THIS ENTIRE TREASURY PLAN IS THE MBA's 2009 PLAN & ONGOING CORKER PLAYBOOK. SMELLING LIKE A NEW KEATING 5 SCANDAL.



**Transition Options - Potential Near and Medium Term Transition Steps**

This is identical to MBA plan from 09 & Corker Warner

**End State Objectives:**

- Government to provide net worth support to government-owned Securitization Utility so as to provide liquidity, standardization, efficiency, and FDIC-like tail risk insurance to residential mortgage backed security market
  - Explicit guarantee by government-owned Securitization Utility of securities to end investor
  - The utility to be subject to national [FHFA] regulatory oversight
- The first loss and most of the credit risk shall be taken by the private sector through well-capitalized First-Loss Providers (FLPs)
  - FLPs will be subject to rigorous counterparty assessments from the securitization utility and also will be subject strong prudential regulation [FHFA]
- Securitization Utility and FLPs to be subject to same capital (Basel III) and supervision standards as banking sector, so as to create level playing field and minimize distortion
- Strong regulation/governance
- Increased transparency and better availability of data

Known & willful violation of HERA, even CSP and single security likely violate conservation of assets

**Legal Constraints:**

- FHFA mandate is to "conserve assets" while the GSES are in conservatorship
- Treasury has to approve any asset sales and other actions out of the ordinary
- Existing legislation, HERA, fos1992 Act, [FIRREA], [FHLB Act], and other non-GSE specific legislation
- Incremental amounts available under the PSPAs after 2012 limited to $275 billion
- More work remains to evaluate constraints to Treasury and FHFA action. Follow-up document to come

**Potential actions which could be taken in the short and intermediate terms [1]:**

1. **Clear plan for ending FNM and FRE in their current form: Corporate Reorganization**
   - GSEs could be restructured into three distinct corporate entities, a credit enhancement/mortgage insurance entity, a securitization utility, and a "bad bank"
   - Even before new corporate entities are established, the GSEs can start engaging in internal cost accounting and management organizational changes
   - Consider additional asset sales of non-core businesses and outsourcing non-core functions to third-party contractors
   - Management retention to ensure that human capital does not flee the GSEs
     - Clear communication with management about the transition path
     - Structuring of appropriate retention packages
   - *Note: A complete reorganization may require FHFA to trigger receivership*

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[1] Note – these actions are for brainstorming purposes only and are subject to legal review. FHFA as conservator would need to determine what was most appropriate for their mandate as prudential regulator and conservator of the GSEs while in conservatorship.

a. **Credit Enhancement/Mortgage Insurance Entity**
    i. Timeline
        1. [Within 6 months] – FHFA lays out detailed restructuring plan
        2. [1 year] - Human capital and physical infrastructure from FNM and FRE's credit analysis teams contributed to newly formed subsidiary ("GMIE")
        3. [3-5 years] - GMIE is either sold to private MI or taken public
            a. Once sold, these businesses will become fully private, receiving no government support and would not be attached to the existing charters
            b. GMIE(s) will be subject to ongoing regulation by [FHFA]
            c. Proceeds from the sale of this business will be returned to the taxpayer and help the process of recouping losses
            d. Potentially maintain some level of legacy debt/obligation/tax to repay assistance which was provided by the taxpayer
    ii. Consider transforming multifamily businesses into dedicated multifamily guarantors that could also be privatized as separate entities

b. **Securitization Utility** will be a separate division, clean of all legacy assets and liabilities of the old FNM and FRE
    i. Will retain keep-wells from the old FNM/FRE (or other form of support from the Treasury) to ensure that investors will be made whole on the securities that they purchase
    ii. Retains the charters from the old corporate entities
    iii. Timeline
        1. [6 months] – FHFA lays out detailed restructuring plan
        2. [1 year] - Human capital and physical infrastructure from FNM and FRE's securitization teams contributed to newly formed subsidiary
        3. [1.5 years] – FNM wraps all of FRE's securities to increase liquidity in the market and begin migration to a single security and TBA market
        4. Post-legislation: FNM and FRE securitization utilities will be merged with GNMA

c. **"Bad bank"** consisting of retained portfolio, legacy guaranty liabilities and 3rd party debt (equivalent of discontinued ops from accounting and management function)
    i. Bad bank will continue as a division of the securitization utility, so as to retain support of PSPAs
    ii. Timeline
        1. [3 months] – Operational plan of how to split up legacy assets
        2. [within 1 year] – clear timetable established for rundown and establish method for disposition
            a. Option 1: legacy assets remain in FNM and FRE corporate shell and employees are given retention packages to manage the unwind
            b. Option 2: Private money manager (e.g. PPIP-like manager) is contracted out to manage the assets and oversee the unwind



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            c. Option 3 (could occur in either of above scenarios) Consider structured sale to ensure taxpayers retain some equity-like upside
        3. [within 2 years] – Consider other block asset sales
            a. NPLs, REO, etc.
            b. These sales would potentially realize a loss
        4. [within 2 years] - In order to ensure that Bad Bank is adequately capitalized for all future net worth deficiencies, consider revaluing full portfolio to disposition value – this would set the stage for faster recovery in value and could push more inventory of credit through resolution process

d. Consolidation of other assets
    i. Consider managing certain assets of FNM and FRE jointly (REO, etc) to realize economies of scale
    ii. Potentially merge management of retained portfolios and bad bank assets

e. [Accounting / Fiscal Consolidation]
    i. Mark to market accounting
    ii. USG accounting treatment

**2. Steps to Privatize the Mortgage Market**

- The Administration is committed to privatizing the mortgage market.
- Transition should be managed at a measured pace that does not disrupt the still fragile housing market recovery

a. Capital standard changes
    i. Work with Fed to establish new risk-weighting for mortgage assets which are consistent w/ Basel III, where higher LTV mortgages require a greater capital charge.
    ii. Capital standards and g-fees become enforcement mechanisms for new "conforming" loan standards
    iii. The desired end state is 300-400 basis points of capital, which implies a 70-100 basis point g-fee. This capital level will be a floor if Basel implies lower required capital levels.

b. Pricing Changes
    i. Slowly phase in Basel III capital requirements over a [5] year time period to the credit enhancement entities by raising G-fees to private market levels
        1. Consider different mechanisms/triggers for price increases to ensure that fragile housing markets are allowed to continue to heal
            a. [No pricing/capital changes will occur before [4] consecutive quarters of national house price increases]
    ii. Allow credit enhancement entities to implement more highly differentiated LLPAs pricing to allow true credit risk pricing – including differences between states to capture the differences in the foreclosure process across state lines.

c. Credit Risk Syndication
    i. Slowly lower government attachment point to bring more equity into housing finance system from private sector – either through down payment



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at borrower level or other forms of credit enhancement at financing level, such as increasing amount of PMI or syndicating risk to capital markets through cat bonds, CMOs or other method

d. Encourage Other Private Sector Participation
    i. Establish clear guidelines and incentives for private mortgage insurers to opt into [FHFA] regulation to gain access to the securitization utility and encourage additional entities to enter the market to provide credit protection

**3. Taxpayer recoupment**

Potential methods for taxpayer recoupment of their investment in FNM and FRE

a. Increase g-fee on new originations
b. Disposition of non-core assets, such as multifamily, shared services, etc.
c. Better than expected disposition of REO through realizing economies of scale of consolidation and NPL disposition
d. Sale of credit enhancement entities to the private markets
e. Residual fee – RTC like solution of a [10] basis point tax on the securitization utility

**4. FHA and FHLB Reform**

Reforms to ensure FHA and the FHLBs do not become the cheapest sources of funding for mortgages

a. FHA, limit footprint through:
    i. Pricing/required ROEs - price FHA to be competitive to private market with some level of required return or market matched pricing
    ii. Restrict eligible borrowers (FHA credit box)
b. FHLBs – limit level of advances which can be made available to banking sector
c. Consider other "non-core" reforms
    i. FHA - governance changes
    ii. FHLBs – single district membership

**5. Increase Transparency**

a. Establish central mortgage data repository where both GSEs [and other mortgages insurers] are required feed data into and all members of the private sector have access to the data – (work with OFR)

**6. Servicing**

a. Establish true "master servicing" and fee for service model to help eliminate misalignment of incentives in the servicing industry and eliminate problems associated with MSRs
b. Securitization Utilities would only wrap loans where the master servicing in a fee for service model sits with the entity that held that first loss credit risk
c. If entire market switched to fee for service model, "fee for service securities" would become TBA eligible.

**7. Consider other initiatives to reform the mortgage contract and embed best practices further into the system**

**a.** Standardized mortgage contracts with binding arbitration
**b.** Simple terms and fact sheets for consumer protection



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**<u>Key Questions/Open Items for Further Exploration:</u>**

- What should be done with the multifamily businesses of the GSEs?
- Can the dividends be adjusted such that we are not drawing to pay ourselves?
- Are there restrictions on where the charter can sit and what entities the charter will be tied to upon emergence from receivership?
- Further exploration of the opportunities for public/private partnerships to sell some of the retained portfolio assets to ensure that the taxpayers retain some equity-like upside in the deal.
- Can the commitment fee be set such that it is equal to the positive net income from the GSEs in every year in the future?
- More detailed modeling work around taxpayer recoupment
    - What is the appropriate fee the securitization utility should charge to raise money, but not price itself out of the market?
    - Over what time horizon will taxpayers be paid back?
        - RTC was set as a 30yr bond, but paid back in 20 years, which was palatable.
- Are there alternative ways to capitalize/pre-fund the newly constituted "good" entities?
- How will we ultimately merge the FNM and FRE securitization utilities into GNMA?



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**PSPA Modification: Key Points To Make**

- The Administration remains committed to winding down the GSEs in an orderly and financially prudent fashion.

- ~~Given this commitment and the recent stabilization of the GSEs' financial profile,~~ Wwe believe it is an appropriate time to restructure the financial support agreements Treasury has with the GSEs (the PSPAs) to simplify the arrangements and preserve operating support capacity.

- We are in the process of working with the FHFA to modify the dividend Treasury earns on its preferred stock investment. The current fixed 10% dividend rate will be changed to one where the GSEs will pay to Treasury the net income they earn over time as they are wound down.

- This is important for a number of reasons:

  --It means the taxpayer will benefit from all future earnings of the GSEs Under the current framework we are limited to the 10% dividend

  Contrast "all" with "limited" & it's clear Ugoletti &DeMarco lied & UST exceeded authoroties

  --It will stop the circular process of the GSEs drawing on Treasury PSPA support in order to pay dividends back to Treasury

  BINGO!!! They had a specific rationale and it was to violate authority and powers of FHFA as conservator

  --This creates a binding contractual obligation requiring the GSEs to pay all earnings to the Treasury. Dividends, by contrast, are discretionary; the Board must declare a dividend, which can only be paid if the GSE is profitable.

  ~~At the end of 2012 any future support of the GSEs from the PSPA will be capped at $200 billion.~~

  --Future PSPA draws will only be made in the event that the GSEs have operating losses.

  --It is consistent with our commitment that the GSEs will not return to their past form.

- The agreement is expected to be finalized later this year, but has been agreed to in principle by both Treasury and FHFA

  We believe the taxpayers will be in a better position to benefit from any GSE profits as they are wound down.

In no way does this change impact our pledge to stand behind these institutions' ability to meet their commitments.

**Question & Answers**

- *Why are you doing this now?*
  - As the Enterprises begin their transition process (per FHFA's strategic plan), we wanted to make it clear ~~to the markets and the housing community [or should we say home owners?]~~ that future PSPA capacity would not be used to fund dividends back to Treasury and that the GSEs pay any and all profits back to the taxpayer.
- *Is the taxpayer in a worse off position?*
  - No – they are in a better position. Under the current arrangement Treasury's upside was capped at the 10% dividend, now the taxpayer will be the beneficiary of any future earnings produced by the GSEs. Also, the GSEs would be making a binding contractual commitment to turn over profits to taxpayers, as opposed to the current discretionary dividend.
- *Did the year end 2012 expiration of Treasury's ability to provide unlimited support to the GSEs factor into this decision?*
  - As we have always said, "we stand behind these institutions so they can meet ~~[all of]~~ their commitments" and continue to fulfill their important mission
  - Taking this step now is a clear sign the Treasury is fully committed to supporting these organizations as they transition
- *Is the remaining PSPA capacity enough to support the GSEs after 2012? Should investors be worried?*
  - As we have always said, "we stand behind these institutions so they can meet their commitments"

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- ~~*Is the tax payer in a worse off position?*~~
  - ~~No – they are in a better position. Under the current arrangement Treasury's upside was capped at the 10% divided, now the tax payer will be the beneficiary of any future earnings produced by the GSEs~~

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- *Will there be other modifications to the PSPAs?*
  - None are contemplated at this time

# PSPA Next Steps

### *Term Sheet: Recommended Changes*

| Proposed Change | Details |
|---|---|
| Modify 10% Dividend To A Net Worth Sweep | • Quarterly dividend payments starting in [2013] will equal the Net Worth of the GSE (i.e. GAAP Assets *less* Liabilities at quarter end) *less* a predefined Capital Reserve<br>• The Capital Reserve will equal [$3.0B] between [January 2013 - December 2017], after [December 2017] the Capital Reserve will fall to $1.0MM |
| Accelerated Retained Investment Portfolio Reduction | • The mandatory "run off" factor for the retained investment portfolios will be increased from 10% per annum to 15% until such time that the GSEs portfolios reach a target $250B balance<br>• A 15% requirement results in meeting the $250B target in 2018 vs. 2022 (with the 10% run off factor)<br>• On an annual basis, each GSE will submit a plan to Treasury detailing how they will take steps through their portfolio wind down to reduce their financial and operational risk profile |
| Annual Plan To Treasury Detailing Steps To Be Taken To Reduce The Risk Profile Of Mortgage Guarantee Business | • On an annual basis each GSE will submit to Treasury a pla[n] that details the steps they will take in the coming year to reduce the risk profile associated with their mortgage guarantee business<br>• The plan should cover their expected usage of credit risk syndication, new forms of mortgage insurance and other risk management steps that will protect the tax payer from future credit losses at the GSEs |

REQUEST THESE DOCUMENTS. ARE THEY IN THE UST DOC LISTS IN COURT?

### *Timing*

Announce the change in mid August after each GSE releases "record" second quarter earnings

- *Earnings will be in excess of current 10% dividend paid to Treasury*
- Record earnings will be driven by large credit loss reserve release

UST as a commercial actor/ investor had material non-public info & acted on it to their sole benefit

### *Rationale*

- The changes will reduce the risk of potential financial market uncertainty and volatility
- The changes protect the taxpayer
  - Taxpayer will now benefit from all future earnings at the GSEs
  - GSEs will need to take pro-active steps to reduce their risk profile
- The GSEs will be wound down faster and will not return to their past state
  - GSEs will not be allowed to build capital and exit conservatorship in their prior form
  - Faster portfolio reduction could help encourage NPL sales to entities that are more aggressive in writing down principal for troubled homeowners

# PSPA Covenant and Timing Proposal: July, 30 2012

***The Treasury housing team recommends finalizing the PSPA agreement changes next Friday. Key elements of the plan are:***

**Form and adjustments to the existing agreement**

- Finalized and signed changes to the PSPAs to be completed prior to public announcement
- Adjustments to the existing PSPAs
  1. Change 10% dividend to net worth sweep
     - Include a [$2-4B] buffer through year end 2018
  2. Increase the investments portfolio reduction rate from 10% to 15% per annum and require each GSE submit an annual plan to Treasury highlighting how the will reduce their financial and operational risk in conjunction with the reduction
     - This will result in the portfolios reaching their mandated $250B target in 2018, rather than 2022
     - Enables Treasury to have a more pro-active voice in encouraging the GSEs to sell non-core / higher risk legacy assets (NPLSs, PLS, etc…)
  3. Require the GSEs to submit annual plans to Treasury outlining the pro-active steps they are going to take to reduce credit risk with their guarantee business
     - Enables Treasury to have a more active role in encouraging / mandating the GSEs to be more aggressive in managing their credit risk profile as they are "wound down"

Exceeding HERA

**Timing**

- Announce changes Friday August 10th after markets close. Rationale:
  - GSE's will report very strong earnings on August 7, that will be in-excess of the 10% dividend to be paid to Treasury
  - Highlight Treasury's focus on winding down the GSEs post the disappointing PRA announcement
    - Covenant 2 above could also be "messaged" within the context of our desire to see the GSEs sell NPLs to special servicers who will be "more creative" in how they manage troubled loans
  - Put to rest any near term market concerns on the financial stability of the GSEs

**Message**

- The proposed changes protect the tax payer interests
  - Tax payer will now benefit from all future earnings at the GSEs
  - GSEs will need to take pro active steps to reduce their risk profile
- The GSEs are being wound down faster and will not return to their past state
  - Investment portfolio reduction will be done in six years not ten
  - GSEs will not build capital and exit conservatorship in their prior form
- Changes will be beneficial to the financial markets as uncertainty will be rem
- Treasury will use the wind down of the portfolios as an opportunity to encourage the GSEs to more effectively manage troubled assets (i.e. sell NPLs to investors who will be more aggressive in loss mitigation)

Where does this authority exist???

Ghana

Kenya

^ Nigeria

Senegal

Tanzania

* Angola

Rwanda small

Cote d'Ivoire

* Ecobank

EBRD

To: Mary Miller
From: Michael Stegman
Subj.: FHFA-Related Discussion at June 25 Morning Meeting
Date: June 25, 2012

The Secretary provided an overview of his and your previous day's meeting with Ed DeMarco. This is the essence of the discussion that took place.

- While he told us he would be directing Freddie Mac to provide same streamlined refinancing benefits to <80% LTV current borrowers that apply to >80% HARP 2.0 borrowers, he no longer thinks the benefits of doing so are worth the costs.

- He has reduced from a major new initiative to a small pilot a rebuild-equity refinancing program for current underwater borrowers. Since he viewed the at-scale program to counter moral hazard of a GSE HAMP-PRA program, shrinking this initiative may signal FHFA's decision not to do principal reduction.

- He is losing interest in REO-to-Rental, saying that the GSE retail REO execution is so efficient and attracting good prices, it's not worth the resources and efforts to do bulk sales.

- His schedule for rep and warranty reform for new books of business has also slipped. While he has announced his intention to direct the GSEs to adopt new reps and warrants featuring 36 month liability for material violations other than fraud, there is no time table for this.

- Through weeks of negotiating terms of possible amendments to the PSPAs, he never questioned the need to adjust the dividend schedule this year. Since the Secretary raised the possibility of a PR covenant, DeMarco no longer sees the urgency of amending the PSPAs this year. He has raised two competing reasons for this new position: (1) the GSEs will be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend well into the future even with the caps; and, (2) instituting a net worth sweep in place of the dividend will further extend the lives of the GSEs to such an extent that it would remove the urgency for Congress to act on long-term housing finance reform. He now sees the PSPA amendments as a backdoor way of keeping the GSEs alive—getting to an Option 3-type plan without the need for legislation.

Is DeMarco playing games to get TG and MS off his back on prin reduction or is this real? How did they flip him back?

| | |
|---|---|
| **From:** | Foster, Jeff |
| **Sent:** | Monday, June 06, 2011 1:15 PM |
| **To:** | Brundage, Amy; Paustenbach, Mark; Parrott, Jim; Siewert, Jake; Psaki, Jennifer R.; LeCompte, Jenni; Bellows, John; Scharlemann, Therese; Zakutansky, Brian; Miller, Sarah |
| **Cc:** | Mlynarczyk, Beth; Anderson, Matthew |
| **Subject:** | RE: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says |

Adding a few more folks.

The numbers are mixing apples and oranges all over the place.

The 130 bn dollars accounts for the total net cash investment made by UST to date. The 187 bn fair value difference is the mark to mark valuation assuming the mortgage assets were liquidated today. Since we are not liquidating/selling these mortgages today, it's not appropriate to add the two numbers together.

As Fannie and Freddie continue to work through their legacy book of business, the actual realized losses are expected to decline significantly. Moreover, the new loans are guaranteeing are of a much higher quality, in terms of LTV, FICO score and other underwriting criteria, and will generate income which will offset losses realized by the legacy loans acquired before conservatorship. OMB takes these factors into account and

OMB has provided a longer term forecast as part of the President's budget which shows the net investment actually decreasing over time and ending at 73 bn in 2021. These forecasts are conservative and consistent with the "stress tests" produced by FHFA. Moreover, as we implement some of the recommendations in the Administrations White Paper, including higher G-fee pricing, these costs may decline further.

Note: the ongoing costs of an average "4bn per year" relates to the way CBO assumes there is an imbedded subsidy that the GSEs benefit from, not actual cash costs that will be drawn on the Preferred Stock Purchase Agreements.

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**From:** Brundage, Amy [mailto:Amy_Brundage@who.eop.gov]
**Sent:** Monday, June 06, 2011 1:07 PM
**To:** Paustenbach, Mark; Parrott, Jim; Siewert, Jake; Psaki, Jennifer R.; LeCompte, Jenni
**Cc:** Mlynarczyk, Beth; Foster, Jeff; Anderson, Matthew
**Subject:** RE: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

So would something like this work?

- **There are different methodologies used here – in short, our estimate is based on actual costs whereas CBO looks at future losses. It is our belief is that prospects of future losses are much lower due to stricter underwriting standards and the steps we have taken to improve the quality of loans going forward.**

- **Regardless, we all agree that the GSEs cannot exist in their current form and reforms are needed. That's why we have proposed a path forward for reforming our nation's housing finance market to better serve families and function more safely in today's economy.**

- **Our plan reduces the government's role in housing finance, gets private capital back into the market and winds down Fannie Mae and Freddie Mac on a responsible timeline. We will proceed carefully and deliberately so that American**



Please show where Congress gave UST or White House these authorities in the law?

**families are not harmed by disruptions in the mortgage-finance chain or the broader capital markets during this transition.**

- **This approach is essential to protecting the health of the economic recovery and in the best interests of taxpayers.**

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**From:** Mark.Paustenbach@treasury.gov [mailto:Mark.Paustenbach@treasury.gov]
**Sent:** Monday, June 06, 2011 1:00 PM
**To:** Parrott, Jim; Jake.Siewert@treasury.gov; Brundage, Amy; Psaki, Jennifer R.; Jenni.LeCompte@treasury.gov
**Cc:** Beth.Mlynarczyk@treasury.gov; Jeff.Foster@treasury.gov; Matthew.Anderson@treasury.gov
**Subject:** Re: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

+ matt

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**From**: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
**Sent**: Monday, June 06, 2011 12:59 PM
**To**: Siewert, Jake; Brundage, Amy; Psaki, Jennifer R. <Psaki_J@who.eop.gov>; LeCompte, Jenni; Paustenbach, Mark
**Cc**: Mlynarczyk, Beth; Foster, Jeff
**Subject**: RE: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

Following up on Jake last point, the steps we are taking to scale back the GSEs and that FHFA has taken to improve the quality of loans they are doing going forward, together reduce the risk of future loss to taxpayers significantly.

"we" and "FHFA" is a recognition of UST control in excess of HERA

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**From:** Jake.Siewert@treasury.gov [mailto:Jake.Siewert@treasury.gov]
**Sent:** Monday, June 06, 2011 12:57 PM
**To:** Brundage, Amy; Parrott, Jim; Psaki, Jennifer R.; Jenni.LeCompte@treasury.gov; Mark.Paustenbach@treasury.gov
**Cc:** Beth.Mlynarczyk@treasury.gov; Jeff.Foster@treasury.gov
**Subject:** Re: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

Copying Beth and Jeff who may be in a better position to analyze CBO. Short answer is that we have very different methodologies. We look at actual cost - cash in/cash out. CBO models potential future losses on new business as well. Safe to say that under-writing standards post-conservatorship are dramatically higher and have significantly lowered prospects of future losses.

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**From**: Brundage, Amy [mailto:Amy_Brundage@who.eop.gov]
**Sent**: Monday, June 06, 2011 12:48 PM
**To**: Parrott, Jim <James_M_Parrott@who.eop.gov>; Psaki, Jennifer R. <Psaki_J@who.eop.gov>; LeCompte, Jenni; Paustenbach, Mark; Siewert, Jake
**Subject**: FW: CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

Jay's concerned about this for the briefing – thoughts on response?

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**From:** Lee, Jesse C.
**Sent:** Monday, June 06, 2011 12:25 PM
**To:** DL-WHO-Financial; Baer, Kenneth S.
**Subject:** CNS News: True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says

Going around the right-wing internets...
http://cnsnews.com/news/article/true-cost-fannie-freddie-bailouts-317-bi

## True Cost of Fannie, Freddie Bailouts: $317 Billion, CBO Says



UST00515561

**Monday, June 06, 2011**

By **Matt Cover**

**(CNSNews.com)** – The Congressional Budget Office (CBO) says the real cost of the federal government guaranteeing the business of failed mortgage giants Fannie Mae and Freddie Mac is $317 billion -- not the $130 billion normally claimed by the Obama administration.

In a report delivered to the House Budget Committee on June 2, the CBO said a "fair value" accounting of guaranteeing the two defunct mortgage companies – known as Government Sponsored Enterprises (GSEs) – was more than twice as high as the Office of Management and Budget had accounted for.

"Specifically, CBO treats the mortgages guaranteed each year by the two GSEs as new guarantee obligations of the federal government," the **CBO report** said. "For those guarantees, CBO's projections of budget outlays equal the estimated federal subsidies inherent in the commitments at the time they are made."

"In contrast, the Administration's Office of Management and Budget continues to treat Fannie Mae and Freddie Mac as nongovernmental entities for budgetary purposes, and thus outside the budget," the report stated. "It records as outlays the amount of the net cash payments provided by the Treasury to the GSEs."

The total of those cash payments is $130 billion, and is normally reported as the cost of the bailout of the GSEs to date. However, the CBO said that merely counting the cash payments, and not the cost of federal subsidies granted to the GSEs, obscures their real costs.

Essentially, the CBO is accounting for the cost of the federal government guaranteeing the loans bought and securitized by the GSEs.

Currently, Fannie and Freddie rely on explicit federal guarantees to continue to secure below-market financing rates. Because Fannie and Freddie are insolvent, the federal government must make up their losses when the loans they have guaranteed lose money in default.

However, the CBO counts not only the amount of federal funds spent to keep the GSEs operating but the cost to the federal government to subsidize the mortgage guarantees issued by Fannie and Freddie. In other words, the CBO counts as a federal spending commitment the subsidy given by the government to the GSEs.

The CBO calls this approach "fair-value" accounting because it treats the federal government's actions just like the actions of any other market participant, taking into account the market risk of guaranteeing a mortgage.

Typically, federal accounting does not do this because it is argued that because the government can print its own money, its risk is zero.

The CBO says that even though the government can print money – technically by issuing Treasury bonds – this merely transfers the risk to the taxpayer, who will eventually have to pay off the bonds issued by the government.

As of March 31, the CBO calculated that the GSEs held a fair-value deficit of $187 billion, meaning that on a fair-value basis Fannie and Freddie held a combined $187 billion more in liabilities than they did in assets.

Added to the $130 billion in bailout payments the government has already made, the total cost of a bailout of Fannie and Freddie rises to $317 billion, which is far above the $130 billion usually cited by the OMB.

"As of March 31, 2011, the GSEs reported a fair-value deficit of approximately $187 billion," the **CBO report** stated. "Adding to that the $130 billion in net payments already received from the Treasury implies a fair-value cost to the government of about $317 billion in obligations incurred through March 2011."

That figure has grown since August 2009 when the CBO calculated that the cost of bailing out the GSEs was $291 billion, due mainly to further weakening in the housing market.

Further, the CBO expects these costs to rise by an additional $42 billion between 2011 and 2021, an average of $4 billion per year.



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"CBO estimated that the subsidy costs of the GSEs' new business would total about $42 billion over the 2012–2021 period, an average of about $4 billion a year," the CBO said.

However, this subsidy cost could grow if the housing market continues to be weak. While the CBO expects it to recover, the difference between the agency's own 2009 and 2011 estimates show that this may not be the case.

Jesse Lee
White House Director of Progressive Media and Online Response
202.456.7681
@jesseclee44
www.whitehouse.gov

From: Bowler, Timothy
Sent: Thursday, August 16, 2012 10:16 AM
To: Chepenik, Adam; Stegman, Michael; james_m_parrott@who.eop.gov; Goldblatt, Alan; Datta, Ankur; Mlynarczyk, Beth; Anderson, MatthewDisabled; Moore, Megan; Colbert, Julian (Drew); Foster, JeffDisabled; Dash, Eric; Roberts, Benson
Cc: Lee, Sandra
Subject: RE: Updated PSPA Q&As

Last call

Adding Sandra

I am going to walk this up to Mary at 11

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**From:** Chepenik, Adam
**Sent:** Thursday, August 16, 2012 9:43 AM
**To:** Bowler, Timothy; Stegman, Michael; James_M_Parrott@who.eop.gov; Goldblatt, Alan; Datta, Ankur; Mlynarczyk, Beth; Anderson, Matthew; Moore, Megan; Colbert, Julian (Drew); Foster, Jeff; Dash, Eric; Roberts, Benson
**Subject:** RE: Updated PSPA Q&As

This version should include all comments to date. Any additional edits?

<< File: 24 PSPA Announcement QA 8_15_12.doc >>

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**From:** Chepenik, Adam
**Sent:** Wednesday, August 15, 2012 8:06 PM
**To:** Bowler, Timothy (Timothy.Bowler@treasury.gov); Stegman, Michael; James_M_Parrott@who.eop.gov; Goldblatt, Alan; Datta, Ankur; Mlynarczyk, Beth; Anderson, Matthew; Moore, Megan; Colbert, Julian (Drew); Foster, Jeff; Dash, Eric; Roberts, Benson
**Subject:** Updated PSPA Q&As

The latest version is attached.

We added a small section up front entitled "Top Framing Talking Points."

That section has the following language:

- In making these changes, Treasury is best protecting the taxpayers' interest and ensuring the continued flow of mortgage credit to households during a time of ongoing market stress as taxpayers will receive every dollar of profit the GSEs make.
- By taking all of their profits going forward, we are making clear that the GSEs will *not* ever be allowed to return to profitable entities at the center of our housing finance system
    - This change eliminates the circularity of the GSEs drawing on Treasury to pay Treasury dividends

Amazing wording & CLEAR violation of HERA's: "AGENCY NOT SUBJECT TO ANY OTHER FEDERAL AGENCY.—When acting as conservator or receiver, the Agency shall not be subject to the direction or supervision of any other agency of the United States or any State in the exercise of the rights, powers, and privileges of the Agency."

- Requiring the GSEs to increase the pace of reducing their retained portfolios from 10 to 15 percent per year, accelerates our commitment to responsibly wind them down.
- Mandating the development of an annual taxpayer protection plan that details the steps the GSEs will take to reduce their financial and operational risk profile limits risk as well.

I suspect the group will want to revise that language somewhat though. Just let me know.

<< File: 23 PSPA Announcement QA 8_15_12.doc >>



UST00505920

**DEPARTMENT OF THE TREASURY**
**WASHINGTON, D.C. 20220**
[December 12, 2011]

**INFORMATION MEMORANDUM FOR SECRETARY GEITHNER**

**FROM:** Mary John Miller, Assistant Secretary for Financial Markets

**SUBJECT:** Potential GSE Restructuring and Transition Options

Over the coming year, the Administration will face a number of key decisions with respect to the operational and financial challenges of Fannie Mae and Freddie Mac (the GSEs). The GSEs have been under the conservatorship of the Federal Housing Finance Agency (FHFA) for over three years. Given the challenges associated with conservatorship, a range of stakeholders are calling for a transition plan and more comprehensive reform. Moreover, at the end of 2012, the funding caps under the Senior Preferred Stock Purchase Agreements (PSPAs) will be permanently fixed based on the 9/30/12 financial results of the GSEs. After this date, the Administration's ability to restructure the GSEs may be more constrained.

As such, the Administration will need to consider how best to (i) ensure that the GSEs continue to be able to meet current and legacy obligations after the funding caps are fixed at the end of 2012; (ii) establish a more robust plan to end conservatorship of the GSEs and start the process of transition to a mortgage finance system more reliant on private capital, and (iii) manage and resolve the pool of troubled legacy assets on the GSEs' balance sheets.

To address these challenges, this memo presents policy options, which taken together could serve as the basis of a comprehensive non-legislative Administration reform proposal. These options are described in detail below.

*Policy Option 1* – Restructure the calculation of Treasury's dividend payments from a fixed 10 percent annual rate to a variable payment based on available positive net worth (i.e. establish an income sweep). This will ensure that remaining PSPA funding capacity is not reduced in the future by draws to pay dividends.

*Policy Option 2* – Develop a plan with FHFA to transition the GSEs from their current business model of direct guarantor to a model more aligned with our longer term vision of housing finance. Additional covenants should also be added to the PSPA funding agreements that requir[e] the GSEs to take certain specific transition steps, including guarantee price increases and credit risk syndication, over the next five to seven years.

Not independent FHFA. Controlled even in 2011

*Policy Option 3* – Transfer NPLs and legacy assets to a special purpose vehicle or joint venture (i.e., creation of a "bad bank") at fair market value (FMV) to accelerate the wind down of those legacy assets and recognize a portion of the GAAP / FMV differences. The size of this transfer could be scaled up or down depending on the objectives of the transfer. Today, a transfer of all

non-performing loans at fair market value could result in as much as a $62 billion PSPA draw.[1]

If structured appropriately, this combined effort could help accomplish several key objectives:

1) *Address capital adequacy issues* – restructuring the dividend payments and recognizing some portion of the unreserved FMV/GAAP differences prior to 2012 when remaining funding capacity will be limited to $275 billion in aggregate would help reduce concerns about Treasury's ability to support the capital position of the GSEs.

2) *Wind down the GSEs* – Establishing a clear transition plan and addressing legacy troubled assets would reduce the amount of new direct credit risk the GSEs can assume going forward, provide a series of specific, contractual transition steps that can give the financial markets increased clarity and clearly indicate to the taxpayers that the GSEs will be wound down.

3) *Reduce operational risks and increase efficiency* – moving legacy assets into the private market reduces the level of reliance on the operational expertise of the GSEs and concentration of risk. This is particularly salient as the GSEs could face future challenges retaining the human capital needed to manage these assets.

4) *Support the housing market recovery* – Recognizing a portion of losses upfront or putting troubled loans in the hands of private investors can incentivize and accelerate (i) loan modifications, (ii) principal reduction, and (iii) healthy transitions (through short sales, foreclosures, NPL/REO sales, etc) as well as provide the GSEs with greater flexibility in their own approach to loss mitigation management.

This memo evaluates the proposed alternatives based on accounting, corporate finance, financial market and economic considerations. Of course, these policy options would also need to be evaluated from a sequencing, messaging and congressional affairs perspective, which this memo does not specifically address. All actions would require FHFA agreement and approval.[2]

We present the potential policy actions in detail below after a brief review of the current status of the GSE capital position, projections and expected need for further Treasury support. Appendix A also presents additional non-legislative and legislative options which could be considered. (take out appendix?)

**Current Projections and GSE Capital Imbalances**

As amended on December 24, 2009, the cap on Treasury's financial commitment under the PSPAs equals the greater of $200 billion or $200 billion plus the cumulative net worth deficits experienced during 2010, 2011, and 2012, less any surplus remaining as of December 31, 2012.

[1] While the funds would originate from existing PSPA authority, the capital would be drawn from Treasury borrowings and would therefore count against the federal debt ceiling.

[2] FHFA agreement and approval is required because the PSPA agreements were signed between Treasury and the GSEs with FHFA acting as the GSEs duly appointed conservator.



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Since 2008, Fannie Mae and Freddie Mac have made total gross draws of $111.6 billion and $71.2 billion (Total aggregate gross draws of $182.8 billion). Once accounting for dividends paid back to Treasury, the net draws are $94.4 billion and $56.3 billion, respectively (for a total aggregate net draw of $150.7 billion). Under FHFA's base case stress test forecast, by 2012, total gross draws are expected to reach more than $210 billion in aggregate ($135.0 billion at Fannie Mae and $75.8 billion at Freddie Mac).

At the end of 2012, Treasury's aggregate funding capacity will be capped at $275 billion ($150 billion at Freddie Mac and $125 billion at Fannie Mae).[3] [footnote the math behind this] We anticipate the market will closely evaluate the amount of expected losses still to come and level of dividend payments necessary at the GSEs in relation to the level of available funding that remains.

Minimizing additional draws after 2012 will be important to maintain investor confidence in the sufficiency of US Government support. The expected level of preferred stock outstanding at the end of 2012 is projected to require annual dividends of $11.8 billion and $7.3 billion for Fannie Mae and Freddie Mac, respectively. While Freddie is expected to be net income positive by the end of 2012 and Fannie by the end of 2013, both institutions will struggle to make sufficient income to pay the 10% required dividend over time. This is the result of the high nominal dividends required on a year basis after 2012 and the likely reduction in income at the GSEs ove time. The reduced income in the GSE will be driven primarily in the reduction in the size of their investment portfolios which need to be reduce to $250B respectively over the course of the next [eight years].

saw profitability in 2011

While the amount of income from the guarantee businesses are projected to increase in size as loan losses decline and fee increases are implemented, it will ultimately be insufficient to cover the lost portfolio investment income and the required dividends under the current projections.

