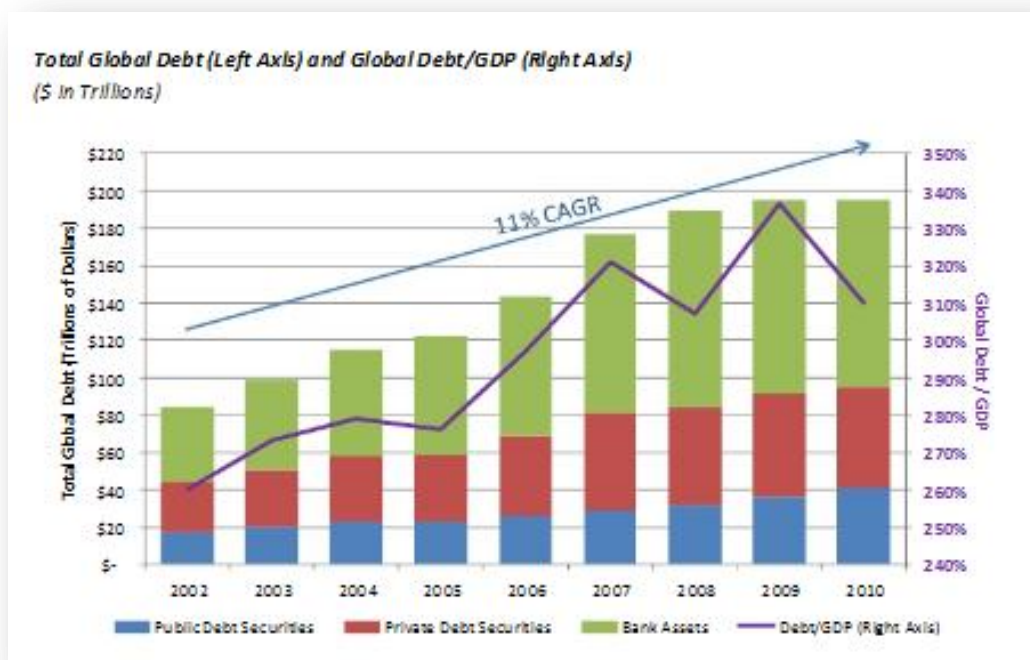




December 4, 2011

“Since 2002, total global credit market debt has grown by more than an 11% compound annual growth rate (CAGR) from \$80 trillion to \$200 trillion. Over the same time, global real GDP has grown at approximately 4% CAGR ... [T]oday, total credit market debt is 310% of GDP—[representing] the largest accumulation of peacetime debts without any playbook for what happens next.”



”Given the enormity of the debt burdens of the PIIGSBF (Portugal, Italy, Ireland, Greece, Spain, Belgium, and France) coupled with those of Japan (and at some point the U.S.), lending schemes designed to lend more into an intractable debt problem is destined to fail miserably. There is no savior large enough with a magical pool of capital to stave off this unfortunate conclusion to the global debt cycle. We think hard defaults are imminent.”

Kyle Bass  
Hyman Capital Management, November 30, 2011

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## Major Events

### *Breaking News:*

S&P Places 15 Euro Nations on Warning for Credit Downgrade

Treasury Delays Release of Government's GAAP-Based Financial Statements  
Until Christmas Eve

### S&P Places 15 Euro Nations on Warning for Credit Downgrade

- Standard & Poor's has warned Germany, France, the Netherlands, Austria, Finland, and Luxembourg on "credit watch negative" [meaning there is a 50% chance of a downgrade within 90 days] due to the deepening economic and political turmoil in Europe. S&P also warned all six governments that their ratings could be lowered from "AAA" to "AA+" if the credit watch review failed to convince its experts. While market observers had anticipated a potential downgrade of France, few expected Germany's top rating to be called into question. S&P said it was worried about "the potential impact [on Germany] of what we view as deepening political, financial, and monetary problems with the European economic and monetary union."
- S&P's action occurs as eurozone governments are working towards a comprehensive deal to contain the region's sovereign debt crisis ahead of a crucial EU summit on December 9. The credit rating agency told the six governments it would conclude its review "as soon as possible" after the summit. "[I]t is our opinion that the lack of progress the European policymakers have so far made in controlling the spread of the financial crisis may reflect structural weaknesses in the decision-making process within the eurozone and European Union," said S&P. (*Financial Times*, 12/05/11)



### Treasury Delays Release of Government's GAAP-Based Financial Statements Until Christmas Eve

- "A Christmas Present from Uncle Sam," wrote John Williams in *Shadow Government Statistics*. "I called the U.S. Treasury, today (December 5th), to confirm the scheduled December 15th release of the 2011 Financial Statements of the U.S. Government, the GAAP-based ...accounting of the government's financial operations for the 2011 fiscal year ended September 30th. The advice received was that the release has been delayed until Friday, December 23rd, which is as close to Christmas

Eve as the government can get. Given the way prior releases of these statements have been handled, though, the 23rd still has to be considered as a tentative release date, and I offer no comment as to any implications of the new timing and the potential for burying unhappy political news.” (*Shadow Government Statistics’ Commentary 404*, John Williams, 12/05/11)

Fannie Mae’s third quarter losses widen to \$5.1 billion

Freddie Mac reports a \$4.4 billion loss for the third quarter

Fannie and Freddie owe taxpayers \$184.4 billion

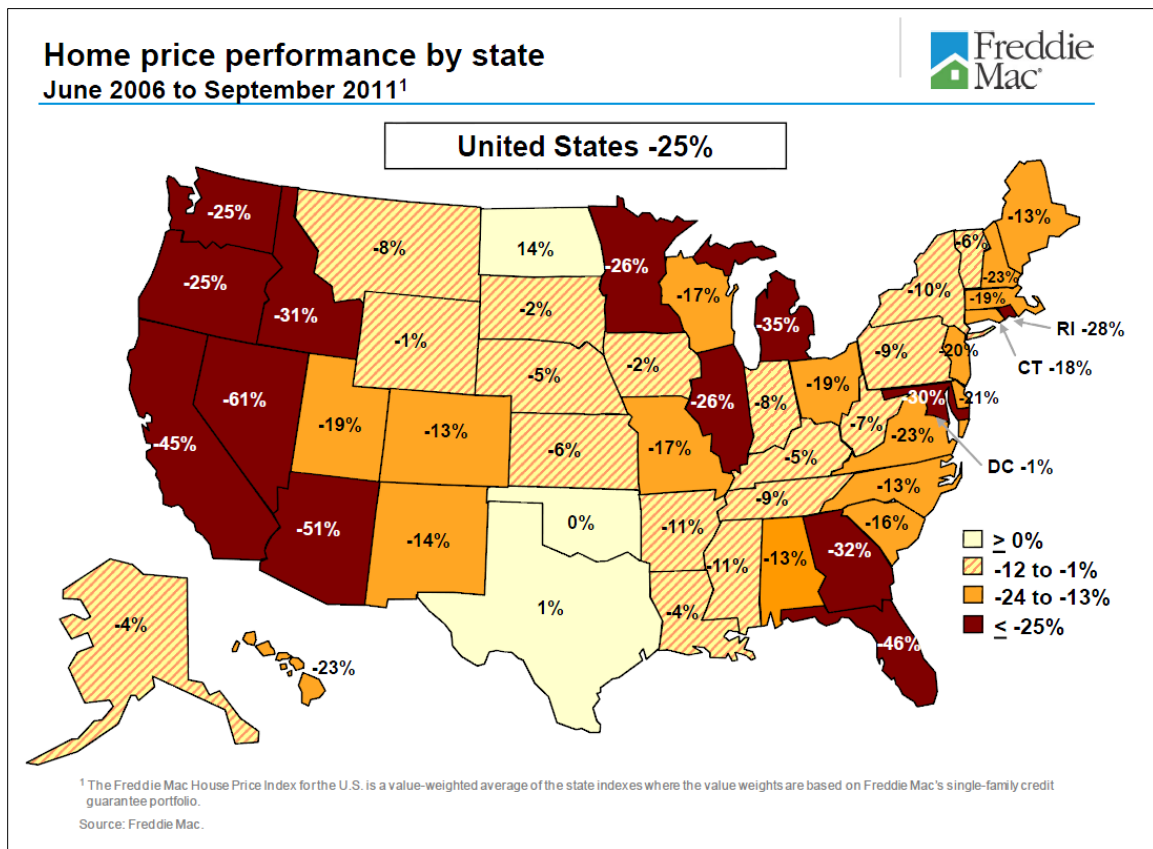
Firestorm on Capitol Hill over GSEs’ executives’ pay

### Fannie Mae’s third quarter losses widen to \$5.1 billion

- Fannie Mae reported a \$5.1 billion loss for the third quarter, resulting primarily from credit-related expenses (\$4.9 billion) and losses on derivatives (\$4.5 billion) used to hedge exposure to interest rate risk. The company’s losses were partially offset by a \$5.5 billion growth in net revenue during the period. Fannie Mae requested an additional \$7.8 billion draw from Treasury, bringing Fannie Mae’s total taxpayer bailout to \$112.6 billion to date. Through September 30, the GSE has paid an aggregate \$17.2 billion to Treasury in dividends on the preferred stock. Fannie Mae CFO Susan McFarland said the company is “working to reduce losses” on its legacy assets and “limit taxpayer exposure.”
- Fannie Mae reported \$114.8 billion of non-performing mortgages and a carrying value for the company’s real estate owned of \$11.0 billion (122,616 properties) on September 30. On that date, the GSE reported a serious delinquency rate for single-family and multi-family properties of 3.80% and 0.31%, respectively.
- “Our results in the third quarter were significantly affected by continued weakness in the housing market and the economy overall,” said Fannie Mae president and CEO Michael J. Williams. “Despite these challenges, we are making solid progress. We are growing a strong new book of business that now accounts for nearly half of our overall single-family guaranty book of business. We help homeowners to avoid foreclosure and provide liquidity to enable working families to buy a home or secure quality affordable rental housing. We are committed to building a stronger housing finance system for the future, and strengthening Fannie Mae to deliver value to customers, families, taxpayers, and the industry.” (*Fannie Mae Press Release*, 11/08/11; *Fannie Mae 10Q*, 11/08/11; *2011 Third-Quarter Credit Supplement*, Fannie Mae, 11/08/11)

Freddie Mac reports a \$4.4 billion loss for the third quarter

- Freddie Mac reported a \$4.4 billion loss for the third quarter, attributable largely to \$4.8 billion in derivative losses and provisions for loan losses totalling \$3.6 billion. Freddie Mac requested a \$6 billion draw from Treasury to offset the company’s operating deficit, bringing the enterprises’ total agency’s investment in senior preferred stock to \$72.2 billion. The company has paid \$14.9 billion in dividends to Treasury on its preferred stock.
- On September 30, Freddie Mac’s serious delinquency rate for single-family mortgages was 3.51%, one basis point higher than that of the second quarter, while its multifamily serious delinquency rate was .033%, up two basis points from the prior quarter. Freddie Mac’s non-performing assets (\$127.9 billion), accounted for 6.6% of its mortgage portfolio (excluding Freddie Mac securities). The company owned 59,616 REO properties at the end of the third quarter with a gross value of \$6.3 billion.



- “The weak labor market and fragile economy continue to weigh heavily on the single-family market, causing many potential buyers to sit on the sidelines or opt to rent despite high affordability and record low mortgage rates,” said Freddie Mac Chief Executive Officer Charles E. Haldeman, Jr. “While this put a damper on home

buying, hundreds of thousands of borrowers were able to refinance into lower mortgage rates or shorter mortgage terms in the third quarter. In fact, the borrowers we helped to refinance will save an average of \$2,500 in interest payments during the next year. Looking ahead, we expect the tepid recovery to continue to put downward pressure on house prices into early next year.

- “Our financial performance in the third quarter was impacted by the weak housing market, as well as challenging financial market conditions,” said Haldeman. “Freddie Mac was a stabilizing force in the mortgage market, ensuring the continuous flow of funds to lenders and borrowers and helping families avoid foreclosure. We also made further progress this year on becoming a stronger and more efficient company – adding high quality loans to our book and streamlining operations. Taken together, these efforts are maximizing the value of our assets for America’s taxpayers, and reinforcing the housing finance system.” (*Freddie Mac Press Release*, 11/03/11; *Freddie Mac 10Q*, 11/03/11; *Third Quarter Financial Results Supplement*, Freddie Mac, 11/03/11)

#### Firestorm on Capitol Hill over GSEs’ executives’ pay

- Fannie Mae and Freddie Mac paid their top five executives \$33.3 million and \$28.1 million, respectively, in 2009 and 2010 with both GSEs set to pay targets of as much as \$17 million to top management this year. Recent salary filings by the GSEs sparked a political firestorm on Capitol Hill, leading lawmakers to introduce bills in the Senate and House to block the pay packages. Sixty senators from both parties have sent a letter to FHFA Acting Director Edward DeMarco, asking that he change the compensation policies at both enterprises. “The idea that Fannie Mae and Freddie Mac, which rely on taxpayer funding to stay afloat, must offer excessive bonuses to its executives to attract effective management strains credulity,” wrote the senators.
- In a November 10 letter, DeMarco responded to the senators saying that the management who were running the enterprises before the financial crisis left the GSEs without any golden parachutes. Today, Fannie Mae and Freddie Mac need effective management to ensure that taxpayers’ losses are minimized and the enterprises continue to function, wrote DeMarco. Moreover, executive pay at the GSEs is about 40% less than before the enterprises received bailouts, he added.
- “As Conservator, I need to ensure that the companies have people with the skills needed to manage the credit and interest rate risks of \$5 trillion worth of mortgage assets and \$1 trillion of annual new business that the American taxpayer is supporting,” said DeMarco in testimony before the House Committee on Oversight and Government Reform on November 16. “I have concluded that it would be irresponsible of me to risk this enormous contingent taxpayer liability with a rapid turnover of management and staff, replaced with people lacking the institutional, technical, operational, and risk management knowledge requisite to the running of corporations with thousands of employees and more than \$2 trillion in financial

obligations each. That conclusion is further buttressed by the realization that, from an Enterprise executive's or staff's point of view, continued employment at an Enterprise risks substantial job and career uncertainty. The public scrutiny and criticism is often harsh, and almost everyone expects the Enterprises to cease to exist, at least in their current form, in the future. At the same time, the taxpayer is backing Enterprise financial commitments that have 30-year lives, and we will need expert management of those guarantees for years to come. Given the amount of money at risk here, small mistakes can easily be amplified to losses far greater than the compensation paid to Enterprise executives.”

- “In short, as Congress considers executive compensation at the Enterprises, the basic fact is that despite the large amounts of government support provided to the Enterprises they remain private companies with uncertain futures, not government agencies. They employ thousands of people. We cannot maintain operational effectiveness while suddenly treating them as ongoing government agencies – something they are not. Major changes to compensation, for executives or staff, cannot be done safely and soundly in a short period of time and attempting to do so would pose substantial risk to the mortgage market and a greater risk of loss to taxpayers.”
- “We need to compensate our executives and employees to ensure that we have and keep the leadership we need to continue our progress,” testified Fannie Mae CEO Michael Williams.
- Freddie Mac CEO Ed Haldeman, who recently announced he will be leaving the company next year, provided the lawmakers a blunt assesment of his concerns about the GSEs’ executive pay. “I understand the outrage,” said Haldeman.. “We had a \$900 billion investment portfolio when I started. We’ve reduced that down to roughly \$688 billion. What I worry about is that if one person makes a 1% mistake that costs the taxpayers \$6.8 billion. The people required to effectively manage that portfolio and not make mistakes are highly skilled, highly seasoned, who can take other higher paying jobs and we need those people at Freddie Mac. That’s the dilemma.” He added that five of his senior vice presidents left Freddie Mac during the past three years to higher paying jobs at other financial institutions. “These are challenging jobs and challenging circumstances, and we need people to do these jobs,” said Williams. (*CNNMoney*, Chris Isidore, 11/15/11; *HousingWire*, Jon Prior, 11/16/11; *Correspondence to Senators*, Edward J. DeMarco, 11/10/11; *Prepared Remarks before the House Committee on Oversight and Government Reform*, 11/16/11; *Reuters*, Margaret Chadbourn, 11/16/11)

“Close to 50%” chance that FHA will require taxpayer bailout in 2012, according to the independent audit of the insurance fund’s finances

“Weathering the Storm”

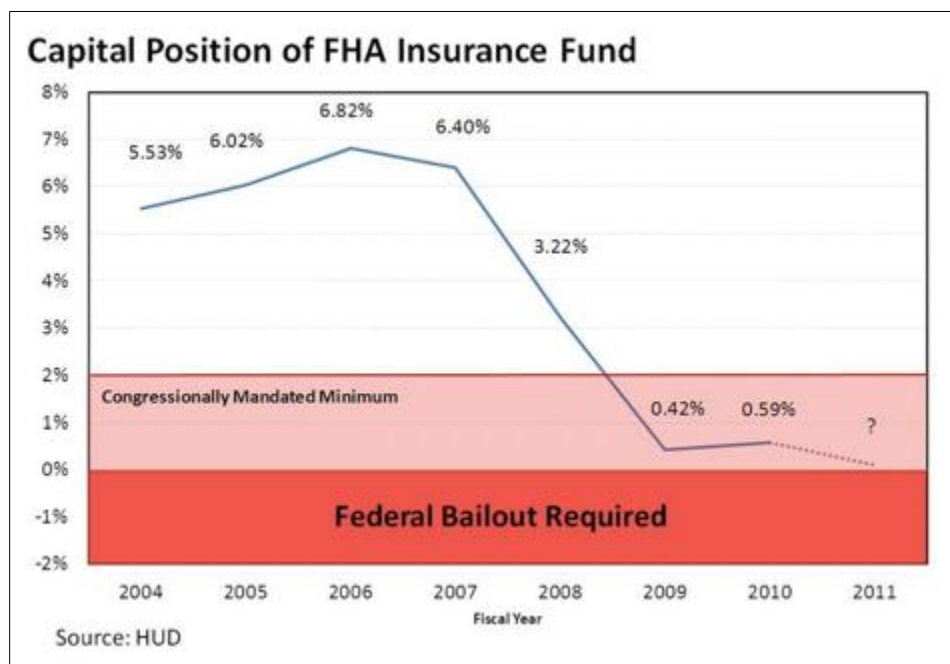
Declining home values make future FHA losses inevitable

Congress votes to extend FHA loan limit hike

Housing hypocrisy

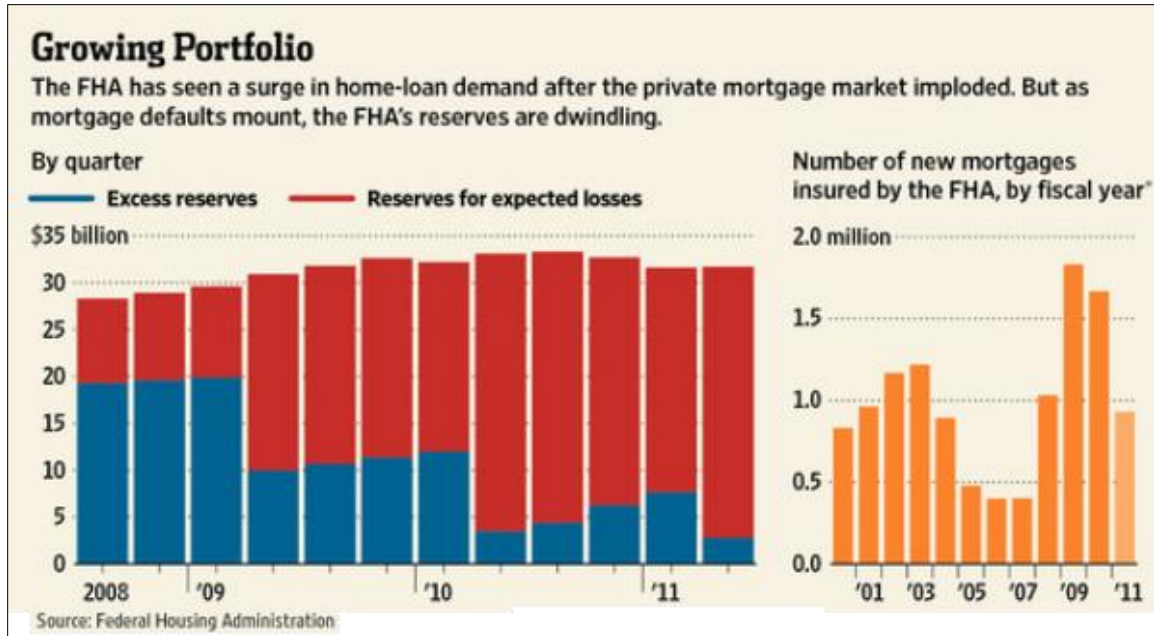
“Close to 50%” chance that FHA will require taxpayer bailout in 2012, according to the independent audit of the insurance fund’s finances

- FHA’s cash reserves have fallen so low that there is “close to a 50%” chance that the insurance fund will run out of cash and require a taxpayer bailout, concluded Integrated Financial Engineering Inc. in an audit and forecast of the insurance fund. The audit estimated that the value of FHA’s reserves totalled \$2.6 billion on September 30, down 45% from the year ago period (\$4.7 billion). FHA’s reserves represents only 0.24% of the \$1.1 trillion of insured mortgages—less than half the reserve level in 2010 (0.5%). FHA’s insurance fund breached its statutory 2.0% reserve level two years ago. The fall in FHA’s reserves reflects the impact of rising home defaults amid falling home prices, which have generated greater losses on the sale of foreclosed homes.



