A Progress Report on the Implementation of FHFA's Strategic Plan for Enterprise Conservatorships

Introduction

In February 2012, the Federal Housing Finance Agency (FHFA) issued a strategic plan for the conservatorships of Fannie Mae and Freddie Mac (the Enterprises). The *Strategic Plan for Enterprise Conservatorships* sets forth three strategic goals for the current phase of the conservatorships:

1. *Build*. Build a new infrastructure for the secondary mortgage market;
2. *Contract*. Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations; and
3. *Maintain*. Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

In March of this year, FHFA published a Conservatorship Scorecard for 2013 that established performance goals for the Enterprises that would further those three strategic goals. This Progress Report summarizes major Enterprise activities to date toward achievement of the 2013 Scorecard's performance goals.

The initial sections of the report cover three initiatives through which the Enterprises are building a new infrastructure for the secondary mortgage market. The first section discusses the effort to develop a model Contractual and Disclosure Framework (CDF)—a set of uniform contractual terms and standards for transparency that can inform single-family mortgage securitization in the future. The second section addresses work on a Common Securitization Platform (CSP) that the Enterprises and eventually other, fully private firms will be able to use to perform major aspects of the mortgage securitization process. FHFA provided an overview of and sought industry feedback on those two initiatives in a white paper, "Building a New Infrastructure for the Secondary Mortgage Market," issued in October 2012. In a progress report on the initiatives issued in April 2013, FHFA summarized industry feedback on the white paper, FHFA decisions about the scope of each initiative, and recent work by FHFA and the Enterprises. The third section discusses progress on the Uniform Mortgage Data Program (UMDP), through which the Enterprises are leading the development and implementation of common data standards for the single-family mortgage lending industry.

To advance the strategic objective of gradually contracting the Enterprises' dominant presence in the secondary mortgage market, this year each Enterprise initiated multiple transactions that transferred single-family mortgage credit risk to fully private investors and reduced its retained portfolio (exclusive of agency securities) by selling less liquid assets equal to 5 percent of that portfolio's year-end 2012 balance. In addition, each Enterprise is in the process of reducing its activity in the secondary market for multifamily mortgages in line with a performance goal of reducing the volume of that business in 2013 by 10 percent from the level in 2012. FHFA has also sought and is now analyzing public input on alternative strategies for reducing the

Enterprises' multifamily activity in 2014 and future years. Sections four through six discuss progress in those three areas.

To further the objective of maintaining foreclosure prevention activities and credit availability for new and refinanced mortgages, in 2013 FHFA launched a public outreach campaign to increase awareness of the Home Affordable Refinance Program (HARP) and encourage borrowers to take advantage of HARP. FHFA and the Enterprises also announced enhancements to the Servicing Alignment Initiative, which established consistent mortgage loan servicing and delinquency management requirements for servicers acting on behalf of the Enterprises. In addition, the Enterprises continued, under FHFA's direction, an initiative to update and align their counterparty risk management standards for mortgage insurers. Further, the Enterprises resolved certain mortgage representation and warranty sales obligations related to loans they acquired before the conservatorships. Sections seven through ten summarize those initiatives. A final section concludes the report.

I. Contractual and Disclosure Framework (CDF)

Many policymakers support reducing significantly the share of the single-family mortgage credit risk borne by the federal government. To achieve that objective, investors will require greater certainty about and have to develop greater confidence in the rules, policies, data, and disclosures used in mortgage securitization. A major element of the work to build a new infrastructure for single-family mortgage securitization, in which the Enterprises are engaged under FHFA's direction, is the development of a model Contractual and Disclosure Framework (CDF) that will help foster greater investor certainty and confidence.

Development of a model CDF includes work to (1) align the contracts and data disclosures that support fully guaranteed mortgage-backed securities (MBS) issued by the Enterprises and (2) craft a set of uniform contracts and standards for transparency for MBS that carry no or only a partial federal guarantee that could be broadly accepted by issuers and investors. That work requires ongoing dialogue between the Enterprises, FHFA, other government agencies, and the industry. The dialogue must consider the unique legal status of the Enterprises and their fully guaranteed MBS, the full range of contractual and incentive issues that contributed to the breakdown of private-label securitization during the crisis, market practices observed in recent private-label securitization transactions, and disclosure requirements applicable to MBS registered with the Securities and Exchange Commission (SEC).

The model CDF will incorporate the changes in the standards for servicing Enterprise-owned mortgages achieved through the Servicing Alignment Initiative that FHFA and the Enterprises began in 2011 as well as ongoing enhancements by the Enterprises to the loan-level disclosures on MBS they fully guarantee. In addition, and as discussed below, the Enterprises have successfully transferred credit risk through various risk-sharing transactions in 2013 and will continue to explore multiple types of structures in the future. FHFA intends for the Enterprises to use such transactions, especially senior/subordinated securitizations, to test alternative standards and features on a pilot basis. Transactions can be used to assess the merits of contractual innovations employed in recent private-label transactions, as well as other ideas, in an effort to iterate gradually toward a model framework, with the ultimate objective of supporting the development of industry standards that promote market liquidity and help to attract private capital.

