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Major Events

Debt ceiling agreement reached and U.S. default is averted

Meanwhile, GDP stalls and economic outlook turns grim

Debt ceiling agreement reached and U.S. default is averted

- On August 1, 2011, the House of Representatives passed the Budget Control Act of 2011 (S. 365) by a vote of 269 to 161 with 174 Republicans and 95 Democrats voting “aye” and 66 Republicans and 95 Democrats voting against the bill. The Senate passed the legislation on August 2, by a vote of 74-26 with 45 Democrats, 28 Republicans and one independent supporting the measure and 19 Republicans, 6 Democrats and one independent voting against it. Following the Senate vote, President Obama signed the bill into law. The Budget Control Act of 2011 provides for at least \$2.1 trillion in a deficit reduction over 10 years, mandates no tax increases, and sets up a super committee to cut \$1.5 trillion from the federal deficit.
- The Budget Control Act has four major titles. Title I establishes ten-year discretionary spending limits for FY2012 through FY2021 which are intended to reduce the deficit by \$917 billion. The bill’s caps are enforced through a sequestration process similar to that used in the Gramm-Rudman-Hollings Act. Adjustments in discretionary spending limits are allowed for (i) emergency appropriations, (ii) appropriations for the war on terrorism, (iii) funding for major disasters, and (iv) spending to combat waste, fraud and abuse. Separate discretionary limits are put in place for specified security programs for FY2012 through FY2021 and for non-security programs for FY2012 and FY2013.
- Title II requires the House and Senate to vote on passage of a resolution with the title “Joint resolution proposing a balanced budget amendment to the Constitution of the United States” between October 1, 2011 and December 31, 2011. The Act sets out expedited procedures in both chambers for consideration of this resolution.
- Title III sets forth the process for raising the national debt ceiling. Specifically, the Act authorizes the President to make modifications to the federal debt limit and delineates a mechanism by which Congress could disapprove of proposed changes to the limit. If the President certifies to Congress before December 31, 2011 that the federal debt is within \$100 billion of the existing limit, the limit would be increased by \$400 billion. If Congress does not enact a Resolution of Disapproval, the limit would be further increased by \$500 billion. Title III also sets up a process by which the debt limit can be further extended by up to \$1.5 trillion. If a balanced budget resolution is adopted by Congress and sent to the states for ratification, the limit may be extended to the full \$1.5 trillion. If such a resolution is not transmitted to the states, but Congress enacts legislation proposed by the Joint Select Committee on

Deficit Reduction which secures deficit reduction in excess of \$1.2 trillion, the debt limit may be increased by an amount equal to the deficit reduction, but in no event more than \$1.5 trillion. All proposed increases in the debt limit may be disapproved by Congress pursuant to specified procedures in the Act.

- Title IV creates a Joint Select Committee on Deficit Reduction which has the “goal” of reducing the federal budget deficit by “at least” \$1.5 trillion over the FY2012 through FY2021 period. The Joint Committee will consist of six Republican and six Democratic members of Congress. If seven or more Committee members approve a bill by November, the legislation is assured a straight up-or-down vote in the House and Senate by December 23 without any amendments or a Senate filibuster. The Joint Committee must issue a report and legislative language by November 23, 2011 and legislation proposed by the Joint Committee must be passed by December 23, 2011. If Congress fails to enact legislation originating with the Joint Committee by January 15, 2012 that secures an estimated \$1.2 trillion in deficit reduction, the Act mandates a \$1.2 trillion across the board reduction in discretionary spending,
- These cuts would likely hit defense more deeply than other types of spending. Half of the reductions would be achieved from non-defense spending and half from defense spending. Some spending would be exempt from the automatic reductions including Social Security and certain other retirement programs, Medicaid, and specified programs for low-income individuals. Medicare reductions would be limited to no more than two percent. The additional deficit reduction could include tax increases only if (i) 7 of 12 members of the New Joint Committee of Congress agree to raise taxes, which would include at least one Republican member; (ii) a majority of the House and Senate vote for the Committee’s recommendations; and (iii) the President signs the bill.
- The Joint Committee’s recommendations on taxes will be measured against the current law baseline before taxes. Under the current law, certain taxes are scheduled to go up, including individual tax rates and rates on capital gains and dividends. In other words, if the Joint Committee allows tax rates to increase in 2013 (e.g., let the “Bush tax cuts” expire), the additional revenue raised will not count toward its target since this is already under current law. “That doesn’t mean that they can’t include them in their legislation (they can), just that they can’t get any numeric benefit for doing so,” wrote Keith Hennessey. “That is incredibly important.” The same is true for (i) capital gains and dividends; (ii) the alternative minimum tax; and (iii) any other tax extender-like provisions scheduled to expire (such as the ethanol tax credit). Other “new” tax increases and “revenue adjustments,” such as the elimination of depreciation for corporate jets, or repeals or scale backs of carried back interest or itemized deductions, etc. would count toward the Joint Committee’s deficit reduction target.
- “If the six committee Democrats can convince one of the Republicans to raise taxes, they have an incentive to raise new taxes rather than tax rates on income, capital

gains, or dividends,” concluded Hennessey. “The tax rate fights are likely to occur outside this process.”

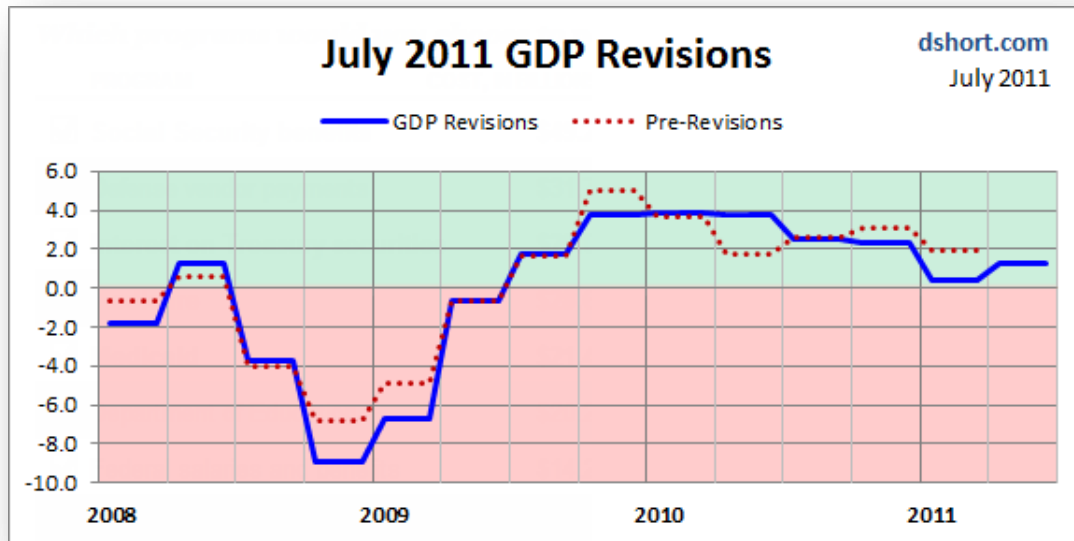
- The Senate, which has not passed a budget resolution in two years, will be “deemed” to have passed a budget resolution for this year (FY2011) and next year (FY2012). (*Washington Update*, Williams & Jensen, 08/02/11; <http://tinyurl.com/4y333ng>, 08/01/11; *Wall Street Journal*, Corey Boles, Michael R. Crittenden and Kristina Peterson, 08/02/11; *Strategic Analysis of the Budget Control Act*, Keith Hennessey, 8/02/11, <http://tinyurl.com/3hmdblu>)
- “[F]or the foreseeable future no political candidate or party will be able to increase public spending and win re-election,” wrote Telegraph [UK] reporter Toby Young. “Socialist welfare programs have become politically toxic. A sea change has taken place within the West’s most developed countries and last night’s debt deal is a reflection of that.” (*Telegraph*, Toby Young, 08/02/11)

Meanwhile, GDP stalls and economic outlook turns grim

- Real GDP rose at just 1.3% during the second quarter and growth in the first quarter was revised down to just 0.4%, according to the U.S. Bureau of Economic Analysis. “While real GDP grew slightly more in the second quarter than it did in the first, the recovery clearly lost momentum during the first half of this year and is now perched on a weaker foundation than previously thought,” wrote Mark Vitner, senior economist for Wells Fargo. “Moreover, when you cut through the details in the report, private final demand, which is our preferred measure of short-term economic growth, was actually slightly weaker in the second quarter than it was in the first, rising at a 0.9% pace in Q2 and 1.9% pace in Q1.”
- “While some economists may cite ‘temporary factors’ as the reason for weaker first half growth, our initial read is that the forces which caused growth to slow are likely to be longer-lasting. Most of the weakness is due to dramatically higher prices, specifically for gasoline and groceries. The GDP deflator rose at a 2.4 % pace in the second quarter and a 2.7 % pace in the previous quarter. Inflation is even worse when you look at domestic purchases, where prices soared at a 3.2% pace in Q2 and 4.0% pace in Q1. With prices rising more rapidly, real after-tax income grew at just a 0.7% pace in both the first and second quarters. The lack of purchasing power, combined with rising fears about employment security, caused consumers to cut back on discretionary purchases. Real personal consumption grew at just a 0.1% pace in Q1, while spending on durable goods tumbling at a 4.4% pace.”
- “...With higher inflation and government spending cuts weighing so heavily on first half growth, policymakers are facing some very tough decisions. Real GDP growth has now decelerated to just 1.6 percent year-to-year, which is well below the 2.0 percent threshold that has predicted recessions in the past. What are policymakers to do? Another round of quantitative easing would likely do more harm than good by

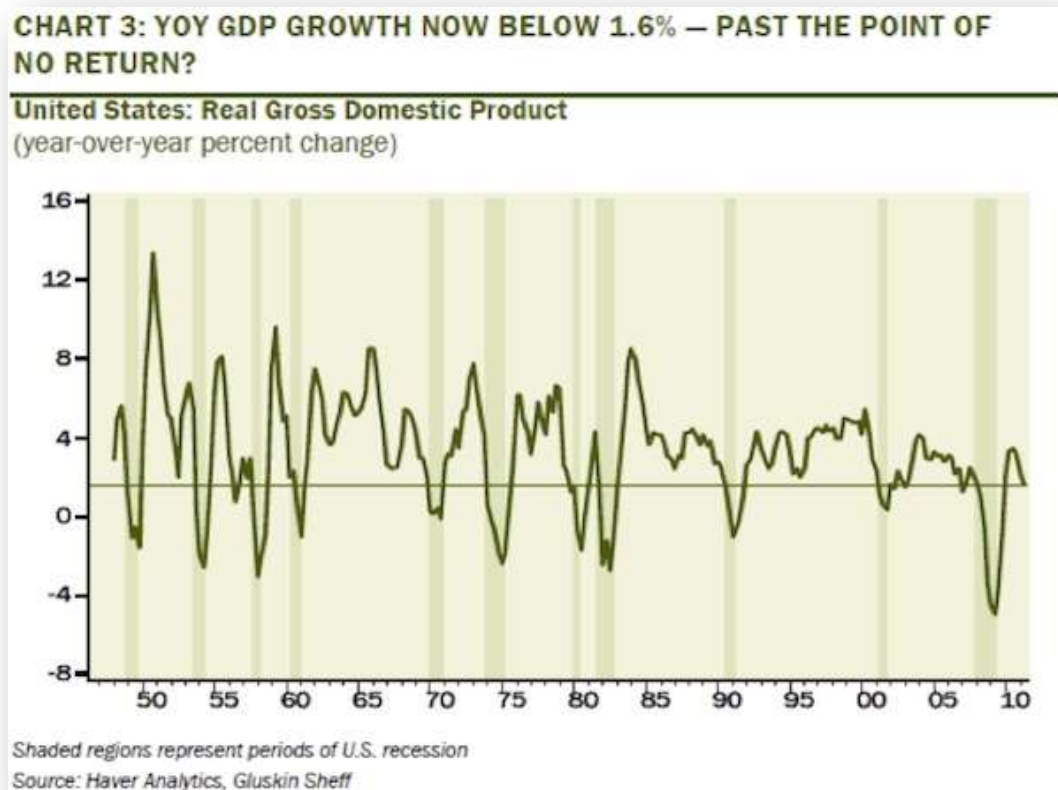
driving prices even higher. More fiscal restraint, while needed to avert a debt-rating downgrade, also does not appear to be a recipe for a stronger second half.” (*Oh My! Game Changing GDP Figures*, Mark Vitner, 07/29/11)

- “The stunner of the day is not only an anemic 2nd quarter GDP of 1.3% annualized, but of huge revisions all the way back to 2007,” wrote Mike Shedlock on *Mish’s Global Economic Trend Analysis.com*.



- U.S. Bureau of Economic Analysis’ revisions included:
 - Over the 13 quarters from Q4 2007 to Q1 2011, the average revision (without regard to sign) was 9 basis points, which did not change the direction of the change in real GDP (increase or decrease) for any of the quarters. For 2007-2010, the average annual rate of growth of real disposable personal income was revised down 6 basis points from 1.2% to 0.6%.
 - From Q4 2007 to Q1 2011, the average annual rate of increase in the price index for gross domestic purchases was revised up from 1.4% to 1.6%. The average annual rate of increase in the price index for personal consumption expenditures (PCE) was revised up from 1.6% to 1.7%, while the increase in the “core” PCE price index, excluding food and energy, was revised up from 1.5% to 1.6%.
 - National income was revised up 0.4% for 2008; revised down 0.6% for 2009; and revised up 0.1% for 2010.
 - Corporate profits were revised down 1.1% for 2008; revised up 8.3% for 2009, and revised up 10.8% for 2010.

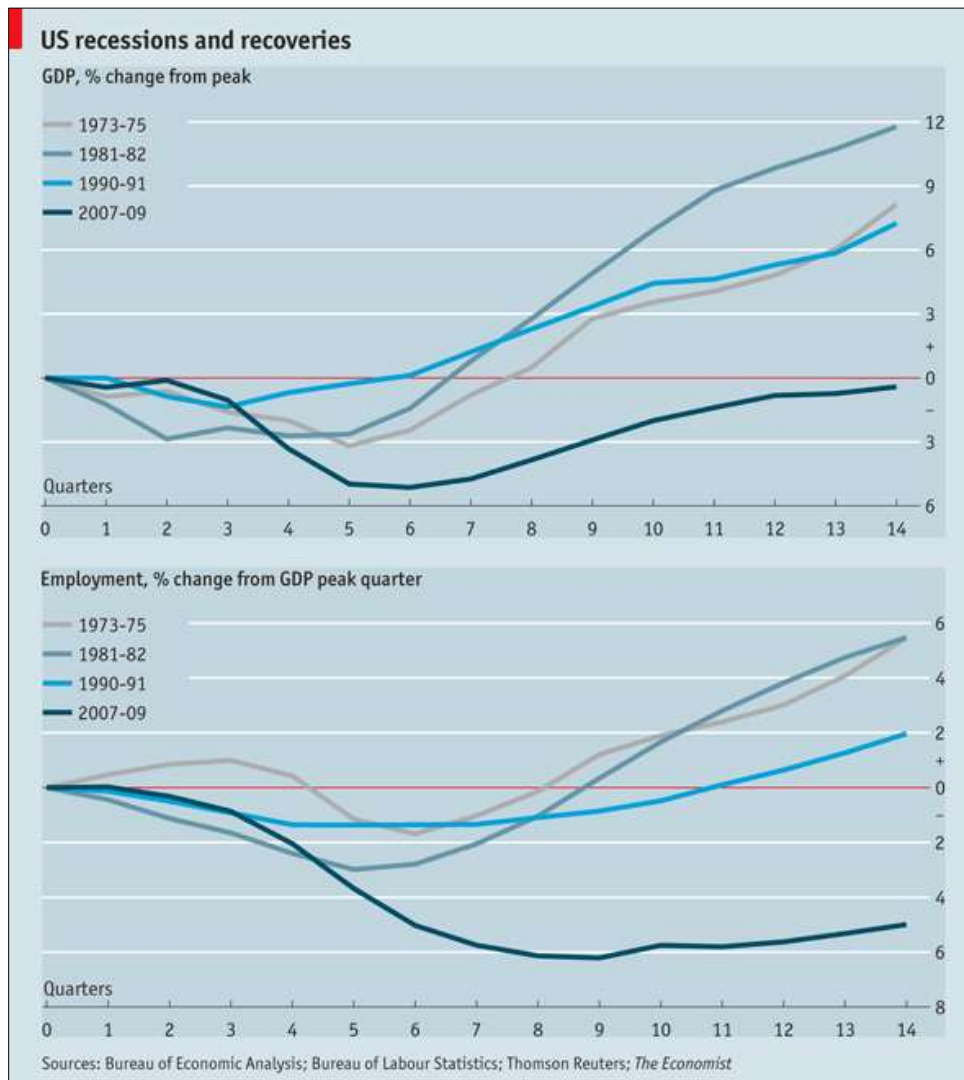
- “BEA went back and revised the numbers for the recession,” wrote John Mauldin in *Thoughts from the Front Line*. “Would it surprise you to learn that the recession was worse than we thought at the time? The peak-to-trough decline was 5.1% instead of 4.1%. That means that in real terms the economy has not yet recovered back to the pre-recession levels. David Rosenberg notes that in his research ‘going back to 1947 and never before have we seen this dynamic of the level of overall economic activity lower on the second birthday of the recovery than it was at the prior cycle peak. Typically two years into a recovery, real GDP is already 9.5% above the pre-recession high.’”



- “So this is not about any particular soft patch — the entire recovery has been a soft patch,” concludes Rosenberg. Mauldin adds, “The economy is at stall speed, it is quite possible we’ll see further downward revisions to the already anemic growth numbers...”
- The government’s latest GDP reading is ominous in more ways than one, said Deutsche Bank economist Joseph LaVorgna. “The disappointing Q2 GDP results and downward revisions for the prior three quarters lead us to believe that this [growth recession] indeed is the case,” wrote LaVorgna in a research note. A growth recession is LaVorgna’s term for an economy that is not growing at a pace that is fast

enough to absorb new entrants into the labor market, which results in rising unemployment levels.

- “It’s hard to overstate how much today’s GDP report blew up our understanding of the recovery,” wrote *The Atlantic*’s Derek Thompson. “The recession was deeper than we knew, and the economy was weaker than we thought. We weren’t making new jobs, because we weren’t making new things period. ... Yesterday, analysts thought the economy was expanding by 2.5% a year. This morning, they learned that the GDP grew by only 1.6% in the last four quarters. This is a remarkable discovery. It’s the difference between thinking we’re expanding at a decent, if disappointing, pace, and knowing we’re growing about half our historical norm. ... The ditch was 33% deeper than we thought. And, we’re driving 33% slower... [as illustrated by the following graphs from *The Economist*].



- Until the latest BEA release, the silver lining in this recovery had been our belief in American workers’ productivity growth. “Until this morning, the official data

showed that the U.S. productivity growth accelerated during the financial crisis, wrote *The Atlantic*'s Michael Mandel. "Nonfarm business productivity growth supposedly went from a 1.2% annual rate in 2005-2007, to a 2.3% annual rate in 2007-2009. Many commentators suggested that this productivity gain, in the face of great disruptions, showed the flexibility of the U.S. economy. Uh, oh. The latest revision of the national income accounts, released this morning, makes the whole productivity acceleration vanish. Nonfarm business productivity growth in the 2007-09 period has now been cut almost in half, down to only 1.4% per year."

- "The biggest threat to advanced economies is that debt will accumulate until the overhang weighs on growth, wrote Kenneth Rogoff and Carmen Reinhart in *This Time is Different: Eight Centuries of Financial Folly*. (*National Income and Product Accounts Gross Domestic Product: Second Quarter 2011 (Advance Estimate) Revised Estimates: 2003 through First Quarter 2011*, Bureau of Economic Analysis, 07/29/11; *Mish's Global Economic Trend Analysis.com*. Mike Shedlock, 07/29/11; *Thoughts from the Front Line*, John Mauldin, 07/30/11; *CNBC.com*, Jeff Cox, 07/29/11; *The Atlantic*, Derek Thompson, 07/29/11; *This Time is Different: Eight Centuries of Financial Folly*, Kenneth Rogoff and Carmen Reinhart, 2009)

Contagion risks escalate in Europe:

Greece receives second EU bailout and appears to be stabilized,
if favorable conditions materialize

Italy's Fannie Mae moment

Bailout ramifications and contagion fears in the PIIGSB

Eurozone appears to entering a new period of interbank lending breakdown

Greece receives second EU bailout and appears to be stabilized, *if favorable conditions materialize*

- "Greece,... after it joined the European Union in 1981, actually became just another Middle East petro-state—only instead of an oil well, it had Brussels, which steadily pumped out subsidies, aid and euros with low interest rates to Athens," wrote *New York Times* reporter Tom Friedman. "...Natural resources create corruption, as groups compete for who controls the tap. That is exactly what happened in Greece when it got access to huge Euro-loans and subsidies. The natural entrepreneurship of Greeks was channeled in the wrong direction— in a competition for government funds and contracts. To be sure, it wasn't all squandered. Greece had a real modernization spurt in the 1990s. But after 2002, it put its feet up, thinking it had arrived, and too much 'Euro-oil' from the European Union went back to financing a corrupt, patrimonial system whereby politicians dispensed government jobs and

projects to localities in return for votes. This reinforced a huge welfare state, where young people dreamed of a cushy government job and everyone from cabdrivers to truckers to pharmacists to lawyers was allowed to erect barriers to entry that artificially inflated prices...” (*New York Times*, Tom Friedman, 07/20/11)

- Greece received its second EU bailout package in two years, which should “stabilize” the country’s debt-to-GDP ratio at approximately 160%, based upon assumptions for [a 3.5%] nominal GDP growth and [3.0%] government’s “primary budget surplus,” wrote Wells Fargo economists Jay Bryson and Tyler Kruse. “...Moreover, what happens if there is another negative shock? ...If these favorable conditions do not materialize, however, the Greek debt problem will raise its ugly head again. ...In our view, it would be premature to conclude that Greece is ‘out of the woods’.” (*Is the Greek Debt Problem Solved*, Jay Bryson and Tyler Kruse, 07/25/11)

Italy’s Fannie Mae moment and contagion to the PIIGSB

- “[I]t is hard to escape the feeling that the market’s turning on Italy is like the run on Fannie Mae in the early summer of 2008—the moment at which it becomes clear that the scope of the crisis won’t allow any easy escape,” wrote Colin Barr in *Fortune’s Term Sheet Blog*. “If the market keeps shunning Italian and Spanish debt and bank stocks keep falling, Europe will face more damaging bank runs and a disorderly default on someone’s debt will become almost unavoidable. The endgame may not come quite as quickly this time round, for which we can be glad. But no matter what Europe’s leaders do, it seems clear that there is going to be no shortage of pain for everyone to share.” (*Fortune’s Term Sheet Blog*, Colin Barr, 07/11/11)

Bailout ramifications and contagion fears in the PIIGSB

- “Undercapitalized banks are supporting over-indebted governments by holding their IOUs; over-indebted governments are supporting troubled banks; and there is insufficient equity in the European banking system to absorb the losses implicit in the solvency gap,” wrote John Plender in *The Financial Times*. “The outcome is that the European Central Bank ends up providing liquidity on an open-ended basis to the peripheral countries to keep their banking systems afloat at the cost of an ever weaker balance sheet. The one surprise in all this is that more of the retail deposit base of southern Europe has not disappeared in capital flight.” (*The Financial Times*, John Plender, 07/12/11)
- “The recent agreement among EU leaders to extend another bailout package to Greece caused government bond yields in the Eurozone’s highly indebted countries to recede from recent highs,” wrote Wells Fargo economists Jay Bryson and Tyler Kruse. “However, relative to earlier this year, government bond yields in these countries remain elevated, suggesting that investors remain nervous about debt

sustainability prospects. Our analysis indicates that investors have reason to be nervous, at least for some of the highly indebted countries.”

- “Ireland and Portugal are the two countries (besides Greece) where the path to debt sustainability is the most challenging. Under the assumption that nominal GDP growth and borrowing costs return to prerecession parameters, both countries will have little trouble stabilizing their respective debt-to-GDP ratios. However, a return to ‘normal’ does not appear to be likely, at least not in the foreseeable future. If borrowing costs remain near current rates, then neither Portugal nor Ireland has much hope of stabilizing its debt-to-GDP ratio. Even if borrowing costs return to average rates that have prevailed since early 2010 (about 8 percent from Portugal and 9 percent for Ireland), both countries will find it difficult to achieve debt sustainability. The probability that both Portugal and Ireland will eventually require concessional financing from the private sector along the lines that have been offered to Greece is not insignificant.”
- “Unless the Belgian economy was to completely stagnate over the next few years and/or political paralysis was to grip the country, the government should have little trouble stabilizing the debt-to-GDP ratio. Our analysis suggests that Spain should also be able to achieve debt sustainability, especially if the economy can achieve nominal GDP growth of 3 percent or higher over the next few years. That said, interest rates could move higher, which would complicate efforts to achieve debt sustainability, if another government infusion of capital into the banking system proves necessary.”
- “Perhaps the most interesting case is Italy. If Italy can return to prerecession rates of nominal GDP growth in the next few years, then it, too, should have little trouble achieving debt sustainability again. In that regard, the IMF projects that Italian nominal GDP growth will average 3.4 percent per annum between 2012 and 2016, just a shade below its prerecession rate of 3.8 percent. If the Italian economy were to stagnate, however, achieving debt sustainability will not be impossible, but it could be very challenging. If Italy is the most interesting case, it arguably is also the most worrying. A fiscal crisis in Italy, should one occur, could be the catalyst that tears the Eurozone apart.” (*With Greece “Stabilized,” Will the Fire Spread*, Jay Bryson and Tyler Kruse, 07/25/11)

Eurozone appears to entering a new period of interbank lending breakdown

- “Italian and Spanish interbank lending is freezing up,” wrote Bluemont Capital Advisors’ Harald Malmgren, Global Economic Strategist, and Mark Stys, Chief Investment Officer. “French Finance Ministry officials and banks have been in emergency meetings this week regarding Eurozone interbank market stress. IMF and EU officials are warning that France might also face downgrade if greater spending cuts are not made. Finance Ministry staff have been warned to be available 24/7

(irrespective of sacred August holidays!) as contagion may soon affect French banks and sovereign debt.”

