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APPENDIX

Volume 3

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EXHIBIT 28

From: Foster, Jeff
Sent: Monday, February 06, 2012 8:59 PM
To: Joseph Tracy (Joseph.Tracy@ny.frb.org); patricia.mosser@ny.frb.org
Subject: Draft Housing Finance Reform Proposal
Attachments: HFR 1 25 12.doc

Joe/Trish – Good to see you tonight. Attached is the draft housing finance / GSE reform proposal. We have shared this with the Secretary. Would like to find a time to discuss with you in the next week or so. Hopefully this will be a good starting point for discussion.

Please keep this close for now, and let's discuss who else should potentially review and provide input.

Thx,
Jeff

HOUSING FINANCE REFORM – WORKING DRAFT PROPOSAL FOR COMMENT

We support reform of the mortgage finance market for single family and multifamily mortgages that draws on the best functional aspects of our existing mortgage market, including many of the services provided by Fannie Mae and Freddie Mac (the GSEs), but which more closely reflects the regulatory structure and key strengths of our banking system.

The GSEs' business model was inappropriately structured, and ultimately failed in three fundamental respects: (i) lack of sufficient regulatory oversight and prudential underwriting standards, (ii) excessive leverage and lack of sufficient capital to support the guarantees and loans on the GSEs' books, and (iii) lack of an explicit relationship with the government to both compensate and protect the taxpayer in the event of failure. Moreover, the perception of government support for the GSEs allowed the institutions to grow in size and systemic importance that would have never been possible for private companies, leading to a significant concentration of mortgage credit risk.

Going forward, we believe that any reformed mortgage finance system should address these fundamental flaws and adhere to the following core principles:

1. Private sector activities, which include credit underwriting and primary "first loss" guarantees, should be fully separate from public sector activities that require the use of the government's balance sheet.
2. Government support, which can include the provision of a catastrophic "second loss" guarantee to support liquidity and stable funding, should be explicitly charged for, both on an ex-ante and ex-post basis. Guarantees should be limited in nature and apply only to securities that support mortgage funding and not to financial institutions. Taxpayer funds should only be drawn upon after an institution has failed and been taken into receivership.
3. Any entities which benefit from access to government support should be subject to (i) stronger oversight through federal regulation, (ii) enhanced prudential underwriting standards, and (iii) capital requirements consistent with those required of banks. All federally regulated financial institutions should be on a level playing field and capital and regulatory arbitrage opportunities should be minimized.
4. Mortgage credit risk should be widely dispersed throughout the financial system and supported through lower barriers to entry for competition, specific concentration limits, and requirements to syndicate credit risk into the capital markets.

There are a number of ways to structure a mortgage finance system that follows these principles and supports the continued availability of mortgage credit, including long-term fixed rate mortgages. The reform proposal detailed in this memo seeks to meet these principles in an effective and balanced way. It builds upon discussions with you and a two-year interagency working group process, which has included participation from Treasury, HUD, NEC, CEA, DPC, and input from the Federal Reserve. This memo builds upon the concepts and presentations discussed with you leading up to and following the release of the Administration's Housing Finance Reform White

Paper, and attempts to address your questions and requests. The specific terms of the proposal are preliminary and meant to be indicative. Further discussions with the interagency group are. Finally, we would expect that any public presentation or discussion would be at a much higher level and would leave room for input and feedback from market participants and a broad range of stakeholders on how best to structure the future system.

<u>Overview of Reform Proposal</u>

The proposed mortgage finance system would replace the current GSE duopoly with a broad set of Private Mortgage Guarantors (PMGs) and a single government Securitization Utility. Well-capitalized and regulated PMGs would fully guarantee the payment of principal and interest on eligible single family and multifamily mortgages (i.e., future "conforming" mortgages). The Securitization Utility would provide liquidity through securitization support (i.e. pooling and potentially tranching) and an explicit government guarantee, or "reinsurance", on mortgage-backed securities (MBS) collateralized by PMG insured mortgages.

The proposed structure is similar to the existing relationship between the Federal Housing Administration (FHA) and Ginnie Mae (GNMA). In addition, the Federal Housing Finance Agency (FHFA) or another independent agency (possibly the FDIC or a new agency) would serve as the Reinsurer and establish a reserve fund similar to the deposit insurance fund (DIF) to support the government guarantee and protect taxpayers in the event of a PMG failure. This new financing channel is not intended to support non-conforming mortgages and FHA would continue to play its traditional role as a provider of mortgage credit for low income and high LTV borrowers.

