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The GSE REPORT ™

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Contents of GSE Report ™

"Owners of capital will stimulate the working class to buy more and more expensive goods, houses and technology, pushing them to take more and more expensive credits, until their debt becomes unbearable. The unpaid debt will lead to bankruptcy of banks, which will have to be nationalized, and the State will have to take the road which will eventually lead to communism."

Karl Marx, 1867

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Major Events

Democrats propose an $825 billion stimulus package to address an "unprecedented" economic crisis

- To confront an "unprecedented" economic crisis, President Barack Obama is urging Congress to pass an $825 billion stimulus plan, called the American Recovery and Reinvestment Bill of 2009. The administration's proposed stimulus package focuses on job creation, infrastructure development, increased regulatory oversight, tax relief for businesses and America's middle class, and aid to struggling states struggling with budget shortfalls. The driving focus of the stimulus package is the creation or saving of up to 4 million jobs, said Obama. The bill also seeks to make good on some of his signature campaign promises, including an income tax cut for most Americans earning less than $200,000 a year. Under the plan, individuals would receive up to $500 and families up to $1,000 through a cut in payroll taxes on the first $8,100 in income. The money would be delivered through paychecks as a reduction in Social Security withholdings, and is intended to bolster consumer spending by giving a small lift to household pocketbooks. The White House said that it plans to spend at least 75% of the stimulus package within 18 months of the bill's passage. The administration also called for greater transparency, saying the bill would including no earmarks and be subject to the review by an independent panel.

- In his January 20th inaugural address, President Obama said, "The state of the economy calls for action, bold and swift, and we will act—not only to create new jobs, but to lay a new foundation for growth. We will build the roads and bridges, the electric grids and digital lines that feed our commerce and bind us together. We will restore science to its rightful place, and wield technology's wonders to raise health care's quality and lower its cost. We will harness the sun and the winds and the soil to fuel our cars and run our factories. And we will transform our schools and colleges and universities to meet the demands of a new age. All this we can do. And all this we will do." In his first weekly radio and video address, Obama argued that the stimulus legislation is essential to jump-starting the economy. Moreover the bill would protect workers from losing their healthcare; modernize public schools, roads, and sewer systems, lower energy costs and taxes and make college more affordable. "In short, if we do not act boldly and swiftly, a bad situation could become dramatically worse," said Obama.

- The 647-page recovery package, crafted by House Democrats and the Obama administration, includes $358 billion for public works projects, $192 billion in other spending and $275 billion of tax cuts. Some of the largest components of the measure include $102 billion to help workers find new jobs and retain employer-provided healthcare; $87 billion for a temporary increase in aid to states for Medicaid costs; $79 billion in aid to local school districts and public colleges to prevent cutbacks; $90 billion in infrastructure spending; and $54 billion to encourage energy

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production from renewable sources. Specific provisions also includes funds for renewable energy and energy efficiency research ($18.5 billion); college financial aid ($16 billion); K-12 education ($13 billion); water-system improvements ($10.1 billion); federal building construction and repair ($6 billion); mass transit improvement and expansion ($6 billion); public housing construction and improvement ($5 billion); defense construction projects ($4.5 billion); government and housing agencies to deal with foreclosed and abandoned homes ($4 billion); and new military and veterans' hospitals ($3.8 billion). Other "less expensive" provisions of the stimulus plan added by House Democrats include, among other things, National Parks renovations ($1.7 billion); worker retention programs ($1.5 billion); homeless shelters ($1.5 billion); state and local summer jobs programs for youths ($1.2 billion); renovation and construction of public health centers ($1 billion); purchase of fuel efficient cars by federal government ($600 million); and infrastructure improvements and jail construction for Indian tribes ($550 million).

- The Senate is developing its own version of the stimulus bill, which will likely trigger intense haggling and fierce lobbying between Congress and the Obama administration, as lawmakers push to pass a final bill quickly. On January 23rd, Senate Finance chairman Max Baucus (D-MT) unveiled a $275 billion tax-plan cut, largely tracking the priorities of the Obama administration and House Democrats. In addition to the $250 billion in tax cutes, the proposal includes $87 billion of assistance to states for Medicare costs, a one-time payment of $300 to Social Security and disability recipients, and help for people losing their jobs to maintain their health insurance coverage.

- The economic stimulus package will also include a provision, restoring the $729,750 GSE loan limit in high-cost markets unit year-end 2009 and increase the FHA-insured reverse mortgage limits to $625,000 form $417,000 nationwide. Additionally, the bill will expand the definition of high cost areas by allowing regulators to designate wealthy communities as "sub-areas" within an MSA.

- According to a CBO analysis of the stimulus package, only 7% of the $355 billion of discretionary spending included in the $825 billion stimulus bill would be spent over an 18 month period. The report concluded that $26 billion would be spent in FY2009; $110 billion in FY2010; $103 billion in FH2001; with the remaining $116 spent from FY12-FY2019. The CBO report appears to confirm complaints by Republicans and other critics that infrastructure expenditures are an ineffective means of quickly jolting a sluggish economy. In an interview on ABC's *This Week*, House Speaker Nancy Pelosi (D-CA) said, "First of all, [CBO] only looked at 40 percent of the investments in the bill. By their own admission. So they didn't even take a complete look at the bill. We have a letter from the administration that says 75 percent of the investments will be paid out in the first 18 months." Pelosi reiterated that she's committed 75% of the bill's resources within the 18-month timeframe, saying, "Seventy-five percent, 18 months. We're committed to that."

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- With the administration's ban on earmarks in the stimulus bill, a "shadowy lobbying effort, making it difficult to discern how hundreds of billions in federal money will be parceled out, has evolved," according to the *Associated Press*. "No earmarks isn't a game-ender," said Peter Buffa, former mayor of Costa Mesa, CA. "It just means there's a different way of going about making sure the funding is there." Instead of legislative language that overtly sets aside money for specific projects, money will be doled out according to arcane formulas spelled out in the bill and in some cases based on the decisions of Obama administration officials, governors and state and local agencies that will choose the projects. "Somebody's going to earmark it somewhere," said Howard Marlowe, a consultant who represents a coalition to preserve beaches. As a result of the new rules, lobbyist are working "indirectly"—and sometimes in ways that are impossible to track—to obtain stimulus funds for the clients.

- Some Republicans have voiced opposition to the Democrats' stimulus plan, arguing that many of the spending programs may not provide immediate economic relief and that the proposed tax cuts are not enough. "Unfortunately, the trillion-dollar spending plan authored by congressional Democrats is chock full of government programs and projects, most of which won't provide immediate relief to our ailing economy," said House Republican Leader John A. Boehner (R-OH). "All told, the plan would spend a whopping $275,000 in taxpayer dollars for every new job it aims to create, saddling each and every household with $6,700 in additional debt," he said. In a January 25th interview on *Fox News Sunday*, Senator John McCain said, "I think there has to be major rewrites if we want to stimulate the economy. I am opposed to most of the provisions in the bill. As it stands now I would not support it."

- Economists' opinions on the stimulus proposal were mixed, with many questioning if the bill's provisions provided the best methods of providing a short-term, shot-in-the-arm to the U.S. economy. Some argued that the stimulus package is too fragmented and politically driven to have a strong impact, while others argued that its effectiveness will likely hinge on whether the program appears credible to the American consumer. "The success of this depends as much on psychological factors as economics, said Mary MacGuineas, president of the Committee for a Responsible Federal Budget. "If it gets passed with strong support in a relatively quick period of time, then it will stand a much better chance of persuading consumers to start spending again."

- The House plans to vote on the stimulus package on January 28th and Democratic leaders have vowed to have the final bill on Obama's desk by President's Day, February 16th. (www.politco.com, 01/25/09; *Financial Times*, Edward Luce, 01/16/09; *Washington Post*, Lori Montgomery, 01/21/09; *CongressDaily*, Humberto Sanchez and Peter Cohn, 01/21/09; *Associated Press*, Julie Hirschfeld Davis, 01/25/09; *Money Morning*, Jason Simpkins and William Patalon III, 01/21/09; *ABC News*, Mary Bruce, 01/25/09; *Washington Post*, Phil Rucker, 01/25/09; *New York Times*, David M. Herszenhorn, 01/16/09; *Bloomberg News*, Roger Runningen and Juliana Goldman, 01/23/09; *CQ Today Midday Update*, 01/23/09; *National Mortgage News*, 01/16/09)

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- In a January 22nd article in the *New York Times*, David Brooks wrote, "The [stimulus] bill has three essential failings. First, it lacks any strategic vision. This $825 billion bill has to be passed within weeks. There's no time for fundamental rethinking or new approaches. Instead, there's a sloppy profusion of 152 different appropriations - off-the-shelf ideas that mostly create costlier versions of the status quo. The committee staff took the kernel of President Obama's vision—infrastructure programs to create jobs—and surrounded it with an undisciplined sprawl of health, education, entitlement and other spending. There's money for nurse training, Medicare, Head Start, boatyard support, home weatherization and so on. Eleven of the programs in the bill account for the vast majority of the actual job creation. The rest may be worthy or not, but they have little to do with stimulus. **The total package is so diffuse, it costs $223,000 to create a single job."** [Emphasis added.]

- "Second, the bill has relatively modest short-term impact. Many parts don't even pretend to be stimulus measures, like funding for basic research, or special ed programs. But even the parts of the bill that aim to stimulate will have modest near-term impact. A study by the Congressional Budget Office found that less than half of the money for infrastructure and discretionary programs would be spent by Oct. 1, 2010. According to *The Washington Post*, of the $30 billion devoted to highway spending, only $4 billion will be spent in the next two years. Less than $3 billion of the $18.5 billion for renewable energy and less than half the financing for school construction will be spent by 2011. The Appropriations Committee chairman, David Obey, fulminated against the C.B.O. Wednesday, and the uselessness of economists in general, but he had no answer to these findings."

- "Third, the spending measures in this bill have no sunset. In the middle of the Appropriations markup, the ranking member, Jerry Lewis from California, asked his chairman the crucial question: What happens when the economy recovers? Does this new spending disappear? Chairman Obey refused to answer, but he didn't have to. The entire argument for these measures over the previous hours had been that they were good in themselves. **The commitments in this bill will constitute the new budget base line.** [Emphasis added.] They will contribute to the coming $2 trillion deficits. Worse, these new structures, and the lobbyists they attract, will create more impediments to the innovation that Obama may seek in the years ahead." (*New York Times*, David Brooks, 01/22/09)

- A January 8th editorial by the *Washington Post* provides some "context" for the Democrat's $825 billion stimulus package. *Post* wrote, "'Fiscal space' is an economist's term for a country's capacity to borrow and spend its way out of recession without risking exorbitant interest rates and inflation later on. Generally speaking, the more public debt a country already has as a share of its economy, the less new debt it can take on. As President-elect Barack Obama and Congress contemplate a fiscal stimulus package that could total hundreds of billions of dollars [$825 billion], they still have some fiscal space to work with. At $6.3 trillion, the publicly held national debt is about 45 percent of the $14 trillion economy—not much

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above the post-World War II average debt-to-GDP ratio of 43 percent. But the space is shrinking rapidly. According to new figures from the Congressional Budget Office, federal debt is rising at the fastest rate since World War II: **It is estimated at $1.2 trillion in fiscal 2009, or 8 percent of gross domestic product**. [Emphasis added.] This stunning number reflects both the direct effect of the recession on tax revenue and spending and the high cost of measures taken to combat the downturn, such as the financial sector bailout. And it is likely to be matched or exceeded when the Obama stimulus plan kicks in..." (*Washington Post*, 01/07/09)

- In a January 6th editorial, the *Wall Street Journal* wrote, "Amid the Great Society spending boom of the 1960s, Illinois Senator Everett Dirksen famously quipped, 'A billion here, a billion there -- pretty soon, you're talking real money.' How quaint. In modern Washington, trillion is the new billion. Barack Obama will soon request an economic stimulus package of some [$825] billion over a mere two years and optimistically hopes to hold the final figure under $1 trillion. …But before we get lost in the policy details, let's pause to consider that number of $1 trillion. The human mind is not well equipped to fathom a number that large. A check for $1 trillion—a million million dollars—would have 12 zeros to the left of the decimal point. …More immediately, $1 trillion is about one-third of annual U.S. government spending and 13% of the U.S. economy. It is more than the GDP of all but 12 countries in 2007 (America, Japan, Germany, China, the U.K., France, Italy, Spain, Canada, Brazil, Russia and India, in that order)."

- "From an historical perspective, $1 trillion is far more than the signature expenditures over the life of American government, the ones the politicians and columnists cite when they say we need another moon shot, Manhattan Project or [insert cliché here] for this or that priority. In fact, in inflation-adjusted dollars, the Apollo space program cost $140 billion between 1961 and 1972, while the race for the atomic bomb came in at a bargain $29 billion. …The only specific American endeavor, ever, that tipped the trillion-dollar scale was World War II. That war—in which 16 million U.S. troops fought for four years over two fronts—cost about $4 trillion in adjusted dollars, or $17 trillion in today's GDP. Leave it to Mr. Obama and Congress to make even WWII seem like a relative bargain." (*Wall Street Journal*, 01/06/09)

- In a January 21st editorial, the *Investors Business Daily* wrote, "…It's fine to spend money on infrastructure, but cutting taxes on both businesses and individuals would improve incentives to work and invest, and bring banks in from the sidelines to start lending again. Then everyone wins—not just Congress' pork-barrel spenders." (*Investors Business Daily*, 01/21/09)

- In an interview on PBS's *Nightly Business Report*, Susie Gharib asked Warren Buffett: :…[T]here is debate about whether there should be fiscal stimulus, whether tax cuts work or not. There is all of this academic debate among economists. What do you think? Is that the right way to go with stimulus and tax cuts?" Buffett responded, "The answer is nobody knows. The economists don't know. All you know is you throw everything at it and whether it's more effective if you're fighting a

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fire to be concentrating the water flow on this part or that part. You're going to use every weapon you have in fighting it. And people, they do not know exactly what the effects are. Economists like to talk about it, but in the end they've been very, very wrong and most of them in recent years on this. We don't know the perfect answers on it. What we do know is to stand by and do nothing is a terrible mistake or to follow Hoover-like policies would be a mistake and we don't know how effective in the short run we don't know how effective this will be and how quickly things will right themselves. We do know over time the American machine works wonderfully and it will work wonderfully again."