- “In spite of last week’s Eurozone Summit agreement on Greece and European Financial Stabilization Fund (EFSF) ‘flexibility’, Italian and Spanish sovereign debt yields have resumed escalation this week. Moreover, the Italians had to cancel issuance of longer maturity debt as demand was insufficient. German Finance Minister Schauble damaged confidence Wednesday when he said the EFSF would not have a blank check to purchase Eurozone sovereign debt in the secondary market.”
- “Eurozone banks’ primary holding of capital is in the form of Eurozone sovereign debt. It is obvious that the EFSF is not large enough to handle crises on the scale of Italian and Spanish sovereign debt. Schauble’s statement is interpreted as indicating precarious support within the German parliament for the recent Summit package for Greece and the EFSF, and that an increase in EFSF is unlikely. (Schauble is personally powerful within the CDU, so his statements most likely carry more political weight than Merkel’s at present.”)
- “Meanwhile, US money market funds have been withdrawing from Eurozone bank commercial paper, leaving Eurozone banks with a big gap in availability of short-term funding and a severe shortage of dollars. In the background, the Fed has quietly advised the ECB and some other central banks that Congress has warned the Fed not to repeat the huge liquidity support to Europe and Asia that it provided in 2008. European officials believe the Fed would be less able to come to the rescue again with increased swap lines and direct loans to Eurozone banks, as it did post-Lehman.”
- “Thus, in parallel with the US debt ceiling uncertainties, the Eurozone appears to be entering into renewed crisis of breakdown in interbank trust and escalating borrowing costs for Italy and Spain, and maybe even France. Whatever happens with the US debt ceiling, attention will soon turn back to Eurozone sovereign debt problems and threats to the viability of Eurozone banks from debt contagion.”
- “It is increasingly possible that the ECB may not be able to function as lender of last resort on the scale required to cope with an interbank lending breakdown. It is also thus likely that the Eurozone will suffer a shortage of dollars for its interbank credit markets. Demand for dollars will likely escalate, while confidence in Eurozone financial institutions falls. This could force Eurozone banks to purchase dollars in the open market and drive the dollar higher.” (*Thoughts from the Frontline*, Harald Malmgren and Mark Stys, 07/29/11)
- “Spain, Italy and supply HERE are weighing heavily on our thought process at the moment,” wrote Steven J. Feiss in Government Perspectives’ *BondBeat* [August 2]. “With the peripheral EU debt widening again this morning, ... we note that spreads of U.S./Germany are clearly favoring German debt ... What we would add is that it is NOT because of the worst offenders –GREECE—for example. Rather the moves are being driven by Spain and Italy: Ruh Roh. *UK Telegraph* [reports]: ‘Italy in eye of

the storm as cash runs low. Fears of a double-dip downturn on both sides of the Atlantic have set off fresh mayhem in Southern European bond markets, dashing hopes that Europe's summit deal in late July would contain the escalating crisis.”
(BondBeat, Steven J. Feiss, 08/02/11)



- “The debt situation in the euro area remains acute, wrote Dave Rosenberg, chief economist for Gluskin Sheff. “The EU rescue plan was supposed to prevent contagion risks, but alas, the yield on 10-year Italian bonds has spiked 12bps to 6.11% and Spain is up 8bps to 6.24%. The closer these yields go to 7%, the more investors begin to discount bailouts for these two countries, **the problem being that they are far too large to save.**” [Emphasis supplied.] *(Breakfast with Dave, Dave Rosenberg , 08/02/11)*

President Obama nominates former Ohio AG Richard Cordray
to serve as CFPB's director

Future of Cordray's nomination remains uncertain

CFPB gridlock

CFPB is open for business and begins its bank examinations

President Obama nominates former Ohio AG Richard Cordray to serve as CFPB's director

- President Obama nominate Richard Cordray , the former attorney general of Ohio, to serve as director of the Consumer Financial Protection Bureau (CFPB), passing over Harvard law professor Elizabeth Warren, who was the driving force behind the agency's creation, because of Republican objections to her nomination. The decision to pass over Warren, who conceived the agency, championed its creation and orchestrated the Bureau's establishment over the last year as a White House adviser, "reflects political realities," according to the *New York Times*.



- "Richard Cordray has spent his career advocating for middle-class families, from his tenure as Ohio's attorney general to his most recent role as heading up the enforcement division at the CFPB and looking out for ordinary people in our financial system," said Obama in a written statement.
- "Cordray has a clear pro-consumer record, and has not been afraid to challenge the banks, making him an ideal candidate to lead the bureau," wrote Pat Garofalo, economic policy editor for *ThinkProgress.org* at the Center for American Progress Action Fund. "He was at the forefront during the foreclosure fraud scandal, and was the first to sue a mortgage lender over incidents of foreclosure fraud, launching a suit

against GMAC Financial. ‘What we’re talking about here is not just sloppy paperwork,’ Cordray said at the time. ‘We’re talking about fraud in a court of law. The [foreclosure document signers] were lying under oath, to a judge.’ He’s called the foreclosure practices of the nation’s biggest banks ‘a business model built on fraud.’ As attorney general, he supported efforts to rein in payday loans, one of the most pernicious financial products. Cordray backed legislation to cap the interest rate that payday lenders could charge and sought the ability for his office to prosecute unlicensed lenders.”

- “The financial industry is already up in arms about his nomination, with one attorney who represents the industry saying that of all the bureau’s officials, Cordray ‘frightens me the most,’ added Garofalo. “Another derided him as having ‘all the hard edge and ambition of Warren without the charm.’ Warren herself supports the choice of Cordray, writing in an op-ed ...that ‘he will make a stellar director.’” (<http://tinyurl.com/3japhm9>, Pat Garofalo, 07/18/11)

- ”I want to be real clear, the reason I can’t run this agency is because of those people [Senate Republicans],” said Elizabeth Warren on the *Rachel Maddow Show*. “They’ve made it perfectly clear they will not let the agency go forward if I’m there. Fine. I can step away from this. What I care about is this agency. The President has now made his nomination.

He’s a good man, Richard Cordray is. And I think it’s time to take the fight straight to the Republicans. We need a Director in place, that’s the law, and we are not, not, *not* going to let the minority come in and dictate the terms of this agency, rip its arms and legs off before it’s able to help a single family. No.”



- “Do you want to be part of that fight [against the Republicans] in the future?” asked Maddow. Warren responded, “ You know, I’m going to be part of that fight one way or another, Rachel. Let me be clear about this. I have really done three things in my life: I have taught school, because that’s what I do, I’ve done research around what happens to middle class families and tried to understand that, and I have thrown rocks at people that I think are in the wrong. I’ve done it before, I’ve continued to do it, and I’m going to do it in the future.” (<http://www.politicaldick.org/2011/07/elizabeth-warren-on-the-rachel-maddow-show/>)

- Treasury announced that Raj Date, who is leading the Bureau's day-to-day operations, will replace Warren as Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau, effective August 1. Warren will return to her position as the Leo Gottlieb Professor of Law at Harvard Law School. (*CFPB Press Release*, 07/26/11)

Future of Cordray's nomination remains uncertain

- The Senate Banking Committee scheduled a confirmation hearing for Cordray for September 6. Securing the Senate's confirmation of Cordray is critical because the agency will not gain the full measure of its powers until a director is confirmed by the Senate. The CFPB can supervise the compliance of banks with existing laws, but the Dodd-Frank financial legislation dictates that it cannot write new rules or supervise other financial companies without a director in place. However, Senate Republicans vow to block any nominee for the Bureau's director until structural changes are made to the CFPB. "Until President Obama addresses our concerns by supporting a few reasonable structural changes [for the CFPB], we will not confirm anyone to lead it," said Senator Richard Shelby, ranking member of the Senate Banking Committee. "No accountability, no confirmation."
- In May, 44 Republican Senators signed a letter outlining three structural changes that must be made to establish accountability for the CFPB which included (i) creating a new governing board of directors rather than a single individual, serving as director; (ii) subjecting the Bureau to the appropriations process; and (iii) establishing a safety-and-soundness check for the prudential regulators, who oversee the safety and soundness of financial institutions to help ensure that excessive regulations do not needlessly cause bank failures. "... [W]e will not support the consideration of any nominee, regardless of party affiliation, to be the CFPB director until the structure of the Consumer Financial Protection Bureau is reformed," wrote the lawmakers.
- The House has passed legislation (H.R. 1315) that would convert the CFPB into a five-member commission and give Congress more leeway over how the new agency operates. The bill, which passed the House 241-173, now goes to the Senate, which is unlikely to act on the measure. (*Associated Press*, Jim Kuhnhen, 07/18/11; *Press Release*, Senator Richard Shelby, 05/05/11; *Housingwire*, Kerri Panchuk, 07/29/11; *National Mortgage News*, Brian Collins, 07/22/11)

CFPB gridlock

- Rich Andreano, an attorney with Patton Boggs, said he doesn't expect any resolution on the Cordray nomination until the fall. Republicans have enough members of Congress pushing against a director for the bureau to filibuster an approval. "I think the really important question here is: What does this nomination get tied to?" said

Andreano. “The issue then becomes: When can it finalize rules? If there’s not a director at the time a rule is finalized, I could see people going to court over it.”

- Obama signaled that he would not bend to the Republican lawmakers’ demands. “There’s been an effort from banks and lobbyists, who’ve spent tens of millions of dollars this year to undo the progress that we made,” said Obama. “We’re not going to let that happen. There were abuses, and there was a lack of strong regulations. We’re not going to go back to the status quo. I will fight any efforts to reform the important changes we passed.” (*HousingWire*, Jon Prior, 07/18/11)
- “What’s going to happen, then, is no director for the CFPB in any case,” wrote Paul Krugman in *The Consciousness of a Liberal* [blog]. “But meanwhile Obama has passed up a chance to symbolically align himself with the public and against the banksters. Sad. Really sad.” (*The Consciousness of a Liberal*, Paul Krugman, 07/18/11)
- “Richard Cordray is actually in a very good position to spend the next year or two being blocked from running the CFPB,” wrote *Washington Post*’s Ezra Klein. “Cordray, a former Ohio attorney general with a great reputation in consumer-protection circles and Warren’s blessing, doesn’t have anything to run for until Ohio’s governorship opens in 2014. By all accounts, he’s a good choice to lead the agency now, if he can somehow get past the Republicans, and spending a few years publicly fighting to protect consumers is unlikely to hurt him back home. (*Washington Post’s Ezra Klein Blog*, Ezra Klein, 07/18/11)
- Elizabeth Warren, a senior adviser to President Barack Obama and Treasury Secretary Timothy Geithner, told a congressional panel that government agencies may not have sufficiently investigated claims that borrowers’ homes were illegally seized by banks such as JPMorgan Chase, Bank of America, Wells Fargo, Citigroup and Ally Financial. (*Huffington Post*, Shahien Nasiripour, 07/15/11)

CFPB is open for business and begins its bank examinations

- The CFPB began operations on July 21 and began to deploy examiners from its regional offices in Chicago, New York, San Francisco and Washington to hold several “informational roundtables” in early August, followed by their first on-site examinations. The Bureau plans to conduct year-round supervision of the nation’s largest banks with assets over \$100 billion, while regional banks will likely face targeted examinations on a less frequent basis, said Treasury. Collectively, the agency supervision team, comprised of 100 examiners transferred from FDIC, the Federal Reserve, OCC and



OTS, will conduct examinations of the nation's 111 largest banks. The Bureau plans to add "several hundred" additional examiners over the coming months, as it ramps up its operations. The examiners will focus on "each institution's internal ability to detect, prevent, and remedy violations that may harm consumers," said Treasury. Non-bank financial companies will not face examinations until the Senate has confirmed the Bureau's director. Treasury's IG determined that the new agency, absent its director, can only prescribe rules and issue orders under consumer financial laws that transfer over from other banking regulators. None of the consumer financial laws apply to non-bank entities, concluded the IG. On June 23, the CFPB issued a notice, seeking public comment on whether six non-bank services—debt collectors, consumer reporting agencies, consumer credit providers, money transmitters, check-cashing agencies—prepaid providers, and debt relief servicers—should be included in the atgency's non-bank supervisory program. (*Bureau of National Affairs*, Mike Ferullo, 07/13/11)

Banks spar with state AGs and federal officials over global settlement

"Serious" mortgage relief is needed—not a token settlement with banks

Objections raised about Bank of America's \$8.5 billion settlement for non-agency MBS

Bank of America reports \$8 billion loss for second quarter, raising questions about the bank's need to raise additional capital

Banks spar with state AGs and federal officials over global settlement

- The nation's biggest banks hit a new hurdle in their settlement negotiations over the home foreclosure mess, as behind the scenes infighting over how the banks would split the fines delayed a resolution. In March, settlement talks between Bank of America, Wells Fargo, JPMorgan Chase, Citigroup and Ally Financial began with the 50 state attorneys general, Treasury, Department of Justice and HUD to resolve claims over the banks' foreclosure processes. Recent discussions broke down as Wells Fargo contended it should pay less than Bank of America or JPMorgan Chase, since it has fewer risky or delinquent mortgages than the other two banks, said sources. Citigroup has argued to regulators that the structure of the settlement should reflect differences between the institutions, contending it should pay less because of the bank's stronger controls on its foreclosure practices, said people familiar with negotiations. Another sticking point in negotiations is whether to release the banks from other types of mortgage-related claims. The banks are pushing for broad protection from liability to mortgage claims as part of the settlement, while the state AGs object to their demand.
- All parties have agreed to a framework to govern how the banks will meet their obligations once a settlement is reached, which includes principal reductions on

certain mortgages; forgiveness of second-lien loans, restitution to borrowers, and dealing with foreclosure related blight. While the banks initially offered a \$5 billion settlement, government officials are now pressing for a \$20 to \$25 billion settlement, according to sources familiar with the negotiations. Citigroup is pushing to keep its portion of the settlement limited to \$1 billion, while Wells Fargo is discussing a settlement of \$4 billion to \$5 billion with hopes of keeping the final tab as close to \$4 billion as possible, said one source.

- Tensions also remain over proposals to provide widespread principal reductions to help troubled borrowers. Privately, Bank of America has indicated a willingness to consider write-downs in cases in which costs are less expensive than pursuing a foreclosure. Wells Fargo's management has indicated that they are willing to consider principal reductions, but remain opposed to any write-offs for loans held by investors, said sources.
- Federal and state officials also disagree over how quickly to finish a settlement with some parties, including HUD, pushing for a deal that provides immediate aid to troubled borrowers, while some state AGs voicing concerns over providing the banks a deal that provides broad relief from additional legal claims. In a letter to officials, Massachusetts AG Martha Coakley (D) said she "will not sign on to any global agreement with the banks if it includes a comprehensive release regarding securitization." A looming issue in the settlement discussions related to the potential liability stemming from the Mortgage Electronic Registry System (MERS), which is owned by the Mortgage Bankers Association, Fannie Mae, Freddie Mac and 25 leading mortgage industry companies.



- The MERS system, which was set up to eliminate the need to record changes in property ownership in local land records, is facing legal challenges to the system's ability to bring foreclosure proceedings because it does not technically own the security or note underlying the properties, as required by law. While some state courts have not objected to MERS's foreclosing in the place of banks, others—such as New York—have been increasingly hostile to MERS. Equally troubling is that MERS officials have filed questionable documents with courts, attesting to ownership of notes and other significant matters. How MERS and its owners—the banks and U.S. taxpayers, as owners of Fannie Mae, Freddie Mac and majority owner of Ally Financial [formerly GMAC]—will fare with the state AGs remains unclear. According to an early settlement proposal, “Issues relating to the use and performance of MERS are reserved from further discussion.” A broad release of MERS in a global settlement would vastly diminish the possibility of an in-depth investigation of the system and make it harder for borrowers to argue that MERS has no standing to foreclose on their homes.
- “And if the banks are insulated from future state lawsuits, responsibility for any abusive acts by MERS would be pushed onto law firms that did the system's work,” reported *New York Times*' reporter Gretchen Morgenson. “With few assets, these law firms are virtually judgement proof. The unit of MERS that held title to the mortgages also has few assets and was set up in a way that lawsuits against it would probably reap little for the plaintiffs.” (*Wall Street Journal*, Dan Fitzpatrick, Nick Timiraos and Ruth Simon, 07/27/11; *New York Times*, Gretchen Morgenson, 07/23/11)

“Serious” mortgage relief is needed—not a token settlement with banks

- “Ever since the current economic crisis began, it has seemed that five words sum up the central principle of United States financial policy: go easy on the bankers,” wrote economist Paul Krugman in a *New York Times* editorial “This principle was on display during the final months of the Bush administration, when a huge lifeline for the banks was made available with few strings attached. It was equally on display in the early months of the Obama administration, when President Obama reneged on his campaign pledge to ‘change our bankruptcy laws to make it easier for families to stay in their homes.’ And the principle is still operating right now, as federal officials press state attorneys general to accept a very modest settlement from banks that engaged in abusive mortgage practices.”
- “...The big drag on the economy now is the overhang of household debt, largely created by the \$5.6 trillion in mortgage debt that households took on during the bubble years. Serious mortgage relief could make a dent in that problem; a \$30 billion settlement from the banks, even if it proved more effective than the government's modification program, would not. So when officials tell you that we must rush to settle with the banks for the sake of the economy, don't believe them. We should do this right, and hold bankers accountable for their actions.” (*New York Times*, Paul Krugman, 07/17/11)

Questions raised about Bank of America's \$8.5 billion settlement for non-agency MBS

- The FHLBs of Boston, Chicago, Indianapolis, Pittsburgh, San Francisco and Seattle filed a brief with the New York State Supreme Court, arguing that research reports used to determine Bank of America's \$8.5 billion proposed mortgage bondholder settlement were too favorable to the Bank and "raise more questions than they answer." The FHLBs argued that the research utilized in the settlement reduced the amount that the trusts could recover or potentially recover to \$61.3 billion from \$208.9 billion. The FHLBs are not formally objecting to the proposed settlement, but instead are seeking to intervene as a party in the proceeding, which would provide them the right to oppose the settlement, if they elected to do so. Together, the six FHLBs own 73 of the 530 Countrywide trusts that are covered by Bank of America's settlement.
- The New York Supreme Court has set a November 17 hearing at which investors will present their objections, if any, to the proposed settlement. New York Supreme Court Justice Barbara R. Kapnick will preside over the hearing. The proposed settlement allows investors to opt out and attempt to negotiate an individual settlement on their own or file a lawsuit.
- Representative Brad Miller (D-NC) is encouraging the FHFA, as conservator of Fannie Mae and Freddie Mac, to consider joining other investors, such as Walnut Creek Place L.L.C., who are objecting to BofA's proposed settlement. "I understand that both Fannie Mae and Freddie Mac have substantial investments in the RMBS subject to [BofA's] proposed settlement and have already suffered substantial losses on the RMBS with further substantial losses expected in the future," wrote Miller in a letter to FHFA's acting director Edward DeMarco. Miller urged FHFA to "zealously pursue" all legal claims that would limit losses on Fannie Mae's and Freddie Mac's private label RMBS, including those subject to BofA's proposed settlement. Miller also asked DeMarco if the agency's 64 subpoenas issued in July 2010 to several mortgage lenders "pertain to the proposed settlement. If so, have Bank of America and Bank of New York Mellon fully complied with the subpoenas?" asked Miller. "Does FHFA intend to issue further subpoenas or take such further actions necessary to decide whether to support the proposed settlement?" FHFA officials are reviewing Miller's inquiry and plan to respond in the near future.
- New York Attorney General Eric Schneiderman (D) has requested additional information about Bank of America's proposed \$8.5 billion settlement and indicated that he may intervene to challenge the agreement. Schneiderman's inquiry is part of the AG's broad investigation into all aspects of the mortgage securitization process. (*New York Times*, Gretchen Morgenson, 07/13/11; *Bureau of National Affairs*, Mike Ferullo, 07/13/11; *American Banker*, Kate Berry, 07/21/11)

Bank of America reports \$8 billion loss for second quarter, raising questions about the bank's need to raise additional capital

- Bank of America reported an \$8.8 billion loss for the second quarter, reflecting \$8.5 billion settlement agreement for legacy Countrywide residential mortgage-backed securities; \$5.5 billion of provisions to cover future claims linked to troubled loans; and an additional \$6.4 billion for a series of other charges. Collectively, BofA's pretax mortgage-related charges totalled \$20 billion for the second quarter. "Obviously, the solid performance in our underlying businesses continues to be clouded by the costs we are absorbing from our legacy mortgage issues," said CEO Brian Moynihan. "All signs point to continued improvement from here," said Barclays Capital analyst Jason Goldberg.
- In a conference call with analysts, Moynihan said he didn't see the need for Bank of America to raise capital, given the bank's "fortress balance sheet" with a Tier 1 common equity ratio of 8.23% and tangible common equity ratio of 5.87%. Tucked in the bank's investor presentation was the bank's disclosure regarding its plans to meet its future capital requirements, which read: "Assuming no benefit for the Basel III capital deduction phase-in (i.e., fully front loaded basis), our *goal* is to achieve a 6.75% to 7% Tier 1 Common Ratio by 01/01/13." [Emphasis supplied.] Moynihan called his company "a tale of two cities" with its non-mortgage operations making money.
- Analysts contend that BofA needs to raise at least \$50 billion if the bank is deemed to be a systemically important financial institutions and required to hold higher capital standards under Basel III. "[BofA will] take a hard look at our balance sheet and the businesses that we were in if, with the SIFI, you were up at 9.5% [capital requirement]," said CFO Charles Noski in March [who was replaced in June by Bruce Thompson]. To meet a 9.5% capital requirement, BofA would have to hold about \$171 billion in capital, compared to the bank's stated goal of 6.75% or \$122 billion. To improve its capital position, BofA is considering selling at least part of its \$21 billion stake in China Construction Bank Corp, according to several sources.
- "Bank of America's capital position relative to peers creates dilution risk, wrote Chris Kotowski, an analyst with Oppenheimer & Co. "While we aren't certain that an equity raise will actually happen, the risk is certainly there"—particularly if the economy continues to weaken. On July 29, BofA closed at \$9.71 with a market cap of \$98.4 billion and price-to-book ratio of 48%. (*Bloomberg News*, Hugh Son, 07/18/11; http://ycharts.com/companies/BAC/price_to_book_value; *American Banker*, Michael Shemi, 07/11/11; *Bloomberg News*, Hugh Son, 07/19/11; *New York Times DealBook*, Ben Protes, 07/19/11)



(Source: Yahoofinance.com, 07/29/11)

Is Dodd Frank cutting off mortgage credit?

Proposed QM rule could cause “serious disruptions” to the availability of mortgage credit

Multiple organizations and individuals urge the regulators to withdraw and re-issue their “flawed” QRM rule

Is Dodd Frank cutting off mortgage credit?

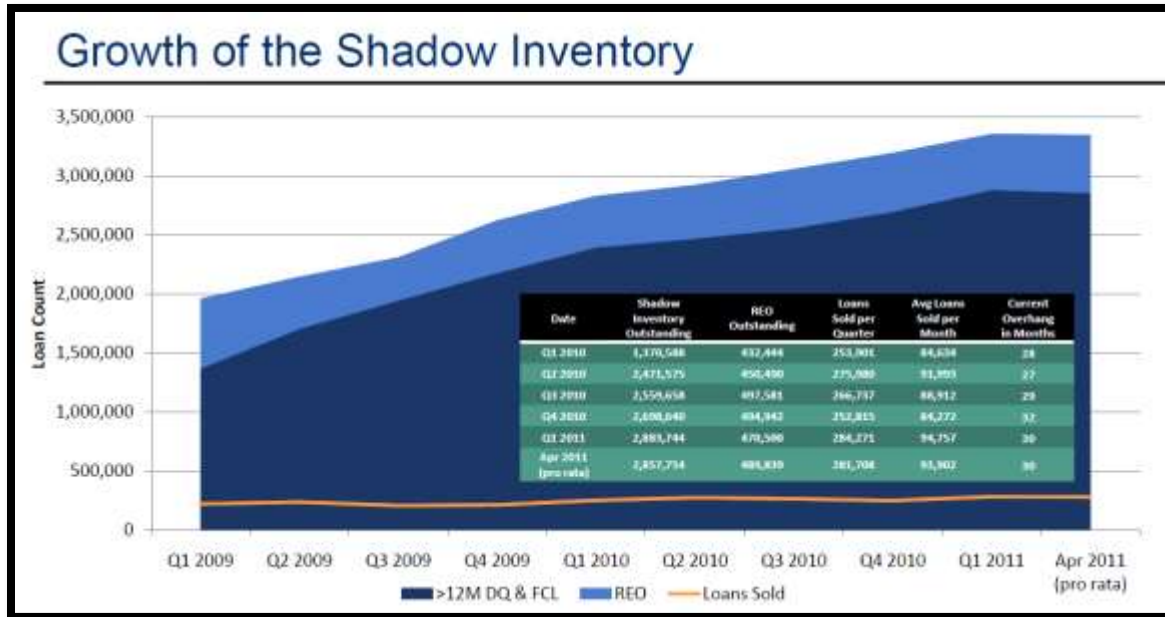
- On July 21, America Enterprise Institute conducted a conference on the impact that Dodd Frank rules—and in particular, the interplay of the proposed QM and QRM rules—may have on the availability of mortgage credit.
- **Flaws in the design of the U.S. mortgage system.** Panelist Anne Canfield, President of Canfield and Associates, discussed the lack of transparency in the U.S. mortgage system, which was doomed to fail. “In my view, it was the structure of the U.S. housing finance system that was really very flawed,” said Canfield. “It was a completely non-transparent system. On the one side, you had [Fannie Mae and Freddie Mac] and the system was designed so that investors would rely on their implied guarantees in determining the quality of their investments. Investors had no access to the underlying data for individual mortgages that were guaranteed by Fannie and Freddie and the government sanctioned that.”

- “In addition, the two agencies [Fannie and Freddie] were highly leveraged. The 1992 Act actually set very low capital requirements for [the GSEs]. If you consider their mortgage portfolios along with their guarantee business, [Fannie and Freddie] were levered up 100 to 1. For a variety of reasons, the GSEs decided to go down the credit spectrum with very thin capital backing that up and, not surprisingly...they eventually blew up.”
- “On the other side of the ledger were the rating agencies, which I believe were the other government-sponsored enterprises... Again, the [government designed] the system to allow investors to rely on the rating agencies and not really do any due diligence on the underlying securities.” [In fact, access to loan level mortgage data is limited.]
- “So, what you had was a non-transparent system that was built around the government—either through an implied guarantee by Fannie and Freddie or rating agencies’ ratings—without any due diligence. Not surprisingly, many people took advantage of this system ...It was doomed to fail.”
- “It is very important that in designing a future mortgage finance system -- it needs to be very transparent and allow analysts worldwide to have access to loan level mortgage data. FHFA has begun a data collection project for Fannie Mae, Freddie Mac and FHA loans and we understand that most of this data will eventually be available to the public. When the private securitization market returns, it will be important that loan level data is made publicly available as well. Transparency will be essential in reducing the mortgage markets reliance on the GSEs and the rating agencies.”
- **Interplay of QRM and QM proposals.** Bank regulators are now attempting to control outcomes in the mortgage market, through the QRM and QM proposed rules, said Canfield. The QRM rule—the regulator’s definition of a safe and sound mortgage—is very narrowly defined as a first mortgage lien for a single-family dwelling that is the borrower’s principal dwelling, which is subject to 20% down payment requirement (for a purchase, with 70 or 75% LTVs for refinances), 28/36 debt-to-income limitations and 3% cap on loan fees. The QM rule, as proposed by the Federal Reserve and to be finalized by the Consumer Financial Protection Bureau, addresses the so-called “ability to pay” standard. Unfortunately, the definitions used in the QM rule are subjective and vague, exposing lenders to liability. The mortgage industry will likely ask for safe harbor for QM loans, said Canfield. Without it, she believes the default safe harbor is going to be the QRM standard, since regulators will have deemed these loans to be safe and sound, and because by statute QRM has to be narrower than QM.
- In addition to enormous litigation risk, lenders will also discover that they will hit the lower HOEPA threshold [for loans \$20,000 or more, no more than 5% of the loan] pretty quickly, which will result in the charging borrowers lower points, but higher loan rates. This will be particularly true of small balance loans, which are often

sought by lower-income borrowers. In turn, these smaller loans may be more likely to face fair lending challenges because they appear to have higher rates. Banks will also face great difficulty in meeting their CRA requirements, because they typically used flexible underwriting to make CRA loans, which will very limited under the proposed standards, Canfield said.

