 credit score for conforming loans. The programs do not allow piggyback loans. "A good amount of people out there [have second mortgages]," said Rosemary O'Neil, vice president of Conway Financial, a loan brokerage firm. If customers are in a declining market for real estate values, borrowers will also be required to supply a 15% downpayment versus a 10% for a conforming loan. Also, the new loans require a lower debt-to-income ratio [45%], relative to conforming loans' requirement [51%]. "The politicians and big banks put out some sizzle," said David Gravelle, a mortgage broker with Family Choice Mortgage Corp. "Then they start backfiring with all the details." (*Boston Globe*, Kimberly Blanton, 04/18/08; *American Banker*, Kate Berry, 04/18/08; *Associated Press*, 04/17/08; *Bloomberg News*, Jody Shenn, 04/18/08)

Fannie Mae and Freddie Mac slow to ramp up their purchases of mortgage loans

- In March, Fannie Mae's mortgage portfolio rose at an annualized rate of only 2% to \$722.7 billion, according to the company's Monthly Volume Summary. The company also entered into agreements to purchase an additional \$8.98 billion in

assets in April. In contrast, Freddie Mac's portfolio increased at an annualized rate of 5% to \$712.4 billion in March.

- In February (the latest data available), Fannie Mae's conventional single-family serious delinquency ratio rose 4 basis points to 1.10%, which included 0.60% for non-credit enhanced mortgages, 3.04% of credit enhanced mortgages. At March 31, 2008, Fannie's effective duration GAP was positive three months.
- Freddie Mac's single-family mortgages, 90 days or more delinquent was 0.74% of all loans on February 28th, comprised of 0.52% of non-credit enhanced mortgages and 1.78% of credit enhanced loans. At March 31st, Freddie Mac's duration GAP was positive one month. (*Bloomberg News*, Dawn Kopecki, 04/25/08; *Fannie Mae's Monthly Volume Summary*, March 2008; *Freddie Mac's Monthly Volume Summary*, March 2008)

<p>The creation of an affirmative statutory duty on loss mitigation activities for the entire mortgage market will be costly and add complexity to the process</p>

- Fannie Mae and Freddie Mac officials testified at the House Subcommittee on Housing and Community Opportunity's hearing on "The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008," which proposes mandates forbidding servicers from foreclosing on a property without first making a concerted effort to help borrowers stay in their homes. Ingrid Beckles, vice president of servicing and asset management at Freddie Mac, told lawmakers that the GSEs are already encouraging servicers to pursue home retention options and that a new federal requirement is not needed. "We do not believe that it is necessary to create an affirmative statutory duty that imposes particular loss mitigation activities on the entire mortgage market," said Beckles. "Such a measure would add unneeded costs and complexity to delinquency management."
- Jason Allnut, vice president for credit loss management at Fannie Mae, told the panel how his company has forged close relationships with servicers and established a framework which encourages servicing partners to pursue all possible home retention initiatives. Allnut stressed that allowing flexibility is critical to foreclosure prevention. "For our purposes, we do not require a standard software solution for workout," Allnut said. "Rather, Fannie Mae leverages a combination of monthly servicer score cards and on-the-ground presence to ensure foreclosure prevention performance and compliance." He warned lawmakers, "Creating a legislative standard for loss mitigation activities prior to foreclosure may actually have the unwanted side effect of making solid loss mitigation activities, negotiated between the borrower and servicer less flexible. It would create an added cost on an already expensive process, and, ultimately, we believe make home mortgages more expensive." (*DSNews.com*, Kerri Panchuk, 04/16/08; *Testimony of Jason Allnut*, 04/16/08)

Senators Landrieu and Vitter question the GSEs' higher credit score requirements

- In letters to Fannie Mae and Freddie Mac, Senators Mary Landrieu (D-LA) and David Vitter (R-LA) told the GSEs that their plans to raise credit score requirements for borrowers could have a chilling effect on Louisiana's housing market. The Senators wrote, "It is our understanding that both Fannie Mae and Freddie Mac plan on charging higher fees for home purchasers with credit scores less than 740 points. From our understanding, this could be potentially harmful to Louisiana where the average credit score totals approximately 663 points. Louisiana has not experienced the same levels of foreclosures and subprime loans as other areas of the country." They added, "Since the 2005 hurricanes, the residents of Louisiana have encountered numerous obstacles in rebuilding the most damaged communities — whether it is the high cost of insurance or the scarcity of labor. By raising credit score requirements, it could become more difficult for some of these communities to rebuild. At the same time, the changing of credit score requirements could make it more difficult for thousands of middle- and low-income residents throughout Louisiana to purchase or sell a home, thereby exacerbating the current problems in the real estate markets." (*New Orleans City Business*, Deon Roberts, 04/18/08)

GSEs' higher pricing structure is "tantamount to both ethnic and gender discrimination"

- In an April 22nd letter to Fannie Mae and Freddie Mac, 84 fair housing and minority interest activists said that the GSEs' tougher lending standards were discriminatory to women and minorities. The groups asked Fannie and Freddie to change their new pricing structures, calling them "tantamount to both ethnic and gender discrimination." The GSEs' new policies included higher downpayment requirements, mortgage fees for borrowers with low credit scores or living in certain zip codes where housing prices have fallen. The groups' biggest objection is how Fannie Mae identifies declining market by zip code rather than by metropolitan areas, as defined by Freddie Mac. The advocates argue that these new policies are tantamount to redlining. Senate Banking Committee chairman Christopher Dodd (D-CT) said the GSEs' new policies violate the public mission of Fannie and Freddie, which includes expanding homeownership and supporting affordable housing. Fannie Mae spokesman Brian Faith said, "We have met extensively with advocates, listened to their concerns, and are considering making changes to our policies." (*Bloomberg News*, Dawn Kopecki, 04/23/08)
- [Editor's Note: A *Bloomberg News* article incorrectly attributed the activists' letter to the Consumer Mortgage Coalition; CMC was not involved with the development of the letter, nor was it a signatory on the letter.]

Fannie Mae and Freddie Mac receive regulatory relief
from certain affordable housing quotas for 2007

- Fannie Mae and Freddie Mac will not be penalized for failing to meet certain affordable housing goals in 2007 because of the upheaval in the housing and mortgage markets, said HUD. Last year, both companies fell short of two affordable housing goals, which they argued were unrealistic for them to meet given market conditions. HUD's decision not to penalize the GSEs also means that Fannie and Freddie will not be required to submit plans for coming into compliance with the quotas that they missed. (*Washington Post*, David S. Hilzenrath, 04/25/08)

Fannie Mae wins two-year battle with IRS over losses in the company's loan portfolio

- On April 22nd, the IRS withdrew proposed regulations, asserting that mortgage loans are capital assets and any losses from them could only be used to offset capital gains. Fannie Mae had taken the lead in opposing the IRS rule, arguing that the proposed regulations were "not sound tax policy." The action clears the way for Fannie Mae, Freddie Mac, and other buyers of defaulted loans to benefit from pending tax legislation, which would allow companies to use losses realized this year to get a tax refund for taxes paid over the past four years. "That's a great victory for Fannie Mae," said Robert Willens, president Robert Willens LLC, a tax-consulting firm in New York. "The losses of Fannie Mae and the others would have been virtually useless, almost impossible to use. That, in turn, would have caused them to have to take write-offs." Willens added, "All the other federal agencies are bending over backwards to help the mortgage market and the participants, both originators and those who took on the mortgages. The IRS was the outlier, taking a contrary position. I'm assuming someone got to them and said 'Let's get in tune with the rest of the program.'" "
- Steven M. Rosenthal, a partner at law firm Ropes & Gray, LLP, said, "The [IRS's] proposed regulations put a looming cloud over the credit market, and I think the situation has been vastly improved now that they've been withdrawn." (*Bloomberg News*, Ryan J. Donmoyer, 04/22/08; *Dow Jones Newswires*, Arden Dale, 04/24/08)

The GSEs' appraisal standards agreement with NY AG Cuomo draws criticism

- The settlement that Fannie Mae and Freddie Mac reached with New York Attorney General Andrew Cuomo regarding the establishment of appraisal standards is drawing criticism from an array of professionals in the banking industry. Comptroller of the Currency John Dugan said that the deal struck by the parties in March will not eliminate flawed appraisals and might unduly burden mortgage companies. Under the agreement, Fannie and Freddie would be prohibited from buying mortgage loans, where the appraisal of the collateral property was performed by an in-house appraiser.

