

The ***GSE*** REPORT™

Special Supplement

What people are saying about Freddie's accounting
issue...

Editorials and Commentaries

July 2003

Domestic Press

Capital Markets Subcommittee Chairman Richard Baker (R-LA) Cites Editorial Support from “Big Four” Newspapers For Stronger Regulation of GSEs

- Cong. Baker (R, LA) referenced editorials from the “Big Four” newspapers – *Washington Post*, *Wall Street Journal*, *New York Times* and *USA Today*-- all of whom Congressman Baker said support stronger regulation of Fannie and Freddie. He notes, “It’s not often than I agree with the editorial position of all four of these prominent newspapers, and it’s probably just as rare that they agree with each other on a single issue. It’s certainly a positive sign to have support from such a diverse group of editorial boards, with perspectives that span the ideological spectrum, and I expect it to help translate into broad support for reform that transcends typical political lines in both chambers of Congress.” (*Congressman Baker press release*, 6/27/03)
- The four editorials, plus many other editorials and columns from news organizations around the world, are summarized below. The majority of editorials and commentaries support strengthening the regulation of Fannie and Freddie.

New York Times

Freddie Who?

New York Times, June 14, 2003

Editorial

- The Freddie scandal “highlights the extent to which these mortgage giants are underregulated. Freddie Mac may not end up threatening the financial system like the savings and loans or Enron did. But it is clear that Freddie Mac plays a crucial role in financial markets that is not fully recognized by government oversight...Until now, Freddie Mac has been regulated by the Office of Federal Housing Enterprise Oversight, a thoroughly overwhelmed outfit within the Department of Housing and Urban Development.” The editorial concludes, “Congress will have to recognize that these mortgage giants are significant financial institutions, not quaint housing agencies. They should, at the very least, be forced to conform to securities laws and to more stringent oversight by the Treasury department and the Federal Reserve.”

Freddie Mac's Lax Disclosure Rules Pose Risks for Economy

USA Today, June 13, 2003

Editorial

- “Freddie’s troubles have one critical difference from the earlier scandals [of Enron and WorldCom]. While the collapse of other corporations involved in misdeeds mainly hit company employees and shareholders, a financial crisis at this company could shake the entire US economy and leave taxpayers on the hook for billions in losses... Though federal regulators have called on Congress repeatedly to require Freddie Mac to be more transparent about its complex finances, lawmakers have refused to close the loophole. And Freddie has plied Congress with \$8.4 million in campaign contributions since 1990 to keep it open. Retaining the exemption... creates an enormous – and unnecessary – risk for the economy and taxpayers.” Fannie and Freddie “argue that forcing them to meet all the rules governing public corporations could mean higher mortgage rates for consumers and less money to lend, particularly to lower-income families. The claim is contradicted by a Congressional Budget Office study in May.” The editorial concludes by calling for full disclosure of Freddie’s finances, noting that it is a “small step Congress can take to lessen the risk of a huge problem for the entire country.”

Opposing View- Calls for greater Freddie Mac Disclosure are Premature

USA Today, June 13, 2003

Susan Woodward, former chief economist at HUD and SEC, and consultant to Freddie

- Woodward wrote a short opinion piece in opposition to the *USA Today's* take on the Freddie situation. According to Woodward, Freddie does not need additional disclosures, since they would raise costs associated with mortgage-backed securities. “The best evidence of the merit of the current disclosures for Freddie’s MBS is the low cost of trading in this market and the low mortgage interest rates that result. Compare this with the market for MBS issued by less-well-known companies on which the market forces more detailed disclosures. The result is the chopping up of a big low-cost market into smaller, high-cost ones. And the interest rates in this other market are a good three-eighths of a point higher.”
- Woodward also claims that the GSEs are “simple firms” that are “confined to a business that is more plain vanilla and thus more transparent. If simplicity were not enough, there are more official noses in Freddie’s and Fannie’s business than in just about any other company’s.” Woodward concludes by advising restraint in calling for more disclosures and to “wait for things to cool down. Otherwise, more harm can be done than good.”

Freddie's Market Bomb

Wall Street Journal, June 10, 2003

Editorial

- “Financial markets got a taste yesterday, and not a pleasant one, of how exposed the US economy is to any trouble at the giant mortgage companies Freddie Mac and Fannie Mae. The event might even awaken a slumbering political class to notice this growing risk to taxpayers...The anxiety is all the greater because it seems that [Freddie and Fannie's regulator] OFHEO hasn't known until recently what was going on...These columns have long argued that with so much housing risk tied up in Fan and Fred, much greater disclosure and adult supervision are necessary. OFHEO has often behaved too much like a cheerleader for the two companies and for the cause of 'housing,' as if the GSE's critics are somehow opposed to expanded home ownership. Ideally, the duo would be privatized and regulated by the Treasury.”
- The editorial concludes with advice for the White House in dealing with the GSEs: “our advice to the White House, and especially to Treasury Secretary John Snow, is to send his own financial SWAT team to discover and more unpleasant surprises early, rather than wait for another Monday morning market bomb.”

The Trouble With Freddie

Wall Street Journal, June 13, 2003

Editorial

- The editorial warns that the problems facing Freddie (and possibly Fannie) “satisfy many of the conditions that make it ripe for a systematic crisis. According to the Office of Federal Housing Enterprise Oversight, these conditions are: Higher levels of inter-dependence with other financial institutions, high leverage, lax safety and soundness regulations, and poor public disclosure.” On how to resolve these issues, the editorial advises Congress to increase the GSEs regulation and disclosures, as well as to increase the amount of capital they hold. “We assume that a now-mobilized Congress will consider all of these solutions, as well as privatization and even breaking the duo up into smaller firms so that no single mortgage company carries so much risk. It is, after all, the government that created these behemoths that thrive on private profit but socialized risk.”