The Conservatorship Scorecard for 2013 expressed FHFA's expectation that the Enterprises would continue work to develop a model CDF that meets the requirements of investors in mortgage securities and investors in mortgage credit risk. Specific performance goals for the Enterprises for the year include:

- Identify and develop standards in data (i.e., leveraging work underway in the Uniform Mortgage Data Program), disclosure, and Seller/Servicer contracts;
- Develop and execute work plans for alignment activities between the Enterprises with regard to common standards and creation of legal/contractual documents to facilitate varied credit risk-transfer transactions; and
- Engage with the public in a variety of forums to seek feedback and incorporate revisions.

The Enterprises have made significant progress toward achieving those goals in 2013. A joint Enterprise team has been performing analysis and working to develop preliminary recommendations related to (1) Enterprise Fully Guaranteed Securities, (2) Non- or Partially Guaranteed Securities, and (3) Master Trust Agreements.

<u>Fully Guaranteed Securities</u>. The team has analyzed and compared certain of the Enterprise's policies and practices related to fully guaranteed MBS while noting comparable practices in the private-label market. The areas of focus have included repurchase or removal of mortgages from, or substitution of new loans into, pools; borrower refinance solicitations by servicers; and document custody policies. By year-end 2013 the team will recommend to FHFA ways to align the Enterprises' policies and practices in each area.

<u>Non- or Partially Guaranteed Securities</u>. The team has focused on identifying best practices for non-guaranteed MBS, including those partially guaranteed by the Enterprises. In addition to the areas considered under Fully Guaranteed Securities Alignment, this work has encompassed the due diligence process, dispute resolution, the representations and warranties needs of investors, and appropriate loan-level disclosures. By the end of this year, the team will make initial recommendations on practices to be used and tested in Enterprise risk-transfer transactions, including senior/subordinated securitizations.

<u>Master Trust Agreements</u>. The team has begun a review and analysis of differences in the Enterprises' Master Trust Agreements for their fully guaranteed securities. A goal of that work is to clarify issues posed by those differences, including the implications of articulating contractual standards in the static master trust agreement versus servicing guidelines that are more easily modified. By year-end, the team will complete a comparative analysis of provisions related to governance, servicing, cash management, and segregation of funds and recommend a work schedule for 2014.

II. Common Securitization Platform

The CSP is a second major element of the new infrastructure for single-family mortgage securitization being developed by the Enterprises under FHFA's direction. The platform will consist of integrated hardware architecture and software applications that Fannie Mae, Freddie Mac, and eventually other, fully private firms will be able to use to perform major aspects of the securitization process. When fully developed, the CSP, acting as the agent of an issuer, will (1) verify certain aspects of the data related to a pool of mortgages; (2) issue mortgage-backed securities, either backed by pools of loans or by other securities; (3) publish required disclosures related to the securities and the pool of loans, both at issuance and on an ongoing basis over the life of the securities; (4) perform aspects of master servicing that are amenable to automation and straight-through processing; and (5) perform certain bond administration functions.

FHFA intends for the CSP to serve as a new technological infrastructure for mortgage securitization that will form a sound foundation on which to rebuild the country's secondary mortgage market. The platform is designed to maintain flexibility in several respects, including providing standardized interfaces with market participants, being adaptable to policy change, and remaining open to modification in response to evolving standards and emerging technologies. The Conservatorship Scorecard for 2013 expressed FHFA's expectation that the Enterprises would, in conjunction with FHFA, continue the foundational development of the CSP. Specific performance goals for the year include:

- Establish initial ownership and governance structure for the CSP. Assign dedicated resources and establish an independent location site for the CSP Team.
- Develop the design, scope, and functional requirements for the CSP's modules and develop the initial business operational process model.
- Develop a multi-year plan, inclusive of CSP build, test, and deployment phases and the Enterprises' related system and operational changes.
- Develop and begin testing the CSP.
- Support FHFA progress reports to the public on the CSP's design, scope, and functional requirements. Update documents based on feedback received.

FHFA and the Enterprises have made significant progress toward achieving each of these 2013 performance goals. Achievement of the longer-term objectives of the CSP remains a significant undertaking, as implementation of the platform encompasses both a complex technology project and significant changes in Enterprise business processes.