“It is not clear that the appraisal function should be outside the institution,” Dugan said, during a question and answer session at an Exchequer Club luncheon. “I don’t think you can address all the issues with a blanket prohibition like that.” He added that in-house appraisers can bring a level of quality control that might not exist with an outside, third-party entity. The OCC plans to issue a statement soon about its stance on the new appraisal standards, Dugan added. (*Reuters*, Patrick Rucker and Karey Wutkowski, 04/16/08)

- CMPS Institute, a trade organization representing certified mortgage planning specialists, said that the appraisal standards that Fannie Mae and Freddie Mac agreed to would be “harmful and impractical.” Gibran Nicholas, chairman of CMPS, said that the standards would increase consumer costs, frustrate customers, and “unnecessarily drag out the appraisal process.” It also appears that homeowners would be prohibited from giving “old appraisals, helpful data, or any other estimate of what a home is anticipated to be worth [to mortgage professionals],” while lenders and brokers would be prohibited from sharing such data from new appraisers, said Nicholas. Another phrase in the agreement “seems to prohibit all forms of” communication between brokers, lenders and appraisers. In general, the appraisal standards use “vague, ambiguous and subjective” language that could cause confusion and result in “daunting compliance costs.” (*American Banker*, Kate Berry, 04/25/08)
- The Title/Appraisal Vendor Management Association said that the appraisal standards “are overly broad and go farther than is necessary to accomplish the [Home Valuation Code of Conduct’s] objectives.” TAVMA added, “In fact, the current scope of the Code may actually hinder rather than promote the very goals the parties seek to achieve.” The interpretation of the current code, as written, may result in a sharp reduction in the availability of appraisers and competition within the industry; increase costs to consumers without improving the quality of appraisals; hinder appraisal independence; and ultimately jeopardize the safety and soundness of Fannie Mae and Freddie Mac. (*Correspondence to Freddie Mac*, Jeff Schurman, 04/22/08)

State AGs conclude that foreclosure prevention initiative are falling short of need

- A group of state attorneys general and banking regulators have concluded that the efforts of recent government- and industry-sponsored initiatives to address the subprime mortgage crisis have had little impact in staving off foreclosures. In a February 2008 report titled “Analysis of Subprime Mortgage Servicing Performance,” the State Foreclosure Prevention Group examined the performance of 13 of the 20 largest subprime servicers from October 2007 through January 2008. SFPG concluded that the loss mitigation programs “have not translated into meaningful improvement in foreclosure prevention outcomes.” The group wrote, “As of the end of January, these efforts have not yet made a major difference in preventing unnecessary foreclosures. The vast majority of homeowners with seriously

delinquent loans [70%] are not on track for a loan work-out of any type.” (*Bureau of National Affairs*, Michael Bologna, 04/23/08)

- According to sources, Treasury Secretary Henry Paulson met with top lenders and servicers to warn them that the housing market is continuing to deteriorate and to press them for a new solution. During the 90-minute meeting, Paulson urged lenders to come up with a new plan to work with underwater borrowers, including those that walk away from their homes. “There clearly is a recognition that people walking away from their homes is a problem,” said a participant at the meeting. “There’s a recognition that the markets are very challenging now and we need to think about different alternatives.” A second attendee said, “There was a clear recognition that borrowers’ psychology affects the success of various modification approaches. One of the goals of the meeting was to talk about how to craft modification solutions that would be viewed as acceptable to borrowers.”
- Although Congress is working on a plan to help these borrowers, the legislative process was too slow and unpredictable, Paulson said. He also expressed frustration with the aggregate data on loan modifications, saying it was difficult to determine which lenders were successful in making modifications. He plans to meet with each lender separately to review each company’s results. The group discussed the report issued by the State Foreclosure Prevention Working Group, which concluded that 70% of seriously delinquent borrowers are still not on track for any loss-mitigation plan. “[The SFPWG report] was definitely the straw on the camel’s back,” said a source familiar with the meeting. “It was all a part of an effort to get a handle on what’s going on. It’s another piece of information in an uncertain economy.” Attendees included Paulson, Treasury undersecretary of domestic finance Robert Steel, and executives of Washington Mutual, Citigroup, Bank of America, JPMorgan Chase, Wells Fargo, Ocwen Financial, IndyMac Bancorp, and Residential Capital, LLC. (*American Banker*, Cheyenne Hopkins, 04/25/08)

Subprime and beyond

- The Organization for Economic Development and Cooperation estimates that first round losses—not write-downs—could reach \$422 billion, including \$90 billion incurred by U.S. banks. “If losses reach this level, the recapitalization of banks would be essential to avoid the harsher economic impacts of deleveraging, including a pronounced drop-off in credit extension,” said OECD. “It could take six to 12 months for banks to grow themselves out of losses of this size, and longer if capital for actual expansion were required. Limited credit availability over such a period would have severe economic consequences.” The committee, comprised of officials from OECD central banks, finance ministries, and other financial authorities, said that the subprime crisis calls for a fundamental reform of the global financial system. (*Bureau of National Affairs*, 04/16/08)

- The implosion of the subprime mortgage market will ultimately lead to greater regulatory powers for central banks, which will focus intensely on controlling risks that were at the core of the crisis, said JPMorgan analysts Jan Loeys and Margaret Cannella. The analysts wrote, “This was a run on the securitized world. The bank regulation and the structure of the supervisory system was created for a banking world of taking deposits and making loans. That world has moved towards capital markets, which were regulated from the point of view of consumer protection, but not from a systemic stability point of view. Banks did not have the tools to try to protect the capital market from its own excesses.” As a result, central banks will be forced to take on more power as they are the entities extending support to the markets. “Central banks’ extension of liquidity to broker-dealers and (the) securitized world is permanent, and will be followed by regulatory control,” the analysts concluded. (*Reuters*, 04/14/08)
- Housing price declines spread to 38 states in February, according to First American CoreLogic (FAC). “Thirty-three states now show year-over-year real estate declines according to this latest LoanPerformance HPI release,” said Mark Fleming, chief economist for FAC. “However, on a quarter-over-quarter basis, there are now thirty-eight states with decreasing property values.” The areas reporting the largest three month price declines included Cleveland, OH, Los Angeles, CA, Oakland, CA, Riverside, CA, and Tampa, FL. “Regionally, it is notable that the three month declines in New York-White Plains, Philadelphia, Seattle, Detroit and Portland are steeper than the twelve month declines in these areas, whereas in California and Florida this pattern is reversed,” said Fleming. (*HousingWire*, Paul Jackson, 04/23/08)
- OFHEO reported that U.S. home prices rose an estimated 0.6% in February, following a 1% decline in January. OFHEO attributed some of the price appreciation to significant shifts in certain areas of the country. “In February, the share of reported sales volumes rose in states with stronger housing markets, which significantly increased estimated appreciation above what it would have been in the absence of such effects,” said OFHEO. “Holding the weights for each state constant, the national increase would have been only 0.3 percent in February.” Regionally, only the Mountain and South Atlantic regions showed price declines according to the agency’ index. (*Dow Jones Newswires*, Michael Crittenden, 04/22/08; *OFHEO Press Release*, 04/22/08)
- A Credit Suisse research report concludes that falling home prices and lack of available mortgage credit may result in 6.5 million loans going into foreclosure by the end of 2012, forcing 12.7% of all residential borrowers out of their homes. The analysts expect home prices to fall by 10% in 2008 and 5% in 2009 before rebounding. (*Reuters*, 04/22/08)
- During the first quarter, lenders repossessed 210,280 home, up 71% from year-ago volume. Lenders filed 515,411 notices of default during the quarter, up 95% from last year. (*HousingWire*, Paul Jackson, 04/14/08)

