

November 2, 2011

“[The EU bailout] is tied to higher risks of losses and to increased sharing of risks. The way they are constructed, the leveraging instruments are not too different from those which were partly responsible for creating the crisis, because they concealed risks.”

Jens Weidmann,
President of the Deutsche Bundesbank
October 28, 2011

“The 50 percent nominal haircut on the proposed bond exchange would be viewed by the agency as a default event under its

Distressed Debt Exchange criteria. Greece would still have a large amount of debt outstanding, its growth prospects are weak and its willingness to implement structural reforms may dissipate.”

Fitch Rating Agency
October 28, 2011

“We are not closer to the solution but are faced with nine years of collapse and poverty.”

Antonis Samaras
Greece’s conservative opposition leader
October 28, 2011

“This is a global crisis. It’s a crisis that calls on all of us, whether in Europe, in Latin America or any other continent.”

Pedro Passos Coelho
Portuguese Prime Minister
October 29, 2011

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Major Events

Is the Eurozone's fate in the hands of the Greeks?

“Europe's problems will visit shores all over the world”

The first EU domino to fall—MF Global, the United States' 8th largest bankruptcy

Will GE be next?

Is the Eurozone's fate in the hands of the Greeks?

- World markets reeled when Prime Minister George Papandreou announced on October 31^s that Greece will hold a national vote on its debt restructuring package, reviving fears that a non-orderly default of Greek debt would spiral out of control in the Eurozone. [The latest polls in Greece showed that 60% opposed the new bailout plan, while 15% supported it.] Papandreou's announcement came just days after European leaders in Brussels agreed on a set of measures to reduce Greece's debt burden and beef up a rescue fund to prop up troubled euro-zone nations. (*Wall Street Journal*, Javier E. David and Deborah Levine, 11/01/11)
- “The last time we had a referendum in Greece was 1974 when the monarchy was abolished and Third Hellenic Republic was established,” wrote David Zervos, Managing Director and Chief Market Strategist, Jefferies & Co. “Since 1829 there have only been 8 referendums in Greece, which ironically enough is very close to the number of defaults since that time at 5. Needless to say Greeks do not call referendums very often. To be sure, the Greek people, the Greek political elite and frankly the entire world do not have a great explanation for why Papandreou has gone for this very aggressive action at this time. One can however speculate which is what I will attempt to do now. Here are a few bullet points on why I think this is being done right now:”
- “It is a basically another Greek blackmail scheme. The Greeks, led by Papandreou's father, executed a blackmail scheme back in 1985 when they withheld a vote for Spanish and Portuguese membership in the EEC. Ultimately they received 30b in EU funds for a yes vote. This type of action is very typical of Greek political leaders - like father, like son.”
- “The protests at the parades on October 28th were extremely upsetting to the Greek political elite. To see broad based negativity on the bailout plans was very surprising, especially at such important and nationally sensitive events.”

- “Papandreou is actually doing the right thing for the Greek people. This is critical decision for the country. The people should decide if they want to take the medicine and stay in the EU, or reset the debt clock and go out on their own. This is no different than the British deciding to leave the ERM in the early 90s (although there was not really a referendum for that in UK, which probably is associated with the fact that they have a monarchy and the Greeks do not, in any case I digress).”
- “There are huge costs to the EU project associated with the Greeks choosing to leave. The idea that any country in the EU is contemplating a referendum on exit will have EMU leaders quaking in their boots. In the end, Papandreou knows this and he is playing an aggressive card as we head into the Cannes G20 meetings where the Americans and Chinese are going to be driving EU policy more than Germany or France. This move could pay off very nicely for the Greeks with better bailout terms. Alternatively, the downside of exit is probably not as bad as staying in the zone under all of the agreed austerity conditions. In that sense it is a free option for Papandreou and the Greeks.”
- “From what I see Papandreou just showed the north who is boss in this situation— ‘It’s our debt, but it’s your problem’— should have been the title of his announcement. Bravo to Papandreou. He is peeling back the layers of the rotten onion that is EMU and exposing the Italian, French and Belgian situations for what they really are! I stand by the idea that the end game here is a Greek exit—and today’s action gets us one step closer. Further, the turmoil in Italy and France gets us one step closer to a Eurobond that has Germany wrapping whatever remains of a tattered EMU. The EMU end game is German fiscal dilution and exit for the weakest links.” (*Over My Shoulder*, David Zervos, 11/01/11)

“Europe’s problems will visit shores all over the world”

- “Politicians have delayed addressing the [eurozone] problem yet again,” said commodities trader Jim Rogers. “It will come back in a few weeks or a few months and the world will still have the same problem, but this time, only worse, because the European Central Bank and other countries will be deeper in debt.” The EU agreement has been widely criticized for being “short on details” and with “very little real work [having] been done,” as analysts looked into the fine print—or lack thereof—of the agreement.
- “We expressed our doubts that last Thursday’s European rescue was sufficient,” wrote Sean Goldsmith in the *S&A Digest*. “It only addressed immediate needs (namely Greece), while ignoring the larger problems (namely Italy). After Thursday’s manic gain, the market is waking up to the realities in Europe... Three out of four of Italy’s leading banks are already trading below pre-bailout levels. UniCredit, Italy’s largest bank (and our preferred bellwether for the nation), is down nearly 6% to \$0.85. Italian bond yields are more than 6% and rising. And U.S. Treasuries are once again the security of last resort— the yield on the 10-year bond

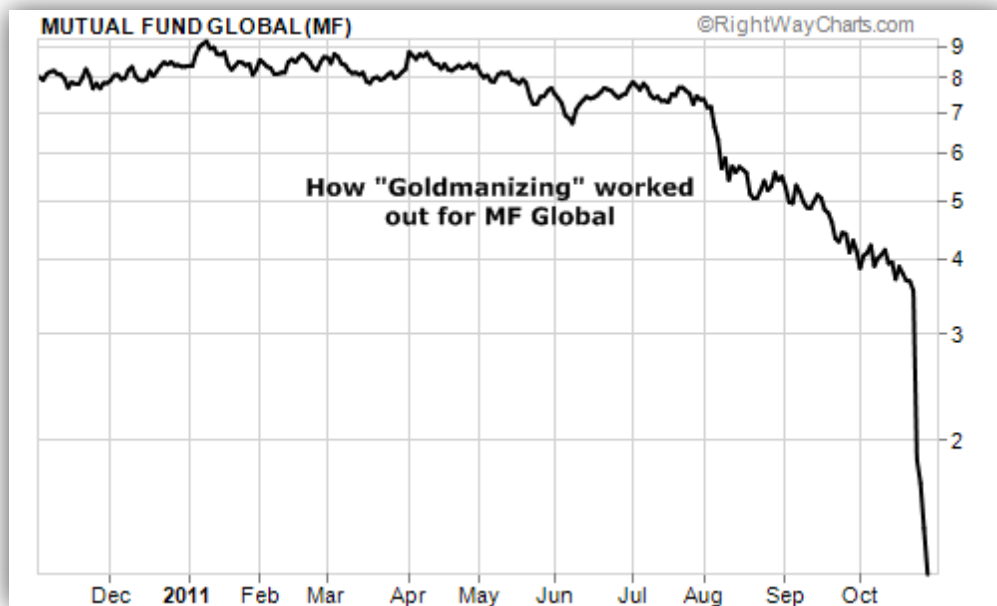
fell 12 basis points today. But it gets worse... In addition to writing down Greek debt by 50%, the European Union bolstered its bailout fund, the European Financial Stability Facility (EFSF). Today, the EFSF announced plans to sell 5 billion euros in 15-year bonds to finance the Irish bailout. Later today, it cut the offering to 3 billion euros and shortened the duration to 10 years. Even with government backing, nobody wants to buy these bonds.”

- “Yet in the light of day, the holes in the rescue plan are plain to see,” wrote *The Economist* in its October 29 lead editorial. “The scheme is confused and unconvincing. Confused because its financial engineering is too clever by half and vulnerable to unintended consequences. Unconvincing, because too many details are missing and the scheme is at its core not up to the job of safeguarding the euro. It is unlikely it will last.”
- Even if the European banks are recapitalized and survive the debt crisis, the Eurozone will not have addressed the underlying problem of the member countries’ budget deficits. “Budget deficits among the PIGS are more than 7% of DGP today, which is double what the EU rules actually permit, and the ability to trim these is curtailed by a recession-bound backstop,” said Gluskin Sheff’s David A. Rosenberg. “The problems in Europe are deep and structural and are not adequately addressed in this plan, even if the banks do end up getting recapitalized successfully. The can has been kicked down the road and incentives for other countries to follow through with fiscal adjustments have been distorted—for long-term thinkers, that is the way to view the situation.” (*Breakfast with Dave*, David A. Rosenberg, 10/27/11; *Thoughts from the Front Line*, John Mauldin, 10/29/11; *The Economist*, 10/29/11; *Five Minute Forecast*, Agora Financial’s Executive Series, 10/31/11; *The S&A Digest from the Desk of Porter Stansberry*, Sean Goldsmith, 10/31/11)

The first EU domino to fall—MF Global, the United States’ 8th largest bankruptcy

- “[W]ith MF Global, we now have the first major casualty besides a sovereign government stemming from the Eurozone crisis (the broker-dealer reportedly had \$6.3 billion in direct exposure to shaky Eurozone debt),” said Dave Rosenberg. “In a domino game, more pieces are likely to fall.”
- MF Global, led by former Goldman Sachs CEO Jon Corzine, declared Chapter 11 on October 31, as a result of the firm making a series of risky bets on the EU crisis, buying up big holdings of debt from Spain, Italy, Portugal, Belgium and Ireland at a discount. The firm only had \$1.23 billion of equity on September 30, yet had total assets of more than \$41 billion, meaning MF Global was leveraged almost 40 to 1. The size of MF Global’s Eurozone debt investments – believed to total \$6.3bn — led two ratings agencies to cut their ratings on the firm the last week of October, triggering investors to demand cash to cover potential losses, which the firm was unable to do.

- Subsequently, MF Global has admitted using clients' money as its financial troubles mounted after regulators raised questions about the company's books, according to federal officials. It is not clear where the money—rumored to total some \$700 million—ended up or what it might have been used for, said the official.
- “[CME Group, owner of the exchange where MF Global did most of its business,] has determined MF Global is not in compliance with Commodity Futures Trading Commission and CME customer segregation requirements,” said CME Group CEO Craig Donohue. “While we are unable to determine the precise scope of the firm’s violation at this time, we are investigating the circumstances of the firm’s failure.”
- It is unclear whether MF Global’s violations could lead to criminal charges.
- MF Global’s bankruptcy is a major embarrassment for Corzine, who took over the firm in March 2010, after serving as a Democratic Senator for New Jersey, where he served on the Senate Banking Committee and co-authored the Sarbanes Oxley Act of 2002. He also served as the 54th governor of New Jersey. Corzine joined MF Global with a mission to turn the sleepy brokerage firm into a mini Goldman Sachs. (*Breakfast with Dave*, David A. Rosenberg, 11/01/11; *The Guardian*, Dominic Rushe, 11/01/11; *Associated Press*, 11/01/11)



Will GE be next?

“While MF Global is the first to go, several U.S. companies carry far more exposure to European debt,” wrote Sean Goldsmith in the *S&A Digest*. “Take General Electric,

for example... About 20% of GE's commercial real estate holdings are in euro nations – about \$16 billion in total exposure. And 50% of GE's consumer finance business (mortgages and credit cards) is euro-based. That's \$71 billion in total exposure. Plus, you can add to that another \$40 billion in European commercial loans and leases (mostly aircraft)."

- "I asked my colleague Porter Stansberry – possibly the biggest GE bear you'll meet – to comment on the situation. He told me '...That's \$127 billion in direct exposure to Europe. Assume a 20% haircut on these assets (based on bond prices), and you're looking at \$25 billion in losses. That's a conservative estimate based on today's prices... but we expect the situation will get worse. Due to \$100 billion-plus of assets sales (including some of its best money-making properties, like NBC), GE now holds \$44 billion in net tangible equity capital, which is enough to weather the storm in Europe – for now. However, I believe GE will continue to sell its trophy assets to cover these losses, which will greatly minimize the earnings power of the surviving company. And... if the crisis in Europe continues to get worse, there's no doubt GE's solvency is at risk.'" (*The S&A Digest from the Desk of Porter Stansberry*, Sean Goldsmith, 10/31/11)

"We Can't Wait"

Obama administration announces HAMP 2.0

Larry Summers calls on FHFA to fix the housing market

And FHFA's Acting Director DeMarco responds

"The fury directed at Mr. DeMarco ... is the fury of a political class that is being denied its housing toys—finally"

Obama announces student loan "relief"

"We Can't Wait"

- President Barack Obama will "continue [to act] independently" without congressional authorization to "benefit the American people" as part of the White House's *We Can't Wait* campaign, said Press Secretary Jay Carney " [The President] fully understands that the kinds of things that are contained within the American Jobs Act require congressional action, require laws being passed, and that's why he's pressing for Congress to take action legislatively," said Carney. "But he can also act independently or, rather, administratively, and exercise his executive authority to benefit the American people in other ways. And he will continue to do that." (*The Daily Caller*, Nicholas Ballasy, 10/31/11; *National Journal*, Goerge E. Condon, Jr., 10/24/11)

Obama administration announces HARP 2.0

- In an October 24 speech in Nevada, President Barack Obama announced changes that his administration will be making to the HARP program to help reduce the monthly payments for homeowners who owe more than their property is worth. Administration officials hope that by reducing borrowers monthly mortgage payments, it will free up cash for consumers to spend elsewhere. “We can’t wait for an increasingly dysfunctional Congress to do its job,” said Obama. “If they won’t act, I will.”
- The Federal Housing Finance Agency unveiled a modified HARP program, which will (i) eliminate certain risk-based fees for borrowers who refinance into shorter-term (e.g., 15- and 20-year) mortgages; (ii) remove the current 125% loan-to-value ceiling for fixed rate mortgages guaranteed by Fannie Mae and Freddie Mac; (iii) waive certain reps and warranties that lenders undertake in making loans owned by the GSEs; (iv) eliminate the need for property appraisals, where a reliable automated value model estimate is provided by the GSEs; (v) extend the HARP program to December 31, 2013. This program, which will be rolled out on December 1, will only be available to borrowers with a GSE-backed mortgage that was originated before May 31, 2009 and who have remained current on their mortgage. FHFA will release implementation guidelines for HARP 2.0 on November 15, which will provide additional details on the program’s revisions.
- FHFA’s goal of HARP 2.0 is to double the impact of the existing program, which has modified approximately 900,000 mortgages to date. The administration anticipates that the changes to HARP will benefit those hit hardest by the housing market downturn.



(Source: *Wall Street Journal*, 10/24/11)

- “Refinancing has been a key focus for President Obama,” said National Economic Council Director Gene Sperling. “He considered putting forward legislation through the jobs act. We made a decision that there was a good opportunity to work with the industry and the FHFA to move forward without legislation.” Sperling also pointed out that FHFA’s agreement to waive reps and warranties could “unleash competition” from banks for new mortgage refinancing. “It also will give far greater incentive for the bank that currently holds the mortgage to preemptively offer these families a competitive rate that will help them,” added Sperling.
- The Mortgage Insurance Companies of America is supporting HARP 2.0, which the trade group views as a step in the right direction of helping to keep homeowners current in their mortgage payments and reducing default claims. “No MICA member will institute any additional requirements for HARP loans beyond the GSEs’ program requirements, aligning with their common goals,” said MICA. “The industry will continue to collaborate with the GSEs, the lending institutions and servicers to further streamline the operational processes. To advance the reach of the program, private MIs will release lending institutions of representations from the original loans.”
- “Under the restructured HARP, I expect an additional 1.05 million [refinancings] through the end of 2012 and 1.6 million [refinancings] through the end of 2013 when the program ends,” said Moody’s economist Mark Zandi. “While HARP won’t live up to the initial expectations of 4-5 million in refinancings, the program will ultimately provide a meaningful boost to the broader economy as financially stressed households will benefit from much lower mortgage payments. It will also provide a bit of help to the housing market by forestalling some mortgage defaults. ... While I think this was a very positive step, it isn’t a magic bullet for the housing market and economy. Policymakers will thus very likely have to do more to support the housing market and economy.”
- Keefe Bruyette & Woods analysts concluded that the anticipated increase in HARP refinancings would likely be small relative to the mortgage market as a whole in which some two-thirds of the 11 million mortgage borrowers who are “underwater” on their homes are paying above market rates on their loans. “Even if [the] HARP volume doubles and equals \$250 billion in volume over the next two years, it would still mean that HARP volume would account for about 10 percent of total mortgage volume,” said KBW analysts in an October 24 note to clients. (*Washington Post*, Zachary A. Goldfarb, Scott Wilson, 10/24/11; *Bureau of National Affairs*, Mike Ferullo, 10/25/11; *HousingWire*, Kerri Panchuk, 10/26/11; *Wall Street Journal*, Nick Timiraos, 10/24/11; *Amherst Mortgage Insight*, Laurie Goodman, 10/24/11; *TalkingPointsMemo.com*, Brian Beutler, 10/24/11; *EconomicMusing.com*, David Schawel, 10/24/11; *HousingWire*, Jon Prior, 10/21/11)

Larry Summers calls on FHFA to *fix* the housing market

- “The central irony of financial crisis is that while it is caused by too much confidence, too much borrowing and lending and too much spending, it can only be resolved with more confidence, more borrowing and lending, and more spending,” wrote Larry Summers, the former Director of the National Economic Council for President Barack Obama. “...Unfortunately, for several years policy has been preoccupied with backward-looking attempts to address the consequences of past errors. While the focus has been on helping individual homeowners, decisions that are ultimately more important regarding the GSEs have been left to their conservator, the Federal Housing Finance Agency, which has taken a narrow view of the public interest. The FHFA has neglected its conservatorship mandate to ensure that the GSEs help stabilize the nation’s housing market. It has taken no account of the reality that the GSEs’ health depends on a national housing recovery. Instead, the FHFA’s focus has been on reversing previous policies, heedless of changes in the environment and treating mortgage finance as a morality play. A better approach would involve a number of substantive changes.
- Summers outlined five essential actions that must be taken to address the housing market and fix the economy which include:
 - “First, and perhaps most fundamentally, credit standards for those seeking to buy homes are too high and rigorous in America today.
 - Second ...there is no reason why those who are current on GSE guaranteed mortgages should not be able to take advantage of lower rates.
 - Third, stabilizing the housing market will require doing something about the large and growing inventory of foreclosed properties. ... Aggressive efforts by the GSEs to finance mass sales of foreclosed properties to those prepared to rent them out could benefit both potential renters and the housing market.
 - Fourth, there is the issue of preventing foreclosures which was the initial focus of housing policy efforts. ... Surely there is a strong case for experimentation with principal reduction strategies at the local level. The GSEs should be required to drop their current posture of opposition to experimentation and move on a more constructive posture.
 - Fifth, there were clearly substantial abuses by major financial institutions and most everyone in the mortgage industry during the bubble period. ...It is equally in the interests of bank shareholders and the housing market that a rapid resolution of disputes be achieved. The FHFA should be striving to bring the current period of uncertainty to a rapid conclusion.” (*Reuters*, Lawrence H. Summers, 10/24/11)