Note: For the purposes of this memo and the analysis presented throughout, the financial models shown assume a 10 basis point guarantee fee increase is made in 2013, which is consistent with calls from the President and Acting Director DeMarco. Additional increases in the guarantee fees would increase the amount of net income that could potentially be generated. To the degree the GSEs could sell first loss credit risk to the market, this guarantee fee income would be offset by a reduction in the portfolios' risk profile and thus, profit of the GSEs. That interplay was not considered for the purpose of this analysis.

The table at the top of the next page shows the expected net income under the FHFA base case forecasts, required dividends (assuming a 10 percent dividend rate on outstanding senior preferred stock) and forecasted gross and net draws from 2012 through 2023.

[3] Math behind the statement….



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**Projected Net Comprehensive Income (Loss)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Base Case Net Income (Loss)** | | | | | | | | | | | | |
| Fannie Mae | ($13.1) | $5.4 | $13.1 | $13.5 | $9.1 | $8.5 | $8.0 | $7.9 | $8.5 | $8.4 | $8.1 | $8.0 |
| Freddie Mac | $6.7 | $9.5 | $10.6 | $6.0 | $5.5 | $5.5 | $5.6 | $5.3 | $5.5 | $5.4 | $5.4 | $5.4 |
| **Total** | **($6.4)** | **$14.9** | **$23.7** | **$19.5** | **$14.6** | **$14.0** | **$13.7** | **$13.2** | **$14.0** | **$13.8** | **$13.5** | **$13.4** |
| **Stressed Case Net Income (Loss)** | | | | | | | | | | | | |
| Fannie Mae | ($49.0) | ($8.8) | $12.9 | $18.6 | $9.3 | $8.7 | $8.2 | $8.0 | $8.7 | $8.5 | $8.2 | $8.1 |
| Freddie Mac | ($7.8) | $6.6 | $8.9 | $6.1 | $5.6 | $5.6 | $5.7 | $5.4 | $5.5 | $5.4 | $5.4 | $5.4 |
| **Total** | **($56.8)** | **($2.2)** | **$21.8** | **$24.7** | **$14.9** | **$14.2** | **$13.9** | **$13.4** | **$14.1** | **$14.0** | **$13.6** | **$13.4** |
| *Inc. (Dec.) from Base Case* | *($50.4)* | *($17.1)* | *($1.9)* | *$5.2* | *$0.3* | *$0.2* | *$0.2* | *$0.2* | *$0.1* | *$0.1* | *$0.1* | *$0.1* |

**Projected Dividend Draws (Repayment)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Base Case Fannie Mae:** | | | | | | | | | | | | |
| Gross Draw | $28.7 | $11.4 | $2.9 | $1.2 | $7.0 | $7.1 | $8.2 | $9.4 | $9.8 | $10.7 | $12.1 | $13.5 |
| Dividend | ($11.8) | ($14.0) | ($14.8) | ($15.0) | ($15.2) | ($15.9) | ($16.6) | ($17.5) | ($18.4) | ($19.4) | ($20.6) | ($21.8) |
| Net Draw | $16.9 | ($2.6) | ($11.9) | ($13.8) | ($8.2) | ($8.8) | ($8.4) | ($8.1) | ($8.6) | ($8.7) | ($8.5) | ($8.3) |
| **Stressed Case Fannie Mae:** | | | | | | | | | | | | |
| Gross Draw | $58.1 | $34.3 | $11.3 | $4.5 | $18.6 | $14.5 | $16.5 | $18.4 | $19.9 | $8.7 | $0.0 | $0.0 |
| Dividend | ($12.9) | ($18.6) | ($21.1) | ($21.9) | ($22.2) | ($23.7) | ($25.2) | ($26.9) | ($28.8) | ($30.7) | ($31.0) | ($31.0) |
| Net Draw | $45.2 | $15.7 | ($9.8) | ($17.4) | ($3.6) | ($9.2) | ($8.7) | ($8.5) | ($8.9) | ($22.0) | ($31.0) | ($31.0) |
| *Inc. (Dec.) from Base Case* | *$28.3* | *$18.3* | *$2.1* | *($3.6)* | *$4.6* | *($0.4)* | *($0.3)* | *($0.5)* | *($0.3)* | *($13.2)* | *($22.5)* | *($22.6)* |
| **Base Case Freddie Mac:** | | | | | | | | | | | | |
| Gross Draw | $10.5 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $1.5 | $2.5 | $2.6 | $3.0 | $3.3 |
| Dividend | ($7.3) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.9) | ($8.2) | ($8.4) | ($8.7) |
| Net Draw | $3.2 | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($7.7) | ($6.2) | ($5.4) | ($5.6) | ($5.4) | ($5.4) |
| **Stressed Case Freddie Mac:** | | | | | | | | | | | | |
| Gross Draw | $20.7 | $2.3 | $0.5 | $2.7 | $3.6 | $4.0 | $4.4 | $5.1 | $5.5 | $6.2 | $6.8 | $7.5 |
| Dividend | ($7.6) | ($8.8) | ($9.0) | ($9.1) | ($9.4) | ($9.7) | ($10.2) | ($10.6) | ($11.2) | ($11.7) | ($12.4) | ($13.1) |
| Net Draw | $13.1 | ($6.5) | ($8.4) | ($6.4) | ($5.8) | ($5.7) | ($5.8) | ($5.5) | ($5.7) | ($5.5) | ($5.6) | ($5.6) |
| *Inc. (Dec.) from Base Case* | *$10.0* | *$1.2* | *($0.8)* | *$1.3* | *$1.9* | *$1.9* | *$1.9* | *$0.7* | *($0.2)* | *$0.0* | *($0.1)* | *($0.1)* |
| **Base Case Combined:** | | | | | | | | | | | | |
| Gross Draw | $39.2 | $11.4 | $2.9 | $1.2 | $7.0 | $7.1 | $8.2 | $10.9 | $12.3 | $13.3 | $15.1 | $16.8 |
| Dividend | ($19.1) | ($21.7) | ($22.5) | ($22.6) | ($22.9) | ($23.5) | ($24.3) | ($25.2) | ($26.3) | ($27.6) | ($29.0) | ($30.6) |
| Net Draw | $20.1 | ($10.3) | ($19.6) | ($21.4) | ($15.9) | ($16.4) | ($16.1) | ($14.3) | ($14.0) | ($14.3) | ($13.9) | ($13.8) |
| **Stressed Case Combined:** | | | | | | | | | | | | |
| Gross Draw | $78.8 | $36.6 | $11.8 | $7.2 | $22.2 | $18.5 | $20.9 | $23.5 | $25.4 | $14.9 | $6.8 | $7.5 |
| Dividend | ($20.5) | ($27.4) | ($30.1) | ($30.9) | ($31.6) | ($33.4) | ($35.4) | ($37.6) | ($40.0) | ($42.4) | ($43.3) | ($44.0) |
| Net Draw | $58.4 | $9.2 | ($18.2) | ($23.7) | ($9.4) | ($14.9) | ($14.5) | ($14.1) | ($14.6) | ($27.5) | ($36.5) | ($36.5) |
| *Inc. (Dec.) from Base Case* | *$38.3* | *$19.5* | *$1.4* | *($2.3)* | *$6.5* | *$1.5* | *$1.6* | *$0.2* | *($0.6)* | *($13.2)* | *($22.6)* | *($22.8)* |
| Cum. Base Case Gross PSPA Draw | $210.8 | $222.2 | $225.1 | $226.3 | $233.3 | $240.4 | $248.6 | $259.5 | $271.8 | $285.1 | $300.2 | $317.0 |
| Cum. Stress Case Gross PSPA Draw | $250.4 | $287.0 | $298.8 | $306.0 | $328.2 | $346.7 | $367.6 | $391.1 | $416.5 | $431.4 | $438.2 | $445.7 |
| *Inc. (Dec.) from Base Case* | *$39.6* | *$64.8* | *$73.8* | *$79.8* | *$95.0* | *$106.4* | *$119.1* | *$131.7* | *$144.8* | *$146.4* | *$138.1* | *$128.8* |
| Cum. Base Case Net PSPA Draw[1] | $159.6 | $149.3 | $129.7 | $108.3 | $92.4 | $76.0 | $59.9 | $45.7 | $31.6 | $17.3 | $3.4 | ($10.4) |
| Cum. Stress Case Net PSPA Draw[1] | $197.9 | $207.1 | $188.8 | $165.1 | $155.7 | $140.8 | $126.3 | $112.2 | $97.6 | $70.2 | $33.6 | ($2.9) |
| *Inc. (Dec.) from Base Case* | *$38.3* | *$57.7* | *$59.1* | *$56.8* | *$63.3* | *$64.8* | *$66.4* | *$66.6* | *$66.0* | *$52.8* | *$30.2* | *$7.4* |
| Base Case PSPA Capacity Left | $275.0 | $263.6 | $260.7 | $259.5 | $252.5 | $245.4 | $237.2 | $226.3 | $214.0 | $200.7 | $185.6 | $168.8 |
| Stress Case PSPA Capacity Left | $275.0 | $238.4 | $226.6 | $219.4 | $197.2 | $178.7 | $157.8 | $134.3 | $108.9 | $94.0 | $87.2 | $79.7 |
| *Inc. (Dec.) from Base Case* | *$0.0* | *($25.2)* | *($34.1)* | *($40.1)* | *($55.3)* | *($66.7)* | *($79.4)* | *($92.0)* | *($105.1)* | *($106.7)* | *($98.4)* | *($89.1)* |

[1] Accounts for cumulative dividends paid back to U.S. Treasury.
Source: Grant Thorton, U.S. Department of the Treasury

As shown in the combined gross draw line above, the GSEs continue to draw upon the PSPAs throughout the forecast period to pay required dividends to Treasury. Consequently, once the caps are fixed in 2012, the collective PSPA capacity is forecasted to decrease by over $100 billion within the next ten years.

The table above also illustrates a stressed scenario where near term deficiencies are significantly



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higher than forecasted in the base case. Under the stressed scenario, $195 billion of PSPA capacity is utilized, leaving the GSEs with only $80 billion of remaining capacity. This downside scenario emphasizes the need for reform.

While the GSEs are expected to become net income positive after 2013, net income will still be reduced by the continued realization of losses from the legacy assets on the GSEs books. The current GAAP book values of mortgage loans, securities and REO on the GSEs balance sheets are $182 billion higher than fair market values. This difference includes a component of model forecasted losses (approximately $67 billion) for both performing and non-performing loans that are not yet reserved due to GAAP accrual standards (see Appendix D).

**<u>Detailed Description of Policy Options for Consideration</u>**

***Policy Option 1: Restructure the PSPA agreements to a variable dividend payment***

*Concept:* Subject to the consultation described below, Treasury could restructure the PSPA agreements to replace the current 10 percent fixed dividend with a permanent "net worth sweep." Going forward, all positive net worth would be paid as a dividend to Treasury.

*Key Benefits / Risks:* This would (i) apply all future net income/profits as reimbursement to taxpayers; (ii) underscore the government will not recapitalize the GSEs in their current form; and (iii) eliminate the need for the GSEs to make gross draws to pay dividends to Treasury, thereby retaining the maximum amount of PSPA funding and thus, Treasury's flexibility to available to offset future operating losses.

Willful violation of HERA law & Congressional intent which explicitly require preserve/ conserve & recap.

Since both Fannie Mae and Freddie Mac are expected to be net income positive (before dividends) on a stable, ongoing basis after 2012, this change would prevent Treasury from incurring additional future draws unless there was either (i) an unexpected downturn in the housing market, or (ii) there was a significant restructuring of the balance sheets of Fannie Mae or Freddie Mac, such as a NPL sale program or separation of assets into a good bank/bad bank structure or receivership (discussed further below).

*Path to Execution:* This change is relatively straightforward and could be completed by amending the PSPAs and resetting the Periodic Commitment Fee (PCF) to establish a net worth sweep. The PCF was part of the original PSPA, however, Treasury has elected to waive setting the fee since the PSPAs were established. Under the terms of the PSPAs, the PCF must be set b agreement with FHFA serving as conservator of the GSEs and in consultation with the Fed.

Sweep contemplated in 2011

Restructuring the dividend payment calculation would require consultation and agreement with the following three entities (i) FHFA, per the agreements currently in place, (ii) the Federal Reserve, with respect to establishing the PCF, and (iii) the Department of Justice (DOJ), because there is a general prohibition on waiving vested contract rights to receive funds owed to the government, so giving up the right to certain amount of money (fixed dividends) for an uncertain amount (a dividend sweep) may require DOJ approval. More work must be done with the DOJ to determine the feasibility of this option.

DOJ AND FRB SIGN-OFF. Does this suggest DOJ as party & not all docs attorney-client privileged?



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*Costs / Capital Adequacy Considerations:* The table at the top of the next page shows the combined impact on draws and dividends paid to Treasury when the dividend payments are converted to a cash flow sweep. The analysis is shown under a base case scenario and a stressed scenario where the losses in 2012 are significantly higher. As shown in the table, the net income before preferred dividends would remain the same under this scenario. Modifying the dividend payment to a cash flow sweep would enable the GSEs to retain the full $275 billion PSPA capacity as it would eliminate any potential gross draws required to fund dividend payments to Treasury.

**Base case with 10% dividend versus positive net worth sweep**

| | Base Case | | | | Stress Case | | | |
|---|---|---|---|---|---|---|---|---|
| | Current 9/30/2011 | FY2012 | FY2017 | FY2022 | Current 9/30/2011 | FY2012 | FY2017 | FY2022 |
| Cumulative Gross Draw under 10% dividend | $172 | $211 | $240 | $300 | $172 | $250 | $347 | $438 |
| Cumulative Gross Draw under net worth sweep | $172 | $211 | $211 | $211 | $172 | $250 | $266 | $266 |
| ***Increase (Decrease)*** | ***$0*** | ***$0*** | ***($30)*** | ***($89)*** | ***$0*** | ***$0*** | ***($81)*** | ***($172)*** |
| Cumulative Net Draw under 10% dividend | $140 | $160 | $76 | $3 | $140 | $198 | $141 | $34 |
| Cumulative Net Draw under net worth sweep | $140 | $160 | $76 | $3 | $140 | $198 | $141 | $34 |
| ***Increase (Decrease)*** | ***$0*** | ***$0*** | ***$0*** | ***$0*** | ***$0*** | ***$0*** | ***$0*** | ***$0*** |
| Remaining PSPA Capacity under 10% dividend | $275 | $275 | $245 | $186 | $275 | $275 | $179 | $87 |
| Remaining PSPA Capacity under net worth sweep | $275 | $275 | $275 | $275 | $275 | $275 | $259 | $259 |
| ***Increase (Decrease)*** | ***$0*** | ***$0*** | ***$30*** | ***$89*** | ***$0*** | ***$0*** | ***$81*** | ***$172*** |

Similar to the base case scenario, Treasury's realized net cash proceeds remain the same and the taxpayer's investment is still repaid by 2023 (on a net draw basis); however, the PSPA funding capacity is not reduced through gross draws incurred to pay dividends.

***Policy Option 2: Increase the contractual obligations under the PSPAs to facilitate wind down and accelerate transition to a more private mortgage market***

*Concept*: Amend the PSPAs to add additional contractual obligations for the GSEs and FHFA associated with transition. These would include:

- *Guarantee fee price increases* – pricing for direct GSE guarantees could be increased by a minimum of five to ten basis points per annum (or at a pace determined annually by FHFA and Treasury) until pricing reaches levels that are consistent with those charged by private financial institutions with Basel III capital standards and a specified return on capital. This provision is similar in concept to a bill Representative Neugebauer (HR 1222) introduced in March 2011. This process could also be required to take place within a five-to-seven year period, with guarantee fees gradually approaching 60 to 80 basis points, depending on the profile of the mortgage. The phasing of such increases should also take into account the current housing market.

- *Risk syndication* – Consistent with the phase-in period of guarantee fee increases, the GSEs could be required to sell a first-loss position (or the majority of the credit risk) to the private market on all of their new guarantee book business within a five- or seven-year time period. It is important to note that risk syndication would likely reduce the



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earnings capacity of the GSEs (similar to how the winding down of the retained portfolios also limits income generation). This further highlights the importance of modifying the PSPAs, as described in policy option 1, and potentially recognizing some level of legacy asset losses, as described in policy option 3, so transition actions such as the ones described in this option are less constrained.

- *Single TBA delivery* – Require the GSEs to align payment standards and issuance processes to establish a fungible TBA market for common delivery of Fannie Mae and Freddie Mac securities. This step would increase the overall liquidity of the TBA market, increase the amount of interchangeable securities in the market and reduce overall rates for borrowers.

- *Additional transition requirements* – additional requirements could also be considered, such as down payment levels, faster retained portfolio wind down (particularly for further growth in NPLs), etc.

*Key Benefits / Risks:* The policy options above would help facilitate wind down and transition of the GSEs. They will help facilitate a return of private capital to the mortgage market as the policies will help create a clearer and more quantifiable framework to evaluate "mortgage" capital allocation decisions.

*Path to execution:* Treasury has certain protections and approval rights under the PSPAs with respect to transition and organizational changes to the GSEs. While these are not affirmative rights, Treasury could pre-approve a broad transition plan that would be executed by FHFA. More legal analysis and work with FHFA would be required. In any and all circumstances, the steps outlined above would require FHFA approval and consent as conservator. **(Jeff to redo paragraph).**

***Policy Option 3: Initiate an NPL disposition program and transfer legacy assets to a special purpose vehicle (SPV) or joint venture (JV) that manages loss mitigation activities***

*Concept:* Have Fannie Mae and Freddie Mac form a joint venture to manage and streamline loss mitigation activities . Under this proposal, Fannie Mae and Freddie Mac would remain under the conservatorship of FHFA but jointly contribute NPLs and REO into a new special purpose vehicle or joint venture co-owned by the GSEs. In return, the Enterprises would receive a pro-rata share of the SPV/JV's equity.

The SPV would be responsible for all loss mitigation activities of the contributed assets and would be able to partner with private market participants to help reduce the operational and financial risks. The SPV would also be responsible for managing a REO and NPL disposition program to move legacy assets back to the private market via bulk sales and partner transactions (similar to the approach FHFA in consultation with Treasury is taking with the "REO to Rental" program). To avoid adverse effects in the broader housing market, the GSEs could also include certain covenants/restrictions in the sales documents that would restrict the usage of REO property sales for a period of time.



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*Key Benefits / Risks:* This is a form of a "good bank/bad bank" strategy that would allow the GSEs to structurally partner with private market participants and separate their legacy assets from their post conservatorship business in a way that generates greater stability and maximizes operational expertise. It would also be an additional measure the Administration could point to in 2012 to show that the GSEs are being wound down.

*Path to execution:* The Enterprises would need to set up the SPV/JV structure because the Government Corporation Control Act prohibits Treasury from forming SPVs. Lawyers at th GSEs and FHFA would need to determine the legal basis under their respective charters that would authorize them to establish SPVs. An exercise of such authority would most likely require FHFA approval and direction, as conservator.[4]

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Other potential solutions include creating a new Resolution Corporation (ResCo) owned or controlled by FHFA and Treasury (Appendix A discusses this option in more detail) or having the GSEs retain the troubled legacy assets, but having these assets marked to market and internally separated such as to create a "bad bank subsidiary". As with policy option 3, a ResCo would fully move troubled legacy assets off the GSEs' balance sheets. However, a ResCo approach would require congressional approval because of the Government Corporation Control Act. (The Government Corporation Control Act prohibits an agency from establishing or acquiring a corporation to act as an agent except when specifically authorized to do so by law.[5] If transferring assets off balance sheet is too operationally and legally complex to complete in the near term, the GSEs could take a less aggressive approach by transferring assets to a wholly owned resolution subsidiary and reclassifying NPLs from "held for investment" to "held for sale." This strategy would result in the assets being marked to market and could potentially ease operational and accounting barriers to a more accelerated disposition of troubled assets.

Regardless of whether the GSEs or FHFA create the entity, Treasury would recommend staffing and coordinating the effort with employees from the GSEs, FHFA, FDIC and Treasury. Fannie Mae would likely manage the venture's core operations given the size of its operations and percentage ownership of REO that would be contributed to the SPV/JV.

INDEPENDENCE?

*Costs / Capital Adequacy Considerations:* The GSEs currently classify nearly all of their NPLs

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[4] GSE charter limitations, and the FHFA mandate of conservatorship, may also require that the legacy entities remain in place. Under their charter acts, Fannie Mae and Freddie Mac continue to exist and may only be dissolved by an act of Congress (12 USC 1717(a)(2)(B)). Even if FHFA places both GSEs into receivership, FHFA is prohibited by law from terminating the charters, and the limited-life regulated entities succeed to the charters by operation of law. There is also an implication in the wording of the receivership provisions of the law that FHFA may not establish one limited-life regulated entity for both GSEs, but only FHFA's interpretation of the wording of that statutory provision would be dispositive. Consequently, combining the assets from both GSEs into an SPV/JV and leaving the chartered GSEs behind could be viewed as a violation of the charter acts. More work with FHFA and the GSEs would be required to determine the feasibility of this option.

[5] Unlike the Emergency Economic Stabilization Act, which provided Treasury with such authority for purposes of the Troubled Asset Relief Program, the legislation that authorized the PSPAs – the Housing and Economic Recovery Act – did not provide Treasury with such authority.



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as "held for investment" rather than "held for sale" on their balance sheets. Such asset sales and/or transfers would be subject to FHFA approval and, under the PSPAs, subject to Treasury approval.[6]

By contributing the NPLs to a SPV/JV and selling them at fair market value, the GSEs would be required to account for the valuation difference. If the entire portfolio of non-performing loans were contributed, for example, the GSEs may be required to draw up to $62 billion of capital in 2012. Further analysis and accounting work with FHFA and the GSEs would be required to fully analyze the impact of such a transfer and its cost. The economics of a more accelerated troubled asset disposition strategy are complex and widely debated. In summary, it is hard to evaluate the longer term economic impact associated with an accelerated restructuring and/or cleansing of troubled inventory versus continuing the current path of one off modification and/or sales. This analysis will need to be completed before any large scale program is started. If a large scale program is too challenging to move forward with in 2012, smaller transfers to a SPV/JV could be initiated at the inception of the program with further transfers made over time. Regardless of whether a small or large scale NPL/REO program is undertaken, combining this with a restructuring of the dividend as discussed in policy option 1 would help to further reduce concerns over capital adequacy due to the acceleration of losses into 2012.

Note: Based on the accounting practices currently applied and the estimated funding PSPA cycle time, GSE restructuring actions that results in a one-time funding requirement would likely need to be completed prior to 9/30/12. This will ensure any draws under the PSPAs occur prior to the establishment of the permanent funding caps. Treasury staff is currently assessing whether it is possible to account for any changes after 9/30/12 and still complete the modification before the funding levels are fixed at the end of 2012.

The table below shows the impact on draws and dividends paid to Treasury from such a change, assuming the full $62 billion is drawn. This is for illustrative purposes only and the actual amount would depend on a number of factors, including the amount of assets initially transferred and the accounting treatment for the entities, among other things. Net income at year-end 2012 would decrease relative to the base case because of the requisite charge from transferring the NPLs at fair market value; however, the GSEs would earn back roughly 70 percent of the accounting charge over time through higher net income (as only the expected loss portion of the FMV difference would be realized if the loans were held to maturity).

[6] More work is required to see whether transfers of such a substantial portion of a GSE's assets would violate any of the financial covenants in their debt indentures or charter requirements.

**Base case with 10% dividend versus positive net worth sweep and NPL disposition program**

| | Base Case | | | | Stress Case | | | |
|---|---|---|---|---|---|---|---|---|
| | **Current 9/30/2011** | **FY2012** | **FY2017** | **FY2022** | **Current 9/30/2011** | **FY2012** | **FY2017** | **FY2022** |
| Cumulative Gross Draw under 10% dividend | $172 | $211 | $240 | $300 | $172 | $250 | $347 | $438 |
| Cumulative Gross Draw under net worth sweep and NPL | $172 | $260 | $260 | $260 | $172 | $300 | $310 | $310 |
| ***Increase (Decrease)*** | ***$0*** | ***$49*** | ***$20*** | ***($40)*** | ***$0*** | ***$49*** | ***($37)*** | ***($129)*** |
| Cumulative Net Draw under 10% dividend | $140 | $160 | $76 | $3 | $140 | $198 | $141 | $34 |
| Cumulative Net Draw under net worth sweep and NPL | $140 | $209 | $100 | $18 | $140 | $247 | $165 | $48 |
| ***Increase (Decrease)*** | ***$0*** | ***$49*** | ***$24*** | ***$15*** | ***$0*** | ***$49*** | ***$24*** | ***$15*** |
| Remaining PSPA Capacity under 10% dividend | $275 | $275 | $245 | $186 | $275 | $275 | $179 | $87 |
| Remaining PSPA Capacity under net worth sweep and NPL | $275 | $275 | $275 | $275 | $275 | $275 | $265 | $265 |
| ***Increase (Decrease)*** | ***$0*** | ***$0*** | ***$30*** | ***$89*** | ***$0*** | ***$0*** | ***$86*** | ***$178*** |

To the extent that NPLs are sold to third parties, a greater portion of the accounting charge would not be recovered. Note: there is no consideration given to the positive or negative effects on the housing market that may be realized by migrating legacy assets to the private sector or the benefits from joint ventures and other public/private partnerships.



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**Appendix A: Additional options which could be considered: (Jeff to slot in and delete appendix)**

There are a number of other alternatives that could be considered to wind down GSEs.

***Alternative 1: Pursue limited legislation to create a Resolution Corporation vehicle for legacy assets, allow Ginnie Mae (GNMA) to explicitly guarantee GSE MBS in exchange for a fee, and explicitly establish a transition path to reduce the direct credit risk exposure of the GSEs over time.***

*Concept:* A limited legislative proposal could be pursued to support the transition of the GSEs from primary mortgage guarantors to more limited reinsurers/securitization utilities and the wind down of their legacy assets. Representatives Hensarling and Garrett and Senators Corker and Isakson have all proposed legislation which focuses on transition and wind down of the GSEs. The Administration could seek to find an interim transition solution which achieves our medium term objectives, but leaves the final end state debate open. However, it may be preferable to seek more comprehensive legislation that addresses a housing finance system end-state. In addition to generally executing on the policy options laid out above, a limited legislative proposal could include:

*The creation of a new Resolution Corporation (ResCo), which would manage and resolve the troubled legacy assets of the GSEs.* This entity would have explicit funding authority and be under the control of both FHFA and Treasury. This type of vehicle, similar to the Resolution Trust Corporation established by Congress to address the savings and loan crisis, would increase flexibility and effectiveness for the Government, as opposed to a SPV formed jointly by the GSEs.

*Explicitly guaranteeing all GSE liabilities through a tender exchange for GNMA wrapped pools, in exchange for a fee.* Despite the explicit capital support of the PSPAs, due to capital treatment of GSE liabilities under Basel III,[7] GSE mortgage backed securities (MBS) trade roughly two to three points lower than GNMA MBS. In exchange for full faith and credit wrap by GNMA, the government could charge GSE MBS investors a portion of this price difference and as a result receive a meaningful upfront value.

***Alternative 2: Initiate receivership***

*Concept:* Ask FHFA to exercise its discretion and place the Enterprises into receivership.

*Benefits:* If FHFA appoints itself as receiver of one or both Enterprises, then as in the case of conservatorship, FHFA immediately succeeds to all rights and powers of the Enterprise and of all the officers, directors, and stockholders of the Enterprise.[8] But unlike the case with conservatorship, the appointment of FHFA as receiver automatically *terminates* all rights and

[7] GSE MBS receive a 20 percent asset risk weighting and are currently expected to be treated as a level 2 asset under the liquidity coverage and net stable funding ratios.

[8] 12 U.S.C. § 4617(b)(2)(A).

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claims that the stockholders and creditors may have against the assets or charter of the Enterprise, except for their right to payment, resolution, or other satisfaction of their claims as determined by FHFA as receiver.[9] Additionally, unlike the case with conservatorship, FHFA as receiver would be required to place the Enterprise in liquidation and proceed to realize upon the assets of the Enterprise by sale of the assets or transfer of the assets to a limited-life regulated entity established by FHFA.[10]

*Considerations:* First, in conservatorship the entities are treated as going concerns, and FHFA as conservator is required to preserve assets. In receivership, the entities would be in wind-down, and FHFA as receiver would be looking to sell the assets for as much money as it could. Additionally, while the definition of the deficiency amount used to calculate draws includes a paragraph about how the deficiency amount is to be calculated even when a GSE is in receivership, it is unclear whether Treasury's preferred stock would be wiped out in receivership.

[9] 12 U.S.C. § 4617(b)(2)(K).
[10] 12 U.S.C. § 4617(b)(2)(E).

## Appendix B: Scenario Analysis

Stressed Base Case Scenario as described on page 4 of the memo

**Stressed Base Case: Net Comprehensive Income (Loss)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Net Income (Loss)** | | | | | | | | | | | | |
| Fannie Mae | ($49.0) | ($8.8) | $12.9 | $18.6 | $9.3 | $8.7 | $8.2 | $8.0 | $8.7 | $8.5 | $8.2 | $8.1 |
| Freddie Mac | ($7.8) | $6.6 | $8.9 | $6.1 | $5.6 | $5.6 | $5.7 | $5.4 | $5.5 | $5.4 | $5.4 | $5.4 |
| Total | ($56.8) | ($2.2) | $21.8 | $24.7 | $14.9 | $14.2 | $13.9 | $13.4 | $14.1 | $14.0 | $13.6 | $13.4 |

**Stressed Base Case: Dividend Draws (Repayment)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Fannie Mae:** | | | | | | | | | | | | |
| Gross Draw | $58.1 | $34.3 | $11.3 | $4.5 | $18.6 | $14.5 | $16.5 | $18.4 | $19.9 | $8.7 | $0.0 | $0.0 |
| Dividend | ($12.9) | ($18.6) | ($21.1) | ($21.9) | ($22.2) | ($23.7) | ($25.2) | ($26.9) | ($28.8) | ($30.7) | ($31.0) | ($31.0) |
| Net Draw | $45.2 | $15.7 | ($9.8) | ($17.4) | ($3.6) | ($9.2) | ($8.7) | ($8.5) | ($8.9) | ($22.0) | ($31.0) | ($31.0) |
| **Freddie Mac:** | | | | | | | | | | | | |
| Gross Draw | $20.7 | $2.3 | $0.5 | $2.7 | $3.6 | $4.0 | $4.4 | $5.1 | $5.5 | $6.2 | $6.8 | $7.5 |
| Dividend | ($7.6) | ($8.8) | ($9.0) | ($9.1) | ($9.4) | ($9.7) | ($10.2) | ($10.6) | ($11.2) | ($11.7) | ($12.4) | ($13.1) |
| Net Draw | $13.1 | ($6.5) | ($8.4) | ($6.4) | ($5.8) | ($5.7) | ($5.8) | ($5.5) | ($5.7) | ($5.5) | ($5.6) | ($5.6) |
| **Combined:** | | | | | | | | | | | | |
| Gross Draw | $78.8 | $36.6 | $11.8 | $7.2 | $22.2 | $18.5 | $20.9 | $23.5 | $25.4 | $14.9 | $6.8 | $7.5 |
| Dividend | ($20.5) | ($27.4) | ($30.1) | ($30.9) | ($31.6) | ($33.4) | ($35.4) | ($37.6) | ($40.0) | ($42.4) | ($43.3) | ($44.0) |
| Net Draw | $58.4 | $9.2 | ($18.2) | ($23.7) | ($9.4) | ($14.9) | ($14.5) | ($14.1) | ($14.6) | ($27.5) | ($36.5) | ($36.5) |
| Beginning PSPA Stock | $171.6 | $250.4 | $287.0 | $298.8 | $306.0 | $328.2 | $346.7 | $367.6 | $391.1 | $416.5 | $431.4 | $438.2 |
| Total Gross Draw | $78.8 | $36.6 | $11.8 | $7.2 | $22.2 | $18.5 | $20.9 | $23.5 | $25.4 | $14.9 | $6.8 | $7.5 |
| Ending PSPA Stock | $250.4 | $287.0 | $298.8 | $306.0 | $328.2 | $346.7 | $367.6 | $391.1 | $416.5 | $431.4 | $438.2 | $445.7 |
| *Implied Dividend Rate* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* | *10%* |
| Beg. Net PSPA Stock | $139.5 | $197.9 | $207.1 | $188.8 | $165.1 | $155.7 | $140.8 | $126.3 | $112.2 | $97.6 | $70.2 | $33.6 |
| Net Draw / Repayment | $58.4 | $9.2 | ($18.2) | ($23.7) | ($9.4) | ($14.9) | ($14.5) | ($14.1) | ($14.6) | ($27.5) | ($36.5) | ($36.5) |
| **Cum. Net PSPA Draw** | **$197.9** | **$207.1** | **$188.8** | **$165.1** | **$155.7** | **$140.8** | **$126.3** | **$112.2** | **$97.6** | **$70.2** | **$33.6** | **($2.9)** |
| **Cum. Gross PSPA Draw** | **$250.4** | **$287.0** | **$298.8** | **$306.0** | **$328.2** | **$346.7** | **$367.6** | **$391.1** | **$416.5** | **$431.4** | **$438.2** | **$445.7** |
| **PSPA Capacity Left** | **$275.0** | **$238.4** | **$226.6** | **$219.4** | **$197.2** | **$178.7** | **$157.8** | **$134.3** | **$108.9** | **$94.0** | **$87.2** | **$79.7** |

Source: Grant Thorton



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## Appendix B: Scenario Analysis (Cont'd)

### Base case forecast for change under Policy Option 1

**Recommendation 1: Net comprehensive income (loss)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| Net Income (Loss) | ($6.4) | $14.9 | $23.7 | $19.5 | $14.6 | $14.0 | $13.7 | $13.2 | $14.0 | $13.8 | $13.5 | $13.4 |
| *NI Difference From Base Case* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* |

**Recommendation 1: Restructure the PSPA agreements and move to a variable dividend payment**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| *Base Case Gross Draw* | *$39.2* | *$11.4* | *$2.9* | *$1.2* | *$7.0* | *$7.1* | *$8.2* | *$10.9* | *$12.3* | *$13.3* | *$15.1* | *$16.8* |
| Total Gross Draw | $39.2 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Dividend | ($19.1) | ($10.3) | ($19.6) | ($21.4) | ($15.9) | ($16.4) | ($16.1) | ($14.3) | ($14.0) | ($14.3) | ($13.9) | ($13.8) |
| Net Draw | $20.1 | ($10.3) | ($19.6) | ($21.4) | ($15.9) | ($16.4) | ($16.1) | ($14.3) | ($14.0) | ($14.3) | ($13.9) | ($13.8) |
| | | | | | | | | | | | | |
| Beginning PSPA Stock | $171.6 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 |
| Total Gross Draw | $39.2 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Ending PSPA Stock | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 | $210.8 |
| *Implied Dividend Rate* | *10.0%* | *4.9%* | *9.3%* | *10.2%* | *7.5%* | *7.8%* | *7.6%* | *6.8%* | *6.7%* | *6.8%* | *6.6%* | *6.5%* |
| **Cum. Net PSPA Draw** | **$159.6** | **$149.3** | **$129.7** | **$108.3** | **$92.4** | **$76.0** | **$59.9** | **$45.7** | **$31.6** | **$17.3** | **$3.4** | **($10.4)** |
| **Cum. Gross PSPA Draw** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** | **$210.8** |
| **PSPA Capacity Left** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** |

Source: Grant Thorton, U.S. Department of Treasury

### Stress case forecast for change under Policy Option 1

**Recommendation 1: Net comprehensive income (loss)**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| Net Income (Loss) | ($56.8) | ($2.2) | $21.8 | $24.7 | $14.9 | $14.2 | $13.9 | $13.4 | $14.1 | $14.0 | $13.6 | $13.4 |
| *NI Dif. From Base Stress Case* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* | *$0.0* |