- Under a more pessimistic scenario assuming a 9% drop in home prices in FY2012, the auditor projects that FHA would require a \$13 billion bailout from Treasury. Price declines of 16% and 20% would require estimated infusions of \$29 and \$43 billion,

respectively for FHA, according to IFE’s audit. Since FHA has “permanent and indefinite” budget authority, the agency would simply obtain funding from Treasury, rather than seek appropriations from Congress.



- The FHA’s level of mortgage delinquences is particularly troubling with 17.02% of its insured portfolio in some stage of delinquency and 9.05% seriously delinquent at the end of October. Moreover, more than 30% of the 282,000 loan modifications completed by FHA in 2010 redefaulted within a year, according to a NewOak Capital study. (*Wall Street Journal*, Nick Timiraos, 11/11/11; *HousingWire*, Jon Prior, 11/18/11; *FHA Total Delinquency Tops 17%*, Edward Pinto, 12/01/11; *Wall Street Journal*, Nick Timiraos, 11/15/11; *HousingWire*, Jon Prior, 11/18/11)

### “Weathering the Storm”

- “...I am happy to say that even though FHA has come through the most severe economic crisis since it was created in 1934, the capital balance of the MMI Fund remains in positive territory and its programs are actuarially sound,” wrote [Acting FHA Director] Carol Galante in a November 15 blog post. “This is no accident. Thanks to the significant number of new risk management policies that the Obama Administration has put in place, as well as premium rate increases enacted over the past few years, we are creating a strong foundation for the recovery of FHA’s capital position as the economy begins to grow again.”

- “As of the end of fiscal year 2011, FHA’s total capital resources stand at \$33.7 billion. This is \$400 million more than a year ago. For new endorsements during this last year alone, the actuaries’ project a profit of nearly \$11 billion. This is nearly double the \$5.7 billion in net receipts projected for that book just one year ago.”
- “These results are the direct result of a three-part strategy: (i) systematic tightening of risk controls; (ii) increased premiums to stabilize near-term finances; and (iii) expanded our use of loss mitigation workout assistance to avoid unnecessary claims.”
- “FHA will continue its historic mission, launched more than 77 years ago, to provide access to mortgage credit to low to moderate income borrowers while acting as a stabilizing force in the nation’s housing finance market. And we will remain vigilant in identifying and managing risks to the MMI Fund to ensure that FHA will continue to play its important role in our nation’s housing market.” (*The HUDudle—U.S. Department of Housing and Urban Development’s Official Blog*, Carol Galante, 11/15/11)

#### Declining home values make future FHA losses inevitable

- “Proponents of FHA argue that even though the insurance fund’s reserves have dropped to a slim 0.24 percent, the reserves are more than adequate to protect the program from future losses,” according to the November 30 issue of *IMF news*. “Critics counter that FHA has a statutory requirement to maintain a 2.0 percent reserve and if the agency were a private MI it would have been closed down by state regulators. Privately, mortgage industry observers acknowledge it may be hard to limit future losses when most of the FHA mortgages made over the past two years have already slipped underwater due to declining home values.” (*IMF news*, 11/30/11)
- “FHA’s present state is precarious,” wrote AEI resident fellow Joseph Gyourko. “The riskiness of [FHA’s] mortgage insurance pool has grown, not declined, since 2007 and is evident from FHA’s expansion during a time of declining nominal house prices and raising unemployment. . . . This combination of leverage at the entity level (i.e., FHA having far less capital per dollar of insurance it guarantees) and among the homeowners being insured (many with negative equity in their homes) has made FHA a very risky proposition for taxpayers, who bear the downside risk if its expansion strategy does not work out. Gyourko concludes that FHA’s main insurance program is “materially undercapitalized” and will require a capital infusion ranging from “\$50 billion to \$100 billion, even if there is no unexpected deterioration in housing markets.” (*Is FHA the next housing bailout?*, Joseph Gyourko, 11/11/11; AEI Working Paper #2011-06, Joseph Gyourko, 11/11/1) 1
- “If the FHA were a private entity, these revelations would alarm investors exposed to the risk and force management to adjust,” wrote the *Wall Street Journal* in a November 28 editorial. “But the FHA is a bureaucracy, so its instinct is the opposite.

In a blog post titled *The Continued Strength of the FHA* [<http://tinyurl.com/d3qqvpk>], Assistant Secretary for Research and Policy Development Raphael Bostic dismisses Mr. Gyourko's 'outrageous claims' and says the FHA's books are 'sound.' His arguments are worth mulling for what they reveal about what passes for FHA thinking.”

- “Mr. Bostic focuses on the FHA's expansion and recent reforms. Although the agency expects ‘record’ payouts next year as borrowers default, it forecasts \$9 billion of new business over the same period. FHA credit scores have improved markedly: At the end of 2007, 47% of borrowers had a credit score of less than 620, but today that figure is 3.5% and the average credit score tops 700. The Obama Administration has increased FHA premiums three times, made ‘reforms to credit policy, risk management, lender enforcement, and consumer protections,’ and ‘total liquid assets are at their highest point ever,’ Mr. Bostic notes.”
- “In other words, the FHA wants to grow its way out of its problems by shedding subprime borrowers and expanding into prime loans, an area historically served by private insurers. Mr. Bostic makes this argument explicit, arguing that the FHA's market dominance—the agency now backs nearly one-third of all new single-family mortgages—is ‘essential’ to a housing-market recovery, adding: ‘Providing access to credit for homebuyers of all income ranges and in all communities, and stabilizing our housing market, has been FHA's mission for nearly eight decades.’”
- “And here we thought its mission was to make housing affordable for lower-income earners. But if the FHA now wants to dominate America's housing market with taxpayer monies, that's even more reason to examine the risks, not ignore them.”
- “Mr. Gyourko made that clear ...that any financial analysis has to look at ‘the entire balance sheet,’ including liabilities. He adds that the FHA's past models “substantially underpredicted default risk, ‘worries about the solvency of FHA borrowers with less than a 5% down payment’ in an economic environment of flat to declining house prices and persistently high unemployment,’ and wonders how many borrowers used the Obama Administration's first-time homeowner tax credit for their down payment.”
- “Far from making ‘spurious’ claims, Mr. Gyourko is doing a public service by chronicling the FHA's reckless expansion at a time when the housing market needs less government intervention, not more of it. The fury of the FHA's response shows that he's onto something.” (*Wall Street Journal*, 11/28/11)

#### Congress votes to extend FHA loan limit hike

- In a minibus spending bill (H.R. 2112), the House and Senate reinstalled the elevated loan limits for FHA through 2013, while allowing the higher loan limits to

revert to \$625,500 from \$729,750 for Fannie Mae and Freddie Mac in high cost housing areas.

- Acting FHA Commissioner Carole Galante said that jumbo loans account for only 5% to 6% of the FHA portfolio and that reinstalling these limits wouldn't necessarily be negative since these loans are usually from higher-credit borrowers. However, the consequence of extending the limits for FHA—but not for Fannie and Freddie—is simply unknown, she added. “It’s hard for us to make any prediction for how much of that business would come to the FHA without finding any other sort of funding alternatives.”
- “Raising the loan limits at FHA only, an unprecedented move, will simply drive more business into Ginnie Mae securities and put the FHA at even greater risk of losses to taxpayers,” said Senator Bob Corker (R-TN).
- “You are combining the extra risk of a higher loan balance with extra leverage [with minimum 3% down payment] that a borrower can obtain,” said Clifford Rossi, professor at the University of Maryland’s Center for Financial Policy. “It will now be even more difficult for the private sector to compete.” (*Bureau of National Affairs*, Mike Ferullo, 11/21/11; *HousingWire*, Jon Prior, 11/15/11)

### Housing hypocrisy

- “Before the housing market meltdown, the Federal Housing Administration was a pokey little agency with a limited mission — insuring mortgages with low down payments for a limited segment of humble but relatively creditworthy home buyers,” wrote the *Washington Post* in a November 20 editorial. “The idea was to encourage homeownership by directing capital to a low-income market segment that could not attract it otherwise. Since the crisis, Congress and the last two administrations have used the FHA to prop up housing more broadly, so much so that the agency’s portfolio exceeds \$1 trillion and it backs about one of every three purchases of new homes.”
- “Expanding the FHA poses long-term dangers. The agency’s latest independent audit reports it has only \$2.6 billion in cash reserves, creating a near-50 percent chance that it will need a bailout if housing prices plunge again next year.”
- “Now is the time to begin unwinding the FHA’s role in the market and ‘crowd in’ private capital. The administration’s white paper on housing finance reform last February backed such a strategy, including a return of the FHA ‘to its pre-crisis role.’ The first step would be legislation that permitted the FHA to insure loans on houses costing up to \$729,750 to lapse Oct. 1 as scheduled. Ditto for the temporary hike in the maximum loan eligible for securitization by Fannie Mae and Freddie Mac, which Congress also set at \$729,750.”

- “So why did Congress pass a law that extends the higher FHA loan limits, and why did President Obama sign it Friday morning? Well, there’s real estate, and people who sell it, in every congressional district. The real estate lobby, and its supporters in both parties on Capitol Hill, tucked this profoundly unwise measure into a must-pass appropriations bill that included funds to keep the government running through Dec. 16. Administration officials protested, but given the bill’s importance, Mr. Obama did not go to the mat.”
- “Congress did allow the Fannie Mae-Freddie Mac loan limit to revert to \$625,500, probably because it would have looked bad to extend it amid all the publicity lately over the entities’ seven-figure executive bonuses. But this is not the concession it may seem. By combining a higher FHA limit with a lower Fannie and Freddie limit, Congress has distorted the market in a new and troubling way. For the first time, the FHA can actually back more expensive loans than Fannie and Freddie can. Those loans will also be riskier than they would have been if done by Fannie and Freddie, since the FHA’s underwriting standards — such as a 3.5 percent minimum down payment — are looser.”
- “‘Hypocrisy,’ says Sen. Bob Corker (R-TN), who has filed legislation to phase out much of the government’s housing finance role. But that strikes us as a mild description of what’s happening. Congress has turned an agency that used to offer lower-income Americans a helping hand into a subsidy machine for expensive home sales.”
- “This step was not only upside down in terms of distributive justice. It was probably unnecessary, because ultra-low interest rates were slowly drawing creditworthy buyers, and private capital, back into the upper end of the market, according to Guy Cecala, chief executive and publisher of *Inside Mortgage Finance*. In short, private capital will be crowded out, not in. If Congress can’t wean housing off subsidies now, can it ever?” (*Washington Post*, 11/20/11)

Representative Barney Frank announces he will not run for re-election

Fallout from Dodd-Frank’s failures

Representative Waters vies for top leadership role on House Financial Services Committee

### Representative Barney Frank announces he will not run for re-election

- Representative Barney Frank (D-MA) announced he will not seek re-election next year after a 32-year career in Congress. The 16-term congressman first took office in Massachusetts’ fourth district in 1980. From 2007 to 2011, Frank served as chairman of the House Financial Services committee, where he spearheaded the landmark

Dodd-Frank financial regulation legislation. Frank, 71, said he decided against running next year because his district was going to be reshaped to include some more conservative towns. "I don't want to be torn [between] a full-fledged campaign... and my obligation to my current constituents," said Frank.

- "...[T]here is more to Frank's [retirement] than meets the eye and behind that decision some insights into public opinion and the state of regulation three years after the bubble burst," wrote the *New York Post's* Terry Keenan. "For all his liberal-leaning bluster, Frank is, if anything, a highly intelligent man. With several dozen IQ points on most of his Congressional colleagues, he is surely smart enough to know that he would likely lose next November, probably even without the voter re-shuffling in his Boston-area district."
- "The question is, why? Although the pin-stripe and green-room set have long loathed Frank, as the most vocal advocate for financial reform and a supposed champion of the 99 percent, Frank has been popular in Massachusetts. Now he can't even keep a seat in the most liberal state in the union, a seat he has held for 30 years. The answer as to why not lies in the landmark piece of legislation that bears his name — the Dodd-Frank Wall Street Reform and Consumer Protection Act — by most measures it has been a spectacular failure, and voters sense this."
- "They sense that although implementing Dodd-Frank has meant billions of spent taxpayer dollars and thousands of new government employees, it doesn't have teeth where it should have them, and is too meddlesome in areas where it shouldn't be. For one, Americans wonder why the Wall Street ratings agencies who aided and abetted the financial meltdown are still getting their fees from the companies they rate. A conflict of interest so glaring that one would think a 3,000 page 'reform' law should have addressed it."
- "Voters also see the wild daily swings on Wall Street, more wild than they were before the crisis, and they wonder why Dodd-Frank does nothing to curtail the high-frequency trading that now dominates the markets. Restoring the up-tick rule would be a quick fix for that."
- "Then this fall, they are treated to watching Frank's fellow-Democrat Jon Corzine run his MF Global trading operation into the ground with the greatest of ease, as if 2008 never happened. The curbs on proprietary trading, i.e. playing with the house's money, that Dodd-Frank was supposed to enforce did nothing to prevent MF's colossal flame-out. So what good are those rules anyway? What gives?"
- "Then there are Fannie Mae and Freddie Mac, piggy banks to the political class (especially Democrats) and ground zero of the housing bubble. Americans haven't forgotten what went on at these government-sponsored enterprises. They want answers."

- Perhaps a Frank-free Congress emboldened by a big class of freshman members will finally bring forth a true investigation into these twin enablers of the housing mess. After surviving a prostitution scandal and Newt Gingrich’s Republican Revolution in 1994, Barney Frank couldn’t survive fallout from the financial reform act he created, or the perception that the bill wasn’t fair, nor was it balanced.”
- “The financial industry bears a lot of the blame for the economic mess we are in, but so too does Washington. Let’s hope that Frank’s departure will usher in a new group of lawmakers who will regulate what needs to be regulated and let the free markets do the rest of the work.” (*New York Post’s* Terry Keenan, 12/04/11)



### Fallout from Dodd-Frank’s failures

- “[T]here is more to Frank’s [retirement] than meets the eye and behind that decision some insights into public opinion and the state of regulation three years after the bubble burst,” wrote the *New York Post’s* Terry Keenan. “For all his liberal-leaning bluster, Frank is, if anything, a highly intelligent man. With several dozen IQ points on most of his Congressional colleagues, he is surely smart enough to know that he would likely lose next November, probably even without the voter re-shuffling in his Boston-area district.”
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seat in the most liberal state in the union, a seat he has held for 30 years. The answer as to why not lies in the landmark piece of legislation that bears his name — the Dodd-Frank Wall Street Reform and Consumer Protection Act — by most measures it has been a spectacular failure, and voters sense this.”

- “They sense that although implementing Dodd-Frank has meant billions of spent taxpayer dollars and thousands of new government employees, it doesn’t have teeth where it should have them, and is too meddlesome in areas where it shouldn’t be. For one, Americans wonder why the Wall Street ratings agencies who aided and abetted the financial meltdown are still getting their fees from the companies they rate. A conflict of interest so glaring that one would think a 3,000 page ‘reform’ law should have addressed it.”
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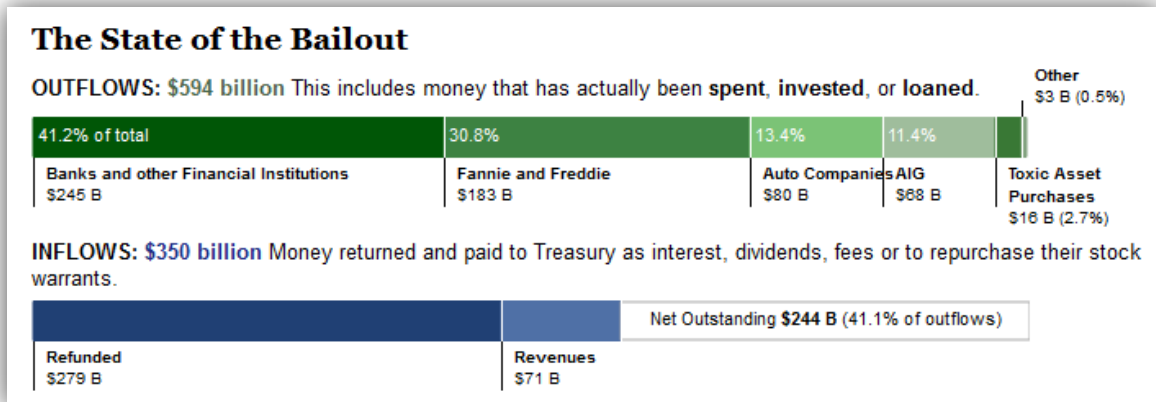
#### Representative Waters vies for top leadership role on House Financial Services Committee

- Representative Maxine Waters (D-CA), an outspoken liberal from California, appears to be the front runner to serve as the most senior Democratic member of the House

Financial Services Committee, given her seniority on the panel and her close ties to Minority Leader Nancy Pelosi (D-CA). “Number one, she’s the most senior,” said former Representative John LaFalce (D-NY), who previously served as the lead Democrat on the panel. “Number two, she is a minority, and I think it would be very difficult not to appoint somebody who is both senior and a minority.”

- Waters wasted no time throwing her hat in the ring for the Committee leadership, saying: “As the next most senior member of the committee, the current ranking member on the Capital Markets subcommittee and former chair of the Housing and Community Opportunity subcommittee, I hope to use my experience to continue and expand [Representative Frank’s] work in the Committee. I will continue to champion practical regulations, while making sure they work for consumers and the financial sector, a sector which has the right to be profitable, but the obligation to be fair, two concepts that are not mutually exclusive.”
- Waters is not a shoo-in, however, largely because of an ongoing ethics investigation into her role in arranging a meeting between executives at the minority-owned OneUnited Bank [with which Waters’ husband had financial ties] and Treasury officials. The agency subsequently gave OneUnited \$12 million in TARP funds. [According to the Special Inspector for TARP, OneUnited has missed 11 non-cumulative dividend payments to Treasury.] If she is not named to the leadership role, other contenders might include Representatives Carolyn Maloney (D-NY), Luis Gutierrez (D-IL) and Melvin Watt (D-NC). (*American Banker*, Kevin Wack, 11/29/11; *National Journal*, Shane Goldmacher, 11/28/11; *Quarterly Report to Congress*, Special Inspector for TARP, 10/27/11)

## TARP



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

## AIG reports \$4.1 billion loss in the third quarter

Former AIG CEO, Maurice Greenberg, sues Treasury and the New York Fed over improper takeover of the insurer

### AIG reports \$4.1 billion loss for the third quarter

- AIG posted a \$4.1 billion loss in the third quarter, reflecting weak performance across all of its operating segments as a result of the unfavorable macroeconomic environment and natural disasters. “AIG continues to navigate a challenging global economic environment, and our results for the quarter were adversely affected by equity market declines, widening credit spreads, and declining interest rates, as well as property catastrophe losses,” said Robert H. Benmosche, AIG president and CEO. “We also took significant impairments at ILFC, reflecting management’s decision on certain aircraft that would be disposed of prior to the end of their previously estimated life in light of technological developments in the aircraft industry, fleet management announcements by certain airlines, and our newly acquired part-out company.”
- In November, AIG repaid \$972 million of bailout funds provided by the U.S. Treasury, marking the sixth major payment to the government in 2011. AIG funded the payment from funds held in escrow from the sale of its former life insurance subsidiary, American Life Insurance Company, to MetLife Inc. AIG owes \$50 billion of the \$182 billion of bailout funds provided by Treasury. “We continue to make steady progress toward our goal of America’s taxpayer recouping their entire investment in AIG,” said Benmosche. “I am confident that AIG’s employees will continue to work hard so we can achieve this goal.” (*HousingWire*, Kerri Panchuk, 11/01/11; *AIG Press Release*, 11/03/11)



### Former AIG CEO, Maurice Greenberg, sues Treasury and the New York Fed over improper takeover of the insurer

- Maurice Greenberg, former president and CEO of AIG, has sued the U.S. Treasury Department and Federal Reserve Bank of New York, over the bailout and takeover of the insurer. Greenberg’s lawsuit against the Treasury contends that the federal government’s takeover of AIG discriminated against the company and its shareholders by charging onerous interest rates on loans extended by the agency (initially 14.5%) and by taking an 80% interest in the firm over the shareholders’ objections. The filing points to terms of the government’s assistance to Citigroup, which was extended at the same time, to illustrate the punitive nature of the bailout, according to the lawsuit. “The government is not empowered to trample shareholder and property rights even in the midst of a financial emergency,” said the filing. The lawsuit against the New York Fed claims that the Fed breached its duty to AIG

shareholders by requiring the insurer to release its trading partners from any possible legal actions related to the mortgage-backed securities that it had agreed to insure. The lawsuits seek at least \$25 billion in damages, representing the value of Greenberg's stock before AIG's bailout by the federal government.