- California has been particularly hard hit by the subprime crisis. During the first quarter of 2008, foreclosures surged 327% from year-ago levels in California. According to DataQuick, foreclosures in California totaled 47,171 during the first quarter—or 517 foreclosures every day during the three month period. California homeowners received 113,676 default notices in the first quarter. California’s unemployment rate rose by 50 basis points in March to 6.2%, as the weakening economy shed jobs in the construction and banking sectors. California’s unemployment rate is the third highest in the country, trailing Michigan (7.2%) and Alaska (6.7%). The uptick in unemployment is more bad news for the state and local governments’ budgets. California projects a \$14 billion deficit for the fiscal year beginning July 1st—up 75% from a projected \$8 billion deficit just two months ago. (*Los Angeles Times*, Marc Lifsher, 04/18/08; *LA Times L.A. Land* [blog], Peter Viles, 04/22/08; *SFGate.com*, Matthew Yi, 04/20/08)
- In March, serious delinquencies rose more than 8% for 2005 and 2006 vintage home equity lines of credit, reported Standard & Poor’s. In March, serious delinquencies rose 10% for 2006 Alt-A mortgage and rose 12.2% for 2007 Alt-A mortgages. According to S&P, delinquencies of prime jumbo loans originated in 2006 rose 15.4% in March, while 2007 vintage jumbos rose 15.5%. Serious delinquencies of jumbos rose even higher—to 22.6% for 2006 vintage and 18.8% for 2007 vintage. (*HousingWire*, Paul Jackson, 04/21/08)
- The turmoil in the mortgage market appears to be making waves in the auto loan industry. Delinquencies on indirect auto loans, made through third parties, reached more than 3% during the fourth quarter of 2007, the highest rate in 17 years. Edmund.com estimates that approximately 1.6 million autos will be repossessed in 2008, approximately a 10% increase over last year. The phenomena of the “upside-down” loan is weaving its way through the auto sector with up to 30% of car shoppers having negative equity in their current auto. To make a sale, auto lenders are extending loan terms to seven or eight years in order to keep monthly payments “affordable” for car buyers. (*BankNet360.com*, Marcie Belles, 04/14/08; *Washington Post*, Ylan Q. Mui, 04/20/08)
- The annual report for American General Finance Corporation (AGFC), an American International Group subsidiary that originates and services first and second mortgages and loans for automobiles and other consumer goods, also illustrates the deterioration of consumer credit across all loan portfolios. On December 31st, AGFC reported an average delinquency ratio of 2.89%, comprised of 2.70% on real estate loans (up from 1.79% at year-end 2006), 4.12% of non-real estate loans (up from 3.70%); and 2.21% of retail sales finance loans (up from 1.76%). During FY2007, the company’s aggregate delinquency ratio increased 38% from FY2006. AGFC’s charge-offs for FY2007 totaled 20 basis points, a 41 basis points swing from its 21 basis point recovery of charge offs in FY2006. (*Form 10K for the fiscal year ended December 31, 2007*, American General Finance Corporation)

- During calendar year 2007, bankruptcy filings increased 38% to 850,912, according to the Administrative Office of the U.S. Courts. In 2007, the number of non-business filings totaled 822,590, up 38% from 2006, while the number of business filings totaled 228,322 in 2007, up 44%. (*Bureau of National Affairs*, Diane Davis, 04/16/08)
- First quarter earnings plummeted at a number of commercial banks and investment banks, including Bank of America (77% decline in earnings due to \$3 billion provision for bad loans); Wachovia (\$350 million loss, after a \$2.1 billion provision for loan losses), Citigroup (\$5.1 billion loss, resulting from a \$13.9 billion write-down of loans), and Merrill Lynch (\$1.96 billion loss, after writing down \$6.6 billion of mortgages and other risky assets). However, Wells Fargo & Co., which is poised to unseat Countrywide Home Loans as the nation's largest residential lender, reported a \$2 billion profit for the first quarter on record revenue of \$10.6 billion. (*Washington Post*, Tomoeh Murakami Tse, 04/22/08; *HousingWire*, Paul Jackson, 04/18/08; *Wachovia Press Release*, 04/14/08; *American Banker*, Allison Bisbey Colter, 04/24/08; *National Mortgage News Daily Report*, 04/16/08)
- Ambac stunned Wall Street investors by reporting a first quarter loss of \$1.66 billion—nearly eight times worse than analysts had projected. During the first quarter, Ambac set aside \$1 billion to cover future payouts for mortgage bonds. According to a Goldman Sachs report, Ambac and MBIA each face about \$12 billion in total losses on mortgage-backed securities and each company will need to raise about \$3.4 billion in capital to preserve their AAA insurers rating. Goldman's projected capital requirement for Ambac is more than twice the amount of capital raised by the company in March (\$1.5 billion). Thus far, MBIA has raised \$2.6 billion in additional capital. (*Wall Street Journal*, Ed Welsch, 04/24/08; *Reuters*, 04/24/08)
- On April 22nd, SEC chairman Christopher Cox told a Senate panel that his agency will propose “in the near future” rules to advance accountability, transparency, and competition in the credit rating industry. Cox said that 40 SEC staff members are conducting reviews at the seven largest credit rating agencies to determine which of the agencies diverged from their usual procedures to publish higher ratings for complex products tied to mortgage-backed securities. The staff's findings will be released by early summer, said Cox. The Securities Industry and Financial Markets Association has formed an industry-wide, investor-led task force to examine the issues surrounding the credit rating system. The SIFMA task force “will take an integrated approach to exploring the credit rating system, including key issues such as the current use and quality of ratings, the issuer-pays model, and rating agency independence,” said SIFMA president and CEO Tim Ryan. (*Bureau of National Affairs*, Malini Manickavasagam, 04/23/08; *Financial Times*, Joanna Chung and Aline van Duyn, 04/25/08; *Bureau of National Affairs*, 04/23/08)

Unintended consequences...