Letter to the Editor in Response to “The Trouble with Freddie”

Wall Street Journal, June 20, 2003

Steven Morris, East Hampton, NY

- Morris congratulates the *Journal* for being the “lone media voice that has questioned the operations of both Freddie Mac and Fannie Mae” and notes that “it strains credulity to insist that nothing additional is awry in the operations of these quasi-governmental, highly secretive agencies. Haven't we learned by now that where there's smoke there's usually fire...when explosive growth and easy profits become

customary, arrogance and greed usually follow. Shouldn't we have learned something from the Enron, WorldCom and Tyco debacles?"

Off the Run: Wall St. Silence on Freddie Another Failure

Wall St. Journal, June 16, 2003

Michael Mackenzie, Reporter

- Mackenzie complains about the apparent lack of concern Wall St. analysts seem to have on Freddie's recent problems – with many analysts refusing to talk to reporters on anything other than background information. Mackenzie notes, “this reluctance to bite the hand that feeds the vast debt underwriting and derivative hedging machine of Freddie Mac and Fannie Mae might make perfect sense to some on the Street but the already tarnished reputation of research is condemned by this silence.” However, **“on the very hush hush...Wall Street believes the level of disclosure for both companies remains inadequate.** This is despite the two companies agreeing last year to voluntarily register their common stock with the Securities and Exchange Commission – something only Fannie has subsequently done.”

A Fannie and Freddie For the 21st Century

Wall Street Journal, June 17, 2003

Commentary

Thomas H. Stanton, Washington lawyer and fellow, Johns Hopkins University

- Stanton, the author of “Government Sponsored Enterprises” (AEI Press, 2002), warns that, “it's in everyone's interest that Fannie Mae and Freddie Mac be stripped of their special advantages so the home mortgage market becomes more competitive and less vulnerable.” Stanton advises that OFHEO should be given additional powers so that it can fully regulate the GSEs. OFHEO “should be placed in the Treasury, alongside other financial regulators. And Fannie Mae and Freddie Mac should be subjected to bank-type capital standards. They currently are subject to low capital standards that are largely hard-wired into law with rigid parameters that fail to reflect actual financial risk.”
- Stanton further notes that, “more fundamentally, it is time to begin unwinding the GSE model...Fannie Mae and Freddie Mac should engage in a systematic transition to give up their government sponsorship.” The GSEs' subsidy amounts to about a quarter of a percentage point for homeowners – less than a deduction from mortgage interest or property tax, meaning that the GSEs can remove government sponsorship without causing turmoil in the housing market. To begin, the government should limit the size of GSE portfolios, says Stanton. Then, each GSE should be restructured. Stanton notes that Peter Wallison of AEI advocates breaking up the GSEs. However, “it is important to assure that the GSE businesses, backed by the perception of implicit government backing, are wound down under conditions that control financial risk.”
- Stanton concludes: “Ultimately, the White House will need to act. If the administration takes on GSE reform as a serious issue, it can galvanize the needed political constituency to end government sponsorship of the GSEs. If the

administration fails to act, and if something ever goes wrong in a big way, its disregard of the warning signs will be a matter of public record. It is time to end today's state of risk."

Fannie, Freddie Use Political Prowess to Parry Regulators

Wall Street Journal, June 17, 2003

Alan Murray, *WSJ* Columnist

- Murray, CNBC's Washington Bureau Chief and co-host of "Capitol Report," notes that the appointment of Gregory Parseghian as CEO of Freddie is unique in the world of GSEs since Parseghian actually has years of experience in mortgage and finance and little experience in the world of politics. This is a reversal of sorts for the GSEs—particularly considering the track record of Freddie's counterpart, Fannie Mae. Fannie "has become a platinum parachute for top government officials – many of whose knowledge of mortgage finance begins with the big houses they buy on their seven-figure Fannie salaries...Fannie believes that managing political risk is as important to the business of the two mortgage giants as managing financial risk, and throws enough of its weight around for both organizations."
- Murray reminisces about a dinner party where he casually mentioned that he didn't see a need for the government to interfere with the mortgage market. Apparently, "Fannie was listening: When I arrived in my office Monday morning, I was greeted by an invitation to a private 'educational' luncheon in Fannie Mae's executive dining room." While serving as Washington bureau chief for the *Wall Street Journal*, Murray said he was often on the receiving end of a "bad-cop, good-cop" routine from Fannie executives. "In nine years on the job, I was never hounded by any other organization with such vigor...My experience wasn't unusual...Which is why, even with Freddie's embarrassing shake-up last week, and Mr. Parseghian's political inexperience, the odds of major action in Washington remain low."
- Murray concludes by advocating that the government should "cut all ties to Fannie and Freddie, and put limits on the size of their portfolios, so the private sector has a chance to compete. Fannie and Freddie argue that approach would raise mortgage rates. Maybe so. But if the government really wants to subsidize housing finance, it would do better by creating two or three more government-sponsored enterprises to compete with Fannie and Freddie. With competition, there's a better chance that the subsidy will be passed down to home buyers; with a duopoly, it is more likely passed on to shareholders." Murray notes that Congress probably will not adopt his suggestions, but could strengthen oversight by moving OFHEO to the Treasury Department. "Fannie and Freddie will fight such a move. But taxpayers should support it. The problems that surfaces last week at Freddie look fairly minor. But if bigger problems occur in the future, it's taxpayers who will pay for the cleanup."

Freddie's Problem – and Ours

The Wall Street Journal (Business World), June 18, 2003

Holman W. Jenkins, Jr., *WSJ* Columnist

- Jenkins notes, “the nation has gotten itself into a foolish fix with Freddie and its bigger sister, Fannie Mae. To let so much residential mortgage risk pool up in just two giant organizations defies every rational standard of risk diversification. Yet such pooling has occurred because Washington awards Fannie and Freddie special privileges that put them beyond the usual discipline of the private marketplace.” Jenkins further adds, “not only are they too big to fail, but Fannie and Freddie spend massively on lobbying and ‘soft money’ donations to make sure politicians don’t curb the privileges that allow them to get bigger and bigger...Top management’s main job is politicking: pulling whatever strings are necessary to keep Fannie and Freddie implicit access to the federal credit card...willing to say whatever will preserve the government-granted privileges that allow them to borrow money on favorable terms that no private competitor can match. Jenkins concludes by calling for privatization, which he says is “better than waiting around and wondering if someday they will blow themselves up.”

