



Weekly Update

Public Policy Network
FHLBank Pittsburgh

Policy Update February 22, 2010

Congress resumes work this week on a full slate of issues.

The biggest development is the likely release of a new version of Senate Banking Committee Chairman Chris Dodd's (D-CT) comprehensive financial reform. This bill will differ dramatically from the Chairman's earlier trial balloon, with the level of Republican support unclear. The Chairman plans a committee vote in early March. It is possible that Ranking member Richard Shelby (R-AL) will release his own alternative version of legislation.

FHLBanks will review these bills quickly with focus on the establishment of a regulatory scheme to address systemic risk (looking like a council of regulators within the Treasury) and derivatives regulation which is expected to differ significantly from legislation that has already passed the House.

At some point in the near future, possibly this week, the Federal Housing Finance Agency (FHFA) will be called to testify on the Hill on the compensation packages of executives at Fannie Mae and Freddie Mac.

FHFA Acting Director Edward DeMarco Speaks on State of the GSEs

In remarks last week, Acting Director DeMarco said, "One of the good news stories in the recent crisis is that the FHLBank System worked as it was designed." He highlighted the increase of advances to more than \$1 trillion in 2008 and subsequent shrinking to pre-crisis levels "without significant adverse consequences for the FHLBanks."

DeMarco cited private-label MBS as the biggest challenge of the FHLB System. He said the FHFA sees a "renewed emphasis on the basic advance business of the FHLBanks, which will continue as a low-risk, low-return business, although likely at a smaller scale." DeMarco stated that CDFI membership is important and will expand the System's already significant affordable housing and community development work. The FHFA will soon publish a proposed rule on community development loans by CFIs.

In response to a question about covered bonds, DeMarco pointed out that advances work very similarly, and that if banks do want to create a market for them, that is fine, but there is no need to replicate what is already available from the FHLBanks.

AEI's Peter Wallison Publishes Paper on Future of Fannie Mae and Freddie Mac

Peter Wallison, former Treasury official and American Enterprise Fellow, published a paper on the future of Fannie Mae and Freddie Mac (F/F) in a paper titled, "The Dead Shall Be Raised: The Future of Fannie and Freddie." Wallison begins the paper by stating it is too early for any call for major changes to F/F until the housing market stabilizes or another competitive source of financing arises, but that it is important for policy makers to begin the discussion.

Wallison's paper discusses and evaluates four possible future mechanisms for Fannie and Freddie: nationalization, reorganization as a public utility, restoration as GSEs and privatization. Wallison rules out nationalization due to political resistance against placing the entities on the federal budget. In evaluating the merits of the public utility model, Wallison believes rates set by the government will not accurately capture risks inherent in mortgage pricing, and believes Congress will force rates to "affordable" levels which will prove to be unprofitable.

Although Wallison prefers privatization, he suggests that unfounded skepticism of the securitization markets in Congress makes it unlikely.

Wallison predicts Congress will take the "course of least resistance" in the restoration of Fannie Mae and Freddie Mac as GSEs. He believes doing so will inevitably lead to the same problems that occurred before the crisis, especially the "fatal flaw" of a private company with a public mission.

Financial Crisis Inquiry Commission Announces Hearing

The Financial Crisis Inquiry Commission will hold its second forum on February 26-27. This forum will include Dwight Jaffee, a professor at the University of California and former public interest director for the FHLBank of New York, who will discuss GSEs and housing policy. Chris Mayer, professor of Columbia University and visiting scholar of the Federal Reserve Bank of New York, will discuss mortgage lending practices and securitization.

Panel Warns of Commercial Real Estate Losses for Smaller Banks

The Congressional Oversight Panel, created to oversee the TARP program, warned losses on commercial real estate (CRE) loans could total up to \$300 billion over the next three years. Such losses could cause "hundreds more community and midsize banks" to fail. One hundred and forty institutions failed in 2009, and sixteen have collapsed in 2010. \$1.4 trillion in CRE loans will mature between 2011 and 2014, and the report highlights a Deutsche Bank estimate that 65% of these loans may not qualify for refinancing due to strict underwriting standards and falling property values. The panel identifies nearly three thousand banks as classified as having a "CRE Concentration" under federal guidelines, but none of these banks is among the 19 largest bank holding companies subjected to stress tests.