For single family and multifamily mortgage borrowers, the process for obtaining a mortgage will remain substantially similar to the process today. The proposed reforms would support the continued wide availability of long-term fixed-rate mortgages, including the to-be-announced (TBA) securities market, which allows borrowers to lock in mortgage rates in advance of purchasing a home and allows investors to access a deep and liquid investment market. Borrowers will have to pay higher guarantee fees, as the new PMGs will be required to hold higher levels of capital against their guarantees than the GSEs held in the past. However, if this approach is executed soundly, the financial system and its institutions will be stronger and pose less risk to the economy.

In the reformed system, PMGs would be limited to four key activities: (i) guaranteeing conforming mortgages, (ii) pooling and warehousing conforming mortgages before delivery to the Securitization Utility, (iii) funding and administering loss mitigation activities, and (iv) syndicating first loss securities to the market, when appropriate. PMGs could be established to support single family and/or multifamily lending. PMGs could be either monoline companies or affiliates/ subsidiaries of banks. PMGs would be required to be separately capitalized and appropriately ring-fenced from all other subsidiaries.

To support strong oversight, regulatory consistency and a level playing field with banks (including capital standards), PMGs would be chartered as a subsidiary of a Bank Holding Company (BHC).

PMGs would be subject to a dual regulatory mandate, with oversight provided by FHFA and the Federal Reserve (and potentially the Reinsurer, if it is a different entity). The BHC approach supports a more integrated and consolidated approach to oversight of the financial services sector and reduces capital and regulatory arbitrage opportunities. (The proposed regulatory framework is outlined in greater detail later in the memorandum.)

In addition to a robust regulatory structure, safety and soundness will be supported by:

- Capital standards broadly similar to those required of insured depositories under Basel III.
- Economic and regulatory incentives to distribute first loss credit risk to the capital markets.
- Concentration limits set to minimize the systemic risk posed by the failure of a single PMG.

<u>Mortgage Funding in the Proposed System</u>

Historically, mortgage originators, many of which are already subsidiaries of BHCs, have relied on two main options to fund mortgages, whether for single family homes or multifamily properties:

1. *Portfolio Lending* – Portfolio lending relies upon funding from (i) deposits, (ii) secured financing in the form of Federal Home Loan Bank (FHLB) advances, or (iii) general unsecured debt issued by the bank. Most portfolio lending generally occurs through a BHC's Insured Depository Institution (IDI), whereby the originator retains four forms of mortgage risk on its balance sheet (credit risk, funding risk, interest rate risk and prepayment risk). Banks have tended not to retain long-term fixed-rate mortgages in their portfolios due to interest-rate risk and costs associated with holding long duration assets. Most portfolio loans tend to be adjustable rate mortgages.

2. *Securitization-Based Origination* – If a mortgage originator cannot or does not want to retain the credit risk, funding risk, interest rate risk and prepayment risk of a mortgage in its portfolio, it can utilize off-balance sheet securitizations to fund mortgages. Through securitization, the originator passes on all four mortgage risks to the market (subject to certain "representation and warranty" put-back risks) and earns an origination/securitization fee for the transaction.[1] Historically, the originator would either (i) sell the mortgage to the GSEs who would then retain the credit risk and pass on the funding, interest rate and prepayment risks to Agency MBS investors, (ii) obtain FHA mortgage insurance and securitize MBS through Ginnie Mae where the government assumed credit risk and investors assumed all other risks, or (iii) sell to the private label securities (PLS) market (where investors assumed all four risks directly).

The GSE and FHA guarantor model has historically been the only way for private mortgage originators to access government or quasi-government liquidity and support securitization-based mortgage lending (and by extension the long-term fixed rate mortgage). This created an extra step of financial intermediation in the mortgage origination process. This is in contrast to a bank's

[1] As well as any retained mortgage servicing rights that may be associated with the contract.

ability to directly access government deposit insurance to support deposit-based lending activities. In addition to substituting the GSE monoline guarantor model with new monoline PMGs (which would continue to support Securitization-Based Origination), the proposed system reforms will provide mortgage lenders with a third, additional channel to fund and support their mortgage business: PMG-based securitization, in which the credit risk is *retained* by an originating BHC's subsidiary, but the funding, interest rate and pre-payment risk is transferred to MBS investors.