**Recommendation 1: Restructure the PSPA agreements and move to a variable dividend payment**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| *Base Stress Case Gross Draw* | *$78.8* | *$36.6* | *$11.8* | *$7.2* | *$22.2* | *$18.5* | *$20.9* | *$23.5* | *$25.4* | *$14.9* | *$6.8* | *$7.5* |
| Total Gross Draw | $78.8 | $15.7 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Dividend | ($20.5) | ($6.5) | ($18.2) | ($23.7) | ($9.4) | ($14.9) | ($14.5) | ($14.1) | ($14.6) | ($27.5) | ($36.5) | ($36.5) |
| Net Draw | $58.4 | $9.2 | ($18.2) | ($23.7) | ($9.4) | ($14.9) | ($14.5) | ($14.1) | ($14.6) | ($27.5) | ($36.5) | ($36.5) |
| | | | | | | | | | | | | |
| Beginning PSPA Stock | $171.6 | $250.4 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 |
| Total Gross Draw | $78.8 | $15.7 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Ending PSPA Stock | $250.4 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 | $266.1 |
| *Implied Dividend Rate* | *9.7%* | *2.5%* | *6.8%* | *8.9%* | *3.5%* | *5.6%* | *5.4%* | *5.3%* | *5.5%* | *10.3%* | *13.7%* | *13.7%* |
| **Cum. Net PSPA Draw** | **$197.9** | **$207.1** | **$188.8** | **$165.1** | **$155.7** | **$140.8** | **$126.3** | **$112.2** | **$97.6** | **$70.2** | **$33.6** | **($2.9)** |
| **Cum. Gross PSPA Draw** | **$250.4** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** | **$266.1** |
| **PSPA Capacity Left** | **$275.0** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** | **$259.3** |

Source: Grant Thorton, U.S. Department of Treasury



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## Appendix B: Scenario Analysis (Cont'd)

Base case forecast for change under Policy Option 1 and 3

**Recommendation 3: Dividend Sweep and Pull NPL Forward**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| Net Income (Loss) | ($55.8) | $22.1 | $29.6 | $24.4 | $18.6 | $17.3 | $16.4 | $15.4 | $15.9 | $15.4 | $14.5 | $13.4 |
| *NI Difference From Base Case* | *($49.4)* | *$7.1* | *$5.9* | *$4.9* | *$4.0* | *$3.3* | *$2.7* | *$2.2* | *$1.9* | *$1.5* | *$1.0* | *$0.0* |

**Recommendation 3: Dividend Sweep and Pull NPL Forward**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| *Base Case Gross Draw* | *$39.2* | *$11.4* | *$2.9* | *$1.2* | *$7.0* | *$7.1* | *$8.2* | *$10.9* | *$12.3* | *$13.3* | *$15.1* | *$16.8* |
| Gross Draw | $88.6 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Dividend | ($19.1) | ($17.4) | ($25.5) | ($26.3) | ($19.9) | ($19.7) | ($18.8) | ($16.5) | ($15.9) | ($15.8) | ($14.9) | ($13.8) |
| Net Draw | $69.5 | ($17.4) | ($25.5) | ($26.3) | ($19.9) | ($19.7) | ($18.8) | ($16.5) | ($15.9) | ($15.8) | ($14.9) | ($13.8) |
| | | | | | | | | | | | | |
| Beginning PSPA Stock | $171.6 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 |
| Gross Draw | $88.6 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Ending PSPA Stock | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 | $260.2 |
| *Implied Dividend Rate* | *8.8%* | *6.7%* | *9.8%* | *10.1%* | *7.6%* | *7.6%* | *7.2%* | *6.4%* | *6.1%* | *6.1%* | *5.7%* | *5.3%* |
| | | | | | | | | | | | | |
| **Cum. Net PSPA Draw** | **$209.0** | **$191.6** | **$166.1** | **$139.8** | **$120.0** | **$100.2** | **$81.4** | **$64.9** | **$49.0** | **$33.2** | **$18.2** | **$4.5** |
| **Cum. Gross PSPA Draw** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** | **$260.2** |
| **PSPA Capacity Left** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** | **$275.0** |

Source: Grant Thorton, U.S. Department of Treasury

Stress case forecast for change under Policy Option 1 and 3

**Recommendation 3: Dividend Sweep and Pull NPL Forward**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| Net Income (Loss) | ($106.2) | $4.9 | $27.7 | $29.6 | $18.9 | $17.6 | $16.6 | $15.6 | $16.0 | $15.5 | $14.6 | $13.4 |
| *NI Difference From Base Stress Case* | *($49.4)* | *$7.1* | *$5.9* | *$4.9* | *$4.0* | *$3.3* | *$2.7* | *$2.2* | *$1.9* | *$1.5* | *$1.0* | *$0.0* |

**Recommendation 3: Dividend Sweep and Pull NPL Forward**

| $ in billions | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 | FY2017 | FY2018 | FY2019 | FY2020 | FY2021 | FY2022 | FY2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Combined:** | | | | | | | | | | | | |
| *Base Stress Case Gross Draw* | *$78.8* | *$36.6* | *$11.8* | *$7.2* | *$22.2* | *$18.5* | *$20.9* | *$23.5* | *$25.4* | *$14.9* | *$6.8* | *$7.5* |
| Gross Draw | $128.2 | $9.9 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Dividend | ($20.5) | ($7.9) | ($24.1) | ($28.6) | ($13.4) | ($18.2) | ($17.2) | ($16.3) | ($16.5) | ($29.0) | ($37.6) | ($36.5) |
| Net Draw | $107.8 | $2.0 | ($24.1) | ($28.6) | ($13.4) | ($18.2) | ($17.2) | ($16.3) | ($16.5) | ($29.0) | ($37.6) | ($36.5) |
| | | | | | | | | | | | | |
| Beginning PSPA Stock | $171.6 | $299.8 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 |
| Gross Draw | $128.2 | $9.9 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 | $0.0 |
| Ending PSPA Stock | $299.8 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 | $309.7 |
| *Implied Dividend Rate* | *8.8%* | *6.7%* | *9.8%* | *10.1%* | *7.6%* | *7.6%* | *7.2%* | *6.4%* | *6.1%* | *6.1%* | *5.7%* | *5.3%* |
| | | | | | | | | | | | | |
| **Cum. Net PSPA Draw** | **$247.3** | **$249.3** | **$225.2** | **$196.6** | **$183.2** | **$165.0** | **$147.8** | **$131.5** | **$115.0** | **$86.0** | **$48.4** | **$11.9** |
| **Cum. Gross PSPA Draw** | **$299.8** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** | **$309.7** |
| **PSPA Capacity Left** | **$275.0** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** | **$265.1** |

Source: Grant Thorton, U.S. Department of Treasury



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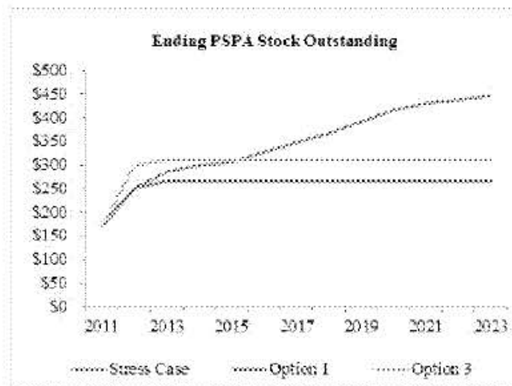
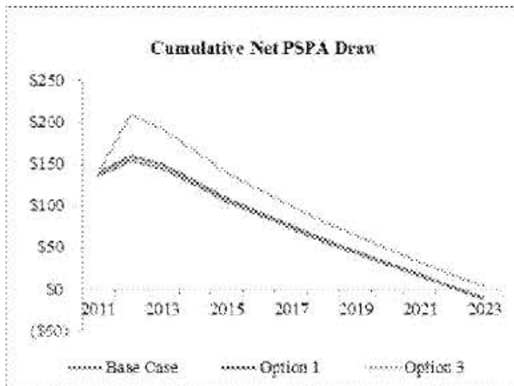
## Appendix C: Graphical Forecasts of Policy Actions

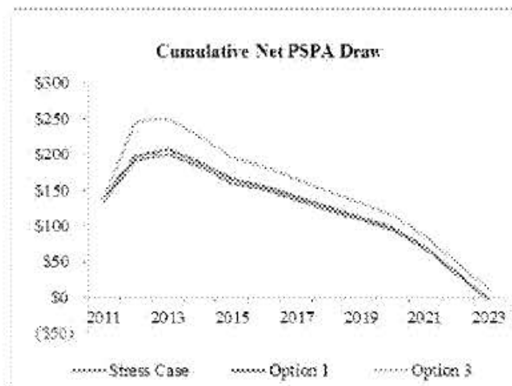
**Gross and Net PSPA Draws**

**Base Case**

**Stress Case**




**Key for the charts above:**

1) Base Case – base case forecast as provided by FHFA and Grant Thorton
2) Stress Case – stress case forecast as provided by FHFA and Grant Thorton
3) Option 1 – Restructure the PSPA agreements to a variable dividend payment
4) Option 2 – Not applicable
5) Option 3 – Initiate an NPL disposition program and contribute legacy assets into a special purpose vehicle (SPV) or joint venture (JV) that manages loss mitigation activities



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## Appendix D: GAAP and FMV Balance Sheet Reserves

| | | | | C-D | | | | | E+F+G | D+H | C-D-H | | C-D-G | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| A | B | C | D | J | K | E | F | G | H | I | L | M | N | O |
| | | | | | | | *Fair Market Value* | | | | | *Carrying Value* | | |
| **Total GSE** | **Count** | **UPB** | **GAAP Allowance** | **GAAP Carry Value** | ***% of UPB*** | **Capital Costs** | **Market Discount** | **Expected Losses** | **Total FMV Allowance** | **Total Allowance** | **FMV Carry Value** | ***% of UPB*** | **FMV Ex-Capital/Mrkt** | ***% of UPB*** |
| Performing | 27,051,977 | $4,117.6 | $33.5 | $4,084.1 | *99.2%* | $54.8 | $5.7 | $47.6 | $108.0 | $141.6 | $3,976.1 | *96.6%* | $4,036.6 | *98.0%* |
| Sub-Performing | 756,904 | 108.1 | 10.3 | 97.8 | *90.4%* | 3.6 | 5.9 | 3.3 | 12.8 | 23.1 | 85.0 | *78.6%* | 94.4 | *87.4%* |
| Non-Performing | 1,372,769 | 263.7 | 65.7 | 198.0 | *75.1%* | 7.8 | 37.7 | 16.3 | 61.8 | 127.4 | 136.3 | *51.7%* | 181.7 | *68.9%* |
| Totals | 29,181,650 | 4,489.4 | 109.5 | 4,379.9 | *97.6%* | 66.2 | 49.2 | 67.2 | 182.6 | 292.1 | 4,197.3 | *93.5%* | 4,312.7 | *96.1%* |
| ***% of Total*** | | | | | | | | | | | | | | |
| Performing | *92.7%* | *91.7%* | *30.6%* | *93.2%* | | *82.8%* | *11.5%* | *70.8%* | *59.2%* | *48.5%* | *94.7%* | | *93.6%* | |
| Sub-Performing | *2.6%* | *2.4%* | *9.4%* | *2.2%* | | *5.4%* | *12.0%* | *5.0%* | *7.0%* | *7.9%* | *2.0%* | | *2.2%* | |
| Non-Performing | *4.7%* | *5.9%* | *60.0%* | *4.5%* | | *11.8%* | *76.5%* | *24.2%* | *33.8%* | *43.6%* | *3.2%* | | *4.2%* | |
| Totals | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | |
| **Fannie Mae** | **Count** | **UPB** | **GAAP Allowance** | **GAAP Carry Value** | ***% of UPB*** | **Capital Costs** | **Market Discount** | **Expected Losses** | **Total FMV Allowance** | **Total Allowance** | **FMV** | ***% of UPB*** | **FMV Ex-Capital/Mrkt** | ***% of UPB*** |
| Performing | 16,064,713 | $2,481.2 | $25.9 | $2,455.3 | *99.0%* | $28.2 | $0.0 | $25.6 | $53.8 | $79.7 | $2,401.5 | *96.8%* | $2,429.7 | *97.9%* |
| Sub-Performing | 465,489 | 64.6 | 4.9 | 59.7 | *92.4%* | 2.1 | 4.1 | 3.8 | 9.9 | 14.8 | 49.8 | *77.1%* | 56.0 | *86.6%* |
| Non-Performing | 886,111 | 166.2 | 39.6 | 126.6 | *76.2%* | 5.6 | 30.4 | 13.6 | 49.7 | 89.3 | 77.0 | *46.3%* | 113.1 | *68.0%* |
| Totals | 17,416,313 | 2,712.1 | 70.4 | 2,641.7 | *97.4%* | 35.9 | 34.5 | 43.0 | 113.4 | 183.8 | 2,528.3 | *93.2%* | 2,598.7 | *95.8%* |
| ***% of Fannie Mae*** | | | | | | | | | | | | | | |
| Performing | *92.2%* | *91.5%* | *36.8%* | *92.9%* | | *78.5%* | *0.0%* | *59.6%* | *47.4%* | *43.4%* | *95.0%* | | *93.5%* | |
| Sub-Performing | *2.7%* | *2.4%* | *6.9%* | *2.3%* | | *5.8%* | *11.8%* | *8.8%* | *8.8%* | *8.1%* | *2.0%* | | *2.2%* | |
| Non-Performing | *5.1%* | *6.1%* | *56.2%* | *4.8%* | | *15.7%* | *88.2%* | *31.6%* | *43.8%* | *48.6%* | *3.0%* | | *4.4%* | |
| Totals | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | |
| **Freddie Mac** | **Count** | **UPB** | **GAAP Allowance** | **GAAP Carry Value** | ***% of UPB*** | **Capital Costs** | **Market Discount** | **Expected Losses** | **Total FMV Allowance** | **Total Allowance** | **FMV** | ***% of UPB*** | **FMV Ex-Capital/Mrkt** | ***% of UPB*** |
| Performing | 10,987,264 | $1,636.5 | $7.6 | $1,628.9 | *99.5%* | $26.6 | $5.7 | $22.0 | $54.3 | $61.9 | $1,574.6 | *96.2%* | $1,606.9 | *98.2%* |
| Sub-Performing | 291,415 | 43.5 | 5.4 | 38.0 | *87.5%* | 1.5 | 1.8 | (0.4) | 2.9 | 8.3 | 35.2 | *80.9%* | 38.5 | *88.5%* |
| Non-Performing | 486,658 | 97.5 | 26.1 | 71.4 | *73.3%* | 2.2 | 7.2 | 2.7 | 12.1 | 38.2 | 59.3 | *60.9%* | 68.7 | *70.5%* |
| Totals | 11,765,337 | 1,777.4 | 39.1 | 1,738.3 | *97.8%* | 30.3 | 14.7 | 24.2 | 69.2 | 108.3 | 1,669.1 | *93.9%* | 1,714.0 | *96.4%* |
| ***% of Freddie Mac*** | | | | | | | | | | | | | | |
| Performing | *93.4%* | *92.1%* | *19.4%* | *93.7%* | | *88.0%* | *38.6%* | *90.7%* | *78.4%* | *57.1%* | *94.3%* | | *93.7%* | |
| Sub-Performing | *2.5%* | *2.4%* | *13.9%* | *2.2%* | | *4.9%* | *12.3%* | *(1.8%)* | *4.1%* | *7.7%* | *2.1%* | | *2.2%* | |
| Non-Performing | *4.1%* | *5.5%* | *66.7%* | *4.1%* | | *7.1%* | *49.1%* | *11.1%* | *17.5%* | *35.2%* | *3.6%* | | *4.0%* | |
| Totals | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | *100.0%* | | *100.0%* | |



UST00473645

# Mortgage Market Issues: Discussion with Treasury Secretary Geithner

**Edward J. DeMarco**
**Federal Housing Finance Agency**
**January 19, 2012**

# Background

On January 6th, 2012, we met to discuss housing market issues and the Administration's thoughts on near-term and longer-term changes in housing finance policy, including matters involving Fannie Mae and Freddie Mac (the Enterprises).

You asked FHFA to consider these matters and to rejoin the discussion with thoughts on what we could or could not do, either as a matter of law or policy.

This briefing responds to that request. We appreciate this opportunity and look forward to a continued, constructive dialogue to seek improved outcomes for homeowners, neighborhoods, markets, and taxpayers.



FHFA00043796_0001

# Agenda

- FHFA View on Key Housing Market Challenges
- Longer-Term Issues
  - PSPAs
  - Strategic Goals for Conservatorship
- HARP
- HAMP
  - Extension
  - Expansion
  - Equity Building
- REO Sales

# FHFA View on Key Housing Market Challenges

FHFA sees the following 4 issues as the key policy changes facing FHFA and housing finance:

- Reps and warrants – goal is first quarter announcement by FHFA
- REO and NPL Disposition – implement program
- Short sales / deeds-in-lieu / deeds-for-lease – needs a HARP 2.0-style review for frictions and impediments for these foreclosure avoidance transactions
- Impediments to market clearing created by state and local laws and practices, especially governing foreclosure

FHFA also seeks to make material progress in 2012 on outstanding litigation and putback requests, which would also remove uncertainty from the market.

# Longer-Term Issues: PSPAs

- Current agreement resets the Treasury funding cap based on losses for the 3 years ending on December 31, 2012.
- Some market participants have begun to raise questions regarding whether this will be sufficient to justify continued investment in Enterprise securities.
- While FHFA projections show draws leveling off, more adverse house price paths and other operational changes at the Enterprises could lead to dividends eating into future cap space.
- The Periodic Commitment Fee has been waived to-date, and the setting of this Fee could also impact near-term stability.
- FHFA is willing to consider PSPA changes that add to the stability of the market. Let's develop a list of items for consideration, establish a FHFA-Treasury working group to work through the list, and set a timeline to wrap this up before the end of the second quarter.



FHFA00043796_0004

## Longer-Term Issues: Strategic Goals for Conservatorship

- In line with FHFA's conservatorship mandates to place the companies in a sound and stable condition, and to limit overall risk as length of the conservatorships extends, FHFA began work in 2011 and seeks implementation in 2012:
  - Price increases
  - Loss-sharing
  - Asset sales
- Many of these issues were also highlighted in the Administration's Housing Finance Reform White Paper as important to bringing private capital back to the market.
- FHFA also anticipates further progress on building a new housing finance infrastructure that will work under any future state of housing finance.
  - Four initiatives underway: uniform data, servicing alignment, servicing compensation, and loan-level disclosures
  - Other steps could include new, single securitization platform, standard setting, MERS.

# Longer-Term Issues: Strategic Goals for Conservatorship

Strategic plan for next two-three years of conservatorship has three principal components:

1. Build for the future
2. Gradually reduce Enterprise imprint on future business
3. Maintain ongoing stability and liquidity in the mortgage market, including:
    1. Loss mitigation efforts
    2. Refinance and home purchase mortgage activity
    3. Human capital and essential infrastructure at the Enterprises
    4. Strengthen risk management and operational controls

Given increased uncertainty brought on through a number of sources, difficult choices may have to be made regarding existing business activities.



FHFA00043796_0006

# HARP

- From April 1, 2009 through October 31, 2011 – a span of 31 months – the Enterprises have refinanced 9.3 million mortgages, including:
  - 962,132 HARP refinances
  - 1,698,967 non-HARP streamlined refinances
- This 9.3 million refinances is about 1/3 of their entire performing mortgage book as of April 1, 2009.
- HARP 2.0 began December 1, 2011, so it is very early in the process. FHFA met with all the key players in mid-December to review implementation progress and no significant issues were identified.
- Refinance activity has spiked. The MBA just reported that last week' refinance index jumped 26 percent last week, its largest weekly increase since early August.
- We find no meaningful market impediment for borrowers below 80 percent LTV from refinancing.



FHFA00043796_0007

# HARP

- The Enterprises implement HARP identically but non-HARP protocols and systems follow proprietary technology and risk management systems. [Meg – can we add something here about technical changes Freddie Mac recently made to align with Fannie?] These differences do not create meaningful barriers to refinance.
- Cross servicer refinancing will be enhanced shortly when the Enterprises' automated underwriting systems are updated to provide valuation and underwriting review.
- A new originator will never be able to do as streamlined a refinance as the current servicer because the new originator lacks the loan files and documents necessary to maximize the streamlining. Enterprise use of automated underwriting systems helps new originators offset this inherent shortcoming.



FHFA00043796_0008

# HARP: Refi Eligibility Data

- Insert here data on distribution of performing Enterprise loans by vintage and note rate.



FHFA00043796_0009

# HAMP: Extension

We understand Treasury is considering two HAMP extensions:

- End-date extend from 12/31/12 to 12/31/13, and
- Loan origination eligibility date from 1/09 to 10/10.

Extending the end-date:

- We can do it and are prepared to follow Treasury's lead.
- Our policy view is that extension is not necessary nor desired by market participants nor by FHFA, Fannie, or Freddie. Ceasing HAMP would free servicers to pursue non-HAMP mods that may have a greater likelihood of success because they are not bound by HAMP's requirements and may have flexibilities beyond HAMP, such as those found in Enterprise standard mods.
  - Our experience shows borrowers continue to resist HAMP's documentation requirements, likely because of borrower misrepresentation on the original loan.
- We recommend that HAMP expire as scheduled, or sooner.

# HAMP: Extension

Extending the Eligibility Date

- We can do it but do not want to on policy grounds.
- We would advise Treasury against extending the eligibility date, which was set to make clear HAMP was structured as a temporary program to deal with a pre-crash set of mortgages.
- An extension at this juncture:
  - Runs counter to commitment to gradually step government away from mortgage support
  - Would create fear and uncertainty in the marketplace for a similar extension of HARP eligibility, something FHFA would resist at all costs as bad faith with the market.
- 2009 – 2010 borrowers who become delinquent have likely done so due to life events and traditional HAMP not likely to be a good solution.
- Universe of 2009-2010 borrowers requiring mods is very small. [data?]

# HAMP: Expansion

Treasury has suggested that an alternative loan mod, based on the Enterprise standard mod, be added to the HAMP waterfall. We will call this HAMP 2.

- Enterprises can and will support this expansion as financial agents
- We understand HAMP 2 will adjust the Enterprises' standard mod to fit HAMP requirements (eg, an NPV test, making incentive payments, documentation) and the profile of non-Enterprise loans.
- After months of effort to develop and implement the standard mod, these adjustments are not likely to enhance the Enterprises' current loan mod offering in any way but will add operational cost and complexity for them.
- FHFA and Enterprise staffs are exploring ways to streamline standard mod reporting into IR2 while preserving its current operations.

# HAMP: Equity Building

Treasury asked FHFA to consider several options for building equity for underwater borrowers, ranging from the Enterprises accepting incentive payments from TARP for principal reduction HAMP mods to various forms of equity-building refinances.

- HAMP mods – PRA
  - Incentive payments from TARP reduce conservator costs but are offset dollar-for-dollar by TARP outlays. No savings for taxpayers.
  - Operational costs of implementation for a limited pool of potentially eligible borrowers is high
    - Data – provide data on number of underwater and delinquent Enterprise borrowers that could potentially benefit from PRA
    - Other relevant data from Andrew & Deb's work?
  - Meg – help!! Need arguments added here on
    - Moral hazard – provide data that 7x percent of Enterprise underwater borrowers are current and this would create meaningful incentive to miss payments to get principal reduction
    - Opportunity cost of resource shift from higher priority activity



FHFA00043796_0013

# HAMP Equity Building

- Equity Building – Refi Approach
  - Treasury floated some ideas for equity-building refinance options for underwater borrowers outside of HARP.
  - FHFA-Treasury staff discussions have not successfully advanced this concept to-date but FHFA is open to continued discussions.
- Equity Building – Loan Mod Approach
  - FHFA proposes that FHFA and Treasury explore an alternative approach to equity building that has the equivalent economic effect of principal forgiveness for current but deeply underwater borrowers.
  - See handout.
  - May satisfy Treasury & FHFA mutual objective of lowering risk to taxpayers from deeply underwater borrowers while stabilizing housing markets, especially where there is a concentration of underwater borrowers.
  - Avoids moral hazard, utilizes TARP housing funds for equity building, keeps focus on borrower continuing to make payments, and is operationally simpler and faster for everyone than a refinance or a full HAMP mod. Is accessible to both Enterprise and non-Enterprise loans.

# REO Sales

- FHFA striving to announce initial REO sale(s) by end of January. [Three] initial offerings being prepared:
  - Tenant-in-place
  - ?
  - Nonperforming loans
- Meg – add data and whatever text you like.
- I think you suggested we report the steady decline in REO inventory and the success of our current retail sales strategy.

# FREDDIE MAC
# CONFIDENTIAL CAPITAL REVIEW

## PRELIMINARY RESULTS

**August 25, 2008**

# Project Purpose

**Freddie Mac has engaged BlackRock to apply its mortgage models and expertise to assess its exposure to single family residential mortgages in the guarantee and ABS books**

- What losses might Freddie Mac experience under various scenarios?
- What implications might these losses have for Freddie Mac's capital through 2010?

**This document presents our <u>preliminary</u> answers prepared with limited data under a tight deadline**

- Used primarily public FRE data to estimate losses on the guarantee portfolio
- Proprietary CUSIP-level data used for the ABS portfolio
- Applied simplified earnings-and-capital model to convert credit losses into capital projections
  - Utilized Street projections for key revenue and expense estimates
  - Did not mirror complexities of FRE accounting

**Our final results will be based on a much more proprietary FRE data and closer approximation of FRE accounting**

- BLK is assembling loan cohorts at the loan-level for the guarantee book
- Cash flows will be projected using 7 base and stress scenarios: 4 BLK scenarios and 3 FRE-defined scenarios
- BLK will work with FRE staff on refining the model for converting scenario outcomes to capital outcomes, with the aim of more closely approximating internal methods/accounting policies

**The final analysis is targeted for completion by September 5**



S&S EENN-7HVSXA01
FHFA00056238

# Key Conclusions on Capital Shortfall

**Freddie Mac runs a substantial risk of falling short of current surplus capital requirements and possibly statutory minimums**

- Base case reflects BlackRock's bearish outlook (25-30% peak-to-trough national house price decline, versus 10-15% so far)
- Reasonable stress case (50% higher default rate than base) – this is not a worst-case outcome

**...But long-term solvency does not appear endangered - we do not expect Freddie Mac to breach critical capital levels even in stress case**

- PRELIMINARY -

BINGO!!! HOLY CRAP. WHOLE THING WAS KNOWN TO BE A SHAM PRE-CONSERVATORSHIP

**Estimated Capital ($BN)***

| | FRE | | |
|---|---|---|---|
| | 2008 Q2 | 2009 E | 2010 E |
| Statutory Requirement | 29 | 29 | 29 |
| OFHEO Requirement | 34 | 34 | 34 |
| Critical Capital | 12 | 12 | 12 |
| Base Case Capital | 38** | 36 | 35 |
| Stress Case Capital | NA | 29 | 26 |

** Numbers are estimates, have not been linked to actual financials and do not include recently reported results from 2008 Q2.*
***Estimated; no adjustment for losses in Q2.*
*Other notes: Net interest income, non interest income and other financial variables used in the capital and earnings model were based on Wall Street estimates.*





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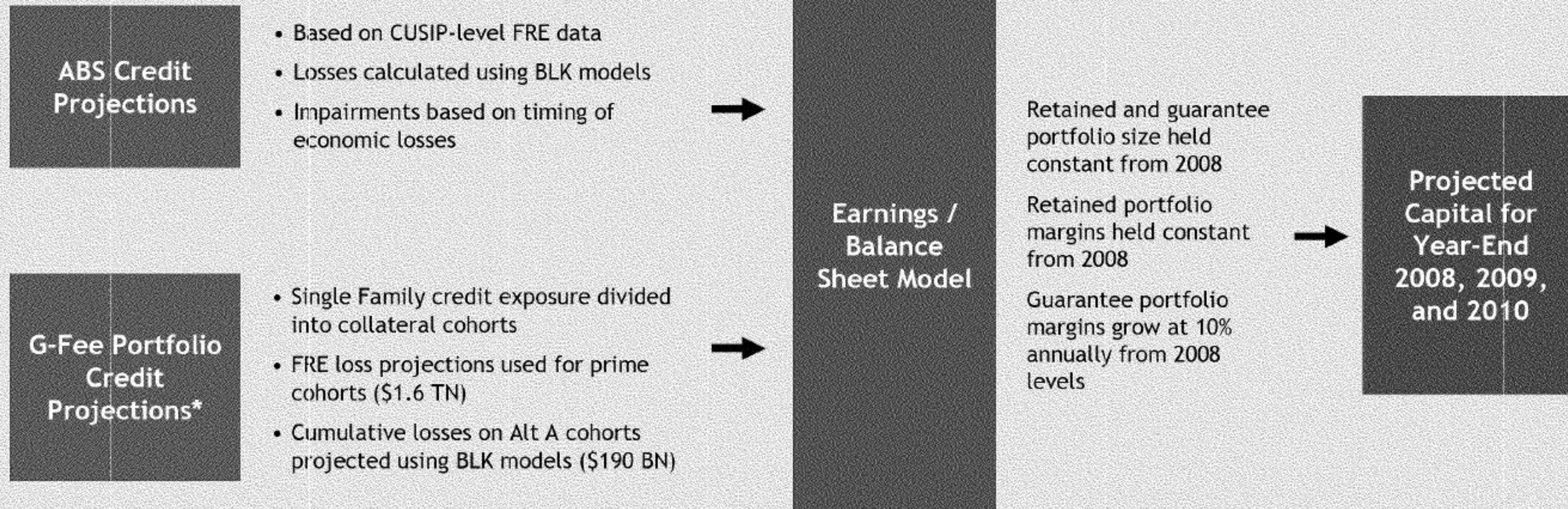
# Model Logic and Underlying Data




## Base Case and Stress Scenarios

**For the Prime book, FRE Base Case and Stress scenarios are used**

**For the Alt A book, BLK scenarios are used**

- Base Case reflects BlackRock's baseline settings of its econometric Alt-A models
- Stress Case reflects 50% higher defaults for Subprime and 25% for Alt-A



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# Assumptions and Caveats

## This analysis should be viewed as preliminary

- Except for loss estimates on ABS portfolio, analysis is based on publicly available data
- Conducted in extremely short timeframe
- We have greater confidence in the gross loss estimates than in the capital calculations;
- Final capital results will be based on a more realistic financial model, developed in conjunction with Freddie Mac

## Key assumptions for loss estimates

- Guarantee portfolio
  - Prime book loss assessment based on FRE projections
  - Mortgage insurance recoveries are implicitly incorporated in prime book based on FRE analysis - FRE assumptions may overstate MI recoveries in prime book; BLK analysis may understate in Alt-A book
  - Timing of recognition of accounting losses on whole loans is stylized and is not tied to actual FRE accounting policy or recently reported financial results
- ABS portfolio
  - ABS portfolio credit loss impairment evaluated only for those bonds on which a principal loss is predicted
  - Timing of impairments based on date of first predicted principal loss
  - Impairment equals the face amount at the first loss date times the difference between par and current market price
- Multi-Family book not modeled



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# ABS Portfolio Loss Assumptions and Results

## "Other Than Temporary Impairment" accounting rule can trigger mark-to-market declines more severe than expected principal loss

- Accounting treatment requires securities to be marked to market if any principal loss is deemed "probable"
- Given the current market environment, MTM losses will likely exceed actual principal losses
  - Impairments diminish capital immediately
  - Future recoveries in market value do not flow through capital

## ABS projections therefore depend on three uncertain variables

- Timing of impairment (see below)
- Face value at time of impairment (projected by model)
- Market value at time of impairment (based on current market value)

## Impairment timing assumptions:

- Predicted losses in 2008 - 2010 impaired in 2008
- Predicted losses in 2011 - 2012 impaired in 2009
- Predicted losses in 2013 - 2014 impaired in 2010

- PRELIMINARY -

FRE
Total ABS Face: $152 BN

| | ABS Principal Loss % | ABS Principal Loss ($ BN) | 2008 - 2010 Potential Impairment ($BN) |
|---|---|---|---|
| Base Case* | 2.3% | 3.5 | 2.9 |
| Stress | 5.7% | 8.7 | 4.3 |

* Loss estimates include the credit support of monoline wraps



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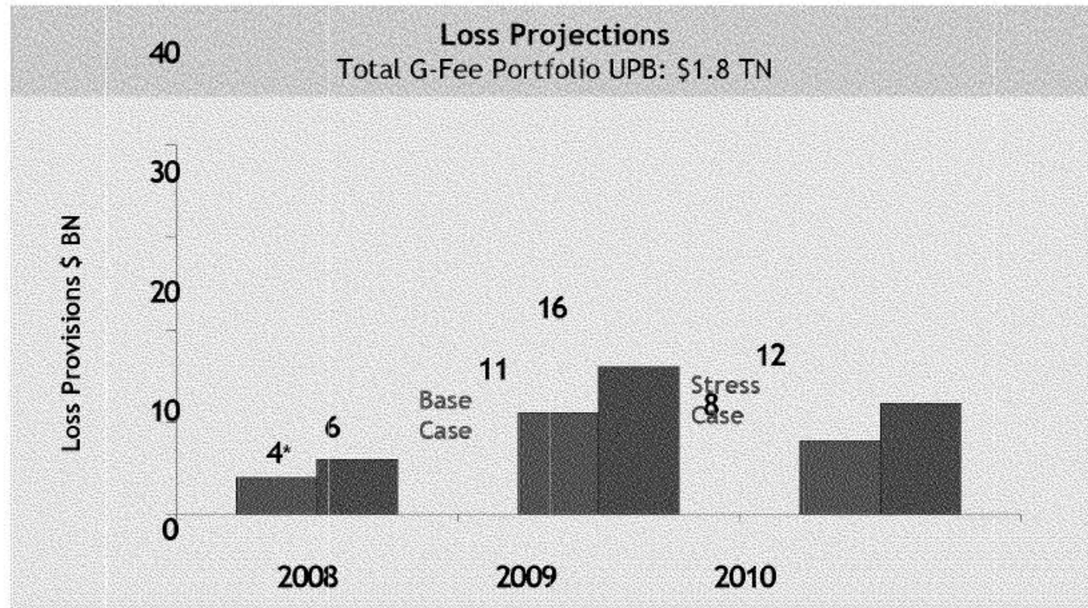
# G-fee Portfolio Loss Assumptions and Projections

Prime portfolio losses were based on FRE's loss projections (FRE provided more detailed information on loss projections for its prime portfolio, which we believe to be reasonable)

We assume approximately 70% of cumulative losses will occur by the end of 2010

Our projections begin accumulating losses in the second half of 2008

- PRELIMINARY -




* Reflects remaining provisions for Q3 and Q4; adjusted for provisions already taken in Q1 and Street estimates for Q2 (at time of this analysis).



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## *Credit Loss and Provision Forecasting*
## *1Q’12--Executive Summary*

**Loan Loss Reserves Governance Committee**
**May 8, 2012**

**DRAFT: 5/7/12c**

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## Key Messages

- Credit losses, which consist of charge-offs and REO ops expenses, are expected to rise modestly from current levels until mid-2012, then gradually decline/improve thereafter.
  - » The projected time profile of losses is generally similar to the 4Q'11 forecast.
  - » Monthly projections exclude impacts of future new purchases (small effects in near term).

| | | |
|---|---|---|
| 2011 (actual): | Total external losses: $13.0B | Charge-offs: $12.4B |
| 2012 (forecast): | Total external losses: $13.8B | Charge-offs: $13.0B |
| 2013 (forecast): | Total external losses: $12.3B | Charge-offs: $11.6B |

- Forecast includes adjustments consistent with LLR on top adjustments and assumption changes adopted in 1Q'12.
  - » Results reflect the $1.5B mod on top adjustment included in 1Q'12 LLR. The on top is incorporated in the credit loss forecast (CLF) by lowering the volume of projected loan mods and increasing REO/FA projections, consistent with the estimated effects of the loan mod reduction.
  - » The 1Q'12 LLR additional mortgage insurance/credit enhancement shortfall on top adjustment ($283M) is incorporated by increasing charge-off severity by 37 bps in all forecasted periods—the amount that severity would have increased had the adjustment been made directly through the severity calculation in the1Q'12 LLR process.
  - » [redacted].
    - – Judgment is required for this on top in order to infer the timing of the effects. [redacted] The results appear reasonable and will be monitored prospectively compared to actual results as they emerge.

WHY REDACTED???

## Key Messages—Cont.

- Drivers of loss projections:
  - » REO/FA counts expected to increase modestly until late 2012, then decline through 2013. The annual level in 2012 is expected to be a little lower than 2011, then show more visible declines in 2013.
    - 2011: 170K (w/T-Deals est.)
    - 2012: 163K (w/T-Deals est. for 1Q'12)
    - 2013: 149K (T-Deals included in base projections)
  - » REO/FA default UPB generally reflects similar patterns, with a comparable decline in 2013:
    - 2011: $33.1B (w/T-Deals est.)
    - 2012: $30.5B (w/T-Deals est. for 1Q'12)
    - 2013: $27.3B (T-Deals included in base projections)
  - » Charge-off severity is projected to worsen through late 2012 before its peak, followed by leveling/modest improvement (based on the corporate house price forecast).

