Appendix T

APPENDIX T — Overview of Selected Government Entities and Government Sponsored Enterprises†

Although there are no real precedents in the United States for the corporatization/privatization of an entity the size and scope of the Postal Service, this document discusses the structure of government corporations and government sponsored enterprises and reviews seven modern-day cases in which U.S. federal government organizations were transformed from their government status to a more private form of ownership and governance.

FORMS OF OWNERSHIP: PUBLIC AND PRIVATE

	Public — Owned and controlled by the public sector		Private — Owned and controlled by the private sector	
Type	Government department/agency	Government corporation	Government-sponsored enterprise	Private corporation
Selected attributes	■ Funded by the U.S.government ■ Strict adherence to federal statutes and regulations throughout operation	■ Fully or partially funded by the U.S. government ■ Some flexibility in adherence to federal statutes and regulations ■ Independent or part of a government department/agency ■ Generally created to serve a public function of a predominantly business nature	■ Typically financed by private investors ■ Privatelyowned/ controlled ■ Credit markets perceive implied financial backing by the U.S. government ■ Regulated by U.S.government to protect the government's interest ■ Profit-seeking	■ Privately owned/controlled ■ Profit-seeking
Examples	■ Department of Commerce ■ Department of Energy	■ Tennessee Valley Authority (TVA) ■ Rural Telephone Bank(RTB)	■ Federal National MortgageAssociation (Fannie Mae) ■ Federal Home Loan Mortgage Corporation (Freddie Mac)	■ International Business Machines (IBM) ■ Procter & Gamble

Public → Private

Source: General Accounting Office

†This appendix was prepared for the United States Postal Service by JP Morgan.

Structural Options/Corporatization

Government corporations have been created throughout history to perform commercial or market-oriented functions as well as to administer public programs. Their attributes vary enormously from one corporation to another. Interest in this type of structure has grown over the last two decades as policy-makers have sought ways to decrease the size of government by making it operate more efficiently using private sector principles. While the form and function of government corporations have received exhaustive review and analysis, the lack of any statutory definition of the term “government corporation” has made it impossible to determine the number of corporations that exist at any one time. A 1995 report by the Congressional Research Service (CRS) of the Library of Congress stated “there is presently no universally accepted definition of what constitutes a government corporation, hence there are several listings of government corporations, each different and based upon the definition employed by the compiler.”

There are a wide variety of government corporations that exist today. Recent studies have identified anywhere from 15-47 government corporations depending on the definitions used. A comprehensive 1995 study conducted by the U.S. General Accounting Office listed 22 entities as government corporations[1]. A 1998 CRS report put the number at 24[2].

In a landmark 1981 study of government corporations commissioned by the U.S. Office of Management and Budget, the National Academy of Public Administration (NAPA), attempted to provide a comprehensive description and definition of the various types of government entities. NAPA stated that there are two “main, overlapping types of agencies,” government enterprises and government corporations.

Government enterprise - a federal instrumentality or program which generates revenue from a commercial-type activity involving the provision of services or goods usually to the general public or a restricted segment thereof and which is intended to be substantially self-sustaining. It may or may not be incorporated; may or may not have special powers not granted to a normal government agency; may or may not have the right to retain revenues in a revolving fund and use them for operating expenses without regard to fiscal year limitations. The term government enterprise is used generically in this report to encompass the broad range of public enterprises whether incorporated or unincorporated.

Unincorporated enterprise - a term embracing a large body of enterprises ranging from those with few attributes distinguishing them from government agencies to those with most of the attributes of a government corporation except the separate legal identity acquired by incorporation. Examples range from such large enterprises as the U.S. Postal Service, which is a government corporation in nearly every sense but formal designation, to the [former] Alaska Railroad, and the many large and small revolving funds such as those established from the sale of surplus equipment by the Department of Defense and the General Services Administration.

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[1] U.S. General Accounting Office, Profiles of Existing Government Corporations (GAO/GGD-96-14, 1996)
[2] Congressional Research Service, Federal Government Corporations: An Overview (98-954 GOV, Nov. 24, 1998)

Incorporated government enterprise - a government corporation which generates revenue from a commercial or business-type activity and which is intended to be substantially self-sustaining. Since a number of government corporations have been formed in recent years which do not provide commercial-type services or goods or raise revenues, all government corporations are not enterprises. Examples of non-enterprises include the Inter-American Foundation, National Park Foundation, and Legal Services Corporation.

Government corporation - a government entity created as a separate legal person by, or pursuant to, legislation. It can sue and be sued, use and reuse revenues, and own assets; its liability is distinct from that of its officers and directors. Each government corporation is created by an act of Congress setting forth its legal powers, obligations, and mission.

According to the NAPA, three kinds of corporations have been established by federal statutes: government, or wholly owned government corporations; mixed public-private, or mixed-ownership corporations; and private corporations.

Government corporations pursue a governmental mission assigned in their enabling statute and are financed by appropriations. Their assets are owned by the government and managed by board members or an administrator appointed by the President or Secretary of a Department. Examples - Export-Import Bank, Government National Mortgage Association, St. Lawrence Seaway Development Corporation.

Mixed public-private corporations have a combination of governmental and private equity; hence their assets are owned and managed by board members selected by both the President and private stockholders. They are usually intended for transition to the private sector. Examples - Student Loan Marketing Association, National Consumer Cooperative Bank, Connie Lee, Fannie Mae, Freddie Mac.

Private corporations are established by federal statute but are privately financed and owned, with no government appropriations, loan or loan guarantee. All or most of their board members are chosen by private stockholders. Example - the Communications Satellite Corporation (COMSAT).

Depending on the specific provisions and ultimate policy goals of their enabling statutes, government corporations may or may not be subject to certain federal statutes related to personnel management, compensation, procurement, and a variety of other topics. The 1995 General Accounting Office study surveyed existing government corporations to determine which of the following 15 federal statutes they were subject to:

- The Privacy Act of 1974 (5 U.S.C. 552a)
- The Freedom of Information Act of 1966 (5 U.S.C. 552)
- Government in Sunshine Act (5 U.S.C. 552b)
- Chapter 51 of title 5, United States Code (5 U.S.C. 5101-5115)
- Subchapter III, chapter 53 of title 5, United States Code (5 U.S.C. 5331-5338)

- Federal Property and Administrative Service Act of 1949, as amended (41 U.S.C. 251-260)
- Federal Tort Claims Act, as amended (28 U.S.C. 2672)
- Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b), (c))
- Anti-Deficiency Act (31 U.S.C. 1341)
- Government Corporation Control Act of 1945 (31 U.S.C. 9101)
- Government Performance and Results Act of 1993 (Public Law 103-62)
- Chief Financial Officers Act of 1990 (Public Law 101-576)
- Inspector General Act of 1978 (5 U.S.C. 1341)
- Federal Credit Reform Act of 1990 (2 U.S.C. 661-661f)
- Ethics in Government Act of 1978 (Public Law 95-521, as amended)

The GAO found little consistency or uniformity with regard to the applicability of these requirements to existing government corporations. The GAO concluded:

Congress established GCs (government corporations) to carry out business-type programs that need more autonomy and flexibility than that provided by a conventional agency structure. Accordingly, GCs may be, but are not always, exempted in part, or in full, from certain statutes governing matters such as civil service pay scales and hiring rules, position ceilings, and procurement. These exemptions are intended to allow GCs to respond more quickly to changes in the marketplace and, in some cases, to take advantage of cost-saving opportunities. However, even when GCs are partially or fully exempt by law from the requirement to adhere to federal statutes, some GCs reported that they choose to adhere to some requirements as a matter of policy.

The GAO also found that the GCs varied widely in their adherence to the 15 federal statutes used in the survey. For example the Federal Housing Administration reported full adherence to 14 of the 15 statutes, while Amtrak reported full adherence to only 2 statutes. In addition, the number of GCs receiving full or partial exemption from Congress was high.

Case Studies

Seven cases of government entities that moved to corporatization/privatization are described below. Each case provides an overview and background on the entity and a description of: 1) the legislation enacting the privatization; 2) key drivers of change; and 3) the process by which the transfer to private ownership occurred and key lessons from the privatization. Discussed are:

- Conrail
- Amtrak
- U.S. Enrichment Corporation

- COMSAT
- Fannie Mae
- Freddie Mac
- Sallie Mae

Government Entities: Conrail, Amtrak, USEC and COMSAT

Consolidated Rail Corporation (Conrail)

Overview

Formed in 1975 as an amalgam of several bankrupt railroads, the Consolidated Rail Corporation ("Conrail") operated more than 15,000 miles of track in the Northeast and Midwest. Conrail was intended to be a transitional entity that would be fully privatized when it became a self-sustaining profitable corporation. After many years of government financial support, a transition to profitability, and protracted debate among policy-makers, Conrail was privatized in 1987 through an initial public offering of the government's ownership interest. Ten years later in 1997, CSX Corporation and Norfolk Southern Corporation acquired Conrail. CSX and Norfolk Southern began operating most Conrail lines and facilities in 1999 under an operating plan approved by the U.S. Surface Transportation Board.