Our Freddie, All Grown Up and In Trouble

Wall Street Journal, June 25, 2003

Letter-to-the-Editor

Stuart D. Root, former Wall Street counsel for Freddie at its inception

- Root criticized Freddie’s use of derivatives to hedge risk. According to Root, Freddie’s first CEO, Thomas A. Bomar, “decried the use of debt to fund Freddie, warning that Fannie Mae’s reliance on debt would render it insolvent in a mark to market basis in 10 years. That is why Mr. Bomar wanted a ‘pass-through’ structure for Freddie, not one funded by debt.” Root notes that by the early 1980s, Fannie was technically insolvent by over \$10 billion, while Freddie “sailed, unsullied, through those torrential years of 1980-1985, and Fannie was forced to clone the Freddie structure onto itself, as if it had invented it.”
- However, the course of business shifted and Freddie has “tripped over its own reliance of so-called government debt by selling securities it guarantees, and then buying them back with a different form of Freddie debt to skim the spread, this time with on-balance sheet leveraging. Now the same home loan has been leveraged twice. And, as a corollary, banks rely on their holdings of GSE debt to lower their risk-based capital requirements, and this additional leveraging resonates throughout the system.” Root warns: “One might also consider the plight of Leland Brendsel’s predecessors, Phil Brinkerhof and Kenneth Thygerson. Each left the helm of Freddie to take over S&Ls during the 1980s, which they leveraged by ballooning with debt, only to sink their respective institutions.”

The Skeptic: Non-US Investors, Have You Met Freddie?

Dow Jones Newswire/Wall Street Journal; June 13, 2003

Spencer Jakab, reporter

- Jakab notes that most non-US investors are not aware of Freddie Mac by name, but warns that they should be aware of the problems facing the GSE. “Why would a problem in the US mortgage market have global financial repercussions? Four key reasons: 1. Their sheer size and impact on US economic growth; 2. Direct foreign holdings of GSE debt; 3. The potential impact on exchange rates and 4. Derivative exposure.” Jakab concludes, noting that “the most critical question to be answered in the probe of Freddie Mac, therefore, is the degree of caution and conservatism – not to mention competence—it used to hedge its incredibly complex mortgage and credit insurance portfolio. The suggestion that the GSEs’ regulator, OFHEO, may have been lax in its oversight should be worrying to investors everywhere...For those non-US investors who skimmed or passed over the stories emerging from this latest corporate scandal, perhaps it’s time to get acquainted with Freddie and friends.”

Washington Post

More Disclosure

Washington Post, June 27, 2003

Editorial

- “The news about accounting problems at Freddie Mac raises broader questions about the mortgage giant and its even bigger corporate cousin, Fannie Mae – specifically, whether they ought to be more closely supervised by government regulators and subject to stricter disclosure rules...Rep. Richard Baker (R-LA) has proposed transferring authority to the Treasury Department, which seems better suited to the task...We’re instinctively in favor of disclosure, particularly when it involves firms that enjoy a government-granted benefit and that play such a critical role. The issues are complex, and they deserve serious attention.”

Unfinished Business at Fannie, Freddie

Washington Post; June 11, 2003

Stephen Pearlstein, WA Post financial staff writer/economics

- Pearlstein believes the relentless criticism of Fannie and Freddie in recent years “has been way overblown,” however, reforming Fannie and Freddie’s executive compensation “is one important thing that needs fixing.” It may be okay for large corporations to pay their executives millions of dollars for generating double-digit earnings growth year after year, “but it is inappropriate for government-sponsored enterprises.” Pearlstein notes that meeting earnings growth targets netted Fannie’s Franklin Raines and Freddie’s Leland Brendsel roughly \$6 million each in incentive pay last year. “With their share of the relevant mortgage market now approaching 50 percent, the only way Fannie and Freddie will be able to reach their growth goals is to eventually nudge still more players out of the business or use their clout to move into areas well beyond their charter.”

- “The more serious problem with the growth imperative is that it is bound to lead some executives some day to take undue financial risks...what happens if and when the market slows or turns and the only way for the next team to meet earnings targets is to leave risks unhedged or pull back from the mortgage market just when extra financing is needed?...It is folly to think that Fannie or Freddie will volunteer to take a hit to their stock prices by relinquishing their ‘growth stock’ aspirations. But regulators can and should demand the two companies adopt compensation systems that reward executives for striking a better balance between public interests and ever-increasing shareholder value.”

Response -- The Problem with Fannie and Freddie

Washington Post; June 18, 2003

Letter-to-the-Editor

Paul Gessing, Director of Government Affairs, National Taxpayers Union

- Gessing wrote a letter in response to Pearlstein’s column. Gessing noted that Pearlstein neglected to mention that the GSEs’ entry into new businesses also hurts banks “that do not receive implicit government backing and do all pay taxes” that are trying to compete with the GSEs. Gessing concludes, “Mr. Pearlstein may see a booming housing market, but the advantages granted to Fannie and Freddie by Congress are unfair and harm the integrity of our banking system. Worse, should either become the next Enron, taxpayers will be on the hook for billions of dollars.”

Baltimore Sun

Freddie and Fannie

The Baltimore Sun, June 13, 2003

Editorial

- “We’re looking forward to the results of the investigations into Freddie’s accounting. But it already seems clear that, with the rapid growth of both it and Fannie Mae the last few years, the Office of Federal Housing Enterprise Oversight, which is supposed to regulate them, needs to be beefed up and that both corporations should be held to higher disclosure standards – much like private firms.”

Fat Freddie Fidgets, Fires and Finally Fudges

Baltimore Sun, June 11, 2003

Jay Hancock, Columnist

- Hancock cautions that Freddie’s recent problems are not like those facing other companies—“a dysfunctional or fraudulent Freddie Mac would threaten the nation’s economic health in way that go far beyond the stock market...Unlike other parts of the financial system, in which multiple companies compete for business and the failure of one player doesn’t necessarily cause wider collapse, the mortgage industry is held hostage by a bunch of overpaid bureaucrats feeding at the federal bucket.” Hancock also notes that the country’s best performing market – housing – is held “captive to these two very opaque and very leveraged companies.”