- There are also interplays between the QM and QRM standards with the SAFE Act, which will result in some loan underwriters being deemed to “loan originators”. Also, the FDIC recently said in a conference call this Spring that 401K contributions will have to be considered part of compensation under these standards, so there might be an interplay with ERISA, she added.
- “The combination of the QRM and QM rules, along with their interplay with other regulations, will result in a very limited availability of mortgage credit in the future,” said Canfield. “Effectively, the QRM and QM rules will institutionalize tight mortgage credit. In the future, the availability of mortgage credit for homeownership will be very limited, resulting in more rentals...”
- Canfield also noted the fundamental change that has occurred in the dynamics of mortgage lending. In the past, the fundamental premise of mortgage lending was based upon a bank foreclosing on a mortgage if the borrower failed to make the mortgage payments. Today, the borrower who defaults has the ability to sue the lender. This is a dramatic shift in our housing finance system, which will increase substantially the costs and the complexity of mortgage lending and have a long-term impact on how the mortgage industry will operate in the future, said Canfield.
- **Foreclosure Issues.** Larry Platt, a partner with K&L Gates, reviewed the creditor and assignee liability under Dodd Frank, which allows a borrower to contest foreclosure proceedings, claiming that the lender either violated the Act’s “ability to repay” standards or the compensation paid to mortgage originators provisions and apply the related damages as an offset mortgage debt. Under the Act, damages include actual damages, statutory damages of \$4,000 per loan (regardless of actual damages), and enhanced damages consisting of three years of interest and fee payments. These provisions are a pretext for stopping the foreclosure process and forcing loan modifications, said Platt.
- “All of this [QM and QRM issues] pales in comparison to the issue of foreclosure, because if you can’t foreclose on a mortgage, all you have is an unsecured loan,” said Platt. “You think interest rates go up when you get outside of QM and QRM loans, imagine how high [rates] will go when you can’t foreclose on a loan—that’s what’s in effect right now. And, it’s only going to get worse.”
- **Shadow Inventory**. Laurie Goodman, Senior Managing Director for Amherst Securities, outlined four salient points regarding the condition of residential real estate market : (i) the housing market is incredibly fragile; (ii) credit availability is already very limited; (iii) QM and QRM will crimp available credit even more,

particularly as the GSEs are phased out of existence; and (iv) the QRM rule should be expanded to include investor-owned properties and expansions should be made to the LTV and DTI definitions. Goodman’s models indicate that one in five homes will face foreclosure, if “nothing else is done.”



(Source: Amherst Securities, Laurie Goodman, 07/21/11)

- To date, we have only liquidated about 30% of the distressed mortgages, said Goodman. Ultimately, we are looking at an over-supply of homes, ranging from 3.6 million to 5.7 million, as a result of foreclosures over the next six years, she added. “The regulators’ proposed QM and QRM regulations will further crimp available credit and exacerbate a growing problem.”
- A video of the AEI conference and the speakers’ slide presentations are available at <http://www.aei.org/event/100431> (*Is Dodd-Frank Regulation Cutting Off Mortgage Credit?*, American Enterprise Institute, 07/21/11)

Proposed QM rule could cause “serious disruptions” to the availability of mortgage credit

- In a July 22 comment letter to the Federal Reserve on the proposed qualified mortgage rule, Anne Canfield, who also serves as the executive director of the Consumer Mortgage Coalition wrote:
- “We believe that these rules are among the most important provisions of Dodd-Frank’s consumer protection provisions. If they are not carefully crafted, serious disruptions in the availability of mortgage credit will occur. It is critical that the Bureau provide lenders with clear, understandable rules, and a safe harbor to properly shield lenders when they make safe loans. A final rule that does not give lenders clarity in standards and a safe harbor will not prove sufficient protection to achieve

the goal of ensuring that consume mortgage credit is available to creditworthy borrowers, including vulnerable populations. With this in mind, we make the following recommendations:”

- **Coordination of rules.** “The final rule should be coordinated with the Dodd-Frank risk retention rule, recognizing the interplay of the two proposed rules with each other, and of both of these rules with the lower HOEPA thresholds established by the Dodd-Frank Act. The QM rule should also be coordinated with other existing statutory and regulatory requirements. ...The most important need for coordination among rulemakings involves the CFPB’s QM rulemaking and the interagency rule on credit risk retention and qualified residential mortgages (QRM).”
- **Safe Harbor.** “‘Qualified Mortgage’ must be a safe harbor from liability under the ability-to-repay requirement to ensure that consumers have access to affordable and reasonably-priced consumer mortgage loans. ...The lack of a bright-line safe harbor and clear QM definition would result in greatly increased litigation risk for the mortgage industry. ...Without a clear QM definition and an ‘air tight’ safe harbor in a final rule, the mortgage industry will be unable to avoid extensive litigation.”
- “Under TILA, when a creditor, assignee, or servicer brings a foreclosure or debt collection action, the consumer may assert a violation of the ability-to-repay requirement as a defense, without regard to the statutory time for bringing an action for TILA damages. Default itself can indicate inability to repay. Under Dodd-Frank, borrowers will be able to default on their loans then sue the lender for TILA damages because the borrower defaulted. That is, consumers would be able to seek damages, not because of an inability to repay, but because of an unwillingness to repay. With or without a foreclosure action, the consumer can recover actual damages, statutory damages, and “all of the finance charges paid by the consumer [.]” That is, damages would exceed all profit on the loan. ... Even if a creditor were to prevail in a lawsuit, the cost of litigation, including the cost and business disruption of protracted discovery, would far exceed the potential profit on the underlying loans.”

“Other unintended, but unfortunate consequences of an unclear QM standard include:

- The banks’ ability to meet their CRA obligations and their requirements under the Fair Lending laws will be impacted negatively.
- Safety and soundness regulators could potentially increase bank reserve requirements in light of the increased risks associated with the unquantifiable liability resulting from potential litigation.
- Investors can be expected to limit their investments to only seasoned loans.

- Given the experience of the past few years, the servicing of loans has become riskier and more expensive. Servicing non-QM loans will be riskier, thus more expensive.
- The lack of a clear QM definition and a bright-line QM safe harbor would make the QRM definition the de facto QM safe harbor.”
- **Points and fees definition.** “The points and fees definition should be adjusted to avoid unintended consequences. ...Dodd-Frank imposed a three percent limit on points and fees on QM loans ... [and] lowered the HOEPA thresholds and extended HOEPA liability to purchase-money loans. The new thresholds are now either the APOR plus 6.5 percentage points (8.5 for junior loans), or points and fees of 5 percent of the loan amount. Points and fees are defined broadly. Loans that have either a high interest rate or high costs will exceed the HOEPA thresholds much more easily.”
- “...There is not enough room under the HOEPA threshold to cover both the cost of the risk retention requirement and, more importantly, the cost of QM litigation risk. This will seriously constrain mortgage credit. The absence of both a very clear QM definition and a bright-line QM safe harbor would exacerbate this credit constraint because it would increase the litigation risk for which creditors must price. The HOEPA limits on rates and points will also constrain lenders’ ability to make non-QRM mortgage loans, a fact regulators need to thoroughly consider.”
- “The QM definition of points and fees is extremely difficult to understand. TILA is a consumer protection law, so Regulation Z should be readily understandable to consumers. ... [T]he definition should be included, in its entirety, in the regulation.”
- **Streamline finance.** “The CFPB should broaden the category of loans eligible for a streamlined refinance under proposed § 226.43(d).”
- **Ability to repay.** “The ability-to-repay rule should retain its flexibility, but definitive guidance is needed.”
- **Clear rule guidance.** “The CFPB should include ‘Know Your Rules’ as an integral part of its ‘Know Before You Owe’ effort, and make a practice of writing consumer rules in plain English so that consumers will be able to understand the rules that govern their financial products and services.”
- **Cost Benefit Analysis and Impact to Credit.** “To underscore the importance of cost-benefit analyses, Congress, by statute, required the CFPB to weigh the costs and benefits of its rulemakings, including the QM rulemaking. [For the QM rule,] Congress requires the CFPB to consider:

‘[T]he potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule [.]’

- “The CFPB is required to weigh the costs and benefits of its rulemakings, including the QM rule. We believe that a thorough cost-benefit analysis of the impact of the combined rules, along with the lowered HOEPA thresholds, is most appropriate because the rules will all interact. Until a robust analysis is completed and reviewed thoroughly, no rulemaking should be finalized.”
- “...Congress explicitly requires the CFPB to address the potential reduction in consumer access to credit, in this rulemaking mortgage credit. Reducing the availability of mortgage credit will make it more difficult for consumers to buy and sell homes. Reduced mortgage credit will remove many potential homebuyers from the market because they will not qualify for a loan. The QM rule will effectively lower demand for housing, which will then lower the price of housing. This aspect of the QM rule is far too important to ignore.”
- “Mortgage loans are currently very difficult to obtain, even for consumers with strong credit profiles. If the final QM rule were to lack a certain safe harbor and clear QM definition, credit would be even more constrained. This would hurt all involved in the mortgage markets, including consumers, lenders, homebuyers, and home sellers. Additionally, the restrictions on points and fees, combined with the restrictions on prepayment penalties, will make it more likely consumers will try to refinance when rates fall, even slightly, because the transaction costs are limited. Faster prepayment speeds with limited ability to recoup the cost of originating loans will reduce the profitability of mortgage lending.”
- “As proposed, the QM rule would incent creditors to reduce mortgage lending because of the new difficulties in making profitable loans. The CFPB needs to expressly address the potential this rulemaking could have to cause creditors to exit the mortgage industry entirely.”
- **Conclusion.** “We are concerned that the proposed QM rulemaking will dramatically constrain consumer mortgage credit and limit it to a small subset of creditworthy borrowers. We urge the CFPB to write a final rule that addresses the problems facing the mortgage markets today without driving creditors and investors away from this sector. At a minimum, this will require a bright-line safe harbor and a very clear QM definition, along with a restrictive definition of points and fees. Ultimately, government policymakers should consider revisiting the direction taken in Dodd-Frank and move the U.S. housing finance system to a more transparent one that allows the market to function efficiently.”
- The Consumer Mortgage Coalition’s complete comment letter for the Proposed QM Rule is available at <http://tinyurl.com/3palqjd>. (*Consumer Mortgage Coalition’s*

Comment Letter on the Proposed Qualified Mortgage Rule, Anne C. Canfield, 07/22/11)

- In separate comment letters, the American Securitization Forum and the Independent Community Bankers Association called for the QM Rule to be re-proposed, while the Securities Industry and Financial Markets Association called on the rule to be re-proposed if significant changes are made. Bank of America called for the QM and QRM rules to be re-proposed and finalized at the same time. The Mortgage Bankers Association suggested that the Consumer Financial Protection Bureau consult with stakeholders before finalizing the QM rule; if the CFPB deviates from the proposal, the MBA said that the rule should be re-proposed.
- Eighteen organizations, including trade organizations, lenders and GSEs, called for the QM rule to provide a “bright-line safe harbor.” These organizations included, American Bankers Association, the American Financial Services Association, the American Securitization Forum, Bank of America, Consumer Bankers Association, JPMorgan Chase, Community Mortgage Banking Project, Consumer Mortgage Coalition, Fannie Mae, Freddie Mac, HBC, Independent Community Bankers Association, Mortgage Bankers Association, Financial Services Roundtable’s Housing Policy Council, National Association of Federal Credit Unions, National Association of Home Builders, National Association of Realtors, the Securities Industry and Financial Markets Association , and Wells Fargo Bank. (*Roadmap to QM Comments*, Canfield Press, 08/02/11)

Multiple organizations and individuals urge the regulators to withdraw and re-issue their “flawed” QRM rule

- In addition to the deluge of approximately 13,000 comment letters that industry experts believe have been filed in opposition to the proposed QRM rule, 24 organizations participating in The Coalition for Sensible Housing Policy also filed comment letters urging the regulators to withdraw and reissue the proposed QRM rule. Their comment letters have been posted at http://sensiblehousingpolicy.org/Responses_to_Regulators.html. For purposes of this Report, we review the following two comments filed by the ABA and NAHB.
- In an August 1 comment letter on proposal to establish credit risk retention requirements (QRM), the American Bankers Association and ABA Securities Association (Associations) wrote, “[We] strongly believe that the [QRM] proposal as currently drafted is so flawed that it must be withdrawn and re-issued. We believe that fundamental concepts in the proposal, such as how to measure the retained risk, are so unclear that it is impossible for the industry to provide well-reasoned responses to those critical aspects of the proposal. In addition to the lack of clarity, we believe that without significant changes the proposal will have a destructive impact on securitization markets and the availability of credit to consumers and businesses, and we have provided detailed comments to address our concerns. The proposed

Premium Capture Cash Reserve Account (PCCRA) is but one example of the fatal flaws in the proposal. By increasing the base risk retention requirement of ‘five percent’ to “five percent plus all of the securitizer’s and originator’s profit as well as a significant percent of their cost basis in the underlying assets, the PCCRA will effectively render most securitizations uneconomically untenable.”

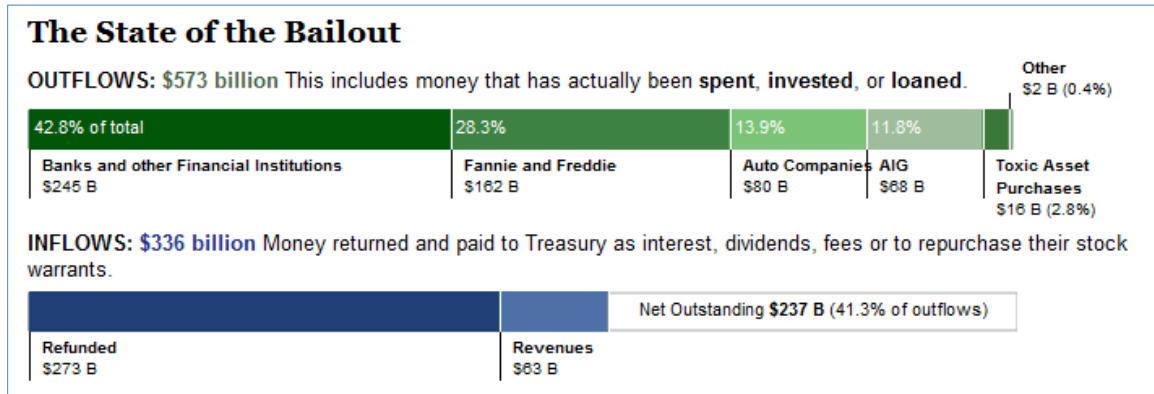
- “Moreover, the exceptions to the risk retention requirements fail to comport with Congressional intent with respect to the narrowness with which they are crafted. Section 941 granted the Agencies significant discretion when promulgating their regulations to establish the scope of the Qualified Residential Mortgage (QRM) exemption, and to employ a range of amounts of retained economic interests from zero percent to five percent that would be reflective of the underwriting standards of particular assets, and finally, to exempt entire classes of assets where warranted. Yet, the proposal reflects an ‘all or nothing’ approach to the retention requirements with zero percent retention for very narrowly crafted asset classes, and five percent retention for all other assets, with nothing in between. These narrow qualified asset exemptions are not workable, with the result that five percent retention will become the standard, leading ultimately to a constriction of credit for otherwise creditworthy borrowers. While Section 941 applies the risk retention rules to all ABS, not just to MBS, we believe the performance of non-MBS sectors throughout the financial crisis should be given significant weight in the Agencies’ deliberations and use of their exemptive authority.”
- “In addition, the Associations believe the risk retention rules must be viewed in a holistic perspective that takes into account additional Dodd-Frank and other rulemakings that, taken collectively, may magnify the impact of the risk retention rules. This is particularly the case in the context of securitizations collateralized by residential mortgages, a market currently experiencing wholesale transformations in applicable regulations. These changes include a regulatory overhaul in light of Title XIV of the Dodd-Frank Act as well as other regulatory initiatives to further regulate residential mortgages that predate that Act. Beyond regulations directly impacting classes of collateral, the risk retention requirements will necessarily interact with current and future Basel capital requirements and accounting rules. As a result, a risk retention requirement that, on its face, appears to be workable, may nonetheless make securitization transactions economically unfeasible.”
- “Given the critical importance of a robust securitization market to provide the business and consumer credit necessary for a healthy economy, the Associations urge the Agencies to conduct appropriate economic analyses of the proposal with respect to the impact on private securitization markets and the expected long-term increased costs of credit to consumers and small businesses. Those analyses should inform the Agencies’ deliberations as the rulemaking process moves forward. The recent economic figures issued by the federal government showing the weakness of the economic recovery provide an additional reason for the Agencies to take the time to reach the best balance in the rule. Otherwise, the markets will continue to display a

lack of confidence that securitization will provide an ongoing funding option for businesses dependent on the creation of consumer and other receivables.”

- “... Collectively, we believe the necessary changes are so substantial as to warrant a re-proposal after additional consultation with industry participants. Given the time-consuming and burdensome interagency process specified in the proposal for seeking interpretations, exceptions, waivers, etc., it is imperative that the Agencies provide final rules that are clear and straightforward to ensure that the industry will be able to understand what is required of it and be able to comply.”
- “While Congress sought to strengthen underwriting standards and properly align incentives in the securitization market, it sought to do so to ensure that the private securitization market would be a robust source of funding. As drafted, the proposal will only end up unduly restricting credit for consumers and businesses, to the overall detriment of our economy. Accordingly, it is critical that the Agencies balance the development of risk retention requirements with the need to ensure that the private securitization market is restored as a viable funding mechanism. A re-proposed rule, developed with industry input and proper economic analyses, will not hinder the return of the private securitization market and will help loan originators to provide credit – and particularly mortgage credit – to borrowers at a reasonable cost.”
- “We note further that revitalization of the private RMBS market is a crucial element in the current national policy debate over the future of Fannie Mae and Freddie Mac and the objective of significantly reducing reliance on them. There is a growing consensus that efforts must be undertaken to reinvigorate the private RMBS market and begin a measured reduction of the role of the GSEs in the marketplace. The rule as proposed would make this more difficult by essentially ceding large segments of the RMBS market which do not meet the Qualified Residential Mortgage exception to the GSEs for the foreseeable future.”
- The ABA’s full comment letter is available at <http://tinyurl.com/3mky35v>. (*American Bankers Association’s Comment Letter on Proposal to Establish Credit Risk Retention Requirements*, Robert R. Davis, 08/01/11)
- In an August 1 comment letter on the QRM rule, the National Association of Homebuilders wrote, “The proposed rule has far-ranging implications across the housing and development sectors. Each aspect of the proposed rule will have a significant impact. The narrow definition of a Qualified Residential Mortgage (QRM) would have a severe adverse impact on the availability and cost of residential mortgages. The proposed requirements on Qualified Commercial Real Estate (QCRE) loans would be virtually impossible to meet and would have a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The premium capture cash reserve account (PCCRA) has the potential to distort the securitization market and create a disincentive for private investors.”

- “NAHB understands that establishing credit risk retention rules was required by the Dodd-Frank Act. However, NAHB is very concerned about the immediate impact this proposed rule will have at this precarious point in the economic recovery and the future implications of overly restrictive rules on future growth of the housing market and the entire economy. NAHB urges the Agencies to take the time to carefully craft these new regulations so as not to have a negative impact on residential and commercial real estate financing. Historically, residential investment and housing services have been on average a combined 17 to 18 percent of gross domestic product (GDP). While the share of GDP tends to vary over the business cycle, there is no denying that housing is a large portion of the national economy, and reworking the entire housing finance market should not be taken lightly. With so much at stake, these regulations should not be rushed.”
- “For these reasons, NAHB requests that the proposed rule be withdrawn and re-proposed as an Advanced Notice of Proposed Rulemaking (ANPR). An ANPR is necessary given the implications and complexity of the proposed regulations under the Dodd-Frank Act. In this case, it would be appropriate for the Agencies to seek additional information from the public to assist them in framing a subsequent notice of rulemaking. Given the volume and detail of the public comments associated with the currently proposed regulation, it is likely that the final rule will differ materially from the proposed rule. Because of the probability that the final rule will not be a —logical outgrowth of the original rule, it will be vulnerable to challenge based on inadequate notice without a new round of public comment.”
- The NAHB’s full comment letter is available at <http://tinyurl.com/3kraxts>. (*National Association of Home Builders’ Comment Letter on Proposal to Establish Credit Risk Retention Requirements*, David L. Ledford, 08/01/11)

TARP



Source: <http://www.propublica.org/ion/bailout>

Taxpayers still face risk of loss with the \$130 billion of TARP investments still outstanding, said SIG-TARP

- As the wind down of TARP continues, U.S. taxpayers continue to bear the risk of \$130.5 billion in outstanding TARP funds and \$53.2 billion obligated and available to spend, said the Special Inspector General of TARP in its *Quarterly Report to Congress*. Taxpayers also bear risk in Treasury’s stakes in AIG (77% ownership), Ally Financial (74%) and GM (32%). SIG-TARP noted that the smaller community banks have failed to exit TARP’s Capital Purchase Program—with 539 of the 707 original participants remaining in the program—and some 188 banks, or 34.9% of banks remaining in the CPP, have not paid their CPP-related dividends, a number which continues to increase.
- Cost estimates for TARP range from \$19 billion—according to a March 29 CBO estimate that assumes only \$13 billion of the housing programs commitments will be spent—to \$64 billion in the administration’s FY2012 budget to \$78 billion, according to a November 15, 2010 Treasury estimate that includes administrative costs and interest effects. Treasury expects TARP’s largest losses will be generated from investments in housing programs, AIG, and the automotive industry.
- Treasury has spent \$200.9 million on administrative costs and \$494.7 million on programmatic expenditures for total expenditures of \$695.6 million for TARP on June 30, 2011. Treasury has employed 92 career civil servants, 114 term appointees, and 30.25 reimbursable detailees, for a total of 236.25 full-time employees to administer TARP.

OBLIGATIONS, EXPENDITURES, AND OBLIGATIONS AVAILABLE TO BE SPENT			
(\$ BILLIONS)			
Program	Obligation	Expenditure	Available to Be Spent
Housing Support Programs	\$45.6	\$2.0	\$43.6
CPP	204.9	204.9	0.0
CDCI	0.6	0.2	0.0 ^a
SSFI	69.8	67.8	0.0
TIP	40.0	40.0	0.0
AGP	5.0	0.0	0.0
TALF	4.3	0.1	4.2
PPIP	22.4	17.0	5.4 ^b
UCSB	0.4	0.4	0.0
Automotive Industry Support Programs (AIFP, ASSP, and AWCP) ^c	81.8	79.7	0.0
Total	\$474.8	\$412.1	\$53.2^d

Notes: Numbers may not total due to rounding. Obligation figures are as of 10/3/2010 and expenditure figures are as of 6/30/2011.
^a CDCI obligation amount of \$570.1 million. There are no remaining dollars to be spent on CDCI. Of the total obligation, \$363.3 million was related to CPP conversions for which no additional CDCI cash was expended and \$100.7 million was for new CDCI expenditures for previous CPP participants. Of the total obligation, only \$106 million went to non-CPP institutions.
^b Total obligation of \$22.4 billion and expenditure of \$17 billion for PPIP includes \$356.3 million of the initial obligation to The TCW Group, Inc. ("TCW") that was funded. TCW subsequently repaid the funds that were invested in its PPIP; however, these dollars are not included in the amount available to be spent.
^c Obligations include \$80.7 billion for AIFP, \$0.6 billion for AWCP, and \$0.4 billion for ASSP.
^d The \$5 billion reduction in exposure under AGP is not included in the expenditure total because this amount was not an actual cash outlay.

Sources: Treasury, Transactions Report, 7/1/2011, accessed 7/13/2011; Treasury, responses to SIGTARP data call, 7/8/2011, 7/13/2011.

(Source: SIG-TARP's Quarterly Report to Congress, 07/28/11)

- As of June 30, Treasury had provided GM approximately \$49.5 billion through the Automotive Industry Financing Program, of which \$19.4 billion was provided before bankruptcy and \$30.1 billion was provided as debtor-in-possession (DIP) financing during bankruptcy. In order to recoup its total investment in GM, Treasury will need to recover an additional \$27 billion in proceeds, which translates to \$53.98 per share on its remaining New GM shares, according to SIG-TARP. [On July 29, GM's last trade closed at \$27.68.]
- On June 30, the U.S Treasury and Government of Canada retained a 6.6% and 1.7% ownership stake, respectively in Chrysler's common equity, while Fiat and UA-VEBA Trust retained a 46% and 45.7% ownership stake, respectively.
- On June 30, Treasury held approximately \$9.4 billion of Ally Financial's common shares (approximately 74% of its common shares) and \$5.3 billion of the company's mandatory convertible preferred shares, according to SIG-TARP.
- On June 30, Treasury had \$24.3 billion outstanding to banks participating in TARP's Capital Participation Program. On that date, 188 banks had failed to pay \$320.8 million owed in CPP dividend and interest payments, up from 173 banks on March 31. According to SIG-TARP, 314 existing CPP participants have applied to

participate in the administration's Small Business Lending Fund and will, if approved, use a portion of the fund proceeds to refinance Treasury's CPP investment "to benefit from lower dividend rates, noncumulative dividends, and the removal of rules on executive compensation and luxury expenditures." (*Quarterly Report to Congress*, Special Inspector General, 07/28/11)

The Senate confirms Timothy Massad to serve as Assistant Secretary for Financial Stability

- The United States Senate confirmed Timothy G. Massad to serve as Treasury's Assistant Secretary for Financial Stability, responsible for overseeing the implementation and wind down of TARP. Previously, Massad served as the Acting Assistant Secretary for Financial Stability. He joined Treasury in May 2009 as the Chief Counsel for the Office of Financial Stability and was later named the Chief Reporting Officer for OFS. Before joining Treasury, Massad was a partner with the law firm Cravath, Swaine & Moore LLP. (*U.S. Treasury Press Release*, 07/01/11)

The U.S. taxpayers were the biggest losers

- "Federal and state prosecutors have built a sorry record since the fall of Enron created a political incentive to pursue white-collar defendants, whether or not they've committed crimes," wrote the *Wall Street Journal* in an August 2 editorial. "In the latest embarrassing episode, the abuses include prejudicial evidence, botched jury instructions and 'compelling inconsistencies' suggesting that the government's star witness "may well have testified falsely."
- "Those were among the problems cited Monday by a three-judge panel of the Second Circuit Court of Appeals when it tossed out the convictions of four former executives of General Reinsurance and one former executive from AIG. The collapse of this case renders even more appalling the way that prosecutors used it to force both companies to fire their CEOs—Joseph Brandon at Gen Re and Hank Greenberg at AIG. **In the latter case [AIG], the resulting loss of shareholder wealth—and creation of taxpayer risk—has been staggering**" [Emphasis supplied.]
- "The federal case was built on an obscure reinsurance transaction between the two companies in late 2000. The feds convinced a jury in 2008 to convict the executives of fraud and conspiracy on grounds that they had engineered the transaction as a sham simply to improve AIG's reported loss reserves and therefore juice its stock price."
- "Yesterday a unanimous three-judge panel vacated all of the convictions. Among other problems, the judges found that trial judge Christopher Droney had improperly defined for the jury what it means to "willfully cause" a crime. As a result, according to the appellate judges, 'the court ended up with a charge that allowed the jury to

convict without finding causation.’ Then there is the government’s key witness, Richard Napier, whose story kept changing about who cooked up the allegedly fraudulent scheme.”