And FHFA's Acting Director DeMarco responds

- “FHFA has been aggressively trying to assist the housing market to ensure that the country continues to have a liquid and stable and functioning secondary mortgage market,” said FHFA Acting Director Edward DeMarco in an October 30 CSPAN interview. “Some of those things that are being advocated for us to do really go beyond what Congress has given us the authority to do and the funds that have been provided. ...On a stand-alone basis, principal forgiveness doesn't accomplish our conservator mandate relative to the loan modifications tools and techniques that we have in place right now. ...[T]he borrower still has a responsibility and an obligation for the repayment of the loan.”
- DeMarco argued that Congress and the administration must decide how to restore the housing market. “That policy debate needs to take place and we need to await an act of Congress to give us clear direction on where we're going forward and what the timeline for that is. The longer this goes on, the harder it is for FHFA to know what to do. ...Conservatorship is really not meant to be a long term solution, and the longer conservatorship goes on, it does become pretty challenging to make decisions about long-term investments that companies are supposed to make.” (*Reuters*, Margaret Chadbourn, 10/29/11; *Wall Street Journal*, Nick Timiraos, 10/29/11; *HousingWire*, Kerri Panchuk, 10/31/11)

“The fury directed at Mr. DeMarco ...is the fury of a political class that is being denied its housing toys—finally”

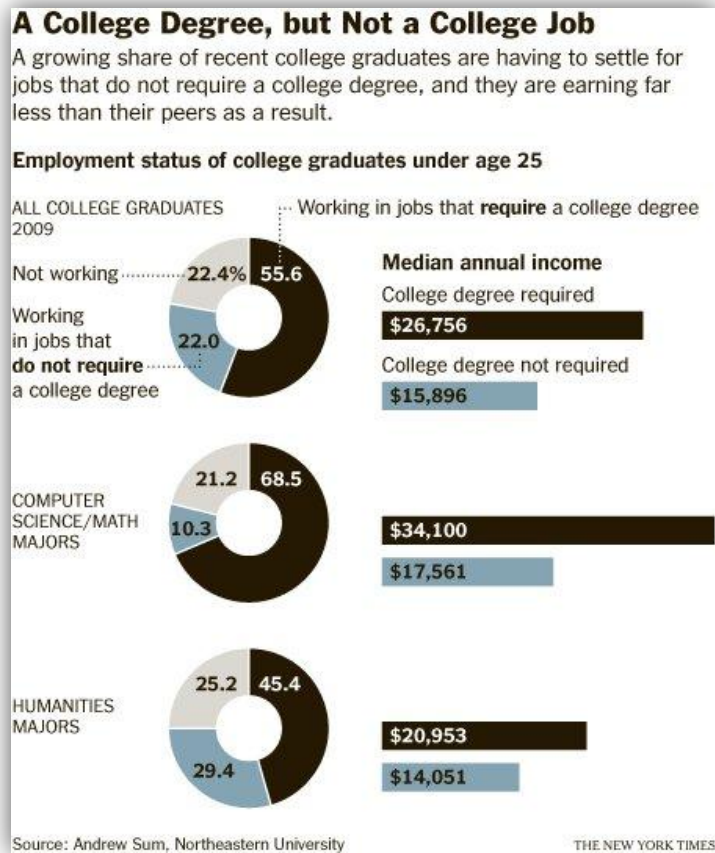
- “Democrats have since moved to outright public assault [on DeMarco], wrote the *Wall Street Journal's* Kimberley A. Strassel. “A group of 17 House Democrats met with Mr. DeMarco in early October and went bananas when he refused to roll to their demands. ‘I said to him twice, “Mr. DeMarco, if you cannot do this job ...maybe you should move to the side and let somebody else come and replace you,” railed Maryland Rep. Elijah Cummings. ‘Either do something or get out of the way,’ griped California's Dennis Cardoza. ...The real problem with the housing market is that politicians, led by this White House, have spent five years spending boatloads to forestall foreclosures, prolonging the pain and frightening mortgage investors. Mortgage forgiveness is more of the costly same. The only juice it provides is political.”
- “Under intense pressure (from a White House that is not supposed to pressure an independent regulator), Mr. DeMarco this week agreed to the administration's latest update to its flailing Home Affordable Refinance Program; this would make it easier to refinance mortgages held by Fannie and Freddie. His gesture left Democrats unsatisfied. And so 19 House members this Wednesday again forced a sit-down to present Mr. DeMarco with their latest principal write-down proposal.”

- “Let’s hope Mr. DeMarco files it with the others. Taxpayers are billions into Fannie and Freddie precisely because of their years as creatures of Washington politics. The fury directed at Mr. DeMarco today is the fury of a political class that is being denied its housing toys. Finally.” (*Wall Street Journal*, 10/28/11)
- “I’m an independent regulator,” said DeMarco in an interview with *Politico*. “I’m not trying to be a friend or foe to anyone. ...I’m going to follow the law.”(*Politico*, Joseph Williams, 10/26/11)

Obama announces student loan “relief”

- On October 27, President Obama said he will authorize changes in federal policy to make college loans more affordable and easier to pay. To a cheering crowd at University of Colorado-Denver, Obama said, “We were paying more on our student loans than we were paying on our mortgage each month. How do we make college more affordable and how do we reduce your burden?” The president answered these questions through the creation of the “Know Before You Owe” plan by an executive order, which would allow some college graduates to limit federal student loan payments to 10% of discretionary income starting in January, two years before the cap was to have gone into effect under federal law. The program would also forgive all remaining debt on federal loans after 20 years, five years earlier than under current law. To qualify, borrowers must have student loans in 2012 and have had loans in at least one of the previous four years. Approximately 6 million borrowers, who have federal student loans, will be allowed to consolidate their debt under this plan, which may reduce the interest rate on their loans by as much as 50 basis points. “The initiative was also an effort to reach out to a voting bloc that was crucial to Obama’s winning 2008 coalition, a bloc that he will need next year as well,” wrote *Washington Post*’s reporters David Nakamura and Scott Wilson. (*Washington Post*, David Nakamura and Scott Wilson, 10/27/11)
- “College graduates are entering one of the toughest job markets in recent memory, and we have a way to help them save money by consolidating their debt and capping their loan payments,” U.S. Secretary of Education Arne Duncan said in a statement. “And we can do it at no cost to the taxpayer.” (*The University of Texas at Austin’s Daily Texan*, Jennifer Berke. 10/27/11)
- In fact, no one knows how much the Income Based Repayment program will cost taxpayers. Since CBO estimates future costs and revenues for a 10-year window, any costs or loss of revenue for forgiving loans outside that window are not factored in. Thus, IBR is treated as a “free” program for budget scoring purposes. (www.mindingthecampus.com, Andrew Gillien, 10/26/11)
- In a *Wall Street Journal* interview, Representative John Kline (R-MN), chairman of the Education and the Workforce Committee, expressed concern about the president’s lower student loan repayments and more debt forgiveness, saying: “I can’t tell you

how many times I've heard in the last couple of days, since the president has come out with this, people saying 'Well wait a minute, I paid my student loan. Why should they not have to pay their student loan?' So, I think that there is some natural anger and, might say outrage, that's not fair. And, I am worried that there are not taxpayer protections in there. So, I wrote a letter to Secretary Duncan to say 'What's going to happen really when these loans aren't repaid?' I think it's also going to give an incentive to students to say, 'Well, it's going to be forgiven anyway; if I'm not going to pay this, I can take out more debt.' So, I think it's going to have some adverse effects across the board with students, with money going to the government sector out of the private sector, and it's going to cost taxpayers' dollars." (*Wall Street Journal*, 11/01/11)



- America's student loan debt exceeds that of credit cards, topping \$1 trillion, according to the Federal Reserve. While 68% of students graduate from high school, only 20% of these students earn a college degree. In 2010, graduating college seniors walked away with a diploma and, on average, \$24,000 in student loans, while the default rate on student loans increased from 7.0% to 8.8% between 2008 and 2009. In today's bleak employment market, a growing number of graduates are finding that their student loans are unsustainable. (*New York Times*, Catherine Rampell, 05/18/11; *New York Post*, Glenn Harlan Reynolds, 10/29/11; *Ezra Klein's Wonkblog*, Ezra Klein, 10/26/11; *RealClearPolitics.com*, Debra Saunders, 10/30/11; *Mindingthecampus.com*, Charlotte Allen, 10/31/11)
- "The fundamental problem here is not debt but a broken educational system that no longer insists on excellence," said Anne Neal, president of American Council of Trustees and Alumni. "College tuitions have risen more than 440% over the last 25 years—and for what? The students who say that college has not prepared them for the real world are largely right." In fact, the students' complaints about what their colleges and universities are charging them *do* have a point. "Too many have paid

much and been taught little, wrote *Wall Street Journal* reporter William McGurn. “They’ve been ripped off—but not by the banks or the fat cats or any of the other stock villains so unwelcome these days in Zuccotti Park.” Neal added, “If these students and grads understood the real issues with their college debt, they would change their focus from Occupy Wall Street to Occupy the Ivory Tower.” (*Wall Street Journal*, William McGurn, 11/01/11)

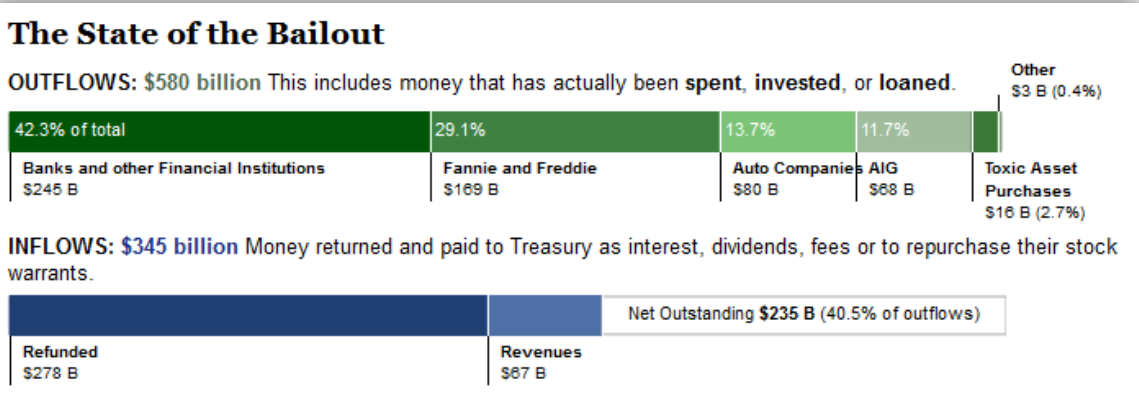
- Glenn Harlan Reynolds, law professor at the University of Tennessee, said the president’s new proposal to help students drowning in debt are “promises” at best. As pointed out by the *Chronicle of Higher Education*, “The benefit is available to only current students. Those jobless college graduates who are



protesting Wall Street and at similar events elsewhere won’t qualify.” Even for those who do qualify, Reynolds notes, the benefit won’t amount to much—less than \$10 a month for the average graduate. “At best, it’s a bandaid solution,” wrote Reynolds in the *New York Post*. “The real problem is we’ve been running a higher education bubble, one that—like the real estate bubble—has been pumped up by cheap government money. Since 1999, student loan debt has increased by 511%, while disposable income has increased by only 73%. That’s because when the government subsidizes something [e.g., housing, healthcare, higher education, etc.], producers respond by raising prices to soak up as much of the subsidy as they can.”

- “[T]he real incentive-alignment part is this: Put the institutions on the hook for the money that they received,” wrote Reynolds. “Making them eat the entire loan balance would probably bankrupt a lot of colleges (though that should tell us something right there), but sticking them with even a small fraction—say 10% or 15%-- would be enough to inspire a much greater degree of concern for how much debt students take on while in school, and how likely they are to find gainful employment after graduation. One way or another, the higher education bubble is going to deflate. Better that it should do so without crushing the students it was supposed to benefit—or the taxpayer.” (*New York Post*, Glenn Harlan Reynolds, 10/29/11)

TARP



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

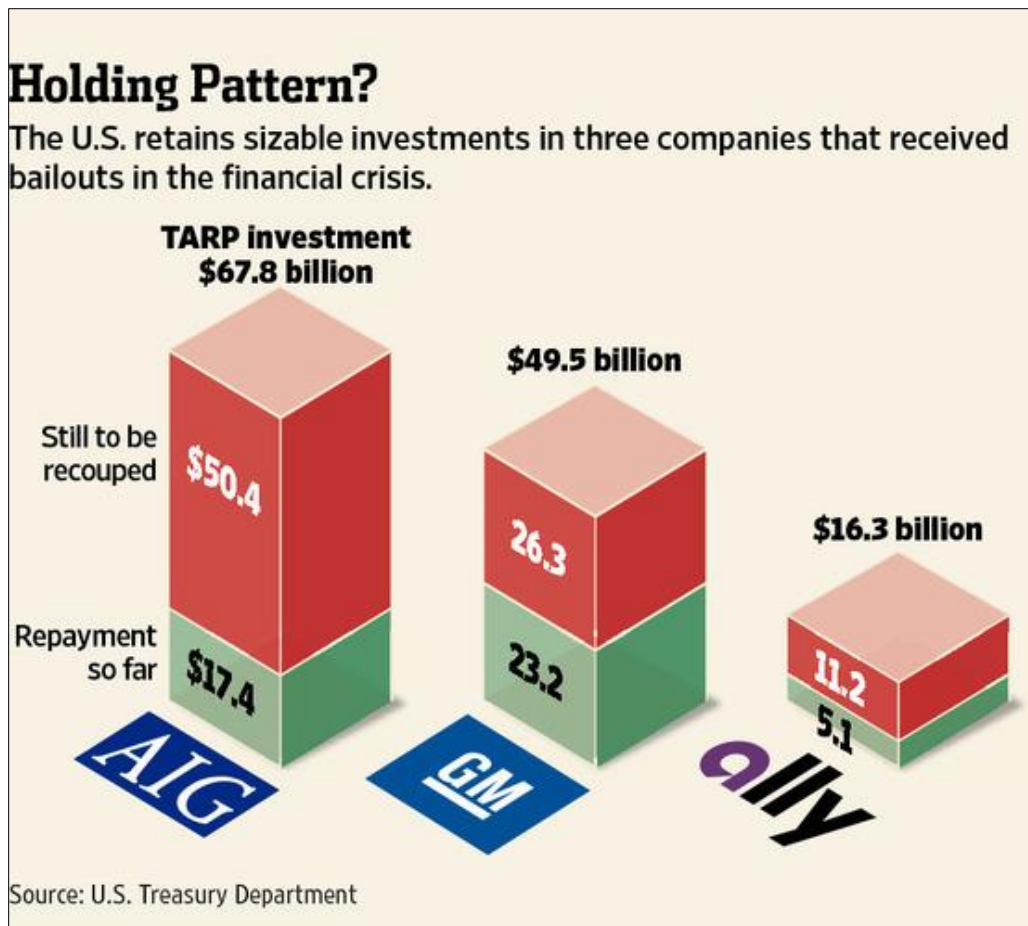
SIG-TARP recommends that Treasury develop “a clear exit path for community banks” from TARP

- In its Quarterly Report to Congress, the Special Inspector General called on Treasury and the banking regulators to develop a clear exit path for 390 small community banks that owe some \$2 billion to TARP’s Capital Purchase Program (CPP). SIG-TARP noted that 193 of these institutions have failed to pay their CPP dividends, totaling \$356.9 million. In 2010, the Obama administration and Congress created a Small Business Lending Fund that allowed 137 banks to use the proceeds to retire their TARP borrowings, using government funds with more attractive terms and conditions to pay-off the higher cost TARP. Thirteen CPP recipients, which held \$2.9 billion of CPP fund, had declared bankruptcy or failed as of September 30.
- “Community banks need a clear exit path out of TARP that is put into action well before a scheduled rise in the TARP dividend (beginning in the fall of 2013 for many banks),” wrote Acting SIG-TARP Christy Romero. “The best exit path for community banks should involve access to new capital to replace the TARP capital. After five years, the 5% TARP dividend rate will rise to a very expensive 9%. SIG-TARP is concerned that when the dividend rate increases, many of these banks will remain in TARP but still be unable to access new capital. If that is the case, many will have no means either to exit TARP or to pay their required dividend payments. Treasury should commit to prudent stewardship of its TARP investments; it must take action to ensure that as many banks as possible repay taxpayers and to prepare to deal with the banks that cannot.” (*Quarterly Report to Congress*, Office of Special Inspector General of TARP, 10/27/11)

- “Something needs to happen,” added Romero in an interview with *HousingWire*. “There needs to be some action taken right now. Otherwise, these small banks have no ability to raise capital. When the dividend increases, they will scramble to raise capital in the same timeframe. That can flood the markets, and that will put these banks in more jeopardy.” (*HousingWire*, Jon Prior, 10/26/11)

Sale of Treasury investments in AIG, Ally and GM in “holding pattern” due to market conditions

- The Treasury Department will likely delay its plans for a second sale of AIG shares in November due to “unfavorable market conditions,” said sources familiar with the officials’ discussions. AIG shares have lost nearly half their value in 2011, pushing its stock value below the level at which Treasury would book a loss for taxpayers on any sale of AIG shares
- Three years after the TARP bailouts were implemented, Treasury remains the largest shareholder in three firms—AIG (77% stake), Ally Financial (74%) and GM (26%). (*Wall Street Journal*, Serena Ng, Sharon Terlep and Randall Smith, 10/31/11)



Treasury will likely postpone a sale of AIG stock due to “adverse market conditions”

AIG will complete a \$2.5 billion debt swap in November

Legal battle “splits” working relationship of Bank of America and AIG

AIG will complete a \$2.5 billion debt swap in November

- AIG announced it will conduct a \$2.5 billion debt swap with its creditors on five separate debt obligations, denominated in several different currencies, and bearing interest rates varying from 4.875% to 8.175%. AIG’s debt swaps will be conducted in November. AIG is hoping to take advantage of record-low interest rates, which could potentially save the insurer several hundred basis points on its debt obligations. (*Annuity News Journal*, Steve Thompson, 10/28/11)

Legal battle “splits” working relationship of Bank of America and AIG

- Bank of America recently declined an opportunity to provide AIG new credit lines, although the bank had helped arrange insurer’s lines of credit in 2010. The move by BofA followed AIG’s decision to sue the Bank over engineering a “massive” fraud and seeking to recover over \$10 billion of mortgage-bond losses. “From an institutional point of view, it’s hard to have a relationship when there’s a lawsuit hanging over them,” said Barry Taff with Silver, Freedman & Taff LLP. In October, AIG obtained \$4.5 billion in new credit lines from a 34 bank consortium, led by JPMorgan Chase, and Citigroup. (*Wall Street Journal*, Serena Ng and Randall Smith, 10/21/11)

U.S. taxpayers have \$44.4 billion outstanding in TARP automotive program investments and have incurred \$2.9 billion in losses to date

Credit ratings for GM and Ford raised one notch, just below investment grade

...and the automakers’ balance sheets are liquid

The “math does not support mass adoption of electric vehicles”

You tax dollars at work: GM is in talks to help bankroll a *Cannonball Run* remake

U.S. taxpayers have \$44.4 billion outstanding in TARP automotive program investments at September 30 and have incurred \$2.9 billion in losses to date

- On September 30, Treasury had \$44.4 billion invested in three TARP automotive programs—the Automotive Industry Financing Program, the Auto Supplier Support Program, and the Auto Warranty Commitment Program.