Background

While the rest of the U.S. economy rebounded in the years following World War II, the nation's railroads went into serious decline, due largely to competition from long-distance trucking, but also because of expensive labor protections negotiated by powerful unions and inflexible government regulation. A series of mergers and bankruptcies ensued, the most serious of which was the failure of the Penn Central Railroad in 1970.

The creation of Conrail was one of several steps taken by Congress to reorganize and overhaul the passenger and freight railway system of the United States.

- The Emergency Rail Services Act of 1970 provided federal loan guarantees to support the national railroads.
- The Rail Passenger Service Act of 1970 led to the creation in 1971 of National Railroad Passenger Corporation ("Amtrak") and provided government guaranteed loans to a private, for-profit corporation owned in alliance by four national passenger rail systems.
- The Regional Railroad Reorganization Act of 1973 ("3R Act") established the United States Railway Association ("USRA") as a mixed-ownership government corporation under the District of Columbia Nonprofit Corporation Act to develop a plan to reorganize bankrupt railroads by forming Conrail. Four designated government officials (a Chairman, appointed by the President; the Secretaries of Transportation and Treasury; and the Chairman of the Interstate Commerce Commission ("ICC")) were incorporators and served on the USRA board along with seven non-government directors appointed by the President).

In November 1975, Congress gave its consent to the final USRA system plan for reorganizing the seven bankrupt railroads. The Railroad Revitalization and Regulatory Reform Act of 1975 (Public Law 94-210) implemented the plan and created the new, federally subsidized entity out of the bankrupt railroads. Conrail was to be the centerpiece of the sweeping plan to revive rail service in the Northeast and Midwest without resorting to a nationalized system. The plan embodied the largest corporate reorganization in U.S. history. Conrail was authorized to take over the operation of 15,000 miles of track that had previously been operated by the bankrupt carriers. The start-up costs of $2.5 billion were to be financed by the federal government through loans and stock purchases, but the plan envisioned that Conrail would become independent and operate at a profit by 1979.

The Railroad Revitalization and Regulatory Reform Act created a 13-member Board for Conrail, of which six members were to represent the holders of Conrail's debentures and "series A" preferred stock; three members to represent holders of "series B" preferred stock; two members to represent holders of common stock; and Conrail's chief executive officer and its chief operating officer. The members of the Board were to be appointed by the federal Department of Transportation (DOT) and the U.S. Railway Association.

The conveyance of rail properties to Conrail was to be completed by March 31, 1976, allowing Conrail to begin operations. Conrail's enabling legislation described it as a private, for-profit corporation and not an agency or instrumentality of the federal government. (USRA, on the other hand, was a government corporation subject to the Government Corporation Control Act and responsible for the oversight of Conrail.) All shares of Conrail were held by USRA. The Railroad Revitalization and Regulatory Reform Act of 1975 also provided substantial government support to Conrail in the form of 1) loans and grants in the amount of $2.1 billion which would be invested in Conrail through the purchase by USRA of Conrail's debt and equity securities, and 2) loan guarantees for capital investments and equipment purchases. The Treasury Department concluded at the time of granting this support that the financial community would not invest in Conrail "absent some type of Government involvement."

Conrail operated similarly to a private sector corporation, although it received financial support from the Department of Treasury and was under the auspices of a government corporation in the USRA. The company continued to receive financial support in the form of USRA's investment in the securities of Conrail until June 1981, after which time no direct federal funds were required for operations or capital investment.

Conrail obtained new management in 1981 bringing on the recently retired chairman of Southern Railroad, which had been named America's "ten best companies" just before his retirement. Because of his ability to keep the railroad solvent, this individual had gained a great deal of credibility with Congress.

A strong push to fully privatize Conrail was begun in 1981 when Ronald Reagan became President and had the support of a Republican-controlled Senate and many conservative House Democrats. However, the White House, Conrail, and the USRA each presented sharply different scenarios for the future of Conrail.

When the Reagan administration took office, it quickly determined that the government's involvement in Conrail threatened the budget and also violated President Reagan's principles forbidding government interference in the private sector. The Administration in its budget, submitted to Congress in March, announced that it wanted to end federal aid to Conrail by fiscal 1983, sell Conrail lines to private railroads and substantially scale back expensive employee benefits, a proposal that some union leaders warned could lead to a nationwide strike.

Despite the initial political opposition, the Reagan administration proceeded ahead with its plans to end federal subsidies by fiscal 1983 and to give the Secretary of Transportation free rein in selling portions of the system to private enterprise.

In 1986, five years after President Reagan had proposed returning Conrail to the private sector, Congress agreed to sell the government's 85 percent share of the freight railroad. However, instead of the direct sale to another railroad that the Administration had sought, the legislation enacted in 1986 mandated a public stock offering.

At its inception and until 1991, Conrail's rates and operations were virtually totally regulated by the ICC. These regulatory requirements made it difficult, if not impossible, for Conrail to compete. Conrail could not use negotiated rates, nor could it control costs through consolidations, line abandonment, nor innovative service management. The sweeping ICC deregulation in the Stagger's Rail Act of 1981 began a process in which Conrail was gradually freed to pursue these objectives, and under its new management was able to do so successfully. The process, however, took time and at the beginning it was unclear whether Conrail could succeed without federal funding.

Privatization Legislation

The Conrail sale provisions were included in the deficit reduction "reconciliation" legislation (Public Law 99-509) passed by Congress in October 1986 as "The Conrail Privatization Act of 1986". This was the fifth and final major piece of legislation over the 15-year period that was necessary to privatize Conrail.

Privatization Process

Pursuant to the Conrail Privatization Act, the public sale of all of the government's (i.e. USRA's) 85 percent equity share of Conrail occurred on March 26, 1987, through an initial public offering. DOT chose a lead underwriter and included six co-managers for the transaction. The transaction resulted in proceeds of $1.5 billion that with added cash payments from Conrail to the U.S. Treasury, produced approximately $1.9 billion for the government.

In October 1987, pursuant to the Privatization Act, Conrail's Employee Stock Ownership Plan was terminated and the remaining 15 percent of Conrail common stock was distributed to approximately 90,000 existing and former Conrail employees who participated in the plan.

Key Drivers of Privatization

The lengthy Conrail privatization process was driven by the need to rescue an essential public service that faced severe financial hardship and possible liquidation. The government's takeover did result in revitalization of the rail system and put it on solid financial footing, making the market receptive to Conrail's privatization through an IPO.

Ironically, the probable "winning" factor in the Administration's decision to push through the privatization legislation had little to do with railroading, labor, freight service continuity, or any other aspect of Conrail that had dominated the debate for many years. In the end, the key to passage of the final stock sale legislation was the urgent need for congressional leaders to find revenue to avoid across-the-board spending cuts that might have been required under the Gramm-Rudman-Hollings antideficit law. The final privatization bill produced an estimated $2 billion dollars of savings in the form of revenue from Conrail's sale.

Lessons

Conrail is a good example of the government corporation structure serving as a successful vehicle for transition to a private entity. A threshold level of sponsorship was provided to assist in the evolution of Conrail from a government-supported entity to one that ultimately had complete access to the capital markets and was viewed as a viable, self-sustaining private corporation. The argument for providing support was grounded in the importance to the national economy and the public interest in Conrail's services. However, the private financial markets needed to be reassured that any ongoing federal involvement in the privatized entity should be reasonable but need not disappear.

The Conrail privatization process also proved the direct correlation between the complexity of an enterprise and the length of time needed to achieve full privatization.

Amtrak (National Railroad Passenger Corporation)

Overview

The National Railroad Passenger Corporation ("Amtrak") provides intercity passenger rail service throughout the United States. Amtrak was established as a for-profit government corporation in 1970 by the Rail Passenger Service Act of 1970 ("RPSA"). Congress created Amtrak to relieve freight railroads from the financial burden of operating passenger rail service. Currently, Amtrak operates a 22,000-mile passenger rail network serving over 500 stations in 45 states, 21.5 million intercity passengers, and 58 million commuters under contract with commuter transit agencies. Amtrak's business activities include core railroad operations (passenger, food service, and state-supported services); commuter (contract management of commuter agencies); reimbursable (project work for commuter agencies); and commercial business lines (real estate, ROW leases, air rights leases).

Amtrak is governed by an eight-member Board of Directors, with seven voting members appointed by the President of the United States and confirmed by the Senate (except in the case of the Secretary of Transportation, who may be appointed without Senate confirmation), and the president of Amtrak, who is an ex-officio nonvoting member.