<u>Formation of Enterprise Joint Venture</u>

In October, Fannie Mae and Freddie Mac formally established an independent business entity—Common Securitization Solutions, LLC (CSS). Currently owned by the Enterprises as a joint venture, CSS will own the CSP and related business and operational functions and will be governed by an independent Chairperson of the Board of Managers and Chief Executive Officer. An executive recruitment firm has been retained to identify candidates for those two positions. Identification and interviewing of candidates is well underway.

A lease for commercial office space for CSS has been executed by authorized officials from Fannie Mae and Freddie Mac. The office space is located in Bethesda, Maryland, and the lease is for three years. The staff working on the CSP will move to the CSS' new offices in early 2014. While the Enterprises have been instrumental to date in staffing the CSP and providing all necessary services to stand up the new company, over the next year both the staff and services will transition to being independent from the Enterprises.

FHFA and the Enterprises are also developing the key legal documents and business infrastructure for the CSS. The legal documents will cover items such as capital contributions by the Enterprises, allocations of profits and losses, the structure of the Board of Managers, voting rights, identification of "significant matters" requiring super-majority voting, and the handling of intellectual property rights. The business infrastructure includes the corporate governance structure, the organizational structure, pro forma financial statements, a draft charter for an Industry Advisory Board, and interim human resource management protocols, including those related to posting, interviewing, and hiring CSS employees and pay and benefits plans. Documents, policies, procedures, and the infrastructure will continue to be updated and refined over the upcoming months. A key goal of FHFA is to have sufficient flexibility in the ownership and governance documents to allow policymakers to shape how the joint venture is ultimately owned and governed in the future.

Development of the Platform

The CSP team that is building the platform has made significant progress this year on developing the design, scope, and functional requirements for the CSP's modules. As discussed in FHFA's October 2012 *White Paper* and April 2013 *Progress Report*, the CSP will be comprised of five core modules—which will perform the data validation, security issuance, disclosure, master servicing, and bond administration functions noted above—as well as transactional data stores, an integrated data store, and other components. The *White Paper* and *Progress Report* also provided additional detail on the operations the five modules will perform and the core design principles—including straight-through processing and functional modularity—that the team is following in developing the CSP.

The team is using an "agile" application development lifecycle methodology, where the functions the CSP is required to perform and the software solutions that satisfy those requirements evolve in an incremental fashion. Under this methodology, the development of the platform occurs in short cycles. For each cycle, a cross-functional team of business and technology experts defines new requirements and incrementally develops and delivers software that satisfies the new requirements. Both the developers and users then test the new software, which is integrated into the platform when that testing is complete. The team is relying on standard industry software throughout the platform, with a combination of Enterprise subject matter experts and industry vendors and consultants installing (or developing, where needed) and integrating the software.

To date, the team has achieved the following milestones in the development and testing of the platform, all in a non-production environment:

- Implementation of the core processing software for single-class mortgage-backed securities (MBS and PCs) and single-class re-securitizations (Megas and Giants), covering the data validation, security issuance, disclosure, master servicing, and bond administration processes;
- Execution of initial performance testing;
- Implementation of key exception processing activities, such as dissolving pools, collapsing pools, and transfers of servicing rights;
- Implementation of interfaces for Enterprise testing of requests for single-class securitization and CSP reporting back to the Enterprises of key loan position data;
- Purchase and development of software to monitor platform performance and support the deployment and testing of platform functionality;
- Development of initial capability of monitoring the platform's operations; and
- Development of key CSP documentation such as process flows and interface specifications.

Development and testing of the CSP, inclusive of expanded functionality and processes, will continue for some time. That work will be challenging, in part due to the scale and scope of the project. The CSP team is currently developing a multi-year project plan for the development of the platform, in consultation with FHFA and the Enterprises.
In addition to the continued work on the platform's core processing software, the CSP team and Enterprise staff have been working on other critical business operations. That includes the development of detailed diagrams of business processes and data flows and the testing of completed software, both on a stand-alone and an integrated basis. Upcoming work will also focus on the establishment of an independent data center and related data hosting facilities and the development of disaster recovery and business continuity plans.

The 2013 Conservatorship Scorecard also expressed FHFA's expectation that each Enterprise would develop a plan that describes in detail how it plans to integrate into the CSP. The scope of that plan should include activities related to technology changes, data migration, business process changes, production readiness, testing, and risk management. Successful execution of those activities will be a multi-year effort that will require significant Enterprise resources. Each Enterprise is in the process of drafting a proposed integration plan for FHFA review.

In the April 2013 *Progress Report*, FHFA noted that respondents to the October 2012 *White Paper* had suggested that the CSP might include a "Life-of-loan" Data Warehouse and a "Loan Acquisition Data" module that would allow lenders to submit one data file that would be subject to uniform data editing and validation procedures. FHFA continues to assess both of those options, but they are not, at this time, included in the scope of the platform.