TARP AUTOMOTIVE PROGRAMS EXPENDITURES AND PAYMENTS, AS OF 9/30/2011 (\$ BILLIONS)					
	Chrysler	GM^a	Chrysler Financial	Ally Financial Inc. (formerly GMAC)	Total
Pre-Bankruptcy					
AIFP	\$4.0	\$19.4	\$1.5	\$17.2	\$42.1
ASSP ^b	0.1	0.3			0.4
AWCP	0.3	0.4			0.6
Subtotal	\$4.4	\$20.1	\$1.5	\$17.2	\$43.1
In-Bankruptcy (DIP Financing)					
AIFP	\$1.9	\$30.1			\$32.0
Subtotal	\$1.9	\$30.1			\$32.0
Post-Bankruptcy (Working Capital)					
AIFP	\$4.6				\$4.6
Subtotal	\$4.6				\$4.6
Subtotals by Program:					
AIFP					\$78.7
ASSP					0.4
AWCP					0.6
Total Expenditures	\$10.9	\$50.2	\$1.5	\$17.2	\$79.7
Principal Repaid to Treasury	(\$8.0)	(\$23.1)	(\$1.5)	(\$2.7) ^c	(\$35.3)
Net Expenditures	\$2.9	\$27.0	\$0.0	\$14.5	\$44.4
Total Loss on Investment	\$2.9				\$2.9
Notes: Numbers may not total due to rounding.					
^a Including GM's debt payments of \$50 million on March 31, 2011, \$45 million on April 5, 2011, and approximately \$15.9 million on May 3, 2011.					
^b The final commitment and repayment amounts reflect the total funds expended under the ASSP loans. Treasury initially obligated \$5 billion under ASSP. Treasury adjusted its obligation to \$0.4 billion.					
^c On March 2, 2011, Treasury entered into an underwriting offering of its Ally Financial TRUPS, which resulted in approximately \$2.7 billion in total proceeds to Treasury.					
Source: Treasury, Transactions Report, 10/3/2011.					

Credit ratings for GM and Ford raised one notch, just below investment grade

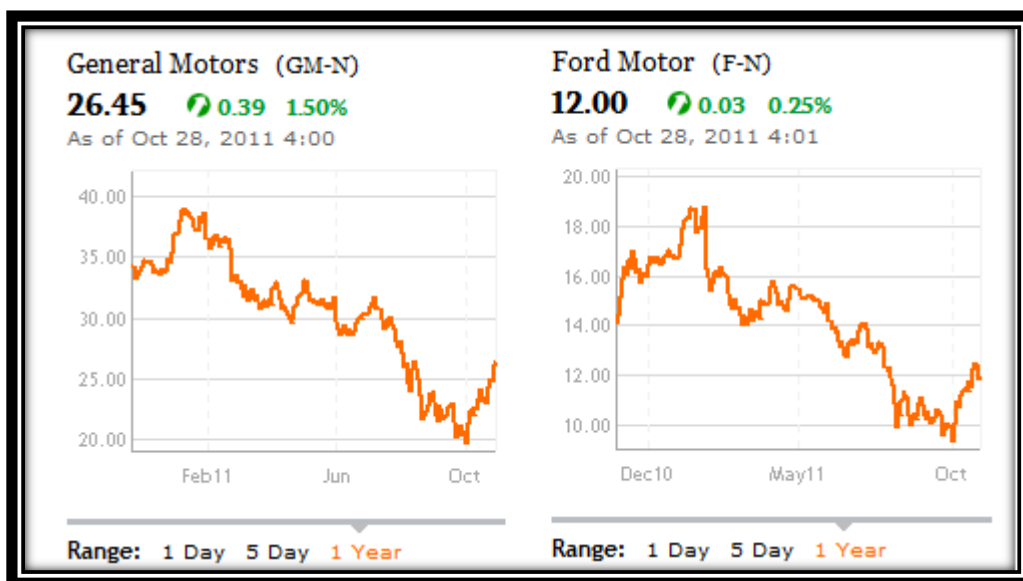
- Investors Services upgraded its credit ratings on Ford and GM one notch to Ba1, one level below investment grade, with a positive outlook, citing the automakers' strong

positions in North America and improved credit metrics. Moody's was the last of the three major ratings companies to upgrade Ford and GM in recent weeks. "One of the hurdles in getting to an investment grade rating is the difficulty in gauging just how bad things could get in Europe," said Moody's SVP Bruce Clark. "The situation there won't be completely sorted out during the near term."

- Moody's said GM's upgrade reflects the automaker's (i) highly competitive North American business model that is sustainable under its new four-year labor agreement and (ii) strong positions in high-growth Asian markets, particularly China. Moody's expects GM to deleverage its balance sheet by funding its large unfunded pension liability and maintaining a robust liquidity position. (*Wall Street Journal*, Nathalie Tadena, 10/28/11)

The automakers' "liquid" balance sheets

- Detroit's two biggest auto makers' shareholders have been fickle in 2011 with fears of a global recession pushing GM and Ford stocks down about a third on the year. At the same time, analysts' calls have been mounting for both companies to distribute some cash. Ford's balance sheet looks particularly strong, after the company generated \$5-billion (U.S.) of operating-related cash flow in the first nine months of 2011 and turned a net debt load into \$8-billion of net cash over the past 12 months. GM has \$31-billion of cash and easy-to-sell securities on its balance sheet—twice as much as its public debt, which could be used for a stock buyback or "even" to repurchase some of the U.S. Treasury's stake in the automaker of approximately \$12-billion. (*Globe and Mail*, Antony Currie, 10/26/11)



- “In order to recoup its investment in GM, Treasury would have to recover an additional \$27 billion in proceeds,” wrote Acting SIG-TARP Christy Romero in her *Quarterly Report to Congress*, dated October 27. “This translates to an average of \$53.98 per share on the remaining common shares in New GM, not taking into account dividend and interest payments received from the New GM entities.” Treasury’s breakeven price falls to \$52.39, when dividends and interest received by Treasury is included in the computation, according to SIG-TARP. (*Quarterly Report to Congress*, Office of Special Inspector General of TARP, 10/27/11)

The “math does not support mass adoption of electric vehicles”

- *Morningstar’s* David Whiston concludes that the public’s slow adoption of electric vehicles is economics. “Even at \$6.00 a gallon, the lifetime fuel savings of a [plug-in electric hybrid vehicle] does not make up the price premium of a vehicle such as the 2011 Volt (lowest MSRP after the tax credit is \$32,780 according to the Volt website),” wrote Whiston. “For example, the Volt’s all-electric range of 25-50 miles equates to, at best, about \$6,100 in fuel savings at \$6 per gallon gas. Compared to an internal combustion 2011 Chevrolet Cruze compact at an MSRP of \$16,525, a Volt consumer pays an extra \$16,255 (\$32,780-\$16,525) to get this \$6,100 in fuel savings even after tax credits. This math does not support mass adoption of electric vehicles, in our opinion.” Whiston added that the volume of these vehicles should increase as “conventional fossil fuels become harder to find” and the federal government increases the CAFÉ requirements. (*Morningstar*, David Whiston, 10/26/11)
- “I’m a Chevrolet dealer,” said Representative Mike Kelly (R-PA). “... We have a Chevy Volt on the lot; it’s been there now for four weeks. We’ve had one person come in to look at it, just to see what it actually looks like... Here’s a car that costs \$45,763. I can stock that car for probably a year and then have to sell it at some ridiculous price. By the way, I just received some additional information from Chevrolet: in addition to the \$7,500 [federal] tax credit, Pennsylvania is going to throw another \$3,500 to anybody foolish enough to buy one of these cars, somehow giving them \$11,000 of taxpayer money to buy this Volt.”
- “When you look at this, it makes absolutely no sense. I can stock a Chevy Cruze, which is about a \$17,500 car and turns every 30 to 40 days out of inventory... or I can have a Volt, which never turns and creates nothing for me on the lot except interest costs... So a lot of these things that we’re seeing going on have a tremendous economic impact on people who are being asked to stock them and sell them. There is no market for this car. I do have some friends who have sold them, and they’re mostly to people who have an academic interest in it, or municipalities who are asking to buy these cars.”
- “I can tell you... as far as job creation, the guy who ordered that Volt for my store is no longer in that job. So it actually worked against him. I was told that the reason that car is on our lot is that General Motors told him he had to stock it. I said ‘let me

understand. I told you that under no circumstances were you to order a Volt,' and he said 'yeah.' 'So, why did you order it?' 'Because General Motors told me.' 'Is this the same General Motors that tried to take my Cadillac franchise from me? These are the guys you're listening to, but the guy who signs your paycheck doesn't have as much influence as the guys who tried to take away the franchise?'"

- “The problem [with the Volt] ... is really twofold,” said Jeremy Anwyl, CEO of Edmunds. “One of them is that there are all sorts of inducements for people to be buying these vehicles... and yet when you look at who’s been buying these vehicles, and there are people buying them, they are at the very high end of the demographic scale... Right now we’re seeing people who would have bought those vehicles anyway, without a tax credit, getting the tax credit at the expense of other taxpayers, and you have to wonder about the wisdom of that.” (*TheTruthAboutCars.com*, Edward Niedermeyer, 10/13/11)
- After launching the \$40,000+ Volt and announcing plans to produce an electric hybrid ELR Cadillac in 2013, GM has now announced plans to introduce an all-electric “mini-car” version of the Chevy Spark in “limited” markets in the U.S. and other countries in 2013. “The Spark EV offers customers living in urban areas who have predictable driving patterns or short commutes an all-electric option,” said Jim Federico, Chevrolet’s global vehicle chief engineer for EVs. To date, GM has not decided where it will manufacture the electric Spark. However, Mark Modica, associate fellow for the National Legal Policy Center, said he has it “on good authority” that the conventional and electric Spark will be built in Korea, according to his conversation with Greg Martin, GM North America director of communications . (*Money CNN*, Peter Caldes-Dapena, 10/12/11; *Green.Autoblog.com*, Eric Loveday, 10/15/11;)
- Thanks to a \$529 million loan from the Department of Energy, the Finnish auto maker, Fisker, has moved forward with its design of the Karma, \$96,895 hybrid electric vehicle, which the company describes as an “exotic luxury sedan.” The 16.5 foot long, 6 foot wide, 2.5 ton sedan has been categorized by EPA as a subcompact, with an estimated 52 mpg—32 miles per gallon when powered by electricity and 20 mpg when powered by its gas engine. “Not a single dollar of the DoE loans has been, or will be, spent outside of America,” said the company. “All expenditures are reviewed by PwC (PriceWaterhouseCoopers) on behalf of the DoE.”
- “After receiving the DoE loan, Fisker made it a priority to create U.S. jobs which led to the purchase of its own assembly plant in Delaware where we plan to establish production of our second, higher volume, line of vehicles (Project Nina [e.g., a less expensive and higher volume hybrid EV]),” said Fisker. “There are currently over 100 workers reconfiguring the Delaware plant so that Fisker will be ready to begin hiring a skilled hourly workforce to producing its Nina platform vehicles in the U.S. for sale around the world. Many of these Delaware costs are covered by the DoE loans. For the Karma program, the DoE loan money was used solely in the U.S. to

fund design, engineering, and integration work.” (*Fisker Press Release*, 10/21/11; *Daily Tech*, Tiffany Kaiser, 10/28/11)



Fisker's 700 employees at its Anaheim, CA headquarters and Wilmington, DE factory

Your tax dollars at work: GM is in talks to help bankroll a *Cannonball Run* remake

- GM “may soon be partnering with Hollywood to encourage speeding, drunk driving, and general mayhem,” according to what “insiders” have told *New York Magazine*'s *Vulture* [magazine section]. GM is in discussions about providing financial backing for a remake of *The Cannonball Run*, which would “be much larger than your average product placement... [that] could double as a big, two-hour demonstration of GM's new cars.”
- “In this still-evolving deal, GM wants to be more involved than just committing to the usual ‘soft’ marketing support (the usual spray of TV commercials hyping a film packed with GM cars, like Michael Bay's *Transformers* franchise),” according to *Vulture*. “**They're thinking of taking an actual hard-dollar, equity stake in a Cannonball production**, which we're told Ritchie would like to shoot at least partly in Europe. ...With more involvement, they could use the road-race film as a way to introduce and spotlight their 2014 car lineup for two hours, maybe giving this new Corvette the lead. If the GM deal comes through, it'll show just how far product placement has come.” [Emphasis added.]
- “The details of this [*Vulture*] article are without merit, and nothing but random speculation,” said GM spokesman Tom Henderson. “GM looks at many opportunities and carefully evaluates the films which we choose to support. As part of this process, acts of drunk driving and complete recklessness are considered reasons for GM to dismiss involvement.” (*New York Magazine*, 10/18/11)

- In the *Weekly Market Comment*, John Hussman wrote: “*Bloomberg* reported last week that ‘Bank of America, hit by a credit downgrade last month, has moved derivatives from its Merrill Lynch unit to a subsidiary flush with insured deposits... The Federal Reserve and the Federal Deposit Insurance Corp. disagree over the transfers, which are being requested by the counterparties. The Fed has signaled that it favors moving the derivatives to give relief to the bank holding company, while the FDIC is objecting. The bank doesn’t believe regulatory approval is needed.’”
- “[Hussman added,] Well, other than that it goes against Section 23A of the Federal Reserve Act, but then, the Fed can make an exemption whether the FDIC likes it or not. And that’s what we’ve come to—government of the banks, by the banks, and for the banks (because banks are people too).”
- “*Bloomberg* ...continued, ‘Bank of America’s holding company—the parent of both the retail bank and the Merrill Lynch securities unit—held almost \$75 trillion of notional derivatives at the end of June, according to data compiled by the OCC. About \$53 trillion, or 71 percent, were within Bank of America NA [the FDIC insured entity], according to the data, which represent the notional values of the trades. That compares with JPMorgan’s deposit-taking entity, JPMorgan Chase Bank NA, which contained 99 percent of the New York-based firm’s \$79 trillion of notional derivatives.’” (*Weekly Market Comment*, John P. Hussman, Ph.D., 11/24/11)
- “The concern is that there is always an enormous temptation to dump the losers on the insured institution,” said William Black, professor of economics and law at the University of Missouri-Kansas City. “We should have fairly tight restrictions on that.” (*Bloomberg News*, Bob Ivry, Hugh Son and Christine Harper, 10/18/11)
- In letters to Treasury Secretary Timothy Geithner and federal banking regulators, 18 Democratic lawmakers have asked the regulators to explain why they approved Bank of America’s transfer of derivatives from Merrill Lynch to the Bank, which appeared to violate Section 23A of the Federal Reserve Act. The lawmakers noted that Merrill Lynch would have had to post an additional \$3.3 billion of collateral after the BofA’s credit rating was downgraded, but was required to post less collateral by transferring the instruments to the (insured) retail bank subsidiary. “If banks are going to gamble, they should do it with their own money,” said Senator Sherrod Brown (D-OH)/ “Ending ‘too big to fail’ means that depositors and taxpayers are not asked to cover Wall Street losses.” (*American Banker*, Kate Davidson, 10/28/11)
- Blackstone CEO Steve Schwarzman gave the keynote speech at the Alfred E. Smith Memorial Foundation Dinner on October 20, where he “brought the house down” with this joke: “Brian Moynihan is here tonight. Brian up in the front. He’s the C.E.O. of Bank of America. As many of you know, Brian’s brother Patrick runs a

Catholic boarding school in Haiti. Their parents must be so proud to see two of their boys each running an underfunded, nonprofit organization. ...Actually it's a terrific bank and we're loyal customers, but I think we just lost our standing over a joke. Not a good idea." (*New York Times Dealbook Blog*, Michael J. De La Merced, 10/21/11)

President Obama appoints Tom Hoenig to serve as Vice Chairman of FDIC

- President Barack Obama has appointed Tom Hoenig, the former president of the Federal Reserve Bank of Kansas City, to serve as the Vice Chairman of the FDIC. Hoenig, who served for 38 years in the Federal Reserve Bank System until his retirement on September 30, will bring his outspoken views on “too big to fail banks” to the FDIC board. He contends that the TBTF policy subsidizes the largest institutions and leads to a misallocation of resources. “It encouraged ever-larger institutions without capitalism being able to cleanse those that were not successful,” said Hoenig. “We need to rethink that model.” (*American Banker Magazine*, Barbara Rehm, November 2011)

The “simple” 298-page proposed Volker rule

- “A couple of days ago, a senior banker in New York showed me a memo that he had just received from his lawyers about the so-called Volcker rule for proprietary trading,” wrote Gillian Tett in the *Financial Times*. “This stretched to 82 pages on an iPad, replete with dense charts. And that was merely his summary document; the ‘full’ explanation ran to several hundred more pages. ‘It’s mad!’ he sighed, explaining that this was only one of several memos he had recently received on Dodd-Frank and Basel rules. It is hard to disagree with that verdict.” (*Financial Times*, Gillian Tett, 10/28/11)
- “If you tried to write a parody of the uncertainty and confusion triggered by federal rule-making, it would be hard to top the latest proposal from Washington’s financial regulators,” wrote the *Wall Street Journal* in an October 24 editorial. “So here’s an ironic hat tip to the bureaucrats who wrote the draft Volcker Rule, which will allegedly limit risk-taking at financial firms backed by taxpayers.”
- “In 298 pages, rather than sketching out simple, clear rules for banks to follow, regulators essentially wonder out loud how they can possibly write this rule. Officially there are 383 questions posed in the document, but many of these questions have multiple parts. Our colleagues at the *Deal Journal* blog counted 1,347 queries, covering everything from how ‘trading accounts’ should be defined to what a ‘loan’ is.”
- “The regulators admit that ‘the delineation of what constitutes a prohibited or permitted activity ... involves subtle distinctions that are difficult both to describe

comprehensively within regulation and to evaluate in practice.’ Think of this as a cry for help from bureaucrats seeking an understanding of the markets they are nonetheless going to restructure come what may.”