Background

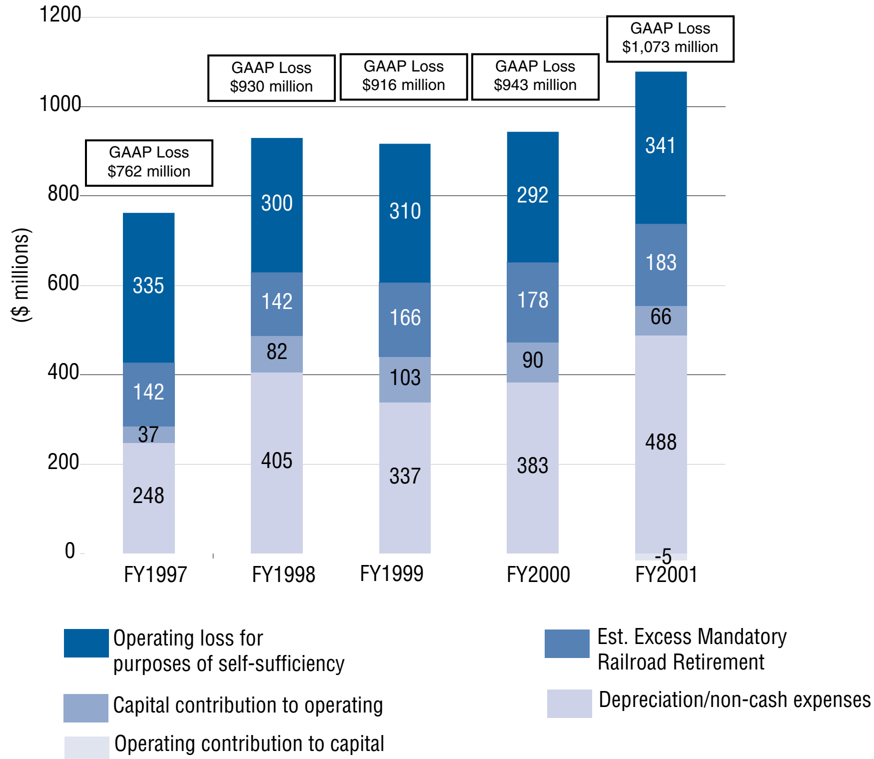
In 1970, the Congress created Amtrak to revitalize intercity passenger rail transportation. Before that time, individual railroads provided both passenger and freight rail service. Both passengers and the rail business suffered under this arrangement. Passengers lacked smooth connections between railroads, and the rail industry was losing money operating unprofitable passenger service. The combined losses of the railroads operating during 1970 were more than $1.7 billion in 1994 dollars. In 1971, most railroads willingly gave up their passenger service and provided the personnel, equipment, and infrastructure that became Amtrak. Amtrak was granted the right of access to the tracks owned by the freight railroads at incremental cost and with operating priority over freight trains. The Corporation was also granted a monopoly to provide intercity rail transportation over its route system and was to receive federal subsidies for the first years, but then was expected to make a profit. Initially, a 15-person Board of Directors was established. The President of the United States nominated eight people to serve on the Board and the remainder of the Board was selected by the corporation shareholders.

In 1994, the federal government established the goal that Amtrak reduce its need for operating subsidies and achieve operational self-sufficiency by the end of FY 2002. In 1995, Amtrak organized its operations into the three Strategic Business Units (SBUs) that exist today. The SBUs are arranged along geographic and market segment lines and consist of the Northeast Corridor (NEC), Amtrak Intercity and Amtrak West.

In 1997, after 26 years and approximately $22 billion in federal operating subsidies and capital investment, and an overall trend of stagnant ridership, Congress debated the viability of continuing to fund Amtrak, knowing that without federal funds, Amtrak would cease operations. As a result of this debate, Congress passed the Amtrak Reform and Accountability Act of 1997 (“Act”). Among other things, the Act created a new Reform Board to govern Amtrak, and created the Amtrak Reform Council (“ARC”) to oversee the company and to make annual reports to Congress. The new governing Reform Board replaced the existing Board of Directors. The Reform Board consisted of seven voting members appointed by the President for five-year terms with the advice and consent of the Senate. The Secretary of Transportation was included as a voting member, the President of Amtrak was an ex officio, nonvoting Board member. The Amtrak Reform Council was created as an eleven member bipartisan commission to serve Congress for a five-year term.

From FY1997 to FY2001 Amtrak's performance continued to worsen.

AMTRAK FINANCIAL PERFORMANCE, FY1997 – FY2001



In 2001, with the 1997 reauthorization approaching its expiration and with Amtrak's financial and operating performance deteriorating, Congress again began to focus on the corporation. The management of Amtrak and the Amtrak Reform Council expressed concerns about the future viability of Amtrak given its mission. During Congressional testimony in July 2001, Amtrak President George Warrington spoke of the difficulty of serving the public interest while trying to run a profitable business at the same time: "Now if you're a public service provider, you go where the community need is. If you're a business, you go where the money is. But if you're Amtrak — which way do you go?" On November 9, 2001, the Amtrak Reform Council, pursuant to its mandate under the Amtrak Reform and Accountability Act, found that Amtrak would not be able to reach operating self-sufficiency by December 2, 2002.

In January 2002, the Office of Inspector General of the Department of Transportation reported that Amtrak was no closer to being financially self-sufficient than it was when Congress ordered reforms in 1997. Additionally, in February 2002, the Reform Council submitted its congressionally mandated proposal to restructure Amtrak.

The Reform Council's plan calls on Congress to pass legislation that would significantly alter the current passenger rail system in the United States. The Council proposes that the current Amtrak be broken-up into three distinct organizations:

Federal Program Management and Oversight. The National Rail Passenger Corporation ("NRPC") would be restructured as a small government corporation, which would administer and oversee the national passenger rail program.

Train Operations. Amtrak would be a separate operating company that would provide train operating services.

Infrastructure. A third government corporation would be created to control the Northeast Corridor infrastructure assets.

Reform Legislation

As noted above, the most recent major Amtrak reform legislation occurred in 1997, after 26 years and approximately $22 billion in federal operating subsidies and capital investment, and an overall trend of stagnant ridership. Congress debated the viability of continuing to fund Amtrak, knowing that without federal funds, Amtrak would cease operations. The result was the passage of the Amtrak Reform and Accountability Act of 1997, which provided that Amtrak:

- Would no longer be a government corporation or hold a rail passenger monopoly;
- Would be allowed to add new routes and close money-losing routes;
- Would receive approximately $2.2 billion in Taxpayer Relief Act Funds; and
- Would have to achieve operating self-sufficiency (i.e. no longer receive federal operating grants) five years after the enactment of the Act.

Additionally, the Act also created the Amtrak Reform Council, an independent bipartisan federal commission of eleven members whose statutory mandate was to:

- Make recommendations to Amtrak to help it reach operational self-sufficiency;
- Report annually to Congress on Amtrak's performance in several areas;
- If ARC were to find that Amtrak would be unable to achieve its goal of operational self-sufficiency by December 2, 2002, then submit to Congress a plan for a rationalized and restructured national passenger rail system; and
- If such a finding were made by ARC, Amtrak would submit a plan for Amtrak's liquidation to Congress.

Key Drivers of Reform

Amtrak's chronic inability to gain solid financial footing has been the primary impetus for the series of legislative reform initiatives. The Amtrak Reform Council's November 2001 announcement that Amtrak would not achieve operational self-sufficiency by December 2, 2002 (as required by the Amtrak Reform and Accountability Act of 1997), led to the Reform Council's recent restructuring plan to create a rationalized and restructured national passenger rail system. Over the next year, Congress will debate this and other approaches as it struggles to determine whether Amtrak can meet desired service objectives at the same time it tries to become financially viable.

Historical Milestones

Year	Event
1970	Congress passes the Rail Passenger Service Act of 1970
1971	Amtrak begins operations on May 1, 1971
1973	Congress passes the Regional Rail Reorganization Act of 1973
1976	Congress passes the Rail Reorganization Act of 1976
1995	The federal government sets a goal for Amtrak to become more financially self-sufficient
1997	Congress passes the Amtrak Reform and Accountability Act of 1997
2001	The Amtrak Reform Council declares that Amtrak will not meet the congressional deadline to become financially self sufficient
2002	The Amtrak Reform Council submits to Congress its proposal to restructure Amtrak

United States Enrichment Corporation

Overview

The United States Enrichment Corporation (USEC) produces and markets uranium enrichment services to electric utilities that operate commercial nuclear power plants in the United States and abroad and is the world's leading supplier of enrichment services. USEC was established by the Energy Policy Act of 1992 as a wholly-owned government corporation to take over the responsibilities of the U.S. Department of Energy's (DOE) Uranium Enrichment Enterprise (UEE).

USEC was fully privatized in 1998 through an initial public offering of the U.S. government's complete ownership interest (NYSE listed). USEC was the first U.S. government privatization since Conrail in 1987. Though the government retained no ownership interest, USEC continues to serve as the U.S. government's executive agent for the Megatons to Megawatts program, the U.S.-Russian nonproliferation agreement to dilute highly enriched uranium taken from dismantled Russian nuclear warheads into low-enriched uranium fuel used by USEC's customers to generate electricity.

USEC serves approximately 86 percent of the domestic markets, approximately 40 percent of the world market, and is the sole marketing agent for uranium enrichment services on behalf of the U.S. government.