- “The appeals court also found that Judge Droney allowed federal prosecutors a stolen legal base: displaying charts to the jury showing AIG’s plunging stock price after details of the investigation appeared in the press in early 2005. Oddly, the judge had realized that a chart with a continuous line moving downward would be prejudicial and disallowed it. But he nonetheless allowed similar charts with bar graphs and a series of dots. The appellate judges found ‘it is inevitable that jurors would connect them’ and that ‘the charts suggested that this transaction caused AIG’s shares to plummet 12% during the relevant time period, which is without foundation.’ If news of an investigation and the resulting stock decline can be used as evidence of fraud, then prosecutors can simply manufacture damning evidence at will.”
- “Along the way, prosecutors also used the investigation to force the two companies to fire their CEOs. Neither federal nor state prosecutors brought criminal cases against either man. But AIG’s stock was losing altitude in early 2005 in part because New York Attorney General Eliot Spitzer was piggybacking on the federal case and demanding that AIG’s board fire Mr. Greenberg. AIG’s directors complied in March of that year. **After Mr. Greenberg’s firing, the company dramatically increased its mortgage exposure, and the rest is financial crisis history.**” [Emphasis supplied.]
- “Over at Warren Buffett’s Gen Re, Mr. Brandon wasn’t forced out until 2008, after the now vacated guilty verdicts had been rendered. The *AP* and other media outlets have reported that Mr. Brandon was fired after pressure from federal prosecutors. Mr. Brandon was never criminally charged, and last winter the Securities and Exchange Commission decided that there wasn’t even a civil case to be made against him. So where does he go to get his reputation back?”
- “Speaking of civil cases, virtually all that remains of this sorry adventure in prosecutorial abuse and wealth destruction is a vestige of Mr. Spitzer’s old lawsuit against Mr. Greenberg. Since it relies so heavily for evidence on the criminal case that has now been obliterated, current New York AG Eric Schneiderman should drop it immediately. That’s also good advice for federal prosecutors considering whether to revive the shoddy criminal case that dissolved on Monday.” (*Wall Street Journal*, 08/02/11)

Auto industry rumblings:

Industry experts express concern about the new austerity’s impact on new car sales

GM inventory backlog “looking a lot like 2008”

GM gives green light to electric network vehicle production
and a Cadillac station wagon “muscle car”

President Obama announces a 54.5 miles per gallon CAFE efficiency standard by 2025

UAW to push auto makers for bigger profit-sharing checks

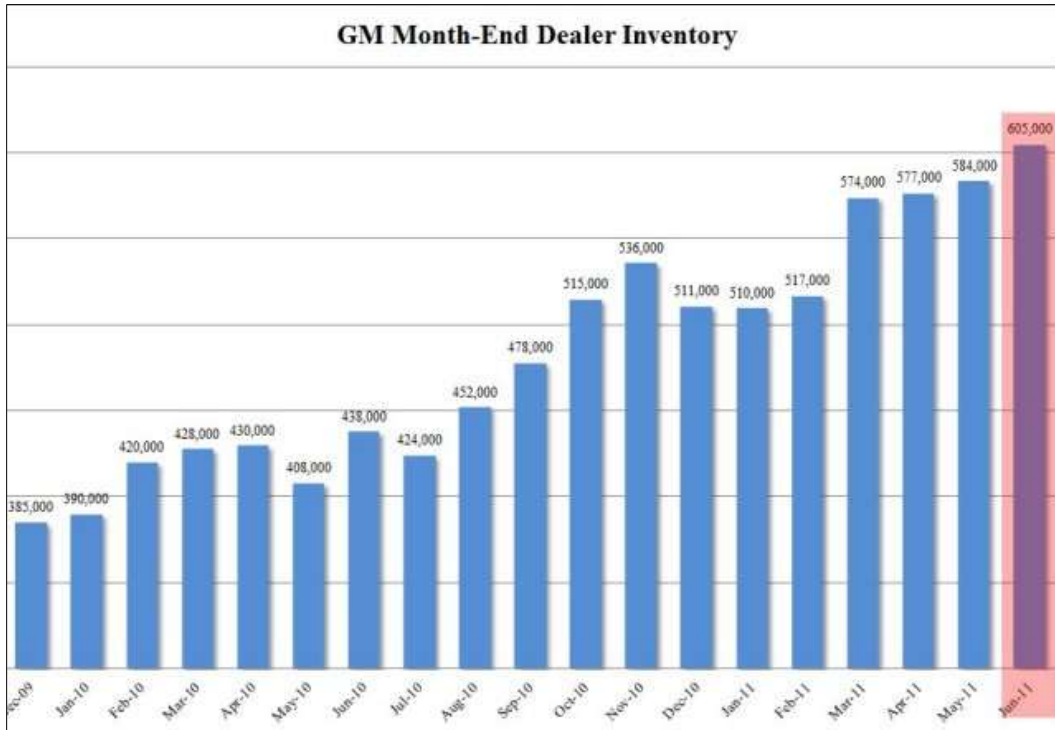
Industry experts express concern about the new austerity’s impact on new car sales

- Suddenly, automakers aren’t so sure any more that all the pent-up demand for new cars will bring back U.S. car sales to their “old glory” and are now predicting that the big recovery may be pushed back a year or more due to today’s new austerity. “[I]f job creation and housing prices stay weak, and especially if the debt ceiling deadlock affects the U.S. economy through higher lending costs, there’s still a chance that this year will see only modest improvements on 2010’s market,” wrote Edward Niedermeyer in *The Truth About Cars*. “In any case, the economic fundamentals will have to come back in a big way if the auto industry ever wants to return to the “old normal” of 15m+ units per year.” Steven Lang added, “You want to know what the pent up demand for new cars is? Zero. Zip. Nada. The sales numbers from 2003 – 2008 were based on overproduction, an exceptionally laissez-faire credit market, and the subsidization of over a dozen unprofitable brands along with thousands of unprofitable dealers. The only way the market will revisit those past levels is if (i) the credit market is willing to support a predominantly subprime consumer market; Americans are able to clear their tattered credit records. (This is the biggest issue of all); (ii) employment returns to pre-recession levels; and (iii) wage growth returns to historical levels. There is no pent up demand for new cars any more than there is pent up demand for trips to Paris.” (*TruthAboutCars.com*, Edward Niedermeyer, 07/25/11)
- U.S. auto sales stalled in July, casting doubt on a rebound this year as persistent unemployment and tighter lending deter buyers, reported *Bloomberg News*. The auto industry may lose 1.5 million units in projected sales in 2011, because the economy isn’t picking up as fast as anticipated, said AlixPartners LLP. Moreover, the drag may continue beyond this year, putting a return to average annual sales of 16.8 million vehicles from 2000 to 2007 out of reach. “This curve of unemployment looks like it’s got a lot of legs,” said Mark Wakefield, a director for AlixPartners. “This is one of the first recent cycles where demand is not going to go back above its prior peak, because there are just so many structural things that are different this time around.” (*Bloomberg News*, Craig Trudell and Joshua Armstrong, 08/01/11)

GM inventory backlog “looking a lot like 2008”

- GM has a growing inventory in its truck lines of 122 days’ worth of sales, nearly twice that of Ford Motors’ similar lines. The Detroit-based automaker has 280,000

Silverado and GMC Sierra pickups on dealers' lots around the country—enough to last until November if sales continue at June's rate. With sales flattening in the auto market, it appears GM has now returned to the high inventory of its pre-bailout condition. "It's unbelievable that after this huge taxpayer bailout and the bankruptcy that we're right back to where we were," said Peter Nesvold, a Jefferies & Co. analyst, who has a "hold" rating on the stock. "There's no credibility." In a research note, Nesvold asked, "Is GM falling into old, bad habits?" (*Bloomberg News*, Craig Trudell and Joshua Armstrong , 07/05/11)



GM gives green light to electric network vehicle production and a Cadillac station wagon “muscle car”

- GM’s electric network vehicle (EN-V)—an upright, two passenger Segway-like prototype—has been given the green light for production. The auto maker has high hopes that EN-V will become a key component of life in major cities and car-sharing programs by 2020. The EN-V will be fully electric, powered by li-ion batteries, similar to those found in the Chevy Volt extended-range electric sedan, and built to be sold for under 7000 Euros--about the same as a top-of-the line Segway. GM, which has yet to reveal the EN-V’s final design, shares their “achievable vision” of a complete mobility system at <http://tinyurl.com/3sx2pxb>. (*Gas2.0.com*, Jo Borrás, 07/23/11)

- “We’ve known Cadillac could dish out some serious hurt since 2009, when the CTS-V sedan elbowed its way through the crowd like a belligerent drunk and delivered a beating to almost anything that crossed its path,” wrote Chuck Squatriglia in *Wired*. “The sedan begat a coupe so potent it prompted Cadillac’s return to racing. But General Motors didn’t stop there. Someone at GM decided that what the world really needs is a CTS-V Wagon because, you know, a 6.2-liter supercharged V-8 good for 556 horsepower is just what you need for running to Costco.” Weighing in at 4,398 pounds and an MRSP starting at \$63,330, the muscle wagon averaged 12.5 miles per gallon according to Squatriglia. “...Before you get your knickers in a twist over the fuel economy, remember this: The CTS-V Wagon will never be a big seller. GM will be lucky to sell a few hundred a year, so it’s not like the world will end because this car gets crappy fuel economy. So why did GM build it? Only someone who doesn’t get cars would ask that question. There is no reason. The CTS-V Wagon exists because it could, because someone at General Motors felt it should and had the chutzpah to pull it off. God bless him.” (*Wired*, Chuck Squatriglia, 07/08/11)

President Obama announces a 54.5 miles per gallon CAFE efficiency standard by 2025

- On July 29, President Barack Obama announced his plan for a 54.5 miles per gallon fuel efficiency target for the 2025 model year, double the current standard. Under current law, CAFE standards must increase from 27.3 mpg to 35.5 mpg in 2016. The new standard requires a 5% annual increase in car fuel economy from the 2017 model year through the 2025 model year. The auto manufacturers agreed to the plan on a condition that full-sized pickups would be exempt from any fuel economy increases from the 2017 through 2019 model years. “The administration recognized that trucks need to be treated in a way that allows them to retain the utility and durability that their drivers require,” said Matt Blunt, president of the American Automotive Policy Council. “They haul, move, and tow supplies.” Under the plan, GM, Chrysler and Ford would get credits toward meeting CAFÉ targets by increasing the use of hybrid technology in pickups. More than a dozen auto manufacturers endorsed Obama’s new CAFÉ standards, while Volkswagen and Daimler did not. (*Automotive News*, Neil Roland, 08/04/11)

UAW to push auto makers for bigger profit-sharing checks



- If the United Auto Workers union agrees to profit-sharing instead of pay raises from Detroit’s automakers, the companies will have to write bigger checks than they do now, said UAW President

Bob King. “Our members deserve a fair share of the upside more than, in my opinion, what the current profit-sharing formula would pay out,” said King. “If we’re willing to take more flexible compensation instead of just putting in fixed costs, we should do better than we would have done [under the current profit-sharing plan].” UAW workers at GM received \$4,300 profit-sharing checks this year, while they received \$5,000 from Ford and \$750 from Chrysler. King also said union workers somehow must be protected against inflation.

- The auto maker may even try to cut the costs, but King said UAW won’t agree to more concessions. “We have said very strongly and very consistently that there’s no justification for further concessions,” he said. “There’s got to be a program that’s viable, that allows our members their fair share of the upside. ...I’m focused on income. I think in today’s world that’s how you’ve got to think about it.” (Associated Press, Tom Krisher, 07/19/11)

Dodd Frank Act’s one year anniversary:

Our U.S. financial system is much stronger today, thanks to Dodd Frank

The debate continues over TBTF

Is Dodd Frank “hobbling” the economic recovery?

Dodd Frank – *The* epic financial services bill

Dodd Frank: Reactionary regulation

Our U.S. financial system is much stronger today, thanks to Dodd Frank

- “By almost any measure, the U.S. financial system is in much stronger shape, not just relative to the depth of the crisis but also relative to conditions that prevailed before it hit,” wrote Treasury Secretary Timothy Geithner in a *Wall Street Journal* commentary on the one year anniversary of Dodd Frank. “We have recovered most of the investments the government made to put out the fires and avert disaster. While many misperceive the investment made in banks under the Troubled Asset Relief Program as an unfair and unjust gift to the financial sector, we have already turned a profit on these investments, and we may do so on all the government intervention programs. Moreover, these actions have helped to restart economic growth, increase the value of American families’ savings by trillions of dollars, make it possible for businesses to borrow again, and prevent a second Great Depression.”
- “...As we move forward, however, many of those who fought reform during the legislative process are now trying to slow down and weaken rules, starve regulatory

agencies of resources, and block nominations so that they can ultimately kill reform. We will not let that happen. Too many Americans are still suffering from the pain of the financial crisis. We owe them a financial system with better protections against abuse and catastrophic risk. As secretary of the Treasury, I will recommend that the president veto any legislation passed by Congress that would undermine these vital financial protections.” (*Wall Street Journal*, Timothy Geithner, 07/19/11)

The debate continues over TBTF

- Standard & Poor’s is skeptical that the Dodd Frank Act has completely “eradicated” the too-big-to-fail doctrine. “Under certain circumstances and with systemically important institutions, future extraordinary government support is still possible,” said S&P in a press release. “Time and time again, the U.S. government has found ways — many times reluctantly — to contain systemic risk and limit economic fallout when large financial institutions are on the brink of failure,” said S&P credit analyst Rodrigo Quintanilla. In response to S&P’s report, Representative Barney Frank (D-MA) wrote the rating agency: “I would suggest that you reconsider your apparent decision to diversify into legislative analysis and political prognostication.” (*American Banker*, Andrew Johnson, 07/14/11; *Washington Post’s Political Economy Blog*, Cezary Podkul, 07/15/11)
- “It’s too early to tell whether Dodd-Frank will ultimately be successful in ending ‘too big to fail,’ and that success will be dependent on the market’s perception of the effectiveness of the acts that are taken by [Treasury] and the regulators now,” said Christy Romero, the acting special inspector general for the TARP, at a June House Financial Services Committee hearing. (*American Banker*, Andrew Johnson, 07/14/11)
- Representative Barney Frank (D-MA), insisted several times that “too big to fail” was *over* at a recent appearance at the National Press Club. “We are the first nation to say, ‘Hey, if you get in trouble, you’re dead,’” said Frank. “And we will then worry about your mess, and we may have to minimize the mess you left behind. But if we — if that costs us any money — it’s coming from your colleagues; it’s not coming out of the taxpayer. And we think that model is an attractive one.” (*Washington Post’s Political Economy Blog*, Cezary Podkul, 07/15/11)

Is Dodd Frank “hobbling” the economic recovery?

- “Two things we know for certain: The massive law will layer more bureaucracy on top of old regulations, and this ‘twilight zone’ period of uncertainty will restrict capital and hobble the recovery,” wrote Tom Donohue, president and CEO of the U.S. Chamber of Commerce. A variety of studies claim that the cumulative weight of Dodd Frank’s new rules will adversely impact economic growth and job creation. Quantitative estimates include a total 2.6% decline in GDP from regulatory changes,

which include (i) 4.6 million jobs lost; (ii) 0.19% decline in GDP for each 1% increase in capital requirements; (iii) 0.2% decline in GDP when the systemically important financial institution surcharge is implemented; and (iv) \$1.25 billion in budgetary costs incurred by next year. (*Santa Barbara's Noozhawk.com*, Tom Donohue, 07/26/11; *Special Edition of Fast Facts*, Financial Services Roundtable, 07/21/11)

Dodd Frank – The epic financial services bill

- “Do you think you might need some financial services products over the next 10-20 years?” asked Thomas Ressler, Editor of Inside Mortgage Finance Publications. “Good luck with that.”
- “Peter Wallison of the conservative American Enterprise Institute calculates that the Federal Reserve has 50 regulations to develop coming out of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Deposit Insurance Corp. 40, the Consumer Financial Protection Bureau 32 and the Securities and Exchange Commission 72. It can take a regulatory agency a year or two to develop JUST ONE complex regulation.”
- “Overall, Dodd-Frank requires a mind-boggling 235 rulemakings altogether, according to an analysis by the Securities Industry and Financial Markets Association. Of that total, 38 new rules have been finalized so far, 26 rule deadlines have been missed, and 215 rules have yet to be proposed. 122 rulemakings come due in the third quarter of 2011 alone.”
- “On top of that, Dodd-Frank could produce anywhere from 5,000 to 10,000 pages of regulation, according to one industry estimate provided at last month’s regulatory compliance conference sponsored by the American Bankers Association.”
- “To go one step further down this road, Dodd-Frank is an epic financial services law compared with its predecessors, as illustrated by the number of pages of each law when enacted:
 - The Federal Reserve Act of 1913: 31 pages.
 - The Glass-Steagall Act of 1933: 52 pages.
 - The Interstate Banking Efficiency Act of 1992: 61 pages.
 - The Gramm-Leach-Bliley Act of 1999: 144 pages.
 - The Sarbanes-Oxley Act of 2002: 65 pages.
 - The Dodd-Frank Act: 2,319 pages.”
- “All of that being said, seems to me Dodd-Frank could be referred to as the Federal Government Apparatchik Lifetime Full Employment Act.”

- “Hopefully, you all have all of the mortgage financing, home equity, credit card, auto and small business loans you’ll need for the next 20 years, because by the time all of this burden gets stapled onto the back of American business— and all of the interconnected cross-currents are put into motion—the cost of any of these financial services products will be prohibitive, and we’ll watch video on the History Channel of the good old days when we could apply for a credit card online or spend half a day at the auto dealer financing the purchase of a new car.” (*Today’s Jim Cramer-esque Rant: Good Luck With That*, Thomas Ressler, 07/26/11)

Dodd Frank: Reactionary regulation

- “Although I think that Dodd-Frank was an understandable outcome of the crisis and that the banks’ own actions brought on Dodd-Frank, I believe it’s time to take a deeper look at how we regulate the financial industry,” said Herbert Allison, who served as president of Merrill Lynch in the 1990s and as Assistant Secretary of the Treasury, where he directed TARP. “In the past, additional laws and regulations have almost always been enacted as a reaction to a crisis. That was true, for example, with Glass-Steagall and Sarbanes-Oxley. So the crafting of regulations is usually backward-looking—aiming to prevent the failures and misdeeds blamed for the last crisis. By focusing on the obvious manifestations, the symptoms, of the last crisis, new regulation hasn’t addressed the underlying forces that repeatedly drive these banks to the brink of failure by taking excessive risks, and also cause them to lose sight of their clients’ interests in their headlong pursuit of profits.”
- “So I think the question is: how can we come up with a regulatory regime that actually harnesses the forces of competition, innovation and profit-seeking in ways that actually work to the long-term advantage of customers, shareholders, and the general public? I think it’s possible to do that in ways that don’t inhibit competition, innovation and efficiency, and actually improve the industry’s performance by shifting the focus of competition to risk-performance for clients and shareholders.”
- “We should also take a broader look at the organizational framework for regulating the financial industry. Although there’s going to be greater coordination among regulators thanks to Dodd-Frank, the configuration of regulators still reflects the old product-oriented structure of the financial industry 40 years ago. And that’s true of Congressional oversight bodies as well. Just as the big banks should reconstitute themselves into client-centered, independent businesses, the regulatory and oversight frameworks should also move from product centered to client centered. For instance, we should consolidate regulation and oversight of financial businesses serving individuals and have a separate structure for comprehensive regulation and oversight of capital markets businesses serving corporations and institutions.”
- “We’ve painfully learned that there were major segments of the financial industry that were not regulated at all, others that were inadequately regulated, and some that were under multiple regulators competing with each other, which led to a race to the

bottom in relaxing regulations and oversight. If we step back from the pressures of responding to the last crisis and take a look at how and why the industry has evolved over the last 40 years, we'll see the need for more completely revamping regulations and the regulatory framework in ways that will reshape the industry to better meet the needs of clients, shareholders and the public, and to provide more effective, efficient and comprehensive oversight. Dodd-Frank makes progress in that direction, but it could be improved in time."

- Allison has written an eBook, *The Megabanks Mess* [<http://tinyurl.com/4yj83zg>], which outlines an 11-point plan to fix our banking system. (*American Banker*, Kevin Wack, 07/28/11)

In his own words...

- "I did not want the bill [The Dodd Frank Act] named after me," joked former Senator Chris Dodd (D-CT) at the Salt Conference in Las Vegas, NV. "My children are going to have to change their name."
- "I know that the too big to fail provisions in Dodd Frank are controversial," said Dodd. "They are not meant to prevent another bank from being too big to fail. They are to prevent them from metastasizing so that they we can avoid another Lehman style bankruptcy."
- "[Dodd Frank] was our best effort," he added. "The markets needed certainty. At first, people complained that the provisions were going to take too long to take effect. Now they are saying we are moving too quickly. ... We didn't want to strangle innovation and needed to balance it with good regulation and offer harmonization of rules. When we were working on the bill, we were faced with time constraints and high emotion." (*Business Insider*, Laura Goldman, 07/08/11)

Fannie Mae and Freddie Mac

657,044 HAMP mortgage modifications have been completed as of June 30

- While Treasury’s HAMP program has helped more than 657,044 homeowners reduce their mortgage payments as of June 30, it has had trouble helping millions more borrowers who are desperate for relief, reported the Special Inspector General of TARP.

HAMP MODIFICATION ACTIVITY BY GSE/NON-GSE, AS OF 6/30/2011						
	Trials Started	Trials Cancelled	Trials Active	Trials Converted to Permanent	Permanents Cancelled	Permanents Active
GSE	880,772	420,891	50,923	408,958	51,248	357,710
Non-GSE	758,610	339,905	64,592	354,113	54,779	299,334
Total	1,639,382	760,796	115,515	763,071	106,027	657,044

Sources: Treasury, responses to SIGTARP data call, 7/22/2011, 7/23/2011.

- Approximately 46% of HAMP trial modifications have been cancelled and approximately 14% of trials that converted to permanent mods were cancelled as of June 30, according to SIG-TARP.

TARP ALLOCATIONS BY HOUSING SUPPORT PROGRAMS, AS OF 6/30/2011 (\$ BILLIONS)	
HAMP	
First-Lien Modification	\$19.1
PRA Modification	2.0
HPDP	1.6
HAFA	4.1
UP	— ^a
2MP	
Treasury FHA-HAMP	0.2
RD-HAMP	— ^b
FHA2LP	2.7
FHA Short Refinance (Loss-Coverage)	8.1 ^c
HHF	7.6
Total Allocations	\$45.6

Note: Numbers may not total due to rounding.
^a Treasury does not allocate TARP funds to UP.
^b Treasury estimates that \$17.8 million will be allocated to RD-HAMP.
^c This amount includes the up to \$117.0 million in fees Treasury will incur for the availability and usage of the \$8.0 billion letter of credit.

Source: Treasury, responses to SIGTARP data call, 6/30/2011, 7/22/2011.

- In aggregate, \$45.6 billion of TARP funds have been allocated to housing support programs, while \$1.426 billion of non-GSE incentive payments have been disbursed through June 30.
- The administration's programs designed to help underwater borrowers refinance their mortgages have been plagued with disappointing results and growing conflicts among regulatory agencies. To date, the FHA's Short Refinance program has extended only 246 loans and servicers have included principal reductions in 4,911 HAMP modifications as of June 30. In Treasury's \$7 billion Hardest Hit Program, only Bank of America and Ally Financial have agreed to participate, but only under investor approval. The Home Affordable Refinance Program has helped 784,000 loans owned by Fannie Mae and Freddie Mac with 84% of the borrowers having loan-to-value ratios of less than 105%; only 5,400 HARP modifications were made to borrowers with LTVs exceeding 105%.
- The success of FHA's Short Refinance program has been hampered by the lack of participation of Fannie Mae and Freddie Mac, triggered by a directive by Edward DeMarco, FHFA's acting director. "FHFA understands that some mortgage investors have sought such solutions in order to recover today what principal they can on outstanding mortgages. However, I am determined that these programs as they work today, while they may be in the best interest of certain other mortgage investors, do not meet FHFA's conservatorship goals," wrote DeMarco in a letter to Representative Brad Miller (D-NC). (*Quarterly Report to Congress*, Special Inspector General, 07/28/11)

BREAKDOWN OF TARP (NON-GSE) INCENTIVE PAYMENTS, AS OF 6/30/2011 (\$ MILLIONS)	
HAMP First-Lien Modification Incentives	Non-GSEs
Servicer Incentive Payment (\$1,000)	\$331.6
Servicer Current Borrower Incentive Payment (\$500)	12.6
Annual Servicer Pay for Success	205.7
Investor Current Borrower Incentive Payment (\$1,500)	37.5
Investor Monthly Reduction Cost Share	446.4 ^a
Annual Borrower Pay for Success	201.4
HAMP First-Lien Modification Incentives Total	\$1,235.2
Second-Lien Modification Program Incentives	
2MP Servicer Incentive Payment	\$14.2
2MP Servicer Pay for Success	—
2MP Borrower Pay for Success	—
2MP Investor Cost Share	6.4
2MP Investor Full Extinguishment	6.0
2MP Investor Partial Extinguishment	0.9
Second-Lien Modification Program Incentives Total	\$27.5
HAFAs Incentives	
Servicer Incentive Payment	10.1
Investor Reimbursement	3.5
Borrower Relocation	24.2
HAFAs Incentives Total	\$37.9
HPDP	\$122.6
FHA2LP	—
PRA	—^b
RD-HAMP	—^c
Treasury/FHA-HAMP Incentives	
Annual Servicer Pay for Success	1.4
Annual Borrower Pay for Success	1.4
Treasury/FHA-HAMP Incentives Total	2.8
TOTAL	\$1,426.0
<small>Note: Numbers affected by rounding. ^a Investor Monthly Reduction Cost Share is considered an incentive payment. ^b PRA has paid \$18,224 in incentives. ^c Treasury could not provide SIGTARP with RD-HAMP incentive data as of June 30, 2011.</small>	
<small>Source: Treasury, response to SIGTARP data call, 7/6/2011.</small>	

- In a *Meet the Press* appearance, Treasury Secretary Timothy Geithner admitted that the Obama administration is running out of options to “engineer artificially a stronger recovery” in the housing market and overall U.S. economy. (*HousingWire*, Jon Prior, 07/15/11)
- “We can’t mod our way out [of this housing mess],” wrote Nomura analysts Brian Foran and Jonathan Shahrabani in a recent report. “Legislators want the option of curing half of distressed borrowers. The problem: re-default rates are highly correlated with delinquency. If a borrower is under 6 months delinquent, re-default is 25%. If a borrower is over 6 months delinquent, re-default is 60%. Of the 4 [million] distressed borrowers, 3.4 [million] are delinquent for more than 6 months. Thus, even if we provide a modification to every distressed borrower, over half would likely

re-default.” (*Mortgage Underwriting Cuts Both Ways—Too Tight*, Brian Foran and Jonathan Shahrabani, 07/07/11)

- Ocwen Financial Corp. has launched a new modification program that will reduce the loan principal and compel the borrower to share future appreciation in of their house’s value with the investor. The Shared Appreciation Modification Program (SAM), which is available only to homeowners with negative equity, will write down qualified loans to 95% of the underlying property value in one-third increments over three years, as long as the borrower remains current on their payment. When the home is sold, the borrower will be required to share 25% of the appreciated value with the investor. “Like all modifications, SAMs help homeowners avoid foreclosure,” said Ocwen CEO Ronald Faris. “But they also restore equity. That’s a significant benefit to the customer, and, we believe the economy and housing market. Psychologically, it’s important too. Our analytics tell us that an underwater mortgage is one and one-half times more likely to default than one with at least some positive equity.” SAM is one of the first principal reduction programs voluntarily introduced by a private company. (*HousingWire*, Jon Prior, 07/26/11)

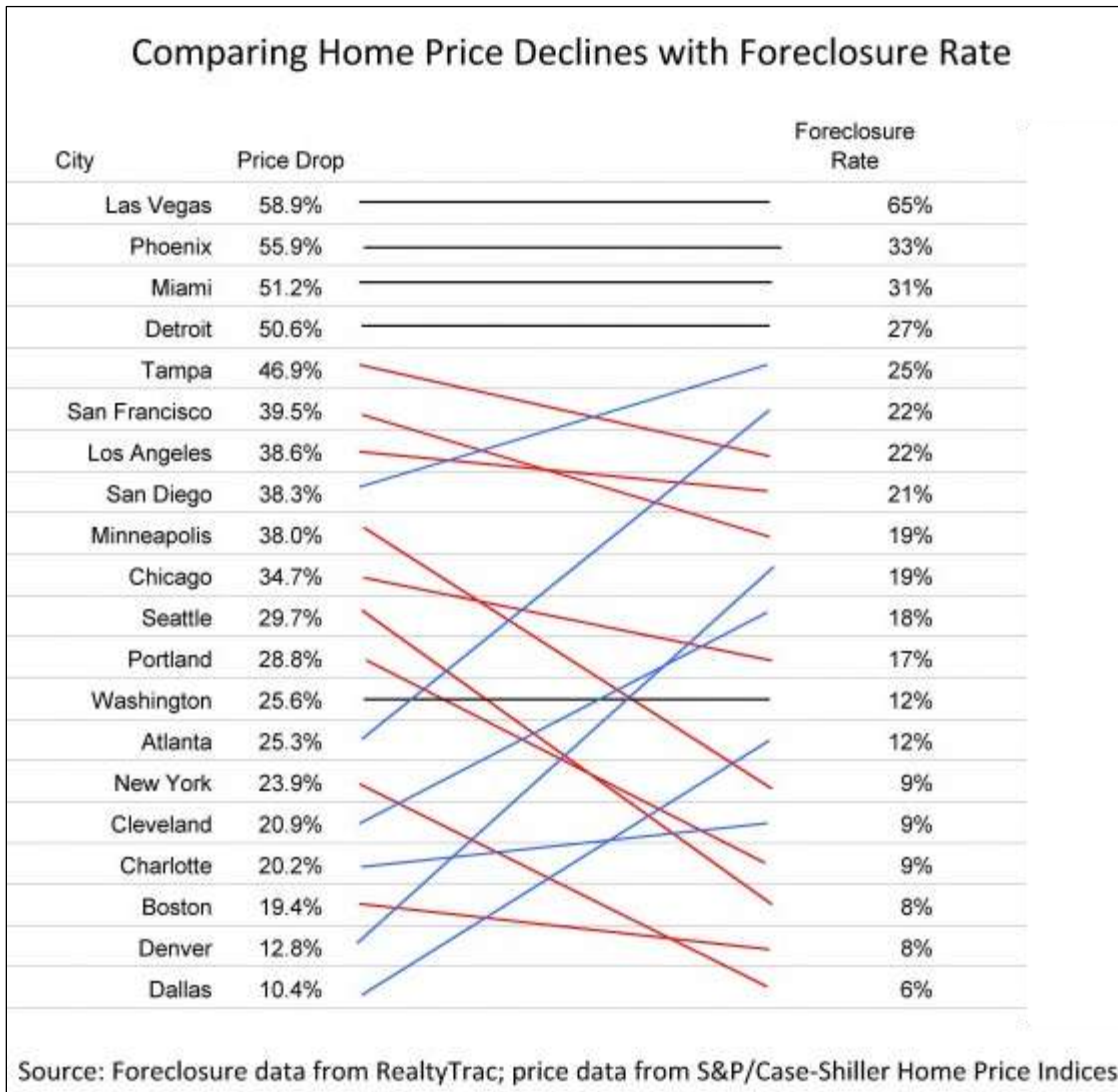
A housing market “bottom,” but no recovery yet, according to Wells Fargo
Demand-side drivers provide additional headwinds for a housing recovery, says PIMCO
Blow them up...