- “...We supported former Federal Reserve Chairman Paul Volcker’s concept of a ban on proprietary trading as a good-faith effort to protect taxpayers from having to rescue too-big-to-fail banks again. Democrats in Congress weren’t going to prevent future bailouts, so whenever an institution is playing with taxpayer money (via insured deposits or access to the Fed’s discount window) it should be allowed to serve clients but should not be permitted to make trades for its own proprietary account. But drafting such a law isn’t easy and the details are crucial.”
- “...Reasonable people have seen enough to say that Washington is incapable of drawing bright lines and applying clear rules fairly across all securities markets. The result is all but certain to be a final rule that different people will interpret different ways, leading to loopholes for traders and arbitrary enforcement. Under this Beltway rendering of Volcker, trading will continue but with a much higher bureaucratic cost and with the illusion of safety that only regulation can create”.
- “Until the government is willing to create a durable financial system that allows failure, the best policy response is to make the rules so simple that even Washington can enforce them. That means higher, even very high, bank capital standards and margin requirements on risky trades between banks. Those aren’t panaceas, but they offer more hope for taxpayers than the bureaucratic and bank-lobbyist jump ball that is now the Volcker Rule.” (*Wall Street Journal*, 10/24/11)
- “I don’t like it, but there it is,” said Paul Volker. “I’d love to see a four-page bill that bans proprietary trading and makes the board and chief executive responsible for compliance. And, I’d have strong regulators. If the banks didn’t comply with the spirit of the bill, they’d go after them.” On *The Charlie Rose Show*, Volker gave a more rigorous defense of the proposed rule, arguing that the actual rule is 35 pages. “Oh, I think [the proposed rule] is ok,” said Volker. “There’s a lot of commotion about the lengths of the rule and the commentary and all the rest. A lot of lawyers have spent a lot of time trying to pick holes in this thing and, of course, the regulators respond by trying to close the holes that they pick in it and you end up with presumably pretty cumbersome of paper. I don’t think that— read it; the rule itself, the regulation itself is only 35 pages. ..[It is] 300, including commentary, rules for how you keep records — most of the banks are going to want to keep these records anyway — but the regulation itself is 35 pages.”
- “Here’s the key word in the [proposed] rules: ‘exemption,’” said former Senator Ted Kaufman (D-DE). “Let me tell you, as soon as you see that, it’s pronounced ‘loophole.’ That’s what it means in English.”
- “This proposal ...is filled with central questions that Congress should have answered before even drafting Dodd-Frank,” said Jonathan Graffeo, spokesman for Senator

Richard Shelby (R-AL). “Instead, Congress willfully ignored the ramifications of its actions, just as it did in repealing Glass-Steagall.”

- “Nobody listened,” said Henry Kaufman, a former managing director of Salomon Brothers. “Paul Volcker and I are the same age [84]. Paul wanted to take an aspect of risk-taking out of the financial conglomerates. That’s a worthy endeavor. But the history of regulation shows that the private sector pushes back and waters it down. Dodd-Frank didn’t want to address the longer-term consequences of ‘too big to fail.’ The 10 largest banks held 10 percent of the assets in 1990; today they control over 70 percent. This trend accelerated in 2008. The ‘too big to fail’ got even bigger. My view is that we should break up the big financial conglomerates and separate investment banking. Otherwise we’re going to have ongoing government intervention in the credit allocation process. That threatens economic democracy, and the U.S. is the last bastion of economic democracy.”
- “The need for 300 pages of rules just shows you’re trying to define something indefinable,” added Kaufman. “I think Paul Volcker is great, but let’s step back and ask, why are we doing this? We’re doing this because we don’t want banks with federal deposit insurance to be involved in risky investments. There’s a simple solution. We didn’t have that problem for over 60 years because we had Glass-Steagall. It worked, we changed it and guess what, we got into trouble. I want to go back to what worked for 60 years. That’s a very conservative position.”
- “We need a strong financial sector,” said Representative Peter Welch (D-VT). “But it should be in service to the real economy, the productive economy. The large banks have become trading platforms. They make the real money on the trading desks. The depositors, the consumers, become a base to fund that trading activity. There should be a separation and there certainly should not be a taxpayer backstop for their losses. Contrast this to the Main Street banks facing severe pressures from the big banks. Their model is more traditional, in service to the productive economy. In Washington the debate is about the needs of the large banks, but there’s no debate about the basic function of these banks. Do we want the financial sector to be in the service of the producing economy, or vice versa? It’s time we call the question.”
- *Financial Times*’ Gillian Tett notes at least three interrelated dangers of Dodd Frank, including (i) “the sheer complexity and opacity of the reform process makes it hard for anyone to forecast with confidence exactly what their net impact will be;” (ii) a “bewildering process,” creating rich arbitrage opportunities for canny players;” and (iii) a so-called “yawning democratic deficit,” in which complex financial products collide with complex reform processes developed by regulators with complex and often unstated reform goals. (*Financial Times*, Gillian Tett, 10/28/11; *New York Times*, James B. Stewart, 10/22/11; *Bloomberg News*, Silla Brush, 10/28/11; *The Charlie Rose Show*, Paul Volker, 10/24/11)

Dodd Frank's sobering assumption

- “I hope we have stronger and more alert regulators than we did ten years ago,” said Paul Volker on *The Charlie Rose Show*. “I mean you couldn't go through that experience without — there was this feeling that the market could take care of itself, that, you know, markets were efficient and people had perfect foresight, get together, you don't have to worry about this kind of thing the way we used to.” (*Charlie Rose Show*, Paul Volker, 10/24/11)

Fannie Mae and Freddie Mac

5.4% of TARP's housing support funds had been spent as of September 30
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- TARP-funded housing support programs continue to struggle to help distressed homeowners with only 5.4%-or \$2.5 billion—of the \$45.6 billion of allocated TARP funds had been expended on September 30, according to the Special Inspector General of TARP.

TARP EXPENDITURES AND ALLOCATIONS BY HOUSING SUPPORT PROGRAMS, AS OF 9/30/2011 (\$ BILLIONS)		
	Expenditures	Allocations
HAMP		
First Lien Modification	\$1.51	\$19.1
PRA Modification	—	2.0
HPDP	0.13	1.6
UP	—	— ^a
HAMP Total Allocations	1.64	22.7
HAFA	0.07	4.1
2MP	0.05	0.1
Treasury FHA-HAMP	—	0.2
RD-HAMP	—	— ^b
FHA2LP	—	2.7
FHA Short Refinance	0.05	8.1 ^c
HHF	0.66	7.6
Total Allocations	\$2.48	\$45.6
<small>Note: Numbers may not total due to rounding. According to Treasury, these numbers are "approximate." ^a Treasury does not allocate TARP funds to UP. ^b Treasury estimates that \$17.8 million will be allocated to RD-HAMP. ^c This amount includes the up to \$117 million in fees Treasury will incur for the availability and usage of the \$8 billion letter of credit.</small>		
<small>Source: Treasury, response to SIGTARP data call, 10/5/2011.</small>		

- A breakdown of TARP-funded expenditures, excluding GSE-funded expenses, related to housing support programs is provided below:

BREAKDOWN OF TARP EXPENDITURES, AS OF 9/30/2011 (\$ MILLIONS)	
HAMP First Lien Modification Incentives	TARP Expenditures
Servicer Incentive Payment	\$355.7
Servicer Current Borrower Incentive Payment	12.6
Annual Servicer Incentive Payment ^d	259.7
Investor Current Borrower Incentive Payment	40.7
Investor Monthly Reduction Cost Share ^a	574.9
Annual Borrower Incentive Payment ^d	265.9
HAMP First Lien Modification Incentives Total	\$1,509.6
PRA	—^a
HPDP	\$134.5
Hafa Incentives	
Servicer Incentive Payment	\$16.0
Investor Reimbursement	7.7
Borrower Relocation	45.2
Hafa Incentives Total	\$68.9
UP	—^b
HAMP Program Incentives Total	\$1,713.0
Second-Lien Modification Program Incentives	
2MP Servicer Incentive Payment	\$20.0
2MP Annual Servicer Incentive Payment ^d	0.2
2MP Annual Borrower Incentive Payment ^d	0.1
2MP Investor Cost Share	13.7
2MP Investor Full Extinguishment	15.2
2MP Investor Partial Extinguishment	1.2
Second-Lien Modification Program Incentives Total	\$50.4
Treasury/FHA-HAMP Incentives	
Annual Servicer Incentive Payment ^d	\$2.2
Annual Borrower Incentive Payment ^d	2.1
Treasury/FHA-HAMP Incentives Total	\$4.3
RD-HAMP	—^c
FHA2LP	—
FHA Short Refinance (Loss-Coverage)	\$55.0
HHF Disbursements	\$655.4
TOTAL	\$2,478.1
<small>Note: Numbers affected by rounding. ^a PRA has paid \$33,645 in incentives. ^b TARP funds are not used to support the UP program. ^c Investor Monthly Reduction Cost Share is considered an incentive payment. ^d Annual incentive payments are paid as long as the loan remains in good standing and has been fully repaid at the time the incentive is paid.</small>	
<small>Source: Treasury, response to SIGTARP data call, 10/5/2011 and 10/11/2011.</small>	

- SIG-TARP set forth four recommendations to improve the loan servicer performance in the loan modification process:
 - “Treasury should require that [Making Homes Affordable] servicer communications with homeowners relating to changes in the status or terms of a homeowner’s modification application, trial or permanent modification, [the Home Affordable Foreclosure Alternatives] agreement, or any other significant change affecting the homeowner’s participation in the MHA program, be in writing.”
 - “Treasury should establish benchmarks and goals for acceptable program performance for all MHA servicers, including the length of time it takes for trial modifications to be converted into permanent modifications, the conversion rate for trial modifications into permanent modifications, the length of time it takes to resolve escalated homeowner complaints, and the percentage of required modification status reports that are missing.”
 - “Treasury should publicly assess the top 10 MHA servicers’ program performance against acceptable performance benchmarks in the areas of: the length of time it takes for trial modifications to be converted into permanent modifications, the conversion rate for trial modifications into permanent modifications, the length of time it takes to resolve escalated homeowner complaints, and the percentage of required modification status reports that are missing.”
 - “Treasury must ensure that all servicers participating in MHA comply with program requirements by vigorously enforcing the terms of the servicer participation agreements, including using all financial remedies such as withholding, permanently reducing, and clawing back incentives for servicers who fail to perform at an acceptable level. Treasury should be transparent and make public all remedial actions taken against any servicer.”
- “Treasury has determined not to take any further action to implement SIG-TARP’s recommendations,” wrote SIG-TARP. (*Quarterly Report to Congress*, Office of Special Inspector General of TARP, 10/27/11)

FHFA lowers its estimate of the GSE bailout costs

- The Federal Housing Finance Agency lowered its estimate of the bailout cost for Fannie Mae and Freddie Mac to \$226 billion through 2014, using its current baseline projections for future home prices. If the housing market conditions were to improve, FHFA’s projected aid for the GSEs would fall to approximately \$220 billion. However, the bailout costs could balloon to \$311 billion, if the economic conditions are worse than projected. Subtracting the dividend payments made to Treasury, the

total bailout costs for Fannie Mae and Freddie Mac would range between \$121 billion to \$193 billion. (*Bureau of National Affairs*, Mike Ferullo, 10/28/11)

Congressional actions to address the housing crisis:

Senate votes to preserve the GSEs' conforming loan limits, but battle looms in the House

Representative Garrett unveils The Private Mortgage Market Investment Act

Senator Schumer unveils bipartisan bill to provide foreign buyers of homes in the U.S. residence visas

SAFE Act introduced to require underwriters to factor in the home's energy cost

33 Senators urge the administration to expedite the GSEs' sale of foreclosed homes

Senate votes to preserve the GSEs' conforming loan limits, but battle looms in the House

- The Senate voted to restore the GSEs' higher conforming loan limits in high cost markets, which expired on October 1. The measure, attached to an appropriations package, was adopted by a vote of 60 to 38, just clearing the required 60-vote threshold. Now, the measure moves to the House, where it faces stiff opposition from conservative Republican members. "The House is going to be a big hurdle, said one housing lobbyist. "We are definitely only halfway there."
- "I will do everything in my power to make sure it's stripped out, when [the appropriation's bill] comes to the House," said Representative Scott Garrett (R-NJ). However, Republican members, who represent districts with high housing costs, are some of the most vocal supporters of the measure. "Allowing the loan limits to be reduced while private mortgage capital remains scarce has made it increasingly difficult for potential homebuyers in California and other high-cost areas to obtain mortgage credit," said Representative Gary C. Miller (R-CA).
- Ultimately, the issue may rest with negotiations between the House and Senate conference committee negotiators. (*Wall Street Journal Developments Blog*, Alan Zibel, 10/27/11; *CQ Today Online News*, Ben Weyl, 10/21/11)

Representative Garrett unveils The Private Mortgage Market Investment Act

- Representative Scott Garrett (R-NJ), Chairman of the Financial Services Subcommittee on Capital Markets and Government-Sponsored Enterprises, has introduced The Private Mortgage Market Investment Act, designed to ensure robust

investment by the private sector in the secondary mortgage market, absent a government guarantee of mortgages.

- “It’s time to turn the page for planning what occurs post Fannie and Freddie,” said Garrett, whose bill begins to draw a picture of what the private market will look like without the GSEs. “Most, if not all, of my colleagues, Republican and Democrats alike, recognize the status quo is unsustainable. The government-sanctioned duopoly of Fannie and Freddie is not only systemically dangerous to our economic security, it’s un-American. For too long the government’s manipulation of the housing market has crowded out private market participants at the expense of the American taxpayers. It’s time to move from the era of crony capitalism that defined our housing finance system during the last century to an era of free market capitalism that will define our housing finance system in the next century.”
- “Since taking control of the House in January, we have remained steadfast in our drive and determination to end the ongoing bailout of Fannie Mae and Freddie Mac, protect taxpayers from future bailouts, and encourage private capital to re-enter the secondary mortgage market. Now that we have taken the important step of introducing a series of bills to wind down the government-backed mortgage twins, it’s time to start thinking about the ways we can jumpstart the private market to step in once they’re gone. My proposal to reform the secondary mortgage market will facilitate continued standardization and uniformity, ensure rule of law and legal certainty, and provide investors with the standardization and transparency necessary to ensure that a deep and liquid market develops in the absence of Fannie and Freddie.”
- “Garrett’s proposal to reform the secondary mortgage market will do the following:
 - **Facilitate Continued Standardization and Uniformity of Mortgage Securitization**
 - Direct Federal Housing Finance Administration (FHFA) to create several categories of mortgages with uniform underwriting standards for each.
 - Direct FHFA to develop standard and uniform securitization agreements and representations and warranties.
 - Streamline the process for securities that meet the standard underwriting characteristics and securitization agreements to be sold to investors.
 - Provide FHFA authority to ensure underwriting and securitization standardization compliance.
 - Abolish risk-retention provisions included in Dodd-Frank.

➤ **Remove conflicts of interest between servicers and investors.**

- Clarify the rules around the eligibility of obtaining second lien mortgages.
- Require mandatory arbitration on disagreements between investors and issuers on reps and warrants.
- Prevent regulators from unilaterally forcing investors to reduce the principal of loans they have invested in.
- Allow for the appointment of an independent third party to act for the benefit of investors in mortgage-backed securities.
- Standardize servicer accounting and reporting for restructuring, modification or work-out of loans used as collateral.

➤ **Provide Additional Transparency and Disclosure**

- Increase the quality of the loan level information and the disclosures that investors can use to evaluate the value of the mortgages.
 - Ensure investors have sufficient time to review and analyze disclosed information before making investment decisions.
 - Increase pricing transparency by disclosing pricing history on securitization deals.
 - Require the creation of an individualized marker for each loan within a securitization.
- A draft of The Private Mortgage Market Investment Act can be downloaded at <http://tinyurl.com/6dv9vkh>.
 - Garrett's legislation to reform the secondary market is the 16th in a series of House bills designed to dismantle Fannie Mae and Freddie Mac and reform U.S. housing finance system, which must all pass the House Financial Services Committee before being voted upon by the full House. Garrett said his bill acknowledges the complexity and fragility of the housing market, as well as the industry's reliance on tax breaks, grants and government guarantees for decades. "It's only because the government has meddled with the market for so long that you need a transition," he said. "Left to their own devices, markets would over time figure things out and move to a market that would eventually operate. The operative word is 'eventually', which takes too long." (*Press Release*, 10/27/11; *American Banker*, Donna Borak, 10/27/11; *Bloomberg News*, Lorraine Woellert, 10/26/11)

Senator Schumer unveils bipartisan bill to provide foreign buyers of homes in the U.S. residence visas

- Senators Chuck Schumer (D-NY) and Mike Lee (R-UT) introduced a bill designed to shore up the distressed housing market by providing resident visas to foreigners who make at least a \$500,000 investment in residential real estate. The measure, which compliments an existing visa program that allows foreigners to enter the U.S. if they invest in new businesses that create jobs, is part of a larger package of immigration measures co-authored by the senators.
- The provision would create a homebuyer visa program (HVP) that is separate from existing programs and would not displace anyone waiting for other visas. There would be no cap on the HVP. Under the proposed HVP, foreigners immigrating to the U.S. would be allowed to bring with them a spouse and any children under 18. If they wished to work, the foreigners would have to go through the normal process to obtain a regular work visa. If they sold their properties, the foreigners would not be allowed to legally remain in the U.S.
- “This is a way to create more demand without costing the federal government a nickel,” said Schumer. (*Wall Street Journal*, Nick Timiraos, 10/20/11)

The SAFE Act is introduced to require underwriters to factor in the home’s energy cost

- Senators Michael Bennet (D-CO) and Johnny Isakson (R-GA) introduced The Sensible Accounting to Value Energy (SAVE) Act, which would require loan underwriters to include an estimate of the home’s energy-consumption expenses as a mandatory new underwriting factor.
- Underwriters would use previous utility bills [for mortgage refinancings] or a survey database published by the Department of Energy [for new construction] to determine the energy costs, which would then be factored into the applicant’s debt-to-income ratio. The lawmakers expect that the allowable DTI ratio probably would be adjusted to account for this new energy component. For houses with significant energy-efficiency improvements that have been documented with a home energy rating system study, lenders would instruct appraisers to calculate the net present value of monthly energy savings and adjust the final appraised value accordingly, which would support a higher mortgage amount. (*Los Angeles Times*, By Kenneth R. Harney, 10/30/11)
- “The SAVE Act would require lenders to take into account, when underwriting the loan, potential savings from various energy savings features of the house,” wrote Cato’s Mark Calabria. “If a new appliance reduced your electric bill, Congress would require that the lender allow that ‘savings’ to [be] used to bid for a higher priced house. The impact of the bill would be to allow for even higher debt-to-income ratios on the part of borrowers, as if high mortgage to income payments has had nothing to

do with the mortgage crisis we are in. Perhaps worse the bill would also direct appraisers to include energy savings into the value of the house. Sadly this is anything but ‘sensible accounting.’ As any decent appraiser knows, a house is worth what someone will pay for it, not what the value of various improvements are. That’s why most residential appraisals are based upon comparable sales, and not simple cost or revenue accounting (marginal theory of value, anyone?).” (*Cato@Liberty*, Mark A. Calabria, 10/30/11)