Background

Uranium enrichment is a multibillion dollar international industry which provides a vital service in the production of commercial nuclear reactor fuel required by electric utilities that operate nuclear power plants.

In the 1950s, the practice of enriching uranium expanded to meet the nation's growing defense needs. The commercial nuclear industry was born in the 1960s with the passage of the "Private Ownership of Nuclear Materials Act of 1964." As a result, all phases of the nuclear fuel cycle became privately owned with the exception of the DOE's Uranium Enrichment Enterprise ("UEE"). In 1969, the UEE began operation as part of the Atomic Energy Commission. The UEE utilized two gaseous diffusion plants at Paducah, Kentucky, and Portsmouth, Ohio, which the United States had operated since the 1950s. These plants originally served defense purposes, but were also equipped to enrich uranium as fuel for consumer electric power plants. The plants had been used in this capacity since the 1960s, and no longer produced weapons-grade enriched uranium.

The United States held a worldwide monopoly in enrichment services until 1974, when the United States, with its total enrichment capacity filled, stopped accepting new orders. Foreign competition emerged very quickly to meet continuing demand. By the 1980s, with the cancellation of many of the government's contracts and the increase in foreign competition, the United States became the highest priced supplier of uranium enrichment services. From 1974 to 1992, the U.S. monopoly position eroded to 40 percent of total market share. When the threat to United States competitiveness in this industry and the vital national interest in self-sufficiency in alternative energy sources became obvious, United States support for corporatization and eventual privatization of the enrichment service grew significantly.

The 1992 Energy Act corporatized the UEE creating USEC as a wholly owned government corporation subject to the Government Corporation Control Act. The Act directed USEC to reorganize and operate the government's uranium enrichment activities as a business, to compete globally, and to make a profit. USEC's start-up date was July 1, 1993. The Act of 1992 mandated that USEC issue capital stock to the U.S. government equal to the greater of $3 billion or the net book value of assets transferred to the USEC as of July 1, 1993. USEC issued 30 million shares of $100 par value common stock equaling $3 billion to the U.S. Treasury. Until the privatization, all of the stock of USEC was held by the Department of Treasury.

As a wholly-owned government corporation, all profits accrued by the USEC were remitted to the U.S. Treasury in the form of a dividend. The DOE leased the two plants at Paducah and Portsmouth and the equipment necessary for production.

The President appointed a five-member Board of Directors in November 1993. The Board was confirmed by the Senate in February 1994. The Board was responsible for setting policy for the corporation, making sound business decisions, and guiding the transition to privatization.

USEC was required to operate as a self-financing corporation with no federal government appropriations or federal source of financing, including the Federal Financing Bank. USEC was granted the right to issue and sell bonds (not guaranteed by the U.S. government), but not for the purpose of constructing new uranium enrichment facilities or conducting pre-construction activities. The U.S. Treasury had the right of disapproval on issues.

The corporatization legislation tried to protect UEE's labor force by protecting the rights, wages, and benefits of the employees in place prior to July 1993 through the two-year transition period. For benefit security, the Act provided that employees could opt to remain in the federal retirement benefit programs, CSRS and FERS, in lieu of coverage by the Corporation. The Corporation also maintained pro rata coverage of contracted employees.

USEC played an integral role in U.S. foreign policy and the United States' efforts towards global nuclear nonproliferation. The Energy Policy Act of 1992 designated USEC as the U.S. Executive Agent responsible for the U.S.-Russian agreement to sell highly enriched uranium (HEU) extracted from nuclear weapons, in the form of blended-down commercial-grade enriched uranium. USEC was contractually committed to purchase Russian uranium and convert it to commercial fuel to be sold in the global markets.

USEC had approximately 110 employees in its Bethesda headquarters and 13 employees at its two gaseous diffusion plants. The operation and maintenance of the two plants was contracted out to Martin Marietta Utilities Services (MMUS). Martin Marietta had about 4,400 operating personnel at the two plants. More than half of these employees were covered by collective bargaining agreements. USEC had in-place an incentive-based compensation system to reward employee achievement.

USEC was regulated by the Nuclear Regulatory Commission (NRC) and the Occupational Safety and Health Administration (OSHA). USEC had to invest approximately $35 million to bring plants into compliance with OSHA and $87 million to prepare the plants for regulation by the NRC. The Department of Energy agreed to reimburse USEC for current and future costs to bring the gaseous diffusion plants into OSHA and NRC compliance.

Privatization Legislation

Two separate pieces of legislation were required to fully implement USEC's privatization. The 1992 Energy Policy Act authorized USEC to implement its privatization plan as long as two conditions were met. First, the President had to approve the plan. Second, the USEC Board had to determine, in consultation with appropriate agencies of the United States, that privatization would satisfy four statutory criteria:

- A return to the United States at least equal to the net present value of USEC as a government corporation;
- Protection against foreign ownership, control, or domination of USEC;
- Protection of public health and safety and common defense and security; and
- A reasonable assurance of adequate enrichment capacity to meet the demand of the domestic electric utility industry.

In 1996, before the President approved USEC's privatization plan, Congress again passed legislation aimed at eliminating some key issues that might impede the sale or diminish the value of USEC. "The USEC Privatization Act" established additional requirements for the certification and licensing of USEC's uranium enrichment activities by the NRC and contained provisions to clarify the allocation of assets and liabilities between the government and a privatized USEC, including a section that provided for the transfer of substantial quantities of natural and enriched uranium from the DOE to USEC. The 1996 Act also enacted protections for USEC's workers, including a requirement that DOE provide benefits to certain USEC workers in the event of a plant closing or mass layoff.

Finally, the 1996 Act directed USEC to privatize, with the approval of the Secretary of the Treasury, in a manner that satisfied several additional statutory criteria of providing for:

- The long-term viability of USEC;
- The continued operation of the gaseous diffusion plants that USEC leases from DOE;
- The maintenance of a reliable and economical domestic source of uranium mining enrichment, and conversion; and
- To the extent not inconsistent with these three criteria, obtaining the maximum proceeds for the United States.

Key Drivers of Privatization

As a result of growing international competition in the enrichment service industry and the advancing technology in the domestic private sector, support began to grow for spinning off the government's enrichment services to secure future profits. In an environment of deficit reduction efforts, privatization of USEC gained solid support in the U.S. Congress. Although some of the labor unions opposed privatization, most tentatively supported the move, believing a private company would promote operating efficiencies and flexibility, and thus, provide greater job security.

A national interest element also played a role in the move toward privatization of the U.S. government's uranium enrichment activities. Nuclear energy provides 20 percent of the United States' electricity needs. Nearly 77 percent of all households receive a portion of their household energy needs from nuclear power plants. Therefore, a healthy and strong uranium enrichment service was deemed a vital national interest. To maintain a position in the world markets, as well as to satisfy domestic energy needs, support grew for a private uranium enrichment service that could be flexible and responsive to competitive market forces.