A housing market “bottom,” but no recovery yet, according to Wells Fargo

- “We are seeing more and more signs suggesting that home sales and new home construction have effectively bottomed out,” wrote Wells Fargo Securities’ senior economist Mark Vitner with the sales of existing homes averaging 4.3 million unit pace and new homes hovering around a 300,000-unit pace. “Our forecast for housing continues to portend a slow recovery, with housing starts not returning to their long-run trend until 2014,” wrote Vitner. “In the near term, we expect starts to rise 2% and 20% in 2011 and 2012, respectively [with] much of the gains ...concentrated in the multifamily sector, where a robust apartment market continues to encourage builders to start new projects.”
- “The key factor determining the pace of recovery will be how quickly the excess supply of existing homes clears,” added Vitner. “Foreclosure inventory continues to grow, and the inventory of homes likely to enter the foreclosure process over the next few years remains large. There are about 2.2 million properties waiting to enter the foreclosure process and another 1.9 million properties with mortgages 90 days or more delinquent.” While home prices for non-distressed homes have likely bottomed out in many areas of the country, falling prices for foreclosed homes and banks’ REO will continue to drag overall home values lower. Home prices for

single-family homes were down 7.4% over the past year, according to Corelogic. However, prices for non-distress home sales were essentially flat—down just 0.4% over the period.

- The homeownership rate declined 1 percentage point to 65.9% over the 12 months ended June 30, the lowest level in 13 years. Tight underwriting standards, coupled with impending loan limit drops for Fannie Mae, Freddie Mac and FHA, have pushed mortgage costs up with closing costs up some 8.8% from a year ago, according to a BankRate Inc. survey. A factor that may help the housing recovery in the U.S. is the return of the international home buyers to long depressed markets—particularly in coastal markets, such as Florida and California. Canadian and South American buyers are taking advantage of the weak U.S. dollar to buy vacation homes. (*Wells Fargo Securities' Housing Chartbook*, Mark Vitner, 07/29/11; *HousingWire*, Kerri Panchuk, 07/18/11)



- “To clear inventory, banks must sell and buyers must buy,” wrote Nomura analysts Brian Foran and Jonathan Shahrabani in a recent report. “The opposite is happening. Sales of foreclosed homes fell by half last fall post state AG



investigations. Moreover, mortgage underwriting is now so tight that less than half the population qualifies for a traditional loan—a basic problem for a country with a 65% homeownership rate. The average GSE loan has a 761 FICO while the average FICO for the US population is 696 (and only one-third of the population is over 760). This is why 25% of all mortgages are now done by the FHA. Mortgage underwriting standards need to ease to fix the housing mess, not tighten.” (*Mortgage Underwriting Cuts Both Ways—Too Tight*, Brian Foran and Jonathan Shahrabani, 07/07/11)

Demand-side drivers provide additional headwinds for a housing recovery, says PIMCO

- “Additional headwinds contributing to what we see as a dramatic cyclical and secular decline in housing demand will likely continue to weigh on the housing market for the foreseeable future,” wrote Rod S. Dubitsky, executive vice president of PIMCO. “In spite of what may be considered good affordability (driven by dramatically reduced prices and low interest rates), it appears that limited mortgage availability and vulnerable consumer health across the income and age spectrum are restraining demand and may continue to do so. Also weighing on the market is regulatory uncertainty over the future structure of mortgage finance and the resolution of foreclosure overhang. For all of these reasons, we believe the housing market, considered to be a key driver of the economic recovery, will generally remain weak for the foreseeable future.”
- **Down payment challenges.** “Saving for the traditional 20% down payment [under the proposed QRM regulation] may increasingly become an insurmountable hurdle. To help gauge how much of a hurdle the 20% down payment can be (which outside of FHA loans is becoming the de facto standard), we estimated how long it would

take the typical consumer to save for a down payment on a median-priced home, which was \$158,700 as of 1Q 2011, according to the National Association of Realtors. Liquid assets held by consumers under 45 years old available for a housing down payment average \$22,600, according to the Federal Reserve Board's Survey of Consumer Finances. In order to cover a 20% down payment and 5% closing costs for the median-priced home, consumers need \$39,667. Therefore the amount needed for a 20% down payment on the median home (and likely a modest home at that) was nearly two times the average savings rate."

- "Looked at another way, factoring in the personal savings rate from after-tax income as reported by the Bureau of Economic Analysis, we can arrive at a "saving duration rate" expressed in years. ...Based on the current savings rate of 5.1% and after-tax income of \$48,300 (as of 1Q 2011), it would take 16 years for buyers to save the 20% down payment based on the national median-priced home and well over 20 years in many coastal cities where prices are higher. This metric assumes a complete depletion of savings and no retirement savings and other simplifying assumptions..."

- **First time homebuyers' balance sheets.**
"The hypothetical balance sheet of the next generation of would-be [first time] homebuyers looks grim. Average student debt for a bachelor's degree reached \$23,118 in 2008 [and it is projected to go higher (see Figure 1)], according to the most recent

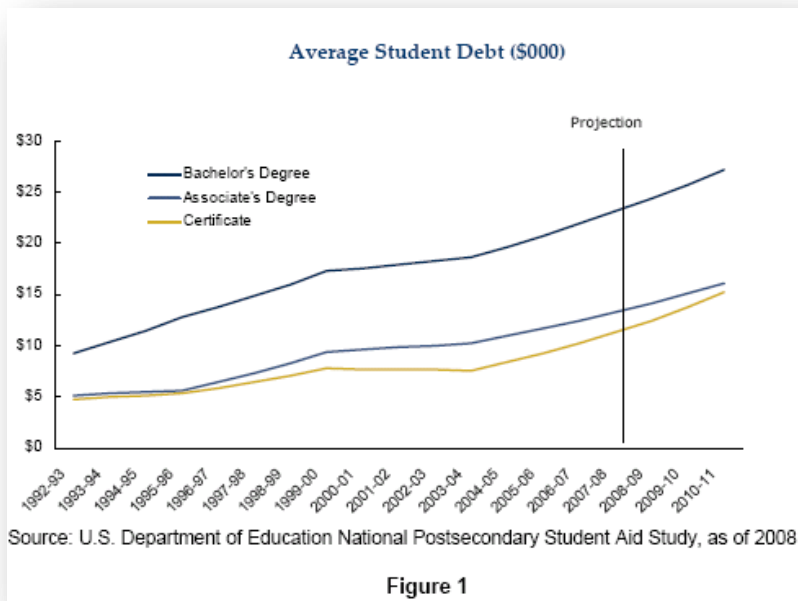


Figure 1

National Postsecondary Student Aid Study conducted by the U.S. Department of Education. This debt roughly equals a 15% down payment on the median priced home in the U.S. as reported by the National Association of Realtors. Moreover, the nominal median salary for recent college graduates declined 10% to \$27,000 in 2010 from \$30,000 in 2007, according to the John J. Heldrich Center for Workforce Development at Rutgers University."

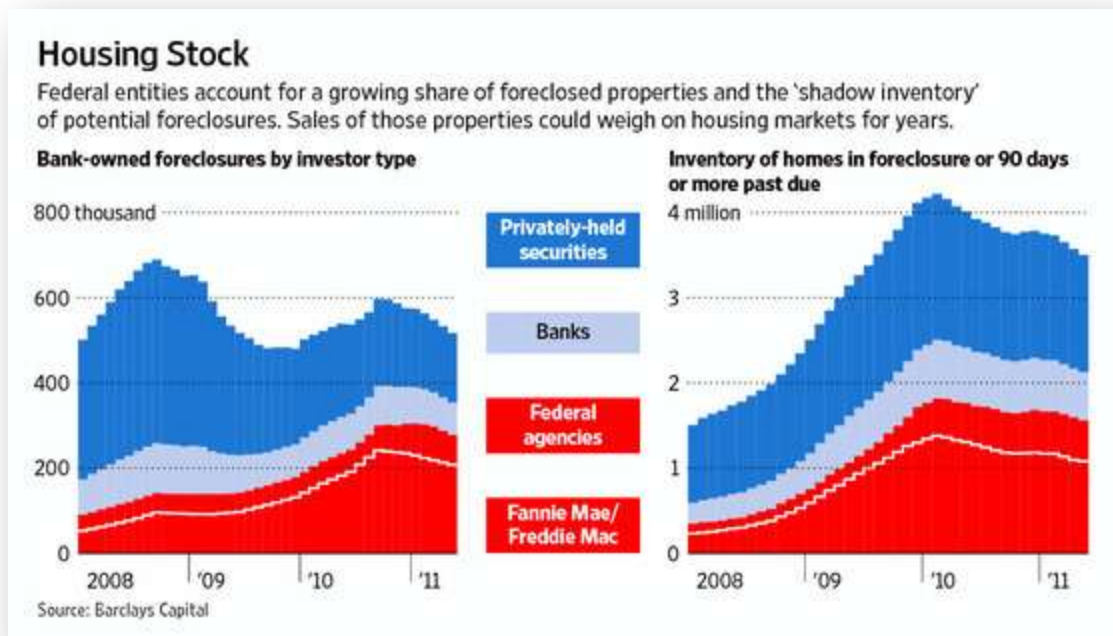
- "This younger age group will likely constitute the bulk of potential new entrants to the housing market, and whether a corresponding demand in housing will materialize hinges largely on their ability to save. Although some of these grim statistics can be

considered a function of recent economic weakness, we believe that some amount of the reduction in graduate earnings power and rise in debt is a longer-term phenomenon that could serve to limit college graduate home purchasing power for the foreseeable future.”

- **Baby Boomers retiring and downsizing.** “A growing percentage of the population appears to be approaching a limited resource retirement, whether due to inadequate retirement resources or doubts about whether “promised” resources will materialize (e.g., state and municipal retirement plans are under threat). . . . The looming retirement income cliff will likely lead to a reduction in housing demand (or at least a change in preferences) from those approaching retirement, as they prepare for financial cutbacks. This could be manifested in permanently postponed home purchases, reduced tendencies to upsize, lower likelihood of buying a retirement home, more affordable post-retirement rental choices, etc. All of this suggests ‘downsized’ housing choices – one home instead of two, rent rather than own, smaller place rather than large. These choices could serve to reduce the dollars committed to housing investment...”
- **Regulatory headwinds.** “In addition to ...affordability constraints, a number of legislative and regulatory developments could potentially squeeze availability of mortgage loans:
 - **Mortgages:** Though it is highly uncertain what the future structure of the mortgage market will look like, one thing is probable: The mortgage market of the future will have less government and more private sector involvement, though this may take several years. This will likely result in rising mortgage rates in general and more risk-based pricing in particular as the private sector increases rates to weaker GSE-eligible borrowers.
 - **Basel III:** Among other changes potentially impacting the mortgage market, Basel III imposes increased capital charges on retained mortgage servicing, which further increases the cost of securitization as servicers who retain the servicing will be subject to more onerous capital charges. Currently, 100% of the value of mortgage servicing rights is applied to Tier I capital. Under Basel III, the capital benefit of mortgage servicing rights will gradually be phased down to 15% of equity capital.
 - **Dodd-Frank:** Among the elements of Dodd-Frank that could suppress mortgage supply are the risk retention rules that require securitizers to retain 5% of securitizations for loans not meeting Qualifying Residential Mortgages (QRM) criteria. Among other elements, QRM mortgages stipulate a minimum 20% down payment and a maximum mortgage debt ratio of 28%.”
- “This could further impair the use of securitization to help stimulate the supply of mortgages. Though the GSEs are exempt from the risk retention rules, given that the future mortgage market will likely be less reliant on the GSEs (and the degree of GSE

involvement will be heavily dependent on the political landscape), the securitization market is considered critical to offsetting the dwindling capacity of the GSEs. With a potentially declining presence of the GSEs and a minimalist securitization market, there simply does not appear to be enough bank capital (and banks are the most likely source of alternatives to GSE and securitization funding) to adequately support mortgage lending...”

- **Appearances can be deceiving.** “A basic concept of personal finance is that as long as borrowers have sufficient funds for a down payment and a stable source of income, the next rungs up on the housing ladder should be within reach. For the typical American homeowner, these requirements have traditionally been satisfied by solid employment for young graduates, reasonable pricing and availability of mortgage credit, accumulation of funds that allow trade-up purchases of larger homes and finally by the view of housing wealth as a potential income supplement during retirement.”
- “However, we believe the challenging economic situation today has dramatically altered this progression. At the bottom of the ladder, dismal employment prospects and the debt situation of young graduates may be impeding their ability to save for a down payment. In the middle of the spectrum, negative equity is effectively preventing many homeowners from advancing (i.e., Core Logic estimates that over 23% of homeowners have negative equity in their homes preventing them from buying a new home). And at the top of the ladder, the erosion of retirement income could result in downscale housing investments and may push retirees to consign themselves to the status of lifetime renters. Instead of serving as a potential wealth builder, housing has in some cases become a potential millstone that can drain limited remaining liquidity and retirement funds. Hence, even buyers who can climb on to the home ownership ladder may opt out of home ownership in favor of what is often times the more flexible, available rental option.”
- “Tight mortgage lending standards, pending GSE reform and weak economic conditions across the demographic spectrum render the prospects for housing demand increasingly grim. Though there will be some rebound in demand as the economy finally achieves escape velocity and income and employment growth return to normal levels, we are arguing that post-recovery demand will be more tempered than it has been in the past. Further, people need to live somewhere, and investors will likely step into the breach (and have already, as a large percentage of today’s home sales are all-cash sales to investors) as more housing becomes rental housing. The implication is that we could see further home price declines as we move from a nation of owner occupants to a nation of renters/investors.”
- “Though much has been made of the distressed supply overhang, we believe the demand side of the housing equation could more than overwhelm the impact of distressed housing supply. Absent a significant economic rebound or more dramatic policy response, housing demand will likely remain a drag on the housing market for the foreseeable future.” (*PIMCO Viewpoints*, Rod S. Dubitsky, July 2011)



“Blow them up...”

- When all else fails, just bulldoze the excess housing inventory. This appears to be the strategy that some of the big banks are taking, as they struggle with a glut of foreclosed homes on their balance sheets. In Cleveland, Bank of America is donating 100 foreclosed homes to Cuyahoga County Land Reutilization Corp. (CCLRC), which works with lenders and government officials to salvage vacant homes. “The best thing we can do to stabilize the market is to get the garbage off,” said Gus Frangos, president of CCLRC, who estimates the cost of demolishing Cleveland’s foreclosed and abandoned properties might cost \$250 million.
- BofA pays the CCLRC \$3,500 to \$7,500 for the home demolition, depending upon the availability of federal taxpayer funds from the Neighborhood Stabilization Program. In addition to the Cleveland donation, Bank of America has also committed to raising as many as 100 properties in Detroit and 150 homes in Chicago. BofA spokesman Rick Simon said the Bank may add as many as nine cities to this program by the end of the year. BofA’s tear-downs are in varying states of disrepair, making it cost too much to make the homes livable, said Simon.
- “No one needs these homes, no one is going to buy them,” said Christopher Thornberg, a partner with Beacon Economics. “Bank of America is not going to be able to cover its losses, so it might as well give them away and get a little write-off and some nice public relations.”

- Since 2009, Wells Fargo Bank has made more than 800 property donations to local communities. Similarly, JPMorgan Chase has donated or sold at a discount nearly 1,900 properties valued at more than \$100 million in 37 states. Since 2008, Citigroup has also been donating foreclosures to the National Community Stabilization Trust, which is launching a pilot program in August to provide funds for the purchase and demolition of homes in distressed neighborhoods.
- Berkshire Hathaway’s CEO Warren Buffet proved sage one more time, when he predicted in February that the solution to the oversupply of housing was “to blow up a lot of houses—a tactic similar to the destruction of autos that occurred with the ‘cash for clunkers’ program.” (*Bloomberg News*, Lindsey Rupp, 07/27/11)

New troubled debt restructuring rules will provide transparency
to the loan modification performance

SEC presses the banks to improve their disclosures
for litigation risk and the valuations of their HELOC portfolios

New troubled debt restructuring rules will provide transparency to the loan modification performance

- The top 100 U.S. banks and thrifts restructured \$102 billion of residential mortgages during the first quarter, according to a review of FDIC data by BankRegData.com. Some of the largest banks—including Citigroup and JPMorgan Chase—restructured as many as one in 12 mortgages during the period. [In a second quarter conference call with investors, Citigroup CFO John Gerspach said roughly 25% of the Bank’s mortgage modifications completed through its private programs redefaulted over the past two years.] Analysts say that the banks are track to report an equal—and perhaps higher—number of troubled debt restructurings in the second quarter.
- “These are sizable figures,” said Brandon Bajema, associate director for Fitch Ratings. “Once we have the enhanced disclosures [for troubled debt restructuring] in the third quarter, we’ll have a sense of whether management is doing the right thing and restructuring loans in such a way that it allows them [the debt] to be current.” New accounting rules will soon go into effect, requiring banks to reclassify a larger number of loans as troubled debt restructurings and disclose default rates for the first time.
- Historically, banks’ practices have varied widely in how they report loan modifications and restructurings, Many institutions classifying troubled debt restructurings as non-performing, which can only be considered after the borrower has made their revised payments for a “reasonable” period, generally six months. Bank management, analysts and regulators disagree over whether offering a lower interest rate to an “underwater” borrower should be classified as a restructuring,

particularly if the workouts being structured are for currently performing loans for borrowers with good credit.

- The banks are doing a better job at restructuring loans so their performance should show some improvement, said Christopher Wolf, managing director at Fitch. “We do think that transparency that will come [from the TDR rules] will be beneficial.” (*American Banker*, Kate Berry, 07/15/11; *HousingWire*, Jon Prior, 07/15/11)

SEC presses the banks to improved their disclosures for litigation risk and the valuations of their HELOC portfolios

- In addition to troubled debt restructuring, the SEC has been pressing banks to make comprehensive disclosures about the potentially large legal bills and settlements the institutions are facing on claims related to the mortgage securitization and foreclosure process. Privately, the SEC has also been pushing hard on another related issue—how banks are valuing their vast holding of home equity lines of credit, which totaled \$624 billion of LOC outstandings on March 31 according to FDIC data.
- Approximately 23% of all mortgages—or 11 million—were underwater on March 31 with an average negative equity of \$65,000, according to Corelogic. Moreover, roughly 4.5 million (40%) of the underwater mortgages carried home equity lines, concluded Corelogic, suggesting that some \$292.5 billion of outstanding HELOCs are not supported by equity in the collateral property’s. Conceptually, the underwater HELOC balances comprise approximately 47% of the banks’ outstanding home equity lines of credit [assuming all such credits are owned by FDIC-insured banks and thrifts]. Importantly, these estimates *do not reflect* any loan losses reserves that the banks may have booked for the HELOC portfolios.
- “The big four [banks] are pretending that the second liens are still money good because many are still performing,” said Christopher Whalen, editor of Institutional Risk Analyst. “If home prices do not stabilize, much less recover, then banks are likely to feel pressure to begin wholesale write-downs of first and second liens. There is probably as much loss prospectively facing the banking industry as a whole on residential real estate exposures as have already been charged off.” (*New York Times*, Gretchen Morgenson, 07/17/11)

Housing legislation update:

Bipartisan bill encourages Fannie Mae and Freddie Mac to rent foreclosed properties

Bill introduced to by Representatives Campbell and Ackerman to extend current conforming loan limits

House subcommittee approves six GSE reform bills

Senator Boxer's bill to refinance underwater GSE mortgages "gains steam"

The PACE Protection Act is introduced as an "end-run" around Fannie and Freddie

Bipartisan bill encourages Fannie Mae and Freddie Mac to rent foreclosed properties

- Representatives Gary Miller (R-CA), Spencer Bachus (R-AL), Barney Frank (D-MA) and Carolyn McCarthy (D-NY) are sponsoring Neighborhood Preservation Act of 2011 that would authorize federally-chartered institutions, Fannie Mae, and Freddie Mac to lease their foreclosed property for up to 5 years with an option to buy. The bill also opens the door for federal institutions to structure deeds for leaseback transactions with homeowners *not in foreclosure*, allowing seriously delinquent borrowers to remain in their home if they agree to pay rent and sign over the deed to the bank or GSE. The deed-for-lease, which would create a technical foreclosure, is estimated the cost 30% less than an REO sale. (*National Mortgage News*, Brian Collins, 07/27/11)
- Alternatively, the Obama administration is considering a proposal from private investors to purchase thousands of foreclosed properties and redeploy the homes as rental units. Approximately a half-dozen private investor groups have expressed an interest in such a plan, which would allow the government to retain a stake in the venture, modeled on the FDIC's loss-share transactions. This approach would eliminate the government's role as a national landlord, administering scattered site rental programs. (*Wall Street Journal*, Nick Timiraos, 07/22/11)
- "The combination of falling prices, limited mortgage credit, continued liquidations, and better rental options is fundamentally changing the way Americans live," wrote Morgan Stanley analyst Oliver Chang in a report entitled *A Rentership Society*. "We believe this change is semi-permanent, and is moving the country towards becoming a Rentership Society. ...Specifically, GSE reform, Dodd-Frank securitization rules, mortgages interest deduction reform, continued home price declines and a long workout period for distressed homes will make it harder to buy an owner-occupied home. As such, we believe that the U.S. will become a Rentership Society, in which the homeownership rate will keep falling, the home rentership rate will conversely rise, and the rental market will dominate the investment landscape in housing for

years to come.” (*Morgan Stanley Securitized Credit Housing Market Insights: A Rentership Society*, Oliver Chang, 07/20/11)

Bill introduced to by Representatives Campbell and Ackerman to extend current conforming loan limits

- Representatives John Campbell (R-CA) and Gary Ackerman (D-NY) have introduced The Conforming Loan Limits Extension Act (H.R. 2508) that would extend the conforming loan limits for Fannie Mae, Freddie Mac and FHA to guarantee or buy mortgages. If the bill is not passed, conforming loan limits would drop from \$729,750 to \$625,500—impacting approximately 17 million homes in 669 counties across 42 states, according to the National Association of Realtors.
- How far H.R. 2508 will move through the House Financial Services Committee remains an open question. Representative Barney Frank (D-MA) said he believes that the Obama administration will reverse course and support an extension of the conforming loan limits. Frank also believes that House Republicans will support the extension, given growing concerns about the health of the housing market. (*Wall Street Journal*, 07/22/11; *Housing Wire*, Jon Prior, 07/15/11)

House subcommittee approves six GSE reform bills

- On July 12, the House Capital Markets and Government Sponsored Enterprises Subcommittee considered and advanced six proposals to reforming Fannie Mae and Freddie Mac. “Already on the hook for \$150 billion and counting to rescue Fannie Mae and Freddie Mac, the American taxpayers can no longer afford to prop up these failed institutions,” said Capital Markets Subcommittee Chairman Scott Garrett (R-NJ). “The six bills we approved ... are an integral part of our effort to end the bailout and get the government out of the way so private capital can reengage in the marketplace. While Democrats may prefer to maintain the status quo, House Republicans are committed to ending the ongoing bailout and protecting American taxpayers from future bailouts.”
- The Subcommittee approved the following bills:
 - **The Fannie Mae and Freddie Mac Taxpayer Payback Act.** To ensure Fannie and Freddie would repay taxpayers for the bailout, the GSEs are required to make dividend payments on the senior preferred stock held by Treasury. However, recent media reports indicate that the Obama Administration is considering lowering the GSEs’ dividend payments. The bill, sponsored by Representative Don Manzullo (R-IL), would prevent Treasury from lowering the 10% dividend payment paid to taxpayers on the senior preferred stock on Fannie Mae and Freddie Mac. The legislation was approved by voice vote.