33 Senators urge the administration to expedite the GSEs’ sale of foreclosed homes

- A group of 33 senators asked the Obama administration and the Federal Housing Finance Agency to expedite pending plans for selling and renting previously foreclosed homes held by the government. In a letter led by Senators Jack Reed (D-RI), Bob Menendez (D-NJ) and banking committee chair Tim Johnson (D-SD), the lawmakers wrote. “We urge you to analyze, quickly and diligently, the input you have received so that all REO properties under your control may be best managed to produce the most value for Fannie Mae, Freddie Mac, and FHA. As part of this analysis, we ask that you also keep in mind the importance of looking for the most effective ways to stabilize neighborhoods and housing values.” The lawmakers requested that a deadline be set to review FHFA’s request for information submissions regarding the sale of REO properties and asked what next step(s) the agency might take. “Foreclosures have taken a heavy toll on too many Americans,” wrote the senators. (*HousingWire*, Jon Prior, 10/27/11)

FHFA explores plan to spread risk in mortgage-backed bonds
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- The Federal Housing Finance Agency and Obama administration are considering a new program designed to attract private investment back into the housing finance market, by having the GSEs sell small tranches of mortgage bonds that would yield an above market interest yield with no federal guarantee. While no final decisions have been made, officials believe that a small pilot program could be rolled out sometime in 2012 to test the willingness of private investors to share the risk of funding home loans securitized by the GSEs.
- Under the proposal, a small piece of the mortgage bond issued by the GSE—say 5% to 10%--would be sold to private investors, who would be in a “first loss” position and receive a higher interest rate. The pilot program would provide the administration a way to start scaling back the government’s role in mortgage finance without waiting for legislation. “It would be enormously valuable to start that transition now, recognizing that congressional action is ultimately required,” said Phillip Swagel, a professor at the University of Maryland and Treasury’s top economist in the Bush administration. FHFA would have to approve the pilot program. Freddie Mac CEO Charles Haldeman recently said that the pilot program is “still in the talking stage.” (*Wall Street Journal*, Alan Zibel, Nick Timiraos and Al Yoon, 10/14/11)

- In an October policy brief, the Progressive Policy Institute recommended that Congress form a bipartisan GSE reform super committee, fashioned after the Joint Select Committee on Deficit Reduction, to jumpstart GSE reform. PPI suggested that the reform panel be given a six month deadline to design a housing finance reform proposal that would be subject to congressional approval.
- The U.S. needs a multi-faceted framework for housing reform, said PPI’s Jason Gold and Anne Kim. “One solution cannot address all,” they wrote. “A package of variously sized measures, both big and small, could in the aggregate be enough to provide the boost the market currently needs.” The authors outlined a five-part plan, as follows:
 - **Do no harm.** The authors cautioned against adopting proposal that would threaten to dampen housing demand, particularly for first time homebuyers. Specifically, PPI recommended that lawmakers *not* mandate a 20% down payment for home buyers and endorsed the restoration of conforming loan limits that expired October 1.
 - **Throw a lifeline to underwater borrowers.** Specifically, PPI recommended that lenders be encouraged to write down loans in exchange for a share of future appreciation in the collateral property. The paper also recommends a mass refinance of GSE portfolio loans to lower rates.
 - **Soak up supply by sparking new demand.** PPI recommends (i) the creation of a permanent homebuyer tax credit for moderate-income homebuyers; (ii) the creation of a “HomeK” retirement set-aside “sub-account” that could be withdrawn without penalty and at a steeply discounted rate to be applied toward the down payment for a home purchase; (iii) the implementation of a bulk REO-to-rental program to encourage investors to purchase foreclosed properties; and (iv) the creation of “homeownership vouchers” for lower-income Americans , fashioned after Section 8, through the conversion of the Low-Income Housing Tax Credit into 1 million homeownership vouchers.
 - **Fix Fannie and Freddie sooner rather than later by establishing a GSE reform super-committee.**
 - **Formulate a new national housing policy.** PPI recommends that Congress appoint a housing policy commission to recommend a new federal housing policy and devise a new housing metrics to gauge the “success” of federal policy. (*All of the Above: What to Do About Housing—Now*, Jason Gold and Anne Kim, October 2011)
- In an October 24 letter to President Obama, Ron Phillips, president of the National Association of Realtors, outlined the following recommendations “intended to

stimulate growth necessary for a sustained recovery in housing and ...positive effect on job creation and the broader economy”:

➤ **“Recommendation #1 – Do Not Risk Weakening Our Nation’s Housing Markets Any Further**

Recraft the Qualified Residential Mortgage rule mandated by the Dodd-Frank Act to include a wide variety of traditionally safe, well documented and properly underwritten products. Requiring a 20% down payment coupled with stringent debt-to-income ratios and rigid credit standards – as defined under the proposed rule by six federal regulators – would be detrimental to prospective home buyers, especially first-time and middle-income buyers.

Restore higher loan limits supported by FHA and the GSEs to provide liquidity in housing markets and to assure mortgage financing options while stabilizing local housing markets. On September 30, the loan limits in 669 counties and 42 states declined. Already, this has had a harmful impact on our fragile housing recovery. Sellers have had to lower their price in markets where mortgages backed by FHA and the GSEs are no longer available. Buyers are confronting higher mortgage rates and larger down payments because only private mortgages are available in these high-cost markets. In some instances buyers have given up their home search entirely.

Resist proposals that call for changing the tax rules that apply to homeownership now or in the future. Without a doubt, now is not the time to change the mortgage interest deduction or any other housing incentives. Making gradual or targeted changes would send the wrong signal further undermining confidence and further depressing home values.”

➤ **“Recommendation #2 – Restore Vitality to Our Communities and Neighborhoods by Reducing the Foreclosure Inventory**

Support S.170, The Helping Responsible Homeowners Act, sponsored by Senators Barbara Boxer (D-CA) and Johnny Isakson (R-GA). Their bill would remove refinancing limits on underwater properties for borrowers that have been paying on time, and would eliminate risk-based refinancing fees charged by Fannie Mae and Freddie Mac.

Support bipartisan Senate efforts calling for improvements to the Home Affordable Refinance Program (HARP). Led by Senators Barbara Boxer (D-CA), Johnny Isakson (R-GA) and Robert Menendez (D-NJ), the time is appropriate to enhance HARP and provide refinancing opportunities to at-risk borrowers as an alternative to defaulting on their mortgage loans.

Direct Fannie Mae, Freddie Mac and servicers to prioritize short sales above foreclosures.

Support all necessary foreclosure/loss mitigation efforts to keep American families in their homes...”

➤ **“Recommendation #3 – Open Opportunities for Private Capital to Return to the Mortgage Marketplace to Foster New Demand among Responsible Homebuyers**

Open up the FHA Section 203(k) rehabilitation loan program to investors to encourage purchasing of foreclosed property. This will facilitate the rehabilitation of the existing housing stock and help reduce the inventory of foreclosed homes.

Require the GSEs to temporarily suspend investor financing limitations, especially the limit on the number of mortgage loans allowed for any one investor/borrower (currently 4 for Freddie Mac and 10 for Fannie Mae). This will give small, private investors the opportunity to absorb some of the excess inventory, resulting in the stabilization of prices for existing real estate-owned (REO) properties.”

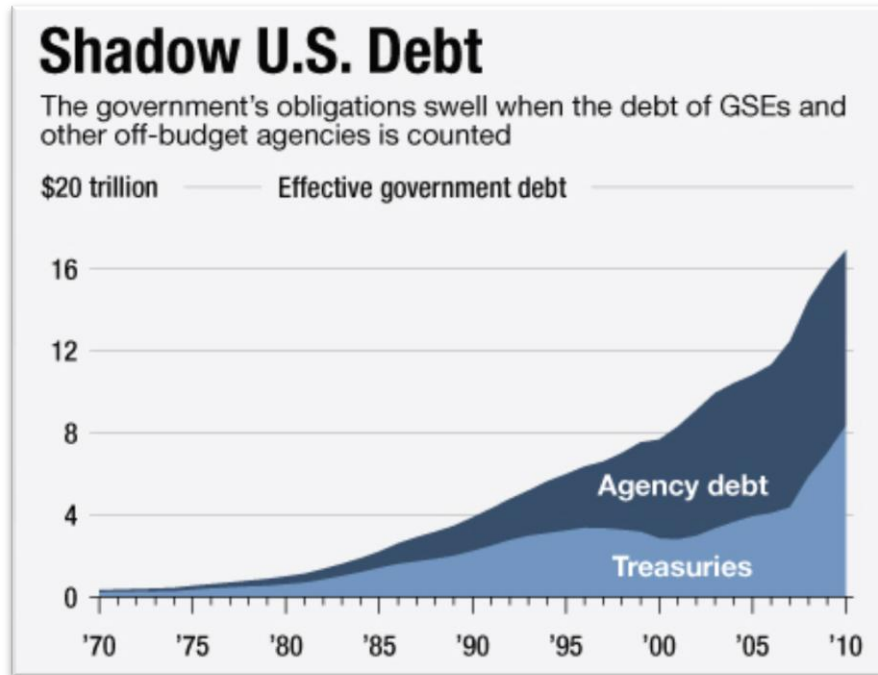
➤ **“Recommendation #4 – Support a Secondary Mortgage Market Model that Includes Some Level of Government Participation**

Reject proposals that call for full privatization of Fannie Mae and Freddie Mac. This is not an effective option because private firm’s business strategies will focus on optimizing their revenue/profit generation. This model would foster mortgage products that are more aligned with the businesses goals than in the best interest of the nation’s housing policy or the consumer.” (*Correspondence to the Honorable Barack Obama, Ron Phillips, 10/24/11*)

Make the U.S. Treasury responsible for “shadow debt”
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- “The huge debt of Fannie Mae, Freddie Mac, ...and Ginnie Mae fully relies on the credit of the United States,” wrote AEI’s Alex J. Pollock in *American Banker*. “It is in fact government debt, but it is not accounted for as government debt. It is not ‘considered officially to be part of the total debt of the federal government,’ the Federal Reserve coyly notes. Not ‘considered officially’ — but agency debt has proven its ability to generate huge losses for the taxpayers. It is off-balance sheet debt and hidden leverage for the government.”
- “...Congress should promptly amend [the Government Corporation Control Act of 1945] to add Fannie Mae and Freddie Mac to its list of mixed-ownership government corporations, thus formally subjecting them to the discipline of the Act. In addition, Treasury should be responsible for reporting to Congress on the cost to the Treasury created by the use of agency debt.”

- “In this way, we could help control, for the future, the use of the government’s credit card by agency debt, the consequent possibility of huge taxpayer losses, and the overleveraging of the housing sector which uncontrolled agency debt aggressively promotes.” (*American Banker*, Alex J. Pollock, 10/25/11)



FHFA directs the GSEs to adopt uniform improvements to foreclosure attorney networks

- The Federal Housing Finance Agency has directed Fannie Mae and Freddie Mac to transition from their current foreclosure attorney network programs to a new system in which mortgage servicers select qualified law firms that meet certain minimum, uniform criteria. This new system dovetails with FHFA’s Servicing Alignment Initiative, which produced uniform foreclosure standards to assist servicers, homeowners and lenders and leads to greater transparency for distressed borrowers. Moreover, the new system will be supportive of the Consent Orders entered into by financial regulators with mortgage servicers. (*FHFA Press Release*, 10/18/11)

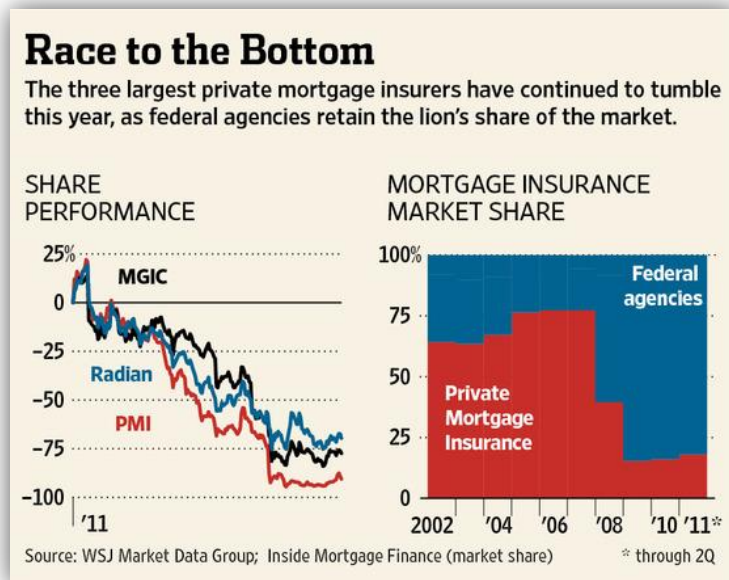
Belt tightening at MBA's 98th Annual Convention?

- Nearly 3,000 people attended the 98th Annual Convention of the Mortgage Bankers Association in October. The price of admission? About \$1,000 per person. “But it might seem jarring that Freddie ...paid \$80,000 to become a ‘platinum’ sponsor of this shindig [and] Fannie Mae ...paid \$60,000 to become a ‘gold’ sponsor,” wrote *New York Times* reporter Gretchen Morgenson. Among the other sponsors were Mortgage Electronic Registration System (MERS) that “made a hash of the nation’s real estate records’ and Lender Processing Services of Florida, “which made robo-signing a household word.”
- “Perhaps more disturbing is that Fannie and Freddie sent an arm of their own to Chicago: 87 people--...more than Mortgage Bankers Association (60), Bank of America (58), Wells Fargo (54) and JPMorgan Chase (24). Only Lender Processing Services had more—91....”
- “I asked Fannie and Freddie what they got out of sending all of these people to Chicago. Representatives of both said participation was an efficient use of taxpayer dollars because it allowed employees to hold crucial meetings with hundreds of customers to discuss ways to address the housing crisis.”
- “They don’t act like companies that have had a huge infusion of taxpayer money,” said Representative Randy Neugebauer (R-TX). “Why do they feel the need to go out and spend the money networking when they have all the mortgage market in its entirety?” Neugebauer has asked FHFA to provide a rundown on the amounts paid by the GSEs to the MBA conference. “We’re going to really look through their entire budget and see if we see signs where [Fannie and Freddie] are tightening their belts,” Neugebauer added. “The American people are tightening their belts. These entities can certainly do the same.” (*New York Times*, Gretchen Morgenson, 10/15/11)

Regulators seize the main subsidiary of PMI Group

- The insurance regulators of Arizona seized PMI Mortgage Insurance Co, the main subsidiary of mortgage insurer PMI Group Inc, and restricted claim payouts to just 50% beginning October 24. Pursuant to an October 20 order of the Arizona Superior Court, the Arizona Department of Insurance now has “full and exclusive power of management and control of PMI.” The takeover comes two months after the state ordered PMI Mortgage to stop selling new coverage.
- PMI Group had been paying about \$1.5 billion a year in claims to investors and lenders, including Fannie Mae, Freddie Mac and Wells Fargo, to cover a portion of their losses on mortgage defaults. Now, the insurer will pay half of these claims with remainder deferred.

- Arizona’s receivership actions “comes as a surprise to the industry,” said David Stevens, president of the Mortgage Bankers Association. “It was assumed that PMI was in the process of a managed runoff scenario with full claims payments expected. America needs a stable and fiscally sound mortgage-insurance, which is so critical to providing financing for low-down-payment borrowers.”
- PMI is one of three mortgage insurers that halted sales of private mortgage insurance at the beginning of the housing crisis. Old Republic International Corp. ceased writing new mortgage insurance sales in August, when waivers granted to allow it to continue business expired, and Triad Guaranty Inc. discontinued sales in 2008.
- MGIC, the nation’s largest PMI company, cautioned that waivers from Fannie Mae and several state regulators that allow the company to continue selling policies if its capital falls below minimum requirements will expire at the end of the year. MGIC CEO Curt Culver said he “doesn’t see an issue with getting those waivers,” since the firm’s home state regulator (Wisconsin) has been assured by outside experts that the company has enough money to pay claims under a stress scenario. Negotiations are underway to obtain an extension of the waivers, Culver added.
- “The housing industry is in a very fragile situation, said Radian CEO S. A. Ibrahim. “We need to work very collaboratively to do everything we can to make sure the housing industry doesn’t suffer any more shocks. I hope PMI’s announcement doesn’t cause any further psychological harm to the homeowners’ market.” Ibrahim said the remaining mortgage insurance companies are healthier than PMI and should be allowed to continue to sell new insurance coverage. “There’s a huge advantage to all of us to being allowed to continue to write business,” he added. As long as the remaining players continue to write business, the industry model will be scarred but whole. Should any more players be forced to stop writing business, it starts to cost the taxpayers even more money [since closed insurers would not be able to use profits on newly written coverage to pay of claims on legacy policies].”
- Only one of the six major private mortgage insurers has an investment-grade credit rating, while a several insurers are dangerously close to breaching their risk-to-capital limit of 25 to 1,



the minimum capital required to ensure that an insurer has adequate firepower to pay claims. For PMI, the company plunged through this threshold in just one quarter, moving from 24.4 to 1 to 58.1 to 1 during the second quarter, according to CRT Capital. (*Wall Street Journal*, Erik Holm, Alan Zibel, and Leslie Scism, 10/22/11; *Wall Street Journal*, Erik Holm, Leslie Scism and Nick Timiraos, 10/22/11; *Wall Street Journal*, Erik Holm, 10/25/11; *Reuters*, Agnes T. Crane, 10/28/11)

- Arizona’s seizure of PMI Group has put hundreds of millions worth of collateralized debt obligations (CDOs), distributed exclusively in Australia, on the brink of collapse, according to the *Australian Financial Review*. *AFR* speculates that three investments in particular—the Torquay, Scarborough and a portion of the Parkes CDOs— would collapse with PMI’s failure, costing Australian investors up to \$250 million. According to *AFR*, councils, charities, churches and wealthy individuals are particularly exposed to CDOs, with the City of Melville, in Perth, having the largest exposure of nearly \$5 million. (*Business Spectator*, 10/25/11)