- Reserves, charge-offs, provision forecast (BPE basis, including new purchases, before GAAP adjustments).
  - » Reserve estimate expected to decline by about $1.1B to $33.8B in 2Q'12, followed by larger declines in subsequent quarters as charge-offs gradually normalize and D90+ inflows continue to decline.
  - » Charge-offs (including assumed impacts for future new purchases) projected to peak and plateau by 3Q'12, then decline in subsequent quarters.
  - » Provision is projected to decrease to $2.2B in 2Q'12 (from $2.4B in 1Q'12), and continue to decline in subsequent quarters.

- GAAP basis reserves generally follow similar patterns. FAS 114 component of the reserve continues to rise with growing accumulated mod volumes before peaking in late 2012, then gradually declines.
  - » GAAP provision forecast also generally trends downward, with some modest volatility.

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## Key Messages—Cont.

- Analysis and highlights of the forecast.
  - Fundamentally, the 1Q'12 forecast projects a slightly higher level than the 4Q'11 forecast with respect to long-term charge-offs and provision on both a BPE and GAAP basis.
  - The overall time profile of the 1Q'12 forecast is broadly similar to the prior forecast, but losses are projected to be slightly lower in the near term (i.e., next 2-3 years), stay higher longer after that, and end up with higher losses in the long run than in the 4Q'11 forecast.
    - Compared to actual charge-offs in 1Q'12, projected charge-offs are expected to remain relatively flat/increase modestly in the near term (e.g., next several quarters), reflecting expected mild worsening of severity and small increases in REO/FA volumes. Charge-offs are expected to peak at $3.3B in 3Q'12 and decline gradually thereafter, although at a slower rate than previously projected. Foreclosure documentation issues continue to contribute to extended timelines for losses.
    - The inventory of serious delinquencies in 1Q'12 declined less than projected in the 4Q'11 forecast. More substantial declines are expected in future periods as D90 inflows decline and outflows from the seriously delinquent population continue prospectively.
    -

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## Key Messages—Cont.

- Notes on selected forecast limitations and/or qualifications.
  - [redacted]
  - [redacted]
  - FHFA directives or business policy/practice changes. For example, potential impacts of HARP changes are highly uncertain (even as to the direction of impacts), but could have a major impact on future results. Similarly, prospective business area repurchase policy/practice overhaul could be significant, increasing uncertainty, but cannot be quantified at this time
- **As a result of the above factors, a high margin of uncertainty persists around these CLF and provision estimates.**

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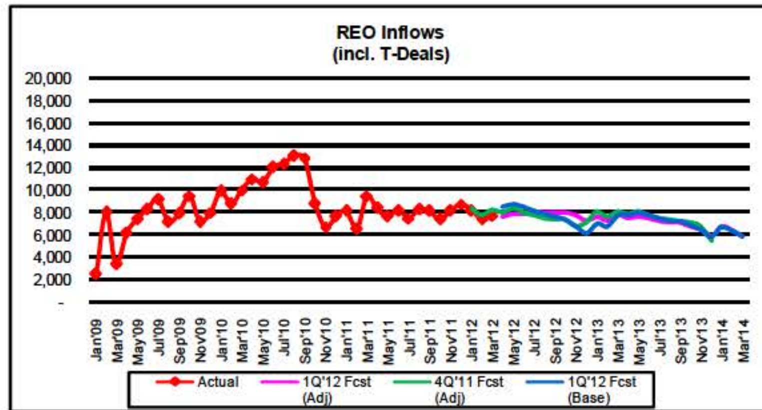
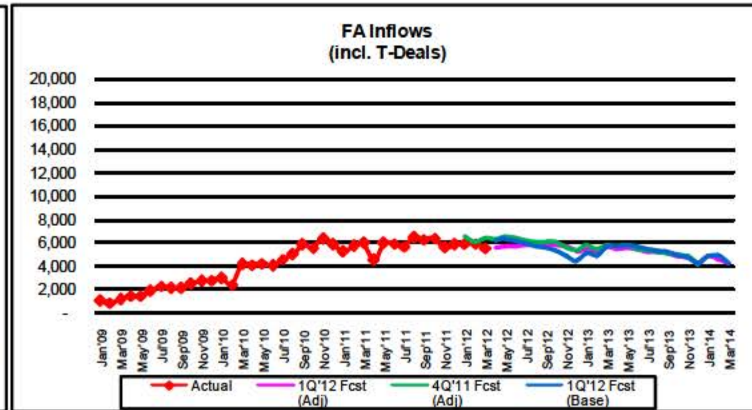
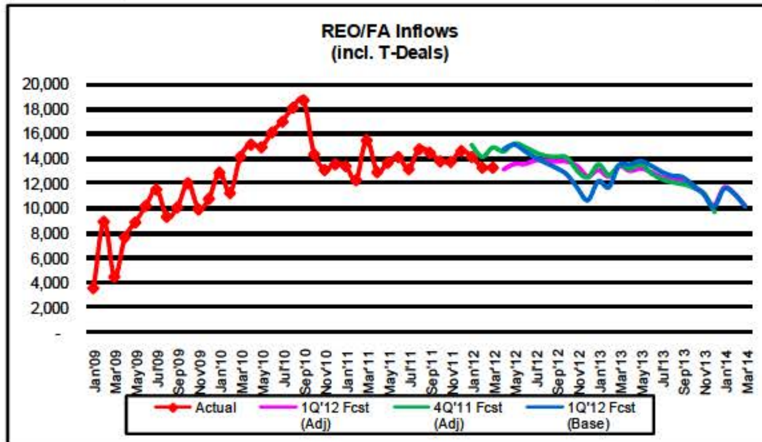
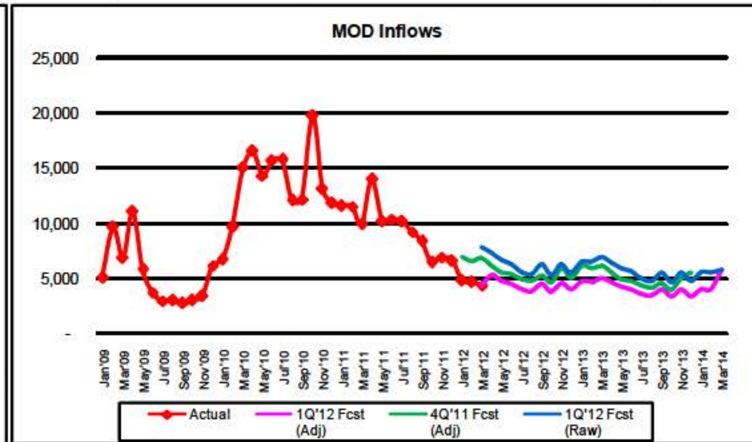
# Forecast REO/FA & MOD Inflow Counts




Notes:

1. 1Q'12 forecasts are based on Feb'12 Neo run. Excludes effects of new purchases after forecast start date.
2. Actuals include REOs and FAs from the core portfolio only; T-Deals are not included (constitute less than 5% of the total).
3. Forecasts of REOs and FAs include core portfolio and all T-Deals. "Base" REO and FA forecast is (a) Neo result directly from the model run with no adjustments, which is then adjusted for (b) a starting assumption concerning mod redefaults and timing, plus (c) adjustment for reduced mod redefaults and REO/FA increases consistent with the mod on top, plus (d) adjustment for the implied LLR transition rate on top based on Feb'12 LLR ($2.4B as of Feb'12), plus (e) projected T-Deal defaults. Model projections combine REOs and FAs. Reporting them separately is through assumptions. The "adjusted" forecast reflects business area and judgments on default timing adjustments.
4. "Raw" mod inflows reflect Neo results directly from the model run with no adjustments; "adjusted" mod forecasts reflect a reduction in mods consistent with the 1Q'12 mod on top.

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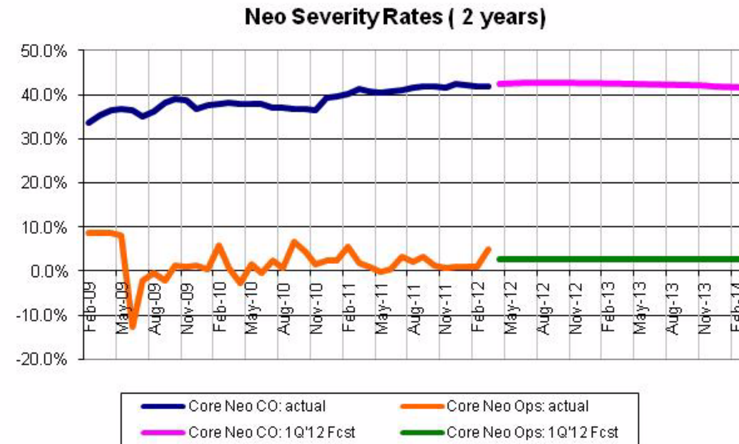
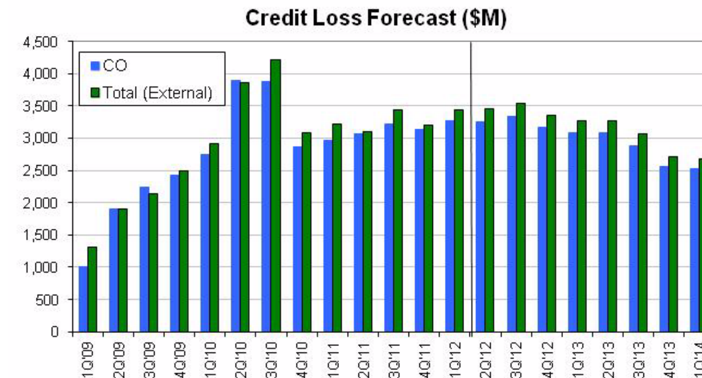
# Forecast Credit Losses by Month and Quarter

| Calendar Year | Losses by accounting: Charge-offs $M | REO Ops $M | Total (External) $M |
|---|---|---|---|
| Jan' 11 | 970 | 63 | 1,033 |
| Feb' 11 | 775 | 136 | 910 |
| Mar' 11 | 1,225 | 59 | 1,284 |
| **1Q'11** | **2,969** | **257** | **3,226** |
| Apr' 11 | 939 | 26 | 965 |
| May' 11 | 1,091 | -4 | 1,087 |
| Jun' 11 | 1,042 | 13 | 1,055 |
| **2Q'11** | **3,072** | **35** | **3,107** |
| Jul' 11 | 892 | 81 | 973 |
| Aug' 11 | 1,167 | 57 | 1,224 |
| Sep' 11 | 1,156 | 87 | 1,243 |
| **3Q'11** | **3,215** | **225** | **3,440** |
| Oct' 11 | 956 | 32 | 988 |
| Nov 11 | 1,092 | 18 | 1,110 |
| Dec' 11 | 1,083 | 29 | 1,111 |
| **4Q'11** | **3,131** | **79** | **3,209** |
| Jan' 12 | 1,176 | 26 | 1,203 |
| Feb' 12 | 1,086 | 26 | 1,112 |
| Mar' 12 | 1,001 | 119 | 1,120 |
| **1Q'12** | **3,263** | **172** | **3,435** |
| Apr' 12 | 1,063 | 65 | 1,127 |
| May' 12 | 1,098 | 67 | 1,164 |
| Jun' 12 | 1,097 | 67 | 1,164 |
| **2Q'12** | **3,258** | **198** | **3,456** |
| Jul' 12 | 1,118 | 68 | 1,186 |
| Aug' 12 | 1,116 | 68 | 1,184 |
| Sep' 12 | 1,106 | 67 | 1,173 |
| **3Q'12** | **3,341** | **203** | **3,543** |
| Oct' 12 | 1,102 | 67 | 1,169 |
| Nov 12 | 1,066 | 65 | 1,131 |
| Dec' 12 | 997 | 60 | 1,058 |
| **4Q' 12** | **3,165** | **192** | **3,357** |
| **1Q' 13** | **3,084** | **188** | **3,272** |
| **2Q' 13** | **3,080** | **188** | **3,268** |
| **3Q' 13** | **2,888** | **177** | **3,065** |
| **4Q' 13** | **2,559** | **157** | **2,716** |
| **1Q' 14** | **2,530** | **156** | **2,686** |
| **Year 2011** | **12,386** | **596** | **12,982** |
| **Year 2012** | **13,027** | **764** | **13,791** |
| **Year 2013** | **11,611** | **710** | **12,321** |
| **12 month total** | **12,848** | **780** | **13,629** |
| **24 month total** | **23,905** | **1,459** | **25,364** |




**Notes:**
1. Forecasts are from Feb'12 Neo run (combined with severity assumptions).
2. Numbers include both core portfolio and T-Deals. Incorporates 1Q'12 on top adjustments and impacts of assumption changes.
3. Does not include estimated effects of new purchases after forecast start date.
4. The 12-month total is from Apr'12 to Mar'13; 24-month total is from Apr'12 to Mar'14.
5. Numbers won't tie exactly to the credit loss summary compiled by Single-Family CFO due to rounding differences.

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## 1Q'12 Provision Forecast (BPE Basis with New Purchases)

| | Portfolio UPB | D90+/FCL inventory | | Charge-offs | Reserves | | Provision | | Change in Reserve |
|---|---|---|---|---|---|---|---|---|---|
| | $m | $m | bps | $m | $m | bps | $m | bps | |
| **1Q'12** | **1,719,436** | **71,969** | **419** | **3,263** | **34,932** | **203** | **2,361** | **13.7** | **(902)** |
| 2Q'12 | 1,700,053 | 67,584 | 398 | 3,258 | 33,844 | 199 | 2,170 | 12.8 | (1,088) |
| 3Q'12 | 1,665,611 | 65,353 | 392 | 3,346 | 32,318 | 194 | 1,820 | 10.9 | (1,526) |
| 4Q'12 | 1,635,476 | 64,148 | 392 | 3,180 | 30,779 | 188 | 1,641 | 10.0 | (1,539) |
| **1Q'13** | **1,606,608** | **61,562** | **383** | **3,109** | **29,227** | **182** | **1,558** | **9.7** | **(1,552)** |
| 2Q'13 | 1,577,739 | 58,845 | 373 | 3,120 | 27,604 | 175 | 1,496 | 9.5 | (1,623) |
| 3Q'13 | 1,548,870 | 56,790 | 367 | 2,938 | 26,073 | 168 | 1,406 | 9.1 | (1,532) |
| 4Q'13 | 1,520,002 | 55,674 | 366 | 2,624 | 24,829 | 163 | 1,381 | 9.1 | (1,243) |
| **1Q'14** | **1,494,205** | **53,042** | **355** | **2,605** | **23,619** | **158** | **1,394** | **9.3** | **(1,211)** |
| 2Q'14 | 1,468,409 | 50,206 | 342 | 2,815 | 22,091 | 150 | 1,287 | 8.8 | (1,528) |
| 3Q'14 | 1,442,613 | 47,893 | 332 | 2,773 | 20,594 | 143 | 1,277 | 8.8 | (1,496) |
| 4Q'14 | 1,416,816 | 46,266 | 327 | 2,521 | 19,432 | 137 | 1,358 | 9.6 | (1,162) |
| **1Q'15** | **1,394,253** | **44,020** | **316** | **2,697** | **18,048** | **129** | **1,314** | **9.4** | **(1,383)** |
| **4Qtrs Ending 1Q'16** | **1,310,466** | **35,891** | **274** | **9,530** | **13,280** | **101** | **4,761** | **35** | **(4,768)** |
| **4Qtrs Ending 1Q'17** | **1,231,254** | **29,892** | **243** | **7,023** | **9,864** | **80** | **3,607** | **29** | **(3,415)** |
| **5-Yr Total (through 1Q'17)** | | | | **51,539** | | | **26,472** | | |

Notes:
1. 1Q'12 portfolio UPB includes core population UPB as of Mar'12 and T-Deals UPB as of Feb'12.
2. 1Q'12 reserve is BPE based on Mar'12 final recommendation (including all management on tops).
3. Reserves and provision forecast do not reflect GAAP accounting adjustments.
4. Charge-offs include all T-Deals for the first 24 months of the forecast period but only the T61+ Prime population after that (other T-Deal amounts are *de minimus*).
5. For the four quarters ending 1Q'16 and 1Q'17 in the table, amounts shown for charge-offs and provision are annual totals.
6. Reserves, provision and D90+/FCL inventory in bps based on Portfolio UPB, which is projected to decline reflecting portfolio run-off in excess of new purchases.
7. Actual charge-offs may not tie exactly to the credit loss summary compiled by Single-Family CFO due to rounding differences.

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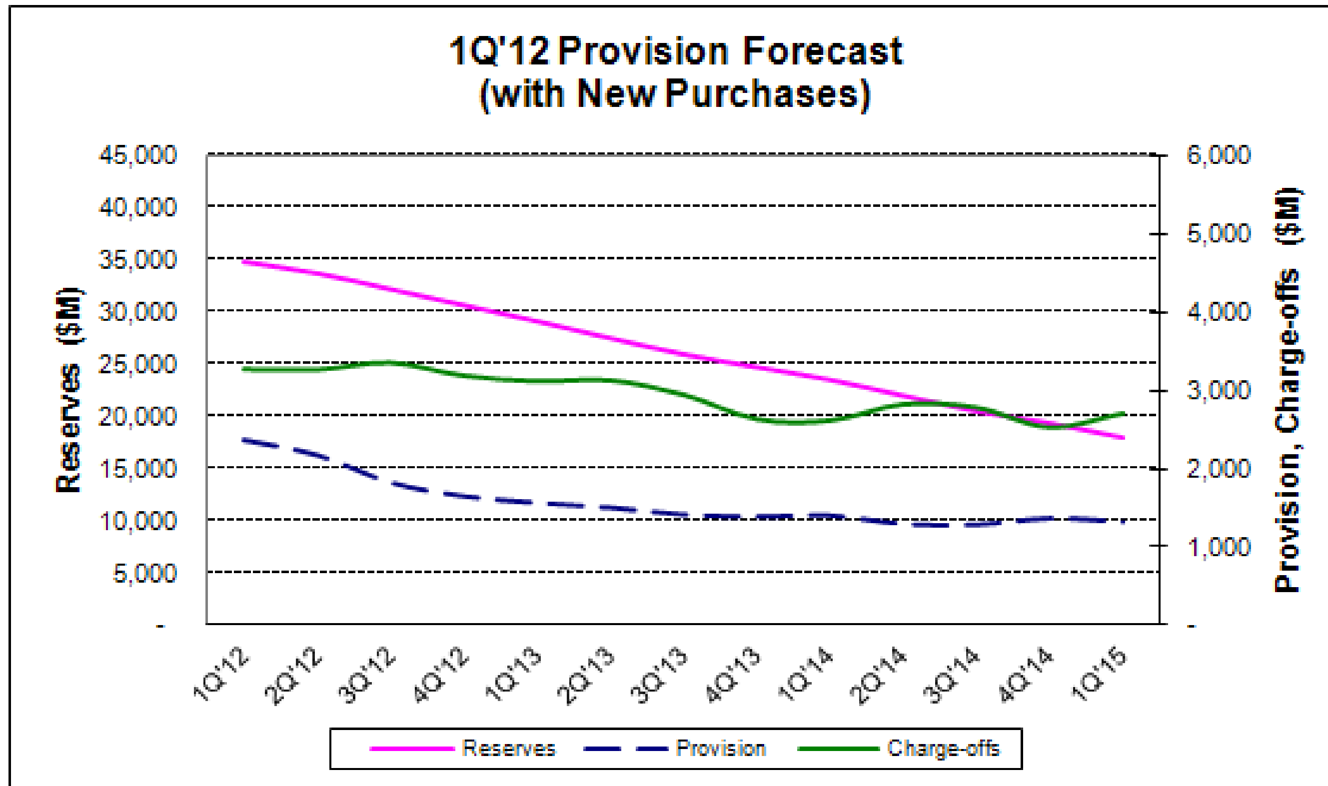
# 1Q'12 Provision Forecast (BPE Basis with New Purchases)—Cont.

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# 1Q'12 Provision Forecast (BPE Basis with New Purchases) and Corresponding GAAP View

- GAAP view reflects the provision/reserve effect of projected TDR results (and other accounting adjustments).
  - » TDR inflows based on business area expected path view through 1Q'14, then adjusted Neo forecast from 2Q'14 to 4Q'15.
  - » Accounting adjustments include eliminating FAS 5 reserves on TDRs and SOP 03-3 loans (and creating FAS 114 reserves on those loans), as well as adjustments for interest income recognized on completing loan modifications and SOP 03-3 adjustments to charge-offs. TDR reserves include impacts from both rate reductions and default costs estimated through the LLR process as well as time value of money considerations.

| | BPE Basis ($ in millions) | | | GAAP View ($ in millions) | | | |
|---|---|---|---|---|---|---|---|
| Period | Charge-offs | Reserves | Provision | Charge-offs | Reserves | Other GAAP Adjustments* | Provision |
| 1Q'11 | 2,969 | 37,126 | 1,263 | 2,969 | 38,558 | (379) | 2,050 |
| 2Q'11 | 3,072 | 36,239 | 2,185 | 3,072 | 38,390 | (362) | 2,542 |
| 3Q'11 | 3,214 | 36,121 | 3,096 | 3,214 | 39,089 | (269) | 3,643 |
| **4Q'11** | **3,131** | **35,834** | **2,844** | **3,131** | **38,915** | **(294)** | **2,663** |
| 1Q'12 | 3,263 | 34,931 | 2,360 | 3,263 | 37,771 | (274) | 1,844 |
| 2Q'12 | 3,258 | 33,844 | 2,171 | 3,258 | 37,045 | (255) | 2,277 |
| 3Q'12 | 3,346 | 32,318 | 1,820 | 3,346 | 35,829 | (285) | 1,845 |
| **4Q'12** | **3,180** | **30,779** | **1,641** | **3,180** | **34,447** | **(290)** | **1,507** |
| 1Q'13 | 3,109 | 29,227 | 1,558 | 3,109 | 32,968 | (277) | 1,355 |
| 2Q'13 | 3,120 | 27,604 | 1,496 | 3,120 | 31,387 | (257) | 1,281 |
| 3Q'13 | 2,938 | 26,073 | 1,406 | 2,938 | 29,895 | (258) | 1,188 |
| **4Q'13** | **2,624** | **24,829** | **1,381** | **2,624** | **28,745** | **(250)** | **1,224** |
| 1Q'14 | 2,605 | 23,619 | 1,394 | 2,605 | 27,535 | (242) | 1,154 |
| 2Q'14 | 2,815 | 22,091 | 1,287 | 2,815 | 25,976 | (191) | 1,065 |
| 3Q'14 | 2,773 | 20,594 | 1,277 | 2,773 | 24,425 | (172) | 1,051 |
| **4Q'14** | **2,521** | **19,432** | **1,358** | **2,521** | **23,231** | **(167)** | **1,160** |
| 1Q'15 | 2,697 | 18,048 | 1,314 | 2,697 | 21,834 | (179) | 1,122 |
| 2Q'15 | 2,430 | 16,851 | 1,233 | 2,430 | 20,591 | (162) | 1,025 |
| 3Q'15 | 2,650 | 15,402 | 1,201 | 2,650 | 19,065 | (146) | 978 |
| **4Q'15** | **2,257** | **14,336** | **1,191** | **2,257** | **17,921** | **(141)** | **971** |

* Includes capitalized interest income on modified loans, SOP 03-3 adjustment to charge-offs, settled counterparty impacts and other miscellaneous adjustments.

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# FHFA STRATEGIC PLAN 2012-2016

## *MISSION*

***Ensure that the Housing GSEs are safe and sound so that they serve as a reliable source of liquidity and funding for housing finance and community investment.***

## *VISION*

***A reliable, stable, and liquid housing finance system***

## *FHFA's VALUES*

| | |
|---|---|
| ***Respect*** | ***We strive to act with respect for each other, promote diversity, share information and resources, work together in teams, and collaborate to solve problems even when we disagree.*** |
| ***Excellence*** | ***We aspire to excel in every aspect of our work and to seek better ways to accomplish our mission and goals.*** |
| ***Integrity*** | ***We are committed to the highest ethical and professional standards.*** |
| ***Diversity*** | ***We seek the full inclusion of all segments of our population in our business endeavors and at the entities we regulate.*** |



FHFA00105087

# FHFA's STRATEGIC GOALS 2012-2016

## STRATEGIC GOAL 1
## SAFE AND SOUND HOUSING GSES

**PERFORMANCE GOAL 1.1:** IDENTIFY RISKS AND REQUIRE TIMELY REMEDIATION OF WEAKNESSES

**PERFORMANCE GOAL 1.2:** IMPROVE THE CONDITION OF THE REGULATED ENTITIES

## STRATEGIC GOAL 2
## EFFECTIVE CONSERVATORSHIP OPERATIONS

**PERFORMANCE GOAL 2.1:** MINIMIZE LOSSES ON THE LEGACY PORTFOLIOS AND DISRUPTION TO FINANCIAL MARKETS.

**PERFORMANCE GOAL 2.2:** EXECUTE AN ORDERLY REDUCTION OF THE ENTERPRISES' MORTGAGE PORTFOLIOS AS MARKET CONDITIONS PERMIT

**PERFORMANCE GOAL 2.3:** ENSURE APPROPRIATE UNDERWRITING OF THE ENTERPRISES' NEW BUSINESS

## STRATEGIC GOAL 3
## STABILITY, LIQUIDITY, AND ACCESS IN HOUSING FINANCE

**PERFORMANCE GOAL 3.1:** MITIGATE SYSTEMIC RISK AND CONTRIBUTE TO RECOVERY OF HOUSING AND FINANCIAL MARKETS

**PERFORMANCE GOAL 3.2:** ASSURE LIQUIDITY IN MORTGAGE MARKETS

**PERFORMANCE GOAL 3.3:** EXPAND ACCESS TO HOUSING FINANCE BY DIVERSE FINANCIAL INSTITUTIONS AND BORROWERS

**PERFORMANCE GOAL 3.4:** IMPROVE THE CURRENT SYSTEM OF HOUSING FINANCE AND PREPARE FOR THE FUTURE



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# STRATEGIC GOAL 1

# SAFE AND SOUND HOUSING GSES

## PERFORMANCE GOAL 1.1: IDENTIFY RISKS AND REQUIRE TIMELY REMEDIATION OF WEAKNESSES

FHFA, as regulator for Fannie Mae, Freddie Mac (the Enterprises), and, the Federal Home Loan Banks (collectively "Housing GSEs") is responsible for examining and regulating their operations to promote their safe and sound operations and condition. As a prudential regulator, FHFA must anticipate, identify, and respond appropriately to risks to the regulated entities and ensure the regulated entities effectively manage risks, irrespective of the sources of risk. In identifying risk and evaluating the Housing GSEs' risk management, FHFA will rely on its full complement of supervisory tools and authorities. FHFA will also monitor corrective action by the regulated entities to remediate weaknesses to ensure any remedy is both timely and effective.

## PERFORMANCE GOAL 1.2: IMPROVE THE CONDITION OF THE REGULATED ENTITIES

The Enterprises have been operating under conservatorship since September 2008. As conservator, FHFA will improve the condition of the Enterprises by restricting new risk-taking, requiring improved underwriting in their new book of business, and preserving and conserving assets from their pre-conservatorship book of business. Certain FHLBanks have been subject to supervisory actions designed to improve risk management and ensure preservation of capital as they deal with troubled real estate related investments, principally dating from 2005-2008. FHFA will continue to require any troubled FHLBanks to preserve capital and to build retained earnings to levels sufficient to support the par value of their capital stock.

## STRATEGIC GOAL 1- MEANS AND STRATEGIES

- ***Conduct annual examinations, and, as warranted, special or horizontal reviews of the regulated entities.*** Annual on-site examinations are a critical means to identify operational and financial risks that could threaten the safety and soundness of the Housing GSEs. FHFA examiners use a risk-based approach designed to 1) identify existing and potential risks that could adversely affect the regulated entity; 2) evaluate the overall integrity and effectiveness of each entities' risk management systems and controls; and 3) determine compliance with



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laws and regulations. FHFA will periodically conduct focused reviews on specific programs or issues, known as "horizontal reviews," of the Enterprises or the FHLBanks.

- ***Identify matters requiring attention of the boards of directors of the regulated entities and monitor their remediation for both timeliness and efficacy.*** Timely resolution of issues that threaten the financial and operational condition of the housing GSEs is essential to their safety and soundness. FHFA's full complement of supervisory programs includes on-site examinations; program reviews over a cross-section of entities (horizontal reviews); regulatory and supervisory guidance; performance monitoring; supervisory compliance and enforcement; market surveillance; and, when appropriate, supervisory or enforcement actions. Through these means, FHFA will identify issues that could compromise the safe and sound operations of the Housing GSEs. FHFA will communicate findings, recommendations, and any required corrective actions to the regulated entity's board of directors and management. FHFA examiners will obtain a commitment from the board and management to correct weaknesses or deficiencies in a timely manner and will monitor remediation and verify the effectiveness of corrective actions. When deficiencies are sufficiently severe, FHFA will pursue enforcement actions such as a memorandum of understanding, board resolution, written agreement, or a cease and desist order – as appropriate.

- ***Identify emerging risk areas and adjust supervisory strategies as appropriate.*** The FHFA's regulated entities may need to operate in markets characterized by uncertainty, volatility, and changing processes and practices. As a prudential regulator, FHFA must respond to changing conditions, ensure the regulated entities identify areas of possible or emerging risk, and adjust its supervisory strategies as appropriate to respond to market developments and identified risks.

- ***Maintain and regularly improve examination standards and procedures.*** As the environment in which the Housing GSEs operate changes and different financial and operational risks arise, FHFA will refine and enhance its examination standards, procedures, and processes in response to market developments and emerging risks.

- ***Use off-site monitoring to strengthen supervision.*** Off-site monitoring and surveillance programs supplement and support on-site examinations with cross-disciplinary resources that can lead to a more comprehensive understanding of a problem by systematically and simultaneously evaluating data across an array of institutions and thereby expanding options considered for problem resolution. The full complement of FHFA's supervisory staff includes examiners, financial analysts, policy analysts, accountants, and economists. Off-site analyses include reviews of monthly and quarterly call report data, daily changes in interest rates and rate spreads, and published financial reports. The analyses address such issues as financial market conditions, interest rate changes and their effects on the regulated



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entities, financial condition, management of troubled real estate assets, executive compensation, and the disclosures in financial statements and reports filed with the Securities and Exchange Commission. Through off-site monitoring systems, FHFA will perform ongoing monitoring of financial trends and emerging risks with a potential to impact the safety and soundness of the Housing GSEs.

- ***Develop regulatory policies and supervisory guidance to improve the Housing GSEs' risk management, governance, pricing, and asset quality.*** As a result of recent legislation, including the Housing and Economic Recovery Act of 2008 (HERA) and the Dodd-Frank Act of 2010 (Dodd-Frank), FHFA has promulgated a series of new or revised regulations and guidance. Some have been finalized, others proposed, and others are still being drafted. In light of changing economic conditions, particularly affecting housing and finance, and market volatility, FHFA will complete required rulemakings and develop additional regulations or guidance, as needed. Regulations and guidance will generally require improvements to the Housing GSEs' risk management practices and governance consistent with prudential management and operating standards. FHFA regulations and guidance also anticipates that the Housing GSEs' policies on asset acquisition, pricing, and retention will be consistent with safe and sound practices and will support housing finance.

- ***Require the Housing GSEs to focus new business on core mission activities.*** During the period leading up to the crisis in the mortgage and financial markets, the Enterprises and some of the FHLBanks acquired mortgage assets and made certain unsecured investments that resulted in charges against income and other risk management challenges. The Enterprises and the FHLBanks each have core mission activities, which have served them well over time. FHFA will expect that an increased share of the regulated entities' new business be concentrated in core mission activities.

- ***Use quality assurance reviews to enhance the effectiveness of supervision.*** FHFA's quality assurance program provides objective assessments of FHFA examinations and supervision practices; identifies potential areas to improve or enhance existing processes; and strives for disciplined and consistent supervisory processes. FHFA will monitor identified areas for improvement, monitor remediation of identified deficiencies, and respond constructively to quality assurance assessments.

- ***Evaluate and monitor compensation and incentives at the regulated entities for adherence to prudential standards.*** FHFA expects the Housing GSEs to adhere to effective practices in corporate governance and defend against inappropriate risk taking. FHFA will supplement its on-site examinations by evaluating the quality of corporate governance at the regulated entities through targeted examinations or horizontal reviews of corporate incentives, as warranted. FHFA will review executive compensation and incentives at the regulated



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entities for adherence to prudential standards and compliance with statutory mandates that compensation be reasonable and comparable to similarly-situated institutions.

- ***Strengthen training and development of examination staff.*** FHFA will establish an examiner accreditation program. FHFA will continue to assess the capacity of its supervision staff and examiners, monitor the development and implementation of an examiner accreditation program, supplement any shortfalls in examination capacity, track progress in addressing identified shortfalls, and report its progress in FHFA's annual Report to Congress.

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## STRATEGIC GOAL 2

# EFFECTIVE CONSERVATORSHIP OPERATIONS AT THE ENTERPRISES

### PERFORMANCE GOAL 2.1: MINIMIZE LOSSES ON THE LEGACY PORTFOLIOS AND DISRUPTION TO FINANCIAL MARKETS.

As conservator of the Enterprises, FHFA has a responsibility to take such actions as may be necessary to put the Enterprises in a sound and solvent condition and to preserve and conserve their assets and property. The Enterprises will not be restored to solvency in the foreseeable future. The continued operation of the Enterprises has been made possible by support from the U.S. Department of Treasury (Treasury) through the Senior Preferred Stock Purchase Agreement with FHFA and through two Treasury credit facilities, which are used to purchase the Enterprises' mortgage-backed securities and GSE debt. Controlling further losses to the taxpayer renders the preservation and conservation of Enterprise assets a high priority for FHFA.

To preserve and conserve Enterprise assets, FHFA seeks to minimize losses on the Enterprises' "legacy portfolio," which consists of their respective books of business entered into prior to being placed under conservatorship. The legacy portfolio includes a large volume of mortgages owned or guaranteed by the Enterprises that are delinquent or in foreclosure. To encourage home retention by borrowers and minimize losses to the Enterprises, FHFA will work with the Administration and the Enterprises to keep, to the extent possible, borrowers from defaulting on their loans by working with lenders and servicers to offer prudent loan refinancing and modification programs. In addition, FHFA has determined that many of the mortgages in the legacy portfolio were poorly underwritten and the contracts were in breach of the sellers' representations and warranties to the Enterprises. The enforcement of these contracts is essential to minimizing taxpayer losses and improving underwriting for future transactions. The FHFA will also ensure that the Enterprises pursue enforcement of their existing contracts.

### PERFORMANCE GOAL 2.2: EXECUTE AN ORDERLY REDUCTION OF THE ENTERPRISES' MORTGAGE PORTFOLIOS AS MARKET CONDITIONS PERMIT

Under the terms of the Senior Preferred Stock Purchase Agreements entered into by the FHFA with the Treasury Department in 2008, each GSE's retained mortgage and mortgage-backed securities portfolio shall decline by 10 percent per year until the balance of holdings reaches $250 billion. The reduction of the Enterprises' retained portfolios has been executed under conditions of significant market uncertainty. Housing markets have been weak, the financial sector cautious, and the national economy has not rebounded as quickly as anticipated. Under



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these conditions, FHFA must seek to reduce the portfolio without disruption to market liquidity. FHFA will continue to reduce the risk of additional losses to taxpayers by reducing the Enterprises' portfolio. To ensure an orderly reduction of the portfolio, the pace of the reduction may be moderated by conditions in the housing and financial markets.

## PERFORMANCE GOAL 2.3: ENSURE APPROPRIATE UNDERWRITING OF THE ENTERPRISES' NEW BUSINESS

FHFA has taken steps to improve the quality of mortgages purchased by the Enterprises. FHFA precludes the Enterprises from offering new products or engaging in new business activities that would either present unfamiliar risk or divert their resources from their core business and mission. FHFA believes that the Enterprises should move toward a sustainable business model similar to what would be expected of private companies. To achieve this goal, FHFA will establish appropriate underwriting standards and risk-based pricing of guarantee fees. FHFA will also ensure that the new mortgages acquired by the Enterprises are soundly underwritten and priced to provide an appropriate return, encourage market competition, and promote the return of the private capital to the housing markets.

## STRATEGIC GOAL 2 - MEANS AND STRATEGIES

- ***Establish Baseline Standards and Targets to Measure the Effectiveness of Modification and Refinancing Initiatives.*** FHFA will establish standards and targets as benchmarks to monitor Enterprise loan modification and refinancing portfolios to ensure that the Enterprises adhere to program standards and that the programs achieve their targets.