- Gharib asked, "But are we creating new problems?" Buffett responded, "Always." (*Nightly Business Report*, 01/22/09)

Obama administration obtains release of the second $350 billion draw for TARP Chairman Frank introduces the TARP Reform and Accountability Act The Obama administration must have flexibility in utilizing TARP funds to prevent future financial meltdowns

<u>Obama administration obtains release of the second $350 billion draw for TARP</u>

- On January 15th, the Senate voted to release the second $350 tranche of TARP funds, for the Treasury Department, sparing the Obama administration a messy legislative fight. Since the release of TARP funds could be blocked by a vote of both chambers, the Senate's vote assures that the money will be released without any action by the House of Representatives being necessary. President Obama said he was "gratified" by the Senate's vote. "Now my pledge is to change the way this plan is implemented and keep faith with the American taxpayer" by imposing new conditions and regulations on TARP. (*New York Times*, 01/16/09; *Wall Street Journal*, Deborah Solomon and Greg Hitt, 01/16/09)

- Prior to the Senate's vote to release the TARP funds, the Obama administration committed to allocate between $50 billion and $100 billion of TARP funds on a foreclosure prevention plan. In a letter to congressional leaders, Lawrence Summers, director-designate of the National Economic Council, said that banks receiving TARP funds "will be required to implement mortgage foreclosure mitigation programs." Summers did not elaborate on the types of programs the government would employ or require the banks to use—but reiterated that stopping foreclosures as a top priority of the administration. Summers wrote, "We will implement smart, aggressive policies to reduce the number of preventable foreclosures by helping to reduce mortgage payments for economically stressed but responsible homeowners, while also reforming our bankruptcy laws and strengthening existing housing initiatives like

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Hope for Homeowners." (*American Banker*, Cheyenne Hopkins, 01/16/09)

Chairman Frank introduces the TARP Reform and Accountability Act

- On January 9th, House Financial Services Committee chairman Barney Frank (D-MA) introduced The TARP Reform and Accountability Act of 2009 (H.R. 384) to establish new requirements for the use of TARP funds that would boost accountability and increase transparency of the program. Frank hopes the bill will serve as a roadmap for the Obama administration in determining how to best deploy the second tranche of TARP funds. Under H.R. 384, the Treasury Secretary would be required to develop a foreclosure prevention and mitigation plan (the Plan) that commits up to $100 billion [but no less than $40 billion] of TARP funds, which is approved by the Financial Stability Oversight Board by March 15, 2009 and implemented by Treasury Secretary no later than April 1, 2009. The Plan's programs would apply only to owner-occupied residences. Under the bill, the Plan's programs would be required to leverage private capital to the maximum extent possible consistent with maximizing prevention of foreclosures.

- The Plan would consist of one or more of the following program alternatives:

  - A guarantee program for qualifying loan modifications under a systematic plan, which may be delegated to the Federal Deposit Insurance Corporation (FDIC) or other contractor;

  - A retooled Hope for Homeowner (H4H) Program, which brings down the cost of loans, either through coverage of fees, purchasing H4H mortgages to ensure affordable rates, or both;

  - A program for loans to pay down second lien mortgages that are impeding a loan modification subject to any write-down by existing lender the Treasury may require;

  - A program providing servicer incentives/assistance that provides payments to servicers for implementing qualified loan modifications, and/or;

  - A program for the purchase of whole loans for the purpose of modifying or refinancing the loans (with authorization to delegate to FDIC).

- H.R. 384 would authorize the use of TARP funds for automobile manufacturers and other uses, such as consumer loans and commercial real estate loans. The bill would require greater oversight and reporting requirements, along with greater restrictions on executive compensation. The bill also would expand the H4H program, require the Treasury to develop a home buyer stimulus program, and permanently increase FDIC's deposit insurance limits. The House passed the bill by a recorded vote of 260 to 166.

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- "[H.R. 384] doesn't have to be enacted," Frank told reporters. If the bill passes the House with a large majority, we have smart and cooperative people in this administration, [and] I'm willing to accept their word that they will act as if this is law." Under the legislation, at least $50 billion of the remaining TARP funds would be used to finance a foreclosure mitigation plan. The bill would also require Treasury to develop a plan to stimulate the housing market and institute conditions on recipients of TARP funds. While there will likely be strong support for the measure in the House, its fate in the Senate is unclear.

- According to the *Bureau of National Affairs'* sources, H.R. 384 will likely see no action following the House's passage. Passage of H.R. 384, coupled with a public endorsement of the bill's basic principals by Obama administration officials, would give House members the political cover they would need to vote against the House resolution of disapproval of the second TARP tranche. Senate passage of H.R. 384 is unlikely, as is Obama's signature, said BNA's sources. (*http://www.thomas.gov/cgi-bin/bdquery/z?d111:HR00384:@@@R*; House Financial Services Press Release, 01/09/09; *Bureau of National Affairs*, R. Christian Bruce, 01/12/09; *American Banker*, Rob Blackwell and Stacy Kaper, 01/12/09)

The Obama administration must have flexibility in utilizing TARP funds to prevent *future* financial meltdowns

- In a January 14th editorial, the *Washington Post* wrote, "….We understand Congress's frustration [with TARP], and we share some aspects of it—such as the concern over AIG's staging of lavish corporate events or the more serious issue of whether TARP has permitted recipient banks to spend too much on dividends. But none of these complaints outweighs the continuing need. Congress should promptly grant President-elect Barack Obama the additional $350 billion he seeks."

- "Much of the criticism, particularly that expressed by a congressional oversight panel, focuses on the program's alleged failure to restart bank lending. This criticism is misplaced, for two reasons. First, of the $250 billion allocated as fresh capital for banks, only $189 billion has actually been delivered; it is simply too early to gauge the money's impact. Second, it is unrealistic to expect that government capital would be instantly passed on to households and firms. In a recession, demand for new credit is bound to be lower than usual, and it would be unwise to impose some sort of lending quota on banks, regardless of risk. Capital infusions should enable banks to resume lending sooner, and to a greater extent, than would otherwise have been the case. Did some banks use government support to buy up others? This, too, can be consistent with TARP's goals; better to have a healthy bank absorb a weak one than to leave the job to the Federal Deposit Insurance Corp."

- "Many in Congress want to earmark TARP money for foreclosure relief. But Mr. Obama's economic adviser Lawrence H. Summers was wise not to promise anything

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too specific. The purpose of TARP was not to stimulate the economy or to rescue each and every troubled sector or industry (the GM-Chrysler bailout notwithstanding). It was to stabilize the financial system—upon which the economy as a whole depends but which, as of late September, had reached the brink of collapse. Arguably, TARP has served that purpose: The one-month LIBOR-OIS spread, a key measure of perceived credit risk, has fallen from an unheard-of 338 basis points on Oct. 10 to 19 basis points yesterday."

- "That is still abnormally high; U.S. banks remain fragile, as Citigroup's recent woes suggest. Federal Reserve Board Chairman Ben S. Bernanke warned yesterday that 'more capital injections and guarantees may become necessary to ensure stability and normalization of credit markets.' Mr. Bernanke suggested a government-backed 'bad bank' to which financial institutions could assign their toxic assets in return for cash and equity. That might be one use for the next TARP installment. Given the uncertainties ahead, and the pitfalls of congressional micromanagement, Mr. Obama should have as free a hand as possible." (*Washington Post*, 01/14/09)

- In a January 15th editorial, the *Wall Street Journal* wrote, "… [Now] there's the Treasury's request for the second $350 billion in … [TARP] cash. …Democrats are also insisting that as much as $100 billion go to prevent more home foreclosures, though this will have little impact on housing prices. The evidence from the last two years is that foreclosure mitigation often merely delays a reckoning because many of these homeowners never could afford the home in the first place. Meanwhile, Mr. Frank, the Dr. Kevorkian of capital injections, wants to impose new management and compensation restrictions on any institution that gets TARP money, whether it is well-managed or not. The bankruptcy 'cram down' now streaking through Congress will also impose more losses that will destroy more bank capital."

- "…[I]f the [TARP] money is squandered on foreclosures and nonfinancial industries, the Obama Administration is setting itself up to need TARP III or TARP IV down the road. Asset values are going to continue to fall until they find a market bottom, and no declaration of Congress can make them stop in mid-descent. There are going to be more bank failures."

- "We supported TARP as a way to prevent a financial meltdown, providing public capital to help regulators manage problem banks, arrange mergers, and work off bad assets. TARP has since become a cash pool for all and sundry, casting a pall over the entire financial system. Mr. Obama would make more progress against recession if he steered the TARP back to the purpose that Paul Volcker and Eugene Ludwig first proposed on these pages—as a resolution agency on the model of the Resolution Trust Corp. of the 1990s. Working in tandem with the Federal Deposit Insurance Corp., such an outfit could close problem banks before they collapse, serve as a holding and work-out agency for bad assets, and then sell them back over time into private hands."

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- "A new TARP should also have a leader of recognized stature and independence -- not something assistant secretary—who isn't afraid to take the heat and can also reassure the public. Mr. Volcker would be ideal for the job, and for that matter for overseeing the design of a new, sturdier financial system. Down the current road lies more uncertainty, and more market selloffs." (*Wall Street Journal*, 01/15/09)

Momentum builds to purge troubled assets from the financial system

- Government officials are laying the groundwork for a second phase of the financial system bailout with plans to remove troubled assets that are paralyzing the U.S. financial system. Officials at Treasury, the Federal Reserve and FDIC are consulting with the Obama administration on the creation of a government bank to buy toxic assets, including real estate mortgages and REO, auto loans, credit card loans, and other consumer debt. "All of these ideas are designed ultimately to facilitate more lending in the economy," said FDIC Chairman Sheila Bair. "It's essential to get some private capital back into these banks." According to Goldman Sachs economists, financial institutions and investors will lose $2 trillion on investments in U.S. assets —of which only half of those losses have been booked to date. Until the remainder of these toxic assets are removed from financial institutions, government officials fear banks will not be able to attract private capital and institutions will remain reluctant to make new loans.

- In a January 14th speech in London, Federal Reserve Chairman Ben Bernanke said the banking system cannot stabilize until a way is found to take illiquid assets off the financial institutions' balance sheets. Bernanke said, "A continuing barrier to private investment in financial institutions is the large quantity of troubled, hard-to-value assets that remain on institutions' balance sheets." The Treasury could foster a market for illiquid assets in one of three ways, said Bernanke. "Public purchases of troubled assets are one possibility. Another is to provide asset guarantees, under which the government would agree to absorb, presumably in exchange for warrants or some other form of compensation, part of the prospective losses on specified portfolios of troubled assets held by banks. Yet another approach would be to set up and capitalize so-called bad banks, which would purchase assets from financial institutions in exchange for cash and equity in the bad bank."

- During a House hearing, FDIC's chief operating officer John Bovenzi told the panel that his agency "believes the original intent of the Tarp — to remove problem assets from the balance sheets of banks and related entities — continues to be vitally important." Bovenzi added, "Such a program is necessary to expand banks' balance-sheet capacity to undertake new lending, as well as to attract private-equity investment. The development of a program to assist institutions in addressing their inventories of troubled assets should be a key component of Tarp funds."

- In an interview on CNBC, Bair said federal officials are considering a plan to create new government-backed banks, called "aggregator" banks, to purchase toxic assets.

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Such a facility would be funded through TARP and be open to large and small institutions, provided they would agree to increase their lending activities and to raise capital. The aggregator bank could then hold the assets or securitize them in the secondary market. "You would set up a facility that would be capitalized through some part of the TARP funds to acquire troubled assets," said Bair. "This was an approach that was used back in the RTC days." Under one scenario being considered, bailout funds would be used to capitalize an aggregator bank, which could then raise a substantial amount of cash by issuing government debt. Banks would sell assets to the aggregator bank at fair market value—the figure banks use to value their own assets, which would remove the challenge of setting a price on the assets, said Bair. The banks also could become part owners of the aggregator bank, by taking part of their payment for the assets in the form of an equity interest. Bair added, "We need a programmatic response. All the regulators would like to have a programmatic approach that's public and transparent in terms of eligibility and criteria." In an interview with the *Wall Street Journal*, Bair said that discussions have gone "beyond the hypothetical …[with] all of the [federal regulatory] agencies …committed to coming up with a program for troubled asset relief. …I think we would like to have something in place in the not too distant future. …I think we're getting near the point to make a decision. But it's complicated. We want to make sure we get it right." Bair, whose term as head of the FDIC will expire in 2011, has been asked by the Obama administration to remain as the agency chairman.

- Another option being considered by federal officials would be to establish loss sharing agreements with banks on select groups of assets, a structure already used in the rescue of Citigroup and Bank of America. Officials are concerned as to whether government guarantees on assets can be offered broadly, given the complexity and variety of instruments held by financial institutions. With loss sharing agreements, the bad assets would remain on the banks' books, which discourages investors from investing in the institutions.