Delaware Attorney General Beau Biden sues MERS for deceptive practices
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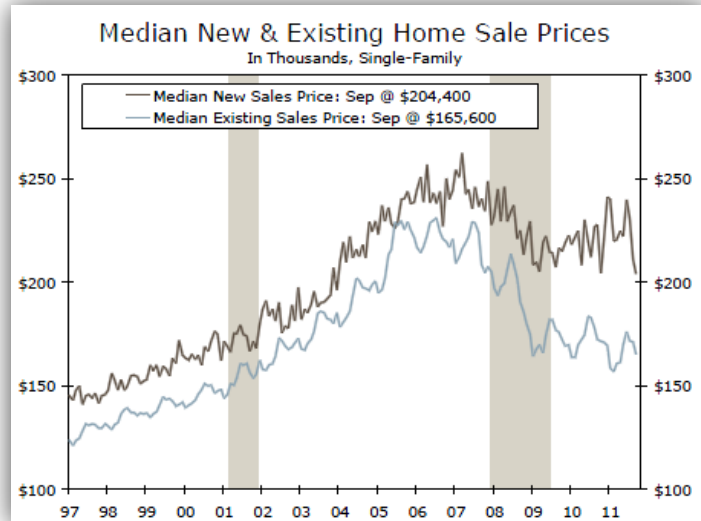
- The Delaware Attorney General Beau Biden (D) has filed a lawsuit against Merscorp Inc. (MERS), claiming the company’s practices are deceptive and it hides information from borrowers. Biden asked the court to bar MERS from (i) initiating any foreclosure actions in the company’s name; (ii) acting as a nominal mortgage lender when it didn’t have a “beneficial interest” in the property; and (iii) recording such mortgages in the company’s name.
- “MERS engaged and continues to engage in a range of deceptive trade practices that sow confusion among consumers, investors and other stakeholders in the mortgage finance system, damage the integrity of Delaware’s land records, and lead to unlawful foreclosure practices,” said Biden. “The unreliability of the MERS System, when compounded with MERS’s reliance on the records in the MERS System, is deceptive and harms consumers by permitting and encouraging foreclosures for which the authority has not been fully determined and may not be legitimate.”
- MERS spokeswoman Janis Smith said the AG’s allegations in the suit have no merit. “MERS’s business practices are transparent,” said Smith. “There is no confusion.”
- MERS’s shareholders include Bank of America, CitiMortgage, Wells Fargo, Fannie Mae and the Mortgage Bankers Association. (*Bloomberg News*, David McLaughlin, Margaret Cronin Fisk and Phil Milford, 10/28/11)

Housing market is “going nowhere fast”

- “Despite renewed attention from the Obama administration and the Federal Reserve, the housing recovery appears to be going nowhere fast,” wrote Wells Fargo Securities’ economist Mark Vitner. “Sales of new and existing homes have been range bound for the past 18 months, and home prices appear set to slide again, as the underlying demand for housing slows even further and foreclosures increase. We have lowered our near-term forecast for new home sales and single-family construction, and stretched out the recovery period needed to bring housing starts back to a more normal level of around 1.5 million units. We now see housing starts totaling just 575,000 units in 2011 and look for starts to rise 11 percent next year to 640,000 units, with most of the gain coming from apartment construction. Housing starts are not expected to return to a 1.5 million-unit pace on a sustained basis until the second half of the decade.”
- “[We] would urge caution before reading too much ‘good’ into ...New Home Sales,” wrote *The BondBeat*’s Steven J. Feiss. “Why? Here’s visual – UP what, almost 6%? Can you tell?? Yeah, we know. Longer term context ruins EVERYTHING.”



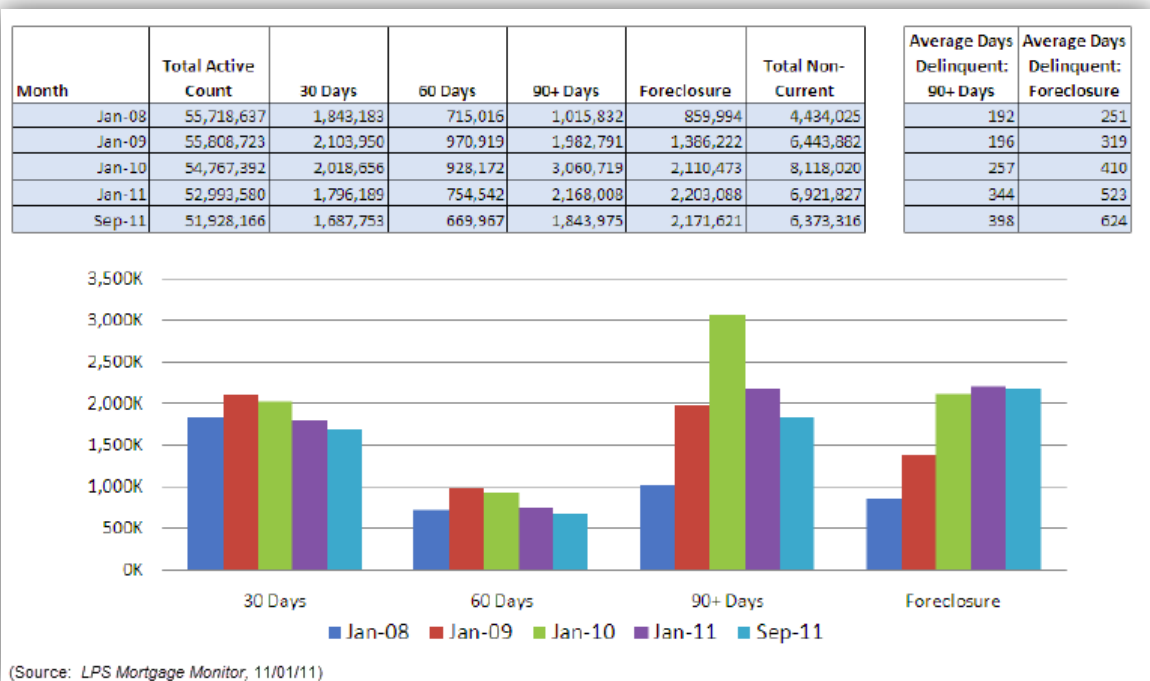
- Vitner added, "... While the 5.7 percent increase [in new home sales] garnered some headlines, the gain reflects only a modest change in activity. Sales have averaged a 300,000-unit pace over the past 15 months, and September's 17,000-unit increase is well within the range of the typical month-to-month fluctuations during this period. Moreover, initial reports on home sales have often been revised



substantially the subsequent month. Even with the increase, new home sales will likely finish the year at a modern era low of just 303,000 units. Sales of new homes are being held back by competition from lower-priced existing homes, as well as by renewed concerns about employment and income prospects. ... The gap between new home prices and existing home prices also widened significantly during this period..., putting builders of new homes at a substantial competitive disadvantage.”

- “With the seasonally-slow fall selling season now upon us, and unseasonably cold weather in the Northeast and parts of the West, we expect foreclosures to account for a larger proportion of existing home sales, which should pull prices lower over the next several months. Some analysts will undoubtedly be quick to label this decline as a triple-dip for housing. Such a characterization, however, oversimplifies what is happening in the housing market. The expected renewed slide in various home price measures will almost entirely reflect changes in the composition of home sales, not further declines in individual home prices. Prices for homes that are not at risk of facing foreclosure have been essentially unchanged and should decline only modestly, if at all, over the next six to nine months.”
- “There is some risk to the downside. The underlying demand for housing appears to be cooling off even further amid renewed concerns about employment security and income growth. The latest consumer confidence report from The Conference Board highlights these concerns, with the proportion of households reporting that jobs are ‘hard to get’ now hovering around an all-time high and more households expecting incomes to fall rather than rise over the next six months. Consumers’ more gloomy assessment of their employment and income prospects, as well as an unemployment rate that has long hovered around 9 percent, has led to a slowdown in household formations, which has, at least temporarily, put the brakes on the demand for apartments and further cooled any thoughts consumers may have had about buying a home.”

- “The lack of a housing recovery has motivated the Obama administration to expand the Home Affordable Refinance Program so that more homeowners, whom owe more on their mortgages than their home is currently worth, can refinance at today’s lower mortgage rates. The program will likely allow up to one million more homeowners to refinance the mortgages, which may modestly speed up the deleveraging process. The program will do little to spur home sales, however, and will have little impact on the price-discovery process.”
- “The Federal Reserve is also doing its part to help the housing sector. The Fed’s ‘Operation Twist’ has been underway for the past month. ...The program has been a limited success so far and the spread between mortgage rates and the 10-year Treasury remains unusually wide. As a result, there has been some discussion by Fed officials about further increasing the size of the Fed’s balance sheet (Q.E. 2.2) and using the proceeds to boost purchases of mortgage backed securities. Such a move does not seem imminent at this time, but may find its way into the policy mix prior to the start of the spring home buying season.”
- “We see little prospect that any policy action will meaningfully impact the housing outlook over the next year. Sales of new and existing homes are likely to remain close to their recent levels, and home price measures are likely to decline further as more foreclosures work their way through the pipeline. Unfortunately, a sustained improvement in housing will not likely get underway until the mountain of foreclosures is cleared and the price discovery process plays out.” (*Housing Data Warp-Up: October 2011*, Mark Vitner, 10/31/11; (*The BondBeat*, Steven J. Feiss, 10/26/11)



Fannie Mae

Fannie Mae issues \$16.7 billion of multi-family mortgage-backed securities in 2011

- Fannie Mae has issued \$16.7 billion in multifamily mortgage-backed securities for the nine months ended September 30, surpassing total issuance for FY2010. The GSE also resecuritized \$4.1 billion of DUS MBS through its Fannie Mae GeMS™ program and expects this resecuritization issuance to top \$6 billion by yearend.
- “Given the volatile market environment, Agency CMBS is thriving. Fannie Mae’s total activity, including MBS issuance, GeMS issuance and portfolio sales was the highest of any quarter this year,” said Kimberly Johnson, Vice President of Multifamily Capital Markets. “Over the past two years, we have seen a significant increase in securities available for trading. Our multifamily MBS outstanding now exceeds \$90 billion.”
- Fannie Mae Capital Markets sold \$2.5 billion of multifamily mortgage securities in the third quarter of 2011, including sales of GeMS, bringing total sales to \$7.8 billion for the nine months ended September 30. (*Fannie Mae Press Release, 10/25/11*)

Fannie Mae employees placed on leave, while FHFA’s IG investigates the GSEs’ multifamily program

- At least four Fannie Mae employees have been placed on administrative leave, while the FHFA’s Office of Inspector General (OIG) conducts an investigation into a transaction by the company’s multifamily program, according to sources. According to *National Mortgage News*, “Fannie Mae’s chief risk officer in charge of multifamily mortgages, David Worley, departed ... Monday morning [October 31].”
- The U.S. Attorney’s Office for the Eastern District of Virginia is also involved in the investigation of a single transaction that was part of a broader partnership involving distressed apartment buildings between Fannie Mae and Related Cos., a closely held New York developer. Sources said that law enforcement agents held “voluntary meetings” with Fannie senior managers the last week of October, but no search warrants were involved.
- “The investigation is limited in scope and we are cooperating fully with FHFA and the OIG,” said Fannie Mae spokeswoman Kelli Parsons. “Consistent with our usual practice, we placed employees on administrative leave pending the outcome of the review.” (*Wall Street Journal, Nick Timiraos, 10/31/11; National Mortgage News, Paul Muolo, 10/31/11*)

- Perseus, LLC won approval from the Department of Energy of \$50 million in loans from the agency’s clean energy program for Vehicle Production Group (VPG), a Miami start-up that will manufacture wheelchair assessable cars and taxis. DoE awarded the low cost government-backed financing to VPG in November and announced its formal approval of the loans the following March.
- Persus Chairman Frank Pearl said in a *Washington Post* interview that it is “an absurd idea’ to think that the political connections of the firm’s vice chairman, Jim Johnson [former CEO of Fannie Mae and fundraiser for President Obama], helped sway DoE’s decisions. “I doubt there was anybody at DOE that even considered the fact that Jim was a part of this firm,” said Pearl. “We went straight through the proper channels of the [loan] program.” Pearl added that Johnson has not—to his knowledge—asked the administration to help VPG. “It seemed to me, and it still does, that dealing forthrightly with people at DOE and not putting them under pressure was the most effective way to do this,” Pearl added. “That’s what we did.”
- “[T]he decision to provide the Vehicle Production Group a loan was made based on the merits after more than two years of review by officials in the DOE loan program,” said DoE spokesman Damien LaVera.
- Persus has been the leading investor in VPG Group since 2008. Pearl has been a longtime friend of Fred Drasner, the president of VPG and former owner of the Washington Redskins and former co-publisher of *New York Daily News*. Collectively, the Persus executives donated \$120,700 to President Obama and the Democratic Party’s three top fund raising committees since the 2007-2008 election cycle.” (*Washington Post*, Carol D. Leonning, 10/28/11)

Freddie Mac

Freddie Mac CEO Haldeman to step down “in the coming year” and three directors to step off the board at the end of their term in 2012

- Freddie Mac CEO Ed Haldeman will step down some time in the coming year, announced the company. “Ed Haldeman has brought strong leadership to Freddie Mac,” said FHFA Acting Director Edward DeMarco. “I appreciate his commitment to leadership stability during the upcoming transition.” The Freddie Mac board will begin the process of finding a successor shortly, said FHFA. Haldeman has agreed to remain serving as CEO until the transition takes place.
- In February, Koskinen and Robert Glauber will step down from Freddie Mac’s board after hitting the company’s mandatory retirement age of 72. In addition, Laurence E. Hirsch has notified the company that he does not plan to seek re-election when his board term ends “due to personal and professional commitments.” Chairman Koskinen will be replaced by Christopher Lynch, a retired national partner of KPMG LLP, who currently serves as a director of AIG. DeMarco has asked Christopher Lynch, the GSE’s incoming chairman of the board and the current chair John Koskinen to work on a CEO succession plan. (*HousingWire*, Jon Prior, 10/26/11; *Associated Press*, Derek Kravitz, 10/27/11)

Freddie Mac’s seriously delinquent single-family rate up 2 b.p. to 3.51%

- Freddie Mac’s total mortgage portfolio decreased at an annualized rate of 1.5% in September to \$2.1 trillion, as its retained mortgage portfolio decreased at an annualized rate of 2.5% to \$679.1 billion. In September, Freddie Mac’s serious delinquency rate [e.g., 90 days or more past due] on single-family mortgages increased 2 basis points to 3.51%, while its serious delinquency rate for multifamily loans declined 2 basis points to 0.33%. (*Monthly Volume Summary*, Freddie Mac, September 2011)

Freddie Mac Foundation to wind-down at year-end 2014

- “When Freddie Mac entered conservatorship in 2008, the Freddie Mac Foundation was fortunate to be self-funded by its own separate endowment – an irrevocable trust created by Freddie Mac in 2003,” wrote the company’s Community Relations EVP Ralph Boyd, Jr. “This endowment has allowed us to continue making charitable investments to help struggling families without using any corporate or taxpayer dollars.”

- “This month, we announced that our conservator, the Federal Housing Finance Agency, has directed us to wind down the Freddie Mac Foundation at the end of 2014, with any remaining investments distributed to the community in 2015. We know from our partners that the Foundation’s resources will be hard to replace, and we are working with them to help find other possible funding sources.”
- “While this is the Foundation’s final chapter, I believe the three years ahead could well be our best. It will be a time of innovative and sustainable investments that will have long-term, measurable, and meaningful results for children and families. We plan to invest more than \$25 million annually through 2014.”
- “We recently invested \$1 million in Virginia Governor Robert McDonnell’s initiative to end homelessness, and another \$1 million in the nonprofit housing organization LISC to help preserve and increase affordable housing for low- and very low-income families. These are the kinds of investments we will be seeking out during the next three years.”
- “The Freddie Mac Foundation is proud of its 20-year legacy partnering with nonprofits and government agencies to invest in our communities. We are privileged to work with an inspiring mix of people, organizations, and agencies joined by a common goal: to make a real, measurable difference in the lives of children and their families for generations to come. We’ve seen some great things happen in that time. Expect great things from us in the Foundation’s final chapter.” (*Freddie Mac’s Executive Perspective Blog*, Ralph Boyd, Jr., 10/17/11)

Federal Home Loan Banks

The FHLB System's profits fall, as their advances decline

- On September 30, 2011, the FHLB System reported total assets of \$778.3 billion, down 11% from year-end 2010 as a result of a decline in advances and investments.

<i>(Dollars in millions)</i>	September 30, 2011	December 31, 2010	Change
Assets			
Investments	\$ 290,246	\$ 330,470	\$ (40,224)
Advances	415,379	478,589	(63,210)
Mortgage loans held for portfolio, net	55,172	61,191	(6,019)
Other assets	17,455	7,859	9,596
Total assets	\$ 778,252	\$ 878,109	\$ (99,857)
Liabilities			
Consolidated obligations, net			
Discount notes	\$ 172,269	\$ 194,431	\$ (22,162)
Bonds	530,260	606,567	(76,307)
Total consolidated obligations, net	702,529	800,998	(98,469)
Mandatorily redeemable capital stock	8,934	7,066	1,868
Other liabilities	26,485	26,304	181
Total liabilities	737,948	834,368	(96,420)
Capital			
Capital stock	35,984	41,735	(5,751)
Retained earnings	8,193	7,552	641
Accumulated other comprehensive income (loss)	(3,873)	(5,546)	1,673
Total capital (GAAP)⁽¹⁾	40,304	43,741	(3,437)
Total liabilities and capital	\$ 778,252	\$ 878,109	\$ (99,857)
Regulatory capital⁽¹⁾	\$ 53,911	\$ 57,362	\$ (3,451)

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

- The FHLB System's capital totaled \$40.3 billion at the end of the third quarter, down 8% from year-end largely due to repayment of advances. The System reported net income of \$469 million for the third quarter, down 36% for the period driven by a 29% decline in net interest income. The System's lower net interest income for the third quarter was attributable to lower yields on interest-earning assets, reductions in average advance balances, and run-off of higher yielding investments and mortgages, and lower prepayment fees on advances.