Proposed Reform of the Mortgage Finance System

In the reformed mortgage system, PMG-based mortgage funding could follow two basic models that are not mutually exclusive:

1. *PMG as an Acquirer of Third Party Originated Mortgages (Traditional Model):* Monoline PMGs would retain a similar function to the roles Fannie Mae and Freddie Mac play today. They would provide secondary market liquidity for mortgage originators who are not affiliated with a PMG. This structure would allow mortgage originators to continue to utilize the Securitization-Based Origination model (similar to the way smaller lenders access the GSEs' cash window today). The viability of independent PMGs could serve as an important vehicle to provide other entities, including community and regional banks, a source of liquidity via a third party if they do not have the size/scale/desire to independently operate a PMG.
2. *PMGs Supporting Affiliated Lender Origination (Integrated Model):* Allows a bank to access USG supported liquidity directly to support their funding of longer duration mortgages. A BHC with both a commercial bank and a PMG would retain credit risk (similar to Portfolio Lending). However, it would fund those mortgages through the MBS market with securities that carry an explicit USG reinsurance guarantee, thereby transferring funding, interest rate and pre-payment risk to investors (similar to Securitization-Based Origination). The USG guarantee is analogous in many ways to the way a bank utilizes stable FDIC-backed deposit funding to support consumer, commercial real estate and business lending. Additionally, a BHC would be required to hold sufficient risk capital against retained mortgages, whether they are funded through its IDI or PMG activities.

The expansion of this funding option for mortgage originators and the democratization of the liquidity support from the USG to a broader set of financial institutions (relative to the past duopoly) will have several benefits. These include increasing access to credit, reducing concentration of credit risk, increasing competition, and improving operational efficiencies in the mortgage market. The PMG financing channel will preserve many of the critical functions of the current system (including the presence of the TBA market) and simultaneously reduce the government's direct risk exposure. Moreover, lower barriers to entry for financial institutions to participate as a PMG and access government securitization and liquidity support should also facilitate participation in the mortgage finance market by both community banks and multifamily lenders.

<u>Key Terms of Reform Plan</u>

Private Mortgage Guarantors

- PMGs would be chartered as a subsidiary of a Bank Holding Company (BHC), similar to a wholesale or limited purpose bank.
    - Could be part of a Diversified Financial Institution (DFI), which would likely have an Insured Depository Institution (IDI) as its dominant business; or
    - Could be a monoline, i.e., the PMG is the single dominant subsidiary of the BHC.
- PMGs guarantee 100% of the principal and interest on insured loans.
    - All loans are recourse to the PMG's entire capital base (all guaranteed loans are fully cross-collateralized and equally supported by the capital of the PMG).
    - USG reinsurance will be tapped only if capital levels of a PMG are insufficient and the PMG goes into receivership, similar to the way bank receivership currently works.
    - PMGs will be qualified risk retainers for the requirements of the Dodd-Frank Act, under Section 941.
- Any BHC may apply for a PMG charter.
    - Standards / requirements of the charter would be established by statute and regulation.
    - Independently capitalized and ring-fenced from other subsidiaries (the IDI, broker-dealer, foreign subs, etc).
    - Similar restrictions on capital transfers and affiliated transactions as required by an IDI.
- Balance sheet funding and the ability to borrow at the PMG will be restricted
    - Generally constrained to short-term warehousing of loans (pre-securitization) and the funding of non-performing loans that have defaulted.
    - Some level of longer-term portfolio funding may be needed for multifamily mortgages, given the more heterogeneous nature of that asset class, but this remains an open question.
    - *Note: Given that a PMG will be a subsidiary of a BHC, most of the warehouse funding will likely be most efficient through a bank's IDI.*
- Existing mortgage insurers, new firms or other financial institution subsidiaries could apply to become a PMG.
    - The same standards outlined above will apply to these "monoline" PMGs.
    - Parts of Fannie Mae and Freddie Mac could be converted/sold to become PMGs.
- Lower barriers to entry in the mortgage guarantee business than in the past supports increased access to credit, greater competition and reduced concentration of credit risk.

Regulatory Structure

- Joint FHFA/Federal Reserve oversight, similar to the FDIC/Federal Reserve structure for BHCs.
    - FHFA provides specific oversight over PMG and their capital reserves, operations, etc.