- In an April 24th editorial, the *Wall Street Journal* wrote, “Guess who’s asking Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke for a bailout now? Hint: They are members of an exclusive club who bet wrong on the credit markets last fall. No, it’s not a cabal of Wall Streeters, but Democrats in Congress.”
- “We’re referring to the ‘student loan crisis’ now appearing in a media outlet near you. In September, Congress vowed to make education more affordable by passing the ‘College Cost Reduction and Access Act.’ The law reduced the interest rates borrowers pay on federally insured student loans. Backed by the Federal Family Education Loan Program, these loans account for more than 70% of education lending. Taxpayers will fork over \$7 billion by 2012 to pay for the rate cuts.”
- “But Congress didn’t stop there. Convinced that the private lenders who make these loans were reaping too much profit, Congress also cut the yield on each loan. The return on the popular Stafford loan for undergrads was reduced by 70 basis points. For loan consolidations, Congress cut returns by 65 basis points. In a vibrant market, banks might have absorbed these hits and continued to lend. But the combination of legislative fiat and fewer investors willing to buy asset-backed securities amid the credit crunch has put the squeeze on lenders.”
- “What’s now clear is that Congress didn’t merely wring the profits out of student lending. It’s blown up the entire student loan market. Market leader Sallie Mae says it now loses money on every new federal education loan. Sallie continues to lend in hopes of a change in D.C., or increased investor demand for securitized loans.”
- “Others can’t wait. A third of the nation’s top 100 lenders to students in 2007 have temporarily suspended new loan originations or exited the business altogether. Citibank subsidiary Student Loan Corporation cited ‘unprecedented federal legislation’ in announcing its recent withdrawal from much of the market.”
- “Usually, the law of unintended consequences takes so long to reveal itself that no one remembers the culprits. But the speed at which Congress’s student lending changes have gone south is raising political danger for Democrats, if Republicans had the wit to point it out. (They don’t; that’s why they’re Republicans.)”
- “Democrats would thus like to clean up the mess they created before May, when a flood of college-bound seniors will seek loans. But the pols can hardly repeal their autumn blunder mere moments after taking credit for it. No doubt many of them are still sending out taxpayer-financed mail bragging of their ‘achievement.’”
- “The result is that the same man who authored last year’s bill to cut lenders’ returns has crafted a new bill to subsidize those same lenders. Last week the House passed

Education and Labor Chairman George Miller's latest foray into collegiate finance. The bill gives the Department of Education new authority to purchase loans directly from lenders."

- "To summarize: Congress mandated a return on student loans that is too low to attract private capital in the current market. So Congress will now use your money to create artificial investor demand. Taxpayers will bear more risk so that Congress can fashion a new business model to replace the one it just destroyed. The Bush Administration, unwisely but typically, has endorsed this approach."
- "Oh, there's more. Mr. Miller's allies in the Senate understand that legislation moves more slowly on their side of the Capitol. There may be too little time before the angry phone calls from parents target the 202 area code. So the same Senators who gave us the autumn accident have begun a letter-writing campaign to request that bailout we mentioned earlier."
- "Daniel Akaka, Bob Casey, Tom Carper, Chris Dodd, Tim Johnson, Bob Menendez and Jon Tester are desperately seeking a bureaucrat with a large checkbook to rescue them from their self-made political disaster. Last Thursday they wrote Mr. Bernanke asking him to accept student loans as collateral under the Fed's new Term Securities Lending Facility. They sent a similar letter to Treasury Secretary Paulson asking him to order the Federal Financing Bank to buy student-loan-backed securities."
- "So having raised solemn alarms when the Fed began to accept dodgy mortgage-backed securities as collateral, the Senators are now demanding that the Fed accept dodgy student-loan paper too. The Senators helpfully note in their letter that a virtue of their proposals is that they can be implemented quickly. Indeed, November is just around the corner."
- "Needless to say, none of this legislative history is appearing in the multiple media sob stories about students who can't get loans. But like airline passengers stranded this month due to panicky inspections, the current student loan "crisis" didn't have to happen. It is entirely a product of Congress." [How much will it cost the taxpayers after Congress "reforms" FHA?] (*Wall Street Journal*, 04/24/08)

Fannie Mae

Fannie Mae announces second quarter dividends

- On April 18th, Fannie Mae's board of directors declared a second quarter dividend of \$0.35 per share on the company's common stock, to holders of record on April 30th, payable May 26th. The board also approved dividend payments on preferred stock in accordance with the terms of the issues, payable on June 30th to holders of record on June 16th. (*Fannie Mae News Release*, 04/18/08)

Fannie to announce its first quarter results on May 6th

- On the morning of May 6th, Fannie Mae will file its first quarter 10Q with the SEC and will host a conference call with investors at 10:30 a.m. to discuss the company's financial results. (*Fannie Mae Press Release*, 04/23/08)

Fannie Mae's HomeStay results

- Fannie Mae has helped 110,000 at-risk homeowners by refinancing 68,000 subprime loans [totaling \$13 billion] and working-out 43,000 delinquent loans, through loan repayment plans, modifications, deferrals and other loss mitigation actions. Fannie has also provided almost \$10 million in grants and hundreds of employee volunteer hours, since the housing crisis deepened in mid-2007. (*Courier News* [Bridgewater, NJ], 04/21/08)
- Fannie Mae announced changes to its underwriting guidelines which go into effect at month-end, which will create disincentives for borrowers to walkaway from their properties. In the future, borrowers with a foreclosure in their past will have steeper requirements to qualify for a new mortgage—including a higher minimum downpayment and FICO score—if Fannie Mae purchases their mortgage. “We want people who can pay [their mortgage] to continue to meet their obligation,” said Marianne Sullivan, Fannie Mae's SVP of single-family credit policy and risk management. “If they can pay and don't, there should be repercussions. The next time around they shouldn't get the same treatment as others who pay their obligations.” Fannie will consider circumstances in which a personal hardship has occurred. The company is also considering tighter requirements for borrowers who want to buy a new home and convert their existing one to a rental property, said Sullivan. In some markets, borrowers are electing to walk away from their old home, once they've closed their mortgage on their new home. (*American Banker*, Kate

Berry , 04/22/08)

Fannie Mae's investment in Gulf Coast region tops \$40 billion

- Fannie Mae said that it has invested \$40 billion in mortgage loans in the Gulf Coast region with \$1 billion dedicated to Orleans Parish [which encompasses the city of New Orleans]. On April 16th, Fannie Mae announced plans to invest an additional \$48.8 million in New Orleans' affordable housing, including rental units and condos. (*Associated Press*, Becky Bohrer, 04/16/08)

Fannie Mae alumni news

- The *Washington Post* reported that Pilar O'Leary, who headed the Smithsonian Latino Center, resigned from her post in February, following an internal investigation which found she violated 14 ethical and conflict of interest policies. Specifically, the investigation concluded that O'Leary abused her expense account by charging "extravagant" and "lavish travel expenses" and using her expense account for personal purchases, including outings to a spa and purchase from hotel gift shops. The report also concluded that she tried to steer a contract to a friend and solicited free tickets for fashion shows, concerts and music award ceremonies. O'Leary, 39, was paid \$200,000 a year by the Smithsonian in 2005 and 2006. She was hired in 2005 by then-Secretary Lawrence M. Small, who formerly served as president and COO of Fannie Mae. Before joining the Smithsonian, O'Leary served as director of operating initiatives at Fannie Mae and coordinator of the company's American Dream Team Internship Program. (*Washington Post*, James V. Grimaldi and Jacqueline Trescott, 04/15/08; *Fannie Mae Press Release*, 05/31/05)

Freddie Mac

Shaun O'Malley, Freddie's lead director, to retire in June

- Shaun O'Malley, Freddie Mac's lead director, plans to retire after the company's annual shareholder meeting in June. O'Malley, 72, has served on Freddie's board for nearly seven years and as its lead director for more than four years. The board of directors will select a new lead director after Freddie Mac's annual meeting of shareholders on June 6.
- Freddie Mac has nominated Jerome P. Kenney, 66, to serve on the company's board of directors. In 2008, Kenney retired as vice-chairman of Merrill Lynch & Co, where he served on the bank's executive management committee for more than 20 years and was chief executive of the Merrill Lynch Capital Markets Group Worldwide. (*Associated Press*, 04/25/08; *Freddie Mac Press Release*, 04/25/08)

Freddie Mac to announce its first quarter results on May 14th

- Freddie Mac will release its first quarter results on Wednesday, May 14th before the NYSE market opens. At 10:00 a.m., the company will hold a conference call to discuss its financial results. (*Freddie Mac Press Release*, 04/15/08)