Privatization Process

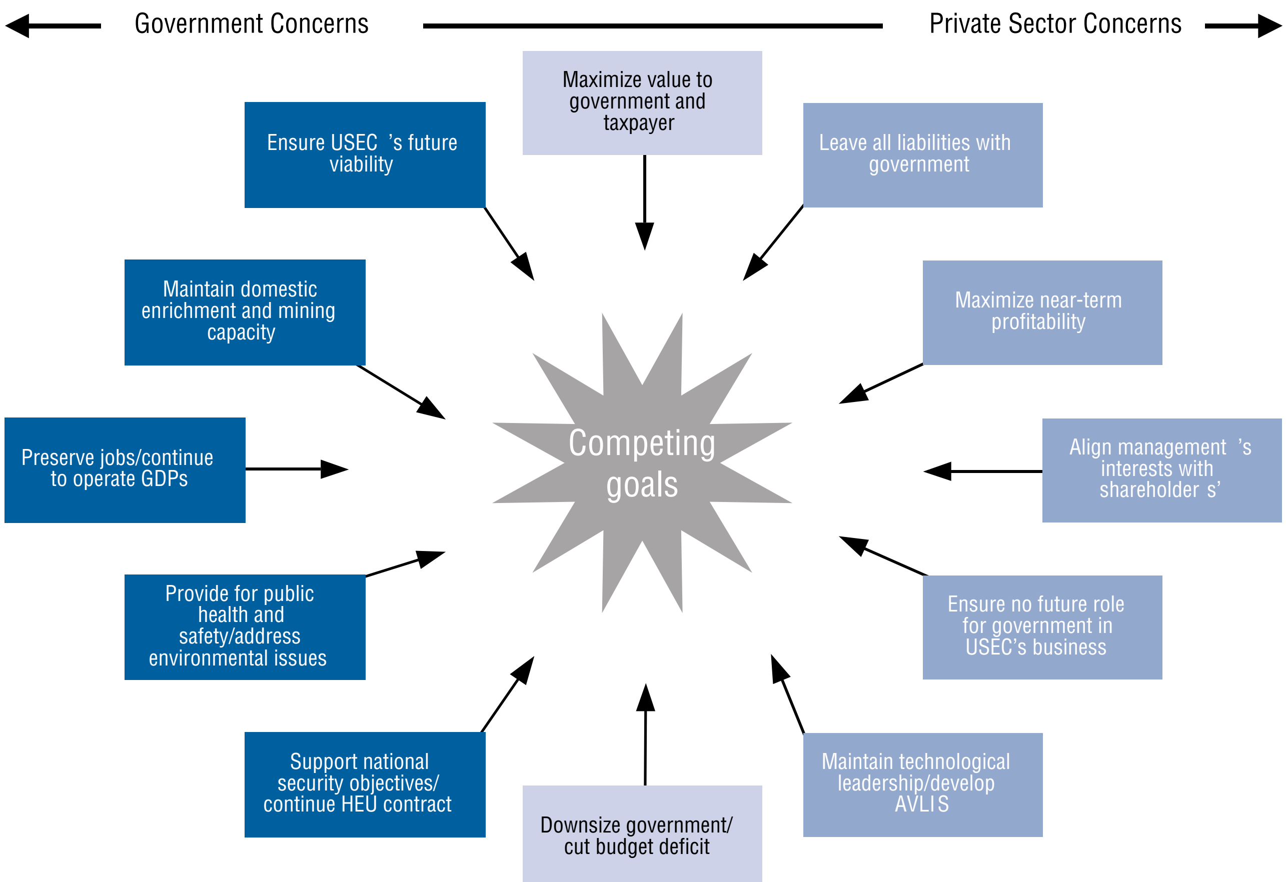
In 1995, USEC submitted its plan for privatization to the President and Congress. The plan accomplished the statutory requirement to evaluate alternative means of privatization by establishing a "dual-path" process, in which USEC simultaneously prepared for an initial public offering of stock and a negotiated sale to a third party. The plan concluded that such a dual-path process would allow decision makers to select the best means of privatization on the basis of concrete information about the relative merits of specific transaction alternatives. In July 1997, the President approved the privatization plan subject to the development of an adequate post-privatization oversight process.

The USEC Board considered third-party sale proposals from two potential buyers. The most attractive proposal was a leveraged buy-out that offered $1.9 billion for the acquisition of USEC, subject to a number of conditions. The second third-party sale proposal was also a leveraged buy-out, but it offered less attractive terms than either the first proposal or the public stock offering proposal.

In June of 1998, the USEC Board determined that both the first buy-out proposal and the public stock offering proposal satisfied the statutory requirements, but that the stock offering provided the superior method of addressing the special areas of concern identified in the two privatization statutes. The USEC Board unanimously approved privatization through the public stock offering.

Lessons

The USEC sale highlighted the importance of close cooperation and consensus building among key stakeholders. A close working relationship and effective communication between and among USEC management, its financial and legal advisers and key government players from the Administration and Congress were critical to assuring a successful sale transaction. The various interested parties had many competing goals and interests.



Reaching consensus required getting support from key government players and dealing with the concerns of outside parties.

Interested government entities

- Executive Office of the President
  - Office of Management and Budget (OMB)
  - National Economic Council (NEC)
  - Council of Economic Advisors (CEA)
- Cabinet Departments
  - Treasury
  - Energy
  - State
  - Justice
  - Defense
  - Commerce
- Nuclear Regulatory Commission (NRC)
- Central Intelligence Agency (CIA)
- U.S. Senate Committee on Energy and Natural Resources
- U.S. House Subcommittee on Energy and Power
- Other interested Senators and Congressman
- Congressional Budget Office (CBO)
- General Accounting Office (GAO)

Interested outside parties

- Unions representing workers at the GDPs
- Advocates for the uranium mining industry
- Russian government officials
- Academics with an interest in the privatization process
- Electric utilities
- Consumer advocates

USEC: Timeline of Key Events

Financial market concerns were addressed in a manner that balanced the government's interest in maximizing USEC's sales value while retaining its important, but less financially attractive national security obligations (i.e., purchasing Russian weapons grade uranium).

KEY EVENTS
Agreement with Russia reached on HEU by George Bush

Bill Clinton elected President

1992

KEY EVENTS
Passage of the Energy Policy Act

Creation of USEC as a government corporation

KEY EVENTS
USEC begins operations on July 1

1993

KEY EVENTS
Clinton takes office

Russian HEU agreement signed

KEY EVENTS
Republicans take control of Congress (November)

1994

KEY EVENTS
Signing of Russian HEU contract with TENEX (January)

J.P. Morgan valuation study (July/August)

J.P. Morgan retained as privatization financial advisor (December)

KEY EVENTS
Congressional testimony for USEC legislation (Feb./April)

Initial passage of legislation (September)

Privatization plan submitted to President (July1)

Transaction Manager and Co-managers selected (October)

1995

KEY EVENTS
Government shutdown stalls USEC legislation (October –December)

KEY EVENTS
Clinton reelected (November)

Republicans retain control of Congress (November)

1996

KEY EVENTS
USEC Privatization Act signed into law (April)

USEC/TENEX contract amendment signed setting prices for five years (November)

KEY EVENTS
Clinton authorizes implementation of privatization (July)

1997

KEY EVENTS
New personnel at Treasury begin to oversee privatization process (December)

KEY EVENTS
Legislation passed/signed addressing worker issues at plants (July)

1998

KEY EVENTS
"Dual-path" process begins (January)

M&A final bids received (May)

USEC Board and Treasury approve IPO process (June)

USEC sold in IPO (July)

■ = Privatization events   ■ = Government events

COMSAT

Overview

In 1962, Congress chartered the Communications Satellite Corporation (COMSAT) to help establish an international consortium to realize the United States' vision of a global satellite communications system. Though private sector parties were not willing to take the large financial and political risks associated with creating a global system, the United States wanted to have the greatest possible private sector involvement. As a result, COMSAT was created as a publicly-traded, for-profit corporation, and not as an agency or establishment of the U.S. government. Through COMSAT's efforts, the International Telecommunications Satellite Organization (INTELSAT) was established in 1964 as a cooperative between multiple member nations (132 prior to INTELSAT's privatization) to operate the global system of satellites. COMSAT was designated the U.S. signatory to INTELSAT and had exclusive rights to provide U.S. companies with access to the INTELSAT system. Full privatization of COMSAT was authorized in 2000 with the passage of legislation eliminating governance limitations and restrictions on the ownership of a majority of COMSAT stock. This legislation also moved INTELSAT toward full privatization.

Background

INTELSAT was formed as an international treaty-based organization in which governments ("parties") and telecommunications entities ("signatories") each had particular roles. The parties designated signatories, who were the actual owners and operators of the INTELSAT system and responsible for distributing INTELSAT services in their respective countries. Member nations hold an ownership interest in INTELSAT based on their percentage usage of the system, for which they are charged. Pursuant to the requirements of the 1962 Act, half of COMSAT's stock was sold to private telecommunications carriers and the other half was sold through a public offering.

COMSAT was incorporated in 1963. The President appointed the incorporators who were to serve as the initial board of directors and arrange the initial stock offering. NASA advised and assisted on research and development and furnished services, such as satellite launches on a reimbursable basis. The President of the United States appointed three of the 15 Directors on the Board. The remaining 12 directors were elected by 6 shareholders who were communications carriers and the remaining 6 by all other shareholders. COMSAT was regulated by the Federal Communications Commission, which authorized stock ownership of the publicly held company by common carriers and also oversaw the capital structure and debt guarantees of the business.

Through COMSAT's oversight of INTELSAT, the United States earned a return on its contributions, which were principally in the form of revenues to INTELSAT. INTELSAT's revenues were derived primarily from utilization charges, and after deduction of operating costs, INTELSAT distributed the remainder of utilization revenues to its members. The cooperative tapped external financing markets in order to promote a higher rate of return on members' contributions.

Privatization Legislation

In March of 2000, Congress passed and President Clinton signed "The Open-Market Reorganization for the Betterment of International Telecommunications Act" (ORBIT) (Public Law-106-180). The legislation abolished the Communications Satellite Act of 1962 and privatized the intergovernmental satellite organizations, INTELSAT and Inmarsat.

Key Drivers of Privatization

At the time of COMSAT's creation, private parties were unwilling to take the large financial risks associated with establishing a global satellite communications system. However, significant technological and market changes led to multiple private sector service offerings and a robust competitive satellite telecommunications market. While initially, the foreign signatories to INTELSAT were government-owned entities (posts, telegraph, and telecom), the global trend toward privatization resulted in a majority ownership stake of INTELSAT by fully or partially privatized signatories. In addition, INTELSAT had realized its vision of creating a global satellite network. A final privatization catalyst was Lockheed Martin's desire to acquire a majority stake in COMSAT and its need to eliminate the statutory impediments to doing so.