  - Federal Reserve provides oversight over BHC and overall capital standards and solvency.
  - Reinsurer (if separate from FHFA) could provide an additional level of oversight.
- The BHC structure would be relied upon in part to ensure that capital standards and prudential regulations are not weakened in the future, and a level playing field between mortgage guarantors and the traditional banking sector is maintained.

Government Guarantee/Single National Securitization Utility

- A single, government-backed Securitization Utility could be formed through existing GNMA operations, with modified responsibilities, and, to the extent additive, take parts of the GSEs' businesses (and human capital/systems).
- The Securitization Utility would be aggregate and structure loans into securities that carry an explicit USG guarantee.
  - All "conforming loans" that are insured by PMGs, as well as FHA and VA, will be eligible to be securitized through this utility.
  - Responsible for creating TBA eligible securities.
  - Administers payments to bond investors and charges explicit USG reinsurance guarantee fee (as set by FHFA as regulator/reinsurer).
- MBS wrapped by the Securitization Utility will be deliverable into TBA market. Standards will be set by the Securitization Utility in conjunction with market participants to maintain a liquid and robust TBA market.
  - Securitization Utility will allow some level of specified pooling to the extent that it does not adversely impact TBA liquidity.
  - Further work regarding pooling and aggregation at the PMG and Securitization Utility level will need to be completed with the FHFA and market participants.

FHFA's Regulatory Role

- FHFA would continue as an independent regulatory agency with an independent, Senate confirmed director. Changes would include:
  - Stronger supervision and capital standards group,
  - Stronger modeling, research, and analytics, and
  - Market supervision and oversight of the Agency MBS market and the credit risk syndication securities market.
- FHFA, in conjunction with the Federal Reserve, would oversee the solvency and capital adequacy of PMGs. In the event of insolvency or inadequate capital, FHFA would act as the receiver of the troubled PMG.
  - FHFA will follow resolution guidelines similar to the Orderly Liquidation Authority (OLA). The FDIC could also be relied upon to administer resolution proceedings.
  - Specific resolution guidelines and processes (and their interaction with an IDI or BHC) will need to be discussed with the Federal Reserve and the FDIC.

- The stringency and uniformity of capital, liquidity, risk management and underwriting standards across PMGs will need to be carefully monitored by federal regulators.
    - Avoid "race to the bottom" in standards to gain share.
    - Ensure solvency through periods of stress.

Reinsurance Agency

- The Reinsurer would be responsible for setting the reinsurance fee, which will be paid by the PMG, but likely passed onto the borrower.
    - Actuarially priced reinsurance for tail risk (based on Treasury borrowing cost), available in both normal markets and in times of stress.
    - Reinsurance fee is expected to be approximately 5 – 10 basis points, depending on the risk scenario the regulator wants to guard against on an ex-ante basis.
    - Reinsurance fee would be a flat rate applied equally to any PMG guaranteed mortgages
- The Reinsurer would also maintain and administer a Reserve Fund similar to the DIF/FDIC.
    - Securitization Utility draws funds as needed to make bond payments when a PMG is in receivership and no longer has resources to make payments.
- Taxpayer Protection: Reserve fund with additional auto-recoupment mechanism for any unexpected losses (similar to the way the DIF and its assessments are managed by FDIC).
- Reinsurance fees could be raised in times of market strength to increase reserves or act as a counter cyclical tool to reduce government footprint.
- Policy makers will need to decide who is best suited to serve as the Reinsurer and administrator of the Reserve Fund (FHFA, FDIC, or potentially a new entity).

Capital Standards and Risk Syndication

- Capital standards at the PMGs will be set jointly by FHFA and the Federal Reserve.
    - Minimum 300 basis points leverage ratio (~six times the historical GSE level).
    - In addition, PMGs would be required to hold additional risk based capital, as determined by regulators in a manner consistent with Basel III.
- The amount of equity capital the PMG must hold can be reduced through the sale of first loss securities to the capital markets due to the reduction in credit exposure the PMG retains.
    - For example, a 10 percent first loss security on a pool of mortgages held by a PMG could reduce capital reserve requirement by 65 - 85 percent (e.g., from 300 basis points down to 100 – 50 basis points). FHFA and the Federal Reserve must jointly determine how capital relief can be achieved via risk distribution to the capital markets.
    - Syndicated first loss securities will not be explicitly or implicitly guaranteed by the USG under any circumstance. In the event a PMG fails, holders of the first loss security would not receive any recovery from the USG.