<i>(Dollars in millions)</i>	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Change	2011	2010	Change
Net interest income after provision (reversal) for credit losses	\$ 988	\$ 1,393	\$ (405)	\$ 3,025	\$ 3,935	\$ (910)
Total other non-interest income (loss)	(230)	(209)	(21)	(924)	(1,437)	513
Total other expense	239	228	11	740	624	116
Total assessments	50	224	(174)	283	491	(208)
Net income	\$ 469	\$ 732	\$ (263)	\$ 1,078	\$ 1,383	\$ (305)

- Two FHLBs reported small losses for the third quarter—the FHLB-Des Moines (\$1 million loss) and FHLB-Topeka (\$2 million loss). (*FHLBanks Office of Finance Press Release*, 10/28/11)

Ginnie Mae

FHA to auction thousands of defaulted loans in a pilot program
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- The FHA is auctioning off thousands of defaulted loans at discounts of up to 65%, in a pilot program that would allow the insurer to minimize losses by avoiding the foreclosure process and provide the borrowers a better chance to remain in their homes. “The pilot is a potential win-win-win,” said Acting FHA Commissioner Carol Galante.
- This program, called the Mortgage Acquisition and Disposition Initiative, is aimed at working with underwater borrowers, who are at increased risk of walking away from their mortgages. A goal of this pilot is to prove to the housing market that writing down negative equity can cost less than foreclosing, said Pete Mills, managing director of Community Mortgage Project. “It’s a tool for the toughest loans out there,” said Mills. “Even if we can save 20 or 30 percent of them, it’s great.” By giving investors a chance to make money, the program provides market incentives to help overcome lenders’ reluctance to reduce mortgage balances, added Mills. “The principal reduction comes via market forces versus political factors.” Winning bidders agree not to foreclose on borrowers for six months while they work with borrowers to modify their mortgage terms, including principal reductions. After six months, foreclosure proceedings may be initiated.
- However, some investors are critical of this pilot program, arguing that the discounts aren’t deep enough, particularly in severely depressed markets. Jon Daurio, a former executive at Ameriquest Mortgage and founder of Kondaur Capital, said that even at a 65% discount “you’re not buying loans cheaply enough” to reduce the mortgage principals. In turn, borrower activists say they are troubled to see the participation of former executives of now defunct subprime lenders in the FHA pilot program. “[This FHA program] is a way to continue to line the pockets of the predators who created the mortgage crisis,” said Bruce Marks, CEO of Neighborhood Assistance Corporation of America.
- To date, FHA has sold approximately 2,500 loans with unpaid balances of \$446.8 million in four loan sales through the Mortgage Acquisition and Disposition Initiative. More than a year in this project, most of the mortgages remain delinquent,

according to data provided to *Bloomberg News* by FHA officials. (*Bloomberg News*, Clea Benson and Lorraine Woellert, 10/24/11)

HUD eliminates geographic restrictions on FHA loans

- In Mortgage Letter 2011-23, HUD amended the relevant Handbook provisions to expand the lending authority for FHA-approved mortgages from specific geographic areas to the entire country. The ML 2011-23 also includes the first changes to HUD's FHA Mortgagee Approval Handbook to begin aligning the Handbook requirements with the regulatory changes made to lender approval requirements in 2010. (*K&L Gates Legal Insight: One Step Closer to Leveling the Playing Field for FHA Lenders*, Krista Cooley, 10/18/11)

Acting FHA Commissioner Galante voices support for HUD's reverse mortgage programs

- “[The Home Equity Conversion Mortgage] is a very important tool for seniors,” said Carol Galante in a speech at the National Reverse Mortgage Lenders Association (NRMLA) 2011 Annual Conference. “We want to make the HECM program the best program it can be.” Galante also said she sees no immediate reason to reduce the current HECM loan limits (\$625,500) and is optimistic that some level of housing counseling dollars will be included in the 2012 budget.
- “We thank Acting Commissioner Galante for her leadership and commitment to the vitality of the FHA reverse mortgage program,” said Peter Bell, president and CEO of NRMLA. “Under Acting Commissioner Galante's direction, HUD, along with the industry, has taken steps to position the HECM program for a bright future.” (*National Mortgage Professional*, 10/26/11)

Farm Credit System / Farmer Mac

“Operation Twist” will likely provide further advantage to the Farm Credit System

- “On September 21, the Federal Reserve launched ‘Operation Twist’ to bring down longer term interest rates,” wrote Bert Ely in *Farm Credit Watch*. “Lower rates will enable the FCS to refinance more of its debt at record-low rates, increasing its competitive edge over taxpaying banks and other private-sector lenders, especially on real estate loans. Although longer-term rates, as evidenced by the yield on 5-year and 10-year Treasuries, have risen since shortly after Operation Twist was announced, the average yield on 10-year Treasuries in the third quarter of this year dropped to 2.41% from 3.20% in the second quarter and 3.46% in the first quarter. Five-year Treasuries showed a smaller but still significant decline, dropping to 1.80% in the third quarter from 2.06% in the first quarter and 2.14% in the second quarter. I fully expect the FCS to report substantial debt refinancing during the second half of this year as a result of these low rates.” (*Farm Credit Watch*, Bert Ely, October 2011)

Farm Credit System’s proposed participation in FHA lending is “just a double-government meat sandwich”

- The banking industry views HUD’s proposal to allow the Farm Credit System to originate FHA loans as another attempt by the System to expand its powers, pointing to the System’s earlier efforts to expand their population cap from 2,500 to 6,000 in 2007 and a proposal the following year to expand their ability to lend in a variety of ways in larger markets. To date, the FCS’s expansion efforts have failed due to lawmakers’ concerns over the System’s expansion. When legislative efforts fail, it’s time to turn to regulatory initiatives.
- “The Farm Credit System has consistently shown an interest in expanding into all conceivable areas of finance in an effort to grow their businesses,” said John Blanchfield, director of American Bankers Association’s Center for Agriculture and Rural Banking, who finds the FHA proposal particularly “biting.” “They already have a ginormous subsidy where they are enjoying some of the lowest cost of funds [as government-sponsored entities.] There is no reason that Farm Credit, flush with earnings, can’t create its own housing program that would look like FHA. This would be a federal guarantee on top of a federal guarantee. That’s just a double-government meat sandwich.”
- “...Most puzzling in the FCS’s pursuit of FHA lending authority is that the FCS barely utilizes a long-standing USDA rural-housing finance program, the Single-Family Housing Loan Guarantee Program (SFHLGP),” wrote Bert Ely in *Farm Credit Watch*. “Just three FCS institutions—two associations and one Farm Credit bank—are approved SFHLGP lenders while hundreds of banks and thrifts participate

in the program. None of the three FCS institutions were among the 146 lenders who have originated the most loans under this program.”

- “The FCS’s interest in becoming an FHA direct lending institution is especially puzzling since the SFHLGP has very flexible lending criteria. In particular, homebuyers financed under the SFHLGP can have incomes up to 115% of the area’s median income, they do not have to make a down payment, there is no purchase-price limit, and no mortgage-insurance or minimum credit-score requirements. Of course, when FCS institutions hold in portfolio rural home loans they make, they can avoid the lending and documentation requirements established by USDA and FHA. However, the FCS bears the full credit risk for loans held in portfolio, which raises this question – why is the FCS trying to shift the credit risk of its rural home lending to the FHA when it seems unwilling to shift that risk to the USDA under its SFHLGP? Does the Farm Credit Administration believe that a larger amount of housing-finance risk can be driven out of the FCS through FHA lending rather than SFHLGP lending?” (*American Banker*, Robert Barba, 10/13/11; *Farm Credit Watch*, Bert Ely, October 2011)

Record land values, record crops and record incomes—largely driven by ethanol subsidies

- Farmland values have doubled over the last decade, driven largely by soaring commodity prices—in particular corn. In some areas of the Midwest, farmland values have jumped as much as 25% over the last year, as hedge funds, foundations, pension funds, and state retirement systems have sought safe investments in the farmland. “It’s an unusual combination, said Ron Plain, professor of agriculture economics at the University of Missouri. “We had this tremendous run-up in corn and soybean prices and we had very low interest rates. That really allows people to pay a lot for farmland.”
- The agri boom was largely aided by the ethanol mandates imposed by Congress in 2006, driving demand for corn and its price sharply higher. Roughly 40% of the nation’s corn goes to the production of ethanol today, compared to 1% 30 years ago. For the first time ever, more corn will go into motor fuel production than into feed for animal stock. While corn used by ethanol plants has increased 382%, corn production has increased only 5.4% over the same period. “Really, it goes back to ethanol and the mandates for ethanol, which elevated demand for corn and limited the supply,” said Steve Witges, a regional lending manager for Farm Credit Services of Illinois. “Corn is the barometer for income on these farms; it’s the primary driver, and profitability has been very strong.”
- Federal subsidies of ethanol has resulted in an excess—and thus exportable—supply of ethanol to Britain, Finland and the Netherlands to ensure the countries’ compliance with the EU’s biofuel mandates. With excess corn ethanol being exported, the U.S. market is in short supply by some 21 billion gallons of “advanced biofuels” [made

from feed stocks other than corn], prescribed by the 2007 overall biofuel mandate. The federal government's byzantine federal biofuel mandates has created a bizarre and complex maze, which coupled with complex tax credits, tariffs and import quotas, defies comprehension—not to mention common sense. [For a detailed analysis of the “biofuels fiasco,” see <http://tinyurl.com/69q5czj>.]

- “Ethanol started out as the quintessential subsidy program back in the 1970s,” wrote *Weekly Standard*'s Dave Juday. “It cost a large number of taxpayers a relatively small amount of money apiece to provide a large benefit to a relatively small number of beneficiaries. It didn't hurt that most of the beneficiaries were—and still are—in Iowa, where 25 percent of all ethanol is produced. Average farmland prices in the Hawkeye State have grown from about \$2,600 per acre to \$6,400 per acre since 2004, the year before the latest mandate was put in place. In 2004, owning 385 acres of typical Iowa farmland made you a millionaire. Today 160 acres will do the trick.”
- “If politicians had set out to cater to and enrich some of the most influential voters in our presidential primaries every four years, they could scarcely have come up with a more ingeniously targeted policy. But the program is now starting to collapse under the weight of its own complexity and market distortion. Indeed, biofuels policy is now recognized by many of those same politicians as a program of dubious if not harmful environmental impact that imposes major costs on taxpayers and food consumers—with additional costs to motorists soon to come.”
- “There are proposals in Congress to establish a trigger based on corn stocks to waive the corn ethanol mandate temporarily, to let states opt out of the federal mandate, and to deny the tax credits afforded biofuels. Those proposals are intended to address the budgetary costs and the now-widely recognized food versus fuel impact of biofuel - policy. But, even if they are adopted, a mind-numbingly convoluted regulatory regime will be left in place. As long as Iowa looms large in our quadrennial selection of presidential candidates, don't look for leadership on the issue to arise in this White House, or its successors.” (*Weekly Standard*, Dave Juday, 10/31/11)
- “Look at the Midwest,” said Wall Street analyst Meredith Whitney. “The U.S. is going to look a lot different over the next 20 years than it did in the last 20 years, and you're going to see agribusiness become a much bigger deal. Most of the states in the middle part of the country have clean balance sheets. They don't have to cut services and they don't have to raise taxes. I'm talking Kansas and North Dakota.” (*The Republic*, Georgina Gustin, 10/27/11; *Wall Street Journal Magazine*, Duff McDonald, 09/29/11; *Crain's Detroit Business*, Howard Lovy, 10/12/11)

Proposed Infrastructure Bank

Senator Harry Reid will push legislation to create an infrastructure bank as part of President Obama's job-creation legislation

- Senator Harry Reid (D-NV) said his party will try to pass legislation in the Senate that would create a national infrastructure bank with \$10 billion of initial funding and spend \$50 billion on infrastructure improvements for road and bridge repairs. This measure, the second element of the Obama administration's job-creation legislation, would be funded by a 0.7% surtax on incomes exceeding \$1 million a year, said Reid, who expects the chamber to vote on the measure the first week of November. (*Wall Street Journal*, Corey Boles, 10/22/11)
- "...Obama's proposed new bank, to be called the American Infrastructure Financing Authority, is guaranteed to create a mere trickle of jobs for at least its first year if it becomes law," wrote the *Washington Examiner* in an October 13 editorial. "Before a single dime could be spent, Obama would have to appoint and the Senate confirm a chief executive officer, who would then have to hire a chief financial officer, chief risk officer, chief compliance officer, general counsel, chief operations officer and chief lending officer. Besides all these chiefs, office space would have to be procured and furnished, then swarms of bureaucrats hired to shuffle paper. This process would take at least a year, probably two, and no money would be spent on infrastructure during that time."
- Once the bank did get up and running—seeded with \$10 billion in taxpayer money—it would essentially function the same way Fannie Mae and Freddie Mac did, as a government-owned corporation that subsidizes sub-market-rate loans and loan guarantees for projects with politically influential backers. Just like Fannie and Freddie, Obama promises there would be teams of government experts to ensure only 'good bets' are funded. But, as the American Enterprise Institute's Peter J. Wallison has amply demonstrated (most recently in the *Wall Street Journal*), pressures from the forces of political correctness in the Clinton administration steered Fannie and Freddie to make horrible bets on billions of dollars in subprime mortgages. By 2008, 70 percent of all subprime loans were guaranteed by Fannie or some other government entity. No wonder Bill Gale, scholar at the liberal-leaning Brookings Institution, told the *Washington Post* that 'the notion that we're going to do for infrastructure what Fannie and Freddie did for housing is not a particularly enticing prospect.'"
- "Obama and his political appointees have demonstrated just how lousy they are at picking winners and losers in the economy. After the Bush Energy Department denied a proposal for a tax-subsidized loan for the solar panel manufacturer Solyndra, Obama's crowd came to town and handed the now-bankrupt firm \$535 million. And SunPower, another solar power company, scored a \$1.2 billion loan guarantee from

Obama's experts. SunPower posted \$150 million in losses in just the first half of this year and faces dire prospects for its future survival unless propped up with more government money. Bottom line: Washington politicians and bureaucrats can never pick winners and losers using other peoples' money—ours— as efficiently and effectively as private investors spending their own money." (*Washington Examiner*, 10/13/11)

Representative Fudge introduces H.R. 3259 to create a National Infrastructure Bank

- Representative Marcia Fudge (D-OH) has introduced H.R. 3259, which would create a National Infrastructure Bank and provide funding of \$5 billion per year through 2015. If the measure were approved by Congress, the bill would provide \$20 billion for the NIB, double the funding level requested by President Obama. Fudge's bill is a companion to S. 1550, sponsored by Senator Sherrod Brown (D-OH) in September. [Separately, Senators John Kerry (D-MA) and Kay Bailey Hutchison (R-TX) have introduced legislation that create a national infrastructure bank and provide \$30 billion of funding over a six-year period.]
- "Whether you are a Democrat or Republican, we all have infrastructure that is crumbling, and we have people in our districts who are eager to get back to work," Fudge said. "This legislation allows us to target the large number of deficient bridges in our communities and other dangerous infrastructure for repair, making travel safer for our residents." (*The Bill Floor Action Blog*, Pete Kasperowicz, 10/26/11)

The limited benefits of a national infrastructure bank

- "[T]here is little added value from any of [the proposed national infrastructure banks] beyond what could be achieved by modest alteration in existing transportation programs," said Dr. Ronald Utt, senior research fellow at the Heritage Foundation, in testimony before Congress. "What value there is could be more than offset by the problems that could emerge from such entities. The reasons for this skepticism are as follows."
- "Beginning in the 1930s, the federal government created a number of bank-like entities and credit insurance facilities, and every one of them has been challenged by serious, if not catastrophic, financial failure that often involved costly taxpayer bailouts. They include the Federal Land Banks, Farm Credit Administration, Federal Housing Administration, Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, Federal Home Loan Banks, and Fannie Mae and Freddie Mac. The latter two are perhaps the most catastrophic of all, with the taxpayer bailout cost totaling about \$150 billion so far."

- “In every case, these entities were believed to have been soundly organized and operated, and they provided loans and guarantees and insurance on products or entities that were also believed to be financially sound. Importantly, these loans and investments also provided a reliable stream of income to fund the federal entity, service its debt, and provide it with the necessary reserves and contingency funds. In short, they were all deemed to be commercially viable, as were their clients. Yet they all failed in one way or the other despite the top-notch talent thought to be running them.”
- “Could the Bank Avoid These Risks? In this regard, what is noteworthy about the typical infrastructure bank proposals is that all will begin with risks and deficiencies that significantly exceed those confronting the federal finance entities cited above. Fannie Mae, for example, was supposed to be investing only in conforming mortgages, thought by most to be a safe, conservative investment providing a steady stream of interest and principal repayment.”
- “In contrast, and with the exception of some well-established toll roads, bridges, and tunnels, most transportation infrastructure earns no revenue and must be supported entirely through taxes or related user fees. Most roads are still ‘free’ to users and likely will remain so, while fares earned on even the best-run transit systems cover none of their debt service and only about half of their operating costs.”
- “While a growing share of new transportation capacity underway will be tolled and thus will yield a stream of revenues, ‘freeways’ will likely continue to be the norm. However, even the act of tolling is no assurance that the necessary and sufficient revenues will be there to cover debt service: Over the past decade or so, a number of new toll roads in Virginia, California, South Carolina, and Texas have suffered revenue shortfalls of some significant magnitude. Obviously, a revenue-generating environment of this degree of uncertainty seems likely to impose important challenges to any transportation infrastructure bank attempting to maintain a sound financial footing.”
- “Moreover, those banks that would also make grants would lose money on every grant made, effectively losing both interest and principal the minute the grant is made. This has led one critic [Ken Orski] to observe that ‘institutions that give away money without requiring repayment are properly called “foundations” not “banks.”’ Senator James Inhofe, ranking member on the Senate’s Environment and Public Works Committee, likewise noted that: ‘Banks don’t give out grants; they give out loans. There is also currently a mechanism for giving out federal transportation grants—it is called the highway bill. I don’t believe an infrastructure bank will increase total transportation investment—it will only take money away from what would otherwise go through the existing highway and transit programs.’”
- “Infrastructure-based stimulus programs have been a disappointment, in large part because of time delays in getting programs underway, projects identified and

approved, and money spent. More recently, supporters of the American Recovery and Reinvestment Act (ARRA) claimed that it would focus on shovel-ready projects, but USDOT recently reported to this committee that as of July 2011—two and a half years after the enactment of the ARRA—just 61 percent of the authorized transportation funds had been spent. Perhaps contributing to this is the fact that the Federal Railroad Administration required 12 months to set up a mechanism to receive, review, and approve rail infrastructure projects authorized by the ARRA.”