Freddie Mac requires loan servicers to diversify their foreclosure and bankruptcy referrals

- Effective June 1st, Freddie Mac will be requiring loan servicers to retain at least two law firms or trustees for foreclosure referrals in states with high rates of foreclosure, marking the first time that a GSE has exerted direct influence over servicing practices. The two-firm or two-trustee policy will protect Freddie Mac and the loan servicer by making sure a backup is available if the servicer's primary law firm or trustee is unable or unavailable to offer assistance on loans in foreclosure or bankrupt borrowers, said Freddie. "Therefore, effective June 1, 2008, we will require that Servicers retain more than one law firm or trustee in any State in which they have 250 or more Freddie Mac foreclosure and bankruptcy referrals in a calendar year," said Freddie Mac.
- The GSE is also requiring servicers to craft contingency plans on how they will direct referrals to backup legal counsel and trustees and directing servicers to ask questions about the reputation and exposure that law firms and trustees may have in connection with housing-related issues. Specifically, Freddie Mac had directed servicers to ask "whether the [law] firm or its attorneys, principals or managers are, or have been, subject to disciplinary action, court-imposed sanctions, or other legal action related to

single-family loan level foreclosure, bankruptcy, eviction, or property closing activities.” (*Bureau of National Affairs*, R. Christian Bruce, 04/18/08)

ICBA and Freddie Mac renew and enhance their Alliance Agreement

- The Independent Community Bankers of America and Freddie Mac announced the extension of their five-year old alliance agreement, which gives ICBA member superior access to the secondary market through Freddie. The alliance also provides ICBA members with incentives, technology, training sources, and competitive mortgage products to assist in sales of mortgages to Freddie Mac. (*PRNewswire*, 04/22/08)

Freddie Mac awards \$10.5 million in grants for foreclosure prevention

- Freddie Mac has awarded \$10.5 million in grants to 16 housing counseling organizations for use in outreach, education and foreclosure prevention efforts for distressed borrowers. Freddie awarded \$6.4 million to the HOPE NOW Alliance, followed by the Center for Responsible Lending (\$1 million), the Neighborhood Assistance Corporation of America (\$500,000), and Don't Borrow Trouble (\$500,000). “It's worth noting that the \$10.5 million in [Freddie's] funding disbursements is the result of a November settlement agreement reached between OFHEO and [former] Freddie Mac CEO Leland Brendsel.” (*HousingWire*, Paul Jackson, 04/18/08; *Freddie Mac Press Release*, 04/18/08)

Federal Home Loan Banks

FHLB-Chicago discontinues purchase of mortgages in its Mortgage Partnership Finance Program

- On April 23rd, the FHLB-Chicago announced it will no longer purchase loans under the Mortgage Partnership Finance program, effectively ending its 11-year old program designed to foster secondary-market competition. To facilitate an orderly transition in the program, current MPF participants will be able to fund their loans through July 31st. The Bank also announced that it will continue to support the loans that it has already purchased from its members through the MPF program.
- “While the credit quality of the MPF portfolio is unparalleled, the absence of a current alternative to funding MPF purchases on the FHLBC balance sheet has resulted in a disproportionate concentration of these loans,” said Matthew Feldman, the bank’s acting president, in an April 23rd letter to member banks. “The hedging and funding costs for these loans, and the need to capitalize our loan portfolio while reducing voluntary stock, have had a significant adverse effect on our income, which ultimately disadvantages our members.”
- Following the Chicago Bank’s announcement, the FHLB-Des Moines said that it will continue to offer its member the Mortgage Partnership Finance program. (*FHLB-Des Moines Press Release*, 04/24/08)

The FHLB-Dallas ratings unaffected by termination of merger, says S&P

- Standard & Poor’s said that its ratings for the FHLB-Dallas remain unchanged [from AAA] after the Bank’s merger negotiations were terminated with the FHLB-Chicago. S&P’s announcement came a week after the rating agency threatened to cut the FHLB-Chicago’s rating to AA+ amid concerns about the Bank’s direction and interest rate risk management. (*Market News Publishing*, 04/14/08; *American Banker*, 04/15/08)
- Separately, Standard & Poor’s placed on negative watch the short-term ratings of \$375 million of bonds sold by the Illinois Housing Development Authority and the Wisconsin Housing and Economic Development Authority because they carry liquidity support from the FHLB-Chicago. (*Bond Buyer*, Yvette Shields, 04/15/08)

Credit crisis in mortgage market “affirms” the integral role of the FHLB System
in the nation’s financial system

- In the 2007 Annual Report’s letter to members of the FHLB-San Francisco, chairman Timothy R. Chrisman, vice chair James P. Giralдин and president and CEO Dean Schultz wrote, “...[R]ecent events [in the mortgage market] have resoundingly affirmed the value of the FHLBanks. As private funding sources abandoned the housing finance market in the summer of 2007, the FHLBanks stepped in and helped the nation avoid a massive liquidity failure. The argument that the United States would be better off without any government-sponsored enterprises is completely undermined by these events, which demonstrate the viability and effectiveness of FHLBanks. Not only have the FHLBanks fulfilled their traditional role as a source of stable, low-cost funds for housing lenders in all phases of the housing cycle, but it is also even more evident that they are an integral part of our nation’s financial system and a major provider of liquidity in times of stress.” (*FHLB-San Francisco 2007 Annual Report*, (04/21/08))

Unrestrained growth of FHLB advances raises moral hazard risks

- In a study published in the May issue of *Journal of Banking and Finance*, Dusan Stojanovica, Mark D. Vaughn and Timothy J. Yeager wrote, “...In the last several years, commercial banks have relied on FHLBank advances to help plug the gap between loan growth and core deposit growth. The increasing reliance is a potential safety and soundness concern because access to advances can undermine market discipline, and the Federal Deposit Insurance Corporation cannot raise premiums sufficiently to deter risk-taking. ...[T]he worrisome incentives embedded in FHLBank advances should give policymakers pause. We put forth two options for consideration. First, because the moral hazard incentives embedded in advances are similar to the incentives embedded in insured brokered deposits, legislators and regulators may wish to impose usage restrictions on advances similar to those on brokered deposits. That is, as bank risk increases and capital ratios decline, access to advances is curtailed. A second issue that we have only tangentially addressed here is the implications of the use of advances on the deposit-insurance fund... Collateralized liabilities such as advances and repurchase agreements have senior claims over deposits in the resolution process. Consequently, such liabilities potentially exacerbate losses to the FDIC. The FDIC and other regulators may wish to remedy this situation by imposing a capital charge on banks with large amounts of collateralized obligations.” (*Journal of Banking and Finance*, Dusan Stojanovica, Mark D. Vaughn and Timothy J. Yeager, May 2008)

FHLB-Cincinnati reports a 23% decline in net income for the first quarter 2008

- The FHLB-Cincinnati reported net income of \$49 million for the first quarter of 2008, a decrease of \$15 million or 23% from the same period in 2007. The Bank attributed the decline in its profitability to the significant reduction in short-term interest rates that began during the third quarter of 2007. On March 31st, the Bank reported total assets of \$91.4 billion, up more than 8% from year-end 2007. Advances grew 15% to \$61.0 billion, a continuing trend that began in the second half of 2007. The Bank's principal balance of mortgage loans remained relatively stable, declining 1% to \$8.8 billion, representing 9.6% of the Bank's total assets. (*FHLB-Cincinnati Press Release*, 04/24/08)