- ***Reduce the Enterprises' Legacy Portfolio.*** FHFA will encourage an orderly transition of the Enterprise legacy portfolio through effective loss mitigation programs, monitoring market conditions, and identifying the near-term and long-term impact of the disposition of assets. To ensure an orderly reduction of the portfolio, the pace of the reduction may be moderated by conditions in the housing and financial markets. This strategy is designed to reduce the Enterprise portfolio and provide the best return to the taxpayer while minimizing market disruption. FHFA will also monitor the portfolio for consistency with the requirements of the Senior Preferred Stock Purchase Agreement.

- ***Pursue Cost-Effective Alternatives to the Disposition of Enterprises' REO Portfolios.*** FHFA has been working with the Enterprises to explore alternatives to the past practice of selling real estate owned (REO) properties one at a time. This initiative will be informed by ideas generated through a Request for Information (RFI), issued by FHFA in consultation with the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury. The RFI solicited views from the public on REO disposition



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alternatives, requesting comment on how the Enterprises could improve loss recoveries compared to individual sales, help stabilize neighborhoods, and, where feasible and appropriate, improve the supply of rental housing. As a result of this effort, FHFA plans to develop pilot transactions to test alternatives to individual sales, will evaluate their progress, and would likely use these as a basis for broader programs.

- ***Align Guarantee Fees to Risk.*** The Enterprises pre-conservatorship guarantee pricing was characterized by cross-subsidization across product types and preferential treatment for loans with certain characteristics. To attract private capital and reduce Enterprise risk exposure, FHFA will direct the Enterprises to price guarantee fees to levels that align pricing with actual risk as if they were being priced in a private, competitive market. FHFA will also evaluate and improve the adequacy of models used to estimate prepayments and set guarantees.

- ***Examine Modeling Assumptions.*** Modeling assumptions will require continual evaluation and improvement. FHFA will examine Enterprise prepayment and guarantee models and evaluating their adequacy. Examination findings of weaknesses in Enterprise models will be designated as Matters Requiring Attention (MRAs) and the Enterprises will be required to correct the deficiencies.

- ***Ensure Appropriate Underwriting of New Business:*** FHFA has directed the Enterprises to reduce their risk exposure in their underwriting and product standards. FHFA will continue these efforts and will ensure that the Enterprises enforce the representations and warranties in their contracts with mortgage suppliers.

- ***Promote Risk-Sharing.*** Risk-sharing between the Enterprises and other market participants can be helpful in providing feedback to the Enterprises' on their guarantee fee pricing. For example, if the market price to absorb a portion of the Enterprises' risk exposure is greater than the price being charged on the guarantee fee, this might be a signal that prices would need to increase to attract private capital. More accurate price discovery would then be established through market competition. FHFA intends to evaluate different options for the Enterprises to share risk among various parties to a transaction.



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# STRATEGIC GOAL 3

# STABILITY, LIQUIDITY, AND ACCESS IN HOUSING FINANCE

## PERFORMANCE GOAL 3.1: PROMOTE STABILITY IN HOUSING MARKETS BY MITIGATING SYSTEMIC RISK AND CONTRIBUTING TO THE RECOVERY OF HOUSING AND FINANCIAL MARKETS.

***Mitigate Systemic Risk.*** The Dodd-Frank Act established the Financial Stability Oversight Council (FSOC) to identify risks to the financial stability of the United States that could arise from the financial distress, failure, or activities, of large financial institutions; to promote market discipline; and to respond to emerging threats to the stability of the nation's financial system. FHFA, as a voting member, will continue to work closely with FSOC and its member agencies to identify emerging risks and mitigate systemic threats to the financial system. FHFA will contribute to market stability through ongoing market surveillance and timely dissemination of information on housing markets.

***Promote Stability in Housing Markets.*** Home retention initiatives, such as loan modification and refinancing programs, could allow eligible borrowers to realize more favorable rates or terms on their mortgages and potentially reduce the scale of defaults and foreclosures. Such initiatives can reduce losses to the Enterprises and can lead to greater stability and liquidity in housing markets. FHFA will be actively engaged in developing prudent home retention programs and foreclosure alternatives including refinements to the Home Affordable Modification Program (HAMP) and Home Affordable Refinancing Program (HARP) that offer troubled homeowners loan modifications, refinancing opportunities or other foreclosure alternatives. A successful home retention program would enhance access to finance by borrowers; reduce risk exposure to the Enterprises, thereby minimizing their losses; and stabilize housing finance. FHFA will also work with the Department of Housing and Urban Development (HUD) and Treasury to consider alternatives in disposing of REO properties owned by the Enterprises and the Federal Housing Administration (FHA) using approaches that are tailored to the needs and economic conditions of local communities.



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## PERFORMANCE GOAL 3.2: ASSURE LIQUIDITY IN MORTGAGE MARKETS

***Federal Home Loan Banks:*** The FHLBanks' core mission is to serve as a reliable source of liquidity for their member institutions in support of housing finance. The importance of the FHLBanks as a source of liquidity for member financial institutions became evident during the financial credit and liquidity crisis that began in 2007. FHLBank advances to members increased from a pre-crisis level of $640 billion on June 30, 2007 to an all-time high of $1.01 trillion on September 30, 2008. Subsequently, liquidity conditions in financial and banking markets changed dramatically as deposits grew at depository institutions while loan demand diminished as a result of weak economic conditions. As a consequence, member use of FHLBank advances fell significantly at each of the FHLBanks. Advances to member institutions declined 60 percent from their peak in September 2008 to $400 billion in September 2011. FHFA will ensure that the FHLBanks continue to fulfill their statutory mission of providing liquidity to their members.

***The Enterprises:*** Although the Enterprises are under conservatorship, the Enterprises must continue to serve as a reliable source of liquidity for housing finance, principally through their mortgage securitization programs. FHFA's Strategic Plan envisions the Enterprises in conservatorship supporting housing finance, but also anticipates initiatives that contribute to an increase in the role of private sources of capital in housing finance, ultimately diminishing the role of direct and indirect government support. While Fannie Mae and Freddie Mac are in conservatorship FHFA will work with the Department of the Treasury to assure that they continue to provide liquidity to the secondary markets in a manner consistent with the objective of eventually withdrawing government support.

## PERFORMANCE GOAL 3.3: EXPAND ACCESS TO HOUSING FINANCE BY DIVERSE FINANCIAL INSTITUTIONS AND BORROWERS

Even in liquid markets, some qualified financial institutions and borrowers may face barriers to finance as a result of imperfect information, insufficient market activity, or inability to attract capital due to their size or area of specialization. Especially during times of market uncertainty, some smaller or niche financial institutions may face disruption in their access to finance. FHFA is committed to assuring that qualified financial intermediaries and other entities have fair and equitable access to finance and to those services offered by the Housing GSEs for which they are eligible. In particular, minority- and women-owned instiutions should be included in the activities of the Housing GSEs.



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## PERFORMANCE GOAL 3.4: IMPROVE THE CURRENT SYSTEM OF HOUSING FINANCE AND PREPARE FOR THE FUTURE

***Reform the Current System.*** The mortgage and financial crisis revealed many weaknesses throughout the entire chain of single-family mortgage finance. As a result of the housing crisis, the operating environment and roles of housing market participants have changed. Many firms have withdrawn from the market or hesitate to more fully participate. To improve the current system of housing finance and set improved standards for the future, FHFA has introduced a series of initiatives to ensure a safer, more effective, and efficient housing finance system. FHFA expects that these improvements, which include changes to mortgage servicing, servicer compensation, and improved data and transparency, will promote greater confidence among potential market participants and will result in increased liquidity from private sources of capital. ~~In the coming years,~~ FHFA will work towardbe perfecting these initiatives as market conditions evolve. As described in the following sections, FHFA intends to develop a series of initiatives and strategies that will lead to greater predictability in mortgage markets and, consequently, greater confidence among stakeholders. FHFA expects to evaluate and either adjust or improve upon these initiatives as market conditions change.

***Prepare for the Future.*** The nation's system of housing finance is currently undergoing a period of transition that will require both short-term and long-term reform strategies. There are significant public policy questions and choices ahead on how to achieve an appropriate~~the right~~ balance between the role of the private sector and the role of government as housing finance conditions change. As part of the deliberative process, FHFA will examine a variety of options across the housing delivery system with the objective of reducing the Enterprises' role in the secondary mortgage market and facilitating the reentry of the private sector. Toward that end, FHFA will conduct such as activities as developing Enterprise transition plans and evaluating the plans prepared by others; analyzing evolving market conditions; and identifying and recommending initiatives or policies that would lead to an improved system of housing finance. To measure the effectiveness of its strategies, FHFA will continue to improve on its housing information systems. FHFA will actively participate in public policy deliberations on housing finance reform and will be available to serve as a resource to the executive and legislative branches.

Comment [A1]:

Comment [A2]: wondering if some of this is a bit more activist than Ed indicated in Thursday's testimony??

## STRATEGIC GOAL 3 - MEANS AND STRATEGIES

- ***Collaborate with other federal regulators to identify and address risk and other emerging issues.*** Consistent with the Government Performance and Results Modernization Act of 2010, which requires Federal agencies to develop a coordinated and crosscutting approach to



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achieve results, FHFA works closely with other federal regulators, for example, through its participation on the Financial Stability Oversight Council and the Federal Housing Finance Oversight Board. FHFA will work closely with these regulators to identify and address risk and to coordinate, where appropriate, ~~their~~ supervision of entities under their examination and supervision. This collaboration will provide FHFA with additional perspectives on emerging or existing risks that are identified outside of FHFA's own supervisory programs. FHFA will also contribute to the Federal Housing Finance Oversight Board's assessment on the safety and soundness and performance of FHFA's regulated entities in FHFA's *Annual Report to Congress* (12 U.S.C. §4521.)

- ***Monitor Housing Markets.*** FHFA's reports to the Federal Housing Finance Oversight Board and the FSOC and its members will address mortgage and financial market trends that affect the financial condition and performance of the Housing GSEs. To enhance its program for monitoring housing markets, FHFA will work to develop a rigorous housing market information system. At a minimum, FHFA's market reports will include the results from the Monthly Survey of Mortgage Originations pursuant to Section 1125 of ~~HERA.~~ the Housing and Economic Recovery Act.

- ***Enhance Home Retention Programs and Initiatives.*** In the fall of 2011, FHFA launched a series of improvements to the Home Affordable Refinance Program (HARP). ~~The~~ HARP provides an opportunity to refinance their mortgages to those homeowners whose loans are owned by the Enterprises and who are current on their mortgage payments but whose mortgages exceed the value of their homes, limiting their ability to ~~and cannot~~ refinance. FHFA expects to be actively engaged in home retention programs, such as HARP and the Home Affordable Modification Program (HAMP) as well as any successor programs. ~~as well as their successor programs~~. In addition, FHFA will encourage the Enterprises' to engage in their own proprietary loan modification programs for borrowers who are ineligible under HAMP.

- ***Pursue Cost-Effective Alternatives for ~~to the~~ Disposition of the Enterprises' Real-Estate Owned (REO) Portfolios:*** FHFA has been working with the Enterprises to explore alternatives to selling foreclosed ~~individual~~ properties one at a time. This initiative will be informed by ideas generated through FHFA's Request for Information (RFI), issued in August of 2011 and prepared in consultation with the U.S. Department of Housing and Urban Development and the U.S. Department of the Treasury. The RFI requested comment on how the Enterprises could improve loss recoveries compared to individual sales, help stabilize neighborhoods, and, where feasible and appropriate, improve the supply of rental housing. As a result of this effort, FHFA expects to develop ~~one or two~~ pilot transactions to test alternatives to individual sales and will evaluate their progress~~,~~ and potential to serve ~~plans to use these~~ as a basis for broader programs.



**Comment [A3]:** ?Is this the mandated monthly survey that we're not yet doing?

- ***Monitor each FHLBank's capital, retained earnings, operations, and debt issuance.*** Ensure FHLBanks can continue to provide advances safely and soundly. FHFA will examine the FHLBanks' operations, internal controls, and strategic assumptions and will ensure that there are no unnecessary impediments to their ability to efficiently and competitively provide liquidity for housing markets through normal or stressed markets and during expansion and contraction cycles. In addition, FHFA will assess and monitor the potential impact to the FHLBanks resulting from the revised framework for capital rules and new liquidity requirements under the Basle III accord.

- ***Closely oversee Enterprise operations while in conservatorship.*** To promote markets stability and ensure liquidity in the secondary markets FHFA will assure that while the Enterprises are under conservatorship they will operate in a safe and sound manner and focus on their core business lines.

- ***Ensure Fair and Impartial Access to the Enterprises' Products and Services.*** To ensure fair and impartial access to Enterprise products and services, FHFA will require that the Enterprises reverse any unwarranted policies or practices that favor large institutions to the disadvantage of smaller institutions.

- ***Foster Fair Access to FHLBank Advances for all Qualified Lenders and Intermediaries.*** To ensure fair access to advances among member institutions, FHFA will examine FHLBanks for compliance with regulations requiring that they administer their affairs fairly and impartially and without discrimination in favor or against any member. FHFA analyses will include consideration of:

    - *Community Financial Institutions*

    - *Community Development Financial Institutions*

    - *State Housing Finance Agencies (HFAs)*

- ***Monitor Access to Housing Markets.*** Using its housing statistics data system, FHFA will produce reports on housing market conditions, identify barriers to mortgage lending and other types of finance and identify options that maximize consumer choice in both rental and homeowner housing, inclusive of lower-income residents.



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- ***Oversee the Housing GSEs' Affordable Housing Programs.*** Under the AHP and CIP, FHLBank member institutions must meet certain standards of community support and provide assistance to first-time homebuyers. As part of its examination program, FHFA will continue to monitor and examine the FHLBank-s' activities in support of these programs. FHFA will also monitor and enforce Enterprise housing goals. The FHLBanks are also required to meet similar housing goals for their mortgage loan purchase programs. FHFA published a rule implementing the FHLBank goals program (75 FR 81096), which became effective in January of 2011.

Comment [A4]: Should we say something about overseeing and enforcing any applicable FHLB housing goals? –sounds odd to give no indication of that, despite its absence of applicability now.

- ***Ensure Minority and Women Inclusion in the Activities of the Housing GSEs.*** Section 1116 of HERA requires FHFA, Fannie Mae, Freddie Mac and the FHLBanks to promote diversity and inclusion of women and minorities in all activities. Pursuant to FHFA's final rule, which became effective on January 27, 2011 (75 FR 248), FHFA will take the following steps: 1) develop diversity standards for employment, management and the business activities of the regulated entities; 2) provide guidance and training; 3) secure status reports in accordance with prescribed formats; 4) develop policies and procedures to assess compliance with the standards; and 5) identify appropriate remedies in the event of non-compliance.

Comment [A5]: Do we do all this for the GSEs as well as FHFA?

- ***Facilitate the Reentry of the Private Sector into Housing Markets.*** FHFA believes that reliable price discovery and consumer choice are enhanced by transparent and open competition. FHFA will identify barriers to the entry of a cross-section of market participants and will identify options that encourage their entry into housing markets. FHFA is aware of the competitive advantage that government-supported institutions can potentially have in the marketplace and is committed to monitoring the impact of Enterprise policies and practices so that they do not result in an unfair competitive advantage over the private sector. To monitor private sector involvement in markets, FHFA will track the mortgage market share of private originations and the issuance of mortgage-backed securities. FHFA will also discourage unsound or harmful industry practices that could jeopardize market reentry by responsible market participants.

Comment [A6]: I may be overly critical here, but this sounds a bit OTT to me, given the broad understanding that government- connected entities seriously underprice for risk

- ***Improve Mortgage Processes:*** FHFA intends to fully implement and monitor the following improvements to mortgage processes:

  - ***Uniform Mortgage Data Program.*** FHFA's Uniform Mortgage Data Program is designed to improve the consistency, quality, and uniformity of data collected at the front end of the mortgage origination process. This data program will reveal potential defects at the front end of the mortgage process, enabling the Enterprises to improve the quality of mortgage purchases, while also reducing the mortgage



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repurchase risk for originators. FHFA expects to continually evaluate its mortgage data program.

- ***Increasedmprove Transparency and Disclosures.*** For market participants to make fully informed decisions and to better evaluate and price risk exposure, the underlying terms for critical aspects of a transaction need to be transparent and fully disclosed. Toward this end, FHFA will require the Enterprises to improve their loan-level disclosures from the point when a mortgage is originated until the securities derived from that loan are extinguished. FHFA also intends to ensure the alignment of contracts.

- ***Joint Servicing Compensation Initiative.*** The Joint Servicing Compensation Initiative seeks to improve compensation structures for servicers to incent timely and appropriate performance in mortgage modifications. In the near-term, the joint initiative should improve service for borrowers, reduce financial risk for servicers, and provide flexibility for guarantors so that they can better manage non-performing loans. In the long-term, this initiative should foster greater standardization of mortgage servicing practices, which will carry forward to a successor system of housing finance. Improved servicer compensation is expected to attract new entrants to this market and thereby enhance competition. FHFA will evaluate alternativethe servicer compensation structuresalternatives, with the benefit of industry feedback received in response to our request for for comments. maintaining a servicing platform and will to solicit industry feedback on the appropriate platform. FHFA will periodically evaluate loan servicing practices to assure that they continue to meet the Agency's objectives.

- ***Implement the Joint Servicing Alignment Initiative.*** The Enterprises are in the process of streamlining and expediting modifications of delinquent or at-risk mortgages. Currently, each Enterprise uses its own servicing standards. Lead by FHFA, the Joint Servicing Alignment Initiative will create parallel and uniform loan modification protocols for servicers, thereby reducing confusion about standards. Alignment of protocols benefits borrowers by preventing simultaneous and conflicting foreclosure and modification processes. FHFA expects to review and, as necessary seek to improve upon these procedures as they are adopted in the marketplace.

- ***Contribute to Housing Finance Reform.*** The transition to a different system of housing finance is inevitable. To address the nation's housing needs, various parties have developed housing reform proposals for discussion, with. More proposals are likely to come forward and it is likely that their policy recommendations will have varying

**Comment [A7]:** We have a better paragraph on this initiative iin a speech or testimony; will find it & send. I'm terrified of moving away from this doc now!

**Comment [A8]:** I think there's also a better paragraph Ed has used on this; will find & send.

**Comment [A9]:** This paragraph doesn't seem to hit the right notes. I think Mario can do a much better job on it; will ask him in the morning.



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implications for the roles of the Housing GSEs, the federal government, and the private sector. FHFA intends to actively participate in the housing reform debate. To inform the deliberative process and facilitate adoption of~~assist in the national transition to~~ an improved system of housing finance of the future, FHFA intends to disseminate its own studies and evaluate and comment on research developed by outside parties. FHFA anticipates presenting testimony on the future of housing finance, as requested, and will prepare reports and other communications for consideration by the legislative branch, the executive branch and FHFA's stakeholders.

- ***Develop and Analyze Alternative Enterprise Transition Plans.*** The post-conservatorship status of the Enterprises will depend on future public policies. As a point of departure, FHFA will ensure that the operations of the Enterprises are supported by standards and processes essential to successful housing finance transactions. In doing so, FHFA expects to increase confidence among market participants. To assist in the policy deliberations on the future of the Enterprises, FHFA will identify and evaluate alternative transition plans and respond to plans proposed by stakeholders.

- ***Establish the Future Roles for the FHLBanks.*** In identifying future roles for the FHLBanks, FHFA is committed to ~~both~~ preserv~~e~~ing and capitaliz~~e~~ing on their strengths ~~of the FHLBanks~~. As liquidity providers with about 8,000 member financial institutions, the FHLBanks are an important source of liquidity in the housing markets and they have nationwide linkages to lenders and their communities. The FHLBanks can serve an important role in coordinating and aggregating resources to deliver to their members. Through their housing and community investment programs, the FHLBanks also have a broad network of community-based institutions. FHFA intends to identify ways the FHLBank System can further the objectives of a safer, more effective and efficient housing finance system that provides broad and inclusive access to finance. As part of the housing reform debate, FHFA intends to evaluate ways in which the FHLBanks can support the transition to a more liquid, safer system of housing finance.

Recognition of HERA and demonstration of interest in changing outcome. Where is this legal authority?!

**Comment [A10]:** ?policymakers

**Comment [A11]:** I know this is your territory. On first read, this par. sounds just a bit too 'we will fight to preserve our regulatees' to me. But your call...



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# RESOURCE MANAGEMENT STRATEGIES

Managing FHFA's resources successfully is critical to goal and mission achievement. Strategic Goals and expected outcomes cannot be achieved without prudent and effective management of resources to ensure that the right people, funds, supplies, physical space, and technology are in place. In addition, achievement of FHFA's goals requires collaboration and coordination by all staff and across all offices and divisions within FHFA.

FHFA has developed three resource performance goals that cut across the Agency's strategic goals that will involve staff at all levels across the Agency. These performance goals are intended to provide our examination and mission program staffs with all of the skills, tools, and materials they need in a timely and seamless manner so that they are able to achieve their individual performance goals and, thus, FHFA's strategic goals unimpeded by resource shortfalls.

## EXPECTATIONS OF EMPLOYEES

***FHFA expects its employees to conduct themselves consistent with FHFA's values and for every employee to:***

- **Contribute to improving the agency's operations and working environment;**
- **Offer conclusions and solutions supported by analysis that takes into consideration facts, context, and alternate views, free of undue or inappropriate influence; and**
- **Treat each other with courtesy and respect, irrespective of grade or position**

### ANTICIPATE RESOURCE NEEDS

Careful and collaborative planning is necessary to ensure that FHFA's Strategic Plan for 2012-2016 is supported and Agency resources are available to support planned activities. FHFA management, technical and program support personnel, and administrative staff will work together to develop long-term workforce, acquisition, and technology plans as well as logistical

plans for space, supplies, and transportation that align with strategic and annual plans. These plans will be modified as necessary to remain relevant in the face of shifting priorities or unanticipated external events and will identify the skills, funding, and all resources necessary to achieve planned FHFA results and specify the timeframes for acquiring the needed resources.

### Acquire Resources in a Timely and Efficient Manner That Promotes Diversity and Inclusion

FHFA acquires its resources through numerous administrative delivery systems. The recruitment system identifies and hires employees with the necessary skills; the contracting system is in place to purchase the technology, goods and services required for FHFA to get its job done; and the financial and budgeting systems makes sure FHFA has the money to hire people and purchase what it needs and to account for its expenditures. Options exist within these administrative systems that can be used to tailor the acquisition approach to the situation. For example, if timeframes are tight, a very different approach might be taken when the required resource is scarce; or, traditional approaches might need to be altered to be certain all segments of society are included in FHFA's contracting and hiring. FHFA management and administrative staffs will develop and execute the most timely and efficient acquisition strategies that consider all aspects of the resource need, including FHFA's objective to achieve diversity.

### Apply Consistent Policies and Internal Controls to Operations

Acquiring the necessary resources to achieve FHFA's goals and mission is costly in terms of time, energy, and money; and, once in place, resources must be managed throughout their life cycles to optimize contributions to achieving FHFA's goals and mission. Defined policies and processes are tools that help managers ensure quality and timeliness through systematic operations as well as equitability in the management of our human resources and contracting efforts. Such policies and processes also help to clarify expectations for employees and contract staff in terms of what their roles and responsibilities are in achieving FHFA's goals and missions and help managers to evaluate progress and results in a consistent manner. FHFA will develop and institutionalize policies and standardize processes to be applied in the course of examination work across the entire agency, and the work and results achieved by FHFA will be evaluated systematically to determine if resources are being utilized most effectively and identify improvement opportunities.



FHFA00105105

## STRATEGIC PLANNING PROCESS

~~Strategic Planning is an~~ The FHFA's *Strategic Plan 2012-2016* was developed through an inclusive process ~~iterative on-going process~~ within FHFA. With guidance from the Acting Director, the strategic goals for FHFA's *Strategic Plan 2012-2016* were deliberated during a two-day retreat that included FHFA managers and subject matter experts. An initial draft of the plan was published for comment on FHFA's website over a 30-day period during July of 2011. The posting of the plan, taking into consideration employee and stakeholder comments, was then followed by robust consultation and meetings within FHFA to produce a strategic plan that would enable FHFA to meet the many challenges ahead. Goal achievement will be carried through FHFA's Annual Performance Plans. To monitor progress toward goal achievement, FHFA senior management will meet on a periodic basis to identify obstacles that might prevent a goal from being achieved. In addition, each FHFA employee will have a job performance plan and individual development plan aligned to achieving FHFA's strategic plan objectives.

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**Comment [SM12]:** Need to verify what these were.

~~In February 2011, FHFA began the process to revise and update its Strategic Plan to provide direction and focus in achieving its mission as a result of several legislation actions including the Dodd-Frank Act. The guidance provided in this strategic plan provides a much needed basis for defining FHFA's current and future roles as conservator. The plan aims to provide the most realistic four year framework for FHFA focusing on preserving and conserving assets, ensuring market stability and liquidity, and preparing the Enterprises for an uncertain future.~~

~~The process began with a review of other agencies' strategic plans as well as working through the newly established Government Performance and Results Modernization Act of 2010 (GPRA). The strategic goals and performance goals from the FHFA FY 2011 Annual Performance Plan as well as content from several of the Acting Director's speeches were used to provide background and direction for the strategic planning process.~~

~~After a large internal reorganization, this four-year Strategic Plan will provide direction and focus to FHFA management and staff. To ensure accountability of managers and staff for goal achievement, FHFA uses a variety of mechanisms to review progress toward achieving annual performance goals outlined in more detail in the Annual Performance Plan. FHFA's senior management meets on a quarterly basis, to discuss any obstacles or issues that would prevent a goal from being achieved. Every FHFA employee's annual job performance plan and individual development plan is aligned in support of the Annual Performance Plan (APP). In addition, FHFA employees are rated annually based on their performance in achieving results that lead to the achievement of the FHFA's goals.~~

### ~~CONSULTATION AND OUTREACH~~



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~~FHFA's management was provided with an opportunity to provide input to the development of this strategic plan. In addition, FHFA requested comment from employees and other stakeholders and the public on the current FHFA *Strategic Plan, 2012-2016*, through a posting on our website over a 30-day period in July 2011. All comments and suggestions were carefully reviewed and incorporated into this updated plan where appropriate.~~

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**DRAFT**
**Sensitive and Pre-Decisional**

**PSPA Amendment Q&A**

**GENERAL:**

**[Eric & Matt] What is the purpose, necessity and meaning of these changes?**

- This proposed modification would have three primary benefits.
  - First, it would eliminate the circularity of Treasury funding the GSE's dividends payments to Treasury.
  - Second, it would capture all future positive earnings at the GSEs to help pay back taxpayers for their investment in those firms.
  - Finally, it would reduce future draws under the PSPAs so that such draws would only be made when needed to fund quarterly net losses.
- In making these changes, Treasury has sought to support three key objectives: (1) winding down Fannie Mae and Freddie Mac; (2) protecting taxpayer interests; and (3) ensuring the continued flow of mortgage credit during a responsible transition.
- Our commitment to ensuring Fannie Mae and Freddie Mac have sufficient capital to honor all guarantees issued now or in the future and meet all of their debt obligations remains unchanged.
- The Administration will not pursue policies or reforms in a way that would impair the ability of Fannie Mae and Freddie Mac to honor their obligations or diminish confidence in the solvency of Fannie Mae and Freddie Mac.

**[Adam] What are the current terms of the Senior Preferred Stock Purchase Agreements (PSPAs)?**

- The current capacity on Treasury's funding commitment under the PSPAs equals $200 billion plus the cumulative net worth deficits experienced during 2010, 2011, and 2012, less any surplus remaining as of December 31, 2012.
- At the end of 2012, the funding commitment capacity under the PSPAs will be fixed permanently, and the remaining PSPA capacity will be limited to approximately $149 billion for Freddie Mac and $125 billion for Fannie Mae. The remaining capacity is different for each GSE since it reflects the $200 billion commitment less the draws prior to 2010.
- Any subsequent draws whether to fund a net loss and/or dividend payments to Treasury would reduce the limited remaining PSPA capacity available to each GSE.

**[Adam] What does this agreement change and why?**

- *Replace the fixed 10 percent dividend with a net worth sweep dividend* - Quarterly dividend payments starting in 2013 will equal the positive net worth of the GSEs (i.e., GAAP assets less liabilities at quarter end), less a defined Applicable Capital Reserve Amount.

**Comment [BR1]:** I would stress: (1) stabilizing the housing market, (2) helping families to buy homes, (3) helping troubled borrowers, and (4) helping to bring back private capital to the mortgage finance market.

**Comment [BR2]:** This is really a mechanical means to broader policy objectives.

**Comment [BR3]:**

Raises the questions: What is time frame for wind-down? What happens after wind down? Maybe better to say "restore private mortgage financing" or "bring back private capital".

Doesn't reducing the retained portfolio encourage the GSE to resolve troubled loans more aggressively … which helps borrowers and stabilizes the housing market?

**Comment [BR4]:** Should be first Q.



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- *Accelerate the wind-down of the retained investment portfolios* - The required reduction rate for the retained investment portfolios will be increased to 15 percent from 10 percent per annum beginning at year-end 2013 until such time that each GSE's portfolio reaches a target $250 billion balance ($250 billion was set in the original PSPA).

- *Require an annual risk management plan be delivered to Treasury* - On an annual basis, each GSE will submit to Treasury a plan that details the steps it will take to reduce the financial and operational risk profile associated with both their mortgage guarantee and retained investment portfolio businesses in order to help protect taxpayers from future losses.

violation of independence clause in HERA

**[Adam] How does the full income sweep operate?**

- Beginning with the financial results as of 1Q 2013, and each quarter thereafter, all positive net worth above the Applicable Capital Reserve Amount at each GSE will be transferred to Treasury in the form of a dividend.
  - Net worth is defined as net assets minus net liabilities (per GAAP)
  - No dividends are paid when there is a net worth deficit or a positive net worth below the Applicable Capital Reserve Amount

misleading & dishonest. Language is: "when and if declared by the boards"

- Over time, this will result in all positive net income generated by the GSEs is paid to the government and will likely exceed the amount that would have been paid if the 10% was still in effect. Furthermore, this amendment eliminates the circularity of payments and preserves for the GSEs their respective PSPA draw capacity.

demonstrates FHFA lied in sworn depositions & that issue was never just about repayment

**[Beth – need Peter to review]] What are the enforcement mechanisms to ensure the GSEs meet these new requirements?**

- The PSPAs and their amendments constitute legally binding contracts between the GSEs and Treasury. Therefore, these amendments, like the rest of the agreements are a valid and legally binding obligation of the GSEs to fulfill.

- [If either party to the contract – the GSEs or Treasury – do not fulfill their obligations, they are enforceable in court.]

Violates HERA's conservatorship powers as the Board. Diminishes power of FHFA and would not be sustainable in court.

- There are laws of general applicability, such as bankruptcy and insolvency laws, that could supersede in court and limit enforceability. [However, these are limited in nature and typical of financial contracts between two parties.]

**[Beth] How will this plan help families seeking mortgage credit, troubled homeowners, and the broader housing market?**

- Although there are signs of housing market stabilization, there are many troubled borrowers who continue to face hardship. These amendments help support the continued flow of mortgage credit and bring greater stability to the housing market in several ways.



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- It helps to ensure that mortgage credit remains available on reasonable terms, ~~because market participants will continue to have confidence in the GSEs ability to meet its guarantee obligations.~~ Until the private sector reemerges as a significant source of financing for the mortgage market, the GSEs will serve the critical role of providing mortgage credit to first time homebuyers as well as those borrowers looking to refinance into a lower rate loan. Market participants will continue to have confidence in the GSEs ability to meet its guarantee obligations, in part because changing the dividend to a net-asset sweep will preserve GSEs' borrowing capacity. The GSEs will no longer need to borrow from the Treasury merely to meet a 10 percent dividend requirement.
  - It is important that credit worthy first time homebuyers are able to access mortgage credit so that they can help reduce excess housing inventory in many communities.
  - Refinancing helps put more money in families' pockets so they can pay off debt or use for other expenses.
- [The risk management plan required of each GSE on an annual basis is expected to encourage activities that help troubled borrowers with loans guaranteed by Fannie Mae or Freddie Mac. This could include asset sales of troubled loans to specialty servicers, which are better equipped to assist borrowers with a mortgage modification or find other ways to keep families in their homes.]

Comment [BR5]: Or portfolio wind-down?

**[Beth] How will these changes help bring private capital back to the mortgage market?**

Comment [BR6]: Doesn't quite explain how these changes will bring private capital back.

- These changes, in combination with other commitments by FHFA, such as gradually increasing guarantee fees, will help bring pricing in line with private market participants so that they begin to again take mortgage credit risk.
- As part of these changes, Fannie Mae and Freddie Mac will be required to submit a risk management action plan each year that will provide clear goals and timetables for the GSEs to reduce the risk of the mortgages they guarantee as well as their mortgages they hold as investments in their retained portfolios.

what happened to this plan? Have they been presented but not public?

- We expect these plans to include ways that private sector will begin to take on some of the GSEs' mortgage credit risk. ~~can be sold or moved to the private sector in order to better protect taxpayers as well as attract private investors back into the market.~~
- ~~These changes should also help attract private investors back into the mortgage market. They help ensure that private mortgage investors, whose purchases of Fannie and Freddie mortgage-backed securities (MBS) are an important source of funding in the housing finance market, will continue to have confidence in their guarantees.~~

Comment [BR7]: Maintaining investor confidence in USG backing for the GSEs is important, but it's quite different from getting the private market to take on credit risks the USG is now taking.

**[Adam] When will these changes become effective?**

- The amendment is effective immediately, and the dividend payment change will become effective starting with the first quarter 2013 earnings.



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**[Adam] Without this amendment, do you think the Enterprises would become insolvent? If so, when?**

- Today, we believe that the GSEs are fully able to meet all current obligations. However, the earnings outlook at the GSEs is difficult to forecast and is subject to speculation.
- ~~Given our intent to wind-down the GSEs over time, the existing 10 percent dividend structure could potentially become unsustainable. Therefore, we made the appropriate change to change dividend to full income sweep.~~
- ~~This~~ Changing the 10 percent dividend payment to a net worth sweep will help ensure financial stability of GSEs and that the taxpayer will be the beneficiary of the income. If their net earnings should be insufficient to pay the 10 percent dividend, the sweep will enable them to pay what they can without requiring additional borrowings from the Treasury that would constrain their overall borrowing capacity. If they should perform well enough to pay a dividend greater than 10 percent, taxpayers will recover their investment sooner.
- Since we intend to wind down the GSEs over time, the GSEs do not need to retain income in excess of amounts required to pay the 10 percent dividend.

**[Ankur] What were the previous amendments to the PSPAs and why were those made?**

- Over last several years Treasury has taken steps to ensure financial stability of GSEs and help the housing market most effectively.
- On September 6, 2008, FHFA, as regulator of the GSEs, placed both into conservatorship.
    - At that time, their combined guaranteed mortgage-backed securities (MBS) outstanding totaled more than $5.4 trillion and their share prices had fallen sharply.
    - The goals of conservatorship, as stated by FHFA, included helping to restore confidence in the GSEs, enhancing the GSEs capacity to fulfill their missions, and mitigating the systemic risk that had contributed directly to instability in the housing market.
- At the same time that FHFA placed the GSEs into conservatorship, Treasury provided capital support by entering into a Senior Preferred Stock Purchase Agreement (PSPA) with each GSE, acting through FHFA as their conservator. The PSPAs were intended to provide confidence to the market that the GSEs would remain solvent.
    - The initial Treasury funding commitment was $100 billion for each GSE.
    - In May 2009, Treasury increased the funding commitment caps to $200 billion for each GSE.
    - In December 2009, Treasury replaced the fixed $200 billion cap with a formulaic cap that increases the amount of capital support available through the PSPAs by the amount of draws between January 1, 2010 and December 31, 2012.



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**Sensitive and Pre-Decisional**

**[Adam] What are the reasons Treasury and FHFA did not get this right in December 2009? Why must we revisit this issue again?**

- Treasury believes the steps taken in 2009 were appropriate to best maintain the financial stability of the GSEs in order to best allow them to continue operating effectively.
- Given their improvement in operating performance and our intention to wind them down, we think the current steps being taken are appropriate.

BINGO! PROVES THAT THEY DID THIS BECAUSE GSEs WERE HEALTHY AND THE GOAL WAS EXTRA-LEGAL TO HERA!!!

**[Ankur] Can Treasury make further amendments to the PSPAs? If so, until when?**

- Treasury and FHFA have authority to make changes to legal agreements, except for the amount of funding that can be provided.
    - Funding authority was fixed in December of 2009 with the expiration of Treasury's authority under HERA.
- Treasury and FHFA do not anticipate additional changes at this time but the Administration will continue to monitor the situation and consider whether any additional changes to the PSPAs would be appropriate.

**What power does Treasury actually have over Fannie Mae and Freddie Mac?**

- Under the Conservatorship mandate, Treasury has the responsibility for approving transactions at the GSEs that fall outside the ordinary course of business; however, Treasury does not control Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac are under the conservatorship of their regulator, FHFA.
- As a member of the Federal Housing Finance Oversight Board (FHFOB), the Secretaries of Treasury and HUD provide policy guidance and recommendations to FHFA on a range of matters related to Fannie Mae and Freddie Mac.