- Hancock notes that while regulators and the bond market seem to think Freddie’s finances are stable for now, “with a sliver of capital, a \$1.3 trillion portfolio and a derivatives apparatus to make Rube Goldberg gasp, it wouldn’t take much for Freddie to crack up...with so little capital the company is almost entirely dependent on borrowed money to buy mortgages. If lenders balked at fronting money to Freddie, Fannie couldn’t step in. It’s already near the edge of its borrowing ability, says the American Enterprise Institute’s Peter Wallison...Taxpayers could pay billions in bailouts. The long-term prescription is to privatize Fannie and Freddie and get some competition.”

Business Week

Freddie Mac Needs a Fiercer Watchdog

Business Week, June 23, 2003

Editorial

- “Freddie and Fannie have grown so large that they have the potential to disrupt the entire financial system should either get into real trouble.” The GSEs “need a lot more serious supervision, ” since OFHEO is not up to the job. However, “tightening the regulatory oversight of Freddie Mac may prove difficult. It was one of the top 10 soft money contributors to political parties in the 2002 Presidential and congressional elections. It has a lot of friends in Congress. But the risks to the nation’s financial system are too great for legislators to avoid their responsibility. Fannie and Freddie are giant financial institutions that need to be supervised by regulators – the Fed, the Comptroller or the Treasury, that know what they are doing.”

Why Freddie’s Mess Matters

Business Week Online; June 13, 2003

David Henry and Laura Cohn column

- The column asks several questions about the Freddie Mac accounting scandal, including what Washington should do about the GSEs. The authors’ answer is this: “Strengthen Freddie’s slothful regulator, the Office of Federal Housing Enterprise Oversight, which is part of HUD. It didn’t swing into action until it was alerted to Glenn’s alleged misconduct after June 5. Some critics want to hand jurisdiction to the Treasury Dept., but it would be quicker for the White House to put a financial expert in charge of OFHEO.

Chicago Tribune

Meet Freddie Mac

Chicago Tribune; June 21, 2003

Editorial

- Noting that Fannie Mae discloses information on its derivatives, the editorial calls for full disclosure from its “cousin,” Freddie Mac. “Derivatives can be risky, but as Federal Reserve Chairman Alan Greenspan has pointed out, they have contributed to

‘a far more flexible, efficient and resilient financial system than existed a quarter century ago.’ Derivatives aren’t the issue; full disclosure at Freddie is.”

Dallas Morning News

Mortgage Blues: Let’s Reexamine at Freddie Mac, Fannie Mae

The Dallas Morning News, July 5, 2003

Editorial

- Congress should “rethink the federal government’s neither fish-nor-fowl relationship with Fannie Mae and Freddie Mac and decide whether the federal government should remain the mortgage market’s traffic cop, or whether competition and access are better serviced if Fannie Mae and Freddie Mac didn’t operate from a playing field intentionally tilted in their favor. The question is difficult enough now, but will become even more problematic as Fannie Mae and Freddie Mac pursue new lines of business. **Freddie Mac’s problems are a wake-up call. Heed it, Congress.**”

Denver Post

Malaise at Freddie Mac

The Denver Post; June 12, 2003

Editorial

- “Freddie Mac got caught with its hands in the cookie jar – and consumers should be worried.” Freddie’s recent troubles are problematic for OFHEO. “Supervision is so lax that regulators didn’t even know about the management shake-up and accounting questions until Freddie Mac told them. The episode not only exposed poor management, it revealed troubling structural problems that Congress needs to fix...The office really belongs in the Treasury Department...under current law, Freddie Mac and Fannie Mae don’t have to give shareholders the same kinds of documentation required from any other publicly traded corporation. That should change.”

Houston Chronicle

Oversight: Freddie Mac’s Troubles Go Deep into the Economy

Houston Chronicle, June 17, 2003

Editorial

- The GSEs have become large companies that many believe are “too big to fail” and would therefore require a government bailout. “What is clear at the moment is that federal oversight is too lax.” In addition, “the public, in this post-Enron environment, cannot be blamed if it is skeptical about the possibility of true reform. Freddie Mac, as pointed out in a recent *Business Week* editorial, was one of the top 10 soft-money contributors to the political parties in the 2002 presidential and congressional election cycle. With interest rates low, homebuying is one of the main drivers of the improving US economy. That makes a full accounting at Freddie Mac all the more urgent.”

Kansas City Star

Fretting About Freddie

The Kansas City Star; June 17, 2003

Chris Lester, Assistant Managing Editor - Business

- Lester has been “fretting” about Freddie’s accounting review and its use of derivatives. If Freddie “were to seize up in some derivatives-related financial meltdown, there would be fewer mortgages available at higher rates. And that could be bad news for a still struggling economy.” Lester criticizes OFHEO for being “disturbingly passive” and calls for a mandatory registration of Freddie’s stock with the SEC. Lester concludes by noting that Warren Buffett has called derivatives “time bombs, both for the parties that deal in them and the economic system.”

Los Angeles Times

Scandal Too Close to Home

Los Angeles Times; June 13, 2003

Editorial

- The editorial chastises OFHEO for recently reporting the GSEs’ status to Congress as “safe and sound.” “Given the recent disclosures, the 10-year-old agency formed to regulate Freddie Mac and Fannie Mae seems less reassuring than out of touch with what’s really going on. That gives the Securities and Exchange Commission, the Justice Department and Congress more reason to speed up their own investigations and Freddie Mac’s newly named top executives more reason to pledge their full cooperation.”

Feeble Mortgage Oversight

Los Angeles Times; June 20, 2003

Editorial

- “There’s a quick way to calm jittery investors and protect taxpayers from a potentially expensive savings-and-loan style bailout; Make these two institutions meet the stringent financial reporting standards that govern other publicly traded companies. That would force the institutions to thoroughly explain the increasingly complicated ways that they balance the risk of buying and guaranteeing home mortgages...Congress should legislate stronger oversight, by the Treasury Department and the Federal Reserve.”