FHLB-New York declares first quarter dividend of 7.8%

- The FHLB-New York's board of directors has approved an annualized dividend rate of 7.8% for the first quarter of 2008, down 60 basis points from its fourth quarter dividend of 8.40%. (*FHLB-New York Press Release*, 04/17/08)
- The FHLB-New York also announced that Thomas O'Brien has joined its board of directors for a term ending on December 31, 2008. O'Brien is president is the president and CEO of State Bank, Long Island, NY. (*American Banker*, Joe Adler, Steven Sloan, and Stacy Kaper, 04/21/08)

International Mortgage Market

Bank of England announces \$100 billion liquidity injection to cushion UK's credit squeeze

- The Bank of England has announced a \$100 billion "Special Liquidity Scheme," designed to improve the liquidity position of UK's banking system and improve confidence in the financial markets. Under the program, banks will be able to enter into new asset swaps at any point during a six-month window beginning April 21st for a term of up to one year. The Bank of England can renew these transactions for a total of up to three years. Since August 2007, the Bank of England has increased by 42% the amount of money made available to financial institutions and has increased the proportion of its lending to that market to 74% (from 31%).
- In coming weeks, UK banks are expected to raise tens of billions of pounds in capital, as they increase the write-downs of mortgage assets in coming weeks with their announcement of first quarter results. (*Bureau of National Affairs*, 04/22/08; *Wall Street Journal*, Carrick Mollenkamp, 04/21/08)

- The UK's plan to improve the liquidity of its money markets could be disrupted by EU regulators because it risks contravening the rules because it gives unfair advantage to British banks over rivals, experts argue. Anthony Woolich, head of competition for LG, the business law firm in London, said, "It seems to me that this is prima facie state aid because this scheme gives banks operating in the UK an advantage over other European banks operating outside the UK." Another leading competition lawyer said, "You can argue that it's a general attempt to improve the system in general and everyone can participate, but in reality it's a measure aimed at helping the British banking sector." If the European Commission were to find that the package breaches its rules, it could order that the loans be paid back more quickly than expected, and at penal rates of interest. The Commission is staying in constant contact with the UK government as the bank rescue plan is implemented. According to a Brussels source, "Even if the Commission does not think that the measures amount to state aid, it will want all the details to make absolutely certain." (*The Times* [UK], Siobhan Kennedy, Rory Watson, 04/26/08)

Canada's housing boom "officially over"

- "Canada's six-year housing market boom is officially over," said Douglas Porter, deputy chief economist at BMO Capital Markets. "There's no question the numbers were probably distorted by a few feet of snow in the first quarter of the year, but I think there's some very real underlying cooling underway here." According to the Canadian Real Estate Association, 75,476 homes were sold in the first quarter of 2008, down 13% from the first quarter of 2007. Home sales dropped 18.7% in March (from the same month the year before), including a 39.7% slide in Calgary, a 34% drop in Edmonton and a 22.2% drop in Toronto. Average prices rose only 5.5% to \$327,620 in the first quarter versus the first quarter of 2007, the smallest price increase since the fourth quarter of 2001. (*Reuters*, 04/17/08)

Farm Credit System / Farmer Mac

Tentative agreement reached on the 2008 Farm Bill

- On April 25th, Congressional negotiators reached a tentative agreement on the 2008 farm bill that includes a hefty increase for nutrition programs at a time of rising food prices. “I don’t think there’s any question now that we can get this done by the eighth of May,” said Representative Collin C. Peterson (D-MN), chairman of the Agriculture Committee. A key breakthrough came when senior lawmakers agreed on a \$1.7 billion package of tax breaks and the means to finance the overall package in the bill. The deal includes an \$861 million increase for nutrition programs, partially paid for by slashing crop subsidies by \$400 million and cutting a program to pay farmers for ruined crops by \$250 million. House Speaker Nancy Pelosi (D-CA) and Representative Charles B. Rangel (D-NY) pushed hard for the nutrition increases, which are “urgently needed because of the run-up in food costs and food prices,” said Senator Kent Conrad (D-ND). “A lot of painful reductions [had] to be made in order to shift resources to places that are being hard hit by this weakening economy.” As a result of these increases, approximately two-thirds of the bill’s resources are dedicated to nutrition, said Senator Tom Harkin (D-IA), chairman of the Agriculture Committee chairman. “We carried a heavy load for nutrition,” said Harkin. “It’s not just a farm bill. This is a farm and a food and an energy bill.”
- Negotiators agreed to cut an ethanol tax credit, which was previously been seen as untouchable because of its popularity in “politically potent” Iowa, by \$1 billion in support for blending fuel with the corn-based additive, bringing the per-gallon credit from 51 cents to 45 cents. Lawmakers also increased support for cellulosic ethanol, made from plant matter, by \$400 million. The agreement also increases funding for conservation programs, including a first-ever infusion of \$372 million of federal farm dollars to clean up the Chesapeake Bay. “This is a very good day for Chesapeake Bay cleanup efforts,” Representative Chris Van Hollen (D-MD)
- Negotiators are still finalizing provisions limiting farm subsidies for the wealthy. Under the current agreement, the government would eventually limit payments to high-earning “non-farmers,” who make only a small portion of their income from farming, but it wouldn’t impose any income limits on wealthy farmers. The Bush administration has called for much tougher limits that would apply to anyone who earned more than an average of \$200,000 annually.
- Negotiators agreed to rely on customs user fees—funds collected on imported goods—to pay for the farm bill spending increase, which resolved a major objection from the White House on how to pay for the bill. According to press reports, the tentative agreement does not include any provisions to expand the lending authority of the Farm Credit Administration, which had been sought by FCA members.

- Advocates of more sweeping farm policy changes said the current proposal wouldn't go far enough to scale back subsidies. Reverend David Beckmann with the nutrition group Bread for the World, called the deal "half victory ... more help for hungry people, but no significant reform yet in the subsidy programs."
- Lawmakers expect to finalize the agreement next week, after staff aides spend the weekend hashing out key details. Leadership must still vet the deal with rank-and-file lawmakers and bring the bill to a full vote in both chambers, before the one-week extension of the 2002 Farm Bill expires on May 2nd. (*Associated Press*, Julie Hirschfeld Davis, 04/25/08; *Reuters*, 04/25/08)

Ethanol's failed promise

- In the April 22nd edition of the *Washington Post*, Lester Brown founder and president of the Earth Policy Institute, and Jonathan Lewis, a climate specialist and lawyer with Clean Air Task Force, wrote, "The willingness to try, fail and try again is the essence of scientific progress. The same sometimes holds true for public policy. It is in this spirit that today, Earth Day, we call upon Congress to revisit recently enacted federal mandates requiring the diversion of foodstuffs for production of biofuels. These 'food-to-fuel' mandates were meant to move America toward energy independence and mitigate global climate change. But the evidence irrefutably demonstrates that this policy is not delivering on either goal. In fact, it is causing environmental harm and contributing to a growing global food crisis."
- "...It is now abundantly clear that food-to-fuel mandates are leading to increased environmental damage. First, producing ethanol requires huge amounts of energy—most of which comes from coal. Second, the production process creates a number of hazardous byproducts, and some production facilities are reportedly dumping these in local water sources. Third, food-to-fuel mandates are helping drive up the price of agricultural staples, leading to significant changes in land use with major environmental harm. Most troubling ... is that the higher food prices caused in large part by food-to-fuel mandates create incentives for global deforestation, including in the Amazon basin. Meanwhile, the mandates are not reducing our dependence on foreign oil. Last year, the United States burned about a quarter of its national corn supply as fuel—and this led to only a 1 percent reduction in the country's oil consumption."
- "Turning one-fourth of our corn into fuel is affecting global food prices. U.S. food prices are rising at twice the rate of inflation, hitting the pocketbooks of lower-income Americans and people living on fixed incomes. Globally, the United Nations and other relief organizations are facing gaping shortfalls as the cost of food outpaces their ability to provide aid for the 800 million people who lack food security. Deadly food riots have broken out in dozens of nations in the past few months, most recently in Haiti and Egypt. World Bank President Robert Zoellick warns of a global food emergency. The immediate necessary step is a major increase in global food aid. But

beyond that, America must stop contributing to food price inflation through mandates that force us to use food to feed our cars instead of to feed people.”