- “What these lawsuits say is that in our country, not even the government is above the law,” said David Boies, Greenberg’s legal counsel with Boies, Schiller & Flexner. “When the government takes action, although it has enormous power, there are legal limits to what they can do. One of those limits is that they cannot take private property even for a good purpose if they do it in violation of legal protection or don’t give just compensation.”
- The lawsuit is meritless, said New York Fed spokesman Tim Massad. AIG’s alternative to a government bailout was bankruptcy, rendering their stock worthless, he added. “The Federal Reserve’s actions with regard to AIG helped restore the financial stability of the United States during a period of intense volatility and vulnerability in the U.S. economy,” said Massad. (*BusinessWeek*, David Voreacos, 12/01/11; *New York Times*, Gretchen Morgenson, 11/21/11)

Treasury boosts its estimate of auto bailout losses to \$23.6 billion, bringing its total TARP loss estimate to \$57.33 billion

Representative Turner asks the House Oversight Committee to investigate the Treasury Secretary’s conflicts of interest in the GM bankruptcy

Chevy Volt fires trigger safety investigation by the NHTSA, as GM offers to buy back the vehicles

Volt tops *Consumer Reports*’ customer satisfaction survey

A reality check on EVs

Michigan governor takes first step toward possible state takeover of Detroit

Treasury boosts its estimate of auto bailout losses to \$23.6 billion, bringing its total TARP loss estimate to \$57.33 billion

- In its monthly report to Congress, Treasury increased its estimated losses for the GM bailout by \$9.27 billion to \$23.6 billion, largely due to the sharp decline in GM shares, which closed at \$20.18 a share on September 30 [down 39% from its \$33.00 IPO price in November last year]. Treasury now pegs the cost of the bailout of GM, Chrysler Group LLC and the auto finance companies at \$79.6 billion, but no longer includes \$5 billion it set aside to guarantee payments to auto suppliers in 2009.

- Treasury now expects to lose \$57.33 billion on TARP, which includes the full cost of the housing program, up from the agency's earlier estimate of \$36.7 billion. (*Detroit News*, David Shepardson, 11/14/11; *Wall Street Journal*, Sharon Terlep, Aaron Lucchetti, and Randall Smith, 11/18/11)

Representative Turner asks the House Oversight Committee to investigate the Treasury Secretary's conflicts of interest in the GM bankruptcy

- Representative Michael Turner (R-OH) has asked House Oversight Committee chairman Rep. Darrell Issa (R-CA) to investigate Treasury Secretary Timothy Geithner's "conflicts of interest" during and after the government bailout of General Motors. In a letter to Issa, Turner alleges there was a conflict of interest with Geithner serving as Treasury Secretary, co-chair of President Barack Obama's Auto Task Force and a board member of the Pension Benefit Guaranty Corporation.
- Turner argues that Geithner's triple role in the bailout process likely caused the 20,000 non-union workers from Delphi to lose their pensions, while union pensions were mostly made whole. "In fact, the GAO similarly recognized the multiple roles of the Department of the Treasury at the [House Oversight] Committee's field hearing in Dayton, Ohio on November 14, 2011," Turner wrote to Issa. "This is an important question that deserves a detailed and unbiased investigation," Turner wrote. "Local leadership of the Delphi Salaried Retirees in my district estimate that nearly 20,000 current and future retirees across the nation and 1,000 retirees in the Dayton area were negatively affected by the decisions of the Treasury, Auto Task Force, and the PBGC."
- In March, Turner told *The Daily Caller* that the Delphi workers' loss of their pensions—likely because they weren't union workers—was a "terrible injustice." He added, "This is a political decision, not a legal or financial decision. There were people who were penalized and people were chosen as winners and losers. The White House, the administration and the Auto Task Force decided who were going to receive their pensions and who were not." (*The Daily Caller*, Matthew Boyle, 12/02/11)

Chevy Volt fires trigger safety investigation by the NHTSA, as GM offers to buy back the vehicles

- GM will buy Chevrolet Volts back from any owner who is afraid the electric cars will catch fire, said Dan Akerson, the company's CEO. While insisting the electric vehicle is safe, Akerson said his company will purchase the Volts because it wants to keep customers happy. If necessary, GM will recall the more than 6,000 Volts that have been sold to repair the vehicles, once federal safety regulators have determined the cause of the fires. "I think in the interest of General Motors, the industry, the electrification of the car, it's best to get it right now than when you have—instead of

6,000 - 60,000 or 600,000 cars on the road,” said Akerson. The auto maker has also offered customers loaner cars, while the National Highway Safety Administration investigates fire hazards related to the Volt’s battery.



- Three fires have occurred in Volts—seven days to three weeks after side-impact crash tests were conducted by the NHTSA—which triggered an investigation of the causes of the fire. GM claims that there are no threats of fires immediately after crashes and that no “real world” crashes involving Volts have resulted in fires. GM has contended that the NHTSA didn’t store the crashed Volts properly. (*USA Today*, 12/02/11)

#### Volt tops *Consumer Reports*’ customer satisfaction survey

- GM’s Chevrolet Volt topped the rankings in the latest *Consumer Reports* customer satisfaction survey with 93% of the owners surveyed, saying that they would “definitely” buy the car again. However, *Consumer Reports* cautioned that, at the time the survey was conducted, the Volt was on sale in only a few states and only a few thousand customers had been purchased the vehicle. “[I]t remains to be seen if the score will hold up as the car rolls out to a wider audience and owners spend more time with their vehicles,” said *Consumer Reports*. (*CNN Money*, Peter Valdes-Dapena, 12/01/11)

#### A reality check on EVs

- “Electric and hybrid-electric vehicles are more expensive to make and bring in less profit than other cars,” wrote AEI resident scholar Kenneth Green. “They cost more to finance, more to repair, and more to insure. Their sales depend heavily on tax incentives, which means that selling more of them will require more taxpayer dollars. The National Renewable Energy Laboratory (NREL) estimates that plug-in hybrid

vehicles cost \$3,000 to \$7,000 more than regular hybrids, even though the performance differences between the two models are slight, and the really fuel-efficient hybrids cost \$12,000 to \$18,000 more than the conventional brand. Consider the GM Volt. When it was first announced, the price estimate from General Motors(GM) was \$30,000. That soon jumped to \$35,000. Today, they sell for nearly \$40,000.”

- “Hybrids are also more expensive to insure, which has been known for some time. Back in 2008, online insurance broker Insure.com showed that it cost \$1,374 to insure a Honda Civic but \$1,427 to insure a Honda Civic Hybrid. Similarly, it cost \$1,304 to insure a Toyota Camry but \$1,628 to insure a Toyota Camry Hybrid. According to State Farm, hybrids cost more to insure because their parts are more expensive and repairing them requires specialized labor, thus boosting the after-accident payout. And that, of course, presumes they don’t burst into flames, which brings us to today’s not-so-‘ideal’ headlines.” (*Real Clear Politics*, Kenneth Green, 11/30/11)
- The United States already had a huge excess in electric vehicle battery production capacity—*before* the question of EV battery safety was raised by the National Highway Safety Administration. In July 2010, Menahen Andernan, founder and CEO of Total Battery Consulting, said that the global capacity for EV batteries would be three times greater than demand by 2014. That day apparently has already arrived.
- A123 Systems, one of the country’s highest profile battery manufacturers for EV batteries, cut 35% of its workforce at two Michigan plants in November after receiving a big reduction in orders from Fisker Automotive. A123 Systems has reported \$412.3 million of losses since its inception at the start of 2009, while its stock price has plummeted 83% from its September 23, 2009 IPO price of \$13.50 to \$2.27 a share on December 2. Ener1, parent company for battery maker EnerDel, announced in August a restatement of its FY2010 losses from \$69 million to \$165 million. The company’s top executives have resigned and the company’s stock has fallen from a 52-week high of \$5.90 a share to \$.10 a share (last trade on December 2). A123 and Ener1 were two of several dozen companies that received federal subsidies from the Obama administration, which has handed out \$2.4 billion in grants and nearly \$2.6 billion in loans to the EV sector.
- Even if the automakers can resolve the problems with the batteries, the remaining big hurdle is lackluster demand. GM had projected sales of 16,000 Volts in 2011, but has only sold 6,000 units to date. Some ask: Why would a car buyer choose a Volt, which gets 40 miles per gallon on the highway and costs \$41,000, when he can get a Chevy Cruze, which is nearly identical in size, gets *better* gas mileage and **costs less than half as much?** [Emphasis supplied.]
- In 2009, Johan de Nysschen, president of Audi America, predicted the Volt’s future: “No one is going to pay a \$15,000 premium for a car that competes with a Corolla. ... There are not enough idiots who will buy it.” (*National Review Online*, Robert Bryce, 12/01/11; *Ann Arbor.com*, Nathan Bomey, 12/02/11; *Forbes*, Kai Petainen,

12/02/11; *Wall Street Journal*, Sharon Terlep, 11/29/11; *New York Times*, Bill Vlasic, 11/28/11) )

### Michigan governor takes first step toward possible state takeover of Detroit

- Michigan Governor Rick Snyder (R) is expected to ask for a preliminary review of Detroit's finances, a move that city council members suggest is tantamount to a setback for racial equality. "[We don't want] someone who feels they have to control the plantation," said Councilman Kwame Kenyatta, who fears a state-run financial review would lead to an emergency manager being appointed by the governor to take over city operations. "We can agree to disagree, but we have to decide what our destiny is going to be." At a December 1<sup>st</sup> press conference, Detroit Mayor Dave Bing and City Council members, along with labor, religious and business leaders, announced their vigorous opposition to the state's preliminary review.
- Organizers behind a petition drive to repeal Michigan's emergency manager law have launched an all-out blitz for signatures. Opponents of Public Act Four contend that the legislation violates the Michigan and U.S. Constitutions by removing local elected officials from power and is being used disproportionately to disenfranchise African American voters. "Here in the city of Detroit, we're faced with the ballot, or the bullet of emergency management," said Brandon Jessup, chairman of Michigan Forward. "So we're gonna turn to the ballot."
- Representative John Conyers (D-MI), who represents Detroit, sent a letter to Attorney General Eric Holder, requesting that the Justice Department perform an immediate review of Michigan's emergency manager law. "I believe the Justice Department has ample authority to review and, if necessary, challenge this unilateral exercise of power by the State towards the City of Detroit and other jurisdictions," wrote Conyers. In his letter, Conyers also invoked the contract clause of the U.S. Constitution, which prohibits states from "impairing the obligation of contracts" and said the appointment of emergency managers "would appear to violate the Voting Rights Act." He added, "While the law itself may be racially neutral, it would seem that it is being applied in a discriminatory fashion, as the impacted jurisdictions have very high proportions of African Americans and other minorities."
- The City of Detroit's recent cash flow report suggests the city will likely to run out of cash by spring, and be \$200 million in the budget hole through June 30, 2012. (*Michigan Radio 91.9*, Sarah Cwiek, 12/02/11; *Fox News*, Jennifer Hlad, 12/02/11; *The Huffington Post*, Simone Landon, 12/02/11; *Michigan Radio 91.9*, Sarah Cwiek, 11/22/11; *Walter Russell Mead's Blog*, 12/03/11)

Ally Financial reports \$210 million loss for the third quarter

Ally refuses to participate in a settlement with the State Attorneys General over the company's foreclosure practices

Innovative Ally Buyer's Choice provides GM and Chrysler buyers a third way to finance

### Ally Financial reports \$210 million loss for the third quarter

- Ally Financial Inc. reported a net loss of \$210 million for the third quarter of 2011, after reporting six consecutive quarters of profitability. Ally's loss was largely driven by a \$471 million pre-tax loss related to the negative impact of the mortgage servicing rights (MSR) valuation, net of hedge, which resulted from falling interest rates and market volatility.
- In order to proactively address the changes in the mortgage industry, Ally is taking immediate action to reduce its focus on the correspondent mortgage channel. "The combination of MSR volatility in the quarter, reduced margins due to regulatory costs and the impending impact of Basel III has caused us to begin significantly scaling back originations in the mortgage correspondent segment," said Ally CEO Michael A. Carpenter. The company will maintain correspondent relationships with its key customers and continue participating in the consumer and broker lending channels, which are higher margin businesses. As the Bank implements these changes, Ally's exposure to MSR asset volatility will decrease over time and the company will be better positioned to comply with Basel III requirements.

### Ally refuses to participate in a settlement with the State Attorneys General over the company's foreclosure practices

- Ally CEO Michael Carpenter said his company will not sign onto a settlement with the state attorneys general regarding the foreclosure practices. "We would not settle for the kind of numbers being bandied about," said Carpenter in a conference call with investors. "Ally is prepared for court, if the final proposal does not fit the Bank's "meager" exposure Carpenter thinks the company has, he added. According to a recent version of the proposed state AGs settlement, the five largest servicers [including Ally] would pay a \$25 billion settlement with roughly \$5 billion paid out directly to borrowers, who were affected by ongoing court costs and lost paperwork. The remaining settlement funds would be used to help underwater borrowers who are current on their mortgages, according to sources at Iowa's Attorney General Office. "If we think the settlement is not in the best interest of our shareholders, **which is still the U.S. taxpayer**, then we will not participate," said Carpenter. "The downside is long-term aggravation and legal fees. But if you think we have significant exposure from a financial implication, the answer is 'no'."

- In a review of 25,000 foreclosures cases with “potential evidence of forged documents and affidavits, Ally found that each borrower reviewed had been delinquent on their mortgage payments for at least one year and in some cases two years, said Carpenter. “We deeply regret the sloppy operational practices that led to this,” said Carpenter. “But we have contractual obligations as a servicer to foreclose when we must.” Ally has corrected the mistakes that were made, he added.
- Carpenter also denounced the lawsuit recently filed by the Federal Housing Finance Agency over \$6 billion of allegedly faulty mortgage-backed securities sold to Freddie Mac between September 2005 and May 2007. He called FHFA’s lawsuit “tactical and completely without merit” and said he’s confident Ally will successfully defend their case.
- On December 2, Ally Financial announced that its mortgage unit, GMAC Mortgage, had stopped buying home loans in Massachusetts after Attorney General Martha Coakley sued Ally and four other mortgage lenders for allegedly trying to seize homes when they didn’t hold the mortgages on the properties [through valid mortgage assignments]. “The company is disappointed that it can no longer participate in offering certain financing options in Massachusetts,” said Ally. “However, it has an obligation to manage risks and deploy capital in an appropriate manner and in a way that protects the investment of the U.S. taxpayer.” Ally will continue making direct loans in the state and will honor any commitments through December 5, said Ally spokeswoman Gina Prioia. “The costs related to the mortgage business overall have increased and when additional litigation costs are added to the equation, the business case in certain channels is no longer viable,” Prioia added. (*PR Newswire*, 11/02/11; *Dow Jones Newswire*, 11/02/11; *HousingWire*, Jon Prior, 11/02/11; *Washington Post*, Dakin Campbell, 12/02/11)
- [Editor’s Note: Michael Carpenter was named Ally’s CEO November 16, 2009 after joining the board in May 2009. His previous experience includes CEO positions at Citigroup’s Global Corporate & Investment Bank, Salomon Smith Barney, Travelers Life & Annuity and Kidder Peabody . During his 35-year career, Carpenter has also held senior positions at GE Capital, General Electric and Boston Consulting Group.]



Innovative Ally Buyer’s Choice provides GM and Chrysler buyers a third way to finance

- Ally Financial plans to expand its offering of flexible Ally Buyer’s Choice product to 12 states in December, increasing the total number of states to 17 by year end with plans for further expansion of the product offering across the country in 2012.
- Under Ally Buyer’s Choice, customers enjoy the advantages of both buying and leasing for the acquisition of new 2011 and 2012 GM and Chrysler vehicles. Ally’s

new financing program allows consumers to own their vehicle through a fixed rate loan with payment terms 60 to 84 months, but have the option to sell the used auto back to Ally at the 48th month of their contract, at a pre-determined price. Ally's Buyer's Choice is ideal for consumers, who prefer to purchase a vehicle, but provides the flexibility during the ownership experience to sell the vehicle to Ally, should their needs or preferences change.

- “Ally Buyer’s Choice is a true differentiator in the market and provides great flexibility and choice for consumers,” said Tim Russi, EVP of Ally’s North American Operations. “Historically, consumers have only had two options when shopping for a new vehicle—financing or leasing. With Ally Buyer’s Choice, we’ve created a third option to help meet a variety of needs for dealers and consumers.”
- Ally Buyer’s Choice debuted in five states in November; it was expanded into 14 states on December 1 [California, Florida, Illinois, New York, Texas, Michigan, Ohio, Pennsylvania, New Jersey, North Carolina, Georgia, Missouri, Maryland and Washington]. The program will be launched in Arizona, New Mexico and Kentucky on December 12. (*Ally Financial Press Release, 12/01/11, Quarterly Report to Congress, Special Inspector General of TARP, 10/27/11*)

*Big banks get bigger, as smaller banks disappear*

FDIC-insured banks earned \$35.3 billion, up 48% from year-ago period

Federal Reserve announces a new series of stress tests for big banks and warns Bank of America to “get stronger”

S&P revises its rating criteria for banks and downgrades 15 large banks

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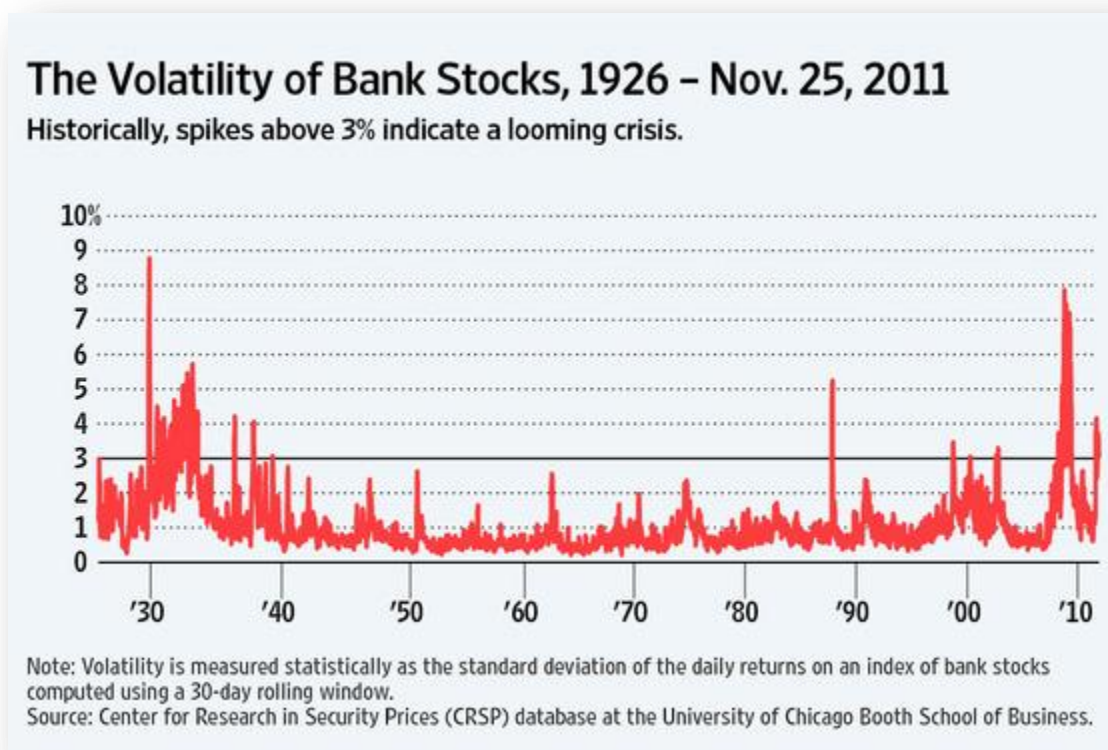
- Bank profits surged in the third quarter to \$35.3 billion, their highest level in more than four years, according to the FDIC. The banks’ profitability, up 48.6% from the year ago period, was largely attributable to lower provisions for loan losses. During the third quarter, banks set aside \$18.6 billion in loan loss reserves, approximately half that set aside during the third quarter of 2010 (\$35.1 billion). Nearly two-thirds of the banking industry reported higher profits than a year ago, while only 14.3% of the institutions reported net losses for the period.
- “Improvement in the industry’s earnings has been almost entirely dependent on reduced loan loss provisions,” said FDIC chairman Martin Gruenberg. “Future revenue growth will likely depend on increased lending.” He added, “U.S. banks have come a long way from the depths of the financial crisis. Bank balance sheets are

strong in a number of ways, and the industry is generally profitable, but the recovery is by no means complete.”