Fannie Mae Adheres to SEC Guidelines

Los Angeles Times; June 25, 2003

Letter-to-the-Editor

Chuck Greener, Fannie’s Senior Vice President for Communications

- Greener wrote a response to the *Los Angeles Times*’ June 20th editorial on the GSEs. Greener claims that Fannie Mae does meet the financial standards that apply to other public companies. He further notes, “In fact, we go further than that by disclosing details about our risk management that no other large financial company of SEC

registrant does, including the results of a regular ‘shock test’ of our books.” Greener concludes, “We are proud of our commitment to financial transparency. The public deserves no less from corporate America.”

New York Daily News

Under the Skirts of Fannie, Freddie

New York Daily News, June 16, 2003

Pete Siris, Columnist

- “Why should you care about these confusing companies and their complex accounting? Because most believe taxpayers will bail them out if something goes wrong. A few mistakes could require a bailout that would make the S&L crisis look like pocket change...Government officials must force them to come clean.”

Oregonian

The Problem With Freddie

The Oregonian; June 23, 2003

Editorial

- Since the management shake-up at Freddie, there has been much attention from Congress, federal regulators, and federal prosecutors. “That’s a lot of investigatory power. The question is, why weren’t the eyes there sooner?” The editorial calls for stronger regulation of the GSEs by moving their regulator to the Federal Reserve, and giving the SEC additional powers of investigating the GSEs’ stocks. Concluding, the editorial notes, “So far, nothing that has come to light that appears to threaten the housing or credit markets. There is no reason to overreact. But the problems do call for getting a better grasp on Freddie Mac’s operation and ensuring that it is better regulated in the future. Freddie Mac is not only a creation of the American imagination in pursuit of the dream of homeownership. It is also a creature of Congress. Now it falls to Congress to fix it.”

Press Enterprise

Freddie Mac Oversight

The Press Enterprise Co. (Riverside, CA); June 12, 2003

Editorial

- “Freddie Mac...needs oversight of an equal, like the Department of Treasury itself. Congress should understand that as it opens hearings into the unfolding scandal.”

San Diego Union-Tribune

Freddie Mac's Mess; From Lax Controls Come Numerous Probes

The San Diego Union-Tribune; June 14, 2003

Editorial

- The likely probes of Freddie from the SEC, OFHEO, US Attorney and Congress “come way late but not, it would seem, too little.” “Freddie Mac has fought further regulation by its arguably squishy federal overseer and capitalized, liberally, on its chumminess with the federal government, In part by becoming the largest corporate contributor of soft money to both political parties and spending multimillions a year lobbying the House and the Senate.”

St. Louis Post-Dispatch

Freddie Mac is One Scandal Congress Can Deal With Directly

St. Louis Post-Dispatch, June 18, 2003

David Nicklaus, Reporter

- Fannie and Freddie are “blatantly political animals” that need to be examined by Congress. Congress could raise capital requirements, aligning the GSEs with other financial institutions; could move OFHEO to the Treasury; or could abolish OFHEO and move all regulation to the Office of the Comptroller of the Currency. Nicklaus concludes, “forcing any change on these two giants won’t be easy...but maybe, just maybe, the travails of Freddie Mac have created a rare opportunity for reform.”

St. Petersburg Times

Corporate Boardrooms Still Home to Sleazy Dealings

St. Petersburg Times (Florida); June 15, 2003

Philip Gailey, *Times* Editor of Editorials

- In an article on corporate scandals, including the one at Freddie, Gailey refers to the GSEs as “rich and arrogant” and calls for Congress to investigate Freddie. Gailey is particularly concerned with Leland Brendsel’s severance package, which included stock options worth \$21 million, \$3.2 million in salary and bonuses and health and life insurance for five years. Gailey notes that the severance package is now on hold, pending review, and asks: “What is there to review? Brendsel’s severance package would be obscene even if Freddie Mac wasn’t under criminal investigation. Or even if Brendsel had not been fired. Has the public’s sense or outrage been exhausted? Apparently so.”

Washington Times

Freddie's Foible

Washington Times, June 23, 2003

Editorial

- “Given the enormous importance of Freddie and Fannie, proposals by some legislators to heighten disclosure requirements make sense. Should the two companies wrack up liabilities investors aren't aware of without properly hedging their exposure, the results could be catastrophic. But Congress shouldn't overplay its hand. Freddie and Fannie's business has helped fuel the ongoing real-estate boom providing critical locomotion right now for the economy.”

American Banker

Force Freddie, Fannie to Register their Securities Like Everyone Else

The American Banker; June 20, 2003

Letter-to-the-Editor

Leslie Paige, director of special projects, Citizens Against Government Waste

- “While the nature and extent of the improprieties have yet to be uncovered, it is clear that Washington must take steps to get Fannie and Freddie under control. Currently, the GSEs are under no obligation to disclose much of the important information regarding their businesses. They tell the SEC what they feel like telling it. The voluntary nature of their disclosures does not force them to reveal much about their mortgage-backed securities, the riskiest part of their finances, or their hedging strategies.” The GSEs are “grossly undercapitalized” for their size and risk. “Passing the Shays-Markey bill will help prevent further financial shenanigans at the GSEs.”

CBS Market Watch

Freddie Isn't the Problem

CBS Market Watch, June 11, 2003

News and Commentary

Yiannis G. Mostrous, editor with Wall Street Winner and Trading Floor Pro

- Freddie was given a lot of slack for postponing its earning announcements this year. The story is “even more amusing since recently Freddie Mac acknowledged that its accounting expertise is not on par with its risk management” but said that it has increased accounting staff by 50 percent and increased its expertise in past months. In other words, one of the most complicated companies in the industry – involved in one of the most dangerous financial games of all times – didn't have the right personnel. To us, the above statement borders the moronic, but if it's true, then things are scarier than we thought.” The GSEs have effectively lobbied Congress into inaction.