Where in HERA?

## FINANCIAL / TAXPAYER IMPACT

**[Adam] How does this change impact taxpayers and the federal budget?**

- The federal budget will continue to maintain the existing non-budgetary presentation for Fannie Mae and Freddie Mac, as it does for the other GSEs.
    - This is consistent with Governmental Accounting Standards that do not require consolidation if ownership control is temporary.
- All federal programs that provide direct support to Fannie Mae and Freddie Mac, including the Senior Preferred Stock Purchase Agreements (PSPAs), are shown on-budget.

**Comment [BR8]:** How can we argue that USG ownership control is temporary if we will be sweeping their net worth? Doesn't that ensure the GSEs will have no exit from conservatorship.

BINGO! THEY HAVE INTENTIONALLY MISLED THE GAO & CBO. VIOLATION OF ACCOUNTING UNDER GASB. MUST CONSOLIDATE.

**[Adam] How does OMB's estimate of Fannie Mae and Freddie Mac's deficit impact differ from CBO's approach?**



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- The 2013 Budget maintains the existing non-budgetary presentation for Fannie Mae and Freddie Mac.
  - This is consistent with Governmental Accounting Standards that do not require consolidation of an entity if ownership control is temporary, as it is for Fannie Mae and Freddie Mac during the period of their conservatorship.
  - However, all federal programs that provide direct support to Fannie Mae and Freddie Mac, including the Senior Preferred Stock Purchase Agreements (PSPAs), are shown on-budget.
- As we understand it, CBO's estimates of the deficit impact of Fannie Mae and Freddie Mac are considerably higher than the Administration's because CBO defines the budget impact as capturing what a private entity would require as compensation for assuming Fannie Mae and Freddie Mac's commitments.
- The compensation is represented in CBO's description as the difference in market value between Fannie Mae and Freddie Mac's assets and their liabilities on a "risk adjusted" basis.
- This "risk premium" assigned by CBO does not constitute a federal outlay, and is not comparable to the budgetary estimates of Fannie Mae and Freddie Mac's costs included in the President's Budget.
- The Administration presents the budget impact as the estimated amount attributable to transactions between Treasury and Fannie Mae and Freddie Mac under the PSPAs.

**[Adam] How much has the government's investment in Fannie Mae and Freddie Mac cost taxpayers to date? What is the expected lifetime cost?**

- Through June 30, 2012, Fannie Mae has drawn $116.2 billion and Freddie Mac had drawn $71.3 billion, excluding the initial $1.0 billion liquidation preference for which the GSEs did not receive cash proceeds.
- Fannie Mae has paid $25.4 billion in dividends back to Treasury and Freddie Mac has paid $20.1 billion in dividends back to Treasury.
- As a result, the current net investment in the GSEs is $142.0 billion – $90.8 billion for Fannie Mae and $51.2 billion for Freddie.
- The overall expected lifetime costs are inherently uncertain. Treasury will continue to work with FHFA and the GSEs to ensure taxpayers are appropriately compensated for investments to date.
- The proposed modifications are not projected to result in the Government receiving less funds from Fannie Mae or Freddie Mac on a net basis over time.

**[Adam] How much PSPA capacity is remaining for each GSE?**

**Comment [BR9]:** See above

**Comment [BR10]:** Sounds like we are not sure we really understand.

BINGO! ACKNOWLEDGE REPAYMENT PRIVATELY.



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- After 2012, the funding commitment cap under the PSPAs will be fixed permanently, and the remaining PSPA capacity will be limited to approximately $149 billion for Freddie Mac and $125 billion for Fannie Mae.

**[Beth] How does this change impact other preferred and common shareholders, including community banks? Does this mean their investments are worthless?**

- The preferred and common stock holders of the GSEs do not have rights while the GSEs are in conservatorship. These amendments do not change that.
- Because all positive net worth will be swept to Treasury going forward, preferred and common shareholders should not expect to receive any dividends or economic gains while the PSPAs are in effect.
- Most community banks have previously written-down their preferred stock holdings and therefore these changes should not affect community banks financial positions. [Can we add a citation here to a third-party source???]

BINGO! ACKNOWLEDGE ABOVE THAT IT IS SUPPOSED TO BE TEMPORARY. IN COMBINATION WITH THIS THEY ACKNOWLEDGE ABRIDGING PREF RIGHTS

**[Beth] Doesn't this change mean you could give the GSEs a bigger bailout by providing more headroom under the PSPAs?**

- These changes do not change the maximum cap of PSPA support for either GSE. However, it preserves the remaining capacity for true business activity and other financial losses – its original intended use - rather than using the capacity in a circular fashion to pay Treasury the ~~10%~~ percent dividend.
- By sweeping the full income of the GSEs each quarter, Treasury will receive no less from the GSEs as we would have under the previous 10 percent dividend. Essentially, it will stop the GSEs from *drawing from* Treasury in order to *pay* Treasury the ~~10%~~ percent dividend.

**[Ankur] Why are you providing the GSEs with a capital buffer under this agreement? How does the buffer work?**

- The declining capital buffer, initially set to $3 billion, is provided to avoid extraneous quarterly draws on Treasury that would otherwise occur as a result of the volatility in earnings arising from the GSEs' normal course of business. The capital buffer will be declining each year going forward and reach zero by 2018. Thus, within six years, the entire capital buffer will be eliminated and paid to Treasury.

## HOUSING FINANCE REFORM

**[Beth] Will this change reduce the urgency for fundamental long-term housing finance reform? Moreover, now that the GSEs are profitable again, can they just continue operating indefinitely as a public utility?**



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- These changes are consistent with Treasury's policy to wind-down the GSEs. Sweeping the GSEs' positive net worth helps ensure that the GSEs will not be able to rebuild capital as they are wound down.

- Furthermore, these changes provide a framework for the GSEs to transition to a future housing finance system that is more reliant on private capital. This agreement sets out clear targets by requiring the GSEs to reducing the size of the mortgage holdings in their retained portfolios by 15 percent per year – faster pace than before. And it forces the management of the GSEs to set concrete goals and timetables to reduce the operational and financial risk of the enterprises by requiring an annual risk management action plan. In other words, this effectively operationalizes our commitment to wind down the GSEs.

**Comment [BR11]:** Doesn't really explain how this brings back private risk-taking

- However, we also recognize the housing market is still fragile and private capital has not yet returned in a robust manner. These changes strike an important balance. They will allow the GSEs to continue to play a critical role supporting the housing market in the near-term, but provide a road map for how they will be wound down going forward.

- Along with other commitments by FHFA to increase guarantee fees, these changes should encourage the return private capital to the housing financing market and reduce the GSEs' market share.

**[Beth] How long is a reasonable transition?**

- Treasury supports a transition to a long-term housing finance system as soon as practicable. We look forward to working with Congress to determine what that end-state should look like and the steps needed to get there.

Again, willful violation of HERA which defines the future state in recapitalization if possible or receivership if not

**[Beth] What information will be included in the "Annual Report on Taxpayer Protection" that Fannie Mae and Freddie Mac submit to Treasury? What is the purpose of the report? Does it have any enforcement or accountability mechanisms?**

- The annual report will contain steps that Fannie Mae and Freddie Mac plan to take in order to reduce the risk profiles of both the mortgages they guarantee businesses as well as those they hold as investments in their retained portfolios. They will have to lay out, in reasonable detail, specific goals, targets and timetables so both management and the conservator has a clear understanding of the wind-down strategy. We expect that these plans will change over time, but would include steps to reduce their risk profile.
  - For their Credit Guarantee businesses, the plan could include sales of mortgage credit risk to private investors so that taxpayers bear less of the burden.
  - For the GSEs retained portfolios, we expect the plans to indicate aggressive managing down their legacy assets in order to reduce risk of non-performing loans, complex securities, and other hard to manage assets to reduce the portfolio's risk over time.

Demostrates 'control' in excess of legal authority of UST under HERA.



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- FHFA, as the GSEs' regulator and conservator, will oversee the implementation of the steps outlined in the report. In addition, each GSE will be required to assess the progress it has made in meeting the goals and timetables in the plans set forth in the previous year. [These reports will be made available to the public.]

Shows FHFA became a puppet of UST in violation of law.

**[Eric & Matt] When is the Obama Administration going to submit a long-term housing finance reform plan?**

- As Secretary Geithner has stated, we're continuing to work to identify a bi-partisan path forward on housing finance reform.
- At the same time, we'll continue to put in place measures right now – including today's announcement -- that help ensure continued access to mortgage credit for American families, promote a responsible transition, and protect taxpayer interests

Corker & Warner already signed up and were briefed by both TG and DeMarco

**[Adam] What is the current status of the other housing finance initiatives Treasury and FHFA are working on, including REO-to-Rental, NPL sales, credit risk syndication, and others.**

- Treasury remains committed to our broader efforts that will restart the private mortgage market, shrink the government's footprint in housing finance, and protect the long-term interests of taxpayers.
- Treasury continues to help FHFA and the GSEs think through the important challenges and questions raised by these efforts.

<u>HOMEOWNER IMPACT</u>

**[Beth] How will these changes affect the cost and availability of mortgage credit?**

- These changes will help to ensure that mortgage credit remains available and on reasonable terms because private investors will continue to have confidence that Fannie Mae and Freddie Mac obligations – including their credit guarantees on their MBS – will be fulfilled.

**[Ankur] Will these changes in the PSPAs make it easier for families to buy a home by lowering the average FICO scores or high downpayment requirements currently required by lenders?**

- We believe that the agreements should give mortgage market participants continued confidence that the GSEs will fulfill their future obligations as they are wound down. That should enable them to continue to play a critical role supplying mortgage credit to families in the near term until more private capital returns to the market. However, access to mortgage credit remains tempered by still-fragile housing market and an economic recovery that is not as fast as anyone would like.

- We are very attuned to the challenge faced by many families seeking to refinance or obtain a mortgage, especially first time ~~lower-income~~ and ~~first-time~~ lower-wealth homebuyers. And we are exploring ways to ease the situation.
- That is also why we are seeking to balance our desire to wind-down the GSEs as soon as practicable with the need for a responsible transition to a mortgage market that is more reliant on private capital. Any changes to the system should be taken with great sensitivity to both of these concerns.

Comment [BR12]: Elsewhere we call this a long-term goal. Sounds confusing.

**[Adam] FHFA recently announced it plans to raise GSE mortgage guarantee fees by the end of the year. Why is it necessary to raise the cost of mortgage loans when the market is still struggling to recover?**

- The GSEs are gradually raising guarantee fees to help restart the private mortgage market, shrink the government's footprint in housing finance, and protect the long-term interests of taxpayers.
- We will work to ensure, however, that the increases occur at a measured pace, allowing borrowers to adjust to the new market, preserving widespread access to affordable mortgages for creditworthy borrowers including lower-income Americans, and supporting, rather than threatening, the health of our nation's economic recovery.

Comment [BR13]: Do we want to endorse G-fees at this time? I thought we wanted to maintain distance?

FHFA & UST hand in glove

IMPACT ON THE HOUSING MARKET AND THE GSES

**[Adam] How will the net worth sweep reassure investors in GSE debt and help maintain investor confidence?**

- Treasury anticipates the financial markets will scrutinize the GSEs' expected losses and dividend payments relative to the level of available PSPA funding that remains.
- Since the existing 10 percent dividend structure could become unsustainable, we made the appropriate change to the dividend with the positive net worth sweep.
- This will help ensure financial stability of GSEs and that the taxpayer will be the beneficiary of the income.
- The GSEs continue to generate the bulk of their profits not in the single-family segments but in the investment portfolio segments which generate interest income on securities and whole loans financed by debt.
    - In 2Q 2012, the portfolio segment for Freddie Mac generated a net income of $2.5bn (versus $0.2bn for the single-family segment). For Fannie Mae the investment portfolio generated $1.5bn (versus what would have been $1.3bn in the single-family business if the reduction in reserves was not recorded as income).



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**[Beth] Why are you giving up your leverage by agreeing to make this change without further concessions? Shouldn't you have used this as leverage to get the GSEs to do more to help homeowners (e.g. principal reduction and/or greater opportunities to refinance)?**

- Treasury continues to remain actively engaged with FHFA in exploring ways to help troubled homeowners.
  - For example, FHFA and Treasury have seen tremendous success with HARP changes, with a significant pickup in HARP refinancing activity since Treasury worked with FHFA to improve the program in the Fall of 2011.
- ~~At this point in time,~~ Although ~~Treasury remains disappointed with FHFA's decision to not have the GSEs participate in the HAMP PRA program. However, as~~FHFA is an independent regulator and conservator of the two GSEs, and~~FHFA~~ is solely responsible for the ultimate decision whether the GSEs can participate or not. Treasury has asked FHFA to reconsider its decision to not have the GSEs participate in the HAMP PRA program.

**[Ankur] What does this change mean for employees at the GSEs? When you say "wind down," what do you mean by that if the GSEs can still keep their systems, still retain people and still have a capital reserve?**

- We believe that employees of the GSEs should not be affected by the latest PSPA amendment. Treasury has consistently stated its intention to wind down the GSEs, and the latest PSPA amendment merely formalizes one aspect of the process by which that long-standing goal can be achieved.
- Winding down the GSEs is not inconsistent with allowing them to retain the basic infrastructure required to conduct their day-to-day operations, as this will allow the GSEs to effectively conduct business and completely repay the funds it has received from Treasury/the taxpayer.

**[Adam] Will accelerating the wind down of GSEs' retained portfolio adversely impact those firms' operations or the housing market?**

- We do not believe this modification will adversely impact the GSEs or the broader housing market. However, we anticipate that the GSEs will have lower earnings from their retained portfolios due to the lower allowable annual balance.

**[Adam] Will these changes trigger any accounting revisions at the GSEs?**

- Treasury does not believe this change will trigger any accounting revisions at the GSEs.

**[Adam] Will any of the changes affect Freddie Mac differently from Fannie Mae, and if so, why, and is this good or problematic?**

- Both GSEs will be required to implement these changes.



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TIMING / STRATEGY

**[Adam] How long will it take to wind down Fannie Mae and Freddie Mac? Why not unwind Fannie Mae and Freddie Mac at a faster pace? Why did you not come out with a specific proposal for pace of unwind?**

- The pace will depend on market conditions.
- We cannot forget that while we have made important progress stabilizing the housing market, this critical sector of the economy remains fragile.
- Private capital has not yet fully returned to the market, and the government continues to play an outsized – though unfortunately necessary role – in ensuring the availability of mortgage credit.
- Proposals that prematurely constrain Fannie Mae and Freddie Mac's ability to guarantee loans could limit the availability of mortgage credit, shock the economy, and expose taxpayers to greater losses on the loans already guaranteed by Fannie Mae and Freddie Mac.

**[Adam] Why make this change now, particularly after the GSEs had such a profitable quarter?**

- Given our intent to wind-down the GSEs over time, the existing 10 percent dividend structure could potentially become unsustainable. Therefore, we made the appropriate dividend change from 10% to a positive net worth sweep.
- This will help ensure financial stability of GSEs and that the taxpayer will be the beneficiary of the income.

Comment [BR14]: How/why?

**[Ankur] Who had to sign off on this change? When did that happen?**

- The latest PSPA amendment was signed by the Secretary of the Treasury, Timothy Geithner, and as the Conservator for each GSE, the Acting Director of FHFA, Edward DeMarco.
- While the formal document execution occurred on [Friday, August 17], the amendment had been jointly drafted and reviewed by Treasury and FHFA.

**[Beth] How is your working relationship with FHFA? Did the negotiations over principal reduction complicate this agreement on the PSPAs?**

- Treasury and FHFA are currently working on many different issues in a productive manner. These include credit risk syndication, REO-to-rental initiatives, federal short sale programs, as well as other steps to reduce taxpayer risk and bring back private capital.
- Both Treasury and FHFA were required to consent to this transaction.

**[Beth] Why does this agreement exclude any requirement for principal reduction at the GSEs?**



UST00406528

- Treasury already pursued a course of action to encourage principal reduction by the GSEs as part of their loan modification programs. Because the PSPAs are contracts between Treasury and the GSEs (through FHFA as their conservator), all changes to the PSPAs needed to receive support and agreement from all parties.

**[Adam] Can Treasury dictate terms of PSPA amendments? What is role of each GSE and what is the role of FHFA?**

- The Housing and Economic Recovery Act of 2008 amended the charter acts of the GSEs to give Treasury the authority to purchase obligations and other securities issued by the GSEs, and to exercise, at any time, rights received in connection with such purchases.
- The PSPAs are the contracts under which Treasury purchased the senior preferred stock certificates issued by Fannie Mae and Freddie Mac.
- In the PSPAs, Treasury received the right to amend the PSPAs, with the GSEs' agreement.
- The terms of the senior preferred stock certificates authorize the GSEs, with the consent of two-thirds of the holders of the senior preferred stock (i.e., Treasury), to amend the terms of the senior preferred stock certificates.

Acting as a commercial and governmental actor

**[Adam] Why are GSEs allowed to keep portfolios of $250 billion each in 2018 if they are to be wound down?**

- The GSEs provide important services to the mortgage market, in particular small lenders through their cash window and other warehousing. The GSEs also need to use their investment portfolios to fund delinquent loans bought out of trusts.
- Given this fact pattern, we maintained the $250 billion level as the maximum retained portfolio size.
- Until such time there is a decision on the ultimate resolution of the GSE's we think this is an appropriate figure.

**[Adam] When did Treasury first think about these changes? When did we approach FHFA? What was their reaction?**

- Within the context of the Administration's goal of winding down the GSEs, we began exploring alternatives to the 10 percent dividend, knowing that the 10 percent dividend was likely to be unstable as the businesses were reduced.
- We have been evaluating the GSEs financial profile since conservatorship. It has remained an ongoing focus for us to help make sure that the GSEs have sufficient capital support.
- We don't comment on discussions between Treasury and independent regulators.

**Comment [BR15]:** Doesn't hold water. Their business won't reduce in the immediate future.



UST00406529

**From:** LeCompte, Jenni
**Sent:** Sunday, July 22, 2012 1:41 PM
**To:** Miller, Mary; Wolin, NealDisabled
**Cc:** Gibson, Campbell
**Subject:** RE: Document for review

Thanks Mary. Since we did not get this out Friday, my preference would be to put some more space between the expected principal reduction announce this week and our announce as detailed in the attached – perhaps identifying a good day next month and revisiting it then. Happy to talk more today or tomorrow if helpful.

---

**From:** Miller, Mary
**Sent:** Sunday, July 22, 2012 8:26 AM
**To:** Wolin, Neal; LeCompte, Jenni
**Cc:** Gibson, Campbell
**Subject:** FW: Document for review

Wanted to make sure that you saw this as well. We have not made any decision to move ahead, and are waiting to hear from Deese. I walked him through the reasoning on Friday and he wanted to think about it.

---

**From:** Miller, Mary
**Sent:** Friday, July 20, 2012 5:05 PM
**To:** Valverde, Sam; Adeyemo, Adewale (Wally); Massad, Timothy; Stegman, Michael; Bowler, Timothy; Deese, Brian C.
**Cc:** Woolf, Andrew
**Subject:** Document for review

This represents our collective thoughts on how to signal a plan to amend the PSPAs, with details to be built out later. Welcome your thoughts. The Secretary also asked to see this.



UST00517872

**From:** Stegman, Michael
**Sent:** Sunday, July 22, 2012 10:36 AM
**To:** Miller, Mary
**Subject:** Re: Document for review

Ok
Michael A. Stegman

Counselor for Housing Finance Policy
202 622 0204
202 622 0696

Department of the Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220

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**From**: Miller, Mary
**Sent**: Sunday, July 22, 2012 10:32 AM
**To**: Stegman, Michael
**Subject**: RE: Document for review

I just left him a voice mail to discuss. We may set up a call later if necessary.

---

**From:** Stegman, Michael
**Sent:** Sunday, July 22, 2012 9:58 AM
**To:** Miller, Mary
**Subject:** Fw: Document for review

Isn't our timing wanting this to get out as in case things blow up this week in which case we won't be able to get tbis done at all?

Also, if you get Ed to ok today and things don't go well thid week he is on record to work with us on PSPAs which would keep estrangement to minimum.

Just some thoughts as you consider a reply to Deese.
Michael A. Stegman

Counselor for Housing Finance Policy
202 622 0204
202 622 0696

Department of the Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220



UST00517875

**From**: Deese, Brian C. [mailto:Brian_C._Deese@who.eop.gov]
**Sent**: Sunday, July 22, 2012 09:43 AM
**To**: Miller, Mary; Valverde, Sam; Adeyemo, Adewale (Wally); Massad, Timothy; Stegman, Michael; Bowler, Timothy
**Cc**: Woolf, Andrew
**Subject**: Re: Document for review

I think the language here looks solid. Gene and I are concerned about timing - moving this out quickly rather than seeing how this week goes and then doing it over the next month. So if you guys are landing on moving out fast we should discuss.
Brian
202 503 5603

**From**: Mary.Miller@treasury.gov [mailto:Mary.Miller@treasury.gov]
**Sent**: Friday, July 20, 2012 05:05 PM
**To**: Sam.Valverde@treasury.gov <Sam.Valverde@treasury.gov>; Adewale.Adeyemo@treasury.gov <Adewale.Adeyemo@treasury.gov>; Timothy.Massad@treasury.gov <Timothy.Massad@treasury.gov>; Michael.Stegman@treasury.gov <Michael.Stegman@treasury.gov>; Timothy.Bowler@treasury.gov <Timothy.Bowler@treasury.gov>; Deese, Brian C.
**Cc**: Andrew.Woolf@treasury.gov <Andrew.Woolf@treasury.gov>
**Subject**: Document for review

This represents our collective thoughts on how to signal a plan to amend the PSPAs, with details to be built out later. Welcome your thoughts. The Secretary also asked to see this.



UST00517876

**From:** Stegman, Michael
**Sent:** Friday, May 11, 2012 3:52 PM
**To:** Bowler, Timothy
**Cc:** Stegman, Michael; Eberly, Janice
**Subject:** RE: PR talking points

TFG will meet privately with Ed on Monday. The whole memo will first crisply list our case for GSE participation in PRA—the studies, etc.

The next piece is what leverage do we have over FHFA to get them to do PRA?
The part I am asking you to do is to do bullets—not a whole lot of text around the PSPA issue.

One option that TFG raised and dismissed was our holding up execution of the PSPAs—this, he decided, would play havoc with market, etc.
So, he asked if any of the covenants were more important to him than to us—I don't think so, but I am not 100% sure. He then asked whether we knew of anything that that either GSE or FHFA wanted from us that we could reasonably withhold unless they participated in PRA.

So, the question is what's our leverage in getting him to do PRA?

The PSPA bullets will go into the memo that Jan has lead on--

Michael Stegman
Counselor for Housing Finance Policy
U.S. Department of the Treasury

---

**From:** Bowler, Timothy
**Sent:** Friday, May 11, 2012 3:45 PM
**To:** Stegman, Michael
**Cc:** Foster, Jeff; Chepenik, Adam; Mlynarczyk, Beth
**Subject:** Re: PR talking points

Yes

Adding the team

I am a bit confused

Can you add some context to the below?

I am a bit confused on what exactly we need to do

---

**From**: Stegman, Michael
**Sent**: Friday, May 11, 2012 03:43 PM
**To**: Bowler, Timothy
**Subject**: FW: PR talking points



UST00520420

Tim
Can you please get your team to put together bullets on the PSPA issues I raise in this note. This will be part of briefer for TFG private meeting with DeMarco on Monday.

Mike

Michael Stegman
Counselor for Housing Finance Policy
U.S. Department of the Treasury

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**From:** Stegman, Michael
**Sent:** Friday, May 11, 2012 3:13 PM
**To:** Eberly, Janice; Miller, Mary; Massad, Timothy; Kingsley, Darius; Shore, Stephen; Scharlemann, Therese
**Cc:** Adeyemo, Adewale (Wally); Patterson, Mark (DO); LeCompte, Jenni; Fitzpayne, Alastair; Bowler, Timothy
**Subject:** RE: PR talking points

Yes, but let's get clear what the PSPA issues were that were raised, so that we can add to Jan's piece. TFG asked how important is it to us to get the PSPAs done quickly vs. how important it is to Ed. Tim also asked how long can we wait to get the PSPAs done. Another thing I heard was whether we know of anything that FHFA wants from Treasury, inside or outside of the PSPAs, that would provide us leverage on the PRA issue.

Do others have other notes on the PSPA issue that we should address?

Mike

Michael Stegman
Counselor for Housing Finance Policy
U.S. Department of the Treasury

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**From:** Eberly, Janice
**Sent:** Friday, May 11, 2012 2:55 PM
**To:** Miller, Mary; Stegman, Michael; Massad, Timothy; Kingsley, Darius; Shore, Stephen; Scharlemann, Therese
**Cc:** Adeyemo, Adewale (Wally); Patterson, Mark (DO); LeCompte, Jenni; Fitzpayne, Alastair
**Subject:** PR talking points

TFG asked for talking points laying out the arguments on principal reduction for his Monday meeting. We'll draft a first pass, based on the document we prepared earlier to make the case for PR. We won't have the language on the PSPAs, though. Can Domestic Finance cover that part?

Thanks,
Jan

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## HARDEST QUESTIONS

1. ***Will the administration's plan raise mortgage rates?***
   - Any credible reform plan to address the irresponsible aspects of the pre-crisis housing market will make credit less easily available. We are coming out of a system in which institutions did not hold enough capital and priced guarantees at a level too low to cover their risk.
   - We will work to ensure, however, that reforms occur at a measured pace, allowing borrowers to adjust to the new market, preserving widespread access to affordable mortgages for creditworthy borrowers including lower-income Americans, and supporting, rather than threatening, the health of our nation's economic recovery.

2. ***How will your plan affect access to the 30-year fixed rate mortgage?***
   - Access to the 30-year fixed rate mortgage will be a key consideration in the long-term structure of housing finance. The 30-year fixed rate mortgage has provided homeowners with a simple and stable vehicle to finance their homes, and can protect American families from financial shocks.
   - The 30-year fixed-rate mortgage is a complex financial product that is not common in other countries around the world. Fannie Mae and Freddie Mac have helped promote the availability of the 30-year fixed-rate mortgage in the United States by guaranteeing the credit risk of mortgages. This has allowed mortgage investors to take only the interest rate risk of the mortgage-backed security. Without a guarantee, few investors would prefer to buy 30-year fixed rate mortgages, and, therefore, the ability for credit-worthy Americans to have access to that product may be greatly reduced.
   - Designing a new system for housing finance will require making difficult trade-offs. Some of these options for a future housing finance system reduce taxpayer risk by eliminating the role of the government beyond the FHA which would make the 30-year fixed more difficult to come by.

3. ***What specific analysis have you performed to support the statements in the paper and when can you share those with us?***
   - This is a really complicated issue as you know, and so we consulted with a wide range of stakeholders ranging from financial services providers to consumer groups and affordable housing advocates. In addition, within the Administration, we worked with HUD and NEC; white paper reflects input from many different sources. Going forward, we would be happy work with you in analyzing various factors that could facilitate the deliberation by Congress regarding policy choices.

The public deserves a full list of those they met with. That shouldn't be privileged.

4. ***How long will it take to unwind Fannie Mae and Freddie Mac? Why not unwind Fannie Mae and Freddie Mac at a faster pace? Why did you not come out with a specific proposal for pace of unwind?***
   - The pace will depend on market conditions. We cannot forget that while we have made important progress stabilizing the housing market, this critical sector of the economy remains fragile. Private capital has not yet fully returned to the market, and the government continues to play an outsized – though unfortunately necessary role – in ensuring the availability of mortgage credit.
   - Proposals that prematurely constrain Fannie Mae and Freddie Mac's ability to guarantee loans could limit the availability of mortgage credit, shock the economy, and expose taxpayers to greater losses on the loans already guaranteed by Fannie Mae and Freddie Mac.



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5. ***How exactly will Treasury ensure that Fannie Mae and Freddie Mac will have sufficient capital to meet their obligations in 2013 when the caps are set? What are the specific steps that you will take?***
   - At the end of 2012, under the Preferred Stock Purchase Agreements (PSPAs) Fannie Mae and Freddie Mac entered into with Treasury, $275 billion of funding capacity will remain to fund any net worth deficits ($125 billion for Fannie Mae and $150 billion for Freddie Mac). Under the conservative baseline stress test forecasts conducted by FHFA, both Fannie Mae and Freddie Mac are expected to have positive net income in 2013. This will mean that Treasury is not expected to need to fund any operating losses at Fannie Mae and Freddie Mac after the expiration of the PSPA funding commitment.
   - To the extent that required dividend payments exceed net income, FHFA, as conservator, could consider not declaring dividends pursuant to the certificates of designation for the preferred shares, so that draws on the PSPAs are not used to pay dividends, preserving as much funding as possible to cover any unanticipated losses at Fannie Mae and Freddie Mac.
   - We expect that $275 billion, nearly twice the amount of net funding provided by Treasury to date, will provide a substantial cushion for any unexpected losses and should give market participants confidence about the government's commitment to these institutions.

Answer to Crapo regarding Watts unilateral authority

6. ***Why increase pricing and not just reduce the conforming loan limit as some have suggested?***
   - There are many levers that could be used to reduce the footprint of Fannie Mae and Freddie Mac. Relying on any one has its downsides: relying on loan limits alone, for instance, would create too dramatic a shift in the availability of credit to those who suddenly fall outside of the reach of Fannie Mae and Freddie Mac.

7. ***What power does Treasury actually have over Fannie Mae and Freddie Mac?***
   - Treasury does not control Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac are under the conservatorship of their regulator, FHFA.
   - As a member of the Federal Housing Finance Oversight Board (FHFOB), the Secretaries of Treasury and HUD provide policy guidance and recommendations to FHFA on a range of matters related to Fannie Mae and Freddie Mac and the conservatorship of Fannie Mae and Freddie Mac.

8. ***Why does Treasury think it can compel independent agencies to follow its requests? Does this plan conflict with FHFA's statutory mission as conservator?***
   - Treasury cannot compel FHFA to act. The joint working group of FHFA and FHA will consider changes to pricing and other standards and will seek comment from the public. This working group will provide regular feedback to FHFOB and FSOC as reforms are implemented.
   - The Administration's plan is consistent with FHFA's statutory mission as conservator.

falacious

9. ***What exactly is the FHFOB and what is Treasury's role in the FHFOB?***
   - The Federal Housing Finance Oversight Board (FHFOB) was established by HERA to provide oversight and policy recommendations to the FHFA.
   - The FHFOB is comprised of the heads of four agencies, including the Secretary of the Treasury, the Secretary of HUD, the Chairman of the SEC, and the Director of the FHFA. The Director of the FHFA serves as the Chairperson of the FHFOB.
   - The FHFOB is responsible for advising the Director of the FHFA with respect to overall strategies and policies in carrying out his or her duties.

*10. What parts of your plan require legislation?*

- Without additional legislation, Treasury, in conjunction with other agencies, can make substantial progress towards responsibly reducing the size of the government's role in housing finance and implement critical reforms to the housing finance market.
- Dodd-Frank and HERA provide the Administration, FHFA, and other independent regulators the tools necessary to complete many critically important reforms in the near-term. Determining the long-term role for government will require serious dialogue with Congress about a difficult set of trade-offs. In all end states, legislation is required to change Fannie Mae and Freddie Mac's charters.

Yet they acted to wind-down GSEs knowing they didn't have legal authority

*11. What is your timeline for legislation? Are you proposing legislative text?*

- We would be happy to work with Congress to provide any support necessary to advance comprehensive housing reform legislation. We believe that we should move as quickly as is prudent to provide certainty to our housing finance system and our economy.

*12. Since the Administration has no plan for Fannie Mae and Freddie Mac to emerge from conservatorship, why hasn't OMB added these entities to the budget as if their operations were conducted by a federal agency?*

- The Budget maintains the existing non-budgetary presentation for Fannie Mae and Freddie Mac, as it does for the other GSEs. This is consistent with financial accounting standards that do not require consolidation if ownership control is temporary.
- All of the federal programs that provide direct support to Fannie Mae and Freddie Mac, including the Senior Preferred Stock Purchase Agreements (PSPAs), are shown on-budget.

So UST knowingly lied to CBO and GAO as they said it was temporary but planned for it to be permanent

*13. How does OMB's estimate of Fannie and Freddie's deficit impact differ from CBO's approach?*

- The 2012 Budget maintains the existing non-budgetary presentation for Fannie Mae and Freddie Mac. This is consistent with governmental financial accounting standards that do not require consolidation of an entity if ownership control is temporary, as it is for Fannie Mae and Freddie Mac during the period of their conservatorship. However, all of the federal programs that provide direct support to Fannie Mae and Freddie Mac, including the Senior Preferred Stock Purchase Agreements (PSPAs), are shown on-budget.
- As we understand it, CBO's estimates of the deficit impact of Fannie Mae and Freddie Mac are considerably higher than the Administration's because CBO defines the budget impact as capturing what a private entity would require as compensation for assuming Fannie Mae and Freddie Mac's commitments. The compensation is represented in CBO's description as the difference in market value between Fannie and Freddie's assets and their liabilities on a "risk adjusted" basis. This "risk premium" assigned by CBO does not constitute a federal outlay, and is not comparable to the budgetary estimates of Fannie Mae and Freddie Mac's costs included in the President's Budget. The Administration presents the budget impact as the estimated amount attributable to transactions between Treasury and Fannie Mae and Freddie Mac under the PSPAs.
- The Budget assumes that Treasury will make cumulative investments in Fannie Mae and Freddie Mac of $224 billion from FY2009 through FY2012, and receive dividends of $55 billion over the same period. These estimates are consistent with the "baseline" case in the range of potential draws announced by FHFA in October 2010. Starting in 2013, the Budget forecasts that Fannie Mae and Freddie Mac will have sufficient earnings to pay part but not all of the scheduled dividend payments. The Budget assumes additional net dividend receipts of $97 billion from FY2013-FY2021.

14. ***Would OMB's estimate of Fannie and Freddie's deficit impact differ from CBO's if Fannie and Freddie were treated as on balance sheet?***
    - It is our understanding that in an on-balance-sheet analysis, OMB's estimate of the Fannie Mae and Freddie Mac's deficit impact would likely continue to be lower than CBO's estimate because of different choices for calculating the discount rate. OMB would most likely use standard Credit Reform treatment, which does not allow for "market risk adjustment" of asset and investment values as conducted by CBO. The calculation of the "subsidy" provided by Fannie Mae and Freddie Mac is sensitive to the choice of discount rate. The subsidy is lower and possibly negative if a Treasury rate is used as the discount rate as required by Credit Reform treatment, rather than using a rate adjusted for market risk as is used by CBO.
    - *Background on Credit Reform:*
      *The Federal Credit Reform Act of 1990 (FCRA) (Title V of the Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508) was intended to improve the measurement of the budgetary costs of federal credit programs. Beginning in 1992, FCRA required the President's budget to use certain principles to reflect the cost of direct loan and loan-guarantee programs. Since under FCRA the budgetary treatment of a direct loan or loan guarantee must reflect the loan's "subsidy cost" ( the net value of the loan's cash flows over the life of the loan, rather than in one year), the only amounts that are recorded in the Federal budget for purposes of calculating the deficit budget are subsidy cost budget authority and outlays.*

15. ***Would the different budgetary treatment for Fannie and Freddie cause CBO and OMB to provide different scores for legislation that would affect those entities?***
    - We believe that CBO's current on-budget and the Administration's current non-budgetary treatments of Fannie Mae and Freddie Mac's costs in conservatorship potentially could result in legislative scoring differences. Given that we have proposed three different options for housing finance reform, we think that defining a specific budgetary treatment at this time for any particular reform structure would be misleading. As noted above, the Administration carefully considered whether Fannie Mae and Freddie Mac should be consolidated in the Government's financial statements and classified as budgetary entities. We may change our determination at a future date based on new information available at that time. The provisions of any legislation reforming Fannie Mae and Freddie Mac will be critical to determining whether such a change in treatment is necessary.

16. ***What steps are you going to take to promote a covered bond market?***
    - There are a number of ideas that could be considered by Congress in enacting housing finance reform – including covered bonds. Legislation could be helpful in promoting a covered bond market as an alternative funding mechanism for banks.

17. ***What can you say about the future of the To Be Announced (TBA) market?***
    - The TBA market provides or facilitates a variety of benefits to borrowers and lenders, including lower borrowing costs, the ability to "lock in" a mortgage rate prior to completing the purchase of a home, flexibility in refinancing, risk management, and the ability to pre-pay a mortgage at the borrowers' discretion. TBA trading greatly enhances secondary market liquidity and provides greater access to these markets for smaller lenders and community banks.
    - The presence of a well-functioning TBA market will depend on the long-term path of reform. Without the presence of a guarantee, it is likely that liquidity in the TBA market would be substantially reduced.