- In an interview with *Financial Times*, House Financial Services Committee chairman Barney Frank (D-MA) said the Obama administration should buy mortgages from investors at a discount to facilitate restructuring these loans. Frank urged the administration to set aside $40 billion to $100 billion to buy the toxic mortgages, calling the move a "twofer"… "It reduces foreclosures and gets rid of some of those toxic assets" said Frank. He conceded that while there would be money to buy "unwanted" mortgages, there "will not be much left for toxic assets in general." (*Wall Street Journal*, Damian Paletta, 01/08/09; *Wall Street Journal's Real Times Economic Blog*, 01/16/09; *Wall Street Journal*, Deborah Solomon, Jon Hilsenrath, and Damian Paletta, 01/17/09; *Bureau of National Affairs*, 01/19/09; *American Banker*, Steven Sloan, 01/14/09; *Financial Times*, Krishna Guha, Edward Luce, and Martin Wolf, 01/16/09)

- In the January 24th issue of *Frontline Weekly Newsletter*, John Mauldin wrote, "…An aggregator bank (the so-called "bad bank") is going to happen. So …let me make a few suggestions. Banks that are technically insolvent and which will need to put

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taxpayer money at risk should just be 'put down.' The shareholders and bond holders need to be wiped out before taxpayer money is spent. And the banks should be put back in strong private hands as soon as feasibly possible. We do NOT want government agencies subject to political manipulation making decisions about lending. But deals should be structured which give taxpayers a real chance to get their investments back. And please, no more deals that are not on the same terms that Warren Buffett or other private investors get. That was simply embarrassing for Paulson and team, or should have been…" (*Frontline Weekly Newsletter*, John Mauldin, 01/24/09)

Citigroup compromise opens door to action on mortgage "cram down" legislation

- On January 8th, Citigroup agreed to support legislation allowing bankruptcy courts to modify home mortgage loans at risk of foreclosure (S. 61 Helping Families Save Their Homes in Bankruptcy Act of 2009). The proposal, sponsored by Senator Dick Durbin (D-IL), would allow so-called mortgage cram-downs only for homeowners who have filed for Chapter 13 bankruptcy protection. The proposed changes to the bankruptcy rules could help as many as 800,000 troubled homeowners keep their homes, according to Mark Zandi, the chief economist for Moody's Economy.com.

- In an agreement with Senate Democrats, Citigroup agreed to support S. 61, as long as (i) the bill applies only to mortgages issued before the measure's enactment date; (ii) it requires that homeowners certify that they attempted to contact their lender about modifying their loan before they filed for bankruptcy; and (iii) it stipulates that only "major" violations of the Truth in Lending law would invalidate claims from creditors in bankruptcy court. Until recently, Citigroup had opposed the Democrats' cram-down proposals. The bank's compromise on the issue comes after the federal government provided Citigroup $45 billion of equity and asset guarantees. In a written press release, Citigroup CEO Vikram Pandit wrote, "Given today's exceptional economic environment, we support [the bill's] swift passage." According to Durbin's aide, two other large banks are negotiating to be included in the compromise agreement.

- Five consumer groups along with attorneys general from 22 states and the District of Columbia wrote letters of support for the legislation, urging lawmakers to pass the bill to help stem the tide of foreclosures.

- The cram-down legislation is risky for banks because it restructures the fundamental element of secured lending—a binding mortgage note—and is a blunt instrument in the hands of a bankruptcy judge. The major banking trade groups, including the Financial Services Roundtable (FSR), the American Bankers Association, the Mortgage Bankers Association, and the American Securitization Forum all issued statements opposing the Citigroup compromise. The trade groups argued that cram downs should be available only to subprime borrowers or to homeowners driven into bankruptcy by an unaffordable mortgage. "The fix doesn't go far enough to address

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all of the problems. It's a good first step, but there is a lot more to be done to make the bill targeted," said Scott E. Talbott, the FSR's senior vice president for government affairs. "We are continuing to work to limit the negative effects, to make it the least worst way to do the wrong thing." ABA executive director Floyd Stoner said, "Anything that is so broad, even if limited in time, is a grave concern. …A key point here is that this [bill] focuses on all mortgages. A lot of the mortgages that caused the financial crisis were nontraditional mortgages that most banks in America did not make. We believe that is an appropriate focus. … Having nontraditional mortgages subject to cram down in bankruptcy is an effective way to prevent a recurrence of the focus on these nontraditional mortgages." Industry lobbyist are also pressing for a sunset date to the legislation, better protection for FHA loans, and a stronger requirement that other modification efforts be pursued before a bankruptcy filing.

- Analysts warn of the unintended consequences of the cram-down legislation, which could wreak further havoc in a fragile financial services industry. Analysts at Keefe, Bruyette & Woods project that the cram down legislation would accelerate losses to most MBS investors, driving new downgrades by credit rating agencies and placing banks under renewed capital pressure.

- The Citigroup deal strengthens the position of cram down proponents, said Brian Gardner, a policy analyst for Keefe, Bruyette & Woods. In a note to clients, Gardner wrote, "The deal between Senate Democrats and Citigroup over bankruptcy cram down legislation probably ensures passage of the bill—something that we already thought was highly likely." The compromise surprised many in the industry, although Citigroup, Bank of America and J.P. Morgan Chase have spoken with Senator Chuck Schumer's office about the bankruptcy provision, said sources familiar with the discussions.

- Senate Democrats want to include housing aid and mortgage mitigation in the $875 billion economic stimulus package that Democrats are drafting, said Senate Budget chairman Kent Conrad and House Budget chairman John Spratt. Although enacting a bankruptcy provision is a "very high priority," House Speaker Nancy Pelosi (D-CA) said the stimulus bill may be moving too fast to insert the bankruptcy provision—but "we will get it done." (*CongressDaily*, Humberto Sanchez and Darren Goode, 01/08/09; *American Banker*, Cheyenne Hopkins and Emily Flitter, 01/12/09; *Washington Post*, Renae Merle and Binyamin Appelbaum, 01/10/09; *Wall Street Journal*, Peter Eavis, 01/09/09; *Bureau of National Affairs*, Jay Horowitz, 01/09/09; *Wall Street Journal*, 01/09/09; *HousingWire*, Paul Jackson, 01/23/09; *National Mortgage News*, 01/23/09).

- In a January 11th editorial, the *Washington Post* wrote, "Surely one of the least intuitively obvious federal laws is the bankruptcy rule that says a distressed debtor can ask a judge to reduce what he owes on a vacation house—but not on a primary residence. You'd think it would be the other way around. But Congress meant to help home buyers: If mortgage contracts are unbreakable, banks feel more confident

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about making them, and the loans are worth more on the secondary market. Capital flows to housing; interest rates are lower than they would otherwise be. If Congress could do it all over again, it might not tilt the playing field like this. People have exchanged trillions of dollars relying on this rule. No one can foresee all the ramifications, good and bad, of rewriting it."

- "That is the cautionary background against which to evaluate Citigroup's announcement of support for a Democratic plan to let homeowners seek mortgage principal reductions—'cram downs' -- in bankruptcy court. Citigroup's decision breaks the financial industry's previously unified opposition to such legislation and therefore greatly increases its chances of passage. Its backers tout the measure as a powerful anti-foreclosure tool. Giving borrowers leverage, they argue, will force lenders to offer more—and more generous—loan modifications. That, in turn, will shore up family balance sheets and save communities from decay, at practically no upfront cost to the government. Citigroup changed its view only after taking a $45 billion federal bailout in the past several months that greatly increased its vulnerability to the ire of the bill's congressional supporters…."

- "Congress should carefully study the backward-looking impact as well. The bill is not limited to subprime and other sloppily underwritten loans of recent vintage—as was a previous version that Congress rejected last year. The argument in favor of broadening the change is that the foreclosure crisis has now spilled past subprime; the risk, however, is undermining hundreds of billions of dollars worth of mortgage-backed securities held by investors all over the world, including already-troubled Fannie Mae and Freddie Mac. The bill also offers relief to borrowers who took out mortgages as large as $1 million; we would rather it focused on neighborhoods populated by people of modest means."

- "There are problems even a well-designed change in the bankruptcy bill cannot solve. In particular, the measure offers little or no help to the fastest-growing category of distressed homeowners: those who have lost their jobs. If you don't have a job, you don't have any income. And, quite correctly, the bill would not allow judges to order a modified loan unless the borrower has the income to pay it. Still, properly refined, a bill could prompt viable loan modifications that should have already been made but which lenders or investors resisted. Given the crisis we face, such a bill would be worth a try." (*Washington Post*, 01/11/09)

Freddie Mac to ask Treasury for as much as $35 billion in aid, bringing the taxpayers' total aid to $48.8 billion Fannie Mae to seek $11 billion to $16 billion from Treasury

Freddie Mac to ask Treasury for as much as $35 billion in aid, bringing the taypayers' total aid to $48.8 billion

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- In a January 21st filing with the SEC, Freddie Mac said it will ask the Treasury Department for "approximately $30 billion to $35 billion" more in aid, which would bring the taxpayers' aggregate equity injection to as much as $48.8 million [or 49% of the agency's $100 billion pledge to ensure the company's solvency]. "Their losses are going to be much higher than anyone anticipated," said Paul Miller, an analyst with FBR Capital Markets. "The more and more that people are digging into these portfolios, they're finding out the more and more these guys were doing subprime and Alt-A loans and classifying them as prime." Miller added, "Given that they have $4.5 trillion of risk out there, $100 billion is a drop in the bucket. Given the fact that their risk profile on these loans is greater than they led everyone to believe, greater than $100 billion in losses on each institution would not surprise me."

- During a January 20th interview, FHFA Director James Lockhart that one or both companies may request federal aid after they report fourth-quarter earnings next month. "They will be reporting numbers in mid-to-late February and, yes, I think everybody would expect that there would be a draw on Treasury," said Lockhart. (*Bloomberg News*, Dawn Kopecki and Jody Shenn, 01/23/09)

Fannie Mae to seek $11 billion to $16 billion from Treasury

- Fannie Mae reported January 26th that it will need a capital infusion of $11 billion to $16 billion from the U.S. Treasury to cover losses related to home-mortgage defaults. While Freddie Mac has already received $13.8 billion from the Treasury, and has requested an additional $35.5 billion, this is the first time that Fannie has requested funds.

- Zachary A. Goldfarb reported in the *Washington Post* that Congressional action on bankruptcy cram down legislation may have an impact on Fannie and Freddie. "The year could bring more losses for Fannie Mae, depending on the state of the economy and housing market and what happens in Congress. .. 'There will be another significant hit in the first quarter as the values of these securities declined significantly following the announcement of bankruptcy cram down legislation,' wrote Moshe Orenbuch, an analyst at Credit Suisse. 'For Fannie and Freddie alone, this could cost the Treasury another $20 billion or so in early 2009.'" (*Wall Street Journal,* James R. Hagerty, 1/27/09; *Washington Post*, Zachary A. Goldfarb, 1/27/09)

Eight of the 12 FHLBs may fall below their capital requirements because of deterioration in their $76.2 billion private-label MBS portfolio

- The FHLB System faces the potential for substantial credit impairments on their $76.2 billion private-label MBS portfolio, which may result in impairing the FHLBs' capital and curtailing of the Banks' lending activities. According to a report by Moody's, as many as eight of the 12 FHLBs may book additional "unrealized market value losses" on their private label MBS holdings that erode the Banks' capital below

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the regulatory requirement. At issue is whether declines in market value of MBS—which totaled $13.5 billion at the end of the third quarter—will be deemed "other-than temporary impairments" and how much will be seen as "irreversible," by the Banks' auditors and regulator. In Moody's analysis, the FHLB-Seattle's regulatory capital could fall to 2.31%, while the FHLBs of San Francisco, Atlanta and Boston would straddle 3%--all below the 4% capital requirement. Only the Cincinnati, Dallas, Des Moines, and New York Banks would have enough capital to meet regulatory requirements. Moody's said it was unlikely that the FHLB System's Aaa credit rating would be reduced because the Banks have government support. Moreover, Moody's said it is unlikely that the FHLBs will suffer actual losses on the private label MBS portfolio as large of those reported under accounting rules.

- Given concerns that year-end asset marks could impair the Banks' capital, the FHLBs of Seattle, Pittsburg, Des Moines, Boston and San Francisco have suspended their dividends and "excess" stock repurchases, while the FHLB-Indianapolis has deferred a decision on its fourth quarter dividends until the year-end marks are finalized. In a letter to members, FHLB-Seattle president and CEO Richard Riccobono acknowledged that his bank will likely report a failure to meet its risk-based capital minimums on December 31st. Riccobono wrote, "[The] ongoing turmoil in the capital and mortgage markets has caused a decline in the market value of the Seattle Bank's private-label mortgage-backed securities, significantly beyond any expected actual loss. …Unfortunately, the risk-based capital rules … rely on market value rather than expected loss as the measure for determining our risk-based capital requirement. …In our opinion, the Seattle Bank … has more than enough capital to cover the risks reflected in the bank's balance sheet. While the market values of mortgage-based assets are currently under extraordinary pressure, the vast majority of the private-label mortgage-backed securities that we hold are highly rated, credit-enhanced, adjustable-rate securities that we have the ability and intent to hold until they mature."

- In an interview with the *Wall Street Journal*, Federal Housing Finance Agency director James B. Lockhart said, "The overall [FHLB] system is strong" and the FHLBs should be able to continue making loans at a normal pace. Lockhart said it may be "prudent" for some of the Banks to conserve capital, but declined to say if his agency planned to ease or increase the FHLBs' capital requirements. Lockhart said he plans to revamp the system's risk-based capital test, which factors in fluctuations in the "fair value" of banks' assets. He added, "Conceptually, I'm a big believer in fair value, but it's tough in a market like this where there's a fear factor, lack of confidence, and lack of liquidity. [Applying fair value accounting to private label securities] is somewhat problematic at the moment. It's really hard to get a good market-based fair value because so few of these securities are trading." A FHFA spokesman said the agency is currently reviewing the FHLB-Seattle's request that the regulator review the risk-based capital methodology. "If a Federal Home loan Bank were to report its capital is less than a minimum requirement, FHFA would take appropriate action consistent with the facts and circumstances," said the spokesman.