- The banks’ asset growth was concentrated in mortgage-backed securities, which increased \$54 billion [including \$23.7 billion rise in residential MBS], along with a 3.6% increase in commercial and industrial loans, totaling \$1.28 trillion. The industry’s inventory of foreclosed properties dropped for the fourth straight quarter to \$50.4 billion on September 30, down 1.5% from the prior period. The level of loans 90 days or more delinquent increased by less than 1% to \$121.4 billion, while the level of loans 30-days to 90-days delinquent declined less than 1% to \$100.2 billion. [According to the Mortgage Bankers Association, approximately 1.08% of all outstanding mortgages were in foreclosure during the third quarter, up 12 basis points from the second quarter.]
- In other positive news, the number of problem institutions on FDIC’s Watch List fell from 865 to 844 during the third quarter, while the agency’s deposit insurance fund nearly doubled to \$7.8 billion from \$3.9 billion. During the third quarter, 26 banks failed versus 41 a year ago, while 74 banks have failed year to date, compared to 127 for the same period last year. “The trend has been improving, but the current number of failures and problem institutions remains high,” cautioned Gruenberg. The FDIC chairman added that continued stress in the residential and commercial real estate markets, coupled with high unemployment, continues to pose significant risk to the credit quality of the banks’ balance sheets. Moreover, the U.S. economic outlook remains clouded “by uncertainties in the global economy and by volatility in financial markets,” he added. While U.S. banks have “relatively limited” direct exposure to the Euro sovereign debt crisis, “the key risk for U.S. institutions, as well as for the global economy, is really the potential of contagion effects if a serious financial crisis should develop in Europe,” said Gruenberg.
- Over the last 12 months, the number of banks with assets over \$1 billion rose by 10. On September 30, 518 banks in the U.S. in this asset category controlled 91% of the industry’s assets. Meanwhile, the number of banks with assets under \$100 million and between \$100 million and \$1 billion declined by 176 and 105, respectively, over the last 12 months. In aggregate, these smaller banks comprise only 9% of the industry’s assets. “[S]tatistics show that the small- and medium-sized banks are really becoming insignificant in the United States banking industry and, given the troubles that many of these banks face, will become even less significant in the future,” wrote John M. Mason. (*American Banker*, Joe Adler, 11/22/11; *Bureau of National Affairs*, Mike Ferullo, 11/23/11; *FDIC Press Release*, 11/22/11; *American Banker*, Joe Adler, 11/23/11; *HousingWire*, Jon Prior, 11/22/11; *Mase: Economics and Finance Blog*, John M. Mason, 11/28/11)

Federal Reserve announces a new series of stress tests for big banks and warns Bank of America to “get stronger”

- U.S. banks with assets of \$50 billion or more will have to submit annual capital plans for review, according to the Federal Reserve’s final rule issued November 22 that takes effect on December 30. Banks will be required to submit “robust, forward-looking” Comprehensive Capital Analysis and Reviews (CCARs), which factor in an array of risks while allowing on-going operations in the midst of a deep recession in the U.S. and significant contracts in other major economies. The Fed also outlined requirements for a special global stress test for the United States’ six largest financial institutions [Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo], which will gauge losses from “hypothetical global market shock” related to the turmoil in Europe.
- The central bank’s tough guidelines are a sign that the Fed hopes to reassure investors that the U.S. banks meet higher standards than those applied in recent stress tests in Europe. “There’s no doubt that the vigor and discipline surrounding the Fed’s testing has been a key differentiator from the European tests,” said Eugene A. Ludwig, a former top bank regulator. Share prices for U.S. banks have plunged in 2011, amid questions about their capacity to withstand a market shock and risk exposure in the home mortgages. (*Wall Street Journal*, David Reilly, 11/28/11; *Wall Street Journal*, Andrew Atkeson and William E. Simon, Jr., 11/28/11; *American Banker*, Kate Davidson, Joe Adler, and Kevin Wack, 11/23/11; *Wall Street Journal*, David Reilly, 11/23/11; *Wall Street Journal*, Dan Fitzpatrick and Victoria McGrane, 11/23/11; *Bureau of National Affairs*, R. Christian Bruce, 11/23/11)



- Banking regulators have told Bank of America’s board of directors that the Bank could face a public enforcement action if they are not satisfied with steps the board has taken to comply with its May 2009 memorandum of understanding. According to sources, the MOU identified governance, risk and liquidity management as problems Bank of America had to resolve. “[T]he board’s view is it’s time to take us out of the penalty box,” said one person familiar with matter. Lifting the MOU has been a major priority of CEO Brian Moynihan, said sources. The regulators recent communication “put the board on the ground,” said one observer. “The Fed does not believe that Bank of America has done all of the work, [while BofA officials believe] they have done all the work and the Fed keeps moving the goal line on them,” said one person familiar with the discussions. Bank of America shares have fallen more than 55% in 2011, the largest decline among U.S. banks. (*Wall Street Journal*, Dan Fitzpatrick, 11/22/11)
- The issue of “too big to fail” has raised its ugly head in the marketplace—specifically in costs of insuring against default. To the dismay of U.S. bankers, some of the largest institutions—such as JP Morgan, Goldman Sachs, and Bank of America— are finding that their CDO costs are higher than the cost of large big French banks. Apparently, investors believe that there is little chance that the French government would allow its largest banks to fail, but the markets no longer believe in the TBTF club. Today’s political environment is viewed to be more hostile to bailouts, thanks to the Tea Party and Occupy Wall Street movements. Moreover, the Dodd Frank Act makes it more difficult to inject capital into struggling firms. (*Wall Street Journal*, David Reilly, 12/02/11)

S&P revises its rating criteria for banks and downgrades 15 large banks

- Standard & Poor’s reviewed its ratings of 37 of the largest financial institutions in the world and applied new ratings criteria. As expected, most—but not all—of S&P’s rating changes involved a one-notch downgrade of long-term ratings. In their review of U.S. banks, JP Morgan retained its stable outlook, while the other four banks received a Negative outlook, but none were left on Watch Negative. S&P’s ratings signal that no further downgrades are expected anytime soon, although they could eventually occur.

Standard & Poor’s long term ratings of major US banks (T2) indicates corresponding Tier-2 short term rating – all others Tier-1					Moody’s long term ratings of major US banks (T2) indicates corresponding Tier-2 short term rating – all others Tier-1				
Ticker	Hold-Co	Bank	Broker-Dealer	Outlook	Ticker	Hold-Co	Bank	Broker-Dealer	Outlook
BAC	A-(T2)	A	A	(NEG)	BAC	Baa1(T2)	A2	Baa1(T2)	(NEG)
C	A-(T2)	A	A	(NEG)	C	A3(T2)	A1	A3(T2)	(NEG)
GS	A-(T2)	NR	A	(NEG)	GS	A1	Aa3	NR	(NEG)
JPM	A	A+	A+	(STABLE)	JPM	Aa3	Aa1	NR	(NEG)
MS	A-(T2)	A	A	(NEG)	MS	A2	A1	NR	(NEG)
WFC	A+	AA-	NR	(NEG)	WFC	A2	Aa3	NR	(NEG)

Source: S&P, BofA Merrill Lynch Global Research

Source: Moody’s, BofA Merrill Lynch Global Research

# ***Fannie Mae and Freddie Mac***

## The GSE triangle

### Fitch may lower Fannie Mae's and Freddie Mac's debt outlook

#### The GSE triangle

- “[T]he Federal Reserve has become a huge holder of mortgage-related securities—it bought about \$1 trillion of them, representing roughly 10% of all U.S. residential mortgage loans,” wrote AEI’s Alex Pollock in an *American Banker* commentary. “This has created a tight relationship between the American central bank and other parts of the government, resulting in a remarkable triangle. This government financial triangle is composed of: (1) the Federal Reserve; (2) the government mortgage companies, Fannie Mae and Freddie Mac; and (3) the U.S. Treasury Department. It works like this:
  - The Federal Reserve buys \$1 trillion of the debt and mortgage securities of Fannie and Freddie.
  - But Fannie and Freddie are completely broke.
  - So the Treasury buys \$180 billion of Fannie and Freddie stock to support their obligations to the Fed and others.
  - But the Federal Reserve is lending \$1.7 trillion to the Treasury, which is running at a colossal deficit.”
- “What are we to make of this triangle? It’s certainly providing elastic currency with a vengeance, intertwined with real estate risk, and adding a new element—government mortgage companies—to Treasury and Federal Reserve interdependence. It does not appear that anybody can know how this will all turn out.” (*American Banker*, Alex J. Pollock, 12/02/11)

#### Fitch may lower Fannie Mae's and Freddie Mac's debt outlook

- Fitch Ratings agency said it will likely lower its outlook for debts linked to the U.S. government to negative, including debt issued by Fannie Mae, Freddie Mac and the FHLBs. The ratings agency’s announcement comes a day after Fitch downgraded its outlook on U.S. debt to negative, saying it has less confidence in the federal government’s ability to rein in the deficit after a special congressional panel failed to reach an agreement on \$1.2 trillion in deficit cuts over the next decade. The panel’s

impasse triggered automatic cuts of the same amount, which are scheduled kick in beginning in 2013. Fitch said there is slightly greater than a 50% chance it would downgrade U.S. debt by 2013, which would trigger a downgrade for the GSEs' ratings.

- The Federal Housing Finance Agency has said the government-sponsored entities will meet their financial obligations because the government will continue to fund them.
- In August, Standard & Poor's downgraded the credit ratings of Fannie and Freddie from "AAA" to "AA+", reflecting the rating agency's downgrade of long-term U.S. government debt. (*Associated Press*, 11/28/11)

HARP 2.0 may benefit 4.6 million loans, totaling \$740 billion, says JPMorgan
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- On November 15, Fannie Mae and Freddie Mac released the details for the HARP 2.0 program, which (i) eliminates the 125% loan-to-value ceiling; (ii) reduces certain risk-based loan-level g-fees; (iii) extends the program's date to December 31, 2013; (iv) streamlines AVM coverage and foregoes the appraisal requirement when an AVM is available; and (v) provides additional reps and warrants relief.
- Under HARP 2.0, Fannie Mae will not hold the lender responsible for any of the reps on the original loan. However, Freddie Mac's policy states the GSE will no longer hold the lender responsible for the original loan file for loans exceeding 80% loan-to-value. For loans with less than 80% LTV, Freddie Mac will still hold the lender liable for the original reps and warrants. Furthermore, if the borrower is under 80% LTV on the first lien, there is a cap on the total first plus second lien of 105% LTV.
- Overall, JPMorgan estimates that approximately \$4.6 million loans totaling \$740 billion of mortgages—\$620 billion of fixed rate mortgages and \$120 billion of adjustable rate mortgages— will be eligible to participate in HARP 2.0. "While this represents the overall HARP-able universe, not all of these borrowers will make it through the program, of course," wrote JPMorgan analysts. "So far, just 900,000 borrowers have gone through HARP (again as defined by the administration as over 80 LTV); we expect another roughly 1.1million to go through the program for a total of about 2 million loans overall." (*MBS Strategy HARP 2.0 Commentary*, Matthew Jozoff, Nicholas Maciunas, Brian Ye and Jonathan J. Smith, 11/15/11)
- The HARP 2.0 program could add \$200 billion to \$300 billion in mortgage originations over 2012 to 2013, said Freddie Mac chief economist Frank Nothaft. The GSE estimates that approximately 1.5 million mortgages, averaging \$200,000 each, will be originated through HARP 2.0 (*HousingWire*, Jon Prior, 11/21/11)
- "Mortgage refinancing policies are quite hard to do at scale," wrote economist Keith Hennessey. "If recent history is a guide, this program may help a few tens of

thousands of homeowners. That's a trivial macroeconomic impact. Even if it does help 900,000 homeowners, the effects will be small enough that they won't show up on most macro forecasts." Hennessey also warns that such mortgage subsidies carry political risk that may be easy for policymakers to discount or even ignore.

"[G]overnment action to help that sympathetic homeowner will leave many more without similar aid, and if past experience is a guide, some of them will be angry at the inequities created (real or perceived). If the expanded program also results in high visibility cases of subsidized big spenders who gambled on the housing bubble by withdrawing equity, a backlash could grow. Whatever your views on the policy merits of placing additional taxpayer funds at risk to subsidize underwater homeowners, it is a political mistake to pay attention only to the one homeowner you're helping, and to ignore possible pushback from the 79 or more homeowners you're not helping, as well as from the taxpaying renters."

([www.keithhennessey.com](http://www.keithhennessey.com), 10/25/11)

- Mark Fleming, chief economist for CoreLogic, argues that HARP 2.0 does not address the strongest headwind facing the housing market—negative equity and the shadow inventory. Today, some 22% of all U.S. homes—or nearly 11 million borrowers—have negative equity totaling \$699 billion (on average some \$65,000 per homeowner). "It's certain that not all of the \$699 billion in negative equity needs to be forgiven," wrote Fleming. "There are 6.3 million borrowers with first liens only who are current on their mortgage payments and underwater by an average of \$52,000, representing \$314 billion in total. Within that segment, servicers could target moderately upside down borrowers (110% to 150% LTV), who are most likely to respond to principal reduction offers. That would help nearly 3 million borrowers (or nearly one third of all negative equity borrowers) at a cost of \$118 billion. Although \$118 billion is clearly not trivial, it is much more manageable than \$699 billion. ...Targeting principle reductions ...would aid the greatest number of borrowers for the least amount of money, reduce current and future distressed shadow inventory and put less downward pressure on prices today and in the future." (*American Banker*, Mark Fleming, 11/22/11)
- Phyllis Caldwell, the chief of the Homeownership Preservation Office at Treasury, will leave her post on December 9. Caldwell joined the administration in March 2009, where she managed the development of the Home Affordable Modification Program from its early stages. She also oversaw the development of the \$7.6 billion Hardest Hit Fund, which provided additional funds to 18 states for foreclosure prevention funds and unemployment assistance programs. Darius Kingsley, deputy homeownership preservation officer, will assume Caldwell's position. Kingsley, who joined Treasury's office of chief counsel in April 2009, was previously a partner at the law firm McKee Nelson [now Bingham McCutcheon], where he specialized in mortgage-backed securities and structured finance litigation. (*HousingWire*, Jon Prior, 11/17/11)

*Legislation News:*

Senate to debate the Covered Bond Act of 2011

Senator Coker introduces The Residential Mortgage Market Privatization and Standardization Act

The Freddie Mac Debt Reduction Act of 2011 is introduced in the House

Bipartisan bill introduced in House to establish watchdog for bank examiners

Senate to debate the Covered Bond Act of 2011

- “The Senate is about to take up a bill that’s advertised as allowing more credit in the housing market... but in fact, would allow the major banks to load more bad debt onto the backs of taxpayers,” wrote the editors of Agora Financial’s *5 Min. Forecast*. “The Covered Bond Act of 2011 would allow the major banks to bundle mortgages into marketable securities that would be guaranteed at face value by the FDIC. But it’s not just mortgages. No, under the language of the bill, auto loans, student loans, credit card debt... it’s all fair game for the treatment, along with ‘any other eligible asset class’ designated by the Treasury secretary.”
- “This abomination already passed a House committee earlier this year. The bill ‘is all about Wall Street and does nothing to increase the availability of housing credit,’ said Chris Whalen from Institutional Risk Analytics at the time. ‘The bill lacks basic protections for investors in bonds and for the FDIC, which would be fully exposed to losses from covered bonds.’”
- “True enough... but think of the insider-trading possibilities this opens up for members of Congress! And as we learned a few days ago in a *60 Minutes* expose, it’s completely legal for them — even as you or I would get handcuffs and a cell at Club Fed.” (*5 Min. Forecast*, Agora Financial, 11/23/11)

Senator Coker introduces The Residential Mortgage Market Privatization and Standardization Act

- Senator Bob Corker (R-TN) has introduced The Residential Mortgage Market Privatization and Standardization Act that would reduce the federal government’s exposure to Fannie Mae and Freddie Mac by 10% per year over 10 years by gradually reduce the percentage of agency mortgage-backed securities that are backstopped by the taxpayers. “This methodical process will allow for clear market signals, so everyone can easily see where the market and the government each price credit risk,” said Cocker. The bill also includes basic infrastructure improvements, including the creation of a uniform servicing agreements, the establishment of minimum

underwriting standards that includes the requirement that loans be fully documented and 5% minimum loan down payment. In addition, the bill would create an industry-financed database for uniform performance and origination data on mortgages through the FHFA and sell off the GSEs' ownership of technologies and home price indices to private investors. It would also direct the FHFA to develop uniform practices and streamline mortgage regulations.

- “We are no closer to transitioning Fannie Mae and Freddie Mac off government life support than the day the firms were taken under direct government control in 2008,” said Corker. “We’re introducing this bill to . . . get a conversation going that Washington has put off for far too long,” he said. “‘Permanent conservatorship’ is not a credible plan.” (*Washington Post*, Bob Corker, 11/24/11; *The [Memphis] Commercial Appeal*, Bartholomew Sullivan, 11/09/11)

#### The Freddie Mac Debt Reduction Act of 2011 is introduced in the House

- Representatives Ed Perlmutter (D-CO ) and David Schweikert (R-AZ) have introduced the Freddie Mac Debt Reduction Act of 2011 (H.R. 3530) that would require Freddie Mac to exercise clean-up call options under REMIC securities issued by the GSE and to prohibit any new mortgage-backed securities issued by the enterprise to contain provisions for a clean-up call option. [A clean-up call option allows for the termination of a REMIC issue when the remaining balance reaches a minimal percent of its original balance...]
- While Freddie Mac has always had the right to exercise clean-up calls, the enterprise has refused to do so even in the current low interest rate environment where potential profits to the institution—and now the taxpayer—are high. If Freddie Mac were to exercise the clean-up call rights available to it, \$150 million could be generated today in shared profit for the taxpayer and the residual holder and as much as \$1.3 billion in the future.
- The legislation contains two basic provisions, which:
  - Mandates Freddie to Mac exercise its clean-up calls when profit sharing is available to it, thus returning money to the taxpayer; and,
  - Removes clean-up calls from Freddie Mac REMICs in the future, bringing its practice into conformity with Fannie Mae. (*Freddie Mac Debt Reduction Act of 2011*; 12/01/11)

Bipartisan bill introduced in House to establish watchdog for bank examiners

- Representatives Shelley Moore Capito (R-WV) and Carolyn Maloney (D-NY) have introduced the Financial Institutions Examination Fairness and Reform Act (H.R. 3461), which would (i) require federal financial institution examiners to include more information with some exam reports, (ii) unify the regulatory treatment of non-accrual loans and (iii) establish a new appeal process for exam disputes. The bill is intended to address issues raised during hearings on Capitol Hill and in field hearings about federal financial institution examinations.
- Specifically, H.R. 3461 would (i) require that financial institutions receive timely examination reports containing full documentation of the information relied upon by the agency in support of a material supervisory determination; (ii) create new standards for examinations; (iii) establish an Independent Office of Examination Ombudsman within the Federal Financial Institutions Examination Council [with jurisdiction over examiners at the Federal Reserve, OCC, FDIC and CFPB], providing a new path for institutions to appeal material supervisory determinations by their prudential regulator; and (iv) establish a timely, independent and fair process for financial institutions to appeal examination decisions free from retaliation from prudential regulators. The bill specially would forbid any regulator from retaliating against a bank for lodging a complaint with the Ombudsman. It also would forbid a regulator from delaying or denying any action “that would benefit a financial institution” because it is under appeal.
- H.R. 3461 has ten co-sponsors, including Capito, Maloney and Representatives Spencer Bachus (R-AL), John Carney (D-DE), Sean Duffy (R-WI), Steve Pearce (R-NM), Bill Posey, (R-FL), James Renacci (R-OH), David Schweikert (R-AZ), and Lynn Westmoreland (R-GA). (*HousingWire*, Jon Prior, 11/21/11)

*Litigation News:*

California AG subpoenas Fannie Mae and Freddie Mac, as Massachusetts AG sues five major lenders over foreclosure practices

Delaware and New York AGs can intervene in Bank of America’s \$8.5 billion MBS settlement with private investors

Court throws out proposed \$285 million settlement between the SEC and Citigroup

District Court rules that CRA’s ratings are not protected by free speech protections

Supreme Court vs. HUD: The race to decide “impact or intent”

California AG subpoenas Fannie Mae and Freddie Mac, as Massachusetts AG sues five major lenders over foreclosure practices