Privatization Process

The COMSAT privatization process was completed in two phases. In the first phase in 1998, Lockheed Martin announced its intention to acquire COMSAT. Lockheed made a cash tender offer for 49 percent of the outstanding shares of COMSAT common stock valued at $1.2 billion and committed to a one-for-one stock exchange. The preliminary phase was completed in September 1999 following COMSAT shareholder approval and initial Federal Communications Commission (FCC) approvals within the limitations placed on common carrier ownership of COMSAT's stock under the Communications Satellite Act of 1962. Lockheed lobbied Congress to change the laws preventing it from completing the purchase.

In January 2000, the ORBIT Act repealed the Communications Satellite Act of 1962 and set in motion the privatization of INTELSAT.

Shortly after enactment of the ORBIT Act, Lockheed Martin filed an application with the Commission for transfer of control of COMSAT's FCC licenses and authorizations. In July 2000, the FCC authorized the transfer to COMSAT as a wholly owned subsidiary of Lockheed. In August 2000, Lockheed Martin purchased COMSAT for $2 billion. The value of the exchange of common stock was approximately $790 million. The transaction was completed via a one-for-one tax-free exchange of Lockheed Martin common stock for COMSAT common stock for the remaining 51 percent of COMSAT stock Lockheed did not own.

COMSAT was integrated with Lockheed Martin Global Telecommunications (LMGT), a wholly owned subsidiary comprising Lockheed Martin's telecommunications services business. The new business planned to offer services in the United States as LMGT and retain offshore COMSAT International operation designations.

In 2001, as a result of several years of losses suffered by Lockheed Martin's telecommunications arm, the company announced its intention to sell some of the components of the unit and absorb others into its remaining businesses. Some pieces of the former COMSAT have already been sold.

Historical Milestones

Year	Event
1961	President Kennedy calls for international satellite communications system.
1962	Congress passes Communications Satellite Act. The Communications Satellite Corp.
1965	COMSAT launches Early Bird, the first satellite designed for commercial communications.
1975	COMSAT joins IBM Corp. and Aetna Life & Casualty Co. to form Satellite Business Systems (SBS), a network for private data and television communications.
1984	COMSAT drops out of money-losing SBS after an investment of $250 million. COMSAT abandons plans to enter the direct broadcast satellite television market, which has 7 million customers.
1989	COMSAT acquires a majority share of the NBA's Denver Nuggets, an example of the company's move into the sports and entertainment industry.
1992	COMSAT President becomes CEO and increases the company's investment in entertainment. In July, COMSAT announces that its entertainment holdings lost $6.4 million for the quarter. CEO resigns and successor is named.
1999	COMSAT was acquired by Lockheed Martin Corporation.

Government Sponsored Enterprises: Fannie Mae, Freddie Mac, and Sallie Mae

Government Sponsored Enterprises (GSEs) are corporate entities created by law for important public policy purposes. Of all the various organizational formats/structures in place in the U.S. government (i.e. wholly owned corporations, independent agencies, etc.), GSEs are the furthest removed from government. GSEs are in essence hybrids — mostly private entities with certain special “governmental” benefits. During the last 30 years, several government entities have been transformed into or created as GSEs. In some cases, GSEs have been fully privatized to remove all governmental ties. While there is no strict “legal” definition of a GSE, the working definition of a GSE is an entity which has the following characteristics:[3]

[3] Budget Enforcement Act of 1990, sections 13112 and 13501. Also Moody’s Special Report, “U.S. Government Sponsored Enterprises (“GSEs”), October 1993. According to the Budget Enforcement Act of 1993, GSEs include Fannie Mae, Freddie Mac, Farmer Mac, the Federal Home Loan Banks, Sallie Mae and the Federal Farm Credit Banks. Though TVA is often listed as a GSE, it is a wholly-owned government corporation, though its debt is not explicitly backed by the U.S. Government.

- A federal charter;
- Private ownership, as evidenced by capital stock owned by private entities or individuals;
- Governance by a board of directors, a majority of whom are elected by shareholders;
- Is a financial institution authorized to make loans or loan guarantees for limited purposes (credit for specific borrowers or one sector) and raise funds by borrowing (without a government guarantee) or to "guarantee the debt of others in unlimited amounts";
- Does not exercise powers reserved to the U.S. government as a sovereign (power to tax, regulate commerce);
- Does not have the power to commit the government financially;
- Has employees who are paid by the enterprise and are not Federal employees subject to Title 5 of the U.S. Code.

Following is a description of Fannie Mae, Freddie Mac, and Sallie Mae. Fannie Mae and Freddie Mac are two GSEs created through the "privatization" of existing government entities. Sallie Mae was created de novo as a GSE and then fully privatized.

Fannie Mae

Overview

Fannie Mae (The Federal National Mortgage Association) is a federally chartered and stockholder-owned GSE. Fannie Mae's public mission is to increase the liquidity and stability of the U.S. residential mortgage market and to help increase the availability of mortgage credit to low and moderate income families and underserved areas. Fannie Mae and its main competitor, Freddie Mac, are the largest investors in home mortgage loans in the United States. Fannie Mae's current market capitalization is approximately $80 billion.

Background

During the 1930s, few new mortgage loans were being made because of the uncertain economic conditions during the Great Depression. Thrift institutions, which were the principal mortgage lenders, were failing in large numbers and foreclosure rates were high because unemployed workers were no longer able to meet their loan commitments. In 1934, the federal government addressed the lack of mortgage credit availability and other problems in the mortgage market by enacting, among other initiatives, the National Housing Act (NHA). The NHA established a system of federal insurance for qualified home mortgage loans. Under the NHA, the new Federal Housing Administration (FHA) was authorized to guarantee repayment of up to 90 percent of acceptable home loans, encouraging private lenders to lend more of a home's market value, accept longer terms on home mortgages, and charge lower interest rates.

In passing the NHA, Congress hoped that a system of private secondary market associations would develop to bring the benefits of lower capital costs to home buyers. In the ensuing years, no such organizations formed and in 1938 the President asked the Reconstruction Finance Corporation (RFC) to form one as a subsidiary. It was chartered as the National Mortgage Association, which soon changed its name to the Federal National Mortgage Association (FNMA).

Fannie Mae remained an RFC subsidiary until 1950, when it was transferred to the Housing and Home Finance Agency. Structured as a government corporation, it was only permitted to buy and sell mortgages insured by the FHA. Fannie Mae funded its activities through the Treasury and the national capital markets.

In 1954, Fannie Mae was restructured because Congress wanted it to act more as a conduit than a holder of loans. As part of the restructuring, Fannie Mae began liquidating its mortgage portfolio. The 1954 Act also transformed Fannie Mae into a mixed-ownership corporation (with a combination of government and private ownership) and provided for its gradual transfer to private ownership. The Treasury Department's stock became preferred stock. Firms selling mortgages to Fannie Mae were required to purchase nonvoting common stock which could be resold to the public. The Secretary of Treasury determined the dividends to be paid into the Treasury by Fannie Mae. Fannie Mae could issue its own debt, but with no explicit federal backing. The Fannie Mae Board was comprised of five members. The Housing and Home Finance Administrator served as the chairman and he appointed the other board members who were Fannie Mae or other government employees.

Privatization Legislation

In February of 1968, President Johnson sent a "Message on Cities" to Congress, in which he requested passage of a variety of urban-aid initiatives. Among them were amendments to Fannie Mae's charter designed to "transfer the secondary mortgage market operations of Fannie Mae on an orderly basis to completely private ownership." Later that year, President Johnson signed the congressionally enacted legislation and Fannie Mae was established as a private, shareholder-owned company.

In 1992, Congress amended Fannie Mae's charter to reaffirm and clarify its role in the housing finance system. The 1992 Act also established a safety and soundness regulator for Fannie Mae and Freddie Mac (the Office of Federal Housing Enterprise Oversight) and gave the Department of Housing and Urban Development (HUD) the responsibility of regulating Fannie Mae and Freddie Mac's mission requirements. The Act established capital rules and affordable housing goals for both GSEs.

Key Drivers of Privatization

The macroeconomic disruptions of the late 1960s significantly diminished the flow of credit from traditional lenders to housing. In order to increase the availability of mortgage credit, Fannie Mae was granted the authority to begin purchasing conventional loans (non-FHA/VA). This resulted in significant additional mortgage purchase activity. Under new unified budget rules passed in 1967, Fannie Mae's mortgage purchases were to be counted as budget outlays. By establishing Fannie Mae as a privately owned corporation, these mortgage purchases were kept off-budget. As such, Federal budget reforms were also a key reason for splitting up Fannie Mae and structuring part of it as a GSE.

Privatization Process

The transfer to private ownership was completed by dividing Fannie Mae into two parts: a privately owned corporation (which retained the name Federal National Mortgage Association), and a new government corporation, the Government National Mortgage Association (Ginnie Mae) within the Department of Housing and Urban

Development. The new Fannie Mae thus became a GSE with a narrowly defined mission. Ginnie Mae became responsible for bolstering the secondary market for special housing programs and liquidating Fannie Mae's remaining mortgage portfolio.