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- Bert Ely, an Alexandria, VA bank consultant, said, “They will bend over backward not to cripple the Federal Home Loan Banks or member institutions. They are a major source of funding for banks and thrifts [which are making home mortgages].”

- In a report to clients, Keefe Bruyette & Woods analyst Frederick Cannon wrote, “Systemic weakness in the FHLBs, which may require federal action, could have a number of implications for U.S. banks and thrifts, including: higher costs of FHLB borrowings, reduced value of FHLB stock, and increased demand for alternative sources of liquidity.”

- Rajiv Setia, a fixed-income strategist at Barclays Capital, noted that the problems in the FHLB System are “far smaller” than they are at Fannie Mae and Freddie Mac. Setia estimated that the FHLBs’ actual losses on their private-label MBS will probably total between $3 billion and $4 billion, well below the unrealized loss reserve of $14 billion (on September 30th) and less than 8% of the System’s capital at the end of the third quarter. Jim Vogel, an analyst at FTN Financial Capital Markets, said, “This is not an emergency that requires an over-a-weekend response.” In a research note, RBS Greenwich Capital analysts wrote, “[R]egardless of headline risk, we think the FHLB has strong funding power as well as ability to hold capital captive.”

- The Moody’s report on the FHLB System will likely increase the FHLBs’ borrowing costs, said Jim Vogel, head of agency debt research at FTN Financial. In an email to clients, Vogel wrote, “Moody’s sees a small chance of large economic losses among the banks (as do we), but the headlines are 100 percent under the control of accountants. So, auditor and regulator decisions are what will matter over the short run.”

- On January 7th, the Financial Accounting Standards Board approved a guidance that may help companies deem fewer asset value declines as “other than temporary” and record fewer write-downs. In the statement, FASB wrote, “[Companies can] exercise judgment when assessing whether declines in fair-value are indicative of a decline in the cash flows expected from the issuer of the security.” (*American Banker*, Steven Sloan, 01/09/09; *Bureau of National Affairs*, Mike Ferullo, 01/14/09; *HousingWire*, Diana Golobay, 01/14/09; *Bloomberg News*, Jody Shenn, 01/018/09; *HousingWire*, Teri Buhl, 01/09/09; *Wall Street Journal*, James R. Hagerty, 01/21/09; *Bloomberg News*, Jody Shenn, 01/13/09; *Rating Implications on the Federal Home Loan Banks from Other-than-Temporary Impairments*, Moody’s Investors Service, January 2009; *Wall Street Journal*, Damian Paletta, 01/23/09)

The U.S. financial regulatory system is classified as a “high risk program” by GAO

- In a January 22nd report, the Government Accountability Office listed the outdated U.S. financial regulatory system as a “high risk” government program. GAO wrote, “The current regulatory approach has significant weaknesses that if not addressed will

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continue to expose the U.S. financial system to serious risks. …Long-term GAO believes that modernizing the U.S. financial regulatory system and aligning it to current conditions is an essential step to reducing the likelihood that our nation will experience another financial crisis similar to the current one." (*Politico*, Lisa Lerer, 01/23/09; *GAO Press Release*, 01/22/09)

- In testimony before the Committee on Homeland Security and Government Affairs, Acting Comptroller General Gene L. Dodaro told lawmakers that the United States' current financial system has relied on a fragmented and complex set of federal and state regulations—put in place over the last 150 years—that has not kept pace with major developments in financial markets and products in recent decades. In today's current financial crisis, this regulatory system is increasingly proving to be ill-suited to meet the nation's needs, said Dodaro. In his written testimony, Dodaro outlines how regulation has evolved in the financial services industry and identifies significant limitations and gaps in the current regulatory system. He also presents an evaluation framework for lawmakers to use in shaping potential regulatory reform efforts. Dodaro's testimony is available at http://www.scribd.com/doc/11357988/GAO-Financial-Regulation-a-Frameowrk-for-Crafting-and-Assessing-Porposals-to-Modernize. (*Testimony before the Committee on Homeland Security and Government Affairs*, Acting Comptroller General Gene L. Dodaro; 01/21/09; *Bureau of National Affairs,* 01/09/09)

- In a January 15th report, the Group of Thirty recommended that the regime regulating the global financial services industry be reformed to mitigate systemic risk by introducing revised, robust regulations affecting large financial institutions. Specifically, institutions possessing significant systemic risk to the financial system should be subject to "particularly strong oversight" while market-oriented institutions such as small private equity funds that do not pose significant systemic risk will be dealt with under separate rules, said former Federal Reserve Chairman Paul A. Volcker. The report outlines four core recommendations, calling for the elimination of gaps and weaknesses in prudential regulation and supervision coverage, improvements in the quality and effectiveness of prudential regulation and supervision, strengthened institutional policies and standards, and greater financial markets and products transparency.

- The Group also recommends that fair value accounting principles and standards be "reevaluated with a view to developing more realistic guidelines for dealing with less-liquid instruments and distressed markets" and be made "more flexible" to allow regulated institution to maintain adequate credit-loss reserves sufficient to cover expected losses over the life of assets in a portfolio. Volker said accounting standards for regulated financial institutions "certainly needs to be reviewed," adding he favors moving toward international accounting standards that are applied globally. "There's been a lot of progress in that direction," he said. The Group's full report is available for review at http://www.scribd.com/doc/11358851/Group-of-Thirty-Financial-ReformA-Framework-for-Financial-Stability.

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- When asked by reporters if the report's recommendations foreshadow the Obama administration's efforts to reform regulation of the financial services industry, Volcker responded, "The fact I chaired the steering group that produced this report speaks for itself. I think it's a reasonable indication of the direction in which we might go [but] it's up to the administration to decide what they want to do," he said. On November 24th, President-Elect Obama named Volker to serve as chairman of a new institution, the President's Economic Recovery Board. (*Bureau of National Affairs*, Stephen Joyce, 01/16/09)

- New York University's Stern School of Business is releasing a series of white papers on restoring the financial stability of the United States' financial system. A summary of the papers' findings is available at http://www.scribd.com/doc/11357668/NYU-Stern-Executive-Summaries. The full white papers project will be published by John Wiley & Sons, Inc. in April 2009. (http://www.wiley.com/WileyCDA/Section/id-370278.html)

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TARP

Treasury Secretary Geithner promises a regulations blitz

- In more than 100 pages of written testimony submitted to the Senate Finance Committee, Timothy Geithner outlined plans to explore new accountability, transparency and statutory requirements of nearly every aspect of the financial markets, if he is confirmed as Treasury secretary. Geithner said he is considering intensifying the oversight of banks, hedge funds, offshore tax holdings, credit rating agencies, credit cards, default swaps and other over-the-counter derivatives, and executives and shareholders at institutions receiving TARP funds. "We are going to need sweeping changes in regulatory policy, the oversight structure and in our tools for crisis management," he wrote. "I very much believe that federal oversight needs to be strengthened."

- Geithner also said he would impose new requirements on banks receiving money from TARP, including the requirement that participants issue quarterly reports summarizing their lending patterns and "a description of the factors that influenced their decisions." He wrote, "We strongly believe that the transparency of this program must be improved." He told lawmakers that the government should also limit executive compensation paid out by those companies and that shareholder dividends by firms receiving "exceptional assistance" should be held to one cent until the government is repaid.

- Geithner also reiterated his support for taking bold government action to stimulate the economy, saying that anything less threatens the economy's long-term well being. He told lawmakers, "If our policy response is tentative and incrementalist, if we do not demonstrate by our actions a clear and consistent commitment to do what is necessary to solve the problem, then we risk greater damage to living standards, to the economy's productive potential, and to the fabric of our financial system. …In a crisis of this magnitude, the most prudent course is the most forceful course."

- The Senate Finance Committee approved Geithner's nomination by a vote of 18 to 5, sending it to the Senate for final clearance. On January 26th, the Senate approved Geithner by a vote of 60-34, and he was sworn into office by Vice President Biden later that evening.

- The Treasury Department has asked 19 TARP participants to provide information on their business and consumer lending activities, along with information on purchases of mortgage-backed and asset backed securities. The first report, due January 31st, will cover information for the fourth quarter of 2008. Separately, the FDIC is implementing a monitoring process for its insured members "to determine how participation in these federal programs [including TARP] has assisted institutions in supporting prudent lending and/or supporting efforts to work with existing borrowers

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to avoid unnecessary foreclosures." The agency is also preparing a detailed guidance for examiners to use in assessing how taxpayer funds received by state nonmember banks under TARP and other federal initiatives.

- On CBS's *Face the Nation*, Lawrence Summers, the director designate of the National Economic Council, said, "Anyone who looks at it [the results of TARP] has got to be disappointed when they look at what's happened to lending, has got to think the results have been unsatisfactory." Louisiana State University professor Joseph Mason said, "Banks are becoming the whipping boy for the Treasury's failed policies. They're going to continue to face this pressure." (*Bureau of National Affairs*, R. Christian Bruce, 01/14/09; *Wall Street Journal Online*, Damian Paletta, 01/12/09; *Bloomberg News*, 01/21/09; *Wall Street Journal Online*, Deborah Solomon, 01/21/09; *HousingWire*, Kelly Curran, 01/23/09; *Politico.com*, Lisa Lerer, 01/23/09; *Wall Street Journal,* Deborah Solomon, 1/27/09)

Our next task: Building a *new* private credit system

- In the January 23rd issue of *Frontline Weekly Newsletter*, John Mauldin wrote, "…Senators at the Banking Committee hearings which looked into the appointment of Tim Geithner as Treasury Secretary …were outraged at the problem of giving banks all that TARP money and other Fed commitments, and now they were not lending that money and indeed it looks like they want more! … Here's the problem. The banks are lending. If you look at bank lending numbers, there is growth. The banks, per se, are not the real problem with the lack of lending. **The real problem is that we vaporized an entire Shadow Banking System that bought securitized debt in a wide variety of forms: autos, homes, student loans, credit cards, etc. That industry exists no more."** [Emphasis added.]

- "Banks over the last ten years became originators of loans, and not actual lenders. They would make the loans and then package them up for other institutions to buy. A pension fund in Norway (or wherever) would look at the rating from Moody's, see AAA, and buy it. Or banks would create off-balance-sheet vehicles (SIVs) to buy their debt and leverage it up, and book some nice profits. In any event, the debt did not end up on the banks' balance sheets for very long. That process was responsible for the majority of debt that was extended over the last decade. Now that process is broken, and it will not be fixed this year or next year or the year after that. We are going to have to come up with new ways of credit creation and debt processing. You can't go to Goldman and tell them to start making auto loans. They simply don't have the people to do that. Now, they used to be able to take auto loans from other actual originators and package them and sell them, but they did not make the loans. And the buyers for much of that securitized auto loan paper are gone. And they are not coming back any time soon without greater transparency and real capital guarantees and higher returns. A Moody's (or any rating agency) rating is not worth the paper, as far as the markets are concerned."

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- "In essence, we are asking the banking system, with greatly reduced capital, to do the heavy lifting that all the buyers of securitized debt did a few years ago. [Professor Nouriel Roubini now estimates that the financial industry's losses could be as much as $3.6 trillion.] And if Roubini is remotely right, [the banking system] simply [does] not have the capital to do it. Further, the banks are in a bind. The regulators, properly so, are making sure that banks have adequate capitalization and are marking assets to real market prices. But they simply have less capital to make loans, even with TARP. And the loans that many banks have made are showing higher losses than normal. Maine fishing buddy and bank maven Chris Whalen of Institutional Risk Analytics thinks that loan charge-offs will be twice the 1990 level, or around $800 billion, not far off from Roubini's number. That will force banks to loan less money and raise capital. Not exactly what the Senators want. And it will force banks to tighten lending standards."