Freddie Fumbles

Christian Science Monitor, June 11, 2003

Editorial

- The recent shake up at Freddie should “renew attention” to the GSEs various government privileges, as well as the Bush Administration’s admonishments that Fannie and Freddie are not providing enough support for low-income borrowers. “Congress needs to take a closer look at the privileges afforded these giants – privileges they clearly no longer need – and seek less risky ways to help low-income people buy homes.”

Inman News

Freddie Mac’s Creative Accounting

Inman News; June 9, 2003

Editorial

- Whatever rationale Freddie gives for altering the company’s books, “it’s still wrong.” The editorial further notes that “this dicey accounting was produced by the very same corporation that last July said it had ‘long been at the vanguard of disclosure practices,’ ‘already meets or exceeds SEC reporting standards’ and ‘is subject to the same standards as every other public company’.” The editorial concludes by asking why it took OFHEO so long to take a closer look at Freddie’s accounting. “Investors deserve better, and federal regulators should throw the book at whoever is responsible for these misdeeds.”

Freddie Mac Hasn’t Told All

Inman News; June 12, 2003

Commentary

Marcie Geffner

- There are many unanswered questions about the firing of Freddie president David Glenn. “What really happened? What meetings did Glenn attend?... Were his notes really altered and if so, why and by whom?... Do these allegedly missing pages still exist or were they destroyed? The answers matter because Glenn was no lower-level functionary at Freddie Mac... Federal regulators and Freddie Mac’s shareholders, employees and customers deserve to know the facts.”

Freddie Should Fork Over Financials

Inman News Features, June 17, 2003

Editorial

- Freddie’s new CEO Gregory Parseghian should “get the corporation’s financial house in order and file auditor-approved financial statements with the Securities and Exchange Commission ASAP. Shareholders deserve nothing less than a full accounting for all prior periods, and they deserve it sooner than three months from now.”

Ex-Freddies Innocent Until Proven Otherwise

Inman News Features; June 19, 2003

Editorial

- The editorial calls to question the number of shareholder lawsuits that have appeared since the scandal at Freddie Mac occurred. “The amended financial statements are still in the works, so it’s too early to assess the full impact of the changes on shareholders. Some Freddie Mac shareholders have lost money or lost the opportunity to have made more money –at least on paper – on their investment in a company that was one of the stock market’s biggest success stories. But not every falling stock price is the result of securities fraud. Investors take a risk when they put money into the stock market, and the legal system shouldn’t be an automatic second venue for them to recoup those losses.”

Congress Should Clamp Down on Fannie, Freddie

Inman News Features, July 8, 2003

Editorial

- Congress should tighten regulation of the GSEs. “A fewer-perks-and-more-scrutiny stance is necessary and appropriate...It’s high time for them to live by rules that more appropriately fit their size and importance to the nation’s housing and mortgage markets.” In addition, the editorial calls for mandatory – not selective and voluntary- - SEC registration. Lastly, Congress should “abolish the inept Office of Federal Housing Enterprise Oversight...give the Treasury Department oversight responsibility for Fannie and Freddie, and make sure regulators crack down on discipline and disclosure of the two mortgage giants. Treasury should supervise the two companies as if they were banks. Regulatory oversight should be at arm’s length from the corporations themselves, be conducted with adequate resources and protect the implied exposure of taxpayers.”

National Mortgage News

A Stunning Turn

National Mortgage News; June 16, 2003

Editorial

Mark Fogarty

- “We have consistently editorialized that if Freddie and Fannie want to break their ties to the government, they should be allowed to do anything their boards decide is wise...But if they want to keep that source of cheap debt and consequently higher margins, we’ve said they need to stay on their side of that “bright line” dividing the primary and secondary markets. To date, they have done so, although sometimes just barely.”

Origination News

GSEs Woes May Have Effect

Origination News, July 2003

Editorial

- Freddie's restated earnings may not be the entire story. "Given the politics surrounding Freddie Mac as a government-sponsored enterprise and the complexities the experts tell me surround accounting in the mortgage industry, I've got to think that there is more to this. Most origination market participants...didn't see many direct implications for their end of the business but we believe there might be some in the long-run. We think this will most likely lie in the government-sponsored enterprises/ relationships with originators – unless this is superceded by other politics at the agencies."

The Pipeline

A New Foundation for Housing Finance

The Pipeline; July 2003

Andrew Davidson, President of Andrew Davidson & Company, Inc.

- Davidson, President of Andrew Davidson & Company, Inc., a New York-based consulting firm that advises financial institutions on risk management and valuation for mortgages and mortgage backed securities, noted that given the excessive portfolio risk at Fannie and the accounting turmoil at Freddie, there are clear signs that the housing finance system in the US needs to be reformed. Specific proposals for change should be built on the principles of public purpose, competition, capital adequacy and effective regulation. Davidson recommended that the government create new housing charters to replace the current GSE charters in order to enhance competition and decrease the systemic risk created by the current concentration of mortgage holdings in the two GSEs. (To view the full column: <http://www.ad-co.com/newsletter/Jun03/AndyConsult.htm>)
- Public Purpose: "The federal sponsorship of housing finance is also intended to more generally facilitate home ownership. In this regard, the efforts of the GSEs housing finance entities must extend beyond lowering interest rates through their secondary market activities. Research has shown that marginally lower interest rates, especially when the lower rates apply to all borrowers, do little or nothing to enhance homeownership. While the GSEs should be supporting the low and moderate-income homeowner, the housing finance system would also be well served by eliminating artificial distinctions between loans of different sizes and credit quality."
- Competition: "With the growth of the mortgage market and the GSEs' respective shares of it, two firms are not sufficient to provide robust competition. Increasing the number of players in the mortgage secondary market would enhance competition and serve to decrease the systemic risk created by the current concentration of mortgage holdings in the two GSEs. To spur competition, the government should create new housing charters to replace the current GSE charters... somewhere between 5 and 10

housing finance entities would be appropriate.” The new charters “could be auctioned to new and existing players,” including Fannie and Freddie. “Under the new charter, housing finance entities could be part of financial institutions that engage in other activities...there must be clear limits on charter benefits, including limits on the size and scope of their activities in the mortgage market. Limiting the size of their mortgage portfolios would help reduce systemic risk, while limiting the amount of their mortgage security guarantees would ensure competition. It would also be appropriate to limit the market share of the servicing portfolio and origination volume of firms.”