18. ***What does the experience of the jumbo mortgage market tell us about whether a privatized mortgage market can serve the broader mortgage needs of America?***
    - The jumbo market has effectively served Americans whose loans fall outside of the conforming loan limits. It is important to keep in mind, however, that the jumbo market did benefit from the presence of the TBA market for mortgages guaranteed by Fannie Mae and Freddie Mac. Origination of Jumbos was often hedged through the TBA market.

19. ***The FHLBs have not required any bailouts. Why are any changes necessary?***
    - Like Fannie Mae and Freddie Mac, the Federal Home Loan Banks (FHLBs) are congressionally chartered government enterprises. Like Fannie Mae and Freddie Mac, they were allowed to run large investment portfolios by funding themselves with debt that the market apparently perceived had USG support.
    - FHLB advances allow member banks to take risks with such loans while shifting the cost of that risk to the FDIC and, therefore, indirectly to taxpayers.

20. ***The FHLB system current pays 20% of its profits to pay off the debt from the Savings and Loans financial crisis of the 1980s. These debt obligations (REFCORP bonds) are finally about to be fully repaid.***

    ***<u>Question from the Right</u>: Given the capital problems in some of the FHLBs that your White Paper highlights, can you allow the FHLBs to retain their profits without attempting to raise their effective taxes once the REFCORP obligations expire?***
    - Congress required the FHLB system to fund certain obligations related to the Savings and Loans crisis. The terms of that obligation were set in statute and were changed by statute. Changes that affect obligations imposed on FHLBs would have to originate in legislation and the Administration would work with the Congress to determine the best policy. I do think that the FHLB system could benefit from additional capital and that the various banks, 8 out of the 12 are under some sort of regulatory or voluntary plan with respect to capital, dividends or stock purchase, should continue to work with their regulator to increase their capital.

    ***<u>Question from the Left:</u> The FHLBs also pay 10% of their profits to support affordable housing programs in their community. Given the need for additional support for affordable housing programs do you support requiring the FHLBs to increase their contribution to affordable housing programs once the REFCORP obligations come off their books?***
    - Support for affordable housing programs is critically important, a point which the White Paper makes. We also believe that it should be conducted transparently, accounted for openly and done in a manner which balances many important objectives, including that of creating affordable rental housing. Whether we are appropriately funding affordable housing, and whether more of the funding should come from the FHLBs, are questions that I want to work with the Congress to answer.

21. ***Why is increased borrower equity being required at FHA and in a reformed housing finance system? Risky loan features during the bubble were not tied to low equity, but to poor underwriting, not escrowing for taxes and insurance, and payment shocks due to adjustable payments.***
    - Lower LTVs provide protection against home price depreciation, so equity is less quickly wiped out by drops in home values.
    - LTV should be just one of a number of factors lenders consider in evaluating borrowers in a reformed housing finance system. Other factors often include: (1) housing cost-to-income and overall debt-to-income ratios; (2) credit scores; (3) whether the loan has an adjustable interest rate

and when and how much payments may increase; (4) how much savings an owner has available for unexpected expenses; (5) whether the owner has received counseling; (6) the condition of the property and its major systems; and (7) the extent to which the owner's future housing expenses will exceed previous housing expenses.

22. ***How will proposed housing finance reforms address the racial wealth gap, and the severe losses in homeownership rates during the housing crisis that disproportionately impacted communities of color?***
    - Unsustainable loans during the housing bubble disproportionately hurt low-income and minority borrowers and communities. Implementation of Dodd-Frank Act reforms, including the establishment of qualified mortgage standards and the Bureau of Consumer Financial Protection, are important and integral early elements of housing finance reform to curb those abusive practices in the future.
    - Access to mortgage credit for all credit-worthy families and all communities is a critical element in any long-term housing finance system. Any adjustments made to mortgage standards will affect individual borrowers and communities in America differently. We believe that any changes to the system should be taken with sensitivity to the potentially disparate impacts those changes might have, appropriately balanced against systemic risk.
    - We will also ensure that housing finance providers comply with antidiscrimination laws. We will work with Congress to establish increased data transparency in the secondary market, to track where and to whom mortgage credit is flowing. This data will help ensure that all mortgage market participants are complying with antidiscrimination laws. And we will consider ways to ensure that secondary market securitizers and guarantors serve all communities, consistent with primary market providers and safety and soundness.

23. ***What role will FICO scoring play in any reforms of the housing finance system?***
    - A reformed housing finance system should have stronger underwriting standards. FICO scores are one of several factors lenders should consider to determine a borrower's creditworthiness. Because of Dodd-Frank reforms, and increased skin in the game by lenders, lenders should engage in a more robust analysis of borrower creditworthiness in a future housing finance system.

24. ***Aren't tax policy changes a better way to provide targeted and effective support for affordability and access?***
    - Tax policy changes were beyond the scope of the white paper. Moving forward, we will work with Congress to evaluate a range of proposals to achieve our goals of rebalancing support between homeownership and rental and providing targeted, transparent, and effective support..

25. ***10% down payment is not an effective means to reduce risk at the GSEs as they are unwound. It unnecessarily bloats FHA during the GSE wind down.***
    - Slowly increasing down payments over time at Fannie Mae and Freddie Mac is an important step to help reduce taxpayer risk and increasing system stability. As Fannie Mae and Freddie Mac's presence in the market contracts, the Administration will coordinate program changes at FHA to ensure that the private market – not FHA – picks up that new market share.

26. ***Do you support the Affordable Housing Trust and/or Capital Magnet Fund?***
    - The Affordable Housing Trust (AHT) and Capital Magnet Fund (CMF) were set up under HERA to provide rental housing assistance in the form of capital grants for the development of affordable rental housing and provide funds for CDFIs and other non-profit organizations for affordable housing.

- The Administration supports a dedicated, budget-neutral financing mechanism to support homeownership and rental housing objectives that current programs cannot adequately address, including the objectives of the AHT and CMF. This will ensure that USG support is explicit, and that taxpayers are not exposed to undue risk.
- The HERA trust funds, including the Affordable Housing Trust Fund and the Capital Magnet Fund, should be part of topics in the conversation between Congress and the Administration on housing finance reform.

***27. What are your thoughts on legislation that would end HAMP early?***

Because of HAMP, struggling homeowners have more opportunities to stay in their homes than they would have two years ago.

- Over 600,000 borrowers have started permanent modifications. These borrowers are experiencing real savings, a median of $520, and are more likely to perform in their modifications. At the end of Dec. 85% of borrowers were still current.
- Hundreds of thousands of homeowners are still struggling to save their homes. HAMP provides critical opportunities for long term and sustainable modifications. The proprietary modifications, while improved, do not provide as deep payment reductions or borrower protections.
- HAMP provides a clear and transparent approach to modifications and mortgage assistance. This is critical for homeowners and counselors to ensure that homeowners are properly evaluated. Consider the infrastructure HAMP has in place to protect borrowers:
  - Requirement that all 60 day delinquent borrowers be evaluated for a mod that can provide median monthly savings of 37%.
  - A requirement that if not accepted into HAMP, borrowers must be provided a reason and considered for a proprietary modification.
  - An escalations process that can negotiate with the servicer on behalf of the borrower.
  - Sound dual track protections so borrowers are not simultaneously being foreclosed upon while in a trial HAMP modification.
- In addition, HAMP provides a comprehensive approach to assist struggling homeowners: a second lien program, short sale and foreclosure alternatives, unemployment assistance, and targeted assistance to hardest hit states.
- Termination of HAMP would increase the likelihood that we will return to environment where there was no servicer accountability, and great inconsistency in "work outs" and mortgage assistance offered.

***28. What are you doing to address the foreclosure crisis? What is the status of the Administration's foreclosure task force?***

- The Administration's foreclosure task force, a group of eleven federal agencies, including Treasury, the Department of Justice (DOJ) and the state Attorneys General, are conducting ongoing investigations to review of foreclosure processing, loss mitigation, and disclosure at the nation's largest mortgage servicers.
- The foreclosure task force is working collaboratively to identify and fix the breakdowns in internal controls, documentation, and corporate governance practices associated with the mortgage servicing and foreclosure processes.
- The agencies participating in the task force share a common objective of holding servicers that engaged in any wrongdoing fully accountable for their actions. Because this is an ongoing investigation, it would not be appropriate to comment further at this time.
- Errors in foreclosure processing and improper loss mitigation practices must be corrected immediately. Servicers that acted improperly must be held accountable and the system must be reformed to prevent these problems from occurring again.



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- That is why Treasury supports national, simplified servicing standards to eliminate conflicts of interest and provide clarity and consistency to borrowers and investors regarding their treatment by servicers, especially in the event of delinquency.

*****THE BELOW IS FOR BACKGROUND PURPOSES ONLY—IT IS NOT TO BE INCLUDED IN TESTIMONY**:**

Under the leadership of the Department of Justice, and with Treasury co-ordinating, a group of federal regulators and State Attorneys General has been reviewing issues in connection with loan modifications and foreclosures, and considering potential remedies. It is anticipated that this may lead to a negotiated settlement with the mortgage servicers. Talks with the servicers have not yet begun, though the states have prepared a draft term sheet. This draft term sheet is currently being revised to incorporate comments from federal agencies. At the request of the AGs, it has not yet been shared with OCC or the Fed. The size, structure and number of institutions covered by a potential settlement have not been finalized. At the same time, the OCC has prepared a draft consent order. The OCC has discussed this order with the banks and appears to be preparing to move forward shortly. Recent coverage on prospective settlement terms has increased urgency to finalize the term sheet and initiate discussion with the servicers.

29. *Why are you punting on the end state after 2 years of work?*
   - We have provided a comprehensive and aggressive plan to reform the housing finance system. These steps are absolutely essential to reducing the role of government on the housing market, reducing taxpayer risk and bringing private capital back into the market.
   - We need to be deliberate in our approach to further steps for reform given the fragility of the overall recovery and the housing market in particular. Determining the long-term role for government will require a serious dialogue with Congress about a difficult set of trade-offs between providing broad access to mortgages for American families, managing the risk to taxpayers, and maintaining a stable and healthy mortgage market.
   - And while the discussion about end states is important, we must be careful not to let it keep us from the immediate task at hand: we need to scale back the role of government in the mortgage market, and promote the return of private capital to a healthier, more robust system.

Admission of increasing SIFI concentration and NO actions w congress (CorkerWarner) to prevent incrased concentration. WH lied on ending TBTF

30. ***How will your reforms help prevent further market concentration in a few financial institutions that are effectively TBTF and that exert anti-competitive pricing pressure on both the primary and secondary market? Won't the full privatization options unduly advantage large institutions?***
   - Potential impacts on consolidation in the financial system should be a consideration in determining the long-term structure of our nation's housing finance system. This should be part of the conversation that we have together as this Congress moves ahead with legislation.

31. ***In Option 2, how would the government backstop mechanism work during a crisis? How would you ensure that it is only scaled up during a true crisis and that its use is reduced when the crisis ends?***
   - One option is to prescribe a limit to the amount of mortgages that can be wrapped by a guarantee. The fee for this guarantee should be allowed to change depending on market conditions. In good economic times, the guarantee fee would be very high, but when the housing market deteriorates, it would be reduced.
   - Alternatively, the cost of the guarantee could be fixed, but the amount of mortgage product that could be wrapped could vary depending on economic and housing conditions. In good economic

Non-answer, obviously didn't figure out an answer

times, there would be only a small amount of mortgage product able to be wrapped, but in stressful times, this amount would increase

32. ***Does the Administration have a preferred option among those it has proposed? Do you favor a government guarantee?***
    - The Administration believes that the right course forward is one where the government facilitates access to mortgage credit for creditworthy Americans, but not at the cost of excessive taxpayer risk or financial instability.
    - We evaluate three proposals according to four key criteria: access to mortgage credit; incentives for investment in the housing sector; taxpayer protection; and financial and economic stability.
    - We ask Congress to work with us to determine the right balance of priorities for a new, predominantly private housing finance market as soon as possible.

33. ***What analysis have you done / what support do you have to show that the government can accurately price the guarantee fee in Option 3?***
    - Removing the conflicts of interests between private shareholders' profit motive and public mission would make and government reinsurer materially different from Fannie and Freddie.
    - If the government did misprice the reinsurance, the system could be built with a mechanism to ensure that actors who participate in the system pay for any losses, and not taxpayers.

Assertion not answer. Failed companied can't pay anything

34. ***Which options minimize systemic risk in the system? Specifically - To the extent that our largest financial institutions (and other very large or systemically significant firms) held or guaranteed any significant portion of the $5.5 trillion in mortgage loans currently financed through Fannie and Freddie, won't greater privatization escalate the problem of "too big to fail," especially given the importance of residential mortgage debt?***
    - There are ways to mitigate systemic risk in all three options and we should take those steps.

Non-answer. FAIL

35. ***I recently read a report on Bloomberg that the FSOC is considering designating insurance companies. What is Bloomberg talking about, and why can't I have a copy if Bloomberg has it?***
    - I do not have the details of the Bloomberg report, and the FSOC has not publically released any report on this topic.
    - The public comment period just ended for FSOC's proposed rule for designating nonbank financial firms for heightened supervision by the Fed. As required by Dodd-Frank, and further explained in the proposed rule, the process for potential designation will be open and transparent, giving the institution both the opportunity to respond and the ability to seek review in court.
    - Congress charged FSOC with the task of considering risks to the financial system and fashioning appropriate responses, and determining whether certain institutions or market sectors pose a systemic risk to the economy generally. The FSOC takes this responsibility very seriously, and is working diligently to analyze and monitor any potential systemic risks.

36. ***How can the government justify spending $162 million defending Fannie Mae and Freddie Mac's top executives in civil lawsuits?***
    - FHFA, Fannie Mae and Freddie Mac's conservator and regulator, determined it had legal obligation to defend certain top executives in certain civil lawsuits.
    - As Acting Director DeMarco testified on February 15th, FHFA is legally obligated to cover the legal fees of certain officers of Fannie Mae and Freddie Mac in lawsuits over actions they took in performance of their official duties. Failing to cover their legal costs would only invite more lawsuits, and would likely increase ultimate cost to taxpayers.



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37. ***Why is there any need at all for a government role in housing, given that other countries seem to get along fine without it?***
    - International comparisons are difficult to make. While it is true that many countries don't directly support their housing finance systems through guarantees on MBS, they may provide support for the housing system in different ways. For instance, in many European systems, banks provide mortgage credit, and receive support from the government. Discussion of what countries do and don't provide support for their mortgage markets is not as simple as many suggest.
    - It is also important to recognize that the US is one of the only countries in the world where the majority of mortgages are pre-payable, 30-year fixed-rate mortgages.

38. ***What do you think about the Canadian housing finance system? Didn't it rely on substantially less government support?***
    - About 70% of the Canadian mortgage market is funded by banks. Of the remaining 30% that is financed through the capital markets, most is explicitly guaranteed through a government-owned mortgage insurance company.
    - The Canadian system relies heavily on strict LTV restrictions to ensure stability.

39. ***Do you think the Danish mortgage system provides an attractive model for the US?***
    - The Danish mortgage market relies on heavily regulated mortgage banks who issue cover bonds. There are also additional strict LTV restrictions in the system.
    - The system is remarkably stable and consumers benefit from a high level of transparency, but it is important to remember that the government provides an implicit backstop for the mortgage banks.

# HOUSING FINANCE FROM THE GREAT DEPRESSION TO THE GREAT RECESSION

## Fundamental Flaws in the Housing Finance Market

***What caused the crisis in the housing market?***

- No single cause can fully explain the crisis. Misbehavior, misjudgments, and missed opportunities – on Wall Street, on Main Street, and in Washington – all came together to push the economy to the brink of collapse. Numerous structural flaws included:
  - Poor consumer protections allowed risky, low-quality mortgage products and predatory lending to proliferate.
  - An inadequate and outdated regulatory regime failed to keep the system in check.
  - A complex securitization chain lacked transparency, standardization, and accountability and allowed lenders to pass toxic product through the system without regard for its risk.
  - Inadequate capital in the system left financial institutions unprepared to absorb losses.
  - The servicing industry was ill-equipped to serve the needs of borrowers, lenders and investors once housing prices fell.

They blame everyone but don't suggest key culpability for Fannie & Freddie... yet want to kill them & allowed TBTFs to continue

***Were homeowners themselves to blame for the housing market collapse, because they took out loans they knew they couldn't afford and made speculative investments on their houses?***

- There were many causes of the crisis and no one factor or player had full responsibility.
- Borrowers bear some responsibility for their decisions to take on more debt. Some consumers took out unsustainable mortgages and used their houses as ATMs to access cash. Other consumers were steered into higher cost products when they were eligible prime loans.

***Is the Community Reinvestment Act (CRA) to blame for the collapse of Fannie and Freddie and the overall financial crisis?***

- No. Claims that the CRA caused the housing crisis are not supported by fact.
- Loans originated by CRA lenders show evidence of less risky lending practices. CRA lenders offered low income areas a higher percentage of fixed rate mortgages (28%) as compared to independent mortgage companies (18.2%).
- Default rates on CRA loans were no higher than those on other similar loans that did not qualify for CRA. Studies indicate that loans made by CRA lenders within their assessment area were less likely to be in foreclosure than those made by independent mortgage companies.
- Loans and securities backed by CRA loans represented a very small percentage of the loans that were originated in the boom years. More than half of subprime loans were made by independent mortgage companies not subject to CRA and another 30% were made by affiliates of banks or thrifts that were not subject to CRA examination.
- CRA did not encourage lenders to buy subprime loans. According to economists at the Federal Reserve Board, in 2006, less than 2% of mortgage originations sold by independent mortgage companies were higher-priced, CRA-credit-eligible, and purchased by CRA-covered banks.
- CRA was enacted in 1977 and the last substantial administrative changes took effect in 1996. The major expansion of subprime and Alt-A lending did not begin until 2004.



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The Failure of Fannie Mae and Freddie Mac

***Did Fannie/Freddie cause the financial crisis by lowering their underwriting standards, allowing consumers to get loans they couldn't afford?***

UST says GSEs didn't cause the crisis

- No. Rather than leading the market into subprime and other risky mortgages, Fannie and Freddie followed the private sector. Initially, Fannie and Freddie continued to guarantee primarily highly-quality, fully-documented mortgages, while the private sector generated increasingly risky mortgages. But as their market share declined (from 70% in 2003 to 40% in 2006), Fannie and Freddie pursued riskier business to chase market share and profits, just as house prices were peaking.
    - *Increase in Alt-A loans in 2005-2007:* About 75% of Fannie Mae and Freddie Mac's current Alt-A loans in the GSE guarantee book were originated from 2005-2007. Only 24% came from 2004 or earlier. In particular, of Freddie Mac's current Alt-A, 27% and 31% were originated in 2006 and 2007, respectively.
    - *Higher LTV lending increased in 2007:* . Loans with LTV above 90% were 15% of all loans purchased in 2007, as compared to just 9% of loans purchased earlier in the decade. Loans of LTV at or below 80% were just 75% of 2007 originations, while they had comprised 86% of originations in 2003 and 2005
    - *Increase in share of loans with risky features in 2007:* The share of loans with risky features such as a combination of low FICO score and high LTVs, increased at Fannie Mae and Freddie Mac in 2007.

***Were Fannie and Freddie's affordability goals a major cause of the financial crisis or of the failures of Fannie and Freddie?***

- No. A combination of fundamental structural flaws – not the affordable housing goals – bears primary responsibility for both the losses at Fannie and Freddie and for the broader financial crisis.
- The mistakes that led to their losses closely mirrored mistakes in the private-label securities market, where affordability goals were a non-factor. Those mistakes include poor underwriting standards, underpriced risk, insufficient capital, and inadequate regulatory or investor oversight.
- Furthermore, GSE acquired loans had higher FICO scores and lower LTVs than the PLS backed loans:
    - *FICO scores are higher in GSE-purchased loans*: 84% of GSE loans had FICO above 660, compared to only 47% in PLS backed loans. Only 5% of GSE loans went to borrowers below 620 FICO, compared to 32% of PLS backed loans.
    - *LTVs are lower for GSE-purchased loans*: 82% of GSE loans had an LTV of 80% or lower, compared to 2/3rds of PLS backed loans.
- Delinquency rates and default were higher on many private-label securities and other loans held by banks and other private market institutions as compared to the loans held by Fannie Mae and Freddie Mac, including loans qualifying for the affordability goals.
    - Only 32% of seriously delinquent loans in Q1 2009 were attributed to mortgages insured or guaranteed by Fannie Mae, Freddie Mac and GNMA/FHA, despite the fact that these entities and agencies insured or guaranteed 67% of all outstanding mortgages.

***Why was oversight of Fannie Mae and Freddie Mac so weak?***

- Fannie Mae and Freddie Mac's previous regulator, The Office of Federal Housing Enterprise Oversight (OFHEO), did not have adequate enforcement authority to constrain risky behavior.



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- Fannie Mae and Freddie Mac's aggressive lobbying efforts successfully defeated efforts to have them regulated more effectively.

## Current State of the Housing Market

***Why hasn't the Obama Administration done more to help the housing market recover?***

- Since taking office in January 2009, the Obama Administration has helped stabilize the housing market and provide critical support for struggling homeowners. Without these initiatives, the downturn in the housing markets and the economy could have been far worse.
- To help stabilize the housing market, the Administration implemented a series of broad actions, including:
  - Supported the First Time Homebuyer Tax Credit, which has helped 2.5 million American families purchase homes.
  - Provided more than $5 billion in support for affordable rental housing through low income housing tax credit programs and $6.92 billion.
  - Support for the Neighborhood Stabilization Program to restore neighborhoods hardest hit by concentrated foreclosures.
  - Housing Finance Agencies Initiative to increase sustainable homeownership and rental resources.
  - Created the $7.6 billion HFA Hardest Hit Fund for innovative foreclosure prevention programs in the nation's hardest hit housing markets.
  - Supported home purchase and refinance activity through the FHA to provide access to affordable mortgage capital and help homeowners prevent foreclosures.

***What are the signs of impact on the market of your housing initiatives:***

- Over 9.5 million Americans have refinanced to lower payments.
- Refinance saving homeowners $150 on average a month, with aggregate savings of $28.5 billion since April 2009.
- Over 500,000 homeowners are in permanent modifications.
- Median HAMP payment reduction of over $500 per month.
- We are seeing positive structural change in the mortgage market as a result of HAMP.
- Hardest Hit Fund helping deliver help to states hardest hit by unemployment and home price declines.

***What can you say about HAMP?***

- To date, the Home Affordable Mortgage Program (HAMP) has achieved three critical goals: it has provided immediate relief to many struggling homeowners; it has used taxpayer resources efficiently; and it has helped transform the way the entire mortgage servicing industry operates
  - HAMP establishes a national, standardized modification program that is helping responsible, struggling borrowers across the country stay in their homes.
  - HAMP has fundamentally changed the paradigm of how servicers work with delinquent borrowers, shifting from a debt collection model to an underwriting model.
  - We continue to see challenges. Servicers were slow to implement HAMP, and must continue to increase the pace of permanent modifications. Recent improvements in the program have accelerated the pace of permanent modifications, and we are implementing adjustments to better address unemployment and negative equity.



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- The HAMP solution still is the best option available to borrowers, and in light of the foreclosure irregularities it remains critically important that servicers focus on their efforts to evaluate borrowers for HAMP.

GSE sources of losses and post-conservatorship book of business

*Note: The Conservator's report included numbers as of Q2 2010:*

***GSE losses since conservatorship are almost entirely attributable to loans that were originated and guaranteed before conservatorship and that remain obligations of the entities.***

- The 2006, 2007, and 2008 vintages account for over 70% of all credit losses.
- Less than 1% of the post-conservatorship credit losses are a result of loans guaranteed in 2009 and 2010.

***The FHFA Conservator's Report highlights that the bulk of capital reductions (over 70%) have come from Single Family guaranteed loans as of Q2 2010.***

- Many commentators tend to point incorrectly to the retained portfolios as the cause of Fannie Mae and Freddie Mac's collapse; while the losses were significant and were indicative of the risks Fannie Mae and Freddie Mac took, the Investment/Capital Markets (Retained Portfolio) segment has only accounted for 9% of the cumulative losses
- The Single-Family Guarantee segment has been the largest contributor to capital reduction, accounting for 73% percent of capital reduction since the end of 2007.
- The Multifamily segment accounted for 5% of capital reduction

***A disproportionally large amount of credit losses have come from loans in the guarantee book with risky characteristics***

- During the housing bubble run-up Fannie Mae and Freddie Mac sought to preserve their market share by guaranteeing loans with riskier characteristics including Alt-A underwriting standards, interest only payments, and high loan to Value (LTV) ratios.
- Many of Fannie Mae and Freddie Mac's credit losses have been disproportionally concentrated in these buckets of loans with risky characteristics. For example, Alt-A represented about 10% of the amount outstanding (UPB) at each enterprise at the end of 2008, but have accounted for more than 35% of the credit losses for both entities since January 2008.

So they acknowledge that the weak oversight & problematic underwriting problem has been solved. They argue the portfolios weren't to blame so what are they even trying to solve for??

***Under the supervisions of the FHFA, progress has been made on improving the credit quality of loans Fannie Mae and Freddie Mac guarantee***

- Under the supervision of the FHFA, the credit quality of the post-conservatorship book of business improved dramatically versus pre-conservatorship:
    - Alt-A loans now account for 0% of the new book of business since conservatorship as compared to 22% for Fannie in 2006 and 22% for Freddie in 2007.
    - Low credit (<620 FICO) purchases are now only 1% as compared to 6% for both Fannie and Freddie in 2007.
    - Average FICO of new business improved from roughly 715 in 2006 to 750 or more for both Fannie and Freddie.



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   - While >90% LTV mortgages are slightly up in 2010 from 2009, this is almost entirely related to HARP refis, which are a loss mitigation mechanism and actually reduces the risk of default.
- Additionally, guarantee fees have been increased and Fannie Mae and Freddie Mac have risk-adjusted their pricing.
- The new, higher credit quality book of business from 2009 has seen substantially lower cumulative default rates when adjusted for loan age

## TOWARDS A NEW SYSTEM OF HOUSING FINANCE

Paving the Way for a Robust Private Mortgage Market

### Winding down Fannie Mae and Freddie Mac on a responsible timeline

***Explain "price Fannie Mae and Freddie Mac's guarantees as if they were held to the same capital standards as private banks or financial institutions"?***

- Fannie Mae and Freddie Mac over time were required to hold far less capital then regulated private institutions. Since they did not have to maintain higher levels of capital, they could set the fee that they charged to guarantee mortgage-backed securities at artificially low levels.
- Fannie Mae and Freddie Mac are currently pricing as if they were required to hold their statutory capital minimum of 45 basis points. Fannie Mae and Freddie Mac will over time increase their pricing as if they had to hold 250-400 basis points of capital depending on the risk characteristics of the loans guaranteed, which is the level that other private banks would have to hold against the same risk. This will increase guarantee fees from approximately 25 basis points to approximately 70-100 basis points over time.

UST says 2.5%-4% capital is the appropriate number!

***Is the plan for Fannie Mae and Freddie Mac to begin to re-build a capital base?***

- No. Treasury will ensure that Fannie Mae and Freddie Mac have sufficient capital to meet their obligations, but Fannie Mae and Freddie Mac will not increase their capital as if they were being returned to their pre-conservatorship status.
- Treasury remains committed to protecting taxpayers and ensuring that future positive earnings of the Enterprises are returned to taxpayers.

Where in HERA is this authority or option? NOT

***What percentage of the market will no longer be covered when the temporary increases in conforming loan limits expire in October 2011? How much will their mortgage rates increase?***

- Looking at the numbers from 2010, approximately 50,000 loans (less than 5% of total mortgage originations in 2010) were loans within the temporary conforming loan increase.
- It is likely that the private sector will have the ability to absorb this incremental supply through bank portfolio lending.

***What is physically going to happen to the operations at Fannie Mae and Freddie Mac including the infrastructure, systems, and human capital? Is just letting these institutions wither away in the best interest of taxpayers?***

- FHFA and the administration will seek to maximize taxpayer recovery in Fannie Mae and Freddie Mac. Where appropriate, FHFA and the administration will consider selling certain business lines and pieces of the infrastructure to private entities.

Contemplated and intended fraudulent conveyance

- However, it is likely that certain pieces of the operation will simply be wound down.
- We will continue to work with FHFA to ensure that talent is retained so that mortgage credit continues to flow during the transition, and that wind down is successful and supports taxpayers' interests.

***If Fannie Mae and Freddie Mac have room under the retained portfolio ceilings, and if mortgages cheapen, will Fannie Mae and Freddie Mac be able to purchase MBS for their portfolios?***

- The Administration will ensure that Fannie Mae and Freddie Mac's retained portfolios are wound down at a pace no less than 10 percent per year.
- Both Fannie Mae and Freddie Mac are ahead of this schedule and we support the efforts to continue to responsibly reduce the size of these portfolios.

***Are there any conditions where the Administration would support a faster wind down of Fannie Mae and Freddie Mac's portfolios?***

- There is no rigid set of conditions that will be used to increase the pace of the portfolio unwind. However, we will constantly monitor the market, and if there is an opportunity to increase the pace of the unwind that will not disrupt markets and is in taxpayers' best interest, we could consider increasing the pace of disposition.
- We recognize that a minimal retained portfolio supplies certain important functions, such as providing liquidity to small lenders through the cash window and providing the ability to purchase delinquent loans out of MBS pools.

***What is the current size and composition of Fannie Mae and Freddie Mac retained portfolios?***

- The current combined size of Fannie Mae and Freddie Mac's portfolios is $1.5 trillion. They consists of approximately $600 billion in agency MBS, $300 billion non-agency MBS, and $600 billion in mortgage whole loans.
- As the agency mortgages are paying down and the agencies continue to buy delinquent loans out of pools, the composition of the portfolios has been changing such that mortgage loans comprise a larger proportion and agency MBS a smaller proportion.

***Fannie Mae and Freddie Mac hold a large percentage of REO on their balance sheets. What is your plan for removing those assets?***

- We recognize that the housing market remains fragile and we will not pursue policies that threaten to disrupt the recovery. The pace of REO disposition should proceed in a fashion that would not overly disrupt the market, negatively affect house prices, and further destabilize communities.
- We will work with FHFA to consider all strategies for the disposition of these properties as long as those strategies maximize recovery for the taxpayer and do not disrupt the fragile housing market recovery.

Returning FHA to its role as a targeted provider of credit

UST discussion of those issues here demonstrates Stevens' involvement in issues concerning specific parties and his violation of 18 USC 207

***Why is it necessary to make adjustments to FHA's single family business?***

- This is necessary to bring private capital back into the mortgage market and reduce taxpayer exposure. As Fannie Mae and Freddie Mac increase their pricing, without corresponding changes at FHA, Fannie Mae and Freddie Mac's old business will flow to FHA rather than the private market as

FHA will become the cheapest source of mortgage financing in the market. This would actually result in increased risk for taxpayers and would not reduce the government's footprint.

- Our goal is to return FHA to its traditional role as a targeted provider of mortgage credit and to reduce taxpayer exposure.

***But, FHA has not cost the taxpayers any money. Why are we concerned about scaling back their footprint?***

- FHA currently has increased its market share to serve as a countercyclical source of credit in the housing downturn. Its current market share is 30% compared to a historic average closer to 10-15% and as low as 3% in 2006. The maximum FHA conforming loan limits were increased to $729,500, which represented a departure from FHA's traditional role as a targeted provider of mortgage credit and access to low and moderate income and first-time homebuyers.
- While FHA has not required a bailout, the agency is currently operating below its statutory minimum capital requirement. If there were another downward shock to house prices, it is possible that taxpayers would face losses on loans guaranteed by the FHA.

## FHLBs

***How would the advance restrictions affect the FHLB system?***

- Advance restrictions would improve the stability of the FHLB system by preventing the system from becoming over exposed with respect to any one institution. During the lead up to the crisis, the FHLB system saw a significant increase in advances from some of the largest institutions, several of which were severely affected by the crisis.
- Depending on the size of the advance cap and the use of advances, it might affect a few of the largest financial institutions. Our intention is not affect small or medium sized financial institutions.

***How would single district membership affect the FHLB system?***

- Single district membership would address one of the significant weaknesses of the FHLB system, the collateral arbitrage between FHLB banks.
- Single district membership would have little effect on small or medium sized financial institutions, which are generally members of only one FHLB. It would require large financial institutions which are members of multiple banks, sometimes four or more, to choose a district. We would work with FHFA to ensure an orderly transition.

***Won't a large covered bond market favor large financial institutions and encourage even greater concentration in the banking sector?***

- We want to promote a deep and liquid private capital market for the availability of mortgage credit. We are open to alternative ways to encourage additional private capital into the market. It is premature to speculate what the effects of a potentially new market would be.



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Restoring Trust and Integrity in the Broader Housing Market

***Is your plan to "fix the flaws in the mortgage market" just to implement the Dodd-Frank Act? What's new here?***

- The authorities and mandates handed down by Dodd-Frank are critical tools for bringing capital markets back into the housing finance system. They fix fundamental flaws in the housing finance system, including consumer and investor protection, conflicts of interest, and systemic risk oversight.
- The Administration has recommended important reforms for mortgage servicing, lien priority, disclosure, and to FHA and other government housing finance programs. These reforms include regulatory reforms, legislative proposals, and industry best practices.

### Reliance on current law and independent agencies

***Given her or his critical role in your plan, when will you appoint the FHFA's director?***

- The President, with the advice and consent of the Senate, appoints the FHFA Director. Congress and the President direct the timing of any appointment. Acting Director Ed DeMarco has done well in reducing risk to the taxpayers and fulfilling his role as conservator.

### Increasing transparency, standardization, and accountability in the securitization chain.

***How does Treasury's plan interact with the Qualified Residential Mortgage (QRM) and Risk Retention rules mandated by Section 941 of Dodd-Frank? Will the rules apply to Fannie Mae and Freddie Mac? Will the Administration's recommendations change once these rules are promulgated?***

- Reforming the securitization market and requiring "skin in the game" is critically important.
- The risk retention rulemaking process is still underway and because rules have not yet been issued, we are not able to comment or predict what those rules might look like or what effect the rules will have on housing finance reform or the economy generally.
- The Administration looks forward to working with Congress and the Section 941 rule writers to determine how the future reforms should incorporate the risk-retention rules once they are issued.

***What were the conclusions of the Study mandated by Section 946 of Dodd-Frank on the Macroeconomic Effects of Risk Retention?***

- The study concludes that risk retention can help reform the securitization market, protect the public and the economy against irresponsible lending practices, and facilitate economic growth by allowing for safe and sound credit formation for consumers, businesses, and homeowners, resulting in market participants pricing credit risk more accurately and allocating capital more efficiently.
- Risk retention alone cannot fix all of the flaws in the system, but it can help by aligning interests of participants in the securitization process and encouraging better underwriting standards. Dodd-Frank has a number of other reforms intended to address these and other problems that became apparent during the financial crisis.
- There are many choices in designing a risk retention framework. The study discusses some of these choices and puts forth principles to use in determining how such a framework could be set.



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***What is the timing of the Section 941 risk retention rules? What is Treasury's role in the rulemaking process? When will a Notice of Proposed Rulemaking (NPR) be released? Will there be an Advanced Notice of Proposed Rulemaking? Will you meet the April deadline?***

- The Treasury Secretary, as Chairman of the FSOC, is the coordinator of the Section 941 rule writing process, but does not have rule writing authority.
- At this point, we are not able to give an indication the timing of the release of either the notice of proposed rules or the final rules. The rule writers are working diligently to find consensus on all relevant issues.
- While we cannot comment on timing of releases, there will be an NPR released with an adequate public comment period before any rules are finalized. We will welcome public comments at that time.

## Regulatory Oversight

***Why do we think the government is going to be more effective at regulating the housing market this time around?***

- As a result of the reforms that will be implemented as part of Dodd-Frank and the additional reforms proposed in this plan, regulation will be consolidated in the hands of stronger regulators who have the ability to effectively oversee and monitor entities in the housing finance system.

***How are you going to prevent predatory lending or liar loans and other consumer fraud?***

- The Dodd-Frank Act created the CFPB both to defend consumers from predatory and deceptive lending and to ensure consumers are able to understand the risks and obligations inherent in their financial transactions.

## Increased Capital

***Won't larger capital requirements lead to slower loan growth in the near term and slower economic growth?***

- Safety and soundness of the financial system is critical to promote our economy's vitality and its ability to take risk and promote innovation. Ultimately, we must strike an appropriate balance, instituting sufficient reforms to ensure a safe and sound system, while continuing to encourage innovation and sound investment.
- As the recent crisis demonstrated, excessive and reckless growth can be destabilizing for the entire economy and is not in the country's long-term interest.