III. Uniform Mortgage Data Program

In 2010, FHFA directed Fannie Mae and Freddie Mac to initiate the Uniform Mortgage Data Program (UMDP), through which the Enterprises are collaborating with the industry to develop and implement uniform data standards for single-family mortgages. Implementation of those data standards will enable the Enterprises to capture consistent and accurate mortgage data, help them ensure that they acquire high-quality loans, and enhance their risk management capabilities. Data standardization will allow all types of lenders to participate in the secondary market on an equal footing and will make it far easier and cheaper for all lenders, including community-based institutions, to acquire technology from third-party vendors and apply it within their institutions.

The Enterprises have already implemented three key phases of UMDP. The Uniform Appraisal Dataset (UAD) standardized the data elements included in appraisal forms that must be submitted electronically to the Enterprises and standardized the definitions and responses for a key subset of fields. The Uniform Collateral Data Portal (UCDP) was created to serve as a single portal for the required electronic submission of appraisal data files, by lenders or their agents, prior to delivery of a mortgage to an Enterprise. The Uniform Loan Delivery Dataset (ULDD) provided a common set of loan delivery data requirements applicable to each Enterprise's loan delivery process and business policies. The Mortgage Industry Standards Maintenance Organization's (MISMO's) Reference Model serves as the basis for the ULDD and UAD, resulting in consistent data mapping, enumerations, and definitions for appraisal and loan delivery data.

In March 2013, the Enterprises started working to standardize data collected in the origination process by reviewing and mapping the MISMO Reference Model to the Consumer Financial Protection Bureau's (CFPB's) proposed Closing Disclosure Form, which integrates parts of the HUD-1 and Truth in Lending forms. That initiative to develop a Uniform Closing Dataset (UCD) will provide standardized data points, enumerations and definitions for fields on the new Closing Disclosure Form once it is finalized by CFPB.

In consultation with FHFA and other Federal agencies, the Enterprises have also identified new data fields to be collected, and a few data fields that are no longer needed, on the Uniform Residential Loan Application. The results of that work will be included in a new Uniform Loan Application Dataset (ULAD). In addition, each Enterprise has completed a review of the requirements for a new Uniform Mortgage Servicing Dataset (UMSD) and submitted a large number of new data definitions and values to MISMO for inclusion in the new version of the reference model released this fall for industry comment. Plans for the collection of servicing data consistent with the UMSD standard are well underway. Finally, in September each Enterprise submitted to FHFA white papers that address strategies for data standardization, collection, and use under the UCD, ULAD, and UMSD initiatives. Each Enterprise will update those documents in future years as it refines these strategies further.

IV. Single-Family Mortgage Credit Risk-Transfer Transactions

In furtherance of the strategic goal of gradually contracting the dominant presence of Fannie Mae and Freddie Mac in the secondary mortgage market, under FHFA's direction each Enterprise has been working to develop and execute transactions that transfer single-family mortgage credit risk to private investors. In 2012 the Enterprises made substantial progress in developing transactions that would transfer risk to capital-market investors and insurance companies. Recognizing that progress, the Conservatorship Scorecard for 2013 expressed FHFA's expectation that each Enterprise would demonstrate the viability of multiple types of risk transfer transactions involving single-family loans with an unpaid principal balance (UPB) of at least $30 billion. Each Enterprise has executed multiple transactions totaling more than $30 billion after first issuing historical data on the credit performance of relevant mortgages.

Issuance of Historical Loan-Level Mortgage Performance Data

To inform potential investors and facilitate the pricing of risk-transfer transactions, in the first half of the year each Enterprise released loan-level information on the characteristics and credit performance of a sizable portion of the single-family mortgages it has financed in recent years. In March, Freddie Mac released information on about 16 million fully amortizing, 30-year, fixed-rate loans originated in 1999 through 2011. Excluded from the dataset were adjustable-rate, initial-interest-payment-only, balloon, government-insured, step-rate, relief refinancing loans (including Home Affordable Refinance Program (HARP) loans, and other affordable or non-standard mortgages. The dataset includes monthly credit performance data on each loan, including information up to and including 180-days delinquency, through mid-2012. Voluntary prepayments and short sales, deeds-in-lieu of foreclosure, third-party sales, and foreclosures that occur before 180-days delinquency are indicated in the performance information. In April Fannie Mae made a comparable release of information on the characteristics of over 18 million mortgages it acquired in 2000 through the first quarter of 2012, along with credit performance data on the loans through the end of 2012. Each Enterprise is updating the credit performance information in its historical dataset on an ongoing basis.. The data releases will facilitate analysis of proposed Enterprise credit risk-transfer transactions.