- California Attorney General Kamala D. Harris (D) has subpoenaed information from Fannie Mae and Freddie Mac as part of her wide-ranging probe into lending and foreclosure practices in the state. The subpoenas ask the GSEs questions about their activities in California, including the enterprises' mortgage servicing practices, home-repossession practices, and role as landlord for some 12,000 repossessed properties in the state. In addition, the AG's investigators want to learn more about the GSEs' purchases and sponsorship of "toxic mortgages" in the state. The California AG's investigation is focused on determining to what extent Fannie Mae and Freddie Mac contributed to the foreclosure crisis in their state. Collectively, the GSEs own approximately 4 million mortgages totaling \$793 billion in California.
- Harris' move to investigate Fannie Mae and Freddie Mac is viewed as a creative way to potentially force policy changes at the Federal Housing Finance Agency. "[Harris has] felt that [FHFA's Acting Director] Ed DeMarco has not done enough to help homeowners and has undue influence over what changes are put in place at Fannie and Freddie," said Edward Mills, an analyst with FBR Capital Markets & Co. "If he's not going to make those changes, she's going to force them through the courts."
- Harris pushed Fannie Mae and Freddie Mac to allow principal reductions for distressed borrowers. "If Mr. DeMarco is unwilling to support principal reduction for these loans in crisis, he should step aside for someone who will," said Harris. In testimony before Congress, DeMarco said, "I do believe we are taking all due effort to provide assistance to homeowners, and I do not believe I'm been authorized to use taxpayer money for a general program of principal forgiveness." (*Los Angeles Times*, Aljandro Lazo and Jim Puzzanghera, 11/17/11)
- On December 1, Massachusetts Attorney General Martha Coakley (D) filed a civil lawsuit against the nation's five largest lenders—Bank of America, JPMorgan Chase, Citigroup, Wells Fargo and [Ally Financial's] GMAC Mortgage—seeking financial relief for the consumers hurt by the banks' "unfair and deceptive business practices." Coakley also named MERS, the electronic mortgage registry, as a defendant in the lawsuit. The AG contends that the banks have improperly foreclosed on distressed borrowers by relying on fraudulent legal documentation or by failing to modify mortgages after promising borrowers that they would do so. The lawsuit contends that MERS "corrupted" the state's public land recording system by not registering legal transfers properly. Coakley did not disclose the financial penalty that the suit is seeking, but promised that "it would be a lot." (*New York Times*, Gretchen Morgenson, 12/01/11; *HousingWire*, Jon Prior, 12/01/11)
- Nevada Attorney General Catherine Cortez Masto (D) filed the first criminal charges against individuals, who were overseeing teams of "robo-signers" that generated improper notices default to initiate foreclosure proceedings. The defendants, Gary Trafford and Gerri Sheppard, allegedly allowed their signatures to be forged and

submitted to the country recorder. The AG's office has not made allegations against the banks themselves. "We simply do not know if the major banks were aware of what these individuals were doing," said John Kelleher, Nevada's chief deputy attorney general. "Our charge is to prosecute criminal activity by whomever may be committing it. There is no provision under the law for an industry to collectively decide to circumvent Nevada statutes." The defendants, who face more than 600 counts ranging from gross misdemeanors to felonies, had bail set at \$500,000 each. According to Las Vegas' KLAS-TV, the defendants work for Lender Processing Services of Jacksonville, FL. (*American Banker*, Jeff Horwitz, 11/16/11)

#### Delaware and New York AGs can intervene in Bank of America's \$8.5 billion MBS settlement with private investors

- Judge William H. Pauley, III of the U.S. District Court for the Southern District of New York has ruled that Delaware Attorney General Joseph R. Biden III (D) and New York Attorney General Eric T. Schneiderman (D) can intervene in court proceedings discussing Bank of New York Mellon's \$8.5 billion settlement with Bank of America over toxic mortgage securities by originated by Countrywide Financial. The judge ruled that the AGs have standing to intervene in certain legal actions that relate to statutes or regulations within their purview. Pauley denied motions by four individual plaintiffs to intervene, finding that they failed to show a direct interest in the dispute. (*Bureau of National Affairs*, R. Christian Bruce, 11/22/11; *HousingWire*, Kerri Panchuk, 11/29/11)

#### Court throws out proposed \$285 million settlement between the SEC and Citigroup

- Judge Jed Rakoff of the U.S. District Court for the Southern District of New York rejected a proposed \$285 million settlement between the SEC and Citigroup Global Markets over the firm's alleged role in a \$1 billion collateralized debt obligation, finding the settlement is "neither fair, nor reasonable, nor adequate, nor in the public interest." The judge dismissed the \$95 million penalty that Citi agreed to "as pocket change" for a firm of its size and set the trial on July 16, 2012. Rakoff's ruling could have a significant impact on future law enforcement efforts against Wall Street. The ruling could open the door to greater liability for Wall Street firms, higher legal costs for the companies and federal agencies, and drawn-out resolutions of pending cases.
- "Judge Rakoff's decision will likely be troubling to the entire federal government, and not just the SEC, said Joseph Grundfest, a Stanford law professor and former SEC commissioner from 1985 to 1990. "By his logic, it's hard to ever support any settlement without a trial. So, will the federal courts be jammed with trials so that judges can know the 'truth' because they are unwilling to accept allegations negotiated in the shadow of a trial?"

- The ruling will likely delay some settlements in the pipeline, including a number related to mortgage-bond deals issued by Wall Street firms in the run-up to the financial crisis, said people familiar with the matter. (*Wall Street Journal*, Jean Eaglesham and Chad Bray, 11/29/11; *Bureau of National Affairs*, Yin Wilczek, 11/29/11)

District Court rules that credit rating agencies' ratings are not protected by free speech protections

- On November 12, the U.S. District Court for the District of New Mexico ruled that allegedly flawed ratings accorded to mortgage-backed securities are not entitled to free-speech protections under the First Amendment. In a 273-page ruling, Judge James O. Browning concluded that regulation of false or misleading commercial speech is permissible under the First Amendment. The court disagreed with the defendant credit rating agencies that their ratings are protected under the facts of the case of *Genesee Country Employees' Retirement System v. Thornburg Mortgage Securities Trust 2006-3*, D. N.M., No. CIV 09-0300 JB/KBM, 11/12/11. In the past, credit rating agencies have deflected litigation by arguing that their ratings are constitutionally protected.
- While the court concluded that the plaintiffs failed to plead actionable misstatements on the part of two CRA defendants, Moody's Corp. and Fitch, Inc., the court said the plaintiffs may proceed with their claims against the third CRA defendant, Standard & Poor's. (*Bureau of National Affairs*, 11/29/11)

Supreme Court vs. HUD: The race to decide "impact or intent"

- The Supreme Court has accepted a fair housing case which could have a direct and indirect impact on mortgage lending and regulatory enforcement. The nation's highest court has agreed to decide whether the plaintiffs in *Magner v. Gallagher* may bring disparate impact claims and, if so, what the proper test for such claims may be. In the case, a group of rental property owners in St. Paul, MN sued the city and city officials over aggressive code enforcement. The plaintiffs claim that the city's strict enforcement led to expensive renovations, increased maintenance costs, condemnations and some forced selling of properties. They claim that St. Paul violated the Fair Housing Act with its get-tough code enforcement, which ultimately reduced the availability of affordable housing in the area and negatively impacted lower-income residents. The Supreme Court has agreed to decide two issues in the case: (i) whether disparate impact claims may be brought under the Fair Housing Act; and (ii) if so, what is the appropriate legal test for analyzing claims.
- "Both of these issues could have a significant impact on fair lending litigation at the private and government levels," wrote lawyers at Ballard Spahr in a note to clients. "The viability of disparate impact claims under the Fair Housing Act is an issue that

could affect mortgage lenders both directly and indirectly. From a direct standpoint, it is not uncommon for fair lending litigation brought against mortgage lenders to be brought in part under the Fair Housing Act. If the Supreme Court holds that disparate impact claims cannot be pursued, it will take away one of the legal avenues that private and governmental litigants could use in such cases. But, more broadly, if the Supreme Court holds that disparate impact claims are not actionable under the Fair Housing Act ... and disagrees with HUD's interpretation of the statute, it would carry serious implications for disparate impact claims under the Equal Credit Opportunity Act. Even if the Supreme Court upholds the availability of disparate impact as a theory for relief under the Fair Housing Act, it will have the opportunity to definitively set forth the applicable analytical model for proving such claims, and to provide guidance to lower courts on the type of evidentiary showing that a plaintiff must make in order to pursue a disparate impact claim.”

- For additional analysis of this case, see *Supreme Court vs. HUD: The Race to Decide “Impact or Intent”* [<http://tinyurl.com/c8vudb7>] by K&L Gates LLP. (*HousingWire*, Kerry Curry, 11/18/11)

*Private Mortgage Insurance News:*

Settlement talks underway between big banks and MBIA

PMI lists \$737 million of unsecured debt in bankruptcy filing

Radian seeks risk-based capital waivers in 12 states

Settlement talks underway between big banks and MBIA

- After two years of stalemate, Bank of America, Morgan Stanley and five other banks and securities firms are negotiating settlements with MBIA to resolve disputes involving payments from the insurer to certain banks, said sources familiar with negotiations. The talks are aimed at resolving a complex web of allegations related to MBIA insurance on mortgage bonds, secured by subprime loans, which is further complicated by the spilt of the insurer into two firms—one to guarantee municipal bonds and the other to guarantee souring MBS and other complicated bonds—in 2009. Because of MBIA's spilt, the banks claim that the company won't be able to honor insurance claims on the mortgage bonds. In turn, MBIA has claimed that the banks misrepresented the safety of the mortgage bonds which the company has insured. The banks have also sued the New York Insurance Department, which approved MBIA's restructuring in 2009.
- Benjamin M. Lawsky, New York's Superintendent of Financial Services, stepped into the negotiations in late October in hopes of resolving issues by year-end, according to sources familiar with the matter. If settlements cannot be reached, the case is

expected to go to trial in early 2012 in New York state court. Many hope that a settlement can be reached to end the thorny battle, which would clear the way for MBIA to sell new guarantees of municipal bonds without a legal overhang.



- In the aftermath of the 2008 financial crisis, insurers such as MBIA and Ambac Financial were downgraded by ratings agencies as housing prices plummeted and home foreclosures spiked. Some insurers, such as Ambac, declared bankruptcy or were seized by regulators. Instead, MBIA opted to restructure with the blessing of the New York State Insurance Department [which has subsequently merged with the New York State Banking Department to form the Department of Financial Services, which Lawskey serves as Superintendent]. As a result of the deterioration of the insurance companies, banks and securities firms were forced to record large losses, reflecting the unlikelihood that insurers would be able to pay claims. From 2007 to 2010, 12 large banks booked \$54 billion of such losses, according to a recent study by the International Swaps and Derivatives Association.
- MBIA, one of the largest bond insurers in the U.S, is among the few left in operation after the 2008 financial crisis. The insurer maintains that its projections show it will have enough funds to cover all obligations, as they come due. (*Wall Street Journal*, Liz Rappaport and Serena Ng, 11/29/11)

#### PMI lists \$737 million of unsecured debt in bankruptcy filing

- In late November, PMI filed for Chapter 11 bankruptcy protection with \$685 million of senior unsecured notes and approximately \$51.5 million of unsecured notes due and payable upon the filing. The nation's second largest mortgage insurer had \$121 billion of policies-in-force on June 30. (*National Mortgage News*, Paul Muolo, 11/30/11)

Mortgage Insurance Coverage	Maximum Coverage <sup>(1)</sup>				Unpaid Principal Balance Covered By Insurance <sup>(2)</sup>	
	As of September 30, 2011			As of December 31, 2010	As of September 30, 2011	As of December 31, 2010
	Counterparty: <sup>(3)</sup>	Primary	Pool	Total		
	(Dollars in millions)					
Mortgage Guaranty Insurance Corporation . . . .	\$20,322	\$1,681	\$22,003	\$23,277	\$ 94,620	\$101,823
Radian Guaranty, Inc. . . . .	14,683	449	15,132	15,370	62,060	64,042
United Guaranty Residential Insurance Company . . . . .	13,913	202	14,115	14,044	58,345	58,416
Genworth Mortgage Insurance Corporation . . . .	13,655	66	13,721	14,331	55,161	57,845
PMI Mortgage Insurance Co. . . . .	11,387	265	11,652	12,359	50,132	53,768
Republic Mortgage Insurance Company . . . . .	8,736	925	9,661	10,566	41,218	46,660
Triad Guaranty Insurance Corporation . . . . .	2,612	892	3,504	3,809	14,620	16,974
CMG Mortgage Insurance Company <sup>(4)</sup> . . . . .	1,936	—	1,936	1,938	8,166	8,174
Others . . . . .	434	—	434	209	2,143	1,140
Total . . . . .	<u>\$87,678</u>	<u>\$4,480</u>	<u>\$92,158</u>	<u>\$95,903</u>	<u>\$386,465</u>	<u>\$408,842</u>
Total as a percentage of single-family guaranty book of business . . . . .			<u>3%</u>	<u>3%</u>	<u>14%</u>	<u>14%</u>

(1) Maximum coverage refers to the aggregate dollar amount of insurance coverage (i.e., "risk in force") on single-family loans in our guaranty book of business and represents our maximum potential loss recovery under the applicable mortgage insurance policies.

(2) Represents the unpaid principal balance of single-family loans in our guaranty book of business covered under the applicable mortgage insurance policies (i.e., "insurance in force").

(3) Insurance coverage amounts provided for each counterparty may include coverage provided by consolidated affiliates and subsidiaries of the counterparty.

(4) CMG Mortgage Insurance Company is a joint venture owned by PMI Mortgage Insurance Co. and CUNA Mutual Insurance Society.

### Radian seeks risk-based capital waivers in 12 states

- Radian Corp is seeking waivers of risk-to-capital requirements in 12 states to ensure the company can continue writing coverage as their RTC edges higher. On September 30, Radian reported at 21.4:1 risk-to-capital ratio, which is expected to rise as additional mortgage losses are incurred.
- Radian has experienced seven consecutive quarters of declining mortgage insurance delinquencies and a stabilization in credit trends. The company has approximately \$600 million of available liquidity at the holding company level and continues to explore other sources of capitalization, including reinsurance options, commutations, and investment gains. (*HousingWire*, Kerri Panchuk, 11/30/11)

Mortgage Insurance by Counterparty			As of September 30, 2011		
Counterparty Name	Credit Rating <sup>(1)</sup>	Credit Rating Outlook <sup>(1)</sup>	Primary Insurance <sup>(2)</sup>	Pool Insurance <sup>(2)</sup>	Coverage Outstanding <sup>(3)</sup>
				(in billions)	
Mortgage Guaranty Insurance Corporation (MGIC) . . . . .	B+	Negative	\$ 50.1	\$29.8	\$13.1
Radian Guaranty Inc. . . . .	B+	Negative	37.1	11.9	10.6
Genworth Mortgage Insurance Corporation. . . . .	BB-	Negative	31.7	0.9	8.1
United Guaranty Residential Insurance Co. . . . .	BBB	Stable	28.9	0.3	7.1
PMI Mortgage Insurance Co. (PMI) . . . . .	R	N/A	25.7	1.4	6.5
Republic Mortgage Insurance Company (RMIC) . . . . .	CC	Negative	21.1	2.1	5.3
Triad Guaranty Insurance Corp <sup>(4)</sup> . . . . .	Not Rated	N/A	8.9	0.9	2.2
CMG Mortgage Insurance Co. . . . .	BBB	Negative	2.9	0.1	0.7
Essent Guaranty, Inc. . . . .	Not Rated	N/A	0.5	—	0.1
Total . . . . .			<u>\$206.9</u>	<u>\$47.4</u>	<u>\$53.7</u>

(1) Except for RMIC, latest rating available as of October 21, 2011. RMIC's credit rating and credit rating outlook reflect an S&P action on October 28, 2011. Represents the lower of S&P and Moody's credit ratings and outlooks. In this table, the rating and outlook of the legal entity is stated in terms of the S&P equivalent.

(2) Represents the amount of UPB at the end of the period for our single-family credit guarantee portfolio covered by the respective insurance type.

(3) Represents the remaining aggregate contractual limit for reimbursement of losses under policies of both primary and pool insurance. These amounts are based on our gross coverage without regard to netting of coverage that may exist to the extent an affected mortgage is covered under both types of insurance.

(4) Beginning on June 1, 2009, Triad began paying valid claims 60% in cash and 40% in deferred payment obligations under order of its state regulator.

**U.S. housing market “dormant” for 2012**

Home prices expected to fall an additional 6% by mid-2012 due to excess supply

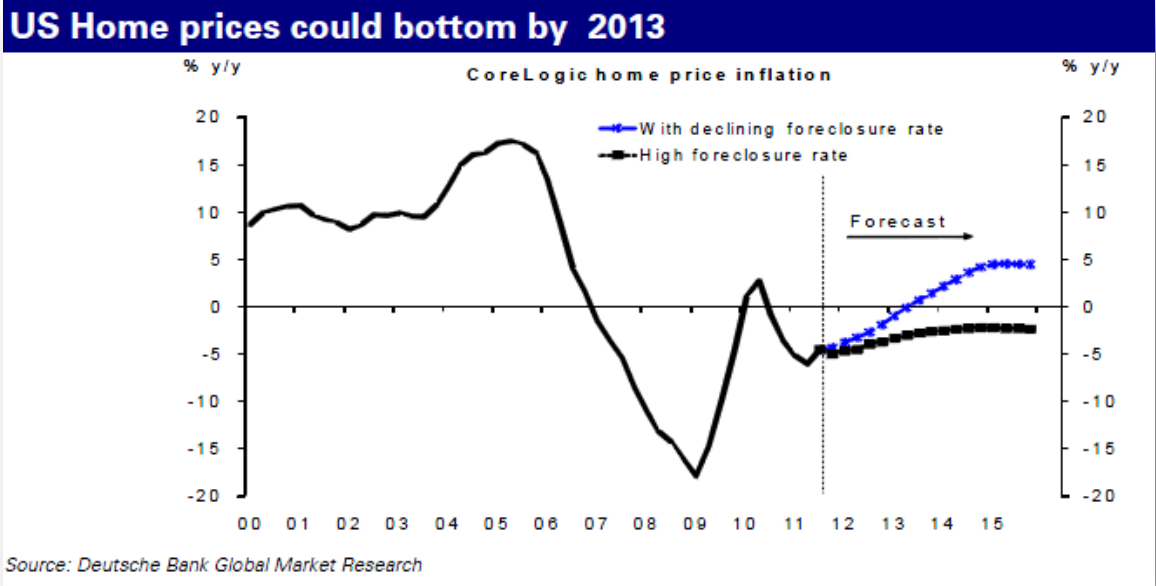
22.1% of residential properties with mortgages had negative equity on September 30

Delinquent mortgages fall to 8% of outstanding loans, while number of loans going into foreclosure reach 1.1% at the end of the third quarter

Average days to foreclose a mortgage hits a record 631 days in October

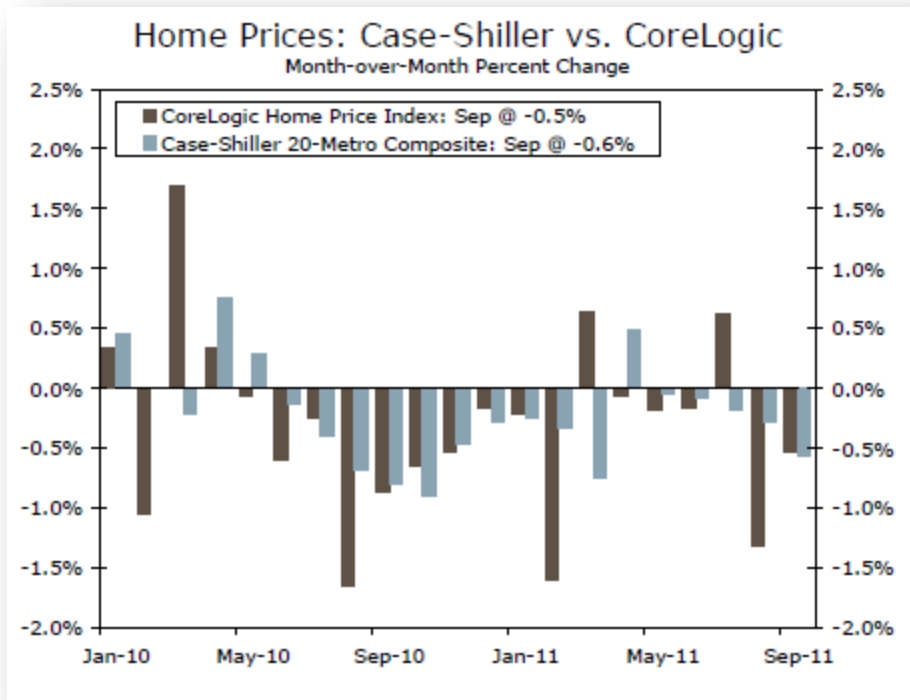
U.S. housing market “dormant” for 2012

- Despite “some green shoots” in the housing market of late, Deutsche Bank’s assessment of the overall picture is that “residential investment will fail to make much of a positive contribution to GDP growth and national average home prices will likely drift still lower” in 2012, while prospects for 2013 “will be somewhat brighter,” as household formations begin to recover and work down the vacancy overhang. “We expect home prices to bottom out at some point during 2013 as downward pressure from foreclosures begin to recede,” wrote Deutsche Bank analysts. (*Global Economic Perspectives: U.S. Housing Dormant for 2012*, Peter Hooper, Thomas Mayer, Michael Spencer, Ph.D., and Torsten Slok, 12/01/11)



Home prices expected to fall an additional 6% by mid-2012 due to excess supply

- “The latest data place the inventory of existing homes at around 2.86 million units,” wrote Mark Vitner, senior economist for Wells Fargo Securities. “We conservatively estimate that the shadow inventory totals at around 2.0 million units, comprised of homes either already in the foreclosure process or homes where the mortgage is currently 90 days or more past due but not currently on the market.”
- “With so much supply on the market and potential supply hanging over the market, home prices have continued to drift lower. Moreover, price declines have accelerated in recent months, as distressed transactions account for a larger proportion of overall sales. The S&P/Case-Shiller Home Price Index has fallen every month since April and is expected to slide an additional 6 percent by the middle of 2012, as distressed transactions account for a larger proportion of overall sales. The prospect of so much additional supply coming onto the market is also weighing on appraisals, which has led to a spike in contract cancelations and also discouraged many would-be home sellers from putting their home on the market.”