***How will the new framework put forth by the Basel Committee on Banking Supervision affect the Housing Finance Market? Does the Administration's plan take these changes into account?***

- In July 2009, the BCBS strengthened supervisory standards and increased regulatory capital requirements for complex securitizations. The BCBS adopted several revisions to the regulatory framework known as Basel II to address some of the main problems highlighted by the recent financial crisis.

- On December 16, 2010, the BCBS announced stricter capital regulatory requirements for banks. These requirements are commonly known as Basel III. Basel III is intended to improve the banking sector's ability to absorb shocks arising from financial and economic stress.
- Basel III must be adopted by the individual regulators of each participating nation, and is by its own terms to be phased in beginning January 1, 2013. Basel III standards include requirements for banks to have: (i) heightened risk weight for some lower-rated and unrated securitization exposures; (ii) more conservative collateral haircuts for securitization collateral with respect to counterparty exposure; and (iii) additional specific risk haircuts for securitization exposures when calculating the capital requirement related to market risk.
- These reforms are consistent with the Administration's commitment to increasing capital in the housing finance system and ensuring that sufficient capital is held by the private sector against residential securitization exposures going forward.

### Mortgage Servicing and Foreclosure

***What does the Administration mean by national servicing standards and which ones would the Administration support?***

- The Administration is leading a broader interagency process working to develop national servicing standards.
- The work on this process is underway, including study of measures that would align incentives and provide clarity and consistency to borrowers and investors regarding their treatment by servicers, especially in the event of delinquency.
- The Administration is also working with FHFA, in coordination with HUD and Ginnie Mae, to explore alternative compensation structures to align industry incentives and promote foreclosure alternatives when in the best interest of both the borrower and the credit guarantor.

***Does the Administration support a fee-for-service model for servicer compensation?***

- A fee-for-service compensation structure could help ensure servicers have the appropriate incentives to invest the time and effort to work with troubled borrowers to avoid default or foreclosure. The Administration is receptive to comments on whether there are other effective means of addressing these concerns as well.

***How does the Administration specifically propose to deal with lien priority issues?***

- Mortgage documents should require disclosure of second liens.
- In addition, mortgage documents should define the process for modifying a second lien in the event that the first lien becomes delinquent. This will prevent a second lien from standing in the way of a first lien modification and help prevent avoidable foreclosures.
- Finally, we could consider options for allowing primary mortgage holders to restrict, in certain circumstances, additional debt secured by the same property. This would require a legislative change.

non answer

A System with Transparent and Targeted Support for Access and Affordability



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## General access and affordability questions

***How can the USG provide targeted support for "hard-to-reach" segments without increasing its risk exposure? Aren't the "hard-to-reach" segments the least creditworthy?***

- Hard-to-reach segments can be served in a creditworthy and responsible manner.
- Many private mortgage lenders, FHA, State HFAs, nonprofits, and CDFIs have all provided responsible underwriting to hard-to-reach segments with low rates of loss.
- Many subprime borrowers could have qualified for prime loans but were subject to discriminatory pricing and predatory products. When given access to safe, stable, well-underwritten mortgages, hard-to-reach borrowers have consistently demonstrated an ability to meet their obligations.
- Private credit markets, particularly secondary markets, tend to systematically under serve certain market segments because (1) secondary markets favor standardization, volume and information, making it difficult to introduce new products designed to meet the needs of underserved markets; (2) less standardized products are more difficult to underwrite and securitize; (3) low-balance loans are less profitable to originate.
- With respect to multifamily rental housing, Fannie Mae successfully targeted properties the private secondary markets seldom reach, including buildings affordable to moderate income families and buildings with government subsidies. Fannie Mae's low rates of loss in its multifamily portfolio demonstrate that such segments can be served in a safe, sensible and efficient manner.

***Shouldn't all high LTV lending be eliminated? Otherwise, we will just keep pushing homes on people who can't afford them and shouldn't be in them.***

- It is essential that home owners have sufficient financial resources to contribute a down payment and carry monthly mortgage and other expenses. Homeownership is not right for everyone. But not all high LTV lending is risky and providing homeownership opportunities for credit-worthy families should remain an important policy goal.
- LTV ratios are only one factor in determining risk and should be considered as part of an overall risk profile. Appropriate borrower and loan characteristics can keep overall risk low even without a large down payment.
- We should empower consumers to avoid unfair practices and make fully informed decisions. Requiring lenders to verify borrower ability to pay will ensure that mortgages are more sustainable and affordable in a reformed housing finance system.

## FHA single family reforms

***Aren't higher down payments and premiums at FHA going to unfairly restrict access to mortgage loans for creditworthy borrowers in need? Isn't increased down-payment assistance a poor substitute for your proposed reduced role and higher cost of FHA?***

- The Administration is committed to ensuring creditworthy first-time homebuyers and families with modest incomes can access a mortgage. Government has an important role to play in ensuring that capital is available to creditworthy borrowers in *all* communities, including rural areas, economically distressed regions, and low-income communities.
- It is important to balance two homeownership objectives: access and sustainability. Mortgage defaults and foreclosures are damaging to families and communities, as well as to mortgage lenders, investors and the FHA and the taxpayers that stand behind it.



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- Strengthening FHA's capital reserve account is necessary to enable FHA to manage housing downturns and to protect taxpayers. Reforms to FHA will ensure that creditworthy borrowers with low- and moderate- incomes will continue to have access to mortgage credit.
- We believe that the private sector should take the lead role in supplying mortgage credit to all Americans. FHA should provide an upper limit on pricing and encourage the private sector to compete successfully, as it did in the 1990s. Changes at FHA are necessary to gradually shrink its market share and allow the private market to grow.
- We will seek ways to support down payment assistance, counseling and other mechanisms to allow creditworthy borrowers without access to personal or family wealth to become homeowners.

### Multifamily/Rental reforms

***Why should the USG provide any support to multifamily rental finance? Wasn't the lesson from the crisis that government involvement creates larger booms and busts and exposes taxpayers to too much risk?***

- FHA, Fannie Mae and Freddie Mac have performed well with multifamily properties.
- Many renters face serious affordability challenges. Half of *all* renters spend more than 30% of their income on housing – the most common affordability benchmark -- and a quarter spend more than half. And for low-income renters, adequate and affordable homes are increasingly scarce; for every 100 extremely low-income American families, for example, only 32 adequate homes are affordable.
- Private credit markets have generally underserved multifamily rental properties that offer affordable rents, preferring to invest in high-end developments.
- Government involvement in multifamily rental finance will be targeted, transparent, and seek to put private capital in the first-loss position. It will focus on supporting affordable rental options to low- and moderate-income families, who face high rent burdens.

***During transition, will Fannie and Freddie continue their multifamily business? Without Fannie and Freddie's support, won't rents increase to unaffordable levels for middle- and lower-income Americans? Will you institute any substantial federal support for multifamily rental markets?***

- We will work with FHFA to ensure liquidity and steady financing remains available to the middle of the rental market, where housing is generally affordable to moderate-income families.
- As we wind down Fannie Mae and Freddie Mac, it will be critical to find ways to maintain liquidity in this segment of the market and to ensure that new sources of capital enter the market.
- FHA currently insures mortgages for multifamily rental properties, and will continue to do so. Furthermore, the Administration will explore ways to expand FHA's capacity to support multifamily markets.
- We will consider a range of reforms, such as risk-sharing with private lenders and developing programs dedicated to hard-to-reach property segments, including the smaller properties that contain one-third of all rental apartments.

***How specifically do you plan to expand FHA's capacity in multi-family lending? What does your proposal for "FHA risk-sharing with private lenders" in multifamily housing mean specifically?***

- FHA would benefit from reforms that incorporate current best practices in the multifamily finance industry. These include streamlined underwriting and approval processes that require private lenders to share losses on loans the FHA insures.
- New flexibilities related to internal infrastructure, processes and human capital development and retention would be required for FHA to have expanded capacity.

- There are a number of ways in which risk sharing can be implemented. Overall, risk sharing with private lenders would put the lender at risk for at least part of the losses in cases of default. Fannie Mae's current multifamily business uses risk sharing to align lenders' incentives with their own and could serve as a model for future FHA activities. We will consider using a version of Fannie Mae's designated underwriting system (DUS).

***Won't an expanded FHA crowd out private capital? How is an expanded FHA consistent with the USG's desire to increase private capital in the housing finance system?***

- Potential reforms to FHA could include risk-sharing with private lenders, which would draw in private capital.
- The private secondary market has not well served all segments of the multifamily market, most notably the small buildings (5 - 50 units) that contain one-third of all multifamily rental apartments. While encouraging private capital to engage in those markets remains important, we believe that FHA can help demonstrate how to serve those segments safely and profitably.

***Why have you not proposed an expansion of the Low-Income Housing Tax Credit (LIHTC) to produce and preserve more affordable rental housing?***

- Tax policy changes are beyond the scope of this white paper.

***Doesn't increased support for rental housing disadvantage rural and suburban communities at the expense of urban areas?***

- Support for rental housing is important in all communities, including urban, suburban, and rural communities. Wherever located, rental housing should provide families access to good jobs for parents and quality schools for children and contribute to community stability.
- Our proposal to support rental housing finance focuses on smaller multifamily properties for federal support. Smaller rental buildings are woven into the fabric of the suburban, rural and urban communities and are an important resource to working families.

### Secondary market access

***Why is secondary market access important?***

- In a more privatized housing market, there is a risk that many communities may face contractions in mortgage credit. Underserved markets, including rural areas, economically distressed regions, and low- and moderate-income LMI borrowers and communities account for about one-half of all home purchase mortgages. LMI borrowers and communities alone account for over 40%.

***Isn't your proposal to "make sure that secondary market participants reflect primary market activity" just Fannie/Freddie affordability goals by another name?***

- No. Fannie Mae and Freddie Mac's affordability goals were poorly designed and implemented in some important ways.
    - *Mis-alignment with primary market*. Fannie Mae and Freddie Mac's goals were set as a share of their overall mortgage purchases, but did not reflect primary market lending activity, changing economic conditions, or even safe and sound lending practice. Future policy should better align activities in the primary and secondary markets, consistent with safety and soundness.
    - *Better targeting of underserved households and areas*. Fannie Mae and Freddie Mac's goals were insufficiently targeted. They did not reach all underserved market segments. They included middle-income communities and borrowers, and did not target rural communities.

  - *Consumer sustainability*. Prior to HERA, Fannie Mae and Freddie Mac were allowed to count certain mortgages that were unsustainable for consumers towards their goals targets.
- Establishing a system where the secondary market reflects primary market activity will help credit flow to all market segments and geographies Going forward, secondary market access should be better targeted and financially sustainable for families, communities, and for financial institutions, and be consistent with safety and soundness.
- Recognizing the dynamic interplay between the primary and secondary markets, we will work with Congress to determine the best measures to ensure that all creditworthy Americans in all communities are able to access mortgage credit in a reformed housing finance system.

***Won't secondary market access cause rates to rise for middle-class families to subsidize people for whom homeownership isn't appropriate?***

- No. Secondary market access does not imply unprofitable or unsafe lending. Homeownership is not right for everyone, but the secondary markets should serve creditworthy borrowers in all communities.
- The secondary market should support the full range of primary market activity. Because the secondary market would mirror the primary market, they should not distort underwriting standards or push inappropriate loans on would-be homeowners. In fact, secondary market access is an important tool to ensure that credit is flowing to middle- as well as low-income families in all communities, including rural and economically distressed areas.

***How does the proposal address racial and ethnic discrimination in the housing finance system?***

- We will work with Congress to require greater transparency in the mortgage market, requiring securitizers to disclose information on the credit, geographic and demographic characteristics of the underlying loans they support. This will make it easier to determine whether market participants are complying with their legal obligations, and also make clear to the public what communities these institutions are and are not serving.

***Doesn't your proposal for more transparency and data disclosure by securitizers place an undue burden on the private sector and unnecessarily raise rates for all Americans?***

- Securitizers should collect loan-level data as part of their due diligence and performance analysis. Better and more transparent data will help protect consumers while also improving market efficiency and accountability.
- Data disclosure can help the private sector identify new opportunities in markets it had previously overlooked. Data disclosure can help firms to improve metrics to assess the loan performance.

## New dedicated funding for targeted affordable housing

***Why should affordable housing programs receive a dedicated funding source?***

- The scale of affordable housing needs will require more support from the federal government.
  - Half of all renters spend more than 30% of their income on housing – the most common affordability standard – and a quarter of all renters spend more than half.
  - The problems are most acute for low-income renters. For every 100 *very* low-income renters, only 60 adequate rental homes are affordable and there are only 32 such units for every 100 *extremely* low-income renters.
  - Increased down payment requirements in a reformed system may require more support for creditworthy borrowers to access mortgage credit.

***Doesn't the federal government already have a large array of affordable rental and homeownership programs? Why should new programs be created and funded?***

- Current policies and programs do not fully support a range of critical needs in affordable rental and homeownership, including:
  - Supply shortages in affordable rental housing for the lowest income families, similar to the Affordable Housing Trust Fund proposed to be capitalized in the President's 2012 Budget;
  - Access to down payment assistance and counseling for creditworthy borrowers in a form that does not expose them or financial institutions to excessive risk or cost;
  - Scaling up proven nonprofit partnerships that can attract much larger amounts of private capital; and
  - Overcoming market failures that make it hard to develop a secondary market for targeted affordable housing mortgages, such as that for small rental properties and location- and energy-efficient mortgages.
- New programs can better engage a range of partners with proven track records of success, including state housing finance agencies, non-profits, and CDFIs.
- To begin to re-balance support for homeownership and rental, greater support of renters and rental housing finance is appropriate.

***Do you support the HERA affordable housing programs, including the Affordable Housing Trust Fund and the Capital Magnet Fund?***

- The Administration's recommended uses of the dedicated funds are consistent with those of the HERA programs. The Affordable Housing Trust Fund primarily addresses the production and preservation of rental housing by the lowest-income families. The Capital Magnet Fund provides seed money that effective CDFIs and nonprofit organizations use for affordable housing that attracts substantial additional funds.

***What funding sources is the Administration considering for its proposed set of affordable housing initiatives? How much funding would be involved?***

- The Administration will work with Congress to determine appropriate amounts and sources for dedicated, budget-neutral financing mechanisms.

***Shouldn't they be part of the regular appropriations process to be properly overseen by Congress? You are just trying to bypass proper government oversight of affordable housing, just like during the Fannie Mae/Freddie Mac goals era.***

- Transparency in all affordable housing programs is an important component of reform.
- Congress will retain all oversight powers over any targeted homeownership and affordable rental programs which use dedicated funding sources.

## A Responsible Path Forward for Reform: Transition

### Preferred Stock Purchase Agreements (PSPAs) Mechanics

***How does the Treasury financial commitment under the PSPAs work?***



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- Treasury's financial commitment will increase until December 31, 2012 to cover any future deficiency amounts (net losses requiring a Treasury draw) less whatever surplus remains by December 31, 2012.
- Treasury's financial commitment will not be reduced below $200 billion per institution.
- For example, if a GSE has cumulative deficiency amounts before December 31, 2012 of $50 billion, the cap would increase to $250 billion.
- However, the formula will also take account of any gains before December 31, 2012 as well. So if either GSE has a cumulative Deficiency Amount of $50 billion, but also has gains of $20 billion, the cap would increase only to $230 billion.
- In all cases, the cap cannot be lowered below $200 billion. So, for example, if either GSE had no losses and generated $50 billion of gains over the next three years, the cap would remain at $200 billion.
- The Q3 2010 draws of $0.1 billion for Freddie and $2.5 billion for Fannie increased the caps to $212.4 billion for both institutions.

Legacy Obligations

***Message to the Market: Our support for Fannie Mae and Freddie Mac should be clear during this time of Transition***

- The Administration will not pursue policies or reforms in a way that would threaten to disrupt the ability of Fannie Mae and Freddie Mac to honor their obligations.
- The 2009 amendments to the Preferred Stock Purchase Agreements should make it clear that the government will ensure that Fannie Mae and Freddie Mac have sufficient capital to perform under guarantees issued now or in the future and the ability to meet their debt obligations.

Capital or credit!?

- As the market improves and Fannie Mae and Freddie Mac are wound down, it should be clear that the government is committed to ensuring that Fannie Mae and Freddie Mac have sufficient capital to perform under any guarantees issued now or in the future and the ability to meet any of their debt obligations. We believe that under our current funding arrangements, there is sufficient funding to ensure the orderly and deliberate wind down of Fannie Mae and Freddie Mac, as described in our plan.
- The structure of the PSPAs provides a substantial margin of solvency for Fannie Mae and Freddie Mac which allows them to meet their obligations even in substantially more adverse economic scenarios.

Fannie and Freddie employee retention and compensation

***Why do you say that you are going to "reward" the current employees of Fannie and Freddie for a successful unwind?***

- It is in the taxpayers' best interest that Fannie Mae and Freddie Mac have the ability to maintain the highest quality people and operations to effectively continue to support a stable housing market.
- The greatest risk to the taxpayer is in contracting the availability of new mortgage finance in such a way that would destabilize the market. A large departure of employees from Fannie Mae and Freddie Mac could potentially threaten the flow of mortgage credit.



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Taxpayer Cost / Repayment

***How much money are taxpayers are going to pour into these companies?***

- The level of losses that Fannie Mae and Freddie Mac experience is highly dependent on the future path of house prices.
- In October, FHFA coordinated an independent stress test for both Fannie Mae and Freddie Mac to project forecasted draws from the Treasury / losses based on various inputs.
- FHFA has identified three scenarios (using Moody's house price paths): (1) Stronger Near-Term Recovery, (2) Current Baseline, and (3) Deeper Second Recession.
    - The cumulative draws from Treasury by 2013 are forecasted under those assumptions to be $221, $238, and $363 billion, of which $148 billion had been drawn as of Q2 2010.
    - Total draws (net of dividends), are forecasted to be $141, $154, and $259B, respectively.
    - Fannie Mae and Freddie Mac have drawn $153B from the Treasury as of Q3 2010 ($135B net of dividends).
    - So the additional draws (net of dividends) would be $6B under the recovery scenario, $19B under the base case, and $124B under the second recession scenario.

***How many loans do Fannie Mae and Freddie Mac currently guarantee in their single family book? How do you view that number changing over time as pricing increases and these entities are wound down?***

- Combined, Fannie Mae and Freddie Mac currently guarantee $4.4 trillion mortgages.
- The ultimate pace of Fannie Mae and Freddie Mac's unwind will be a function of market conditions and the ultimate recommendations to FHFA.

***Why aren't you cutting Fannie and Freddie's excessively high 10 percent dividend rate on the PSPA? If it weren't for the dividend, those firms would be profitable.***

Where is this authority?

- Treasury remains committed to protecting taxpayers and ensuring that future positive earnings of Fannie Mae and Freddie Mac are returned to taxpayers as compensation for their investment.
- According to the FHFA stress tests in the base case, the dividend payments will cover all positive earnings at Fannie Mae and Freddie Mac and return that money to taxpayers.

***Why did you choose to waive the Periodic Commitment Fee? Isn't the Periodic Commitment Fee an opportunity to recoup some of the taxpayers' investments in Fannie Mae and Freddie Mac?***

- Fannie Mae and Freddie Mac are currently required to pay a dividend equal to 10% of the taxpayers' total investment. According to the FHFA stress tests in the base case, both Fannie Mae and Freddie Mac are expected to require additional draws through the end of 2011 to cover net income losses and required dividend payments meaning that no excess income would be available for taxpayer recoupment.
- Given the size of the current draws from Fannie Mae and Freddie Mac, imposing the Periodic Commitment Fee would only lead to increased Treasury draws and not generate increased net proceeds for the taxpayer.

***Why not merge the assets of Fannie and Freddie to cut costs for taxpayers?***

- FHFA and the administration should consider managing certain assets of Fannie Mae and Freddie Mac jointly and outsourcing certain non-core operations functions in instances where that is in taxpayers' best interest.

- However, Fannie Mae and Freddie Mac have different systems and different risk management tools that aren't easily compatible. Undertaking a large scale project to consolidate all of the operations would take many years and result in large taxpayer expense.

## OPTIONS FOR THE LONG-TERM STRUCTURE OF HOUSING FINANCE

***How did you select these four criteria, access to mortgage credit, incentive for investment in housing, taxpayer protection, and financial and economic stability? Why not [x]?***

- These four criteria take into account the fundamental choices we face when designing a new system and assessing its impact on borrowers, lenders, and taxpayers. They provide a clear yardstick upon which different choices can be assessed so that the benefits and drawbacks can be weighed carefully.
- However, all criteria should be considered, including [x] in any robust discussion about potential long-term solutions for our nation's housing finance system

***Why did you include "access to mortgage credit" as a key principle for evaluating a future plan? You already stated that not everyone needs to own a home. Couldn't households rent instead of accessing a mortgage?***

- While the Administration is committed to a more balanced approach toward both rental and home ownership, we will preserve the ownership option for a wide variety of households. Those households who have appropriate credit history and are in a financial position to purchase a home should have this option regardless of demographic or geographic location.
- Although not appropriate for all households, homeownership provides a means by which Americans can accumulate savings by building equity in their homes. Although we witnessed excessive "cashing-out" of this equity when some households used their homes as if they were piggybanks at the height of the bubble, responsible equity building can be a gateway to the middle class.

***Why do we care about standardization in the mortgage market?***

- A standardized mortgage market allows consumers to compare products easily across states, which is of particular advantage when moving homes.
- Additionally, as in most industries, there are advantages to uniformity, which could lower costs to consumers.
- There are instances where unique mortgage products are appropriate and sustainable for borrowers. Where appropriate, the non-standard nature of the mortgage should be clearly documented and communicated to the borrower, so that he or she can fully understand and agree that the mortgage product indeed suits his or her unique circumstances.

***Why does government involvement in housing increase access to credit for many communities?***

- By facilitating deep, liquid secondary markets, government involvement can expand the ability for small banks to sell their loans into the secondary market.
- Secondary markets and mechanisms for accessing them are particularly critical for small and community banks, who have more limited access to funding sources besides deposits.
- Without other mechanisms of access, small banks might be forced to rely on larger banks for secondary-market sources of funding, which would likely mean less attractive pricing for small banks and their communities.



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***Why does government support make investment in housing more attractive and distort credit markets?***

- The presence of a government guarantee dramatically reduces the riskiness of the security to the end investor and increases the number of capital that investors are willing to devote to the sector. The guarantee both increases the amount of investors who are willing to participate in the market and the amount of capital that each investor devotes to the sector.

***Why do you claim that government support can help promote financial stability? The US had Fannie Mae and Freddie Mac yet our housing boom and bust was more severe than that in most other country.***

- Delinquency rates were much higher on mortgages originated outside of Fannie Mae and Freddie Mac, in the PLS market that did not have either government support or government supervision. Additionally, prices on agency mortgages were only minimally affected in the crisis, especially relative to the PLS market. Borrowers who qualified for mortgages that conformed to Fannie and Freddie's standards were able to access the market for mortgage credit through the entire crisis.
- Many of Fannie and Freddie's problems can be attributed to the fact that their government support was not transparent and was not priced.
- In "normal" times, the presence of a government guarantee prevents investors from engaging in fire sales of securities in the same way that the FDIC prevents runs on banks from depositors.
- In times of stress, the presence of the guarantee allows borrowers to continue to be able to access the secondary markets and have access to the credit that they need to sell their home and move or refinance their existing mortgage.

Admits the problems were not GSEs but, instead, the SIFI banks w capital market access (like Wells) to whom they are trying to give market.

***Why are we so concerned about access to mortgage credit in a crisis? Aren't the reforms we are implementing going to dramatically reduce the probability of future crises?***

- The reforms we are implementing will create a more safe and sound system that substantially reduces the probability of a future crisis.
- This does not change, however, the fact that government should consider the value of having the tools necessary to minimize the impact of a future crisis should one result from unforeseen circumstances.

***How much capital would move outside of the mortgage market and/or outside of the US if there were no guarantee in a future system?***

- It is difficult to determine exactly how much capital would flow away from the domestic mortgage market. However, at a minimum, it's likely that several hundred billion dollars in investments in MBS from overseas investors would gradually flow into Treasuries.

Option 1: FHA-only

***What approximate percentage of the market do you envision being covered by FHA in such a plan?***

- The percentage of the market covered by FHA should be dictated by the types of borrowers who should be served, not by an abstract market share target.
- We look forward to working with Congress to develop policy to reduce the market share of FHA significantly from today's current unsustainable levels.

***Why does Option 1 reduce the government's ability to effectively step in to ensure access during a crisis? The Federal Reserve played a stabilizing role during this last crisis. Couldn't they do the same in a future crisis?***

- While the Federal Reserve, Treasury or other agency could step in and provide support during future crisis, there are several drawbacks to relying on such assistance in the future. Without a clear and transparent process established in advance, there is less certainty about how – if at all – support would be provided
- The associated moral hazard of ensuring government support without explicitly charging for it could result in the private sector taking on more risk than it should.

***In Option 1, wouldn't the FHA drastically expand its market share if Fannie Mae and Freddie Mac were no longer an available option?***

- In a privatized market with the government role limited to FHA, in order to prevent all mortgages going through FHA, strict limits would be necessary to ensure that FHA only provides loans to low and moderate income borrowers.
- By decreasing the conforming loan limit and increasing FHA guarantee fee pricing, the amount of market share that FHA will cover will decrease.

***Can the government credibly avoid stepping in amid a true crisis? Won't the market still be left guessing if, when, and how the government might intervene under the "FHA only" model?***

- Predetermined rules will be needed to govern when the government would and would not step in during a crisis to avoid excessive risk taking and moral hazard.
- Ensuring that the government takes no action over the course of many cycles is, however difficult to control and predict ex ante and should be taken into consideration when designing such predetermined rules and reforms.

## Option 2: FHA with Additional Guarantee Mechanism to flex in times of stress

***Are options 1 and 2 radically different?***

- In Option 2, there would be an explicit mechanism to provide mortgage credit in a crisis. Option 1 does not have this.
- However, under normal economic conditions, Options 1 and 2 share many of the same benefits and drawbacks.

***Why do we need a separate mechanism? Would FHA and the Federal Reserve alone have the capacity to respond with sufficient speed and force during a crisis to preserve access to mortgage credit for American families?***

- While the FHA and Federal Reserve have played a significant role in backstopping the housing market during the recent crisis, they should not be counted upon in future crises.
- The Federal Reserve is limited in its capacity to provide a liquidity backstop for all asset classes. Additionally, if the Federal Reserve stepped in during every crisis, it could promote financial recklessness. FHA, while allowing a significant portion of Americans to access mortgages during the recent crisis, has taken on an unsustainably large market share, which the Administration is committed to reducing. If the FHA is allowed to increase its market share during every crisis, there should be proper structuring and pricing in advance to avoid greater taxpayer risk.

***In Option 2, how would the government backstop mechanism work during a crisis? How would you ensure that it is only scaled up during a true crisis and that its use is reduced when the crisis ends?***

- One option is to prescribe a limit to the amount of mortgages that can be wrapped by a guarantee. The fee for this guarantee should be allowed to change depending on market conditions. In good economic times, the guarantee fee would be very high, but when the housing market deteriorates, it would be reduced.
- Alternatively, the cost of the guarantee could be fixed, but the amount of mortgage product that could be wrapped could vary depending on economic and housing conditions. In good economic times, there would be only a small amount of mortgage product able to be wrapped, but in stressful times, this amount would increase.

***How will you prevent a future Administration and Congress from changing the nature of the backstop so that it becomes a guarantee used extensively during all economic conditions?***

- While this is a risk for any reforms put in place, there are methods that this Congress and Administration can put in place to structure a backstop that can weather political change.
- Other provisions could be considered to limit the ability of future regulators to interfere with the proper functioning of a backstop. They might include auction mechanisms for guarantees where the private market determines the appropriate price for a guarantee. Additionally, the amount of guarantee offered could change based upon certain economic indicators, to ensure that the guarantee properly adjusts for changing economic conditions.

Option 3: Government Reinsurance with Private Mortgage Guarantors bearing significant first loss

***Won't the presence of a government reinsurer just institutionalize more bailouts and moral hazard?***

- An actuarially fair fee in return for reinsurance gives the government the ability to charge for the risk that it takes prior to any crisis. It also provides a mechanism to recoup losses.
- A government reinsurance program would provide clearer "rules of the game" so stakeholders and investors are not stuck in a guessing game about if, when, and how the government might take action in future housing or financial crises.
- The fact that the government is in a very remote risk position through the structuring of reinsurance reduces moral hazard risk to taxpayers.

***In the reinsurer option, won't there only be a handful of private mortgage guarantors that are all Too Big To Fail?***

- It will be essential to ensure adequate capital standards and strong regulation of the private mortgage guarantors to protect taxpayers.
- Broad reinsurance will likely attract a larger pool of investors to the mortgage market, enough to support a number of private mortgage guarantors. If large number of mortgage guarantors take attritional risk, it will encourage competition, more appropriate and efficient pricing, and reduce the likelihood of "too big to fail" through competition.
- It is important to note that the government reinsurance would only cover the loan or security itself, and would not be available to the mortgage guarantor .

IDIOCY! The competition they cite means increased correlation among guarantors which means multiple guarantor failures at the same time, in crisis. Hence credit will evaporate OR the government will be called on to support credit provisioning.

- Additionally, if any of these entities is designated by the FSOC as systemically significant, they will be regulated by the Federal Reserve, pursuant to Dodd-Frank.

*How would a government reinsurance scheme be different from the old Fannie/Freddie system?*

- A well-capitalized set of private mortgage guarantors would put substantially more private capital at risk of first loss in front of the taxpayer than Fannie and Freddie, who held insufficient capital. Instead of building capital reserves by retaining earnings, Fannie and Freddie disbursed their profits to managers and shareholders.
- An explicit guarantee would be more transparent.
- A priced guarantee with a put-back mechanism and a first-loss position would encourage robust underwriting.
- Removing the conflicts of interests between private shareholders' profit motive and public missions would make and government reinsurer materially different from Fannie and Freddie.

The Spinal Tap (this one goes to 11) answer. Can't they just fix GSEs in this same manner, with less disruption and cost?

***How will you prevent private mortgage guarantors from competing on market share and engaging in a "race to the bottom" with lower underwriting standards, especially over the course of multiple housing cycles?***

- The fact that these institutions are the first to bear losses related to borrower delinquency or default gives them a strong incentive to maintain credit standards.

hee hee hee

- The deterioration of underwriting standards in the recent crisis was caused by several factors that will no longer issues under this plan.
  - Mortgage guarantors would be wholly private entities, unable to use public resources to absorb losses.

    until a crisis

  - Additionally, in the previous system many mortgage chain participants were able to pass all of the credit risk to the entity that purchased the loans. In this model, the mortgage guarantor would retain significant (and first) credit exposure.
- Stronger oversight will also help maintain robust credit standards through multiple economic ups and downs.
- The explicit credit risk associated with government reinsurance would also encourage federal policymakers to consider potential budgetary effects, and will encourage them to maintain rigorous oversight of the industry.

*Where will the reinsurance fees go when they are collected?*

- There are two leading options. Reinsurance fees could be returned to general revenue fund as is done by GNMA, or they could be placed into a separate trust fund, as the FDIC does with the Deposit Insurance Fund (DIF).

*How is the reinsurer different than GNMA? Would the reinsurance be accomplished through GNMA?*

- The function of the reinsurer is very similar to that of GNMA, and we could consider having GNMA become the reinsurer.

## OTHER

***Why doesn't this plan address concentration in the lending industry and how that affects access to affordable mortgage credit?***

- The Administration supports drawing on competitive forces to lower consumer lending rates, whether through reduction of the governmental presence in the mortgage market or through ensuring competition among private mortgage guarantors.

***Why didn't the Administration address the Mortgage Interest Deduction (MID) in the paper and will the President address it in his budget?***

- We are not actively considering a change to the MID, and the Administration considers tax reform to be a separate issue. That said, we are taking a holistic view of housing finance reform, and all reasonable reforms will receive due consideration.

International comparisons

***How do homeownership rates in the US compare with other countries?***

- The US has average homeownership rates compared to other countries
- However, the US also has substantially greater access to mortgage credit, illustrating that there are other factors that influence homeownership rates.

***How much securitization of mortgages is there in other countries?***

- The US mortgage market is unique in its reliance on securitization as a funding source – 60% of outstanding mortgages in the US are funded by securitization
- The next biggest users of securitization are Australia, Canada, Spain, Netherlands, and the U.K., but MBS securities account for less than 30% of the mortgages outstanding in all these countries



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## FACTSHEET: HOUSING FINANCE REFORM BY THE NUMBERS

**Fannie Mae and Freddie Mac**

- Buy, bundle, and guarantee residential mortgages as mortgage-backed securities (MBS).
- Guarantee millions of loans, currently totaling $4.4 trillion as of December 2010.
- Traditionally guarantee about half of new mortgages, but their market share temporarily declined during the housing boom, as private-label securitization swelled.
- Hold investment portfolios of $1.49 trillion in mortgage-related loans and securities, about 20% of which in private-label MBS.
- Fund their investment portfolios with $1.522 trillion of debt at low interest rates because of the perception of USG support.
- Have traditionally drawn a large portion of their profits from their investment portfolios.
- Concentrate their activities in single-family mortgage loans, although also both securitize and invest in multifamily loans that finance rental housing.

**The Federal Home Loan Bank system (FHLBs)**

- A cooperative composed of 12 regional banks that are themselves owned cooperatively by private financial institutions domiciled in their individual districts.
- 600 members each, on average, from small community banks to large commercial banks.
- Currently $500 billion "advance" loans outstanding to members, collateralized by high-quality mortgage-related loans and securities.
- In the crisis, the FHLB advances ballooned to over $1 trillion, providing an important source of back-up funding to their members.
- Hold investment portfolios of about $330 billion in mortgage-related loans and securities.
- Fund their advances and investments with $814 billion of debt at an exceptionally low interest rate because of the apparent market perception of USG support (like Fannie and Freddie, the FHLBs are congressionally chartered).
- Allow members to take risks with mortgage loans while shifting the cost of that risk to taxpayers via the FDIC.

**The Federal Housing Administration (FHA)**

- Guarantees loans that are then bought and bundled as privately-issued securities, which are guaranteed as by Ginnie Mae (the Government National Mortgage Association).
- Traditionally focuses on first-time and lower-income homebuyers, in part through lower requirements for down payments than Fannie and Freddie.
- Guarantees millions of loans, currently totaling over $1 trillion.
- Traditionally guarantees only 10-15% of new mortgages, but the FHA's market share has swollen to nearly 30% during this housing crisis;
- Ginnie Mae also stamps MBS backed by loans guaranteed by the VA (about 15% of recent GNMA issuance) and the USDA (rural housing, under 10% in the last two years).

**Multifamily / Rental Housing**

- One-third of all Americans are renters – about 100 million people.

- Fannie Mae and Freddie Mac's market share in multifamily lending expanded from 40% in 2007 to 80% in 2009 as market conditions eroded and private lenders collapsed or withdrew.
- Fannie Mae and Freddie Mac's aggregate multifamily investment portfolios totaled $347 billion in mortgage-related loans and securities, about 70% of which in whole loans and 30% in mortgage-related securities (as of September 30, 2010).
- About $42 billion of multifamily loans are guaranteed by Fannie or Freddie but held by private investors.
- Risk Sharing: Fannie delegates underwriting but requires 33% risk retention of underwriters, while Freddie assumes all credit risk after detailed credit review.

**Affordability & Access**

- Over 40% of home purchases are by low/moderate-income families and communities.
- Almost 50 million renters now spend more than 30% of their income on rent (the most common benchmark for affordability); and one-fourth spend more than 50% of their income on rent – double the share in 1960.
- For every 100 *very* low-income renters, there are only 60 rental homes that are both adequate and affordable rental homes; for every 100 *extremely* low-income renter there are only 32 such units.

**Housing Market: fragile but signs of stabilization**

- House prices remain fragile as the FHFA purchase-only index remains below its November 2009 level after changing little in the fall of 2010.
- Low mortgage rates continue to keep affordability indices at record high levels.
- In 2010, single-family sales were at their lowest level since 1997. New and existing home sales increased in December, but remained below levels seen in 1H 2010.
- Inventory of existing homes has fallen to 8 months' supply, still double the pre-boom average.
- Mortgage delinquency rates have leveled off, but remain quite high, with over 9% of all mortgage loans delinquent in the third quarter of 2010 – about twice the historical average.
- New foreclosures have temporarily declined as lenders review internal procedures related to foreclosure processing, but the number of foreclosures currently in process is roughly equal to the number completed since 2009, and analysts predict that in the next several years, the total number of completed foreclosures may triple.
- Homeowners in HAMP permanent modifications perform well, with re-default rates below industry norms.

**Concentration**

- Currently, the top 5 mortgage originators control more than 60% of all origination. This is triple their market share in the early 1990's