- Capital: “The current capital regulation of the GSEs is inadequate in that it fails to adequately address their credit and the portfolio management risk...New capital requirements can and should be structured to attract capital to the housing finance markets. As the GSEs have expanded beyond traditional prime mortgages, the charter requirement for credit enhancement for loans with LTVs above 80% is now too simplistic. New forms of mortgage insurance or other forms of credit enhancement should be encouraged...Capital can also be used to control the expansion of the federal housing finance entities beyond their allowable scope. Significant capital surcharges can be added for those institutions that go beyond their limits. Added capital will reduce the risk of expansion to the housing finance system and prevent the use of the charter advantages for non-mission purposes.”
- Regulation: “Integrating the regulators of the housing finance system with other financial regulators is necessary for effective regulation. In addition, all housing finance regulation including that of the Federal Home Loan Banks should be integrated into a single entity. The regulator must have clear and strong regulatory powers. This would include powers to determine whether the regulated entity is appropriately engaged in charter activities, cease and desist powers, and receivership powers. SEC registration and disclosure should be required for all securities issued by the federally chartered entities. The public is not served by depriving GSE debt, equity and MBS investors the protections that they receive on all other securities.”

Realty Times

Freddie Mac’s Woes: Could They Hurt Home Buyers, Builders, Realtors?

Realty Times; June 16, 2003

Kenneth Harney, columnist

- Harney, a nationally syndicated columnist on housing and real estate issues, writes that the real estate market should be somewhat concerned about the Freddie scandal. “It’s too early to say for sure, the odds are that Freddie Mac’s problems will not have significant short-term effects on the national housing market. In the long-term, they could trigger changes in the company’s charter with the federal government, and that, in turn, could have unpredictable effects on the overall housing market.” Harney adds that the GSEs will likely face stricter oversight from Congress and federal regulators, which could theoretically “raise costs for both corporations and indirectly

raise home mortgage interest rates.” The “de-federalization” of the GSEs is also a possible scenario in the future. However, that “could only occur after a bruising fight on Capitol Hill. Both companies have many friends – and campaign donation recipients – sitting in Congress.”

Is it Time to Re-Write the Rules for Fannie Mae & Freddie Mac?

Realty Times; June 17, 2003

Peter Miller, columnist, author of six real estate books

- Miller outlines the various concerns that have arisen about the GSEs and notes that “private companies say Fannie Mae and Freddie Mac no longer need special protections to compete. Now Congress has begun to look into the matter and for the first time in decades it’s possible that the basic rules for Fannie and Freddie may change.”

The Republican

Mortgage Companies Can’t Follow Own Rules

The Republican; June 13, 2003

Editorial

- “What’s become clear recently is that both investors and federal regulators have been left largely in the dark about the goings-on inside Freddie Mac. And what’s becoming clearer by the day is that the rules proposed by Market and Shays are badly needed.” The editorial calls for stronger regulation of the GSEs as well as mandatory SEC registration. Quoting Alan Greenspan, who said “There is no reason to differentiate Fannie and Freddie from the rest of the securities industry as far as I am concerned,” the paper agreed. “He’s right and Congress must end their exception.”

The Street.com

The Risks of Fleeing to Safety

The Street.com, June 17, 2003

Howard Simons, special academic adviser at Nasdaq Life Markets and author of “The Dynamic Options Selection System”

- “Last week’s trapdoor opening underneath Freddie Mac should be taken as no less than a waning shot into the forehead...Freddie and Fannie Mae are the next great financial accidents waiting to happen. Whenever you allow anyone to trade with an implied put option courtesy of Uncle Sam, bad things happen, as witnessed in the savings and loan bailout...all of us should have learned...just because someone is big and rich doesn’t mean he (or she) is smart; there is nothing more dangerous than traders who are too smart for their own good playing in the derivative sandbox.”

The Mother of All Financial Scandals

Townhall.com; June 11, 2003

Michelle Malkin, columnist

- Malkin compares the recent troubles of Martha Stewart to those of Freddie Mac. “If Martha Stewart is the face of capitalist excess, Fannie Mae and Freddie Mac are the poster children for government-sponsored gluttony. The potential fall of Freddie Mac or Fannie Mae could rival the savings and loan collapse of the 1980s.”

International Press

The Economist

Trouble at Home – A Troubled Mortgage Giant

The Economist, June 14, 2003

- While Freddie may be restating profits with higher returns, this is not necessarily a good thing. “If Freddie Mac has benefited from falling rates, then it is surely vulnerable to rising rates. That may disturb investors who believed that Freddie Mac had hedged its portfolio cleverly, putting behind it the days when its fortunes rose and fell with the bond market.” The editorial concludes by quoting James Grant of Grant’s Interest Rate Observer as saying that Freddie’s management departures “could mean the end of Freddie’s ‘imperial’ phase. Inevitably, ‘it will be given less rope to hang itself and ourselves.’ That means it will either have to be absorbed back into the government, or, far more likely, be forced to operate more like an ordinary company. That would drive up its financing costs, shed more lights on its activities and its accounts, and take a toll on its growth. Freddie Mac has strong political ties, so change will not come easily. Even so, change now would be far less painful than a disaster later.”

Crony Capitalism – Time for an Overhaul

The Economist, June 28, 2003

- Past efforts to strengthen the regulation of the GSEs have not been extremely successful, due to the GSEs’ close political ties to most members of Congress. However, “America’s long litany of corporate scandals has changed all this. More companies are coming under scrutiny, especially if they have large debts, are exposed to these capital markets and have perplexing accounts – like Freddie Mac and Fannie Mae...Now America’s accounting scandals have belatedly brought Fannie Mae and Freddie Mac into legislator’s purview. Many on Wall Street have watched efforts such as Mr. Baker’s fail before, and are skeptical about the latest. Yet with every new, questionable report that emerges about the mortgage companies the pressure for change increases. Nobody in Washington wants to be tagged with having fiddled while Fannie and Freddie burned.”