- “While there will likely be a few positive developments in 2012, for the most part, the year is likely to look like a re-run of 2011. Sales will likely languish during the early part of the year and pick up modestly in the spring and summer. We are still a long way off from a ‘true’ recovery in homebuilding. Conditions will not improve on a sustained basis until the backlog of distressed properties is cleared, which will enable the price discovery process to play out. From there appraisals and underwriting standards will normalize, which should set the stage for a true recovery. There are other issues to be decided as well, including the little issue of what the federal government’s role in financing home ownership should be and what to do with Fannie Mae, Freddie Mac and the FHA.” (*Wells Fargo Securities’ Housing Chartbook: November 2011*, Mark Vitner, 11/30/11)

22.1% of residential properties with mortgages had negative equity on September 30

- Approximately 10.7 million—or 22.1%—or all residential homes with mortgages had negative equity on September 30, down slightly from 10.9 million (22.5%) at the end of the second quarter, according to CoreLogic. Nevada reported the highest negative equity (58%), followed by Arizona (47%), Florida (44%), Michigan (35%) and Georgia (30%). CoreLogic also reported that approximately 22 million borrowers (45% of all borrowers) have loans with 80%+ LTV and 69% of these mortgages have “above-market interest rates of 5% or more.” (*CoreLogic Press Release*, 11/29/11)

Delinquent mortgages fall to 8% of outstanding loans, while number of loans going into foreclosure reach 1.1% at the end of the third quarter

- Mortgage delinquencies declined 46 basis points to 7.99% in the third quarter—the lowest level since 2008 in the third quarter, while the level of loans entering foreclosures increased 12 basis points to 1.08%, according to the Mortgage Bankers Association. The seasonally adjusted delinquency rate fell to 7.99% in the third quarter from 8.45% in the previous period. Last year, the rate was at 9.43%.
- The MBA said 1.08% of loans were in foreclosure during the third quarter, up from 0.96% in the prior three months. The foreclosure rate is still down from 1.34% one year ago as mortgage servicers restart the process frozen last year to correct fraudulent documentation practices. However, foreclosures are rebooting sporadically across the country.



- “While the delinquency picture changed for the better in the third quarter, the foreclosure data indicated that we are not out of the woods yet and that the issues continue to vary by geography,” said Michael Fratantoni, vice president of research and economics. “The increase in the foreclosure starts rate this quarter was driven by large increases from just a few servicers, concentrated in certain ‘hardest hit’ states.” (*Mortgage Bankers Association Press Release, 11/17/11*)

Average days to foreclose a mortgage hits a record 631 days in October

- The average loan in foreclosure has been delinquent a record 631 days with significant variances occurring in judicial and non-judicial states, according to Lender Processing Services. Today, non-judicial states’ foreclosure inventories are less than

half those of judicial states, while the foreclosure sale rates in non-judicial states are four to five times that of judicial states.

- “The discrepancy will go on in perpetuity, as there always has been a difference between judicial and non-judicial timelines,” said Kyle Lundstedt, managing director of LPS Applied Analytics. “Even prior to the worst of the crisis, loans were 4-5 months more delinquent in judicial states at time of foreclosure sale. The number today is more like 8 months, but will return to the 4-5 month difference depending on when and how fast foreclosure sales occur.”
- Repeat foreclosures made up nearly 45% of new foreclosures in October, caused in part by “ineffective” loan modifications. Of the 2.1 million modifications completed since the beginning of 2008 more than 10% were in foreclosure with another 27.4% delinquent 30 or more days, on September 30 according to the OCC. (*CNBC.com*, Diana Olick, 12/01/11)

CFPB began accepting mortgage complaints “on or about” December 1
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- The Consumer Financial Protection Bureau announced it will begin accepting mortgage-related complaints from the public on or about December 1.
- “Mortgages are a complicated product, so there’s a lot more basis for complaints than you might have in, say, the credit card area,” said Jo Ann Barefoot, a co-chair at Trelia Risk Advisors. “And mortgages are so much in the political, media, cultural spotlight that I would think they’ll generate a lot of complaints.” Barefoot expects the Bureau will receive more complaints alleging discrimination, which the agency may use to target unfair or deceptive practices. “The fact that the complaint can arise over things that are not the subject of a technical rule causes difficulty for banks because they are mostly set up to check for the technical rules,” she said. “Starting a UDAP questioning process with a complaint turns the traditional compliance setup on its head.”
- The agency’s complaint system includes a toll-free hotline and web-based complaint form. The bureau has recruited help from other regulators to process consumer complaints, until the agency’s systems and consumer response staff, which will eventually total 150 people, are in place to field the public’s calls. (*American Banker*, Kate Davidson, 11/30/11)

Fannie Mae and Freddie Mac suspend evictions for owner-occupied properties during the holiday season
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- Fannie Mae and Freddie Mac announced that they will suspend all evictions involving foreclosed occupied single family and 2-4 unit properties from December

19, 2011 to January 2, 2012. The suspension will apply only to eviction lockouts related to Freddie Mac- and Fannie Mae-owned REO properties and will not affect other pre- or post-foreclosure processes

- “The holidays are meant for families to spend time together, especially if they’ve gone through the stress of financial challenges and foreclosure,” said Terry Edwards, EVP of Fannie Mae’s Credit Portfolio Management. “No family should have to give up their home during this holiday season. Fannie Mae is committed to helping borrowers avoid foreclosure whenever possible and we encourage any homeowner who is having difficulty making their payment to reach out for help.”
- “If the property is occupied, our foreclosure attorneys will suspend the eviction to provide families a greater measure of certainty during the holidays,” added Tracy Mooney, SVP of Servicing and REO at Freddie Mac. (*Fannie Mae Press Release, 12/01/11, Freddie Mac Press Release, 12/01/11*)

#### FHFA loses bid to halt class action suit against Fannie Mae

- On November 14, U.S. District Court Richard Leon denied a request by the Federal Housing Finance Agency for a stay in a class action lawsuit against Fannie Mae. FHFA argued that the litigation, which had already cost taxpayers \$80 million in fees, had no hope for resolution until the fate of Fannie Mae was more certain. The GSE regulator argued that even if the plaintiffs were to prevail, they “almost certainly will never be able to collect even a single dollar in a final judgment.” Judge Leon denied FHFA’s request, but didn’t give a reason in writing for his decision. (*Legal Times, 11/15/11*)

#### FHFA Announces senior staff appointments

- The Federal Housing Finance Agency has appointed Richard B. Hornsby to serve as Chief Operating Officer (COO) and Jon Greenlee as the agency’s Deputy Director of the Division of Enterprise Regulation. Hornsby served at the Federal Reserve Bank of San Francisco for 26 years, in a variety of senior level management and banking supervision positions, most recently as Group Vice President and Division Head for the Bank’s Financial Planning and Control and Corporate Administration Divisions. In addition to his senior management positions, he was a Supervising Examiner in the Division of Banking Supervision and Regulation for ten years. Hornsby, who has an MBA in Finance and Marketing, and a BS in Business Administration and Finance, both from Utah State University, as the agency’s COO, will be responsible for the strategic management of FHFA’s operations and oversight of its administrative and support services, including budget and finance, human resources, and information technology.

- Previously, Greenlee was KPMG LLP’s Managing Director in the Financial Services Regulatory Advisory Practice. At KPMG, he provided support to financial services companies concerning the Dodd-Frank Wall Street Reform and Consumer Protection Act and Basel II and III, and credit, capital, liquidity and resolution planning issues. Before joining KPMG, Greenlee held supervisory positions in the Division of Banking Supervision and Regulation at the Federal Reserve Bank during his 21-year career at the agency, including Director for Risk Management; Deputy Associate Director for Large Bank Supervision; and, Assistant Director for Regional Bank Supervision. Prior to joining the Board of Governors staff in 2001, he worked at the Federal Reserve Bank of San Francisco, rising through the examiner ranks to the position of Principal Examiner. As FHFA’s Deputy Director of the Division of Enterprise Regulation, Greenlee will be responsible for overseeing the safety and soundness examinations of Fannie Mae and Freddie Mac.
- “Having extensive large bank supervision and executive management experience, Messrs. Hornsby and Greenlee each bring outstanding backgrounds and skills to their new roles at FHFA,” said FHFA Acting Director Edward DeMarco. “Since the creation of FHFA and the establishment of the Conservatorships, FHFA has grown, as have the demands for strong oversight and experienced management. These individuals bring expertise well matched to the tasks at hand.” Hornsby and Greenlee will join FHFA on December 5. (*FHFA Press Release*, 11/29/11)

<p>FHFA’s Inspector General criticizes the Freddie Mac’s repurchase settlement with Bank of America</p>
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- The Federal Housing Finance Agency failed to review problematic mortgage buyback requests that Freddie Mac made against Bank of America, said the agency’s Inspector General. After taking a closer look at the Freddie Mac’s \$1.35 billion settlement with Bank of America, the IG concluded that FHFA gave “undue deference” to the GSEs on this and other business decisions. The IG concluded that the agency did not test any concerns about the settlement raised by the examiner, who concluded that Freddie Mac did not account for foreclosure patterns on loans originated during the housing boom in their loan review process. “According to the senior examiner, this could potentially cost the enterprise a considerable amount of money,” said the IG.
- The FHFA agreed with the IG’s recommendations that the agency act promptly to address the concerns and ensure senior managers are told about any that arise. However, the FHFA said it “has not changed its view that the [BofA] settlement was ...appropriate and reasonable.” (*HousingWire*, Jon Prior, 11/29/11)

## HUD IG cites The National Community Reinvestment Coalition's conflict of interest

- In a November 14 audit report, John P. Buck, Regional Inspector General for Audit (Philadelphia Region), found that the National Community Reinvestment Coalition (NCRC) had “improperly accepted” approximately \$2.4 million in donations from 10 of 38 lenders that NCRC tested for possible discrimination under its HUD grant within a year of the grant testing period, “thereby creating a conflict-of-interest situations in violation of the grant agreement.”
- Buck noted that the donors to NCRC included Citibank (\$775,000), Bank of America's Foundation (\$450,000), JPMorgan Chase (\$400,000), Wells Fargo (\$400,000), Wachovia Foundation (\$125,000), HSBC (\$100,000), Regents Bank (\$100,000), SunTrust Bank (\$60,000), PNC (\$50,000) and BB&T Corp (\$20,000). NCRC received \$2 million in HUD funding from 2007 to 2019, according to the inspector general.
- “We recommend that the Director of Fair Housing Initiatives Program require [NCRC] to repay \$59,800 in ineligible grant funds expended and develop and implement controls to detect and avoid conflict-of-interest situations...” wrote Buck.
- NCRC president John Taylor contended that there is a “firewall,” which separates its fund raising activities and its investigative operations. Since there is no connection between the two, there is no conflict, argued Taylor. “The factual bases for [the IG's] conclusion, and the legal interpretation are so badly flawed that they render this finding erroneous,” argued Taylor.
- The IG's investigation was triggered by a December 2010 letter from Senator David Vitter (R-LA), who requested an audit of NCRC. Vitter said his office had received complaints from financial institutions being tested by NCRC. The banks alleged that “resolving the matter with NCRC and avoiding a fair lending complaint involves activities such as making a significant contribution to NCRC.” In his letter to the IG, Vitter wrote, “This behavior is tantamount to blackmail.”
- “Conservative members of Congress have been after this program [e.g., Fair Lending Initiatives Program] for years,” said a NCRC spokeswoman. (*TheDailyBeast.com*, Aram Roston, 11/28/11; *Office of Inspector General Audit Report 2012-PH-1002*, John P. Buck, 11/14/11)

## HUD's Home program is a “million-dollar wasteland”

- The *Washington Post* conducted an investigation into HUD's affordable housing construction program, dubbed, the “*Million-Dollar Wasteland*” [<http://tinyurl.com/3camsmd>]. The *Washington Post* found, among other things:

- Approximately 700 HOME projects were delayed in the *Post*'s sampling of 5,000 projects to review (out of the 28,000 open projects). [These projects had either been launched more than five years ago, had stopped drawing federal money or faced other obstacles noted by local housing agencies];
  - At least 17 projects HUD reported as complete did not deliver all of the units promised;
  - At least 16 projects reported as complete by HUD took months or even years before low-income buyers purchased the units;
  - 75 construction projects drew and spent \$40 million in HOME funds with little or nothing built.
- Staff members of the House Financial Services Committee struggled to verify HUD's data on completed projects by visiting construction sites for older projects, which HUD had reported to Congress last July. In some cases, staff found empty lots, fewer units than expected and incorrect addresses—and in one instance, the wrong city.
  - The HUD data supplied to Congress for the \$32 billion HOME Investment Partnerships Program is “completely unreliable,” said Representative Randy Neugebauer (R-TX), chairman of the House Financial Services subcommittee on oversight and regulations that has probed the program. “HUD has almost no way of knowing whether taxpayer dollars have been wasted or used for their intended purpose.”
  - HUD provided Congress a chart earlier in the year, showing more than \$250 million of HOME funds had been repaid or forfeited by local housing agencies. The data provided showed only the total amount repaid by each local jurisdiction, but did not indicate why the money was returned, when it was returned or which project it was tied to. Officials at several local housing agencies with defunct projects said that they had no idea if the federal funds had been repaid to HUD. When money is returned, it often takes years, they added.
  - “Not knowing what's out there troubles us,” said John McCarty, HUD's acting deputy inspector general, in an appearance before Congress. The agency submitted an overhaul of the HOME regulations to Congress on November 5—the first major rule change in the program since 1996. The revised rules will strengthen standards and require more timely construction or renovation of housing.
  - “The program is a success story for housing low-income Americans and creating jobs,” said HUD Secretary Shaun Donovan. “However, there's more we can do to boost the program's performance and accountability. Through these new steps, we want to expand HOME's impact and ensure that every dollar is used smartly to help to help families afford their homes.” (*Washington Post*, Debbie Cenziper, 11/06/11)

## **Fannie Mae**

Fannie Mae's seriously delinquent mortgages remain unchanged at 4% on October 31

- Fannie Mae's book of business declined at an annualized 2.8% rate in October, as its book fell \$7.6 billion to \$3.2 trillion. Similarly, the GSE's gross mortgage portfolio declined at a compound annualized rate of 2.1% in October to \$720.9 billion. Moreover, Fannie Mae's gross mortgage portfolio declined at a compound annual rate of 10.2% over the ten months ended October 31. The GSE's Conventional Single-Family Serious Delinquency Rate remained unchanged at 4.00%, while its Multifamily Serious Delinquency Rate increased one basis point to 0.58% in October. (*Monthly Summary*, Fannie Mae, October 2011)

## **Freddie Mac**

Freddie Mac's seriously delinquent mortgages increase 3 basis points to 3.54% at the end of October

- Freddie Mac's total mortgage portfolio decreased at an annualized rate of 5.2% in October to \$2.1 trillion, while its mortgage-related investment portfolio declined at an annualized rate of 17.7% to \$669.1 billion. The GSE's single-family seriously delinquent rate increased three basis points to 3.54% in October, while its multifamily delinquency rate declined 2 basis points to 0.31%. (*Monthly Volume Summary*, Freddie Mac, October 2011)

Freddie Mac launches a winter promotion to sell single-family REO properties

- Freddie Mac's HomeSteps, the GSE's real estate sales unit, has announced a new winter sales promotion that offers closing-cost assistance for borrowers and bonuses for selling agents. Under the new program, HomeSteps will pay up to 3% of the final sales price toward the buyer's closing costs and a \$1,000 selling agent bonus for offers received between November 15 and January 31, with escrow closed on or before March 15, 2012. The offer is valid only for owner-occupant buyers.
- The selling agent bonus is only available for HomeSteps real estate sales in the District of Columbia and 28 states [Colorado, Connecticut, Delaware, Iowa, Idaho, Illinois, Indiana, Massachusetts, Maryland, Maine, Michigan, Minnesota, Montana, North Dakota, Nebraska, New Hampshire, New Jersey, New York, Ohio,

Pennsylvania, Rhode Island, South Dakota, Utah, Virginia, Vermont, Wisconsin, West Virginia and Wyoming]. (*MortgageOrb.com*, 11/16/11)

#### Freddie Mac clamps down on short sale fraud

- Freddie Mac will require parties entering into short sale agreements to sign affidavits that make them liable for negligent or intentional misrepresentations in the transaction. The GSE said it was taking this step to ensure that the short-sales are arms-length transactions.
- In August, Freddie Mac warned real estate agents about the rise in shady short sale deals called “flopping,” in which realtors failed to disclose other bids on a property and rigged the sale at a lower price. In turn, the fraudster would then flip the property—often on the day purchase—and pocket the difference. CoreLogic has observed an increase in property fraud in 2011 directly attributable to flopping.
- “With this change, you will have more information to identify potential mortgage fraud and a clearer understanding of the intent of all parties involved in the real estate transaction,” said Freddie Mac in its guidance to mortgage servicers. (*HousingWire*, Jon Prior, 11/18/11)

#### Newt Gingrich’s \$1.6 million consulting contract with Freddie Mac surfaces in his bid for the Republican race for the presidential nomination

- In 2007, former Speaker of the House Newt Gingrich (R-GA) extolled the virtues of Fannie Mae and Freddie Mac, saying he would be “very cautious” in changing the GSEs’ public-private business model. In an interview appearing on Freddie Mac’s website (see <http://tinyurl.com/btqtx5c>), Gingrich said the GSE model could serve as a guide for rebuilding the Gulf Coast in the aftermath of Hurricane Katrina, improving health care, and funding space exploration. “I’m convinced that if NASA were a GSE, we probably would be on Mars today,” said Gingrich in the April 24, 2007 web posting. “While we need to improve the regulation of the GSEs, I would be very cautious about fundamentally changing their role or the model itself ... [which] marries private enterprise to a public purpose.” said the former Speaker.
- Five months after resigning his House speakership, Gingrich entered into a consulting relationship with Freddie Mac in 1999. “He’s not going to represent us externally or lobbying on our behalf, said a company spokesman at the time.” A former Freddie Mac vice president in charge of “political schmoozing” told *Bloomberg News* that Gingrich was hired to indicate how Freddie might cozy up to conservatives.
- The 2007 interview showed Gingrich arguing for improved regulation of Freddie and Fannie and “directly contradicts the erroneous reports” that he was trying to stop GSE

reforms, said Gingrich's spokesman Joe DeSantis. As a presidential candidate, Gingrich has argued for ending the government guarantees for the GSEs and breaking Fannie and Freddie into smaller firms. "The total collapse of the global financial system has a tendency to make one look at a situation with a fresh set of eyes," added DeSantis.