The 1968 charter amendments provided that Fannie Mae would assume responsibility for its own management after a transitional period, which could end at any time on or after May 1, 1970. This could not occur, however, until the board of directors found, with the concurrence of the Secretary of HUD, that at least one-third of Fannie Mae's common stock was owned by persons or institutions in the mortgage lending, home building, real estate or related businesses. In February of 1970, the board of directors made this finding and the transitional period was declared at an end. The board was then restructured to consist of 15 persons, 10 elected annually by the stockholders and five appointed by the President of the United States.

Pursuant to the legislation, Congress sold the government's remaining interest in Fannie Mae. Fannie Mae paid the Treasury $216 million for the government's preferred stock and its other interests using proceeds from the sale of subordinated debentures. The preferred stock was retired and Fannie Mae was taken off the federal budget. In 1970, Fannie Mae stock was listed for trading on the New York Stock Exchange making its transformation to private shareholder ownership complete. Fannie Mae's earnings are exempt from state and local income tax but it does pay federal income tax.

Privatization Lessons

Federal budget imperatives often provide a compelling rationale for privatization. In this case, Fannie Mae's privatization demonstrated that by using the GSE model, a government entity could be privatized and moved off-budget while retaining a number of valuable government related characteristics as well as a public mission where the value of the GSE status can accrue to private shareholders.

Historical Milestones – Fannie Mae

Year	Event
1934	Federal government creates National Housing Act, forming a system of federal insurance for qualified home mortgage loans.
1938	Fannie Mae established under New Deal program. Initial purpose was to provide liquidity and bring stability to residential mortgage market and to ensure that funds for housing would be available on a continuing basis. Incorporated under Title III of the National Housing Act. Wholly owned government corporation. Borrows operating funds directly from Treasury. Purchases and resells mortgages insured by FHA.
1948	Fannie Mae begins to purchase and resell mortgages insured by Veterans Administration.
1950-65	Fannie Mae acts as constituent agency of Housing and Home Finance Agency.
1965-68	Fannie Mae operates under Department of Housing and Urban Development.

Historical Milestones – Fannie Mae

Year	Event
1968	Charter Act (the "Act of 1968") enacted. Allows Fannie Mae to: Conduct secondary market operations in FHA/VA insured home mortgage loans; Perform "special assistance functions" in the purchase of mortgage loans as authorized by the President or Congress to assist in financing home loans in instances where established home financing facilities were inadequate; Manage and liquidate certain mortgage loans. President Johnson requests transfer of the secondary market functions of Fannie Mae to "private ownership". Congress passes Act of 1968: Splits old Fannie Mae into Government National Mortgage Association ("Ginnie Mae") and today's Fannie Mae; Changes each share of outstanding non-voting common stock (old par value of $100 per share) into one share of voting common stock; Shares authorized to be sold to public; transitional period given to allow for public control of Fannie Mae; all federal ownership of Fannie Mae is removed.
1969	Emergency Home Finance Act expands Fannie Mae's purchase authority to include conventional mortgages (i.e., those mortgages without a federal guarantee).
1970	Fannie Mae shares listed on NYSE.
1989	Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") gives General Accounting Office ("GAO") authority to audit Fannie Mae.
1992	Office of Federal Housing Enterprise Oversight created as part of HUD to oversee Fannie Mae and Freddie Mac.

Freddie Mac

Overview

Similar to Fannie Mae in its structure and mission, Freddie Mac (The Federal Home Loan Mortgage Corporation or FHLMC) is a federally chartered and stockholder-owned GSE. Established in 1970, Freddie Mac's public mission is to increase the liquidity and stability of the U.S. residential mortgage market and to help increase the availability of credit to low and moderate income families and underserved areas. Freddie Mac purchases, guarantees, and securitizes conventional residential mortgages. Though today Fannie Mae and Freddie Mac's businesses are almost identical (though Freddie Mac's balance sheet is roughly two-thirds the size of Fannie Mae's), Freddie Mac was originally mandated to establish a secondary market for conventional residential mortgages, while Fannie Mae was charged with creating products and services to facilitate home ownership, as well as purchasing and providing a secondary market for FHA/VA mortgages. Freddie Mac's current market capitalization is approximately $45 billion.

Background

As Fannie Mae proceeded with its mission of providing a secondary market for FHA and VA mortgages, it became apparent throughout the 1950s and 1960s that a secondary market for conventional mortgages was also needed. The thrift industry launched a limited attempt to develop such a market in a partial effort to correct the regional imbalances in mortgage money supply and demand. However, this activity was confined mostly to private sales of mortgages by one savings and loan association to another.

By 1970, the U.S. economy was experiencing a new round of inflation, which pushed FHA mortgage rates to the almost unheard level of 8.5 percent. The housing industry and aspiring homebuilders were caught in a situation where the Federal Reserve Board was attempting to discourage borrowing in order to control inflation. Despite a record number of housing starts in 1969, the country was 2.5 million units behind projected production by the early 1970s. In the meantime, mortgage lenders (mainly savings and loan associations) were unable to generate a sufficient number of new loans because of Federal Reserve Board policies to discourage such borrowing. Public and industry pressure began to mount for President Nixon and the Democratically controlled Congress to alleviate the effects of inflation and rising interest rates on the housing industry.

Both the Administration and members of Congress realized that a robust secondary market for conventional home mortgages was required, and they advocated legislation to create a “facility” that would handle such mortgages, either in the Federal Home Loan Bank system or Fannie Mae. Both the Nixon Administration and members of Congress had proposed separate legislation for this purpose, and the concept was incorporated into the housing bill compromise, with both the House and Senate passing nearly identical secondary market provisions.

All the major components of the housing and thrift industries supported expansion of the secondary market. The Federal Reserve Board opposed conventional mortgage purchase authority for Fannie Mae because it would increase the costs and risks to Fannie Mae of purchasing mortgages that had no federal backing, but the Federal Reserve Board’s view on this and other matters was ignored by elected officials and constituencies angry with the Federal Reserve Board over its existing monetary policies.

The Emergency Home Finance Act (the Act), passed in 1970, established another secondary mortgage market entity, the Federal Home Loan Mortgage Corporation (FHLMC, later Freddie Mac). The FHLMC was placed under the direction of the Federal Home Loan Bank Board, which was also the federal regulator for savings and loan institutions. Freddie Mac’s mission was to relieve the often-chronic regional mismatch between savings deposits and demand for mortgage credit by creating a national secondary market for conventional mortgage loans.

Privatization Legislation

In 1989, Freddie Mac’s governance structure and operations were altered significantly under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), a sweeping overhaul of federal laws governing savings and loan institutions. FIRREA was prompted by the massive failure of hundreds of savings institutions in the early to mid-1980s. Among other things, FIRREA eliminated and shifted the functions of Freddie Mac's umbrella agency, the Federal Home Loan Bank Board, and spun Freddie Mac off on its own, on equal footing with Fannie Mae. Freddie Mac's three-member board (the Federal Home Loan Bank Board) was replaced with an eighteen member Board of Directors with thirteen elected annually by shareholders and five annually appointed by the president. Like Fannie Mae, Freddie Mac's earnings were exempt from state and local income tax, though not from federal income tax.

In 1992, Congress amended Freddie Mac's charter to reaffirm and clarify its role in the housing finance system. The 1992 Act also established a safety and soundness regulator for Fannie Mae and Freddie Mac (the Office of Federal Housing Enterprise Oversight) and gave the Department of Housing and Urban Development (HUD) the responsibility of regulating Fannie Mae and Freddie Mac's mission requirements. The Act established capital rules and affordable housing goals for both GSEs.

Key Drivers of Privatization

In the wake of the thrift crisis, The Federal Home Loan Bank Board — the thrift industry's main regulator — was blamed for fostering a lax regulatory environment that allowed thrifts to operate in an unsafe and unsound manner. Inherent conflicts in the mission and structure of the Bank Board often placed it in a position of being both industry regulator and advocate. Freddie Mac was wholly owned by the Federal Home Loan Banks and its members, and the Bank Board was Freddie Mac's Board of Directors and regulator. Congress sought to eliminate these various conflicts by dissolving the Bank Board and restructuring Freddie Mac to be a GSE in the same form as Fannie Mae. In addition, Freddie Mac's restructuring in FIRREA took it off the federal budget.

Privatization Process

When it was established in 1970, Freddie Mac was granted initial maximum capital stock of $100 million. Initially, Freddie Mac stock was held by the twelve Federal Home Loan Banks (which were in turn owned by member thrifts). Freddie Mac's ownership was broadened in 1984 when the thrifts were allowed to recognize their ownership interest on their books. The 1989 FIRREA legislation simply converted the 60 million shares of Freddie Mac non-voting, senior participating preferred stock into voting common stock and removed the law's provisions restricting ownership of FHLMC stock to FHLB member institutions.