- The interaction with the 5 percent leverage ratio requirement in order to be a "well capitalized" BHC will be an important issue to work through with the Federal Reserve.
    - This issue could potentially be addressed if some level of regulatory capital relief and accounting consolidation was possible upon a sufficient level of risk syndication by the PMG.

PMG Pricing/Guarantee Fees

- Risk-based pricing at the loan level will be explicitly allowed. This will include adjustments for credit risks such as LTV and DTI levels, as well as geographic considerations (such as accounting for a market which may be overheating / riskier or which has weaker enforcement laws).
    - Access considerations for risk-based pricing must be carefully considered by policy makers and duty-to-serve or anti-redlining policy may merit consideration.
- PMGs, subject to bank-like capital requirements, are likely to charge 75 – 125 basis points for their guarantee (relative to 15 – 25 basis points historically charged by the GSEs) depending on risk level and the extent credit risk has been sold to the capital markets.
    - Given lower pre-tax return requirements of fixed income investors relative to equity investors in "levered" financial institutions[2], credit risk syndication should help to facilitate a reduction in the guarantee fees charged by the PMG.
- There will no longer be the need for Private Mortgage Insurance, which was traditionally required for loans above 80 percent LTV, due to the ability of PMGs to apply risk-base pricing and hold capital according to risk.[3] The PMGs will have the ability to charge higher fees on higher LTV loans. This should enhance system efficiency.
- Despite higher guarantee fees, the impact to the borrower may be muted by a number of factors.
    - Explicit nature of the USG guarantee and improved liquidity from a more centralized TBA market should improve MBS spreads by 20-40 basis points.
        - Today, GNMA securities trade approximately 40-50 basis points lower in yield than Fannie Mae and Freddie Mac securities.
    - Increased access to government liquidity and greater competition may also help improve mortgage origination competition, which would help narrow the primary – secondary origination spread (currently at ~100 basis points, which compares to its historic average of ~50 basis points).

Concentration limits/restrictions to reduce systemic risk

- No PMG that is a subsidiary of a DFI substantially engaged in other banking activities may guarantee more than [10-15] percent of the total amount of PMG guaranteed securities.

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[2] Investors in levered financial institutions look for 15% – 20% pre-tax ROEs (10% – 13% after tax) relative to the 7% – 12% pre-tax return generally required by unlevered fixed income investors who would invest in a first loss transaction.

[3] Subject to a minimum LTV requirement.

  - Any DFI PMG that guarantees more than [2.5-5] percent of the system assets must fully syndicate the first loss credit risk to the capital markets before assuming additional incremental exposure.
- No monoline PMG may guarantee more than [20-25] percent of the total amount of PMG guaranteed securities.
  - Any monoline PMG that guarantees more than [5-10] percent of the PMG system assets must fully syndicate first loss credit risk to the capital markets to take on incremental exposure.
  - This will ensure that the majority of the credit risk taken on by larger PMGs is distributed to the capital markets during normal times. This will reduce the systemic risk posed by any PMG and also ensure that pricing of the guarantee is reflective of market signals.
- Monoline PMGs would be allowed to have higher system concentration in order to allow them to gain sufficient economies of scale to be competitive with DFIs and ensure smaller mortgage originators have a viable securitization option.
- To preserve competition in mortgage markets, concentration limits should apply separately to single-family and multifamily mortgages.
- FHFA and the Federal Reserve could make adjustments to these restrictions depending on overall market share, loan volumes in the PMG system, and prevailing market and economic conditions.
- The combination of a PMG's private capital funding and concomitant ROE expectations with explicit concentration limits should support price stability and discipline that prevents the PMGs from competing exclusively on price at the expense of capital adequacy (and help avoid sparking a race-to-the-bottom).

Access for borrowers

- Several policies should help promote mortgage financing access to creditworthy single family and multifamily borrowers in a variety of communities.
- Reforms would be structured such that community reinvestment, fair lending and other antidiscrimination laws would extend to PMGs as they do to other banks.
  - This approach would be more efficient than the past affordability goal-based lending measures required by the GSEs.
  - Providing liquidity and funding support directly to BHCs should increase the ability to meet CRA requirements.
  - Additional conversations on how CRA requirements would apply to a PMG would need to take place with the Federal Reserve.
- To ensure transparency and effective monitoring, PMGs would also be required to collect and publicly disclose timely data on the mortgages they buy, subject to the Home Mortgage Disclosure Act (HMDA).