Issuance of Debt Equivalent to Credit-Linked Notes

Following its release of historical credit performance data, each Enterprise sold debt securities that transfer to private investors a portion of the credit risk of a large reference pool of single-family mortgages that the Enterprise had previously securitized. Freddie Mac has done two transactions to date, and Fannie Mae has completed one. Each transaction provides credit protection to the issuing Enterprise by effectively mimicking a credit-linked note structure in which the principal repayment of the notes is subject to the credit performance of the loans in the reference pool. If credit losses on the mortgages in the reference pool exceed a specified level, the notes' principal is reduced, effectively reimbursing the issuing Enterprise for a portion of the losses.

Freddie Mac STACR Securities. In July and November Freddie Mac sold two offerings of a new type of debt security, Structured Agency Credit Risk (STACR) notes. Each issue was backed by a reference pool of 30-year, fixed-rate mortgages. The loans in each reference pool had loan-to-value (LTV) ratios from 60 percent to 80 percent and, thus, were not covered by mortgage insurance. In the July offering, Freddie Mac sold $500 million in STACR notes, resulting in credit protection on $18.5 billion of collateral consisting of mortgages funded in the third quarter of 2012. In the November offering, Freddie Mac sold an additional $630 million in STACR notes, resulting in credit protection on $23.3 billion of collateral that it had funded in the first quarter of 2013. The STACR notes are unsecured general obligations of Freddie Mac.

The credit event that results in losses on the STACR notes is determined to occur if a loan becomes 180 days delinquent or there is a third-party sale, a short sale, a deed-in-lieu at foreclosure, or a sale of real-estate owned (REO) before 180-days delinquency. When such a credit event occurs, a credit loss is calculated based on a tiered loss severity schedule, where the severity increases with the cumulative UPB of the underlying loans that experience credit events. Specifically, the assumed loss severity is 15 percent for cumulative UPB experiencing a credit event of less than or equal to 1 percent, 25 percent severity for cumulative credit-event UPB greater than 1 percent and less than or equal to 2 percent, and 40 percent severity for cumulative credit-event UPB greater that 2 percent.

To mimic a credit-linked note structure in which the principal repayment of the notes is subject to the credit performance of the underlying loans, Freddie Mac divided the reference pool for each STACR transaction into four tranches. The senior-most tranche, Class A-H, is a reference tranche equal to 97 percent of the UPB of the reference pool that benefits from credit enhancement provided by 3 percent of subordinated tranches. Most of the subordination is provided by two mezzanine reference tranches, Classes M-1 and M-2. The senior (M-1) of the November STACR offering's tranches received investment-grade ratings from two credit rating agencies, whereas the July offering was unrated. In the July offering, the M-1 and M-2 tranches were each equal to 1.35 percent of the reference pool. Those two tranches are protected by subordination of 1.65 percent and 0.3 percent of the pool, respectively. In the November offering, the M-1 tranche was equal to 1.05 percent of the reference pool, and the M-2 tranche was equal to 1.65 percent of the pool. Those two tranches were protected by subordination of 1.95 percent and 0.3 percent of the pool, respectively. Lastly, there is a Class B-H residual reference tranche equal to 0.3 percent of the pool. Each transaction is structured such that the B-H tranche takes credit losses first, then the M-2 and M-1 tranches sequentially. Thus, if calculated credit losses exceed 0.3 percent of the UPB of the reference pool, the principal of first the M-2 tranche and then the M-1 tranche is written down by the amount of the excess, until the calculated losses exceed 3 percent and the two tranches are wiped out, to the benefit of Freddie Mac.

In each STACR transaction, Freddie Mac sold about four-fifths of the M-1 and M-2 tranches to investors, retaining the balance of each as reference tranches. The Enterprise can elect to sell part of those retained tranches later, but has committed to maintain a minimum 5 percent interest in each tranche of each deal. The risk-retention requirement is designed to align the interests of Freddie Mac and investors that have bought a portion of the M-1 and M-2 tranches.

The STACR notes have a final maturity of 10 years. With a fixed loss severity and final maturity, Freddie Mac is exposed to some basis risk on calculated credit losses on the reference pool from 0.3 percent to 3 percent. In addition, Freddie Mac retains exposure to the first 0.30 percent of calculated credit losses and to calculated losses beyond 3 percent.

<u>Fannie Mae Connecticut Avenue Securities</u>. In October, Fannie Mae issued a new type of debt security that follows the structure of Freddie Mac's STACR notes. Specifically, Fannie Mae sold \$675 million worth of Connecticut Avenue Securities, resulting in credit protection on \$25.0 billion of mortgages securitized in the third quarter of 2012. As with the STACR transactions, the securities were backed by about 80 percent of a reference pool of 30-year, fixed-rate mortgages that the Enterprise had previously securitized, and all the loans in the pool had LTV ratios from 60 percent to 80 percent and, thus, were not covered by mortgage insurance. A

material difference between from the STACR transactions was in the tiered loss severity schedule. Specifically, for the Fannie Mae securities the assumed loss severity is 10 percent for cumulative UPB experiencing a credit event of less than or equal to 1 percent, 20 percent severity for cumulative credit-event UPB greater than 1 percent and less than or equal to 2 percent, and 40 percent severity for cumulative credit-event UPB greater that 2 percent. Further, the senior (M-1) tranche of the Fannie Mae security received an investment-grade rating from one credit rating agency.