Financial Times

Mortgage Mayhem: Time to Open Up Fannie and Freddie

Financial Times (London), June 11, 2003

- “The lesson of this week’s cull goes well beyond managerial ineptitude. It is now way past time for government to shine a much more probing light into the activities of Freddie Mac, and its larger sister, Fannie Mae...it has long been an unacceptable quirk of financial history that these government-sponsored enterprises operate with de facto public guarantees...compounded with a regulatory structure that makes Enron look like a model of corporate governance.” The editorial concludes by calling for stricter regulation of the GSEs, “perhaps through an expansion of the remit of the

Office of the Comptroller of the Currency at the Treasury...Fannie and Freddie now represent a regulatory black hole in the US financial system...Dominating the world's largest mortgage market but accurately vulnerable to financial shocks, they could be a catastrophe waiting to happen. It is time to start establishing order in the chaos."

Fragile Freddie? The list of Unanswered Questions Keeps Growing

Financial Times (London), June 16, 2003

- The fallout from the Freddie scandal has been relatively modest, but "Unfortunately, this sanguine reaction could imply two things: either there is little wrong with the mortgage provider's finances, as Freddie Mac insists; or investors are sure that US taxpayers would pick up the bill because Freddie Mac and its even larger sister Fannie Mae are too big to fail...One thing is clear. Freddie Mac's size, the opacity of its accounts, its lack of disclosure, its relatively lax regulation, implicit government guarantees, the volatility of its income as a result of households refinancing mortgages when interest rates fall and its extensive use of derivatives could be a dangerous combination...Freddie Mac should disclose why its boardroom cull was so extensive; investigators should outline their concerns; the government should tell investors whether they are right to assume Freddie Mac's debt comes with a guarantee; and all mortgage finance providers should seek to reassure investors over their exposure to risk." While Fannie and Freddie have been very successful in providing liquidity to the US mortgage markets, "that success has to be accompanied by transparency. The stability of the financial system is at stake."

Freddie Needs Some Competition

Financial Times; June 16, 2003

Commentary - Peter J. Wallison, AEI Resident Fellow

- Wallison believes Freddie needs more competition. "The stunning news that Freddie Mac...has dismissed its top three officers should alert all of us to the fact that the health of the US economy is hostage to the decisions of only two corporate managements [Fannie and Freddie]." Citing the immense size of Fannie and Freddie and their dominant position in the housing market (owning or guaranteeing almost half of all US mortgages), he noted, "If either of them were unable to buy mortgages from banks or other loan originators, and thus keep money flowing to the residential mortgage market, the housing market would be seriously disrupted - and with it the entire US economy." He noted, "Thus, the shake-up at Freddie raises the question of whether these two giant mortgage companies could create what regulators call 'systemic risk' - the risk that a problem in one area will spread to and adversely affect the economy as a whole."
- "Needless to say, this would not be a problem if the secondary market for conventional conforming mortgages - the middle-class mortgages Fannie and Freddie alone are able to buy and sell - consisted of more than two gigantic companies."
- Wallison believes it is "unrealistic" to strengthen regulation over the GSEs. "As we saw in the savings and loan crisis of the early 1990s, efforts by a regulatory agency to limit an industry's growth are often met by congressional opposition if it will

adversely affect consumers' housing costs. If OFHEO, or any other future 'tougher' regulator, finding risky activities at Fannie and Freddie, tried to restrict their growth, it would be strongly opposed both by the two companies themselves and by those in Congress who might fear the resulting rise in home mortgage rates. This is opposition that no regulator is able to resist. The likelihood, then, is that Fannie and Freddie will be allowed to continue their risky course - as were the savings and loans - because Congress does not want to face the short-term result of a regulatory crackdown."

- "In the end, the only protection against the systemic risk associated with Fannie and Freddie is their full privatisation - their complete separation from their many government benefits - so that a fully competitive and diversified secondary mortgage market will develop in the US. But since they will still be too big to fail, privatisation must be accompanied by their break-up into five or six smaller mortgage groups. In that way, if one or more of them encounters financial difficulties there will be no collapse in residential lending and no systemic effect on the general economy."

They Fiddled, but the Economy Didn't Burn: Home Cooking in the Public Sector

Financial Times (London), June 16, 2003

John Plender

- Freddie Mac "is set to join the rogue's gallery of those who cooked the books." He calls for OFHEO, Freddie's "somnolent watchdog" to be "forcibly awakened and given electric shock treatment."

New Zealand Herald

Growing Scandal to Test Investors

The New Zealand Herald; June 14, 2003

Roger Franklin

- Wall Street has not yet shown much concern over the events at Freddie Mac. However, there is reason for concern - "starting with the fact that Freddie's chief financial officer shredded a pile of records before being escorted out of the office in disgrace." Freddie's use of derivatives is troubling. "If those derivatives were to go sour, Freddie's financial foundation would crumble as Federal Reserve Chairman Alan Greenspan noted when he observed that Freddie and the even larger Fannie have potential to prompt a systemic economic collapse." And possibly, "If Freddie's woes ripple through the mortgage market, banks will become less able and willing to lend, liquidity dries up, the superheated property market tanks, and millions of home owners see their paper wealth incinerated."

Sunday Telegraph

How Freddie and Fannie Could Get Us All in a Pickle

Sunday Telegraph (London); June 22, 2003

Terry Smith, Chief Executive, Collins Stewart

- “If you thought Freddy Krueger was frightening in Nightmare on Elm Street, wait until you read about the goings on at Freddie Mac.” The US markets have been fairly “sanguine” about the going-on at Freddie, due to the GSEs’ implied government guarantee. However, “what it truly alarming is that the thinking about the implications of the Freddie Mac problem seems to stop there. To repeat, this is the second-largest provider of mortgages in the largest economy in the world. Its problems would seem to indicate that its ability to continue supplying 30-year fixed-rate mortgages – which US consumers can refinance when rates change in their favour – is at the very least severely in question.”

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