- "…Think what a Senate hearing in 2010 would be like if [the banks] lowered lending standards and their balance sheets got worse. Senators would be asking how they could put taxpayer money (FDIC) at risk by making risky loans that had now gone bad. And where were the regulators? …Bottom line? It is going to take a lot more TARP and private money to capitalize the banks. A whole lot more. And that is before any of the other stimulus. And all that next $1 trillion does is get the banks back to where they were two years ago. Further, it does not give them the capital they need to make up for the loss of the Shadow Banking System. It is going to take some time to build what I call the new private credit system…." (*Frontline Weekly Newsletter*, John Mauldin, 01/21/09)

TARP distributions total $299.6 billion as of January 16th

- According to Treasury's January 22nd Transaction Report for TARP, the agency has distributed (as of January 16th) $193.8 billion to financial institutions through the Capital Purchase Program; $40 billion to AIG (a "systemically significant failing institution); $20.8 billion to General Motors, GMAC, Chrysler Holding and Chrysler Financial Services through the Automotive Industry Financing Program; $40 billion to Citigroup and Bank of America though the Targeted Investment Program; and $5 billion to Citigroup through the Asset Guarantee Program. (*TARP Transaction Report*, 01/22/09)

- Treasury's January 22nd report includes the agency's second round of equity injections into Bank of America to help facilitate the Bank's acquisition of Merrill Lynch. Under an agreement announced January 15th, Treasury invested an additional $20 billion of preferred stock in BofA. FDIC and Treasury also agreed to share losses on $118 billion of the company's assets which were largely assumed through the acquisition of Merrill. Despite the new capital, Bank of America's stock price has fallen 25% since January 15th, closing at $6.24 on January 23rd. The company's price slumped after Freidman Billings analyst Paul Miller suggested that BofA needs more than $80 billion in new common capital, due to the company's acquisition of

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Countrywide Financial and Merrill Lynch. (www.finance.google.com; *HousingWire*, Paul Jackson, 01/21/09; *HousingWire*, Kelly Curran, 01/16/09)

- "[With TARP,] you really have opened the door to picking winners and losers." Wayne Abernathy, American Banker Association. (*ABA Banking Journal*, December 2008)

- In the January 17th to 23rd issue, *The Economist* wrote, "…In normal times, governments rightly try to avoid insuring bank credit. Taxpayers bear many risks but credit risk is one left best to bankers, however ineptly they may have dealt it in the recent past. When politicians and their officials start deciding who should and who should not get loans, the allocation of credit tends to be decided by who lobbies most effectively rather than by where the money should go. Taxpayers end up footing the bill for dud loans and the economy underperforms as the flow of finance is misdirected…" (*The Economist*, January 17th-23rd, 2008)

Lawmakers step into the fray to help banks obtain TARP funds

- According to reports in the *Wall Street Journal* and *Boston Globe*, lawmakers have pressed Treasury officials to use TARP funds to help their troubled bank constituents. The *Boston Globe* reports that House Financial Services chairman Barney Frank (D-MA) asked a Treasury official to consider giving bailout funds to Boston's OneUnited Bank. Frank argued that his action was a "legitimate" effort on his part to protect the only minority-owned bank in Massachusetts. He added that the Bank's recent loss ($54.3 million) was "through no fault" of OneUnited's and he wanted to help while the bailout bill was under consideration by Congress last fall. "To help a minority bank stay in business—that is what democracy means," added Frank. The House Financial Services Committee chairman said he took two steps to that helped OneUnited and other small banks: (i) Frank inserted language in the rescue legislation designed to help banks that suffered losses on Fannie Mae and Freddie Mac preferred stock be eligible for the TARP funds, and (ii) he mentioned the plight of minority owned banks to then Treasury Secretary Henry Paulson and the case of OneUnited to Paulson's assistant for legislative affairs, Kevin Fromer. As a result, OneUnited received $12 million in federal rescue funds in December, weeks after FDIC issued a cease-and-desist order calling on the bank to raise capital, and overhaul its lending and executive compensation practices.

- FDIC's C&D required the OneUnited to cut its financial ties with a California-based limited liability company that owns a $6.4 million beachfront home in Santa Monica, CA. The LLC is owned by Kevin Cohee, the bank's chairman and CEO, and Teri Williams, Cohee's wife, who also serves as the bank's president. The bank also pays for Cohee's Porsche for his personal use. During 2008, OneUnited sustained a $54.3 million loss on the company's investment in Fannie Mae and Freddie Mac preferred stock, resulting in a negative capital balance of $6.6 million. Subsequently, the Bank has raised more than $20 million from shareholders to recapitalize the bank. As a

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result of the bank's losses, FDIC issued a cease and desist order, directing OneUnited's board of directors to bolster capital, provide adequate supervision over all bank officers, and diversity its stock portfolio.

- Steve Ellis, vice president of the nonpartisan Taxpayers for Common Sense, which has been critical of the bailout provisions, said Frank's effort on behalf of OneUnited underscored the problem with the program. "We are talking about trying to save the nation's financial system, not about saving my hometown bank," Ellis said. "It creates an opportunity to favoritism and power plays in the corridors of the nation's capital." (*Boston Business Journal*, 01/22/09; *Boston Business Journal*, Tim McLaughlin, 12/02/08; *Boston Globe*, Michael Kranish and Ross Kerber, 01/23/09)

- According to the *Wall Street Journal*, Representatives Danny K. Davis (D-IL) and Luis Gutierrez (D-IL) urged Treasury officials in October to avoid taking any regulatory action against National Bank of Commerce (Berkley, IL) and provide the bank bailout funds. Similar to OneUnited, National Bank's capital was depleted when it wrote-off its $72 million investment in Fannie Mae and Freddie Mac preferred stock. Given the institution's perilous financial condition, Treasury officials rebuffed the lawmakers' request and National Bank was taken over by FDIC on January 16th. FDIC estimates that the bank's failure will cost taxpayers $97.1 million. In January, Gutierrez was named head of the Financial Services subcommittee, which oversees banks. (*Wall Street Journal*, Damian Paletta, 01/23/09)

Projected net cost of TARP in 2008 is $64 billion

- According to a January 16th report, CBO projected the net cost of government outlays for the TARP program would be $64 billion. In a separate report, CBO said it expected the TARP program to cost about $189 billion in 2008 and 2009 on a net present value basis, based upon the assumption that the entire $700 billion of program funds would be disbursed by the end of 2009. (*Bureau of National Affairs*, Jonathan Nicholson, 01/19/09)

The Congressional Oversight Panel issues report sharply critical of TARP

- On January 9th, the Congressional Oversight Panel released its second report, sharply criticizing Treasury's implementation of TARP. In a 49-page report, the panel said that Treasury defied the intent of Congress in creating TARP; failed to answer basic questions about the program, and has provided very little evidence that the program has worked effectively. Specifically, the panel cited the agency's refusal to use TARP funds to mitigate foreclosures, which was a specific requirement of the legislation that created the program. The report also criticized the restrictions placed

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on executive compensation for companies participating in the TARP program, saying the restrictions were weak. (*American Banker*, Cheyenne Hopkins, 01/09/09)

Treasury issues an interim final rule on executive compensation for TARP participants

- Effective January 21st, TARP participants must comply with new Treasury rules governing compensation and certifications. The rules amend and clarify the executive compensation standards issued by the agency in October 2008 and add reporting requirements for financial institutions participating in TARP's Capital Purchase Program. Under the new rules, the CEO must certify within 120 days of the closing date of a TARP investment that the company's compensation committee has reviewed its senior executives' incentive compensation structure to ensure that the terms do not encourage unnecessary and excessive risks that could endanger the value of the institution. On an on-going basis, CEOs also must certify that their company and its compensation committee have complied with mandatory governance and executive compensation standards in the interim final rule within 135 days of their companies' fiscal year end. (*Bureau of National Affairs*, Florence Olsen, 01/19/09)

Treasury opens the Capital Purchase Program to S Corps

- On January 14th, Treasury published the eligibility requirements for the Subchapter S Corporations to participate in the Capital Purchase Program. Since this type of corporation cannot issue a second class of stock, S corporations can participate in CPP through the use of debt instead of equity. Under the agency's term sheet, the debt will pay a dividend of 7.7% each of the first five years and 13.8% thereafter. While the rate appears high relative to that rates paid for CPP preferred shares, Treasury officials say the pricing is comparable on an after-tax basis. The S corporations have until February 13th to apply with their federal banking regulator to participate in CPP. Mutually-owned thrift institutions are still waiting for Treasury to announce how their companies can participate in CPP. (*Bureau of National Affairs*, 01/15/09; *American Banker*, Robert Barba, 01/16/09)

83% of America's largest companies are doing business in "tax haven hot spots," including 14 participants in TARP

- According to GAO, 83 of the 100 largest public companies are doing business in "tax-haven" hotspots, such as the Cayman Island, Bermuda, and the British Virgin Island, where income can be moved to tax-free accounts. AIG, Bank of America, Citigroup, and Morgan Stanley are among the companies participating in TARP, who also have operating subsidiaries off-shore that could help them avoid paying U.S. taxes. Senators Byron L. Dorgan (D-ND) and Carl Levin (D-MI) requested the GAO

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report to use as a launching pad for their efforts to crack down on “tax dodgers.” (*Washington Post*, Carol D. Leonning, 01/17/09)

Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac have $200 billion shortfall, according to CBO

- According to the CBO, the federal takeover of Fannie Mae and Freddie Mac has added $200 billion to the national deficit, in discounted present value terms. In addition, the cost of the GSEs’ new credit activity in 2009 will total $38 billion, according to CBO estimates. By 2019, CBO expects Fannie and Freddie to cost the federal government $310 billion, if the GSEs’ level of federal support tapers off as the mortgage markets stabilize. These estimates come four months after Treasury Secretary Henry Paulson committed to invest up to $100 billion in Fannie Mae and Freddie Mac individually to keep the enterprises solvent.

- At the end of September, Fannie’s and Freddie’s fair value was almost negative $90 billion at the end of September and “that’s certainly worsened in the fourth quarter,” said Credit Suisse analyst Moshe Orenbuch. “If credit is continuing to deteriorate, then the fair value of their equity would likely decline also.” (*The Budget and Economic Outlook: Fiscal Years 2009 to 2019*, CBO, January, 2009; *Bloomberg News*, Dawn Kopecki, 01/08/09)

Fannie Mae and Freddie Mac REO inventories are still rising

- Fannie Mae’s and Freddie Mac’s acquisition of REO jumped 25% in the third quarter to a monthly rate of 9,167, according to the Federal Housing Finance Agency’s Foreclosure Report for the third quarter. On September 30th, Fannie and Freddie held 95,550 REO properties versus 76,150 at the end of the second quarter. According to the latest data, the GSEs started 47,100 foreclosures in October, up from 41,000 in September, while the enterprises completed 17,000 foreclosure sales in October, up from 15,600 in September.

- Concurrently, the GSE’s delinquency rates continue to rise, as are the GSEs’ loan modifications. “Loan modifications completed increased to 5,639 for October from a monthly average of 4,475 for the third quarter—an increase of 26%,” said FHFA in a in a report to Congress. (*Foreclosure Prevention Report for the Third Quarter of 2008*, Federal Housing Finance Agency, 01/16/08)

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Fannie Mae and Freddie Mac strive to serve the housing markets and the taxpayers

- Following four months of operating under federal conservatorship, Fannie Mae and Freddie Mac executives again find themselves facing conflicting goals in serving the mortgagee market and taxpayers. Today, the GSEs face a conflict between promoting the government's efforts to spur housing through lower mortgage costs and the desire to avoid large loan default losses that would by born by taxpayers. Over the past 18 months, the GSEs have gradually increased their fees and imposed larger surcharges on mortgage rates and fees for higher-risk borrowers. Real estate brokers and homebuilders are up in arms. "It's appalling," said Jerry Howard, CEO of the National Association of Homebuilders. "They're kicking people with relatively high credit scores out of the que [for financing]."

- In an interview with the *Wall Street Journal*, Federal Housing Finance Agency director James B. Lockhart said he is balancing the needs of the housing market against the risks being assumed by the taxpayers. "We don't think it's appropriate to tell them [the GSEs] to write business at a loss," said Lockhart. On the other hand, they don't need to be as profitable as in the past, he added. Lockhart said he has given the enterprises a target for their returns, but declined to elaborate further. A source close to the situation, said Lockhart set the target at less than 10%.

- Freddie Mac CEO David Moffett said he doesn't expect to see any major change in his company's credit standards or pricing soon, but expects fees could possibly be reduced later this year. Moffett added that this is a particularly challenging time for mortgage lenders with home prices haven fallen 20% and poised to fall an additional 10%. "We're in unchartered territory," said Moffett.

- In an interview, Fannie Mae CEO Herbert Allison said, "We're not out to maximize profits. We want to promote responsible homeownership….Our first priority is to keep people in their homes." To that end, Fannie Mae and Freddie Mac have extended their holiday-season moratorium until January 31st. The moratorium applies to single-family and 2-4 unit properties with GSE-owned mortgages, but does not cover properties that have already been vacated. The extension provides loan servicers more time to help at-risk homeowners enroll in the GSEs' streamlined modification program (SMP). To date, Fannie Mae and Freddie Mac have sent approximately 50,000 solicitations to homeowners for the SMP

- At yearend 2008, Fannie Mae and Freddie Mac received approval from FHFA to resume their charitable grant programs following a three-month hiatus. "We did get our plan approved by the end of the year by the conservator, and we are able to make grants again," said Freddie Mac spokeswoman Shawn Flaherty. "They were definitely supportive of the idea of us continuing being investors in the community." It is unknown how much the GSEs will donate to charity in today's economic downturn. Flaherty said that Freddie Mac donated approximately $18 million in 2008, representing a $7 million cutback from the GSE's donations in 2007. (*Correspondence to Senator Christopher Dodd*, James B. Lockhart, III, 01/15/09;

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CNNMoney, Les Christie, 01/09/09; *Bureau of National Affairs*, Mike Ferullo, 01/09/09; *Wall Street Journal*, James R. Hagerty, 01/20/09; *Washington Business Journal*, 01/16/09)

Treasury Secretary Paulson recommends that the utility model be utilized with Fannie and Freddie

- In a January 7th speech to the Economics Club, Treasury Secretary Henry Paulson recommended that lawmakers consider using a public-utility type of company to guarantee mortgage credit in place of Fannie Mae and Freddie Mac. Such an approach may be the best means of addressing the inherent conflicts that the GSEs' faced with their hybrid structure of private ownership coupled with a public mission. "Under a utility model, Congress would replace Fannie Mae and Freddie Mac with one or two private-sector entities," said Paulson. "These entities would purchase and securitize mortgages with a credit guarantee backed by the federal government and would not have investment portfolios." The privately-owned companies would be governed by a rate-setting commission, which would establish a targeted rate of return on mortgage financing provided to "a population to be defined by Congress" and be responsible for approving mortgage products and underwriting procedures.