Fannie Mae Purchase of Mortgage Pool Insurance

In October Fannie Mae executed a pool insurance policy with National Mortgage Insurance (National MI). The policy transfers a substantial portion of the credit risk on a pool of single-family mortgages securitized by the Enterprise in the fourth quarter of 2012. The aggregate initial UPB of the loans in the pool was nearly $5.2 billion, and each mortgage had an initial LTV ratio of between 70 percent and 80 percent. Under the policy, Fannie Mae is responsible for actual credit losses on the pool up to 0.2 percent and above 2 percent of the initial aggregate UPB. National MI is exposed to credit losses above 0.2 percent and less than or equal to 2 percent of the initial aggregate UPB, but its exposure on each loan is limited to 50 percent of its initial UPB. Thus, the policy has an aggregate loss limit of about $103.4 million with a deductible of about $10.3 million. The coverage will be provided for about 10 years. National MI will pay claims based on actual credit losses determined after an REO sale, short sale, or third-party disposition of the property. To limit its counterparty risk, Fannie Mae has required National MI to maintain a risk-to-capital ratio not to exceed 15:1 through 2015. Thereafter National MI will maintain capital levels required by Fannie Mae's then-applicable requirements.

Freddie Mac Purchase of Reinsurance

In November Freddie Mac executed a transaction that transferred to Arch Reinsurance, a global reinsurer, a portion of the residual credit risk that Freddie Mac had retained on the reference pool of mortgages underlying the first STACR transaction. Specifically, Freddie Mac had retained the credit risk associated with $109.7 million (about 18 percent) of the UPB of the M-1 and M-2 reference tranches. Under the reinsurance transaction, Freddie Mac sold about 71 percent of that risk. Thus, between the first STACR offering and the Arch transaction, Freddie Mac sold just under 95 percent of the credit risk associated with the M-1 and M-2 tranches.

Comparison of the Transactions

The Enterprises have executed transactions that transfer single-family mortgage credit risk to capital-market investors and to firms in the insurance industry. Each type of risk-transfer model has inherent strengths and weakness. From an Enterprise perspective, the sale of securities to capital-market investors provides upfront funding of credit risk without posing any counterparty risk, while transferring credit risk to an insurer leaves an Enterprise exposed to the claims-paying ability of its counterparty.

From an overall housing finance system perspective, the leverage of participating investors in capital markets transactions may not be regulated, so there may be significant variation in the amount of equity capital deployed to bear credit risk. Further, capital markets may be more volatile as a source of funding for mortgage credit risk over the credit cycle. Transferring risk to the insurance sector could be a more stable source of funding mortgage credit risk over the cycle to the extent insurer financial strength and leverage can be closely monitored either by the market or through regulatory requirements. FHFA and the Enterprises will continue to assess those strengths and weaknesses as we explore both models of credit-risk transfer in parallel.

V. Retained Mortgage Portfolios

FHFA's strategic goal of gradually contracting the dominant presence of Fannie Mae and Freddie Mac in the secondary mortgage market is consistent with the terms of the Senior Preferred Stock Purchase Agreement (PSPA) between each Enterprise and the Treasury, which require each Enterprise to gradually reduce its retained portfolio of mortgage assets. In August 2012, the Treasury modified the PSPAs to accelerate the required rate of reduction in each Enterprise's retained portfolio to 15 percent per year and maintained at $250 billion the level to which each Enterprise's retained portfolio must decline. For 2013, the PSPA requires that each retained portfolio decline to $553 billion. As of the date of this Progress Report, each Enterprise's retained portfolio was less than that amount.

As a result of the reductions in the retained portfolios made pursuant to the PSPAs and Enterprise purchases of delinquent mortgages from pools backing guaranteed MBS, the portfolios are increasingly concentrated in non-agency securities and whole loans, which are less liquid assets than fully guaranteed MBS. In recognition of that trend, the Conservatorship Scorecard for 2013 expressed FHFA's expectation that each Enterprise would reduce its retained portfolio (exclusive of agency securities) by 5 percent from the year-end 2012 level. That established targets for sales of less liquid assets in 2013 of $21 billion for Fannie Mae and $15.7 for Freddie Mac. In addition, FHFA required that the transactions be economically sensible, operationally well-controlled, involve a meaningful transfer of credit risk and be transparent to the marketplace.