Lessons

As in the case of Fannie Mae, Freddie Mac's transformation to a GSE demonstrated that by using the GSE model, a government entity could be effectively privatized but still retain a number of valuable government-related characteristics along with a public mission where the value of the GSE status can accrue to private shareholders. A legislative response to a crisis (in this case the thrift debacle) often provides the opportunity to enact significant changes which might not be politically feasible during more prosperous times.

Historical Milestones – Freddie Mac

Year	Event
1970	Compromise housing legislation, "Emergency Home Finance Act of 1970", enacted by Nixon Administration and Congress to alleviate housing shortage: Establishes Freddie Mac under direction of FHL Bank Board; Sets goal for creation of national secondary mortgage market; Gives initial capital of $100 million to Freddie Mac; Empowers Freddie Mac to buy, hold, and sell mortgages; Allows Freddie Mac to borrow funds and issue mortgage obligations; Freddie Mac is initially federal tax exempt.
1984	Deficit Reduction Act of 1984 repeals Freddie Mac's federal tax exemption.
1989	Financial Institutions Reform, Recovery and Enforcement Act splits Freddie Mac from FHLBank Board. Freddie Mac shares begin to be actively traded on NYSE.

Sallie Mae

Overview

Sallie Mae was established in 1972 as a federally chartered stockholder-owned GSE to provide liquidity for federally insured student loans made by lenders (including educational institutions) under the Guaranteed Student Loan Program, (now known as the Federal Family Education Loan Program or FFELP).

Sallie Mae provides financial and related operational and technological services to participants in the nation's education market. Sallie Mae makes a secondary market in education loans and provides secured advances, as well as operational support, to originators of such loans. It is the largest single source of financing for loans originated under the FFELP. Sallie Mae is also the largest servicer of education loans, administering loans for its own account, as well as for many of its client loan-selling institutions. In addition, Sallie Mae provides other educational-related financial services such as financing for colleges and universities for academic plant and equipment.

Sallie Mae's secondary market activities generally involve the direct purchase of guaranteed student loans by the corporation as well as issuance by the corporation of commitments to purchase student loans in the future. Warehousing operations involve the making of loans, called "warehousing advances," to lenders, collateralized at 100 percent by student loans, U.S. Treasury or agency securities, or other acceptable collateral. Sallie Mae also offers credit support to state agencies that make or buy educational loans, providing, for example, letters of credit which lend the highest investment grade rating to the agencies' student loan revenue bond issues. Sallie Mae competes directly with the federal government's direct lending program (resurrected in 1993) for a share of the federally-backed student loan market.

Background

Congress approved the first federal aid to higher education in 1867 by creating land grant colleges. Until 1950, programs of federal aid to higher education remained targeted on vocational education and aid to veterans. During the 1950s and 1960s, Congress enacted a variety of higher education aid programs to assist the large number of World War II and Korean War veterans, and later, the post-World War II "baby boom" generation that entered college in the mid-1960s. The federal government began making direct education loans to students in 1958. The most important of the higher education programs, popular among veterans and middle-income families, who aspired to higher education for their children in ever increasing numbers, were authorized by the National Defense Education Act, the Higher Education Facilities Act, and the Higher Education Act of 1965.

While public desire for a college education was expanding dramatically, colleges and universities were attempting to accommodate greater numbers of students through increased admissions. However, these institutions were finding it difficult to provide the same level of financial aid to deserving students than had been possible when fewer students were seeking college admission. As a result, many colleges and universities were experiencing significant financial troubles and sought the expansion of federal higher education assistance programs. Sallie Mae was thus created.

Sallie Mae's enabling legislation provided for a 21-member Board of Directors, 14 of whom were elected by shareholders. The remaining seven were appointed by the President of the United States, who also designates the Chairman of the Board from among the 21 directors. Sallie Mae voting stock was issued to qualified Guaranteed Student Loan Program lenders and educational institutions. The legislation also provided initial financial support for Sallie Mae by authorizing appropriations of up to $5 million for start-up operations through the Department of Health, Education and Welfare. The government also gave Sallie Mae debt a full faith and credit guarantee until 1984. Sallie Mae never received the direct appropriations but did issue government guaranteed debt securities in the capital market until 1975. From 1975 to 1982, Sallie Mae issued debt through the Federal Financing bank under a Department of Education guarantee. In 1981, Sallie Mae began issuing nonguaranteed debt and stopped issuance of explicitly guaranteed debt altogether in 1982. In 1992, amendments to the Higher Education Act converted all outstanding Sallie Mae equity classes to unrestricted voting common stock.

Although like other GSEs, Sallie Mae enjoyed an implicit government guarantee that allowed it to borrow at lower rates than private sector entities, Congress singled out Sallie Mae in trying to mitigate the value of the GSE funding advantage. In the Student Loan Act of 1993, Congress imposed on Sallie Mae an "offset fee" equal to 30 basis points of the "principal amount of each loan made, insured or guaranteed".

Privatization Legislation

On September 30, 1996, President Clinton signed The Student Loan Marketing Association Reorganization Act of 1996 (20 U.S.C. 1087-3) authorizing Sallie Mae to restructure itself as a fully private, state-chartered corporation.

Privatization Process

Pursuant to the privatization legislation, Sallie Mae's board of directors developed a plan for full privatization that was submitted to and approved by Sallie Mae shareholders. The common shares of the Student Loan Marketing Association (the GSE) automatically were converted, on August 7, 1997, on a one-for-one basis to shares of SLM Holding Corp., a Delaware-chartered corporation, with a 15-member shareholder-elected Board of Directors. Simultaneously, the GSE became a wholly owned subsidiary of SLM Holding Corp. SLM Holding Corp. was renamed USA Education, Inc. on July 31, 2000. The 1996 Act requires the GSE to wind down its operations and be liquidated no later than September 30, 2008. Under legislation passed in 1998, if USA Education, Inc. affiliates with a depository institution, the GSE must wind down within two years (unless extended by the Secretary of Treasury). Sallie Mae recently announced that it will wind down the GSE two years ahead of the 2008 deadline.

Lessons

Sallie Mae's establishment as a GSE and its privatization 24 years later showed that legislation can be structured to provide a transition to GSE status as well as a complete separation from the government. Sallie Mae's charter provided direct financial support in the form of appropriations authority and a full faith and credit guarantee on its debt for up to 10 years after its creation. The 1996 privatization legislation provided a 10-year phase out of its GSE status.

Historical Milestones – Sallie Mae

Year	Event
1971	Senate and House subcommittees consider extending higher education assistance programs.
1972	Nixon Administration proposes Higher Education Opportunity Act and Congress/Senate pass legislation: Authorizes additional funds for education; Creates Sallie Mae and gives federal government backing of Sallie Mae until 1982; Allows Sallie Mae to borrow from Federal Financing Bank; Sallie Mae issues voting common stock to qualified Guaranteed Student Loan Program lenders and educational institutions.
1980	Education Amendments of 1980 broadened Sallie Mae's product and financing capabilities. Authorized non-voting common stock.
1982	Agreement reached in 1981 that allowed Sallie Mae to borrow outside of Federal Financing Bank once $5 billion in total borrowings reached; $5 billion level reached in 1982. Sallie Mae Technical Amendments Act reassures private lenders that they would have chance to get their money back in unlikely case that Sallie Mae went bankrupt.
1993	The Higher Education Amendments Act of 1992 allows Sallie Mae to convert all of unrestricted voting and unrestricted nonvoting common stock into single new class of unrestricted voting common stock on a share for share basis.
1994	Clinton Administration enacts direct student lending program.
1995	Sallie Mae announces intention to become a "fully privatized" institution.
1996	Student Loan Marketing Association Reorganization Act of 1996 mandates full privatization of Sallie Mae and phase out of GSE.

COMPARISON OF GSES' LINKS TO THE GOVERNMENT

	Fannie Mae	Freddie Mac	Sallie Mae
Chartered by Congress	Yes	Yes	Yes
Ownership	Private	Private	Private
President or presidential appointees appoint some board members	Yes	Yes	Yes
Treasury lending authorized	$2.25 billion	$2.25 billion	$1.0 billion
Treasury approval of debt issuance	Yes	Yes	Yes
Eligible for Fed open market purchase	Yes	Yes	Yes
Use of Fed as fiscal agent	Yes	Yes	Yes
Eligible to collateralize public deposits (all U.S. Government; most State and local)	Yes	Yes	Yes
Exempt from SEC registration (1933 Act)	Yes	Yes	Yes
Government securities for purposes of the Securities Exchange Act of 1934	Yes	Yes	Yes
Eligible for unlimited investment by national banks and State bank Federal Reserve members	Yes	Yes	Yes
Eligible for unlimited investment by thrifts regulated by FDIC or OTS	Yes	Yes	Yes
Exemption of corporate earnings from Federal income tax	No	No	No
Exemption of corporate earnings from State and local income tax	Yes	Yes	Yes
Exemption of interest paid from State income tax	No	No	Yes
Subject to GAO audit	Yes	Yes	No
Federal regulator	OFHEO and HUD	OFHEO and HUD	Treasury