- Gingrich earned more than \$1.6 million under two consulting engagements with Freddie Mac from 1999 to 2008, according to people familiar with the matter. When pressed about his consulting relationship Freddie Mac during a November debate, Gingrich said he provided "advice as a historian" and told the GSE when he learned it was "making loans to people who have no credit history" that "this is a bubble. This is insane."
- "While Fannie and Freddie were ruining the housing market and causing millions of homeowners to lose their homes and life savings, Newt Gingrich was earning millions advising them and advocating for them," said Gary Howard, a spokesman for Representative Ron Paul (R-TX). "Now, Newt wants to deny the facts of his role in the whole mess. Unfortunately for him, the facts are right there for everyone to see." (*Wall Street Journal*, Nick Nirimasm, 12/02/11; *Bloomberg News*, Lorraine Woellert, 12/02/11; *Wall Street Journal*, Holman W. Jenkins, Jr., 11/19/11)

## **Federal Home Loan Banks**

The FHLB System's assets have declined 50% from their peak in 2008
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- The FHLB System reported total assets of \$778.3 billion on September 30, down nearly \$100 billion or 11.4% over the nine month period. From the System's peak in 2008, the FHLBs' combined total assets have declined by nearly 50%, driven by sharply falling advances from \$1 trillion in 2008 to just \$415 billion on September 30. The FHLB System's balance sheet constriction reflects their member banks' high levels of liquidity and consequent decline in the demand for advances, as the financial system continues the deleveraging process.
- On September 30, FHLB System balance sheet was comprised of member advances (53% of total assets), non-MBS investments (19%), agency and federal MBS (15%), mortgage loans (7%), and private-label mortgage-backed securities (4%). The FHLB System reported regulatory capital totaling \$55.4 billion, or 6.5% of assets, on September 30.
- The FHLB System's profitability has declined, as its balance sheet—and level of earnings assets—has shrunk and lower interest rates has reduced the Banks' yield on earning assets. For the nine months ended September 30, 2011, all FHLBs were

profitable, although some Banks have reported quarterly net losses. On a consolidated basis, the FHLBs reported net income totaling \$475 million for the third quarter, down 30% from the third quarter 2010 (\$680 million). For the nine months ended September 30, the FHLB System reported net income of \$1.1 billion, down 15.4% from the corresponding period last year (\$1.3 billion). (*Testimony before the House Financial Services Subcommittee on Oversight and Investigations*, Edward J. DeMarco, 11/14/11)

FHFA issues final rule governing the process for voluntary mergers of FHLBs
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- The Federal Housing Finance Agency has published its final rule outlining the regulatory process for voluntary mergers for FHLBs. The agency’s final rule fulfills the mandate of the Housing and Economic Recovery Act of 2008 to “promulgate regulations establishing the condition and procedures for consideration and approval of any voluntary merger” authorized by the Act.
- The agency’s final rule, which was largely similar to its original proposal, offered some flexibility regarding the level of detail that would need to be included up front in the merger agreement; but requires, at a minimum, that the Banks’ include the size and composition of the board of directors. Specifically, the rule states: “In order for the director to make an informed decision about the appropriate size and composition of the board of the continuing bank, both immediately after the merger and over the longer term, the directors should have the benefit of the Banks’ views on those matters, and thus the final rule requires the Banks to provide that information,” according to the final rule.
- FHFA also restructured the approval process into a single step in response to banks’ concerns that the proposed two-step approach would be “overly lengthy and burdensome.” The agency had initially proposed a two-step preliminary process to win FHFA approval. Instead, the final rule would create a single approval process in which conditions would have to be met and certified by FHFA before the merger is consummated.
- FHFA’s final rule also modified the voting rights of each member of a constituent bank in order to ensure “equity and appropriate corporate governance.” Under the final rule, each member of the bank will be allowed to cast one vote for each share of bank stock that the member was required to own by a certain date.
- FHFA stated clearly that there were limitations to the rule, which only applies to voluntary mergers; in cases of liquidations or any reorganizations, the rule would not apply. FHFA also broadened the definition of a merger to include consolidating, a purchase, and any other type of business combination that could occur among the banks. The intent of this expanded definition was to provide the FHLBs “wide latitude” to pursue endeavors with other Banks. (*Testimony before the House*

*Financial Services Subcommittee on Oversight and Investigations, Edward J. DeMarco, 12/014/111 American Banker, Donna Borak, 11/29/11)*

FHLB-Seattle President announces his retirement

- Steven Horton, the Bank’s acting president and CEO, has announced his retirement, effective November 18. Horton, who joined the Bank in 1986, has served as acting president since October 2010. A committee of four of the Bank’s executives— Vincent Beatty, acting COO; Mike Brandeberry, chief counsel; Christina Gehrke, chief accounting and administrative officer; and John Stewart, chief risk officer—will replace Horton until the board of directors can select his successor.
- The FHLB-Seattle has been classified by the Federal Housing Finance Agency as “undercapitalized,” due to the Bank’s declining advance franchise, its problematic private-label mortgage-backed securities portfolio and insufficient level of retained earnings. The Seattle Bank has operated under a Consent Order with FHFA to resolve outstanding capital and other supervisory matters since October 2010.
- (*Testimony before the House Financial Services Subcommittee on Oversight and Investigations, Edward J. DeMarco, 12/014/11; American Banker, Kevin Wack, 11/28/11*)

## ***Ginnie Mae***

Ginnie Mae had \$1 trillion of mortgage-backed securities outstanding in 2010, representing 25% of the market

- From 2007 to 2010, Ginnie Mae-guaranteed MBS outstanding grew from \$412 billion to more than \$1 trillion, driving the agency’s market share grew from 5% to more than 25%. With the demand for FHA and other federally insured or guaranteed mortgages exploding during this period, financial institutions increased their issuance of Ginnie Mae-guaranteed MBS to finance these federally insured or guaranteed loans.
- “Ginnie Mae has taken steps to better manage operational and counterparty risks, and has several initiatives planned or underway,” wrote the GAO in a November report. “The agency may face operational risk—the risk of loss resulting from inadequate or failed internal processes, people, or from external events—and counterparty risk—the risk that issuers fail to provide investors with monthly principal and interest payments. GAO and others, including HUD’s Inspector General, have identified limited staff, substantial reliance on contractors, and the need for modernized

information systems as operational risks that Ginnie Mae may face. ...Ginnie Mae has identified gaps in resources and conducted risk assessments on its contracts but has not yet fully implemented changes based on these analyses. To manage its counterparty risk, Ginnie Mae has processes in place to oversee MBS issuers that include approval, monitoring, and enforcement. In response to changing market conditions and increased market share, Ginnie Mae revised its approval and monitoring procedures. Ginnie Mae also has several planned initiatives to enhance its risk-management processes for issuers, including its tracking and reporting systems, but these plans have not been fully implemented. It will be important for Ginnie Mae to complete these initiatives as soon as practicable to enhance its operations.”

- “The growth in outstanding Ginnie Mae-guaranteed MBS resulted in an increased financial exposure for the federal government as Ginnie Mae fulfills its mission of expanding affordable housing by linking capital markets to the nation’s housing markets. Nonetheless, Ginnie Mae’s revenues have exceeded its costs and it has accumulated a capital reserve of about \$14.6 billion. However, GAO found that in developing inputs and procedures for the model used to forecast costs and revenues, the agency did not consider certain practices identified in Federal Accounting Standards Advisory Board (FASAB) guidance for preparing cost estimates of federal credit programs. Ginnie Mae has not developed estimates based on the best available data, performed sensitivity analyses to determine which assumptions have the greatest impact on the model, or documented why it used management assumptions rather than available data. By not fully implementing certain practices identified in FASAB guidance that GAO believes represent sound internal controls for models, Ginnie Mae’s model may not use critical data which could affect the agency’s ability to provide well-informed budgetary cost estimates and financial statements. This may limit Ginnie Mae’s ability to accurately report to the Congress the extent to which its programs represent a financial exposure to the government.” (*Ginnie Mae: Risk Management and Cost Modeling Require Continuing Attention*, GAO, November 2011)

Pressure grows in Congress to preserve VA loan limits
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- The American Legion has called on Congress to extend VA limits, currently set at \$729,750, before the ceiling drops to \$625,500 at yearend. Previously, the House of Representatives passed a three-year extension of VA loan limits in high cost markets, but the Senate stripped the provisions from the Veteran Jobs bill (H.R. 674), which President Obama signed into law on November 21. American Legion national commander Fang Wong said that veterans groups had lobbied hard for the VA loan limit extension and there was “genuine disappointment” when the provision failed to pass. Veterans and active servicemen “shouldn’t be forced to make higher down payments,” said the American Legion. The group argued that although Congress has extended the FHA loan limits, the FHA program is not an adequate substitute. (*National Mortgage News*, Brian Collins, 11/30/11)

## Big banks flee reverse mortgages

- Bank of America, Wells Fargo and other large lenders that have long dominated the reverse mortgage market have pulled out of this specialty lending product, leaving a vacuum in the market. MetLife, the third largest reverse mortgage lender in 2010, remains the one holdout—but its recent moves to sell most of its banking and mortgage operations leave many wondering how much longer the insurer will continue to originate reverse mortgages.
- “It’s been a seismic shift over the last couple of quarters in the industry,” said mortgage banker Richard Booth. With lenders leaving the market, the number of reverse mortgage originations have fallen sharply—down 11.9% in October to 4,653 from a year ago, according to *Reverse Mortgage Insight*. (*American Banker*, Victoria Finkle and Kate Berry, 11/21/11)

## Proposed new HUD rule would ensure that gender and sexual orientation would not be considered in extending FHA loans

- “[W]e’ve proposed new regulations to ensure HUD’s programs are open to all regardless of gender identity,” wrote HUD Secretary Shaun Donovan in a November 16 blog post. “Specifically, this rule would:
  - Make clear that gender identity and sexual orientation should not and cannot be part of any lending decision when it comes to getting an FHA-insured mortgage.
  - Clarify that the term ‘family’ includes LGBT [lesbian, gay, bisexual and transgender] individuals and couples as eligible beneficiaries of our public housing and voucher programs, and
  - Prohibit owners and operators of HUD-funded or -insured housing from inquiring about the sexual orientation or gender identity of an applicant.”
- “Collectively, this rule would cover a third of the single-family housing market, and our public housing and vouchers programs which serve 5.5 million people nationwide.” [<http://portal.hud.gov/hudportal/documents/huddoc?id=LGBTPR.PDF>].
- Second, we’re working to better understand the challenges facing the transgender community by conducting the first-ever national study of LGBT housing discrimination, led by Assistant Secretary for Policy Development and Research Raphael Bostic. This study is not only about getting a clearer picture of the problem, but it’s also providing the evidence that LGBT discrimination – including transgender discrimination—is real. And we can’t wait to do something about it.”

- That’s why HUD is pursuing cases alleging housing discrimination because a person’s identity or expression didn’t conform to gender stereotypes. We’ve also provided staff with guidance that instructs them to assess whether any LGBT-based housing discrimination complaints could be pursued through the Fair Housing Act or state or local discrimination laws.”
- “With resources and efforts helping uncover discrimination that had gone unreported for too long, last year reports of LGBT housing discrimination increased 15 times compared to the year before. This doesn’t mean that there’s more discrimination – it means that people are now coming forward and speaking out.”
- “Finally, we are working to educate the transgender community about what their rights are. With HUD’s Live Free fair housing education and outreach campaign we’ve been targeting print and social media with videos, podcasts, and ads that address discrimination due to gender stereotypes and let people know how to report it.”
- “For me, these efforts are about the same thing: civil rights. The story of HUD is a story of expanding civil rights. That story may begin with a painful history, but with work like this, President Obama and I are committed to ensuring it leaves a proud legacy: one of opening the doors of America’s homes to all Americans.” (*The HUDdle-- U.S. Department of Housing and Urban Development’s Official Blog*, Shaun Donovan, 11/16/11)

## ***Farm Credit System / Farmer Mac***

Fitch lowers Farm Credit System’s outlook to negative
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- On November 28, Fitch Ratings affirmed its “AAA” rating for Farm Credit System, but revised its outlook to Negative from Stable.
- “As a government sponsored entity (GSE), the ratings of the FCS are linked to the U.S. Sovereign rating,” said Fitch. “The FCS has historically benefited from their affiliation with the U.S. government, and their current ratings benefit from the implicit support that they receive. Fitch noted in its affirmation of FCS on Aug. 3, 2011 that the ratings of FCS would remain equalized with those of the U.S. Sovereign rating. Fitch anticipates resolution of the Negative Outlook will coincide with Fitch’s resolution of the Negative Outlook on the U.S. Sovereign.” (*Reuters*, 11/28/11)

### Farm Credit System reports \$1 billion net income for third quarter

- “The FCS’s after-tax profits hit a record \$1.008 billion in the third quarter of 2011, up from \$982 million in the second quarter of the year and \$1.004 billion in the first quarter of 2011,” wrote Bert Ely in *Farm Credit Watch*. “...This high profitability, despite shrinking average assets and loan volume, is due primarily to the FCS steadily lowering its funding costs through a continual calling of its longer-term debt, with much of that debt then refinanced at a lower interest rate. ‘Operation twist’ clearly is paying off for the FCS.”
- “During the first nine months of 2011, the FCS called \$42 billion of its outstanding Systemwide Debt Securities, including \$22 billion in the third quarter alone. The third-quarter redemptions equaled 18.6% of the FCS’s outstanding longer-term debt (due more than one year in the future) on June 30, 2011. The FCS’s strong pace of debt refunding has continued since then, with \$8.1 billion of debt called during the first two months of the fourth quarter of 2011. Since the beginning of 2010, the FCS has called longer-term debt equal to the amount of its outstanding longer-term debt on December 31, 2009. The FCS has taken full advantage of today’s low-rate environment.”
- “As a result of its debt refinancing, as well as ‘adjustments in loan pricing to better reflect credit risk and market conditions in the current agricultural economic environment,’ the FCS has maintained a nearly constant level of net interest income. It also has held its net interest margin (NIM) in a narrow range, with its NIM fluctuating over the last five quarters between 2.82% and 2.93%.”
- “Over the last year, increases in the FCS’s net non-interest expense have been entirely offset by a decline in its provision for loan losses. Increased compensation has been a key factor driving up the FCS’s net non-interest expense. Salaries and employee benefits in the third quarter of 2011 were 8.6% higher than in the third quarter of 2010. For the first nine months of 2011, that expense item was 9.2% higher than the comparable period in 2010. Based on last year, FCS employee compensation will skyrocket in the fourth quarter of 2011 as year-end bonuses are declared. Due to an increase in its fully tax-exempt real estate lending (from 47.6% of total loans at the end of 2010 to 49.9% at September 30, 2011), the FCS’s effective tax rate dropped steadily over the last four quarters, from 7.2% in the fourth quarter of 2010 to 5.7% in the third quarter of 2011. It will be interesting to see how much lower the FCS tax rate goes as the FCS continues to minimize its income-tax liability.” (*Farm Credit Watch*, Bert Ely, November 2011)

### FCA ranks as fifth best place to work among small federal agencies

- FCA was recognized by the Partnership for Public Service as the fifth best place to work of all small federal agencies, based upon a survey of more than 266,000 federal

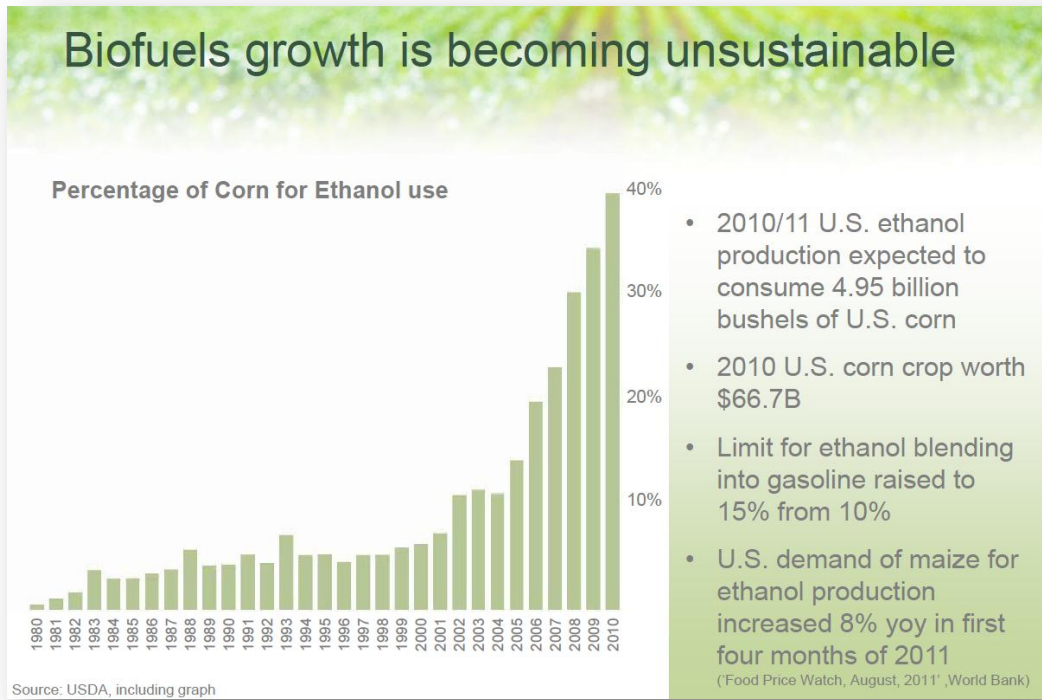
employees. “At FCA, we recognize that employee satisfaction is critical to achieving the agency’s mission,” said FCA chairman and CEO Leland A. Strom. “I am pleased that we have achieved this ranking, and I look forward to continuing to find ways to increase the satisfaction of FCA employees.” (*FCA Press Release*, 11/23/11)

An unsustainable biofuels policy

A case study in the folly of politically directed biofuels investment

An unsustainable biofuels policy

- Today, only two out of every 10 ears of corn grown in the U.S. are consumed directly by humans as food with the remaining eight are used in almost equal shares for animal feed and for ethanol. For the 12 months ended August 2012, more corn was used for fuel than for livestock feed – a first for the industry. This significant milestone, the tipping point in the conflict between crops for food versus fuel, is largely the result of government subsidies for the biofuels industry. China, which was once able to supply its internal corn demand, expects to import from the U.S. a few million tons of corn next year, ramping up demand –and corresponding market pressures—for the nation’s corn harvests.



- Steven Rattner, former counselor to the Secretary of the Treasury and Car Czar advisor for the Obama Administration, points to ethanol is a prime “example of government policy run amok.” In the *New York Times*, Rattner wrote: “Eating up just a tenth of the corn crop as recently as 2004, ethanol was turbocharged by legislation in 2005 and 2007 that set specific requirements for its use in gasoline, mandating steep rises from year to year. Yet another government bureaucracy was born to enforce the quotas. To ease the pain, Congress threw in a 45-cents-a-gallon subsidy (\$6 billion a year); to add another layer of protection, it imposed a tariff on imported ethanol of 54 cents a gallon. That successfully shut off cheap imports, produced more efficiently from sugar cane, principally from Brazil. Here is perhaps the most incredible part: Because of the subsidy, ethanol became cheaper than gasoline, and so we sent 397 million gallons of ethanol overseas last year. America is simultaneously importing costly foreign oil and subsidizing the export of its equivalent.”
- “Even farm advocates like former Agriculture Secretary Dan Glickman agree that the [ethanol] situation must be fixed,” concluded Rattner. “Reports filtering out of the budget talks currently under way suggest that agriculture subsidies sit prominently on the chopping block. The time is ripe.” (*Scientific American*, Melissa C. Lott, 10/07/11)

#### A case study in the folly of politically directed biofuels investment

- “As taxpayer tragedies go, Broomfield, Colorado-based Range Fuels has all the plot elements—splashy headlines, subsidies and opportunistic venture capitalists,” wrote the *Wall Street Journal* in an editorial. “Range got its start in 2006 when George W. Bush used a State of the Union address to extol wood chips as a source for cellulosic ethanol that would break America’s ‘addiction to oil.’ Mr. Bush pledged that with government funding cellulosic ethanol would be ‘practical and competitive within six years.’”
- “[Sun Microsystems’] Vinod Khosla stepped in with his hand out. The political venture capitalist founded Range Fuels and in March 2007 it received a \$76 million grant from the Department of Energy—one of six cellulosic projects the Bush Administration selected for \$385 million in grants. Range said it would build the nation’s first commercial cellulosic plant, near Soperton, Georgia, using wood chips to produce 20 million gallons a year in 2008, with a goal of 100 million gallons. Estimated cost: \$150 million.”
- “The media and political class swooned. Bush Energy Secretary Samuel Bodman attended the plant’s groundbreaking in November 2007, hailing Range as a private-sector ‘pioneer’ that would “reduce our dependence on foreign oil.” Range was celebrated in the *New York Times* and *Forbes*.”

- “In 2007, Congress doubled down by mandating that the U.S. use 100 million gallons of cellulosic ethanol yearly by 2010, and 250 million gallons by 2011—though not a single commercial facility existed at the time. The [EPA] explained in a subsequent report that the bulk of that initial 100 million gallons would come from Range Fuels and another Khosla-funded venture, Cello Energy.”
- “By spring 2008, Range had also attracted \$130 million of private funding, the largest venture investment in the nation in the first quarter of that year. Investors included such prominent VC firms as Blue Mountain and Khosla Ventures and California’s state pension fund, Calpers. The state of Georgia kicked in a \$6 million grant, and all told Range raised \$158 million in VC funding in 2008.”
- “The result has not been another Google. By the end of 2008 with no operational plant in sight, Range installed a new CEO, David Aldous. In early 2009, the company said production was not expected until 2010. Undeterred, President Obama’s Department of Agriculture provided an \$80 million loan. In May 2009, Range’s former CEO, Mitch Mandich, explained that the problem was that nobody had figured out how to produce cellulosic ethanol in commercial quantities. Whoops.”
- “In early 2010, the EPA said Range would finally produce some fuel in 2010—but only four million gallons, not 100 million, and of methanol, not cellulosic ethanol. So taxpayers have committed \$162 million (along with at least that much in private financing) to produce four million gallons of a biofuel that others have been making in quantity for decades. This politically directed investment might have gone to far more useful purposes.”
- “As a closely held firm, Range Fuels doesn’t disclose financial details. But Range technical adviser Bud Klepper told Georgia Public Broadcasting last month that the company would create only one batch of cellulosic ethanol of unspecified size—then shut the Georgia plant and lay off all but four employees as it seeks to raise still more money and work through some technical issues. A Range Fuels spokesman didn’t return calls seeking more details.”
- “As for current Range CEO Mr. Aldous, he’s blaming this failure on—brace yourself—Washington’s failure to impose a tax on carbon via cap and trade. ‘The critical issue is really that there’s no mechanism to price carbon today,’ he told a Colorado newspaper. He also blamed ‘public apathy toward green fuels.’ Apathy? How many other products get the Presidential seal of approval, taxpayer subsidies, forced-purchase mandates and glowing media attention?”
- “As for Mr. Khosla’s other great cellulosic hope, Cello Energy filed for bankruptcy last year. The EPA, which had projected that Cello would create 70 million gallons, has dropped Cello from its list of potential suppliers. More broadly, the EPA last year had no choice but to reduce the government’s 100 million gallon target for 2010 to 6.6 million gallons. It is also fiddling with the definition of what qualifies as a

‘cellulosic’ fuel. Perhaps Newt Gingrich will ask EPA to let corn ethanol make the cut.”