- "In this model, continued safety and soundness regulation would be essential," said Paulson. The federal government would receive compensation from the private entities for providing a guarantee, he added. Such a mechanism would encourage private-sector competitors to the utility model and serve as a potential substitute for government backing. (*Bureau for National Affairs*, Mike Ferullo, 01/08/09)

- *National Mortgage News* reports, "A National Association of Home Builders task force on housing finance has recommended that the politically powerful organization adopt a policy blueprint that calls for a sharing of the interest rate and credit risk by the private sector institutions which benefit from the government's secondary market support. The task force, which was established by the NAHB's senior officers last fall, also recommends that Fannie Mae and Freddie Mac retain their federal backing but be limited primarily to providing credit enhancements for mortgage-backed securities. The sharing concept would be a 'cooperative structure' loosely based on the Federal Home Loan Bank model, according to Chellie Hamecs, assistant staff vice president for housing finance. Under the proposal, lenders would be liable for a 'significant portion of the risk' in direct proportion to the volume of loans they sell to the government-sponsored enterprises. As envisioned by the task force, Fannie and Freddie would be given only limited portfolio capacity and then only to accommodate mortgages and housing-related investments that have no other secondary market outlet." (*National Mortgage News*, 01/19/09)

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Banking crisis needs a 9/11-style investigation

- Senator Johnny Isakson (R-GA) called for a full-scale congressional investigation into the financial crisis which has rolled financial markets worldwide. Isakson and Senator Kent Conrad (D-ND) have introduced legislation that, if approved, would create a seven member Financial Markets Commission to determine why U.S. banks have suffered massive losses and put borrowers, taxpayers, and the world economy at risk. The commission, modeled after the bipartisan September 11th Commission, would have full subpoena power, a $3 million budget, and could refer any illegalities to federal and state persecutors and state and federal bank regulators. Members of the commission would be appointed by the President, leaders of the House and Senate and Federal Reserve chairman Ban Bernanke. (*The Atlanta Journal-Constitution*, Bob Keefe, 01/22/09)

FHFA announces new mortgage data requirements

- On or after January 1, 2010, Fannie Mae and Freddie Mac will be required by the Federal Housing Finance Agency to obtain loan-level identifiers for the loan originator, loan origination company, field appraiser, and supervisory appraiser for all mortgage applications. According to the FHFA, this new requirement for loan level data is consistent with Title V of the Housing and Economic Recovery Act of 2008, the S.A.F.E. Mortgage Licensing Act. (*Federal Housing Finance Agency Press Release*, 01/15/09)

Foreclosure crisis is "Job 1" for HUD, says HUD Secretary Donovan

- Shaun Donovan, recently-confirmed HUD Secretary, promised lawmakers at his confirmation hearing a more aggressive and far reaching effort to ease the mortgage crisis and promote affordable housing. Donovan promised to return HUD to the forefront of the government's response to the housing crisis, if confirmed. "Housing is the root of the market crisis we are now experiencing, and HUD must be part of the solution. Donovan, the housing commissioner for New York City, said HUD would be key player in developing the administration's plans to help homeowners and prevent foreclosures. Donovan also supported the use of TARP funds to effect loan modifications. Specifically, he told lawmakers that HUD would look at FDIC's IndyMac model, along with the voluntary Hope for Homeowners program. On January 22nd, Donovan was unanimously confirmed by the Senate to serve as HUD Secretary. (*Bureau of National Affairs*, Thecla Fabian, 01/14/09; *American Banker*, Joe Adler, 01/14/09; *CQ Today*, Karoun Demirjian, 01/13/09; National Mortgage News Online, 01/23/09

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Changing of the guard

- Representative Carolyn Maloney (D-NY) will no longer chair the Financial Institutions Subcommittee of the House Committee on Financial Services. Representative Dennis Moore (D-KS) will succeed Representative Mel Watt (D-NC) as chairman of the House Financial Services Oversight Subcommittee. (*American Banker*, Stacy Kaper, 01/23/09)

- Two of the most conservative members of the House Financial Services Committee gained leadership roles when Representative Spencer Bachus (R-AL) named Representative Jeb Hensarling (R-TX) to be the ranking member for the financial institutions subcommittee and Representative Scott Garrett (R-NJ) as the ranking member for the subcommittee with jurisdiction over capital markets, insurance, and government-sponsored entities. (*American Banker*, Joe Adler, Rob Blackwell, and Steven Sloan, 01/12/09)

- The Democrats have added Senators Herb Kohn (D-WI), Mark Warner (D-VA), Jeff Merkley (D-OR), and Michael Bennett (D-CO) to the Senate Banking Committee, which will have 13 Democratic and 10 Republican members versus the split of 11 to 10 in the 110th Congress. Senators Robert Casey (D-PA) and Tom Carper (D-DE) have left the committee. (*American Banker*, Joe Adler, Rob Blackwell, and Steven Sloan, 01/12/09)

- The Republicans have added Senators Jim DeMint (R-SC), David Vitter (R-LA), Mike Johannas (R-NE), and Kay Bailey Hutchison (R-TX) to the Senate Banking Committee. Senator Michael Enzi (R-WY) has left the committee, while Senators Chuck Hagel (R-NE) and Wayne Allard (R-CO) have retired and Elizabeth Dole lost her bid for re-election. (*American Banker*, Joe Adler, Rob Blackwell, and Steven Sloan, 01/12/09)

- Treasury Secretary Henry Paulson has announced that he will take a position at John Hopkins University's School of Advanced International Studies after he leaves government service. Paulson said he has not made up his mind on any long-term option, but wants to be involved in nature conservation. He said he is not interested in taking a job as a CEO nor is he seeking to make money. (*Washington Post*, David Cho, 01/17/09)

- Randall S. Kroszner submitted his resignation as a member of the Board of Governors of the Federal Reserve System, effective January 21, 2009. Kroszner will return to the Booth School of Business at the University of Chicago to assume a newly created chaired professorship. (*Federal Reserve Press Release*, 01/12/09)

- Ronald A. Rosenfeld resigned as chairman of the Federal Housing Finance Board, effective December 31, 2008. FHFA director James B. Lockhart, III said, "Mr. Rosenfeld has demonstrated a commitment to public service throughout his career.

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Under his leadership, the Federal Housing Finance Board took steps to strengthen the oversight of the Federal Home Loan Banks and encouraged the Banks to adopt policies that are in the best interests of the public." (*Federal Housing Finance Agency Press Release*, 01/06/09)

- The Obama administration has asked Ginnie Mae president Joseph Murin, HUD chief financial officer John Cox, and FHA commissioner Brian Montgomery to remain in their posts for four weeks to allow the new administration to put their staff in place. Sources indicate that Treasury assistant secretary Neel Kashkari, who is director of TARP, has also been asked to stay on. By statute, FHFA director James Lockhart should stay in his post until his successor is confirmed by the Senate.

Supreme Court to hear case on federal preemption

- On January 16th, the Supreme Court announced it will decide whether states have the power to enforce their own anti-discrimination lending laws against national banks. By accepting the appeal of *Cuomo v. Clearing House Association*, the Supreme Court is stepping into a fight between New York Attorney General Andrew Cuomo and the federal Office of the Comptroller of the Currency, which contends that only federal regulators have the power to investigate national banks. Lower courts have agreed with the OCC, which filed suit to block then Attorney General Eliot Spitzer from investigating several national banks, including J.P. Morgan Chase, Wells Fargo and Citigroup, in 2005.

- Cuomo argues that since states are allowed to have their own anti-discrimination laws, they must be able to enforce them against all banks. The OCC regulation "prohibits states from bringing even the same kinds of judicial actions against national banks that can be brought by a private party," said Cuomo. At issue is whether and to what extent state authorities are able to exercise "visitorial powers" over national banks.

- In December 2007, the U.S Court of Appeals for the Second Circuit ruled that the powers belong exclusively to the Office of the Comptroller of the Currency. One judge dissented from the ruling, arguing that the OCC rules went too far by usurping the state's power to police by preventing New York officials from enforcing their own laws. (*Washington Post*, Robert Barnes, 01/17/09; *Bureau of National Affairs*, R. Christian Bruce, 01/19/09)

A few notes on the economy

- According to RealtyTrac, 3.2 million foreclosure filings were reported in 2008, an increase of 81% filings in 2007. Filings in December totaled 303,410, up 17% from

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November and over 40% from December 2007. (*HousingWire*, Kelly Curran, 01/15/09)

- The Federal Housing Finance Agency reported that its home price index fell 1.8% on a seasonally-adjusted basis from October to November. For the 12 months ended November 30th, U.S. housing prices fell 8.7% with home prices now off 10.5% since their peak in April 2007. (*HousingWire*, Paul Jackson, 01/22/09)

- Housing starts tumbled 15.5% in December, setting a new low, while permits—a forward indicator—fell 10.7% For the 2008, there were 904,300 units started, a decline of 33.3% from total housing starts of 1.355 million units in 2007. (*Bureau of National Affairs*, Diana I. Gregg, 01/23/09)

- Unemployment hit a 16-year high in December, reaching 7.2%--the highest unemployment rate since January 1993. In 2008, employers have eliminated 2.6 million jobs, swelling the unemployment ranks to 11 million people. According to the Conference Board's latest forecast, the 2 million more jobs may be lost in the U.S. in 2009. (*Washington Post Online*, Howard Schneider, 01/09/09; *CNNMoney*, Larissa Padden, 01/12/09)

- The American Bankers Association reports that delinquencies on indirect auto loans and home equity lines of credit reached their highest levels ever in the third quarter of 2008. Delinquencies for indirect auto loans, which comprise 90% of all auto loans, were up 18 basis points to 3.25%, while HELOC delinquencies were up seven basis points to 1.15%. Credit card delinquencies dropped 34 basis points to 4.2%--down from 4.54%. (*Bureau of National Affairs*, 01/08/09)

- Fitch Ratings said the outlook for U.S. mortgage insurers remains negative over the immediate term. As an industry, mortgage insurers are heavily exposed to the 2007 vintage, which accounts for 30% of the industry's risk in force and coincided with a low point in mortgage underwriting standards. "Mortgage insurers face a real risk of breaching their capital limits, which will likely limit the industry's ability to take advantage of new and potentially more profitable business to offset the challenges in legacy portfolios," said Roger Merritt, Fitch's managing director. Separately, MGIC Investment Corp. announced a fourth quarter loss of $273.3 million and said it does not expect to return to profitability in 2009. (*Fitch Press Release*, 01/13/09; *HousingWire*, Diana Golobay, 01/20/09; *American Banker*, Harry Terris, 01/21/09)

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Fannie Mae

Fannie Mae adopts a National REO Rental Policy

- On January 13th, Fannie Mae announced a new National Real Estate Owned Rental Policy that allows qualified renters to remain in company-owned properties. The new policy applies to renters occupying foreclosed properties—including single family, two-to four unit properties, condos, co-ops, and manufactured houses—at the time Fannie Mae acquires the property. Eligible renters will be offered a new month-to-month lease at current market rates with Fannie Mae or financial assistance for their transition to new housing, if they choose to vacate the property. All REO properties must meet state laws and local code requirements for a rental property. The REO properties will be listed for sale and may undergo repairs, while the tenant is occupying the property. The property lease will transfer to the new owner at the time of sale.

- "Renters in foreclosed properties have often been a casualty of the foreclosure crisis the country is facing," said Fannie Mae COO Michael Williams. "This policy will allow qualified renters to remain in Fannie Mae-owned properties should they choose to do so, mitigate the disruption of personal lives that foreclosures can cause, and help bring a measure of stability to communities impacted by high foreclosure rates." (*Fannie Mae News Release*, 01/13/09; *HousingWire*, Diana Golobay, 01/20/09)

FDIC may face a $10 billion exposure on IndyMac loans

- According to the *New York Post*, the FDIC may be facing up to $10 billion in previously unknown liabilities tied to mortgages failed lender IndyMac sold to Fannie Mae. Such a liability, representing nearly a third of the FDIC's $34.6 billion insurance fund, would leave the agency less able to deal with the number of bank failures expected this year. On January 2nd, FDIC sold IndyMac's assets to an investor group, which included Dune Capital Management and J.C. Flowers & Co, and agreed to share losses on a portfolio of IndyMac loans as part of the transaction. According to the *Post*, Fannie Mae and the FDIC have been battling over the questionable mortgages for months. Although the sale of IndyMac has closed, the liability for Fannie Mae mortgages was not transferred to the buyers. (*Reuters*, 01/12/09)

Fannie Mae tests "short sales" as an alternative to foreclosure

- Fannie Mae has started two pilots testing the "short sale" of homes, as a means of speeding up the sales process and minimizing foreclosures and all-end expenses. Through these pilots, Fannie is attempting to reduce the delay and spur sales by

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agreeing on a price for a home—and defining the loss that the company is willing to accept on the sale—even before a buyer has been found.

- In December, Fannie Mae began a three-month test of short sales in Phoenix, AZ and Orlando, FL for properties secured by a Fannie mortgage and serviced by Countrywide Financial, a subsidiary of Bank of America. Only homes listed for sale at less than the unpaid balance on the mortgage are eligible for the pilot. To date, 400 homes have qualified for preapproval in the pilot program in both markets. According to a Clayton Holdings' analysis, short sales result in average loan losses of about 19% versus the average loss of 40% for homes sold after foreclosure.