As of the date of this progress report, Fannie Mae has achieved the 2013 scorecard objective by selling at least $21 billion of less liquid assets. Freddie Mac has also met the 2013 scorecard objective by selling at least $15.7 billion of less liquid assets.

VI. Multifamily Business

To further the strategic goal of gradually contracting the dominant presence of Fannie Mae and Freddie Mac in the secondary mortgage market, the 2013 Scorecard established the expectation that each Enterprise would reduce the unpaid principal balance of its new multifamily business by at least 10 percent relative to 2012. That reduction can be achieved through various means such as tightening underwriting, adjusting pricing, or limiting product offerings, but could not increase the proportion of credit risk retained by the Enterprises. The goal of the contraction is to attract private capital into the market and reduce the Enterprises' footprint.

Each Enterprise has submitted a plan to FHFA on reducing its multifamily business that contains monthly volume estimates and reports on its production on a quarterly basis. FHFA monitors those business volumes to ensure adherence to the plans and assess whether measures taken are sufficient to achieve the 10 percent reduction. Each Enterprise has taken steps to meet this goal, and the market appears to have absorbed the changes in business volumes without major disruption.

FHFA is evaluating alternatives for reducing the multifamily businesses of Fannie Mae and Freddie Mac in 2014. In August, FHFA requested public input on the potential impact of several strategies for doing so.[1] The deadline for submission of that input was in early October, and FHFA is in the process of reviewing and evaluating the responses.

VII. Home Affordable Refinance Program

The Home Affordable Refinance Program (HARP), introduced in 2009 as part of the Administration's Making Home Affordable program, is a key way in which Fannie Mae and Freddie Mac support the strategic goal of ensuring credit availability for refinanced mortgages. HARP gives borrowers whose mortgages are owned or were securitized by Fannie Mae or Freddie Mac and who have little or no home equity, the opportunity to refinance into mortgages with more affordable payments. In light of initial experience with the program, FHFA modified HARP in 2011 by:

- Eliminating certain risk-based fees for borrowers who refinance into shorter-term mortgages and lowering fees for other borrowers;
- Removing the 125 percent loan-to-value ceiling for fixed-rate mortgages;
- Waiving certain representations and warranties originally made by lenders on mortgages being refinanced under HARP;
- Eliminating the need for a new property appraisal where the Enterprise provides a reliable estimate from its automated valuation model; and
- Extending the end date for HARP to December 31, 2013.

Those changes led to a surge in program activity throughout 2012 that resulted in more than a million HARP refinances for that year, an amount equal to activity over the prior three years. As of August 2013, HARP refinances since program inception totaled more than 2.8 million. FHFA estimates that as many as 1 million more borrowers are HARP-eligible (depending on interest rate and home price increases) and is taking steps to reach those borrowers.

In April 2013, FHFA extended HARP through 2015 and launched a public outreach campaign to increase HARP awareness and encourage borrowers to take advantage of the program. The campaign was initiated in and around Chicago, Cleveland, Detroit, Southern California/ Riverside, Las Vegas, Atlanta, Miami, Tampa, and Orlando. In addition, the new campaign includes a HARP website (www.harp.gov), a series of virtual events in targeted markets covered extensively by local media, customizable tools to help lenders promote HARP, and a working relationship with Zillow to amplify FHFA's message and allow access to the site's housing experts and refinancing tools.

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[1] http://www.fhfa.gov/webfiles/25420/MultifamilyInput080913Final.pdf

In October 2013, the Enterprises announced a change to the HARP eligibility date requirement. The change makes a mortgage's eligibility for HARP depend on the date of the note rather than the date of Enterprise acquisition of the loan. Thus, to be eligible for HARP, the original loan must have a note date on or before May 31, 2009. The change makes the HARP eligibility date more transparent to borrowers since most know when they closed on their prior mortgage, but typically do not know when their loan was acquired by an Enterprise.

VIII. Servicing Alignment Initiative

FHFA and the Enterprises announced the Servicing Alignment Initiative (SAI) in April 2011. The SAI established consistent mortgage loan servicing and delinquency management requirements for loan servicers acting on behalf of the Enterprises, effective in October of that year. Those requirements include policies related to borrower contact, delinquency management, loan modifications, servicer incentives, and compensatory fees. Aligning the approaches of the two Enterprises allowed servicers to streamline and simplify their processes for the purpose of

- Improving service to borrowers and communicating with borrowers more consistently;
- Processing loan modifications more efficiently;
- Ensuring consistency, fairness, and efficiency in the foreclosure process; and
- Increasing servicer accountability via new incentives and compensatory fees.