- “If there’s a silver lining here, it is that the folly of this exercise in corporate welfare has been exposed so quickly. There is no excuse now for throwing more money after bad, or to listen to more self-serving pleas from superrich investors who want taxpayers to finance their politically correct attempts to get even richer.” (*Wall Street Journal*, 02/10/11)
- AgSouth Farm Credit has begun foreclosure on its \$80 million loan to Range Fuels secured by the company’s ethanol plant in Soperton, GA. A foreclosure sale is planned for Jan. 3, according to the Agriculture Department. (*Macon.com*, S. Heather Duncan, 12/01/11; *Bloomberg News*, Mario Parker, 12/02/11)

## ***Postal Service***

USPS reports a \$5.1 billion loss for FY2011

Postal Service hires Evercore Partners to “review and advise” the agency on restructuring

USPS resumes its payments of the defined benefits retirement payments

A cost saving plan: slower first class mail

“A refrigerator has never been hacked”

Your name can be right here....

### USPS reports a \$5.1 billion loss for FY2011

- The USPS reported a net loss of \$5.1 billion for FY2011 ended September 30. The agency’s loss would have been approximately \$10.6 billion for FY2011 had Congress not passed legislation that postponed the Postal Service’s mandated payment of \$5.5 billion to pre-fund retiree health benefits.
- FY2011 mail volume declined by 3 billion pieces or 1.7% from the prior year with its most profitable product, First-Class Mail, continuing its year-over-year decline of 5.8%, dwarfing the continued growth in its more competitive products, packages and Standard Mail. USPS Shipping Services revenue, which includes Priority Mail and Express Mail, increased 6.3%, while



revenue from Standard Mail increased 2.9% on a volume increase of 2 billion pieces (2.6%).

- “The Postal Service can become profitable again if Congress passes comprehensive legislation to provide us with a more flexible business model so we can respond better to a changing marketplace,” said Postmaster General and CEO Patrick Donahoe. “To return to profitability we must reduce our annual costs by \$20 billion by the end of 2015. We continue to take aggressive cost-cutting actions in areas under our control and urgently need Congress to do its part to get us the rest of the way there.”
- The USPS continued to increase its operating efficiency in 2011 through a reduction in work hours by 34 million despite an increase of 636,500 delivery points. Since 2001, the Postal Service has reduced work hours by 28%, while delivering to almost 14 million additional addresses.
- “The continuing and inevitable electronic migration of First-Class Mail, which provides approximately 49 percent of our revenue, underscores the need to streamline our infrastructure and make changes to our business model,” said Chief Financial Officer Joe Corbett. “Since peaking at 213 billion pieces in 2006, our volume has continued to decline each year.”
- The Postal Service, which has warned lawmakers that it may run out of money to operate next year, has proposed closing post offices, cutting 220,000 jobs by 2015, ending Saturday mail delivery and delaying its payment of health benefits of future retirees. The postal reform measures currently under consideration by Congress do not go far enough, said Postmaster General Patrick Donahoe. (*United States Post Office Press Release*, 11/15/11)

#### Postal Service hires Evercore Partners to “review and advise” the agency on restructuring

- The USPS has hired Evercore Partners Inc. to “review and advise” the agency on restructuring. “The U.S. Postal Service must make fundamental changes to its business model to return to profitability and continue its mission of providing quality service to every address in the nation,” said the Postal System. Evercore, an investment banking firm that was founded by former U.S. Deputy Treasury Secretary Roger Altman, is also advising Ally Financial Inc., a financial institution that is 74% owned by taxpayers. Previously, Evercore advised PMI Group Inc., the mortgage insurer whose main unit was recently seized by Arizona regulators, and Kinder Morgan Inc., a natural-gas pipeline company
- “Hiring a top restructuring firm like Evercore is an important first step in the right direction,” Harry Wilson, the founder of MAEVA Advisors LLC, who worked on the taskforce to restructure GM and Chrysler. “Now they clearly need to develop a business plan that allows the Postal Service to succeed and will be politically acceptable.”

- In October, the National Association of Letter Carriers, the second largest postal-workers union, hired Lazard Ltd. and former Auto Czar Ron Bloom to help the union develop a restructuring plan for the Postal Service. (*Bloomberg News*, Angela Greiling Keane and Jonathan Keehner, 11/22/11)

#### USPS resumes its payments of the defined benefits retirement payments

- The USPS announced that it plans to resume payments to the defined-benefit portion of a federal worker retirement fund in December, saying it has enough cash on hand to make the biweekly payments. The agency is resuming the retirement payments on the advice of the Justice Department, which was consulted by USPS and the Office of Personnel Management over whether agency had the legal right to stop the FERS payments. Declining to elaborate on the specifics, CFO Corbett suggested to reporters that a legal opinion by the Office of Special Counsel ran counter to the Postal Service's plans.
- Elaine Kaplan, OPM's general counsel, said Wednesday that her agency welcomes the Postal Service's decision to resume the payments. "We can assure U.S. Postal Service retirees that they will receive full credit for their service notwithstanding the delay in the U.S. Postal Service's contributions," Kaplan said. Corbett said USPS has "sufficient cash on hand" to make biweekly payments to FERS and once again warned that postal coffers soon run the risk of going dry.

#### A cost saving plan: *slower* first class mail

- The USPS will announce a cost-savings proposal that would no longer deliver first-class mail on the next day. Postal Service management plans to propose changing its national standard for first-class mail to two-to-five days from one-to-three in a filing with the Postal Regulatory Commission, according to mail industry officials who received a presentation by the agency. "This isn't a change we're happy about," said Art Sackler, executive director of the National Postal Policy Council. "But if they don't cut somewhere and substantially, they're going to run out of cash next summer. It's one of the lesser evils."
- "These changes are being proposed, because they will allow for significant consolidation of the entire postal network in terms of facilities, processing equipment, vehicles and employee workforce," said U.S. Postal Service spokeswoman Sue Brennan.
- The Postal Service's proposal could be quite controversial, particularly among unions that oppose any moves that degrade the quality of mail service and cost mail customers. (*CNNMoney*, Jennifer Liberto, 12/02/11)

“A refrigerator has never been hacked”

- The USPS has begun a print and media advertising campaign, urging customers and businesses to use the mail for “an added feeling of safety and security.” The Postal Service’s video advertisement (<http://www.youtube.com/watch?v=oysFmSVzCnM>), along with its full page color advertisement in the *Wall Street Journal* (11/21/11) and other media outlets reminds readers.



- “Today, the U.S. Postal Service, whose financial condition resembles that of the federal government, of which the USPS is another ailing appendage, is urging cancellation of Saturday deliveries, perhaps en route to three-days-a-week delivery,” wrote columnist George Will. “The USPS lost \$5.1 billion in the latest fiscal year — after serious cost-cutting. Total 2012 losses may exceed \$14 billion, a figure larger than the budgets of 35 states.”
- “The fact that delivering the mail is one of the very few things the federal government does that the Constitution specifically authorizes (Article I, Section 8: “The Congress shall have power to ...establish post offices and post roads”) does not mean it must do it. Surely the government could cede this function to the private sector, which probably could have a satisfactory substitute system functioning quicker than you can say ‘FedEx,’ ‘UPS’ and ‘Wal-Mart.’ The first two are good at delivering things; the third, supplemented by other ubiquitous retailers, could house post offices. All three are for-profit enterprises, so they have an incentive to practice bourgeois civility — to be helpful, even polite. These attributes are not always found at post offices.”
- “Unfortunately, privatization collides with a belief sometimes deemed reactionary but nowadays characteristic of progressives. The belief is: In government, whatever is should forever be. So, efforts to prop up and prod along the postal service, which is older than the nation (it was established by the Second Continental Congress in 1775), include the sweet suggestion of Sen. Claire McCaskill (D-MO). Weary of ‘gibberish spelling’ in text messages from her children, McCaskill’s cri de coeur is: ‘Gaps in history were filled in with letters. ...everything from our Founding Fathers to soldiers in the field. ...I don’t think we should give up on the notion that we’re going to sit down and write a letter.’”

- “But McCaskill’s proposal — an advertising campaign to revive the epistolary culture — is no match for the main culprit responsible for the USPS’s woes: progress. This includes e-mail (even electronic Christmas and other greeting cards are gaining popularity), the digital delivery of movies (as by Netflix, one of the USPS’s biggest customers but perhaps not for long) and those pesky private-sector delivery companies.”
- “The USPS may shed as much as a third of its 653,000 employees — the nation’s second-largest civilian workforce (second to Wal-Mart). This would require Congress to overturn no-layoff provisions in labor contracts, which should make conservatives queasy. Labor costs are 80 percent of the USPS’s costs (53 percent of UPS’s, 32 percent of FedEx’s), in part because it has negotiated very friendly union contracts. The postal service did that because it is free from the tiresome need to make a profit and its competition is limited by law, which forbids anyone else to deliver a letter that is not “urgent.”
- Mail volume has declined 20 percent in five years, and the decline probably will accelerate, in spite of the odd USPS ads seeking customers by saying that letters ‘don’t get lost in thin air’ and ‘a refrigerator has never been hacked. An online virus has never attacked a corkboard.’ Surely privatization beats depending on the USPS for delivering the intellectual light that irradiates the republic.” (*Washington Post*, George Will, 11/25/11)

Your name can be right here....

- The USPS and Denver-based Lighted Promotions, which installs lighted outdoor ads on big rigs, have partnered in a pilot program, selling advertisements on the back of 17,000 USPS freight trucks in 11 states. The ads, costing \$500 to \$600 a month, have been sold to state safety agencies, that are running ads related to highway safety, such as drunk driving, seatbelt safety, as well as anti-drug and anti-alcohol abuse spots.



- Accepting appropriate advertisers and denying inappropriate ones will be one issue that the Postal Service—or any government agency—would have to carefully manage, said Jerry Buckley, marketing director at EMC Outdoor.

“[Taxpayers] would react negatively if USPS ran certain types of advertisers,” said Buckley. “It’s important as a brand to be sure they are putting appropriate

advertisements up. I think it all comes down to proper management and proper messages” Lighted Productions

- CEO Dan Goter said that his agency has already declined ads for political candidates and medical marijuana for the USPS pilot. “We’ve demonstrated in that groups of folks that are willing to pay for this are people that will not damage the postal service’s brands,” said Goter. The Postal Service has refused to discuss the subject other than to confirm that the pilot program is underway.
- The Postal Reform Act introduced by Rep. Darrell Issa (R-CA), includes an expanded advertising program for the USPS, which allows access to all agency vehicles and buildings. The bill requires that the Postal Service to recoup 200% of the cost of pursuing revenue from advertising. (*Advertising Age*, Kerem Ozkan and Riley Wilson Pu, 12/02/11)

## **TVA**

S&P downgrades TVA’s leases by two notches to “AA-”

- Standard & Poor’s downgraded by two notches, to ‘AA-’, various long-term leases with the TVA (AA+/Negative) as obligor. The outlook on TVA’s leases is stable, given the fact that a further downgrade by S&P of the United States would not lower the rating on the leases. “The downgrade reflects the application of our government-related enterprise criteria to the leases,” said S&P credit analyst Theodore Chapman. “We view the credit quality of the debt associated with the leases as aligned with TVA’s stand-alone credit profile of ‘aa-’ because the leases were entered into based on TVA’s general creditworthiness. Applying our government-related entity criteria, we believe that the debt service associated with these leases, which are paid as operating expenses of TVA’s electric system, is less likely to receive extraordinary financial support from the federal government in periods of distress compared to debt issued directly by TVA and that is denominated in TVA’s name as government-sponsored enterprise debt.”
- The rating action affects approximately \$1.2 billion of TVA’s leaseback obligations, including (i) New Valley Generation I, entered into by TVA in 2000, for peaking capacity at TVA’s Johnsonville and Gallatin, Tenn. facilities; (ii) New Valley Generation II, entered into in 2001, for peaking capacity at TVA’s Lagoon Creek, Tenn. facility; (iii) New Valley Generation III, entered into in 2002, also for peaking capacity at TVA’s Lagoon Creek facility; (iv) New Valley Generation IV, entered into in 2003, for peaking capacity at TVA’s Kemper County, MS facility; (v) New Valley Generation V, entered into in 2003, for certain transmission-related monitoring and reporting assets; and (vi) Chattanooga Computer Center Associates Ltd., entered into in 1981, for certain real property in Chattanooga, Tenn.

- TVA spokesman Duncan Mansfield said the utility believes its leases and bonds are both of high credit quality. “The fundamental financial strength of TVA and its leases of TVA-operated power facilities and other assets remains as strong today, if not stronger, than a decade ago when some of these arrangements were made,” said Mansfield. While the S&P downgrade “is not expected to affect” the costs or risk of TVA’s outstanding leases, TVA’s lower rating could push up the costs of future leaseback arrangements for its new combined cycle gas plant near Rogersville, TN and the completion of the Bellefonte Nuclear Power Plant in Hollywood, AL. With the utility’s outstanding debt nearing its \$30 billion cap, TVA is proposing to finance some or all of the \$4.9 billion expense for completing Bellefonte’s Unit 1 reactor by selling and leasing back the new John Sevier combined cycle gas plant and the Watts Bar Unit 2 reactor. (*Standard & Poor’s Press Release*, 11/30/11; *Chattanooga Times Free Press*, Dave Flessner, 12/01/11)

TVA awards 13,000 full-time employees bonuses averaging \$8,300, as the utility boosts fuel charges and rates to offset falling power demand

TVA is “not too far from a Freddie or Fannie situation”

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- TVA awarded a record \$107 million of incentive pay in FY2011, an increase of 29% over last year’s bonuses. On average, the federal utility is giving its nearly 13,000 full-time employees bonuses of \$8,300 per person. TVA contends that its employees are entitled to the bonuses for meeting various goals in the past fiscal year, including power reliability and economic development.
- TVA’s board of directors voted to freeze executive pay for a second straight fiscal year, keeping the nation’s largest public utility in line with a federal salary freeze. TVA President and CEO Tom Kilgore will receive a base salary and incentives in an annual compensation package that will again exceed \$3.5 million, making him one of the highest paid federal employees. However, Kilgore will not be among the highest paid CEOs of major utilities, said the utility’s spokesman.
- In FY2011 ended September 30, TVA’s power sales dropped about 3.5% largely due to mild weather and the slowed economy and generated net income was \$162 million for the year. “While we are happy to have finished in that position we are concerned, because somewhat softer sales will present challenges,” said CFO John Thomas, III. “We do feel we will have some cash pressures in 2012.”
- Kilgore reported to the utility’s board of directors that TVA met most performance goals and “made all milestones” in its ongoing, \$1.2 billion cleanup of a huge

December 2008 coal ash spill at the Kingston Plant. In FY2011, Kilgore gave (i) a “C” grade for the utility’s rates, with TVA having the 40th cheapest retail rates in a comparison with the 100 largest utilities, following a 2% rate increase during the year; (ii) an “A: for reliability, including the utility’s storm response; and (iii) a “D” for nuclear, due to problems at the Browns ferry Nuclear Plant and a delay in finishing the Watts Bar Unit 2 reactor. “This is just one area where we do not get a passing grade,” said Kilgore.

- The board elected vice chairman Bill Sansom of Knoxville as chairman. He succeeds Denny Bottorff of Nashville. Sansom previously served two terms as chairman from 2006 to 2009.
- “[I]n the same edition of the newspaper in which the hefty bonuses were reported, it was also reported that TVA had made up for a big drop in electricity usage over the past year by ‘boosting its rates and fuel charges for consumers ...’, wrote the *Chattanooga (TN)Free Press*. “With TVA already heavily in debt— and with customers having to pay higher rates and fuel charges—does it seem reasonable to you that the utility is lavishing large bonuses on thousands of employees? We do not begrudge any good worker a good wage, but record-high bonuses at a federal utility in the midst of an economic crisis—when many people are having trouble even paying their utility bills—are troubling.” (*Chattanooga Free Press*, 11/30/11; *Associated Press*, Bill Poovey, 11/17/11)

TVA is “not too far from a Freddie or Fannie situation”

- TVA customers in Dyersburg, TN expressed outrage to the area’s s Dyersburg Electric Power Board (DEPB) members about rising power rates, triggered by TVA’s Fuel Cost Adjustment, as the utility awarded its employees substantial end-of-the-year bonuses. DEPB members voiced their disapproval over TVA’s bonuses, citing the Kingston ash spill and its pension problems that have adversely impacted the utility’s bottom line and were recently been passed on to power customers throughout the TVA region.
- “(These events have) caused our base rates and FCA to increase,” said Dyersburg Electric System president Steven Lane. “We just feel that maybe now is not the correct time to be giving out record bonuses.”
- “They still have not reached a final total cost on the ash spill,” said City Attorney John Lannom, who questions TVA’s solvency. “It is well over \$1 billion now. To give in excess of \$1 million in bonuses when their solvency is questionable ... this is not too far from a Freddie or Fannie situation.” The DEPB plans to send a letter to lawmakers outlining their concerns about TVA’s bonuses, which will be approved at their meeting next month. (*Dyersburg State Gazette*, 12/02/11)

- In 2012, the Obama EPA has a robust schedule for proposing, finalizing, implementing and defending a series of new rules, right through Election Day. Most of these rules, which contain long-term compliance deadlines and likely face court challenges, have inspired the GOP House leadership to pass legislation to halting EPA air regulations and make big changes to the administrative process. However, the House efforts will likely face a Senate stalemate in the face of presidential veto threats.
- The EPA's rule making plans include:
  - By yearend, EPA will finalize rules regulating emissions for boilers and solid waste incinerators and to curb mercury and toxic emissions from power plants.
  - By yearend, EPA will finalize with automakers and the Department of Transportation new CAFÉ standards for automobiles and lower the amount of sulfur in gasoline.
  - On January 1, EPA's new rule governing air pollution that blows across state lines will take effect. Forty-five petitioners have filed a massive lawsuit against the new rule, driven largely by states which will fall under more stringent requirements and utilities that will have to implement the new rules. The EPA is joined in the lawsuit by cities and states that will benefit from the new air pollution limits, along with environmentalists.
  - On April 3, the EPA will (i) finalize air standards for wells that use hydraulic fracturing to access natural gas and for oil and natural gas processing plants and (ii) set greenhouse gas emission standards for fossil-fueled power plants and petroleum refineries.
  - In the summer of 2012, EPA plans to decide how to regulate coal ash.
  - In July, EPA will finalize a rule for water discharge permits for cooling towers, which keep power plants and manufacturing facilities from overheating. The cooling towers pull water from rivers and streams, posing dangers to fish and fish eggs that become caught in intake screens.
  - The EPA will phase in their plans to cut haze-causing pollution from coal-fired power plants in 45 states, under judicially mandated deadlines, ranging from December to November 2012. . (*Politico*, Erica Martinson, 11/13/11)

“The success of economic freedom in increasing human prosperity, extending our life spans and improving the quality of our lives in countless ways is the most extraordinary global story of the past 200 years. Gross domestic product per capita has increased by a factor of 1,000% across the world and almost 2,000% in the U.S. during these last two centuries. In 1800, 85% of everyone alive lived on less than \$1 per day (in 2000 dollars). Today only 17% do. If current long-term trend lines of economic growth continue, we will see abject poverty almost completely eradicated in the 21st century. Business is not a zero-sum game struggling over a fixed pie. Instead it grows and makes the total pie larger, creating value for all of its major stakeholders—customers, employees, suppliers, investors and communities. So why is our economy barely growing and unemployment stuck at over 9%? I believe the answer is very simple: Economic freedom is declining in the U.S.”

John Mackey

Co-founder and co-CEO of Whole Foods Market, 11/16/11

“Capitalism is not the source of our problems, as an economy or as a society, and capitalists are not the scourge that they are too often made out to be. As a group, we employ many millions of taxpaying people, pay their salaries, provide them with healthcare coverage, start new companies, found new industries, create new products, fill store shelves at Christmas, and keep the wheels of commerce and progress (and indeed of government, by generating the income whose taxation funds it) moving. To frame the debate as one of rich-and-entitled versus poor-and-dispossessed is to both miss the point and further inflame an already incendiary environment. It is also a naked, political pander to some of the basest human emotions – a strategy, as history teaches, that never ends well for anyone but totalitarians and anarchists.”

Leon G. Cooperman

Open Letter to the President of the United States, 11/28/11

<http://tinyurl.com/7yqwo8e>

“But the 99% is undaunted. Occupy Wall Street’s message already has created a new day. This movement has created a seismic shift in our national debate—from austerity and cuts to jobs, inequality and our broken economic system. [I]t will keep spreading no matter what elected officials tell police to do. But that doesn’t mean these raids are acceptable. In fact, they are inexcusable. ...The AFL-CIO will do everything in our power to make sure the free speech rights of these peaceful protesters are protected.”

Richard Trumka

President of the AFL-CIO

11/15, 2011

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