- If the pilot programs are successful, Fannie Mae plans to expand the program to other lenders and regions. "Fannie Mae's goal is to make the short-sale process as fast as possible for homeowners in financial distress [so as to ensure a] graceful exit strategy for homeowners," said Kevin Brungardt, Fannie Mae's vice president for servicing management. (*Wall Street Journal*, Nick Timiraos, 12/09/09)

Fannie Mae cuts hundreds of jobs at its Washington headquarters, but adds staff in the field to combat rising foreclosures

- Fannie Mae has eliminated several hundred jobs at its Washington headquarters, as it refocuses on preventing home foreclosures and added a similar number of employees to its loss mitigation team in Dallas to combat rising foreclosures. Brian Faith declined to provide precise figures for job reductions or comment on whether the workers would be given severance packages. "Fannie Mae is taking steps to realign the company's organization, personnel and resources to focus on our most critical priorities, which include preventing foreclosures to help keep people in their homes and aiding in the recovery," said Faith. Most of the positions being eliminated came from among Fannie's single-family mortgage unit, communications workers and technology division at the company's headquarters, while a small number of jobs were from the company's regional offices outside of Washington, said Faith. Overall, Fannie's workforce should remain the same in 2009 as in 2008 with just over 5,500 employees. (*Washington Post*, Zachary A. Goldfarb, 01/23/09; *Bloomberg News*, Dawn Kopecki, 01/23/09)

Court of Appeals upholds contempt ruling against OFHEO

- The U.S. Court of Appeals for the District of Columbia has upheld a January 2008 contempt ruling against the Federal Housing Finance Agency, formerly called the Office of Federal Housing Enterprise Oversight, for withholding key documents in a class action securities fraud lawsuit against Fannie Mae's former chairman and CEO Franklin Raines, former CFO Timothy Howard and former Controller Leanne Spencer. Under the ruling, the regulator must turn over some 20,000 internal documents to the defendants' legal counsel. (*Bloomberg News*, Dawn Kopecki,

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01/06/09)

Cost of financing a condo goes up—adding additional stress to a battered market

- Effective April 1st, Fannie Mae will charge borrowers a new fee of 0.75% of the loan amount for mortgages collateralized by a condominium, if the borrower's loan-to-value ratio is 25% or less. According to Fannie Mae spokesman Amy Bonitatibus, "These are targeted pricing adjustments aimed at aligning price with risk for the highest-risk products in the market today, including interest-only loans, cash-out refinancings, low credit scores, high loan-to-value loans and condos. Fannie Mae continues to support lenders and provide liquidity to the market."

- Mortgage broker Dan Green argues that Fannie Mae's new fee on condominium properties and numerous other loan charges recently announced, put the government at cross-purposes with itself—specifically the Federal Reserves push to drive down mortgages rates. Instead, Green expects the affected condo loans to be financed by FHA, which insures low down payment mortgages. (*Chicago Tribune*, Mary Umberger, 01/18/09)

Fannie Mae alumni update

- Former Fannie Mae general counsel Beth A. Wilkinson will join Paul Weiss Rifkind Wharton & Garrison LLP's white collar practice group in the firm's Washington, D.C., office as a partner on February 2. At Fannie Mae, Wilkinson held the positions of executive vice president, general counsel and corporate secretary from February 2006 to September 2008. Wilkinson is the wife of *Meet the Press* moderator David Gregory. (*The Am Law Daily*, Amy Kolz, 01/21/09)

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Freddie Mac

Freddie Mac and JP Morgan Chase reach a settlement on WaMu mortgages

- Freddie Mac and JP Morgan Chase (JP Morgan) have reached a settlement agreement concerning Washington Mutual's assets acquired by the Bank. Under the agreement, Freddie Mac has agreed to consent to JP Morgan becoming the servicer of loans previously serviced by WaMu. In exchange, JP Morgan will assume WaMu's recourse obligations for those loans sold to Freddie Mac with recourse. For loans sold by WaMu to Freddie without recourse, the Bank has agreed to make a one-time payment to Freddie Mac to cover other loans that WaMu would have been required to buy back because the mortgages failed to meet promises made to Freddie about their quality. (*Bloomberg News*, Dawn Kopecki and Jody Shenn, 01/23/09; *Form 8K*, Freddie Mac, 01/23/09)

Freddie Mac's single-family delinquencies rise 62% in December from year-ago levels

- In December, Freddie Mac's "mortgage related investments" [formally known as retained mortgage portfolio] declined at an annualized rate of 1.0%--or $665 million—to $804.8 billion. During the month, Freddie Mac's total guaranteed PCs and Structured Securities increased at a rate of 0.4%, bringing the growth rate to 5.1% for 2008. The company's single family delinquency rate was 1.72% in December, up 20 basis points from November (1.52%) and 107 basis points from December a year ago (0.65%). The rate of multi-family delinquencies was 0.01%, unchanged from November. (*Monthly Volume Summary*, Freddie Mac, December 2008; *HousingWire*, Paul Jackson, 01/23/09)

Freddie Mac is violating the "spirit" of the moratorium agreement," say legal aid groups

- Freddie Mac continues to pursue legal action to evict tenants living in foreclosed properties, drawing criticism from legal aid groups who argue the company's actions violate the spirit of their November moratorium on foreclosures and evictions. Although Fannie and Freddie have suspended sales of foreclosed properties and aren't locking people out of their homes, both companies continue to initiate court cases against homeowners and pursue existing cases, according to Freddie Mac spokesman Brad German and Fannie Mae spokesman Brian Faith.

- In addition, Freddie is also still filing eviction proceedings against renters, while Fannie has suspended all action against tenants living in repossessed homes. "The new filings send the message that Freddie Mac doesn't want to work with them and causes immense fear, stress and instability," said Amy Marx, a staff attorney with the

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New Haven Legal Assistance Association. "People think they're being evicted." Stephanie D'Ambrose, an attorney for Greater Hartford Legal Aid in Connecticut, said, "The tenants, meanwhile, still have to defend these cases. People feel very powerless. A lot of people will move out or take cash for keys without knowing that come February 1 they will have an opportunity to get a lease."

- The activist groups argue that Freddie is following a different policy from Fannie by continuing to take legal steps toward tenant evictions. "The actual sale, the actual eviction has stopped, but the process continues," said German. "The moratorium does not affect the normal process of legal filings. But no one is being evicted, the homes are not being sold. …We are not evicting anybody—renter or owner—during the moratorium, and we are working on policies similar to those announced by Fannie." In contrast, Fannie Mae is "not undertaking eviction proceedings, filings, court cases, etc. with regard to renters in our foreclosed properties," according to an email from Faith. When cases have fallen through the cracks and court action continued, Fannie is ``literally sending people out to knock on doors to make them aware of the policy and, when they're not home, we leave flyers with information about their options," added Faith. (*Bloomberg News*, Dawn Kopecki, 01/15/09)

Federal Home Loan Banks

FHLB-Boston president Jessee to retire

- Michael A. Jessee, president and CEO of the FHLB-Boston, has announced his plans to retire at the end of April. During his 20 year tenure as CEO, the Bank's assets have grown eight-fold from less than $10 billion to more than $80 billion today. Jessee said, "I am deeply grateful to have had the opportunity to serve such a fine institution and to guide the Bank in the fulfillment of its mission. "I have great affection and respect for the Bank's employees and members and am most proud of the communities we have helped to build and support as a team." He has agreed to remain in his current executive capacity during the next four months to allow the board time to appoint a new CEO and to ensure a smooth transition. (*FHLB-Boston Press Release*, 01/09/09)

FHLB-Des Moines introduces a new certificates of deposits program

- On January 21st, the FHLB-Des Moines announced it will begin purchasing certificates of deposits from its members in early February. Under this new program, the Bank would purchase a member's certificate of deposits which (1) are insured by FDIC or NCUA; (2) have balances not exceeding $250,000 "per member" (including

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interest); (iii) have a maximum term of 270 days; and (iv) mature no later than December 31, 2009. As of January 21st, the "indicative" rates for this program ranged from 1.42% for 90 day CDs to 1.73% for 270 day CDs. The Bank said that rates for the program will be posted at its website and would be subject to change throughout the day. (*FHLB-Des Moines*, 01/21/09)

Ginnie Mae

FHA needs to boost its oversight of its $180 billion mortgage insurance program

- In January 9th testimony before the House Financial Services Committee, HUD Assistant Inspector General James Heist said that FHA does not have enough resources or proper systems in place to properly oversee its portfolio of single-family insured mortgage loans, which tripled from $59 billion in FY2007 to $180 billion in FY2008. "FHA may not be able to handle its expanded workload or new programs that require the agency to take on riskier loans than it historically has had in its portfolio," Heist told the panel. One of FHA's largest problems is a rapidly increasing default rate of approximately 6.5% of all FHA loans, spurred by falling home prices, he added. "The tightening credit market has increased FHA's position as a loan insurer and, with that, is coming an increase in lender/brokers seeking to do business with the federal program and an overall concern regarding some of these loan originators." Heist also expressed concern that former subprime lenders are infiltrating FHA programs, as the number of FHA-approved lenders increasing more than five-fold from 692 at the end of FY2006 to approximately 3,300 at the end of FY2008. "The integrity and reliability of this crop of program loan originators, in our view, is unproven," said Heist. "In light of the aggressive recent history of this industry, it may pose a risk to the program." Heist also cautioned that an "unknown hazard" is FHA's entry into new metropolitan areas afforded by the agency's higher conforming loan limits. "Simultaneous to this confluence of events, is an increase in the reported incident of mortgage fraud," Heist warned the panel.

- Heist told the panel that the "once fairly robust" FHA reserves to cover losses have dropped 40% to $12.9 billion, or 3% of FHA-insured mortgages, over the past year. "If more pessimistic assumptions are factored in, the ratio could dip to below 2% in succeeding years, requiring an increase in premiums or congressional appropriations intervention to make up the shortfall," said Heist.

- Phillip Murray, deputy assistant secretary of HUD, said the agency needed to bolster the its monitoring and oversight capabilities, particularly in the areas of information technology systems. "This is a critical need," he testified. "FHA data is stored on 35 separate legacy systems, which have been obsolete for nearly two decades."

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However, Murray argued that it's unfair to draw comparisons between FHA-insured mortgages and risky subprime loans made by unscrupulous lenders. "FHA loans are neither high-cost or high-risk for homeowners," said Murray. "…FHA prohibits underwriting based on 'teaser' rates, requires that lenders escrow for taxes and insurance, and will not tolerate any prepayment penalties or balloon mortgages."

- House Financial Services Committee chairman Barney Frank (D-MA) urged Heist and Murray to provide him recommendations on increasing FHA funding and staffing. "We need to make you more of a player than you currently are," said Frank, who envisions an even larger role for agency as the Obama administration focuses a greater share of TARP funding toward government-backed mortgage modifications. (*Bureau of National Affairs*, Mike Ferullo, 01/12/09; *CongressDaily*, 01/09/09)

Ginnie Mae seeks ways to assist with loan modifications

- Joseph Murin, president of Ginnie Mae, said he would like for Congress to amend his agency's charter so it could securitize any kind of federally-insured loan—a move which would dovetail with plans floated by other agencies to take troubled assets off banks' books or provide guarantees to lenders that modify mortgages. Murin argues that by repacking these loans into bonds with the Ginnie Mae stamp, the loans could easily be sold to investors around the world. "Giving Ginnie Mae the additional authority could be beneficial, especially now when our value in the investor marketplace is at such a premium," said Murrin. "I just believe that a government guarantee is a government guarantee, and whether it comes from the FHA, VA, or even the Treasury, what would it matter? During this time when loan workouts, modifications, and foreclosure prevention are at the forefront of the government, they may be compelled to be creative." The FDIC- or Treasury-guaranteed loans he envisions Ginnie securitizing would go into separate pools. Investors would likely be attracted to the securities, Murrin argued, "because there is very little chance for prepayment via refinance. Therefore, if there is volume it will sell."

- John Courson, the president of the Mortgage Bankers Association, said lenders' big concern is making sure that Ginnie Mae continues to allow only homogenous loans into its two most frequently issued types of securities — Ginnie Mae I and Ginnie Mae II. "Ginnie Mae Is and IIs are incredibly liquid and incredibly fungible, and anything that disturbs that, it does not well serve getting the best execution, the best pricing for the borrowers in FHA," said Courson. One problem with temporary FHA programs, like Hope for Homeowners, is that the loans would have to go into separate pools. Investors will not be willing to pay up for the securities because "it's a program that at some point is going to go away," said Courson. "[There will not be] enough size out there to create an ongoing, viable market." (*American Banker*, Kate Berry, 01/16/09)

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Ginnie Mae to take into account the effect of H4H program on pool delinquencies

- In a January 16th memo, Thomas R. Weakland, FHA's acting executive vice president, wrote that H4H loans "may experience higher delinquency levels than other FHA loans. …[I]f an issuer's delinquency levels exceed Ginnie Mae's threshold, Ginnie Mae will consider the impact of H4H loans when determining the nature of any action it may take." (*American Banker*, Marc Hochstein,

Farm Credit System / Farmer Mac

Biofuel industry seeks bailout

- With numerous biofuel companies are shutting down and going bankrupt, the biofuel industry is seeking billions in subsidies and tax credits—*on top* of the $1.1 billion in farm energy subsidies authorized by Congress in 2008. In a letter to Congressional Democrats, a coalition of 33 lobbyists argued that a farm energy bailout will "help resuscitate our nation's economy and create hundreds of well-paying jobs." Specifically, the industry is seeking (i) $1.2 billion per year to build and operate "clean energy" facilities; (ii) a five year extension of the federal Production Tax Credits for renewable energy, cellulosic biofuels, and biomass with a provision making the PTC "fully refundable;" and (iii) an expansion of the clean renewable energy bond program. The lobbyists also argued that the bailout funds would expand the use of biofuels (over dirty fossil fuels), which would reduce carbon dioxide emissions that are causing man-made global warming. (*Reason Magazine*, Ronald Bailey, 01/13/09)

Georgia governor obtains an "unusual" FCS loan

- According to the *Atlanta Journal-Constitution*, Governor Sonny Perdue (R-GA) obtained a $21 million personal loan from AgGeorgia Farm Credit, secured by his personal home and his grain elevator business assets, worth less than 20% of the loan's value. The *Journal* termed the loan "unusual," since FCS members typically require collateral of at least 50% and the loan is roughly three times the governor's personal assets, according to his latest public financial statement dated December 31m 2006. The governor's spokesman, Bert Brantley, said "[Perdue is] a small businessman. As small businesses and small business owners around the state know, sometimes you have to personally sign for loans for your business." Because he isn't running for office again, Perdue is not required to disclose the details of the loan, which is due by March 1st. (*Associated Press*, 01/19/09)