- “In both of these cases, the stimulus funds were being spent through existing federal, state, and local channels by departments, managers, and employees with many years of experience in the project approval business. In large part, these delays are not due to any particular institutional failing but simply to the time it takes to establish guidelines and rules for project submission, for outside parties to complete the request, and for USDOT to review the many requests submitted and pick the most promising, perhaps with modifications, and fulfill the contractual details of awarding the contract. Once the award is made to state and local entities, they in turn must draw up the RFP (and perhaps produce detailed engineering plans as appropriate), put the contract out for bid, allow sufficient time for contractors to prepare bids, review submitted bids, and finally accept the winning contract. It is at this point that money can be spent on the project, and the time that elapses from the beginning to the end of the beginning can easily exceed a year or more.”
- “In the case of an infrastructure bank, such delays will be much longer—perhaps even double that described above. In the case of the above example, the assumption is that the newly authorized stimulus money would flow through an institutional ‘infrastructure’ of well-established channels staffed by experienced people. In the case of the proposed infrastructure banks, no such administrative structure exists, and one will have to be created from scratch once the enabling legislation is enacted.”
(The Limited Benefits of a National Infrastructure Bank , Ronald Utt, Ph.D., 10/20/11)

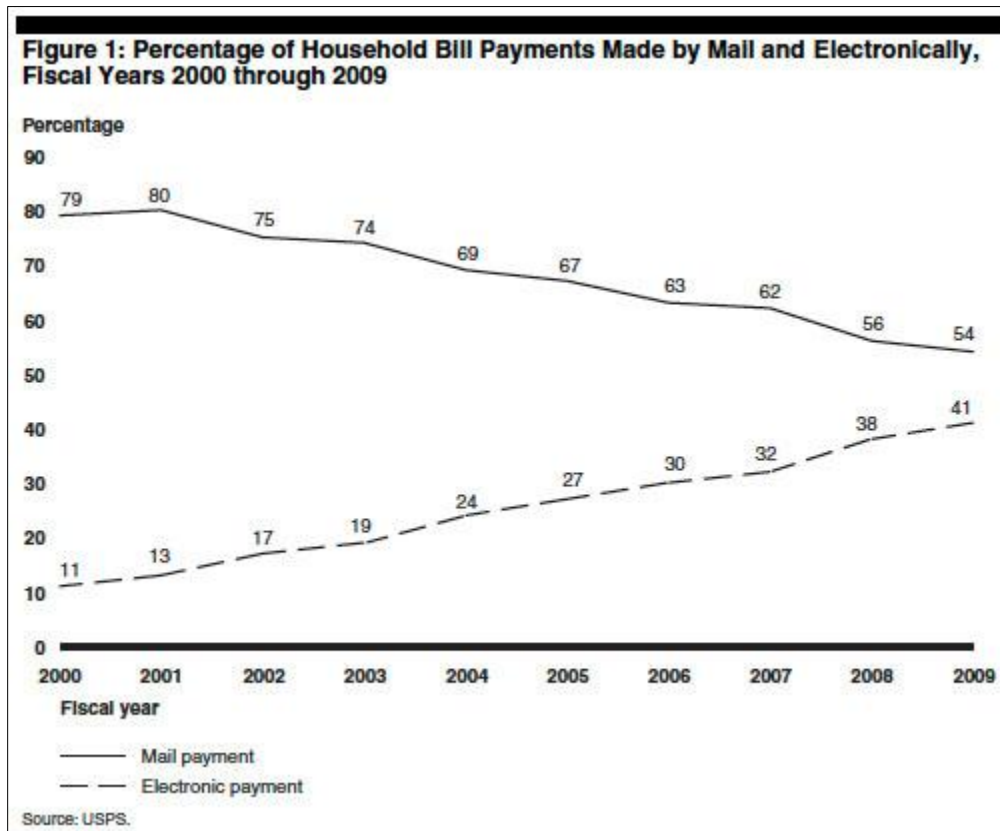
Postal Service

Re-engineering the USPS in the era of the Internet



- "Washington's antiquated policies, combined with rising internet use, are killing the U.S. Postal Service, wrote Rick Geddes, associate professor at Cornell University and adjunct scholar at American Enterprise Institute. "Mail volumes are down over 20 percent since their highs in 2006, declines not seen since the Great

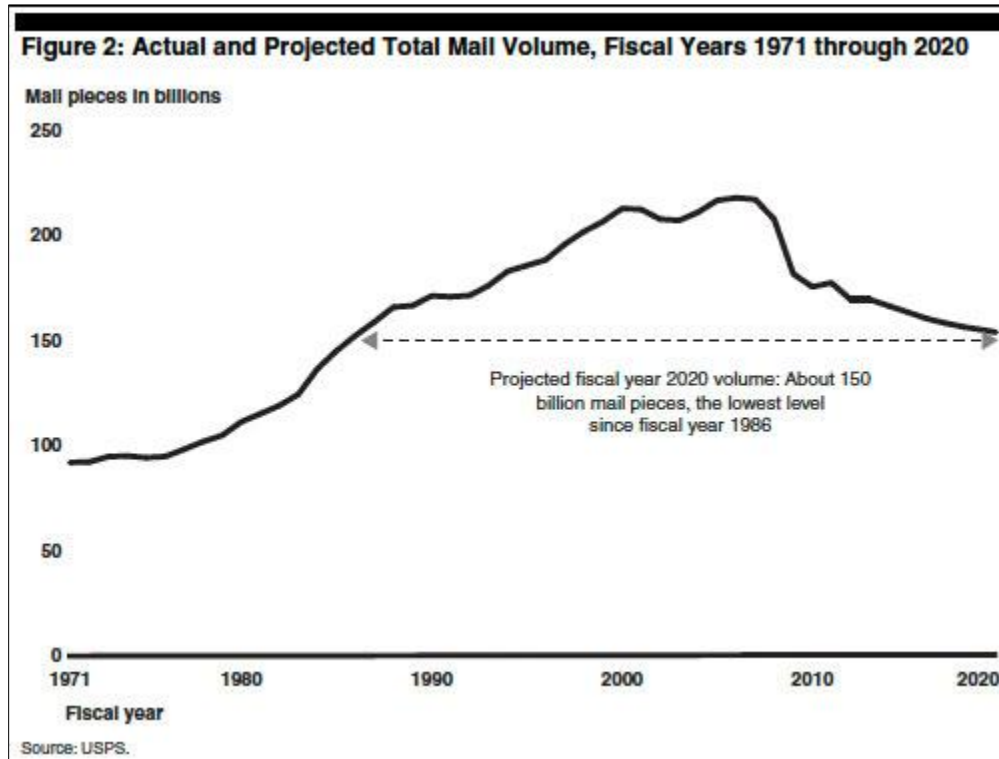
Depression. First-class mail--by far the Postal Service's most profitable class--is down almost 25 percent since its 2001 peak. The Postal Service expects to lose between \$9 and \$10 billion this year, and was unable to meet a \$5.5 billion payment to the U.S. Treasury due on September 30th, which Congress deferred until November 18th."



- "Moreover, the composition of the mail has changed dramatically. About 90 percent of all mail is now business-originated commercial material. The Post Office's original public mission of "binding the nation together" is patently obsolete when

people around the world can communicate instantly via the internet, and receive only catalogs and advertisements by mail.”

- “The decline in physical mail, and the growth in low-profit advertising content, is likely to continue. ‘Kicking the can down the road’ through incremental reform and accounting gimmicks are no longer sufficient to avoid a massive taxpayer-funded bailout. The time has come for meaningful reform that will protect taxpayers and create a sustainable Postal Service.”



- “The Postal Service needs to be converted into a regular business, facing market competition and disciplined by active, focused shareholders. It must be permitted to reduce its high and rigid costs, and to adjust to the realities of a new communications marketplace. This should be done through de-monopolization, corporatization, and eventual privatization, as has been done in many other countries.”

Table 1: Postal Service Financial Results and Projections, Fiscal Years 2006 through 2011

Dollars in billions

Fiscal year	Net Income (loss)	Total revenues	Total expenses	Outstanding debt
2006	\$0.9	\$72.8	\$71.9	\$2.1
2007	(5.1)	75.0	80.1	4.2
2008	(2.8)	75.0	77.8	7.2
2009	(3.8)	68.1	71.9	10.2
2010	(8.5)	67.1	75.6	12.0
2011 (projected)	(6.4)	67.7	74.1	15.0

Source: USPS.

- “The Obama Administration has proposed a timid, ineffective plan. It provides only temporary fixes by returning to the Postal Service some \$7 billion in overpayments it made to the Federal Employees Retirement System since 1971, deferring for two years a required annual \$5.5 billion payment due to U.S. taxpayers, and allowing postage rates to increase by 2 cents. The plan would do nothing to address the underlying, inexorable problem of adjusting to a new communications marketplace. In short, such changes would only push off--and make more costly--the day of reckoning when real reforms become inevitable.”
- Congress must answer two questions in light of widespread electronic communications and increasingly commercial mail. First, what level (such as days per week) of government-guaranteed mail delivery is appropriate in such a world? Second--assuming that Congress decides that some routes are worthy of a direct taxpayer subsidy--what is the cheapest and most transparent way to pay that subsidy? Taxpayers have a right to know exactly how much guaranteed mail service is costing them, as well as assurances that they are paying the minimum amount necessary for such service.”
- “Even if Congress decides that direct taxpayer subsidies are warranted--and increasingly commercialized mail suggests that they are not--the Postal Service should nevertheless be put on a course toward de-monopolization and privatization. This approach would free up the Postal Service to evolve into a typical private corporation, and to bid itself on those routes it refused to serve without subsidies. The Postal Service would also be free to set its rates as it wished.”
- “The greatest benefit of this approach, however, is that it would lead to privatization. This would avoid a taxpayer bailout by allowing the enormous latent value in the Postal Service’s network to be realized by the taxpayers who own it. That network is valuable both because of its real estate and--freed of political constraints--it would have huge value as a going concern.”

- “U.S. taxpayers, through the Postal Service, own prized real estate in many downtown locations, including its headquarters in L’Enfant Plaza in Washington, its Boston Processing Center, and its massive James A. Farley Building in Manhattan. Postal real estate is certainly worth many times its value as recorded at purchase price in Postal Service accounts, which is about \$15 billion. Much of that real estate could be sold to reduce taxpayer liabilities that are currently unfunded. This is appropriate: taxpayers own the Postal Service.”
- “If the Postal Service were allowed to operate like a typical business and make normal business decisions, such as where and how large its network will be, it would likely be valuable purely as a broadcast advertising medium. It could sell its vast sorting centers, and replace many post offices by contracting with local drug and convenience stores. Even though mail volumes are declining, it still receives about \$65 billion in annual revenue, paid mostly by advertisers. With aggressive and tough-minded changes, the Postal Service could again be profitable.”
- “Privatization—a postal IPO—combined with de-monopolization and proper oversight, would allow taxpayers to realize that vast market value. The proceeds would likely be sufficient to retire the huge unfunded taxpayer liabilities generated by the Postal Service since its creation in 1970.”
- “Postal privatization is no longer novel. The German mail authority Deutsche Bundespost was privatized in 1995, and now maintains only a few post offices of its own, including one in the German Parliament Building. In Britain, the Postal Services Act of 2011 allows the government to privatize up to 90 percent of Royal Mail, with 10 percent being held by Royal Mail employees. Royal Mail has already closed about 95 percent of its post offices, and offers many of the same services by contracting with drug stores and other outlets.”
- “De-monopolization and privatization are the only sustainable alternative to endless taxpayer subsidies and ever-greater taxpayer liabilities, which are unthinkable in an era of looming downgrades of U.S. debt. Taxpayer value embedded in the U.S. Postal Service is vast. Given the Postal Service’s current fiscal crisis, the time has never been better to liberate that value.”
- “A government-enforced monopoly is not necessary to subsidize some delivery routes. If some routes lose service in a competitive marketplace, then bids can be solicited from a variety of companies (including the Postal Service) based on which one will provide that service for the lowest possible subsidy. The Postal Service would benefit from the competitive pressures of the marketplace and from better corporate governance, the latter of which is currently very weak.”
- “The federal government already has a body in place that could conduct such bidding: the Postal Regulatory Commission. The Commission is currently the Postal Service’s regulator, overseeing rate increases and service standards. The Commission’s new

task would be to ensure that bidding on routes was fair and transparent.”
(www.RealClearMarkets.com, R. Richard Geddes, 10/19/11;)

Postal rates scheduled to increase in January

- The USPS announced it will increase the cost of a first-class stamp a penny to 45 cents starting on January 22, 2012, the first increase in more than two years. In addition, the agency will increase the cost to mail a postcard by three cents to \$0.32, while bulk mail and parcel prices will increase by 2.1%. The Postal Service, which is allowed to raise prices in line with the rate of inflation, said it filed the new prices with the Postal Regulatory Commission, which has 45 days to approve the changes.
- “The overall average price increase is small and is needed to help address our current financial crisis,” said Postmaster General Patrick Donahoe. “We continue to take actions within our control to increase revenue in other ways and to aggressively cut costs.” (*Associated Press*, Joyce M. Rosenberg, 10/29/11)

The NALC “lobbies up,” hiring former “car czar” Ron Bloom and Lazard to advise union in its postal reform negotiations

- The National Association of Letter Carriers, the biggest union representing postal workers, has hired Ron Bloom, the former “auto czar” for the Obama administration, as an adviser and is bringing on investment bank Lazard as a financial consultant. “Our efforts will be fact-based, non-political, non-ideological, and focused on the continued provision of universal service to the public and the preservation of hundreds of thousands of good middle-class jobs,” said NALC president Fredric Rolando, who did not disclose what fees the union would pay for the advisory services.
- Rolando suggested that NALC would try to expand its participation in the postal reform debate, adding that both Bloom and Lazard had extensive experience working on complex business issues. Specifically, the union would look to protect six-day-a-week delivery, said Rolando. The union is also interested in finding ways to make the Postal Service’s business model more viable by expanding the services or functions offered by the agency or by embracing the Internet more. “That’s the million-dollar question,” said Rolando. “We believe there are different things that can be done.”
- The NALC has joined forces with the National Postal Mail Handlers, the National Rural Letter Carriers Association and VoteVets.org. [the progressive-leaning “voice of America’s 21st century patriots”] in an advertising campaign designed to attempt to derail postal reform legislation, cosponsored by Representatives Darrell Issa (R-CA) and Dennis Ross (R-FL.) that would reduce the Postal Service’s workforce.

- “The ad isn’t entirely accurate: The bill wouldn’t “force” USPS to fire employees — it would force them to use layoffs, as the bill calls for at least \$3 billion in operational costs that would require a need to trim the workforce,” wrote *Washington Post*’s Ed O’Keefe. “That said, cutting the postal payroll would fulfill the wishes of Postal Service officials who are seeking permission from Congress to break union contracts and lay off up to 120,000 workers. But the general message of the ad is correct: The Postal Service is one of the nation’s largest employers of military veterans, with roughly 135,800 vets on the postal payroll, according to the American Postal Workers Union.”

The Postal Service Hires More Veterans Than Any Other Civilian Employer



Some in Congress Want to Fire Them

The Postal Service puts more veterans to work than any other civilian employer. But the Issa-Ross Bill (H.R. 2309), which the House Oversight and Government Reform Committee is expected to vote on this week, would force the USPS to fire employees—including tens of thousands of veterans. That’s American vets fired in the worst economy in decades.

Putting tens of thousands of America’s veterans out of work won’t fix the Postal Service. Congress talks a lot about patriotism, but there’s nothing patriotic about destroying the USPS, devastating mail service, and telling our veterans they’re not wanted.

TELL CONGRESS TO DELIVER FOR OUR VETERANS—AND AMERICA.



- “The committee’s Republican staff produced [a] Web video in defense of the bill... [that said;] ‘Postal workers receive their benefits from the U.S. Treasury, and the Postal Service pays those benefits by selling postage. That’s the way it’s supposed to work. ...When the Postal Service stops paying, retired postal workers still get benefits. The law says someone has to pay. The question is, who? The answer is, you. And that’s a bailout.’” (*Washington Post’s Federal Eye Blog*, Ed O’Keefe, 10/12/11; *Chicago Magazine*, Whet6 Moser, 09/07/11)

TVA

TVA faces a “challenging financial situation,” as the utility approaches its statutorily imposed debt ceiling of \$30 billion

- “TVA is fast approaching a crossroads,” wrote TVA Inspector General Richard Moore in a review of the agency’s financial condition. “TVA may experience issues with its ability to adequately fund operations, maintenance and capital projects without increasing the debt ceiling, raising rates, or choosing among options.” While TVA’s debt is approaching its \$30 billion cap, the IG’s audit suggests that the utility’s borrowing is not necessarily out of line with that of investor owned utilities. TVA’s current \$30 billion debt ceiling, adopted by Congress in 1979, would exceed \$90 billion, when adjusted for inflation, concluded the IG.
- “TVA faces many challenges, including an aging fossil fleet, increased environmental regulations, and a pending pension shortfall,” wrote the IG. Aside from borrowing, TVA uses other forms of finance, including prepay arrangement for power sales and alternative financing arrangements such as sale /leaseback agreements. The agency also considers financing options from distributor-owned generation and partnering agreements. Other “less feasible” financing options may include issuing securities and seeking congressional appropriations for federal mandates such as clean air compliance.
- “...TVA’s position is that a financial metric (e.g., something similar to the debt service coverage ratio), rather than a debt ceiling stated in terms of an arbitrary dollar amount, would provide control of TVA’s borrowing authority that is tied to TVA’s ability to pay outstanding debt, similar to investor owned utilities, while still providing Congress with oversight and control,” wrote the IG. “The Inspector General agrees with TVA management in their efforts to maintain maximum financial flexibility, including (1) the adoption of sound financial principles, (2) ensuring multiple options and strategies are pursued to achieve the most economical approach, and (3) seeking to ensure that debt remains a viable option in future financing decisions.

- “TVA should be able to support additional debt to help meet energy demands as long as the TVA Board maintains its ratemaking authority, TVA maintains its service territory and customer base, and TVA uses the debt proceeds to successfully build generating capacity.” (*Review of TVA’s Debt and Assessment of Alternative Financing Arrangements*, TVA’s Office of Inspector General, 10/17/11)

“Your time is limited, so don’t waste it living someone else’s life. Don’t be trapped by dogma — which is living with the results of other people’s thinking. Don’t let the noise of others’ opinions drown out your own inner voice. And most important, have the courage to follow your heart and intuition. They somehow already know what you truly want to become. Everything else is secondary.”

Steve Jobs
 CEO of Apple Computer
 Commencement address at Stanford University
<http://tinyurl.com/df3udd>
 June 12, 2005

“Steve Jobs should be remembered as the personification of creative destruction. This whirlwind of change described by Joseph Schumpeter is what happens in free markets, especially these days as new technology reaches parts of the economy where the government hasn’t yet picked winners and losers. This is where Jobs thrived. ... Business executives should ... say good for Jobs for focusing on new products instead of on Washington. He spent a career liberating consumers with new technology, and in the process ensured an unusually liberated life for the company he built.”

L. Gordon Crovitz
Wall Street Journal
 October 10, 2011

“Apple nearly disappeared as an independent company in the mid-1990s, having fallen so far and become so dispirited that its leaders seriously entertained a sellout to another company. Apple got a stay of execution when its board couldn’t come to terms with the potential acquirers, and Jobs returned soon thereafter. If Apple had capitulated and been acquired, there’d very likely never been no iMac, iPhone, iPod or iPad. Greatness requires the Churchillian resolve to never give in, but it also requires having the reserves to endure staggering defeats, bad luck, calamity, chaos, and disruption.”

Jim Collins and Morten T. Hansen
Great by Choice
<http://tinyurl.com/5r9jko7>

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