- **The Housing Trust Fund Elimination Act.** With Fannie Mae and Freddie Mac continuing to rely on their taxpayer bailouts to fund their losses, this bill, sponsored by Representative Edward Royce (R-CA), ensures that the American taxpayers will not be required to fund the Affordable Housing Trust Fund. In September 2008, FHFA suspended the GSEs' contributions to the Housing Trust Fund in light of their losses and their taxpayer bailout. Many have expressed concerns that the Housing Trust Fund will be nothing more than a slush fund for special interest housing groups funded by borrowers through a tax on Fannie Mae and Freddie Mac. The legislation was approved by a vote of 18 to 14.
- **The Fannie Mae and Freddie Mac Transparency Act.** This bill, sponsored by Representative Jason Chaffetz (R-UT), would subject Fannie Mae and Freddie Mac to the Freedom of Information Act (FOIA). Since Fannie and Freddie were originally chartered by the federal government, but are not technically part of the federal government, the GSEs have been exempt from FOIA. Now that the enterprises are under federal government conservatorship, essentially making them government companies, both companies should be subject to the same FOIA standards as the rest of the federal government. The legislation was approved by voice vote.
- **The Market Transparency and Taxpayer Protection Act.** The bill, sponsored by Representative Robert Hurt (R-VA), would reduce the government's role in the mortgage market by directing FHFA to require Fannie Mae and Freddie Mac to dispose of all non-mission critical assets. The legislation was approved by voice vote.
- **The Cap the GSE Bailout Act.** This bill, sponsored by Representative Michael Fitzpatrick (R-PA), would end the blank check provided to Fannie Mae and Freddie Mac by the Obama Administration on Christmas Eve 2009, by setting sets a limit on the amount of money that the American taxpayers will be charged for the bailout of Fannie Mae and Freddie Mac to the larger of (i) the amount Fannie and Freddie have received from 2010 to 2012; or (ii) \$200 billion. The legislation was approved by voice vote.
- **The Removing GSEs Charters During Receivership Act.** The bill, sponsored by Representative Steve Stivers (R-OH) would provide FHFA the power to revoke the charters of Fannie Mae and Freddie Mac and require FHFA to revoke the charter when a successor, limited-life entity is dissolved. The legislation, approved by a voice vote, makes certain that the failed Fannie and Freddie model is abolished. (*House Financial Services Press Release, 07/12/11*)

- The subcommittee delayed consideration of a bill, sponsored by Representative Rand Neugebauer (R-TX) that would prohibit taxpayers from funding legal bills for former Fannie Mae and Freddie Mac employees. The bill’s language is being reworked and will be re-introduced in the future, said a source familiar with discussions.
- Representative Spencer Bachus (R-AL) said the House Financial Services Committee has not scheduled any hearings or markups for GSE reform legislation. (*House Financial Services Press Release*, 07/12/11; *Bureau of National Affairs*, Thecla Fabian, 07/13/11; *HousingWire*, Jon Prior, 07/13/11)

Senator Boxer’s bill to refinance underwater GSE mortgages “gains steam”

- Senator Barbara Boxer’s Helping Responsible Homeowners Act (S. 170) has a new co-sponsor, Senator Johnny Isakson (R-GA) and has attracted the endorsement of Mark Zandi, chief economist at Moody’s Analytics, Ronald Phipps, president of the National Association of Realtors, William Gross, managing director of PIMCO, the National Consumer Law Center, and the National Association of Mortgage Brokers.
- S. 170 would force Fannie Mae and Freddie Mac to invite underwater homeowners, who are current on their mortgages, to apply to refinance their GSE mortgages. In the program, Fannie and Freddie would waive their risk-based financing fees and allow loan-to-value ratios above 125%, but would be subject the applications to underwriting. Some 8 million of the 27.5 million mortgages guaranteed by the GSEs carry an interest rate of 6% or more, said Boxer. “[The bill] would remove the barriers that have prevented millions of non-delinquent homeowners from seeking to refinance mortgages with above market interest rates,” added Boxer, who estimates that the program would prevent 54,000 homeowners from falling into foreclosure annually. The Senator urged FHFA to use its existing authority to eliminate the barriers to allow these homeowners to refinance their GSE mortgages.
- Zandi estimated that allowing non-delinquent, but underwater, homeowners to refinance their mortgages would (i) reduce foreclosure rates and resulting declines in home values; (ii) preserve and increase property tax revenues; and (iii) boost affected homeowners’ spending by \$2 billion annually.
- Barclays Capital analysts noted that S. 170 does *not* address one risk that originators may be unwilling to take on—the representation and warranty risk that would transfer to the originator of a newly financed loan. “Rep and warranty risks reset when loans are refinanced, so refinancing a high risk loan transfers that risk to the originator of the new loan,” wrote Barclays Capital analysts. “Without alleviating this risk, we believe it is doubtful underwriting standards will ease, making a refinancing wave from the passage of the bill unlikely.”
- “The clock on rep and warranties start over as a refinance, and you have first payment defaults to worry about, early payment defaults within 12 months, etc.,” said J.T.

Smith, chief investment officer of Aristar Funding. “Repurchase waivers will be needed for an originator to consider it.”

- “Due to the existence of HARP and HAMP, programs which have performed well below initial expectations, the practical need for this new, seemingly sensible legislation is hard to rationalize,” wrote Bank of America Merrill Lynch analysts. “Why would this program have any more implementation success than its predecessor programs? Senator Boxer’s push for legislation to refinance underwater homeowners stands in opposition to perhaps the most pressing need of the U.S. economy and fiscal situation: reliance on, not help for, responsible citizens.”
- “Even if one could get massive refinancings, there is the question of whether the infrastructure could support such a move,” said MF Global analyst Jaret Seibert. “We saw with the robo-signing controversy that the system could not handle the crush of record foreclosures. In our view, there would be similar problems if there was a crush of refinancings. This would be a massive amount of paper to process at once and each loan would need to be recorded in a county clerk’s office.” (*HousingWire*, Jon Prior, 07/12/11; *Bureau of National Affairs*, Jeff Day, 07/13/11; *HousingWire*, Jon Prior, 07/15/11)

The PACE Protection Act is introduced as an “end-run” around Fannie and Freddie

- Representatives Nan Hayworth (R-NY), Dan Lungren (R-CA) and Mike Thompson (D-CA) have introduced the PACE Protection Act of 2011 to address concerns about the Property Assessed Clean Energy Program (PACE) that allows municipalities to float bonds to finance the installation of home solar arrays and other energy efficient projects. The bill would require homeowners to hold at least 15% equity in their property and limit the size of the energy improvement project to 10% of the home’s value. Under the PACE Protection Act, local governments would have to determine an applicant’s ability to pay the PACE surcharge and an energy audit would be mandated.
- “If [FHFA isn’t] willing to fix it on their own, we’ll fix it legislatively,” said Thompson. “This is too important to our energy future, too important to job creation across the country, and it’s the right thing to do.”
- “We can make PACE advantageous for everyone concerned and allow for energy savings and improvements for the environment and the creation of jobs all at no net cost to our taxpayers,” said Hayworth. “If you’re looking for a bipartisan, bicoastal, transcontinental effort to deal with the challenges of energy, the challenges of the economy and the need to create jobs, this is a win-win-win,” said Lungren. “Frankly, it’s hard to figure out why someone would be opposed to this.”
- Whether the bill’s protections will satisfy the FHFA remains unclear. “FHFA continues to have concerns with the first lien created by certain PACE programs and

the absence of effective consumer protections,” said FHFA spokeswoman Corrine Russell. “We will work with the members of Congress on the particulars of any legislation.” (*Forbes Blog*, Todd Woody, 07/20/11)

FHFA sues UBS AG to recover the GSEs’ losses on private-label MBS

- FHFA has sued UBS AG, accusing the Swiss investment bank of causing Fannie Mae and Freddie Mac to suffer at least \$900 million of losses related to non-agency MBS that the GSEs purchased from the firm. The lawsuit alleges that UBS made “materially false statements and omissions” about \$4.5 billion of residential private label mortgage-backed securities that it sponsored and sold to Fannie and Freddie from 2005 through 2007.
- “Significant percentages of the underlying mortgage loans were not originated in accordance with the represented underwriting standards and origination practices and had materially poorer credit quality than what was represented in the Registration Statements,” said FHFA in the complaint. The regulator also alleges that UBS Americas, UBS Real Estate and the individual defendants—former UBS executives David Martin, Per Dyrvick, Hugh Corcoran and Peter Slagowitz—have controlling personal liability for the actions of the other entities.
- The securities in question contain loans originated by New Century Financial, American Home Mortgage, IndyMac, and Countrywide Home Loans. Fannie and Freddie have already lost at least 20% of their investment in the MBS, according to the lawsuit. The suit seeks rescission and recovery of the consideration that Fannie and Freddie paid UBS for the 16 MBS outlined in detail in the 102-page complaint. FHFA acting director Edward DeMarco promised “further actions to come. We continue to seek redress for the losses.”
- “You could recover tens of millions of dollars [for taxpayers],” said Tim Rood, a former senior director and principal of Fannie Mae’s eBusiness division and currently the managing director of the Collingwood Group. However, Rood cautioned that some of the big banks might not be able to absorb any more large settlements stemming from the subprime crisis. “You’re at a tipping point with these institutions as it is,” said Rood. (*Wall Street Journal*, Alan Zibel and Al Yoon, 07/28/11; *Bureau of National Affairs*, Nancy J. Moore, 07/28/11)

Chicago City Council changes the definition of “owner” for vacant properties and holds banks “more accountable” for the problems of abandoned homes

- Despite opposition for the financial industry, Chicago’s City Council passed a new ordinance that will hold banks and /or securitization trustees more accountable for the problems caused by abandoned houses. The ordinance passed by the Council amends

the municipal code of Chicago to define “mortgagee” as an entity who holds a mortgage on a property, as a property owner. The ordinance will hold the mortgagee liable for the property’s maintenance, security and upkeep. Within 30 days of a property becoming vacant or of “assuming ownership” of a vacant property, Chicago will require registration, renewable every six months. The City’s registration fees start at \$250 and will assess fines for noncompliance. The owner must maintain liability insurance of at least \$300,000. The ordinance provides the City rights to access of the property, including the interior, to determine compliance with the municipal code.

- “What we’re trying to do is protect the community,” said Ald. Pat Dowell, 3rd, chief sponsor of the ordinance. “We’re unprotected when a vacant property is allowed to have squatters and is not boarded up, when it’s a potential for fire hazards and when we have gangbangers take over homes and turn them into drug dens.” The City of Chicago spent \$15 million dealing with abandoned properties in 2010, which included \$13.7 million spent on boarding up and demolishing the properties. (*City of Chicago Press Release*, 07/28/11; *Chicago Tribune*, Antonio Olivo, 07/28/11)
- In a July 26 comment letter [<http://tinyurl.com/3jwkybf>] to the Chicago City Council, Tom Deutsch, executive director of the American Securitization Forum, wrote, “In sum ... we object, on behalf of our members, to any legislation that would unfairly and inappropriately require lenders to take actions and incur costs that are rightly attributable to the property owners. We believe that characterizing lenders as owners of property prior to transfer of title through foreclosure or similar legal process presents significant constitutional and legal concerns. We believe that the adoption of the proposed amendment to the ordinance, and particularly the proposed clause (4) of the definition of ‘owner’, will have long-term negative effects on the desire and ability of lenders and other secondary market participants to provide competitive and attractive mortgage financing options for properties located in the City of Chicago.”
- “This increased risk, and the resulting increased costs of borrowing would be felt even more keenly in areas of Chicago where home prices are declining, local economic conditions are poor, or a borrower tends to have a riskier credit profile. Given the current conditions in the mortgage market with tight lending conditions, it is already difficult for some borrowers to access mortgage credit at all. The changes proposed in the bill will exacerbate this problem and will harm those Chicago neighborhoods it intends to help by making it even more difficult and expensive for new borrowers to obtain affordable new financing to fill vacant homes. For the foregoing reasons, we oppose the proposed amendment to Chapter 13-12 of the Chicago Municipal Code to the extent it includes clause (4) of the definition of “owner” or any other provisions intended to characterize mortgagees (or their assignees or agents) as “owners” of the property...” (*Correspondence regarding Amendment of Chapter 13-12 of the Chicago Municipal Code Concerning Owner and Minimum Requirements for Vacant Buildings*, Tom Deutsch, 07/26/11)

- “FHFA is concerned that the proposed amendment to the ordinance conflicts with existing mortgage holder obligations under Illinois state law and the Fannie Mae and Freddie Mac Uniform Security Instruments and expands existing mortgage holder costs and liabilities and may produce harm to Chicago homeowners,” wrote Alfred M. Pollock, FHFA’s General Counsel in a letter [<http://tinyurl.com/4327cx9>] to the Chicago City Council. Pollock outlined his agency’s concern about the ordinance’s conflicts with laws and obligations, the “significantly new costs and liabilities relating to any Chicago property in which the Enterprises hold a mortgage, even for loans not in default”; and its negative impact on Chicago neighborhoods and homeowners, particularly regarding the resulting higher costs and lower availability of mortgage credit. (*Correspondence regarding Proposed Amendment to the Municipal Code of Chicago Section 13-1-25 Concerning Owner Requirements for Vacant Buildings*, Tom Deutsch, 07/26/11)

FHFA’s proposed margin rules could drive up the GSEs’ hedging costs

- Fannie Mae and derivative dealers warned the FHFA and FCA that the regulators’ proposals on margining uncleared derivatives will significantly increase the cost of trading, making hedging more expensive for the Fannie Mae, Freddie Mac, the FHLBs, and FCA. Under the rules, the GSEs regulated by FHFA and FCA receive special treatment, requiring them to collect variation margin and also to segregate it. [Other derivative users would be exempt from this requirement.]
- “By requiring the segregation of variation margin in a third-party custodian – which prevents rehypothecation – the rules effectively render two-way collateral posting agreements a one-way CSA, where the dealer will receive no funding benefit whatsoever,” wrote one fixed-income derivatives trader at a European bank, which trades regularly with FHFA-regulated entities. “It acts as a huge liquidity drain, and the upshot is that the dealer will have to factor in considerable funding costs into the price of the swaps.”
- Currently, Fannie Mae and Freddie Mac do not require its counterparties in uncleared swaps to segregate variation margin. If the proposal is adopted, the GSEs will be the only market participants that would be subject to variation margin rules, “putting them at competitive disadvantage compared to the rest of the market,” according to Fannie Mae. Moreover, the funding implications would be huge.
- Market participants speculate that the regulators’ proposal has roots in the GSEs’ experience in the Lehman Brothers bankruptcy. “It looks like a few of the FHFA-regulated entities got burnt with respect to variation margin posted with Lehman Brothers, and the regulators want to ensure this doesn’t happen again,” said one source at a GSE entity. (*Risk Magazine*, Matt Cameron, 07/19/11)

Fannie Mae and Freddie Mac are not being considered to administer the new Small Business Lending Fund, says Treasury Secretary Geithner

- Treasury Secretary Timothy Geithner has assured Republican lawmakers that Fannie Mae and Freddie Mac will *not* have a role in administering the agency's new Small Business Lending Fund. "We are not considering Fannie Mae and Freddie Mac to serve in this capacity," wrote Geithner in response to the Republican lawmakers' concern that the new program "seemingly provides an opportunity" for the GSEs to play a role. Geithner noted that the program will finance activities outside the GSEs' mission of supporting housing. (*Dow Jones Newswires*, Alan Zibel, 07/25/11)

New York Fed accepts Fannie Mae and Freddie Mac as participants in the Fed facility

- The Federal Reserve Bank of New York has accepted Fannie Mae and Freddie Mac as Reverse Repo operation counterparties, designed to drain liquidity from the financial system. The GSEs are "consistent cash [investors] in the triparty repo market" and capable of confirming and arranging settlement of significant volume of transactions with the Fed, according to a NY Fed press release. (*Wall Street Journal Blog*, Michael S. Derby, 07/27/11)

Fannie Mae

Fannie Mae single-family mortgage delinquency rate declines to 4.08% in June

- Fannie Mae's conventional single-family serious delinquency rate declined 6 basis points in June to 4.08%, while its multifamily serious delinquency rate also fell six basis points to 0.46%. Fannie's total book of business decreased at a compound annual rate of 1.0% in June to \$3.2 trillion, while its retained mortgage portfolio declined at an annualized 9.4% compound rate to \$731.8 billion. (*Monthly Summary*, Fannie Mae, June 2011)

Fannie Mae suspends RMIC as an approved MI

- Fannie Mae suspended Republic Mortgage Insurance Co. and its subsidiary through which the insurer had planned to write new business as an approved MI. In a 'Selling Guide' announcement, Fannie said that the North Carolina Department of Insurance will not extend its waiver on RMIC's failure to meet the state's minimum policyholder position requirements. As a result, North Carolina will not allow RMIC to write new policies in the state after September 1.

Fannie Mae provided liquidity to the multifamily mortgage market in 2010

- Fannie Mae issued \$10.3 billion of mortgage-backed securities collateralized by new multifamily mortgages and sold \$5.3 billion in new MBS during the first six months of 2010. Fannie's issuance of structured multifamily securities created from its portfolio totaled \$2.6 billion, including \$1.2 billion in GeMS™ ACES and \$1.4 billion in GeMS™ Megs through June 30, 2011. (*Fannie Mae Press Release*, 07/27/11)

Freddie Mac

Bank of America rumored to be selling \$40 billion of mortgage servicing

- *National Mortgage News* reports that Bank of America is “exploring the idea” of selling approximately \$40 billion of “legacy” mortgage servicing rights tied to Freddie Mac loans. “One advisor, requesting his name not be used, said the sale of servicing may not have been the bank’s idea, and was forced upon BofA by Freddie,” reported NMN’s Paul Muolo. “The GSE, he said, has not been happy with the servicing of the underlying loans. ...One source said a “handful” of investors have already been shown the MSR package.” (*National Mortgage News*, Paul Muolo, 07/15/11)

Freddie Mac’s seriously delinquent rate for single family mortgages falls to 3.5%

- Freddie Mac’s seriously delinquent rate for single-family mortgages fell 3 basis points to 3.50% in June, while its multifamily seriously delinquent rate declined 7 basis points to 0.31%. The GSE’s total mortgage portfolio fell 1.7% in June to \$2.1 trillion, while its retained mortgage investment portfolio declined by \$4.6 billion to \$685.0 billion. (*Freddie Mac Monthly Volume Summary*, June 2011)

Freddie Mac introduces the Servicing Success Program

- Freddie Mac has launched its Servicing Success Program (SSP), a new robust and balanced approach to setting performance expectations, providing feedback on servicer strengths, and weaknesses, and promoting a dialogue with servicers to improve portfolio performance and preserve homeownership. The SSP, posted on the company’s website on July 25, is scheduled to take effect for all Freddie Mac servicers on August 1, 2011.
- Freddie Mac’s SSP is designed to evaluate servicer performance in investor reporting and remitting and default management, using performance criteria designed to better align with the GSE’s business objectives in the current environment and help servicers more effectively assess their progress. The new program combines a servicer scorecard and loan file reviews and—for larger servicers—individualized requirements and Servicing Account Plans that set objectives and goals to reduce costs and preserve homeownership. A new ranking system tied to SSP’s criteria and weightings will replace Freddie Mac’s traditional performance tiers. In its place, Freddie Mac will provide each servicer a monthly ranking based on the performance points it earned the prior month, allowing to servicer to compare its overall performance relative to its competitors. Freddie Mac’s individual ratings and

rankings for servicers in August will be published on the company's website beginning October 7.

- Freddie Mac plans to announce a companion Servicer Success Rewards and Remedies component later this year, which will integrate the SSP with the Servicing Alignment Initiative the company is undertaking with Fannie Mae at the direction of FHFA.
- “Today’s announcement marks the beginning of a significant advance in the scope and sophistication of servicer performance management,” said Tracy Mooney, Freddie Mac’s SVP, Single-Family Servicing and REO. “The robust, balanced approach we are launching in 2011 underscores Freddie Mac’s commitment to invest in the future of U.S. homeownership by strengthening servicing practices and enabling servicers to more effectively preserve homeownership.” (*PRNewswire*, 07/25/11)

S&P withdraws its preliminary rating for \$1.19 billion Freddie Mac CMB offering

- Standard & Poor’s withdrew a preliminary rating on a planned \$1.19 billion Freddie Mac commercial mortgage-backed security, following an internal review in which the rating agency found “potentially conflicting methods” for calculating certain data in multi-loan CMBS. On July 27, S&P said it would not assign new ratings on CMBS transactions until it completes a review.
- The rating agency’s move set off a firestorm of criticism for failing to deliver a final rating on a \$1.48 billion Goldman Sachs Group Inc. and Citigroup Inc. CMBS that had already priced and was only hours away from settling. The deal failure added greater uncertainty into the market, which is a key funding source for the recovery in U.S. commercial real estate.
- According to *National Mortgage News*’ Bonnie Sinnock, “S&P appears to have not been able to deliver the ratings due to a larger, pending review of its conduit/fusion CMBS criteria for debt service coverage ratio calculations. (Fusion deals combine smaller and larger loan sizes.) The review appears to have suspended the company’s ability to rate new deals of this type where the calculations are required until the review is completed.” (*Dow Jones Newswires*, Al Yoon, 07/29/11; *National Mortgage News*, Bonnie Sinnock, 07/29/11)

Alumni watch

- The Collingwood Group has retained Manoj K. Singh as a Special Advisor to bring his unique expertise in risk management and his senior level experience on Wall

Street to help clients navigate the business opportunities that exist in Washington as a result of the housing crisis.

- Singh most recently served as Freddie Mac’s Senior Vice President of Pricing and Securitization (Single Family) and, before that, the GSE’s Senior Vice President, Head of Market Risk Management. Prior to joining Freddie Mac, During his 13 years on Wall Street, Singh held executive-level positions with Bear, Stearns & Co (Senior Managing Director, FAST Group), Lehman Brothers, Inc. (Senior Vice President, Risk Management), and Wasserstein Perella Capital Management (Vice President, R&D). (PRWeb, 07/27/11)

Federal Home Loan Banks

The FHLB System’s advances continue to shrink, along with the Banks’ profitability

- The FHLB System reported total assets of \$809.2 billion on June 30, down 8% from yearend 2010, resulting primarily from declines in advances and investments that were partially offset by increases in certain other assets, particularly cash. The System’s GAAP capital totaled \$41.1 billion at the end of the second quarter, a 6% decrease from December 31, due to a decrease in capital stock that was partially offset by growth in retained earnings.

FHLB System's Consolidated Balance Sheet				
(Dollars in millions)	June 30, 2011	December 31, 2010	Variance	
ASSETS				
Investments	\$ 295,794	\$ 330,470	\$	(34,676)
Advances	428,460	478,589		(50,129)
Mortgage loans held for portfolio, net	55,862	61,191		(5,329)
Other	29,103	7,859		21,244
Total assets	\$ 809,219	\$ 878,109	\$	(68,890)
LIABILITIES				
Consolidated obligations:				
Discount notes	\$ 180,960	\$ 194,431	\$	(13,471)
Bonds	551,198	606,567		(55,369)
Total consolidated obligations	732,158	800,998		(68,840)
Mandatorily redeemable capital stock	9,290	7,066		2,224
Other liabilities	26,677	26,304		373
Total liabilities	768,125	834,368		(66,243)
CAPITAL				
Capital stock	36,795	41,735		(4,940)
Retained earnings	7,859	7,552		307
Accumulated other comprehensive income (loss)	(3,560)	(5,546)		1,986
Total capital (GAAP)⁽¹⁾	41,094	43,741		(2,647)
Total liabilities and capital	\$ 809,219	\$ 878,109	\$	(68,890)
Regulatory capital⁽¹⁾	\$ 54,751	\$ 57,362	\$	(2,611)

(1) The difference between GAAP capital and regulatory capital relates primarily to accumulated other comprehensive income (loss), which is excluded from regulatory capital, and mandatorily redeemable capital stock, which is included in regulatory capital.

(Source: FHLBanks Office of Finance Press Release, 07/29/11)

- The FHLB System reported a \$251 million net income for the second quarter, down 23% from the same period last year. The System's lower profitability was driven largely by a decline in yields on interest-earning assets, which exceeded the decline in yields on interest-bearing liabilities, and, to a lesser extent, lower average balances of interest earning assets and interest-bearing liabilities. (*FHLBanks Office of Finance Press Release, 07/29/11*)

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2011	2010	Variance	2011	2010	Variance
Net other-than-temporary impairment losses	\$ (341)	\$ (495)	\$ 154	\$ (616)	\$ (728)	\$ 112
Net losses on derivatives and hedging activities	(157)	(324)	167	(27)	(578)	551
Net gains (losses) on trading securities	35	157	(122)	(36)	186	(222)
Other	59	(17)	76	(15)	(108)	93
Total other non-interest income (loss)	\$ (404)	\$ (679)	\$ 275	\$ (694)	\$ (1,228)	\$ 534

(Source: *FHLBanks Office of Finance Press Release, 07/29/11*)

Ginnie Mae

President Obama names Carol Galante as the acting commissioner of the FHA

- President Barack Obama named Carol Galante to serve as the acting commissioner of the FHA, replacing Robert C. Ryan who held this position since the end of March. Ryan has assumed a new role as senior advisor to HUD Secretary Shaun Donovan, where he will focus on housing finance issues, including mortgage servicing standards and compensation. Galante, 56, was previously HUD's deputy assistant secretary of multifamily housing. (*Washington Post, Cezary Podkul, 07/11/11*)

FHA's serious delinquency rate was 8.2% on June 30

- FHA reported a serious delinquency rate of 8.2% at the end of the second quarter, while FHA servicers foreclosed on 68,900 loans during the nine months ended June 30. Servicers also filed 5,650 claims on FHA-insured Home Equity Conversion Mortgages during the past nine months, a 70% increase over the corresponding period in FY2010. During the nine months ended June 30, lenders originated \$186.4 billion of FHA-insured loans, down 23% from the same period last year (\$242.6 billion). (*National Mortgage News, Brian Collins, 07/26/11*)

FHA's Short Refi Program is off to slow start

- The \$8 billion Short Refi Program launched by FHA in September is off to slow start with 24 participating lenders and only 246 new loans originated, according to a HUD spokesman. The program, designed to help between 500,000 to 1.5 million underwater borrowers, has expended more than \$50 million toward helping current—but underwater—borrowers obtain a new FHA loan, if the lender or investor agrees to write-off the original unpaid principal balance of the first lien by at least 10%. The main hurdle to the Short Refi's success is the lack of participation by Fannie Mae and Freddie Mac.
- Fannie Mae and Freddie Mac have run a pilot programs to test how the program would work for their own portfolio, said several sources. "As with any new mortgage program, the lenders and servicers need ample time to build the necessary infrastructure to facilitate the program, said a HUD spokesman in a *HousingWire* interview. "This infrastructure includes technology, systems, product training and borrower outreach. These initiatives take significant time and money to complete."
- "We are encouraging GSE participation and in the meantime we are working diligently to engage the remaining one third and are starting to see the ball get rolling," the HUD spokesman added.
- Servicers and the GSEs have been unwilling thus far to promote more widespread principal reductions. President Obama said his administration will put more pressure on banks to solve this problem. "We are going back to the drawing board to put more pressure on banks to see if we can help more homeowners through modification and see where reducing principal is possible," said Obama. (*HousingWire*, Jon Prior, 07/08/11)

Farm Credit System / Farmer Mac

FCS—neither “fish nor fowl”

- “What does it mean to be a ‘GSE?’” asked Bert Ely in *Farm Credit Watch*. “...Some recent news items raise that question anew, specifically with regard to the Farm Credit System, or FCS [with total assets of \$175 billion at yearend 2010]. As a GSE, the FCS is neither fish nor fowl – it is not a purely governmental entity and yet it is not a purely private enterprise either. The FCS uses that ambiguity to advance its business objective –to gain and maintain a competitive edge over its purely private-sector competitors. More specifically, the FCS is a federal government entity when that circumstance best suits its objectives yet it tries to mask itself as a private-sector enterprise when that best suits. The following is a discussion of three ways in which the GSE straddle between public and private has become increasingly evident.”