- “Taking these together—the environmental damage, the human pain of food price inflation, the failure to reduce our dependence on oil—it is impossible to avoid the conclusion that food-to-fuel mandates have failed. Congress took a big chance on biofuels that, unfortunately, has not worked out. Now, in the spirit of progress, let us learn the appropriate lessons from this setback, and let us act quickly to mitigate the damage and set upon a new course that holds greater promise for meeting the challenges ahead.” (*Washington Post*, Lester Brown and Jonathan Lewis, 04/22/08)
- At the Third Annual Farm Journal Conference on December 1, 1998, Vice-President Al Gore said, “I was also proud to stand up for the ethanol tax exemption when it was under attack in the Congress — at one point, supplying a tie-breaking vote in the Senate to save it. The more we can make this home-grown fuel a successful, widely-used product, the better-off our farmers and our environment will be.” (*The Corner at National Review Online*, 04/25/08)
- In an April 26th commentary, Mark Steyn wrote, “...Western governments listened to the ecowarriors and introduced some of the ‘wartime measures’ they’ve been urging. The EU decreed that 5.75 percent of petrol and diesel must come from “biofuels” by 2010, rising to 10 percent by 2020. The United States added to its 51 cent-per-gallon ethanol subsidy by mandating a fivefold increase in ‘biofuels’ production by 2022. The result is that big government accomplished at a stroke what the free market could never have done: They turned the food supply into a subsidiary of the energy industry. When you divert 28 percent of U.S. grain into fuel production, and when you artificially make its value as fuel higher than its value as food, why be surprised that you’ve suddenly got less to eat? Or, to be more precise, it’s not ‘you’ who’s got less to eat but those starving peasants in distant lands you claim to care so much about. The biofuels debacle is global warm-mongering in a nutshell: The first victims of poseur environmentalism will always be developing countries. In order for you to put biofuel in your Prius and feel good about yourself for no reason, real actual people in faraway places have to starve to death.” (*Orange County Register*, Mark Steyn, 04/26/08)
- In the April 21st edition of *Investors Business Daily*, Bogdan Kipling wrote, “We can and must stop the madness of ethanol at any cost. It is a pernicious fraud driven by naked, subsidy-fattened corporate greed that’s good at staying in the shadows.” According to William Tucker, writing in *The Weekly Standard*, “Ethanol has become a virtual franchise of Archer Daniels Midland, ...whose scores of distilleries around the Midwest now produce half our [ethanol] supply.” According to OpenSecrets.org, Archer Daniels Midland has contributed more than \$8 million to federal candidates and political parties from 1990 to 2008. (*Investors Business Daily*, Bogdan Kipling, 04/21/08, *The Weekly Standard*, William Tucker, 04/28/08; <http://www.opensecrets.org/orgs/summary.asp?ID=D000000132&Name=Archer+Daniels+Midland>)

- In an April 24th editorial, *National Review* wrote, “The federal government can do something right now to provide relief to Americans facing higher food prices: Repeal the ethanol mandate. ... We realize that a repeal is highly unlikely, given that the machinery of government is currently calibrated to move in the opposite direction on biofuels, but as food prices keep going up, pro-ethanol politicians will find it increasingly difficult to justify their position.” (*National Review*, 04/24/08)
- In *Urgent Agenda*, William Katz wrote, “...A Honda mechanic told me that the ethanol stuff also lowers gas mileage, defeating the whole purpose. But would anyone listen to a mechanic when you can listen to Al Gore? You think maybe the whole ethanol craze has something to do with money for big farmers in Iowa? You think? This is going to be very tough on the chattering classes. Just as they’re getting into the global warming bit, they’ve got to learn about rice production. I can understand how they might resent those food rioters. So ungrateful. So indifferent to environmentalism. You know, it’s true what Obama says, the little people just get bitter.” (*UrgentAgenda.com*, William Katz, 04/25/08)
- Texas Governor Rick Perry has asked the EPA for an immediate waiver on the state’s requirements under a federal ethanol mandate because of “skyrocketing food costs.” Specifically, Perry has asked the EPA to reduce the state’s federal renewable fuel standard mandate by 50% for ethanol produced from grain. “We appreciate the good intentions behind the push for renewable fuels. In fact we’re diversifying our state’s energy portfolio at a rapid rate, but this misguided mandate is significantly affecting Texans’ family food bill,” said Perry. The governor also told the EPA that the grain-to-ethanol requirement is hurting the state’s cattle industry, particularly small family ranches. (*MarketWatch*, Wallace Witkowski, 04/25/08)

<p>Are American farmers edging toward a financial crisis?</p>

- Soaring land values, farmers’ increasing debt and heavy reliance on government subsidizes for ethanol production have prompted economists to warn that the “golden age of agriculture” may be coming to a sudden end. “We’re in a very risky time, and yet we don’t seem concerned about that risk nearly as much as we should be,” said Barry L. Flinchbaugh, an agricultural economist at Kansas State University. Strong demand for corn and other grains has caused prices to reach historic highs, which has led to record farmland values and to steadily increasing debt, as farmers have borrowed money to buy more land, to finance the higher costs of fertilizer and seed and to upgrade their equipment. If demand for corn and grain falls, farmers could find themselves in a situation reminiscent of the early 1980s when the farm economy largely crumbled. Farm economists question whether the federal backing for ethanol, now estimated at about \$6 billion a year, will continue in the face of soaring corn prices, which are increasing food costs. “U.S. energy policy has been friendly to ethanol in the last couple of decades. The question is, will it continue to be. It’s running up food prices and that’s causing pressure on Congress to limit mandates for

ethanol usage,” said Neil Harl, an emeritus professor of economics at Iowa State University. (*Associated Press*, David Pitt and Henry C. Jackson, 04/21/08)

FCA’s debt increased 6% in first quarter of 2008
to meet seasonal credit demand caused by higher commodity and input prices

- According to a speech by Andrew J. Jacob, director of FCA’s Office of Regulatory Policy, the Farm Credit System’s loans outstanding to cooperatives and processing and marketing entities totaled about \$26 million on December 31, 2008, representing 18.2% of loans outstanding. Jacob noted that the System’s concentration in all grains and cotton was only around 13% of total loans due to commodity diversification. During the first quarter of this year, he said FCA has seen a significant increase in credit provided to elevators and other process and marketing entities, who have had to draw down funds to cover margin requirements from using commodity futures to hedge their positions.
- Jacob said, “As you know, margin requirements have increased significantly as a result of higher commodity prices and changes imposed by the commodity exchanges. The [FCS] has met the increased credit demand of eligible elevators and other processing and marketing entities... by obtaining funds through the sale of securities in the Agency debt markets. Debt securities outstanding increased by about \$10 billion over the first quarter of 2008, or 6 percent. Debt outstanding fluctuates based on seasonal credit demand factors. This year we are seeing seasonal credit demand increasing to a new level in light of higher commodity and input prices. Along with increased credit demand, we observed that the Farm Credit System did not materially change its underwriting standards. It has prudently stepped up risk management and credit controls to closely monitor and perform due diligence on borrowers’ assets that collateralize their loans. As part of their underwriting and credit practices, we expect the Farm Credit System to carefully evaluate the risk management capabilities of customers, particularly in light of recent commodity price volatility.” (*Comments by Andrew D. Jacob*, 04/22/08)

Vagueness of the FCA lending authority rule draws ire of the commercial bankers

- FCA said that it approved a new rule to give more “flexibility” to a “rigid” rule that has prevented FCA members from retaining processors as customers as their ownership structures have changed. However, commercial bankers argue that it will be a massive departure from the system’s core mission of lending to farmers, and that it could cut banks out of the business of lending to the ethanol plants sprouting up across rural America. Although bankers are in no position to block the new rule which goes into effect in June, their trade groups will ask Congress to look into whether it goes beyond the FCA’s mission. Mark K. Scanlan, the Independent Community Bankers of America’s director of agricultural and rural policy, said the rule’s language is so vague that even large agribusinesses, such as Archer-Daniels-

Midland Co., might qualify for Farm Credit System loans. “It might be intended for farmers and their sons, but could be used by corporations what their subsidiaries,” said Scanlan. “Because of the wording, it can be taken much broader than its stated intent.”