Since SAI's inception, FHFA and the Enterprises have monitored its implementation to ensure that outcomes are consistent with FHFA's original intent. In 2012, enhancements were made to the foreclosure timelines and compensatory fee structure and Standard Short Sale and Standard Deed-in-Lieu initiatives were launched. In 2013, FHFA and the Enterprises announced additional enhancements to the program:

- In March, FHFA and the Enterprises announced a Streamlined Modification initiative in response to documentation challenges associated with traditional modifications. That initiative allows servicers to solicit certain eligible borrowers who are delinquent between 90 to 720 days with reduced documentation requirements, beginning in July of this year.
- In August, the Enterprises announced changes to their servicer incentives framework in support of trial modification starts. Those changes eliminated the borrower response package incentives and related performance benchmarks and increased the modification incentive structure under the Home Affordable Modification Program (HAMP) by $500.00.
- In September, the Enterprises extended their HAMP programs to align with the Treasury. All mortgages eligible must have a Trial Period Plan with an effective date on or before March 2016. The Enterprises also extended the Streamlined Modification initiative to December 2015 to correspond to the HAMP sunset date.
- In October, the Enterprises issued servicing requirements in response to the Consumer Financial Protection Bureau's final rule implementing the mortgage servicing provisions of the Real Estate Settlement Procedures Act and the Truth in Lending Act, as amended by the Dodd-Frank Wall Street Reform and Consumer

Protection Act of 2010. The updated servicing requirements relate to early intervention and communication with delinquent borrowers, alternatives to foreclosure and right of appeals, foreclosure referral and foreclosure suspension, and error resolution. The changes are effective January 10, 2014.

IX. Mortgage Insurer Master Policies and Eligibility Requirements

As set forth in the Strategic Plan for Enterprise Conservatorships, achieving the objective of maintaining credit availability for new and refinanced mortgages requires a viable private mortgage insurance (MI) industry to provide credit enhancement for loans with loan-to-value ratios over 80 percent. In recognition of the importance of the MI industry, the 2013 Scorecard established the expectation that the Enterprises would update and align counterparty risk management standards for mortgage insurers, including uniform master policies and aligned eligibility requirements.

An MI master policy sets the terms of business between an MI and a seller/servicer counterparty. The Enterprises must approve all MI master policies. An Enterprise's MI eligibility requirements set the criteria and terms an MI must meet in order to do business with the Enterprise. The updated, aligned MI eligibility requirements being developed by the Enterprises will establish uniform risk management standards for MIs, which will lead to a more stable mortgage market. The new risk management standards will include:

- Financial strength standards that will require MIs to demonstrate adequate resources to pay claims when due;
- Performance metrics and thresholds that, if breached, will trigger Enterprise remediation; and
- Standards for the MIs' quality control processes.

FHFA and the Enterprises have made considerable progress toward developing the new MI master policies and eligibility requirements. The joint team has worked through a master policy for each MI and anticipates approving by the end of 2013 the submission of the master policies to state insurance regulators for approval. The new master policies are scheduled to take effect in mid-2014. The team has also developed a unified conceptual framework for the new eligibility requirements, engaged in outreach to learn the perspectives of a variety of investors, and solicited feedback from regulatory stakeholders at the state level and the National Association of Insurance Commissioners (NAIC). FHFA expects to solicit public feedback on proposed new MI eligibility requirements by the end of 2013.

X. Resolution of Mortgage Representation and Warranty Sales Obligations

To restore confidence in marketplace norms and practices and accelerate the resolution of outstanding claims, the 2013 Scorecard indicated that each Enterprise should complete its review of pre-conservatorship loan acquisitions and demand restitution for breaches of selling representations and warranties. Such resolution could be achieved in two ways. First, the Enterprises could expand existing capacities to conduct the requisite number of loan-by-loan file reviews to identify selling breaches and issue lender repurchase or make-whole demands.

Second, the Enterprises could pursue a global settlement of claims whereby lenders make a lump sum payment to resolve both existing and future legacy loan demands.

Each Enterprise has effectively used both strategies to ensure attainment of this objective by the end of 2013. To date this year, Fannie Mae has executed resolution agreements with Bank of America, CitiMortgage/Citibank, SunTrust Bank, JPMorgan Chase Bank, First Tennessee Bank, and Flagstar Bank. During the same period, Freddie Mac has completed settlement agreements with CitiMortgage/Citibank, Wells Fargo Bank, SunTrust Bank and JPMorgan Chase Bank. On a combined basis, including amounts recovered through ongoing loan-level repurchase demand processes, the Enterprises will have recovered more than $18 billion in lender payments during the first ten months of 2013.

XI. Conclusion

This Progress Report has documented the major activities of Fannie Mae and Freddie Mac to date in 2013 toward achieving the goals set forth in FHFA's Strategic Plan for Enterprise Conservatorships. FHFA welcomes public input on that progress from interested parties. Input can be submitted via email to ConservatorshipStrategicPlan@fhfa.gov.