Farm Credit System Major Financial Indicators, Annual Comparison					
As of December 31					
Dollars in Thousands					
	31-Dec-10	31-Dec-09	31-Dec-08	31-Dec-07	31-Dec-06
Total Farm Credit System⁷					
Gross loan volume	175,351,000	164,830,000	161,423,000	142,906,000	123,436,000
Nonperforming loans	3,386,000	3,535,000	2,416,000	621,000	615,000
Nonaccrual loans	3,229,000	3,369,000	2,282,000	512,000	533,000
Nonperforming loans/gross loans ⁴	1.93%	2.14%	1.50%	0.43%	0.50%
Bonds and notes	189,575,000	178,358,000	179,769,000	155,295,000	134,466,000
Capital/assets ⁵	14.46%	13.90%	12.65%	14.17%	15.00%
Surplus/assets	11.80%	11.48%	10.80%	11.52%	12.25%
Net income	3,495,000	2,850,000	2,916,000	2,703,000	2,379,000
Return on assets	1.60%	1.32%	1.41%	1.53%	1.56%
Return on equity	10.90%	9.86%	10.70%	10.38%	9.99%
Net interest margin	2.82%	2.65%	2.41%	2.43%	2.48%

Sources: Farm Credit System Call Report as of December 31, 2010, and the Farm Credit System Annual Information Statement provided by the Federal Farm Credit Banks Funding Corporation.

Note: Changes to previous periods occasionally occur for accounting reasons.

1. Includes Farm Credit Banks and the Agricultural Credit Bank.
2. Excludes loans 90 days or more past due.
3. Nonperforming loans are defined as nonaccrual loans, accruing restructured loans, and accrual loans 90 days or more past due.
4. Capital excludes mandatorily redeemable preferred stock.
5. Operating expenses divided by average gross loans.
6. Capital excludes protected borrower capital.
7. Cannot be derived through summation of above categories because of intradistrict and intra-System eliminations used in reports to investors.
8. Capital includes restricted capital (amount in Farm Credit Insurance Fund), excludes mandatorily redeemable preferred stock, and protected borrower capital.

(Source: *Farm Credit Administration Annual Report*, 2010)

- “The potential effect of a federal debt default on FCS debt On July 15, S&P, one of the three major rating agencies, put ‘select ‘AAA’ rated [GSE] entities,’ including the FCS, on ‘CreditWatch Negative’ because ‘the ‘AAA/A-1+’ sovereign credit rating on the U.S. was placed on CreditWatch with negative implications.’ That is a fancy way of saying that if the United States loses its AAA debt rating, that loss will lead to a downgrading of the debt issued by the FCS through the Federal Farm Credit Banks Funding Corporation, the FCS’s access to Wall Street and the global debt markets. S&P warned that if there is a default, and subsequent credit-rating downgrade of federal government debt, that downgrade will trigger a corresponding downgrade of FCS debt as well as all other GSE debt.”

- “At March 31, 2011, the Federal Farm Credit Banks Funding Corporation had \$190 billion of debt outstanding and other FCS entities had another \$3.1 billion of outstanding debt. As S&P explained, this linkage of the federal government’s debt rating to the rating on FCS debt ‘reflects the potential reduction in the implicit support that we have historically factored into [the FCS’s] credit ratings.’ In other words, FCS debt is rated AAA because of that ‘implicit support,’ support which became very explicit in the 1987 taxpayer bailout of the FCS when it was experiencing severe self-inflicted credit problems. Any downgrade of FCS debt would immediately lead to higher rates on FCS debt, thereby reducing the FCS’s funding-cost advantage over banks and other taxpaying lenders.”
- “...In addition to the FCS’s exemption from all corporate income taxes on profits from its real-estate lending and its exemption from state income taxes on its non-real estate lending, FCS institutions also enjoy numerous exemptions from state and local taxes and filing fees by virtue of being a GSE—they claim they are a ‘federal instrumentality.’ That point was brought home on July 20 when *Marketplace* radio reported that the treasurer of Oakland County, Michigan sued Fannie Mae and Freddie Mac, claiming they owed millions of taxes on foreclosed properties. Oakland County, with a population of 1.2 million, lies just north of Detroit. According to the *Marketplace* report, ‘Fannie and Freddie claim they’re exempt because they’re government entities. But are they really?’ Which leads to this question, using *Marketplace*’s phrasing, ‘where [do] Fannie and Freddie sit on the spectrum of public company or private concern?’ That same question can be asked of the FCS.”
- “The Michigan tax in question is a real estate transfer tax; Fannie and Freddie claim they are exempt from that tax. In many states FCS lenders are exempt from transfer taxes on the sale of foreclosed property as well as mortgage recordation taxes, an exemption their private-sector competitors do not enjoy. The Oakland County treasurer told *Marketplace* that Fannie and Freddie ‘are trying to have it both ways – enjoying the profits of a private company, and the protections of a government entity.’ That sounds familiar to bankers competing against the FCS. The county treasurer also said that ‘if it walks, flies and quacks like a duck, it’s a duck. And Fannie and Freddie walk, fly and quack like private companies.’ The same is true of the FCS. As state and local governments search for revenue in these trying times, they should eliminate the tax and fee exemptions FCS institutions now enjoy.”
- “What is in a name? In the world of GSEs, names must do double-duty—they should sound business friendly or at least not sound like the name of a government agency, yet to one audience –investors in GSE debt—the name must convey a sense of financial backing by federal taxpayers. For example, the official statutory name of Fannie Mae is the Federal National Mortgage Association. While the FCS is not referred to as the Federal Farm Credit System, the word ‘federal’ does occur within the FCS. While in relatively small type, the FCS’s quarterly and annual information statements for investors do carry the name ‘Federal Farm Credit Banks Funding Corporation.’ More importantly, the debt securities issued by the Funding

Corporation carry the name ‘Federal Farm Credit Banks.’ Even though these securities ‘are not obligations of or guaranteed by the United States government,’ to quote the FCS information statements, investors and the rating agencies are highly confident that federal taxpayers will ride to the rescue of GSE debt, as they did in 1987 for FCS debt and as they did more recently for Fannie’s and Freddie’s debt and MBS (mortgage-backed securities).”

- “On the lending side of the FCS, the word ‘federal’ shows up in the name of just one association. While Farm Credit appears in many association names, those words do not convey their GSE status. However, as FCS associations have become more aggressive in their non-farm lending, they increasingly adopt names which do not even hint of their GSE status or their supposed focus on farm lending, names such as ArborOne, Badgerland Financial, Lone Star, and CoBank. Expect more FCS associations to make name changes that mask their GSE status.” (*Farm Credit Watch*, Bert Ely July 2011)

	2006	2007	2008	2009	2010	Percent change from 2006
Production agriculture						
Long-term real estate mortgage loans	56,489	63,458	71,892	75,352	78,021	38.1
Short- and intermediate-term loans	28,731	32,267	37,468	39,610	40,584	41.3
Agribusiness loans*	21,141	28,091	26,901	23,626	29,581	39.9
Rural utility loans	9,569	10,846	13,931	14,562	15,091	57.7
Rural residential loans	3,408	3,965	4,611	4,977	5,475	60.7
International loans	2,183	2,135	4,077	3,956	4,036	84.9
Lease receivables	1,489	1,708	1,952	2,160	2,021	35.7
Loans to other financing institutions	426	436	591	587	542	27.2
Total	123,436	142,906	161,423	164,830	175,351	42.1

Sources: Federal Farm Credit Banks Funding Corporation Annual Information Statements

* At December 31, 2010, agribusiness loans consisted of loans to cooperatives of \$16.2 billion, processing and marketing loans of \$11.1 billion, and farm-related business loans of \$2.3 billion.

(Source: *Farm Credit Administration Annual Report*, 2010)

Farmer Mac reports 3.2% “capital coverage” at year-end 2010

Farmer Mac Condensed Balance Sheets, 2005–2010

As of December 31

Dollars in Millions

	2005 Restated	2006	2007	2008	2009	2010	Percentage growth rate 2009–2010
Total assets	4,341.4	4,953.7	4,977.6	5,107.3	6,138.8	9,479.9	54.4
Total liabilities	4,095.4	4,705.2	4,754.0	4,947.7	5,798.4	9,001.0	55.2
Net worth or equity capital	246.0	248.5	223.6	15.3	196.2	478.9	144.1

Sources: Farmer Mac’s Securities and Exchange Commission Form 10-Ks.

(Source: *Farm Credit Administration Annual Report*, 2010)

- On December 31, 2010, Farmer Mac’s net worth was \$478.9 million, compared with \$196.2 million a year earlier. Farmer Mac’s increased net worth is largely attributable to the agency’s issuance of \$250 million in Farm Asset Linked Credit Notes (FALConS), a “hybrid equity” issued by Farmer Mac II, LLC, a newly created subsidiary of Farmer Mac that now houses virtually all Farmer Mac II program business. Farmer Mac used a portion of the FALConS proceeds to repurchase and retire all \$150 million of its Series B Preferred Stock.
- On December 31, Farmer Mac reported a 3.2% “capital coverage” ratio, representing the agency’s support of its off -balance-sheet program assets (e.g., guarantee obligations) and on balance- sheet assets. Farmer Mac continued to be in compliance with all statutory and regulatory minimum capital requirements at yearend 2010.

Farmer Mac Capital Positions, 2005–2010

As of December 31

Dollars in Millions

	2005 Restated	2006	2007	2008	2009	2010
GAAP equity	\$246.0	\$248.5	\$223.6	\$15.3	\$196.2	\$478.9
Core capital	\$230.8	\$243.5	\$226.4	\$207.0	\$337.2	\$460.6
Regulatory capital	\$239.4	\$248.1	\$230.3	\$223.4	\$351.3	\$480.7
Statutory requirement	\$142.5	\$174.5	\$186.0	\$193.5	\$217.0	\$301.0
Regulatory requirement	\$29.5	\$42.9	\$42.8	\$57.3	\$35.9	\$42.1
Excess over statutory or regulatory requirement*	\$88.3	\$69.0	\$40.4	\$13.5	\$120.2	\$159.6
Capital margin excess > minimum	62.0%	39.6%	21.7%	7.0%	55.4%	53.0%

Sources: Farmer Mac’s Securities and Exchange Commission Form 10-Ks.

* Farmer Mac is required to hold capital at or above the statutory minimum capital requirement or the amount required by FCA regulations as determined by the Risk-Based Capital Stress Test, whichever is higher.

21. See the FCA Website at www.fca.gov for more information about the RBC Model.

22. The statute requires minimum capital coverage of 2.75 percent for on-balance-sheet assets and 0.75 percent for off-balance-sheet obligations.

(Source: *Farm Credit Administration Annual Report*, 2010)

- On December 31, 2010, Farmer Mac’s 90-day delinquencies were \$70.2 million, or 1.63%, up 41.8% from \$49.5 million (1.13%) at year-end 2009. Farmer Mac’s REO totaled \$2 million at yearend 2010, up from \$739,000 a year earlier. Ethanol loans comprised 16% of Farmer Mac’s 90-day delinquencies on December 31. (*Annual Report*, Farm Credit Administration, 2010)

FCA addresses ethanol and farm subsidies

“No need to ‘compromise’ in trimming ethanol subsidies,”
says the *Washington Post*

Biofuel subsidies represent a drain on the U.S. economy of over \$6 billion

FCA addresses ethanol and farm subsidies

- “Rapidly rising U.S. ethanol production in recent years has pushed up corn demand, but that ramp-up in corn demand may have largely ended,” wrote the Farm Credit Administration in the *2010 Annual Report*. “U.S. ethanol production grew 238 percent in the past five years, reaching 13.2 billion gallons in 2010 and is expected to grow further this year. In the process, the industry is expected to utilize 5 billion bushels or about 40 percent of the 2010 U.S. crop. Policy changes with respect to blender tax credits and permitted blending levels of ethanol in gasoline present risks to future demand. Also, under current legislation, a maximum of 15 billion gallons of the annual renewable fuel standard mandate is to be derived from conventional biofuels by 2015, suggesting that future growth could be limited in the absence of changes in policies. The conventional mandate for 2011 is 12.6 billion gallons.”
- “...Farm program and foreign trade agreements are two important policy forces that help shape farm income and thus affect borrower repayment risk. The flow of Government payments has generally supported farm income, mostly for crop producers, and helped stabilize prices, but sometimes at a heavy cost to taxpayers....A key concern for agricultural lenders will be the outcome of the 2012 Farm Bill debate. As the 2012 legislative debate approaches, the current budgetary environment suggests that farm program costs will be scrutinized closely as part of the continuing efforts to reduce deficits in the Federal budget. Agricultural lenders cannot assume that the Federal safety net for agriculture will automatically keep pace with structural changes in the industry and the rise in production costs. In fact, the safety net is likely to play a lesser role in off-setting farmer repayment risk in the near future.” (*Annual Report*, Farm Credit Administration, 2010)

No need to ‘compromise’ in trimming ethanol subsidies,” says the *Washington Post*

- “Last month, the Senate voted 73 to 27 for an amendment that would have immediately cut two indefensible federal ethanol subsidies,” wrote the *Washington Post* in a July 5 editorial. “But the bill lawmakers attached it to failed. Now supporters of the policy are trying to pass it some other way, affixed to another bill or as part of the deal the White House and Republicans will eventually strike (we trust) on raising the federal debt limit.”
- “Either way, the supports must go. Congress has protected ethanol three ways: with a \$6 billion-a-year tax subsidy to those who blend it into gasoline, a tariff on competing imports and a mandate that billions of gallons enter Americans’ fuel tanks every year, which come on top of three decades of federal patronage of the industry. The Senate voted to get rid of the first two, which would still leave a federal mandate guaranteeing ethanol a market — a comfort that other businesses would be giddy to have.”
- “And for what? Ethanol, which comes almost entirely from corn, doesn’t help the environment much, even as its government-sponsored use puts upward pressure on the price of corn and rural land. The Congressional Budget Office found that, using corn ethanol, it costs taxpayers an astonishing \$750 to cut one metric ton of carbon dioxide, whereas estimates of the value of avoiding that same ton range in the tens of dollars. The Environmental Working Group’s Sheila Karpf argues, further, that higher production of corn contributes to the depletion of soils and the dirtying of water.”
- “Despite all this, ethanol still seems to have hope in Washington. Somehow, some conservatives are wary of repealing the fuel’s tax subsidies because they could be construed as tax increases. And the White House says it would like to see “new approaches” to promoting biofuels. Sen. Dianne Feinstein (D-Calif.), one of the sponsors of last month’s anti-ethanol amendment, now feels it necessary to negotiate a deal with Sens. Amy Klobuchar (D-Minn.) and John Thune (R-S.D.), both ethanol backers. Those two farm-state senators want to take some of the money saved from ending support for blenders and use it to ...support blenders, financing such things as ethanol pumps. But the Senate has registered strong support for repealing all of the blenders’ subsidy, which is scheduled to expire later this year anyway. It’s hardly time to “compromise” with yet another support for ethanol.”
- “Ms. Feinstein shouldn’t have to negotiate at all. Saving money by slashing ethanol supports should be among the most obvious items in any debt deal. President Obama and the House of Representatives should join the Senate in good sense.”
(*Washington Post*, 07/05/11)

Biofuel subsidies represent a drain on the U.S. economy of over \$6 billion

- The United States' biofuel policies “represent a drain on the U.S. economy of over \$6 billion relative to the same reductions from more cost effective policies,” concluded Christopher R. Knittel, professor of energy economics at MIT's Sloan School of Management and research associate at the National Bureau of Economic Research. In a study on the costs and benefits of U.S. ethanol subsidies [download at <http://tinyurl.com/3pqjrw>], Knittel wrote, “The evidence leads to six conclusions:
 - It is not clear that biofuels have a lower social cost compared to petroleum-based fuels. This is the case even when one considers the social costs related to climate change, local pollution, and energy security.
 - Perhaps most importantly, there is no well-founded scientific research suggesting that subsidy programs, such as the VEETC, and performance standards, such as the RFS and LCFS, are cost-effective ways to reduce petroleum-based fuel consumption. Indeed, the social costs of such programs are likely to be at least five times larger than those of an efficient policy.
 - Subsidies and performance standards carry a substantial increase in the risk associated with measuring the indirect land-use changes associated with biofuels. Errors or biases in the true GHG content of biofuels are exacerbated when relying on performance standards and subsidies, compared to more efficient policies.
 - If the goal of the current biofuel policies is to reduce our dependence on foreign oil or reduce GHG emissions, tariffs on foreign low-GHG biofuels, such as Brazilian ethanol, should be abandoned. Existing work measuring the lifecycle GHG content of Brazilian ethanol suggests that, even accounting for changes in land use arising from production, Brazilian ethanol has less GHG emissions associated with it than corn-based ethanol produced in the United States.
 - If the goal of the current biofuel policies is to increase farmer wealth, basic economics shows that subsidies are an inefficient way of funneling money to farmers. Instead, policymakers should rely on policies that do not distort market prices, such as lump sum transfers to farmers.
 - Given points one through five, the evidence overwhelmingly suggests that the VEETC, RFS, and import tariffs should be eliminated, and a national LCFS should not be adopted. If the goal of these policies is to reduce GHG emissions, they should be replaced with an economy-wide cap-and-trade system, or carbon tax. If the goal is to increase farmer wealth, they should be replaced with payments that are unaffected by changes in the farmers' production (so called lump-sum payments).” (*Corn Belt*

Proposed Infrastructure Bank


Infrastructure bank would strengthen our economy for the “long term “

- “I ...urge the president to move forward [with the creation of the national infrastructure bank] so we can begin to restore America’s infrastructure and strengthen our economy for the long term,” wrote Felix G. Rohatyn, special adviser to the chairman and chief executive officer of Lazard, in a *Politico* commentary. “...We should view infrastructure financing as an investment rather than an expense and should establish a national, capital budget for infrastructure. This idea is not new.
- “Five years ago, former Sen. Warren Rudman and I co-chaired a commission on public infrastructure at the Center for Strategic and International Studies — a bipartisan group of congressional and business leaders, governors and bankers that unanimously recommended an infrastructure bank and called for a capital budget. Yet these proposals were— and perhaps still are —unable to gain political traction.
- “...This national infrastructure bank should be owned by the federal government but not operated by it. In this, it would be similar to the World Bank and European Investment Bank. Funded with a capital base of \$50 billion to \$60 billion, the infrastructure bank would have the power to insure bonds of state and local governments, provide targeted and precise subsidies and issue its own 30-to-50-year bonds to finance itself with conservative 3:1 gearing. Such a bank could easily leverage \$250 billion of new capital in its first few years and as much as \$1 trillion over a decade.”
- “Run by an independent board nominated by the president and confirmed by the Senate, the bank would finance projects of regional and national significance, directing funds to their most important uses. It would also provide a valuable guidance-system for the \$73 billion that the federal government spends annually on infrastructure and avoid wasteful “earmark” appropriations. The money would come from funds now dedicated to existing federal programs.”
- ”Legislation already has been proposed that would create such an infrastructure bank. Rep. Rosa DeLauro (D-CT) has introduced a House bill and Sens. John Kerry (D-MA.) and Kay Bailey Hutchison (R-TX) have introduced similar legislation in the Senate. The Senate bill, with \$10 billion of initial funding, is a modest proposal — but passing it would give us a strong start.”

- “It is difficult to understand why an infrastructure bank is not already in place — with so many in Congress calling for more efficient federal spending and public investment that can pay for itself. Part of the problem may be the belief among some legislators that government action is always a bad thing.”
- “...From a federal budgeting standpoint, creating an infrastructure bank would be the wisest thing to do. We can leverage private capital, both at home and overseas, to modernize our transportation systems, deal safely and effectively with wastewater and hazardous materials, renew ports and inland waterways. With a national bank for infrastructure, we could begin to do all these things and more.” (*Politico*, Felix G. Rohatyn, 06/12/11)
- At a recent Senate Commerce Committee hearing, Kerry stressed that he does not see the American Infrastructure Financing Authority in competition with federal programs such as TIFIA. The proposed infrastructure bank would be free-standing with its own rules, and would perform as a professional bank, without “undue political pressures” on the loans it makes, testified Kerry.
- The concept of an infrastructure bank will have to overcome a number of concerns by lawmakers. Senator Kelly Mayotte (R-NH) sought assurance that the proposed infrastructure bank would not leave the taxpayer on the hook in the event of bad loans. Assistant transportation secretary Polly Totenberg told the Senate panel that—while the DOT is not in principle opposed to the bill—her department has the expertise to do the job. Robert Dove, managing director of Carlyle Infrastructure Partners, told the committee that an independent infrastructure bank would have more credibility with investors. (*Truckinginfo.com*, Oliver B. Patton, 07/25/11)

Postal Service

Washington Post: “Postal Reform Act is imperfect, but needed”

- “The biggest crisis surrounding the U.S. Postal Service is the fact that no one seems to notice how bad the crisis is,” wrote the *Washington Post* in a July 28 editorial. “Further delay in addressing the system’s troubles is literally unaffordable. Facing a deficit of \$8 billion this year, the Postal Service will default on its obligations by October and leave taxpayers footing the bill unless serious changes are made.”
- 
- “The only bill before Congress that offers any opportunity to fix this is the Ross-Issa Postal Reform Act of 2011. Is the act perfect? By no means. But the bill includes a mechanism for fundamental change, as well as several reforms that the Postal Service sorely needs: a shift to five-day delivery, which would save an estimated \$3 billion over the first four years; a requirement that the financial predicament of the Postal Service be taken into consideration in any arbitration; and the ability to renegotiate existing contracts if the Postal Service’s finances require it.”
 - “Unlike at least one other bill aimed at the Postal Service, the Ross-Issa bill does not depend on a recently discovered windfall of up to \$50 billion that some actuaries claim was overpaid by the Postal Service some years ago — a cache that has given those unwilling to change the status quo an argument for postponing critical structural reforms.”
 - “The Ross-Issa bill creates two commissions—one to focus on post office closures, excess processing capacity and unnecessary administrative offices, and the other to take charge of the USPS’s finances if it goes into default and take whatever measures are necessary to bring it back into the black, including renegotiating collective bargaining agreements.”
 - “On [July 26], Postmaster General Patrick Donahoe announced that 3,653 local post offices are being studied for closure. But closing post offices will not resolve the USPS’s problems. Eighty percent of the Postal Service’s current costs stem from labor — a higher percentage than more than 30 years ago, when the USPS lacked automation. Some employees still enjoy a no-layoffs clause. Even after recent concessions, they contribute a smaller share of their salary to health-care plans than do most federal workers — a gap the Postal Reform Act would close. And rules preventing arbitrators from taking the financial crisis of the USPS into consideration

have resulted in new contracts that give employees raises even in the face of ever-mounting deficits.”

- “The USPS blames its woes on the requirement that it pre-fund employees’ retirement benefits. **We have repeatedly supported the prepayment, based on the simple logic that the USPS, at its present rate of decline, will not have enough money to fund the plans when employees retire. This remains the case.**” [Emphasis supplied.]
- “In the long run, the best solution for the Postal Service would be one that cuts it loose of the cumbersome oversight structure that prevents it from efficiently downsizing or competing, allows it to negotiate more sensible contracts and behave more like a private-sector business, and rethinks its universal service obligation for a century where people no longer rely on the mail to pay bills or send messages.”
- “Currently, taxpayers do not fund the Postal Service. But if present trends continue, they may have to. The Issa bill, while not perfect, supplies several necessary reforms and offers a path to pull the USPS out of the red.” (*Washington Post*, 07/28/11)

3,700 post offices under review for closure

- The USPS released a list of 3,700 small post offices that are being studied for possible closing to save money. Most of the retail outlets being reviewed generate less than \$27,500 a year in revenue and have only enough customers and mail to keep them busy two hours a day, said Postmaster General Patrick Donahoe. The USPS will spend at least four months reviewing each post office. As branches are closed, the agency said it will set up “village post offices” in supermarkets and gas stations that provide basic postal services such as stamps and flat-rate package shipping.
- Senator Tom Carper (D-DE), chairman of the subcommittee that oversees the Postal Service, said the office closings were a “difficult but necessary step” to save the Postal Service from collapse.
- “The fact is, maintaining our nation’s rural post offices costs the Postal Service less than 1 percent of its total budget and is not the cause of its financial crisis,” Senator Susan Collins (R-ME). “While there are some areas where postal services could be consolidated or moved into a nearby retail store to ensure continued access, this simply is not an option in many rural and remote areas.” Collins has proposed legislation that would ease the Postal Service’s budget deficit by reforming workers’



compensation and contracting requirements and letting the postmaster tap “an enormous overpayment” into retirement funds. (*USA Today*, Carly Mallenbaum, 07/27/11)

USPS takes steps to preserve cash to ensure the delivery of mail and payment of suppliers and employees

- “Our cash flow crisis is at a critical level,” said Postmaster General Patrick Donahoe during an interview with *USA TODAY*. “Right now, we will have enough money to get to the end of the year. Our fiscal year ends on Sept. 30. I’ve got a payment of \$5.5 billion for the federal government to pre-fund retiree health benefits. I can’t make that payment, so we’ve taken some actions to preserve cash so that we make sure we deliver mail, pay our suppliers and pay our employees.”
- The USPS will likely discontinue Saturday delivery and ultimately reduce delivery to three times a week over the long-term. “Saturday delivery is something that has been part of our brand for many years,” said Donahoe. “What we’re facing is a substantial amount of cost pressure around the loss of first-class mail, and it has caused us to look at everything. And one of the things we’ve looked at is the elimination of Saturday mail. Now that’s just delivery, collections and outgoing mail. Post offices will stay open, you can rent a mailbox at a post office and get Saturday delivery, and our networks will still stay open.”
- “I think in 15 years, we’ll probably be talking about delivering mail three days a week, just because the Internet will take up a lot of what we do today in first-class mail. I think that will be a good way of delivering packages, and will be a viable way still of (delivering) hard-copy advertising — because people like that. It’s still the most direct way, until they figure out how to make the Internet show up in front of your eyes. They haven’t figured it out, thank goodness. Now from a cost standpoint, does that stay as a five-day-a-week delivery? At some point we’ll have to move to three. Monday-Wednesday-Friday, so you have the ability to make substantial cuts; you can cut your vehicle numbers in half, for example. So I think we’ll see that at a certain point in time. When you get out past that to a certain time, say 2040, who the heck knows? But there will always be packages, and there will always be some requirement or demand for some hard-copy delivery. Maybe one day a week in some of these places. We do that now; there’s places in Alaska, even in the continental United States, like in Montana and Wyoming.”
- Postal rates will likely increase again in January. “We’ll probably have a price increase in January of next year,” said Donahoe. “We charge 44 cents; I think we’ve kept our stamp price the same for three years. Probably we’ll go up to 45 cents.”
- The USPS continues to evaluate its postal office network for closure or consolidation. Donahoe said, “The review process is this: What should we do in a place that really doesn’t generate that much revenue and doesn’t have that many people come in? Can

it be served through a consolidation with the closest post office so you don't put customers out? Can we contract that work out? Is there some other solution in there? We're going to be announcing it at the end of July. But the key thing is, we want to have a lot of customer input. We'll have customer meetings, we'll have options that will be explored, and nothing would happen until next spring before we make final decisions. We're reviewing 3,600 post offices for some change in access, and again that's either closure or consolidation or contracting out. But it's wide open. We'll have a lot of public input."