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Postal Service

NAPUS urges Congress to include the USPS in the economic stimulus package

- According to the January 16th *eNAPUS Legislative & Political Bulletin*, "NAPUS has been working closely with other postal employee groups to include H.R. 22 within the $825 billion '2009 American Recovery and Reinvestment Act,' aka the economic stimulus package. On January 6, Reps. John McHugh (R-NY) and Danny Davis (D-IL) introduced H.R. 22; it is identical to legislation introduced in December. The bill would permit the USPS, for an 8-year period, to pay employee FEHBP premiums out of its Retiree Health Benefits Trust Fund. In 2017, the USPS would begin to repay the obligation to the Fund. Basically, the proposal refinances the Fund, helps the USPS through the current national economic crisis, and does not jeopardize active or retiree health benefits. Moreover, the bill does not call upon taxpayers to foot the bill. The postal community, plus the USPS, support including H.R. 22 in the stimulus package. … [The January 15th] rollout of the American Recovery and Reinvestment Act did not include H.R. 22; nevertheless we will continue to seek inclusion…" (*eNAPUS Legislative & Political Bulletin*, 01/16/09)

The USPS needs a full-sale restructuring—which includes privatization

- On *Forbes.com*, Robert R. Schrum wrote, "As the economy continues its downward slide, the U.S. Postal Service just made it even more difficult for businesses already struggling to survive. On Jan. 18, USPS raised prices between 3% and 8% for both Priority and Express Mail. To make matters worse, USPS is now lining up at Congress' financial soup kitchen—seeking what amounts to a taxpayer bailout. But the rescue plans under consideration—like postponing USPS' benefit-funding obligations—won't suddenly make the agency profitable. Perhaps it's time to face the hard truth: To survive in the 21st century, the Postal Service will need to undergo a full-scale restructuring, including privatization. Neither a short-term cash injection nor an exemption from benefit-funding obligations can solve the agency's problems."

- …Privatization of the mail is not as far-fetched as it may seem. Other nations—including Germany, Austria and Japan—have enjoyed favorable results privatizing their postal services. Even France is looking to sell an equity stake in its national carrier. USPS is certainly an attractive asset, with its experienced workforce, unparalleled brand recognition, massive fleet, real-estate empire and vast distribution network that reaches into every American home. A sale to private interests could perhaps even fetch enough money to cover the Postal Service's benefit-funding requirements. The present economic crisis is sure to bring restructuring to many American firms. Why not take this opportunity to get serious about privatizing the USPS?" (*Forbes.com*, Robert R. Schrum, 01/19/09)

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- In a Letter to the Editor of *Forbes*, the Postal Service's VP of corporate communications Mitzi Betman responded to Schrum's column, writing: "In his recent commentary…, Robert Schrum once again advocates for the privatization of the U.S. Postal Service, an old idea that has been rejected many times by those with a better understanding of postal issues and one which has never been accepted by Congress. In laying a very thin foundation for his current argument, Mr. Schrum asserts that the Postal Service is seeking a 'taxpayer bailout.' This is completely untrue. What we are seeking from Congress is a small word change to amend a 2006 law to allow the Postal Service to use its own monies to pay its retiree health premiums out of an already established retiree health benefit trust fund created through Postal Service funding, rather than make a separate payment to the Office of Personnel Management."

- "This option would accelerate a provision of the 2006 law which states that after 2016, premium payments would no longer be paid separately, but would be drawn from the trust fund. This change would help the Postal Service weather the broad economic storm affecting the entire country and reduce the need for the Postal Service to borrow money from the Treasury for the sole purpose of depositing that money into the trust fund. The Postal Service would continue pre- funding its retiree health benefits obligations — the only Federal entity to do so. The Postal Service does not have the options available that are available to private sector firms, such as reducing or eliminating contributions to retirement plans, which have been invoked by many firms since this financial crisis began." (*Letter to the Editor of Forbes Magazine*, Mitzi R. Betman, 01/22/09)

An opening salvo from APWU president Burrus

- In a January 23rd update to APWU members, union president William Burrus wrote, "Over the past several months I have attempted to alert APWU members to the financial crisis that is confronting the Postal Service, and the substantial impact it will have upon postal employees. Although some in the postal community dismissed my warnings as alarmist, it was my intent to prepare APWU members that — unless there was a sudden and dramatic improvement in the economy — significant changes were inevitable."

- "…Well, change is upon us: In the near future, the Postal Service will implement modifications to postal operations that are unprecedented in the 230-year history of this great institution. Change will take place, and the changes will affect employees. Rumors have been circulating throughout the system recently, but at this time I have received no information from the Postal Service about which alternative or alternatives management plans to implement."

- "When I receive official notification about the course of action management intends to pursue, I will be in a better position to inform APWU members of the contractual provisions and employee protections that apply. Any plan that is adopted will include

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work-hour reductions, which has been at the very core of management's response to reduced volume and financial deficits. I have previously expressed my concern over this narrow approach. No business can exist for long with this strategy; eventually it will become impossible to maintain an acceptable level of service."

- "But when work-hour reductions are implemented, they should not be applied disproportionally to bargaining unit employees. Staffing is based on workload and responsibility, so if the number of employees must be reduced, reductions should be made across-the-board, including all craft employees, supervisors, postmasters, managers and contract employees."

- "The very foundation of the postal complement is craft employees, with the remaining categories staffed at a ratio of responsibility for the activities of those employees. Since the number of craft employees has already been reduced by more than 100 million work hours over the last four years, there should be proportional reductions in the remaining categories. There is no justification for the retention of supervisors, managers, and contract employees at previous levels when the number of craft employees has been reduced to this extent. If postal executives want craft employees to understand the need for significant changes, the sacrifices must be shared by every segment of the postal community."

- "If the sacrifices are not shared, employees will reject the plan, and I will proudly lead that effort. If there are fewer craft employees, there must be fewer supervisors, fewer postmasters, and fewer contract employees. And 'workshare discounts,' which subsidize the major mailers at the expense of the Postal Service and employees, must end." (*APWU Burrus Update*, William Burrus, 01/23/09)

TVA

State of North Carolina wins lawsuit against TVA, forcing the utility to lower emissions from four of its coal-fired plants

- On January 13th, U.S. District Court Judge Lacy Thornburg ruled that TVA must install pollution controls at four plants—a victory for the State of North Carolina in its lawsuit against the nation's largest public utility. In the 2006 lawsuit, North Carolina Attorney General Roy Cooper argued that TVA wasn't doing enough to control sulfur dioxide, nitrogen oxides, and mercury emissions from its coal-burning plants ask asked the court to order the utility to lower its emissions to meet state's Clean Smokestacks Act by 2013. In his ruling, Thornburg ordered TVA to install scrubbers and other controls in its four plants closest to North Carolina and meet specific emissions caps—of which one plant has the necessary equipment in place.

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The judge denied the AG's request that controls and caps be required at TVA's other seven plants, finding that the State failed to prove emissions from those facilities hurt North Carolina's air quality.

- The cost for TVA to comply with the court's ruling was not immediately known. During the trial, experts testified that the cost of installing the requested pollution controls at all 11 of TVA's plants. To date, TVA has spent $4.8 billion over the past two decades to improve air quality and emissions with an additional $1 billion in process with plans to spend $3 billion more over the next ten years. TVA said it currently is paying out $1 million a day to clean up the utility's coal ash spill in and expenses will rise even more if it must meet the federal judge's accelerated deadline for reducing smokestack pollutants affecting North Carolina. In a filing with the SEC, TVA wrote, "…[A]dvancing the construction schedule or taking additional actions [to comply with the order] could increase TVA's expenses or cause TVA to change the way it operates these facilities." TVA is considering whether to appeal the ruling. (*Associated Press*, Duncan Mansfield, 01/20/09; *Associated Press*, 01/13/09)

TVA's "mission drift"

- In a January 18th editorial, the *Chattanooga Times Free Press* wrote, "The Tennessee Valley Authority isn't just going through a rough patch. Its recent problems reflect something much larger and perceptibly much more fundamental than that. After three toxic spills in three weeks—including one of over 1.1 billion gallons, the largest toxic spill ever in this nation—and a federal judge's order to TVA to clean up continuing air pollution at four of its coal-fired plants, critics would say it looks like the wheels are starting to fall off at TVA. That may be an overstatement, yet it is undeniable that some long-standing problems—problems that reflect a long history of TVA's desultory management style regarding major environmental issues—are coming home to roost. Taken together, these recent events ought to challenge TVA's tired devotion to its standard operating procedure. That is no longer good enough. In reality, it never was."

- "Each of the recent problems owes to a mindset in TVA's hierarchy that for decades has deferred—indeed, preferred to let slide—the remediation of known and major environmental problems in favor of business as usual; more specifically, in favor of a myopic focus and exalted priority of producing the cheapest power possible. Burdened by the staggering cost of its grand but failed nuclear power strategy of the 1970s, TVA's management approach the past 20 years has simply been to say that TVA doesn't have to bother with fixing its environmental problems as soon as possible; fixing them later is OK, never mind continuing damage to human health and the environment."

- "Like the dirty dozen of other big, polluting electric power utilities in the South and the Ohio Valley by which it has come to measure its performance, TVA's leaders

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since 1988 have been much too content to stretch out the schedule for installing air pollution scrubbers and improving disposal of coal's toxic fly-ash waste as long as possible. Or as long as it can get away with it through legal strategies and joint lobbying with the dirty-dozen cabal of electric utilities doing the same scheming. In fact, the agency has, since former chairman David Freeman left more than 20 years ago, pragmatically abandoned its sense of historical mission as something far more than just another big electric utility."

- "TVA's leaders, of course, still like to pay public homage to TVA's broad charter mission of environmental stewardship, integrated resource management and economic development in its Tennessee Valley territory, a region that covers Tennessee and parts of six surrounding states. But the agency's underlying strategy and business model has been to operate like a for-profit, investor-owned utility that puts the bottom line first well above other public interests."

- "Time was, TVA honored its founding charter as a public agency, a nationally unique mission forged in Franklin Roosevelt's New Deal era. Pieces of its 1933 charter goals—forestry management, agricultural innovation, fertilizer production—have naturally fallen away in recent decades. But as an integrated resource agency at heart, TVA still should be as responsible and accountable for energy conservation and clean power production as it is for river management and overall electrical generation. That sense of mission evaporated in 1988, when new board chairman Marvin Runyon took over. Under him, TVA immediately began shedding its nation-leading energy conservation program—a program developed at the behest of President Carter in the wake of the 1973 oil embargo—in favor of low-priced, high-volume sales of electricity. That suited its 160 local power distributors—their goal also was to sell electricity, not conserve it—and TVA never looked back. That changed a bit only last year, when electric demand finally strained capacity and its board allocated $20 million to develop—surprise—a viable energy conservation program."

- "In the interim, TVA kept overhauling its old, horribly polluting, coal-burning plants. Those plants, built mainly from the mid-1940s to the 1960s, couldn't keep going without being rebuilt. TVA did that work with faint regard for the Clean Air Act of 1970 and the Clean Air Act amendments of 1977, which required the installation of modern pollution-control technology when old power plants were rebuilt. That led directly to a lawsuit by the EPA toward the end of the Clinton administration, and again to the federal court order in the North Carolina lawsuit last week, among others. The recent lawsuit could have been avoided had TVA abided by the consent decree it had reached in 2000 with the Clinton administration's EPA to quickly finish installing air pollution scrubbers. Instead, when the Bush administration took over in 2001 and stalled the EPA's push to make the nation's dirtiest utilities at last comply with the Clean Air Act, TVA returned to its foot-dragging schedule on pollution control."

- "TVA is now likely to appeal the latest federal court ruling and continue to drag out its installation of air pollution scrubbers. It shouldn't get by with that. Its huge emissions of sulfur dioxide and nitrogen oxide cause respiratory disease, acid rain and

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plant death and contribute mightily to Tennessee's ubiquitous toxic smog. But the agency has a track record of resisting pollution-control upgrades that should have been budgeted decades ago. Similarly, it should proceed, at last, with an aggressive policy of shifting its unrecyclable coal-ash wastes to dry, lined landfills—the method the EPA proposed in 2000, but pulled under opposition from the electric power industry."

- "Ratepayers, of course, will have to bear the cost of new pollution controls, just as we must now pay the million-dollar-a-day clean-up cost for the gigantic ash spill at the Kingston coal plant, and the cost of clean-ups at the Widow Creek plant spill and the inexplicable Ocoee spill of toxic bottom sludge from the top Ocoee dam. None of these spills should have occurred. Corporate attention to the life-cycle of sludge ponds and the need to shift to safer disposal would have precluded the first two spills. A common sense analysis of the bottom sludge at the Ocoee dam, the residue of many prior decades of copper mining in Copper Hill not far upstream from the dam, would have prevented that spill."

- The cost of TVA's environmental negligence, at least, has prompted the concern of Governor Bredesen and Representative Zach Wamp [D-TN]. Governor Bredesen has ordered more stringent environmental oversight by state officials and endorses a return to TVA's charter ethic. Representative Wamp agrees. 'If TVA devolves into a super-duper private power company without a mission of land and water stewardship and economic development for the region, then they are not carrying out their original charter,' he says, 'and that's the fear for me.' In fact, it's amply apparent that TVA has been 'devolving' that way for years, without stirring much concern. The question is, what are our state and federal officials, and TVA's directors, going to do about it. (*Chattanooga Times Free Press*, 01/18/09)

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

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