- According to a 76-page detail of the new rule, FCA said that even though the change could expand the eligibility, the criteria “properly ensure that there is a sufficiently strong economic link” between farmers and the processing and marketing firms. John Blanchfield, director of the American Bankers Association’s Center for Agriculture and Rural Banking, said that there is no clear language defining “sufficiently strong” in the new rule. “The rule becomes totally subjective and obtuse,” he added. An investor-owned ethanol plant that buys corn from particular farmers could be eligible for Farm Credit financing, even if the farmers have no ownership stake, he said “I see it as a way to allow Farm Credit to lend money to any business that processes or markets agricultural products, regardless of the ownership,” said Blanchfield, which leaves bankers at risk of being “cut out of the equation.” (*American Banker*, Robert Barba, 04/14/08)
- Camden Fine, the president and CEO of the Independent Community Bankers of America, said, “ICBA adamantly opposes allowing the Farm Credit System’s lenders to become the equivalent of commercial banks while retaining tax and funding advantages as government-sponsored enterprises (GSEs). ...FCA’s new regulation allows FCS to utilize its government-derived advantages to finance many investor-owned or privately held non-farm businesses now well served by tax-paying, private sector community banks. FCS, which has been growing its assets by 16 percent per year, should not be permitted to continue its encroachment and crowding out of private sector community banks. Further, the FCA has failed to show any lack of credit availability for processing and marketing firms that supports such an open-ended regulation.” (*Targeted News Press Release*, 04/14/08)

Postal Service

House bill introduced to ensure continued availability of stamp vending machines to underserved communities

- Congressman Edolphus “Ed” Towns (D-NY) has announced his co-sponsorship of the Postal Service Access Assurance Act of 2008 (H.R. 5548), which would serve to ensure the continued availability of automated stamp vending machines by the USPS for underserved communities. In October 2006, the Postal Service announced that it would phase out stamp vending machines by 2010 by removing approximately 5,900 machines each year until nearly 23,000 machines now in service have been retired. The USPS is phasing out the machines due to aging equipment, lack of repair parts, and the high costs of maintenance. (*Postcom.org*, 04/25/08)

Private contractors are the best antidote to the USPS’s billion-dollar losses

- In 2007, the USPS lost \$5 billion and is on track to lose at another billion this year. While the Postal Service works on straightening out its balance sheet, some federal lawmakers are attempting to eliminate the best option the USPS has to cut costs—outside contracting—despite the fact that the agency has used private contracting since 1785. According to Lexington Institute fellow Robert R. Schrum, “The problem is when you raise [postal] rates every year, it puts off strategic initiatives [by the Postal Service].” Schrum pointed out that postal rates have increased about 30% over the last ten years. “I don’t think that trend is sustainable. It’s simple economics,” said Schrum. “Price increases are going to prompt consumers to use email and on-line bill paying. When prices are too high, consumers will revolt.” Today, private contractors serve fewer than 4% of all routes and deposit mail in fewer than 2% of all delivery points in the U.S., according to a CBO study released in February. Given those numbers, Schrum said he didn’t understand the urgency of some lawmakers to curtail the USPS’s authority to use more contractors, except perhaps because of postal “union leaders desire to grow the memberships.”
- Advocates who want to limit the Postal Service’s use of private contracting say that contracting hinders mail delivery service and puts customers at security risk. They also claim that contractors pose a significant threat to the integrity of the mail and to the future of the USPS work force. Denying the USPS the ability to maximize its efficiency through strategic use of contracting could prove to be a “very expensive mistake.” Senator Tom Harkin (D-IA) argues, “Outsourcing mail delivery to people who have not undergone the Postal Service’s extensive screening and training process leaves open the possibility that convicted felons, identity thieves or other undesirable workers could have access to the sensitive materials that pass through the mail on a daily basis.”

- In a letter to Congress, Postmaster General John E. Potter told lawmakers that 90% of private contractors are small minority- and women-owned businesses. He argued that if Congress passed legislation to restrict the Postal Service’s use of contractors, “the ability of the Postal Service to effectively manage its vast delivery operations for transporting and delivery would be eliminated.”(*Courier-Journal* [Louisville, KY], Robert R. Schrum, 04/18/08; *CNSNews.com*, Fred Lucas, 04/22/08)
- The APWU, with its unique perspective on USPS subcontracting, reported that “eight more members of the U.S. House of Representatives have become co-sponsors of the Mail Network Protection Act (H.R. 4236) in the past two weeks, thanks to continuing outreach efforts by APWU locals.” According to the union, “The legislation would help reduce wasteful, inefficient, and detrimental subcontracting by requiring the USPS to bargain with postal unions before it engages in significant contracting-out.” (*APWU Web News Article #34-08*, 04/17/08)

The PRC requests public comments on the postal monopoly in the U.S.

- The Postal Regulatory Commission has opened docket PI2008-3 and has invited public comment on universal postal service and the postal monopoly in the United States. The Postal Accountability and Enhancement Act requires the commission to submit a report to the president and Congress on universal service and the monopoly, no later than Dec. 19, 2008. Initial comments are due 60 days after publication in the Federal Register. (*Postcom.org*, 04/20/08)

USPS introduces on-line, customized greeting cards and documents

- The Postal Service now offers an online product that allows consumers and businesses to create customized greeting cards that can also be used in combination with a gift card. Create Mail, found at www.usps.com/createmail, allows the customer to select or design a mail piece and enter addresses or upload an address list. It also allows the customer to submit electronic documents and mailing lists to the Postal Service website. The Postal Service then sends those files to a contract printer, who prints the items and enters them into the mail. The service can provide customers a discounted postage rate by automating and presorting the mail pieces with no minimum number of pieces required and no permit fee or an annual fee required. (*The Hammond News*, Karen McTamney, 04/23/08)

USPS’s “Stamp Out Hunger” drive to be held May 10th

- USPS mail carriers will collect non-perishable foodstuffs on May 10th to help ease hunger in their “Stamp Out Hunger” drive. (*Postcom.org*, 04/21/08)

TVA

<p>Five shutdowns of Browns Ferry nuclear unit causes NRC to require new round of inspections</p>

- As a result of five unplanned safety shutdowns at Browns Ferry Unit 1 reactor, the Nuclear Regulatory Commission has downgraded its assessment of the reactor and scheduled a new round of inspections of TVA's reactor which was restarted last May after being dormant 22 years. NRC officials said that the shutdowns did not indicate a huge safety problem, since the plant was supposed to be shut down during safety situations. TVA spokesman Craig Beasley said, "We agree with their assessment. [I]f there are any lessons learned or improvements that we can apply going forward." Beasley also noted that the Unit 1 reactor had operated without a shutdown since last 2007. (*Times Daily* [Florence, AL], Trevor Stokes, 04/18/08)

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