- "Fifteen years from now, we will still be an important part of the American economy and society, though probably different than today. People will not be paying bills through the mail; about half of them don't today, and that'll continue. But we'll still be delivering packages and hard copy. As you look ahead, you can see a lot more e-commerce, a lot more packages coming through the delivery system — we work with FedEx and UPS on that — and there's always going to be a market for direct mail, because people like to get something in front of a customer's eyes.." (*USA TODAY*, 07/19/11)

APWU refuses to stop running an ad about the Postal Service that Chairman Issa calls "misleading"

- Representative Darrell Issa (R-CA), chairman of the House Oversight Committee, sent a letter to the American Postal Workers Union (APWU), asking them to stop running a "misleading" advertisement [<http://tinyurl.com/3b4lwkd>] about the financial situation of the Postal Service. The ad, which APWU is running Monday on CNN, MSNBC, and FOX, asks the viewer: "Ever wonder what this costs you as a taxpayer? Not a single cent."
- "It is true the Postal Service no longer receives an annual subsidy for basic operations from the federal government, and has not for some time," said Issa in a letter to APWU. "But the Postal Service does receive support from the American taxpayers, [citing a 2007 Federal Trade Commission report that] includes a long list of implicit subsidies the Postal Service receives that are not available to private companies. According to the report, the Postal Service is exempt from, among other items, federal, state, and local income tax, all state and local taxes (including property tax), and vehicle registration and titling fees. Additionally, the Postal Service has the ability to exercise eminent domain to secure property ... Finally, because it can borrow through the U.S. Treasury, the Postal Service is able to borrow at very low interest rates." (*Daily Caller*, Alexis Levinson, 07/13/11)
- "The APWU stands by the ad, which dispels the myth that the USPS is funded by taxpayers," wrote APWU President Cliff Guffey in a July 15 letter to Chairman Issa. "Your reference to so-called 'implicit subsidies' incorrectly suggests that the Postal Service is being funded by taxpayers. The USPS enjoys benefits because of its obligation to provide service to every American business and household — even when it is not cost-effective to do so. ... Our ad is correct. The Postal Service is not

subsidized by taxpayers. We will continue to publicize this important truth.”
 (APWU Web News Article 078-2011, 07/18/11)

“Go Green” with the USPS

- The USPS has published its *2010 Sustainability Report*, which outlines the agency’s efforts to minimize its carbon footprint. The Postal Service said it is “off target” with regard to its goals on (i) reducing waste sent to the landfill 50% by FY2010; (ii) reducing the Postal vehicle petroleum fuel by 20% by FY2015, and (iii) improving its Voice of the Employee approval rating.



- The Postal Service currently operates the nation’s largest fleet of alternative fuel-capable vehicles of more than 44,000, which can run on electricity, ethanol, compressed natural gas, liquid propane and bio-diesel. The agency’s alternative fuel fleet now comprises 20.5% of the Postal Service’s 215,000 vehicle fleet. During FY2009 and FY2010, the USPS replaced 6,558 older gasoline-powered vehicles with more fuel- efficient ones and increased its use of alternative fuels in postal vehicles to 2.2 million gasoline gallon equivalents, a 9 % increase from FY2009. (*2010 Sustainability Report*, United States Post Office, 2010)

- The USPS is currently testing an hybrid electric step van from Azure Dynamics, joining an existing hybrid electric fleet of 10 Ford Escapes, 533 Chevrolet Malibu and 370 Ford Fusion vehicles. Five companies are participating in a pilot program to convert USPS gasoline long-life vehicles to battery power.
- The USPS has introduced “Go Green” forever postage stamps, containing 16 different images with reminders on how to reduce your carbon footprint. With reminders such as “walk instead of drive” and “fix water leaks,” the Go Green stamps quietly contribute to green mindfulness. The USPS also provides its customers with downloadable animated screen saver for the Mac or PC to remind them of how easy it is to go green. Information on the agency’s ongoing efforts to improve the economy are available at <http://www.usps.com/green/> (www.marvistapatch.com, Jeanne Kuntz, 07/15/11)

The USPS courts “irony-loving hipsters” via social media

- “[T]he dying government institution that is the United States Postal Service made one last attempt at staying relevant by offering sneak-peeks of new 2012 stamps over Facebook and Twitter,” wrote Willis Plummer on the *Village Voice Blog*. “They will post a new stamp every weekday for some undetermined amount of time. The USPS social-media person must be too old to appreciate the irony in trying to save snail mail on the interwebs, or maybe the Postal Service has finally realized that the only young people who are going to buy stamps are irony-loving hipsters.”



- “So far, USPS has unveiled two new stamps; one celebrates the cherry blossom centennial and the other honors Edgar Rice Burroughs (who?). After a quick Wikipedia search, we learned that he’s the author of that Disney movie *Tarzan*. Just saying: If this new social media campaign is in fact an attempt to reach a younger audience, the next stamp should probably honor someone who hasn’t been dead for 60 years. Until that day, we young folk will continue to believe that The Postal Service is just some band that pre-teen girls like.” (*Village Voice Blog*, Willis Plummer, 07/19/11)

TVA

Richard Howorth joins the TVA board of directors

- Richard Howorth was sworn in on July 13 to serve a five-year term on the TVA board of directors. “I am honored to have been nominated to this post by the president and confirmed by the U.S. Senate,” said Howorth. “As one who has had a lifelong interest and stake in the progress of the region, I know that TVA is a vitally important entity, and I look forward to working with the TVA board.”
- Howorth, who served two terms as mayor of Oxford, MS from 2001 to 2009, is the founder and owner of Square Books, a leading independent bookstore in Mississippi and former chairman of the American Booksellers Association. During his tenure as mayor, Howorth served as chairman of the authority overseeing the Oxford Electric Department. He served for eight years as a director and officer of the North Mississippi Industrial Development Association, an economic development consortium comprised of utility directors and mayors of cities in 29 counties in the TVA service territory. (*PRNews Wire*, 07/13/11)

Why the U.S. *still* needs nuclear power

- “In two weeks the Tennessee Valley Authority, America’s largest public power producer, will decide whether to complete construction of a long-deferred generating unit at the Bellefonte Nuclear Plant, in northeast Alabama,” wrote Tom Kilgore, TVA’s president and CEO, in a *New York Times* commentary. “If we proceed, Bellefonte 1 would become the TVA’s third nuclear unit brought into service in the 21st century.”
- “This is, understandably, a controversial issue. Why are we thinking of expanding our fleet of nuclear plants in the wake of the Fukushima disaster? After all, some countries seem to be going the other way: Germany and others are planning to cut back or eliminate their nuclear power facilities altogether.”
- “Indeed, whether the Bellefonte project moves forward or not, the TVA is committed to demonstrating that a methodical, safety-driven approach to nuclear development works. Along with the possibility of restarting work at Bellefonte, in recent years we have upgraded our Browns Ferry 1 reactor, also in Alabama, and we are completing a second reactor at our Watts Bar plant, in eastern Tennessee.”
- “The reason for the commitment is simple: for all the recent news, nuclear is still our best choice for producing large amounts of round-the-clock, reliable electricity that is affordable, safe and clean. ... The Tennessee Valley Authority has operated nuclear plants for three decades, but our program was hindered, as many energy providers

were, by safety concerns and a public backlash against nuclear generation in the 1980s.”

- “Our response, however, was not to abandon nuclear energy. Instead, we revamped our program and adopted a more conservative, disciplined approach to both operations and construction. In a departure from the 1970s, when we were building 17 nuclear units at once, today we allow only one unit to be in any single stage of development at a time.”
- “We believe that nuclear power, developed properly, is not only a promising option, but the best available. Our forecasts for the region’s energy demands by the end of the decade show we will need more base-load electricity — or continuous minimum power — something nuclear plants excel at providing.”
- “Fortunately, we have a ready option at hand. Construction at Bellefonte began in 1974, but projections of stagnant energy demand led the T.V.A. to stop work in 1988. Because Bellefonte was never operated and was well preserved after being deferred, much of the plant is in excellent condition today.”
- “Moreover, if approved, the plant would undergo a six- to eight-year, \$5-billion makeover. Major components — like the two large steam generators — critical wiring, instrumentation and thousands of other pieces of equipment would be replaced. When completed, the plant that some label a dinosaur would be among the most modern, thoroughly inspected and safest nuclear facilities in the nation.”
- “Nevertheless, critics have rightly asked, why not simply bypass nuclear power and rely on more wind, solar, gas and energy efficiency? In fact, the T.V.A. is adding power from all of those sources in record amounts. But none can produce sufficiently large volumes of base-load electricity as consistently and affordably as nuclear power can.”
- “No energy source is perfect. But the risks associated with nuclear power are well understood and — with the proper emphasis on safety — they are entirely manageable. Fukushima taught us that we must be prepared for what was once considered almost unimaginable, and we are incorporating the lessons of that disaster into our everyday operations.”
- “At the Tennessee Valley Authority, our strategy for meeting the electricity challenges of the future is a balanced portfolio of energy production that relies somewhat less on coal, and more on energy efficiency, gas, renewable and nuclear power. If cost, reliability and cleaner air are important, nuclear energy must be part of the mix.” (*New York Times*, Tom Kilgore, 07/30/11)

TVA failed to monitor groundwater at its coal-burning plants

- TVA failed “on many levels” to monitor groundwater at its coal-burning plants and three Eastern Tennessee plants—in Bull Run, John Sevier, and Kingston—has chemicals in the groundwater that exceeded normal limits, according to an internal review of the utility’s actions from 2008 to 2009. The review, which evaluated 11 of TVA’s coal burning plants, examined how the utility disposed of coal waste and gypsum.
- Bull Run and John Sever had higher levels than normal of nickel, fluoride, arsenic and other chemicals in the groundwater, while the Kingston plant had higher levels of arsenic. “Those chemicals were found, but they are not impacting drinking water,” said TVA spokesperson Cynthia Anderson. “We have to do off site impacts when we find those above a certain level.” TVA has been installing monitoring wells at all sites that collect the remnants from coal and perform more voluntary monitoring, added Anderson. TVA has taken corrective steps to resolve the issues and is implementing the collection of new groundwater samples at all sites by yearend. (*WBIR.com*, 07/25/11)
- “A report from the Tennessee Valley Authority’s Inspector General found that contaminants from coal ash at nine of the utility’s power plants is leaching out of containment areas, underscoring the need for strong federal rules on its storage,” wrote the *Knoxville News Sentinel* in an editorial. “Coal ash regulations are left to the various states. In Tennessee, coal ash is considered municipal waste, and the facilities that hold it are regulated as municipal landfills.”
- “The U.S. Environmental Protection Agency is in the process of choosing between two rules to enact. One would allow states to continue to treat coal ash as regular garbage, though wet storage ponds like the one at Kingston and other TVA plants would be banned. The other, stricter rule would force utilities and other industries to treat coal ash as a hazardous waste and authorize the EPA to enforce compliance. The tougher rule, though more expensive, better protects the public and establishes one set of rules for a utility to follow. TVA would have to continue to comply with regulations in three states — Kentucky, Alabama and Tennessee — if the less stringent rule is adopted.”
- “The energy lobby opposes the stricter rules because of the higher cost, and a bill that cleared a key committee in the U.S. House of Representatives would block the EPA from treating coal ash as hazardous waste. In voting for the ban, the Republican majority in the Energy and Commerce Committee rejected a bipartisan compromise that would regulate coal ash in the same way as hazardous waste without giving it the hazardous waste label. If the bill is approved on the House floor, it will have a tougher time in the Democratic-controlled Senate. U.S. Sen. Lamar Alexander, who has a seat on the Environment and Public Works Committee, is in an excellent

position to take the hard lessons learned by his constituents and apply them nationwide.”

- “...Coal ash must be handled with more care than the utility industry has used in the past. By treating coal ash as hazardous waste, the EPA can hold the utility industry accountable for any environmental issues that arise in the future. The Kingston spill was a wake-up call for many in Tennessee and throughout the country. The EPA and Congress must finish the job by enacting tough but evenly-enforced regulations on coal-ash disposal.” (*Knoxville News Sentinel*, 07/30/11)

“Sweetheart lawsuits” and EPA grants

- In late June, EPA settled a lawsuit filed by environmental groups to address haze pollution by agreeing to issue new regulations that will force Western coal-fired power plants to install haze-reducing pollution-control equipment at a cost of \$1.5 billion a year. One litigant in the law suit, the Environmental Defense Fund, has filed almost half a dozen lawsuits against the EPA over the last decade. In turn, EPA has given EDF grants totaling \$2.76 million over that same period, according to *Investor’s Business Daily*. This “strange relationship” goes well beyond EDF with several other environmental groups receiving millions in EPA grants while regularly filing lawsuits against the agency. Twelve “green groups” have filed more than 3,000 suits against the EPA and other government agencies over the past decade, according to a study by the law firm Budd-Falen Law.
- “The EPA even tacitly encourages such suits, going so far as to pay for and promote a ‘Citizen’s Guide’ that, among other things, explains how to sue the agency under ‘citizen suit’ provisions in environmental laws,” reported *IBD*’s John Merline. “The guide’s author — the Environmental Law Institute — has received \$9.9 million in EPA grants over the past decade. And, to top it off, critics say the EPA often ends up paying the groups’ legal fees under the Equal Access to Justice Act.”
- “The EPA isn’t harmed by these suits,” said Jeffrey Holmstead, a former EPA official during the Bush administration. “Often the suits involve things the EPA wants to do anyway. By inviting a lawsuit and then signing a consent decree, the agency gets legal cover from political heat.” This form of litigation—known as “sweetheart suits”—are common. Holmstead pointed to EPA’s settlement of a greenhouse gas emissions suit as a good example. The 2008 lawsuit, file by EDF, the Natural Resources Defense Council (the recipient of \$6.5 million in EPA grants since 2000), the Sierra Club and several states, sought to compel the EPA to issue regulations setting forth greenhouse gas “performance standards” for power plants and refineries. The EPA agreed to issue the performance standards in its settlement.
- “This is hard to describe as anything other than a victory for the states and the environmental plaintiffs,” wrote Nathan Richardson with Resources for the Future in a paper. “By committing to performance standards in the settlement agreement, the agency is tying its own hands.” House Energy and Commerce Committee Chairman

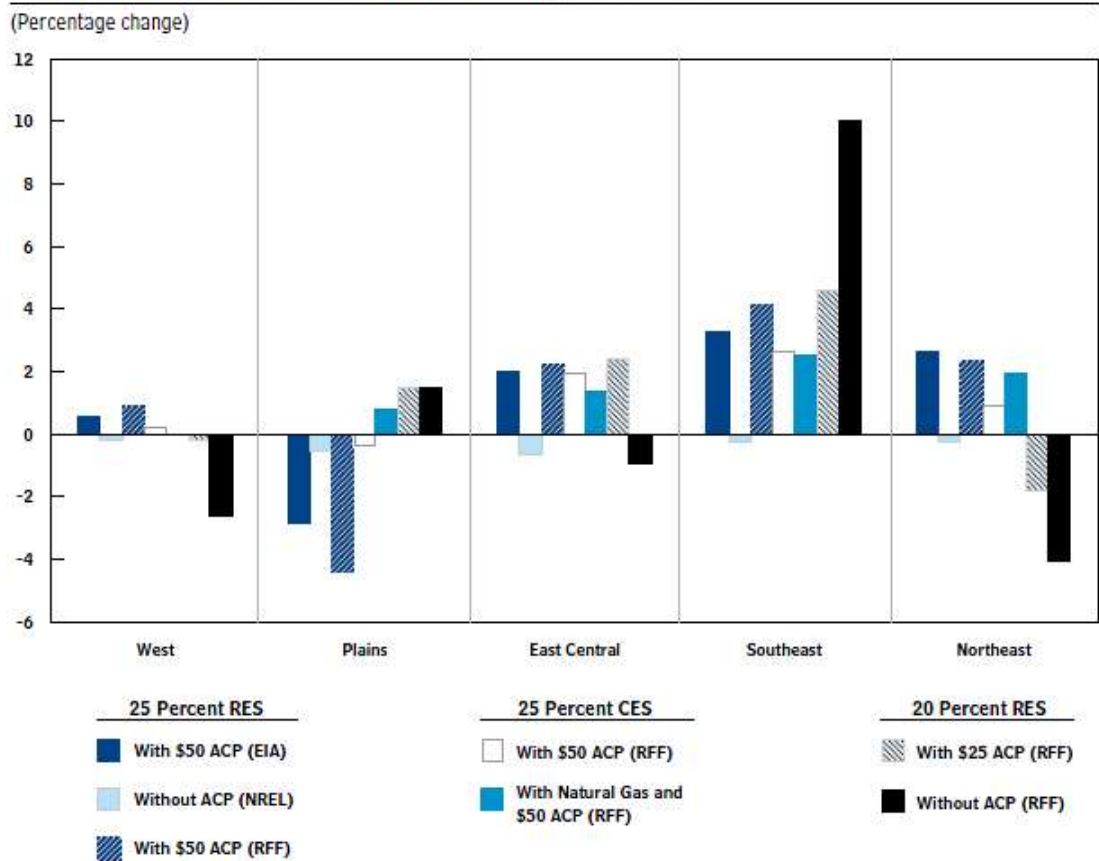
Fred Upton (R-MI), and Senator James Inhofe (R-OK), ranking member of the relevant Senate panel, voiced outrage at EPA's settlement in a letter to the agency. The lawmakers argued that the costly settlement was "concocted in secret" and was "entirely discretionary, no court ordered them." Representative Ed Whitfield (R-KY), who serves as the chairman of House Energy and Commerce Committee's Subcommittee on Energy and Power, warns that environmental policy is increasingly "being determined by privately settled lawsuits and monetary payoffs with absolutely no input from elected representatives."

- Other examples of sweetheart lawsuits filed against EPA from grantees include:
 - In 2005, several states and environmental groups, including EDF, NRDC, and Physicians for Social Responsibility (\$135,000 in an EPA grant), sued the EPA claiming its mercury rule didn't go far enough. In 2008, the courts agreed. The EPA, under a court-supervised deadline negotiated by the EPA, the EDF and others, have until mid-November to finalize rules that cut emissions of mercury and other toxins. EPA estimates the new rules will cost \$11 billion a year.
 - In 2006, EDF, the NRDC and others parties, including several states, sued EPA for its decision not to regulate carbon dioxide.
 - In January 2009, the Chesapeake Bay Foundation filed suit claiming the EPA wasn't doing enough to clean the bay. The following July, EPA gave CBF a \$1.3 million grant (from stimulus funds) to retrofit a dozen boats.
 - In 2010, the Pesticide Action Network, a recipient of \$238,000 in EPA grants, and the NRDC sued to force EPA to ban the pesticide chlorpyrifos.
 - In May 2011, the NRDC, Physicians for Social Responsibility and others announced plans to file a lawsuit against the EPA for the agency's failure to enforce smog standards in California.
- Defenders of the sweetheart lawsuits argue that there's no connection between the grant money, dedicated to projects or programs, and the suits. Moreover, the defenders argue that the environmental groups are simply trying to force the EPA to do what the law requires it to do.
- Senator John Barrasso (R-WY) has introduced legislation to limit sweetheart lawsuits. Under the bill, environmental groups whose net worth exceeds \$7 million would not get their legal fees paid for by the Equal Access to Justice Act and attorneys' fees would be capped at \$175 an hour. (*Investor's Business Daily*, John Merline, 07/06/11)

Renewable energy standards *will* increase electric rates, says CBO

- Today, coal provides 45% of the United States’ power generation, followed by natural gas (24%) and nuclear (19%). The administration’s push to have 80% of the country’s electricity from windmills and solar panels by 2035 will only happen if the federal government adopts Renewable Energy Standards (RES) or Clean Energy Standards CES).
- “Either an RES or CES would also raise the average cost of generating electricity in the United States because, in the absence of the standard, regulators and generators would generally choose the lowest-cost method of producing electricity,” concluded the Congressional Budget Office. [The following chart provides CBO’s estimates of the increased cost of electricity by region under seven different energy standards.]

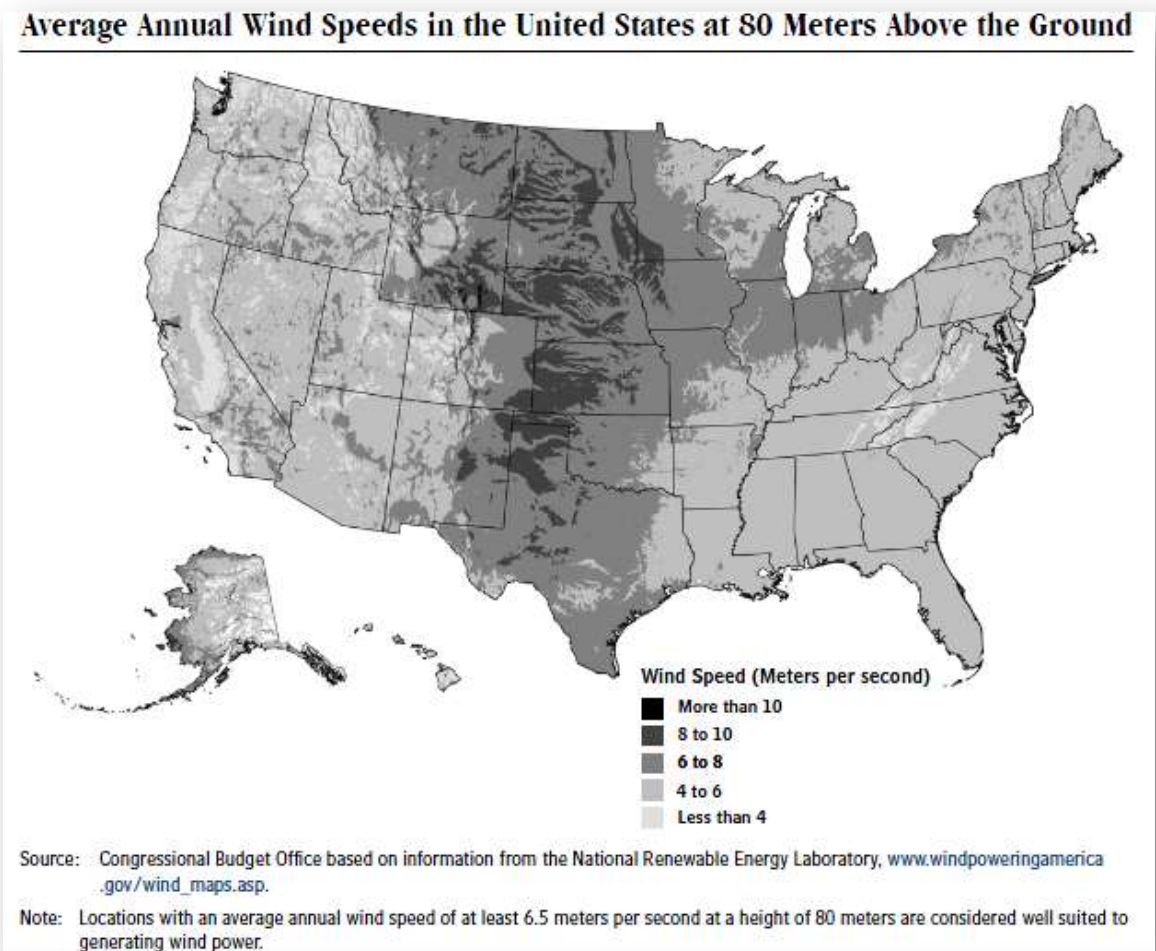
Average Change in Electricity Prices Between 2020 and 2030, by Region, Under Seven Potential Federal Electricity Standards



Source: Congressional Budget Office based on analyses by the Energy Information Administration (EIA), the National Renewable Energy Laboratory (NREL), and Resources for the Future (RFF).

Notes: RES = renewable electricity standard; ACP = alternative compliance payment; CES = clean electricity standard.

- “In a sane world, that would be the end of the story, but it isn’t,” wrote the *Washington Times* in a July 27 editorial. Instead, government regulators want to mandate that private companies must produce 20% to 25% of their electricity from clean sources, using a complex scheme of production credits to implement the government’s mandate.
 - CBO concluded that the bulk of the increase in renewable energy generation from resulting from RES or CES would come from additional wind generation, mainly in the High Plains region of western and central U.S. and from biomass from the Southeast. (*The Effects of Renewable or Clean Electricity Standards*, CBO, July 2011; *Washington Times*, 07/27/11)



(Source: *The Effects of Renewable or Clean Electricity Standards*, CBO, July 2011)

Sierra Club receives \$50 million “coal fighting” donation from Mayor Bloomberg’s main charitable organization

Senator Manchin responds to Bloomberg’s “anti-coal” donation

Sierra Club receives \$50 million “coal fighting” donation from Mayor Bloomberg’s main charitable organization

- New York City Mayor Michael Bloomberg announced that his main charitable organization would donate \$50 million over four years to the Sierra Club’s Beyond Coal Campaign, which aims to shut down as many as 33% of America’s oldest coal plants by 2020. Bloomberg’s donation represents about one third of the Sierra Club’s \$150 million four-year budget. The Club will use the donation to expand their campaign from 15 states to 45 states and increase their membership base from 1.4 million to 2.4 million. Michael Brune, director of the Sierra Club, called Bloomberg’s donation a “game changer” in the fight against coal.
- “If we are going to get serious about reducing our carbon footprint in the United States, we have to get serious about coal,” said Bloomberg. “Coal is a self-inflicted public health risk, polluting the air we breathe, adding mercury to our water and the leading cause of climate disruption.”
- In the spring, Bloomberg pledged nearly \$20 million over three years to C40 Cities Climate Leadership Group, a group of cities around the world that are engaged in reducing greenhouse gases. Bloomberg currently serves as chairman of C40. (*New York Times Green Blog*, John M. Broder, 07/21/11)

Senator Manchin responds to Bloomberg’s “anti-coal” donation

- “I am very disappointed that at a time when we should be looking for a balance in this country’s energy policy—a balance that considers both the economy and the environment, and that takes into account all of this nation’s vast domestic resources – the approach that Mayor Bloomberg has chosen is entirely one-sided and wrong,” said Senator Joe Manchin (D-WV). “Coal not only built this country, but it built the skyscrapers of New York City, and without coal, the lights of that city would be dark and its economy would be devastated. I have said from day one, and will say until my last breath, that there has to be a balance in our country between the environment as well as our economic and national security, which are threatened by this country’s addiction to foreign oil.
- “The bottom line is that coal is an abundant, affordable source of energy that powers more than half this nation. It provides countless American jobs in my little state of West Virginia, and all over this country, and now is not the time to eliminate those jobs and create the conditions for utility rate hikes on the people who can least afford

them. Rather than a strictly ‘anti-coal’ agenda, I would hope that individuals with financial resources like Mayor Bloomberg would choose a more balanced approach that recognizes the vital role that coal plays in our nation’s energy portfolio both now and into the future.” (Comtex, 07/22/11)

“Only government can ensure integrity, transparency, and fair dealing...even though private companies compete, only government can ensure that there is competition. Everyone wants to be a monopolist.”

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