Access for small banks and community lenders

- Community banks could potentially form their own PMGs, either separately or cooperatively; or might be able to sell mortgages to another PMG.
- The combination of concentration limits and lower barriers to entry would likely promote competition among PMGs and encourage them to partner with community bank lenders.
    - This is particularly relevant because the limits will likely restrict large Affiliated PMGs to a substantially smaller market share than the largest lenders have today.
- To prevent larger entities from undercutting small and medium BHCs competition, PMGs could also be required to comply with further restrictions, including prohibitions on volume discount offers to mortgage origination partners.
    - However, these requirements may also lead to unintended market distortions and any potential pricing restrictions should be carefully evaluated.

Support for Multifamily Mortgages

- PMGs will be allowed to specialize in multifamily mortgage guarantees. The multifamily market often requires a more customized execution so PMGs might apply different strategies, structures and relationships – such as risk sharing with originating lenders and specific securitization processes – to accommodate the distinctive characteristics of multifamily mortgages.
- Compared with single-family mortgages, common multifamily mortgage characteristics include lower overall market volume, large average mortgage size, relative heterogeneity, more detailed underwriting, and appeal to investors willing to understand the loan(s) in each security, and loan servicing practices.
- Allowing a bank to gain more direct access to government liquidity and funding support for eligible multifamily mortgages should also help facilitate increased multifamily lending and increased product innovation, given the bespoke nature of multifamily underwriting.
- Competition and specialization would also likely benefit smaller multifamily properties (where one-third of multifamily renters live but the GSEs and FHA under-serve) and the development and preservation of affordable housing. However, such housing will continue to require attention as the plan develops and is implemented.

<u>Preliminary Transition Steps</u>

Below is an indicative transition path that could be followed to reach the proposed structure.

Step 1

- Establish plan to gradually increase guarantee fees to private market levels over time.
- Begin to syndicate risk from GSEs to capital markets in form of first loss securities to investors to establish a market for mortgage credit risk.
- Implement servicing compensation reforms and transition to "fee for service" model. Restructure PSPAs to allow for variable dividend payment based on positive net worth.
- Potentially merge the GSEs' legacy assets into a single run-off business.
    - Establish good bank / bad bank for legacy assets at GSEs.
    - Contribute NPLs and high risk assets into single SPV or Resolution Company.

Step 2

- Create single liquid, fungible TBA market for legacy and new GSE books of business.
- Consider additional GSE asset sales of non-core businesses and outsource non-core functions to third-party contractors.
- Establish clear data transparency and access to GSE IT systems (DU/LP) and historical data for eventual new entrants (i.e., PMG).

Step 3

- Prior to any corporate divestment/separation, GSEs could be restructured into three distinct divisions: a mortgage guarantor entity, a securitization utility and a legacy retained portfolio.
    - Allows for clearer delineation of function and purpose of GSE activities.
    - Even before new corporate entities are established, the GSEs can start engaging in internal cost accounting and management organizational changes.
- Management retention to ensure that human capital is retained.
    - Clear communication with management about the transition path.
    - Structuring of appropriate retention packages.

Step 4

- Divest Fannie Mae and Freddie Macs' mortgage guarantor businesses.
    - Potentially privatized as new PMGs, subject to Fed and FHFA supervision.
    - PMG concentration limits will be phased in over a 10 year period.
- Establish a charter process for new applicants / entrants.
    - Potentially give a window for capital relief or special treatment to attract new entrants.
- Merge Fannie Mae and Freddie Mac securitization functions with GNMA to create a single Securitization Utility.
    - GNMA to potentially explicitly guarantee legacy GSE MBS securities.
- Retained portfolio businesses combined and operated from a legacy asset wind down vehicle.

Step 5

- Establish new reinsurer to manage on-going credit reinsurance; parts of Fannie and Freddie to be contributed.

Other Key Parts of Plan

Note: Additional detail for the points below will be developed further in separate memos.

Affordability initiatives: Affordability initiatives are paid for and delivered in a separate and transparent way. To complement other existing affordable housing programs administered by HUD, state HFAs and other agencies, the Affordable Housing Trust (AHT) and Capital Magnet Fund (CMF) will be funded by a direct fee on the mortgage finance system. A portion of the funding could also be allocated to support other new initiatives (potentially including matched savings). There are open questions on how any direct fees will be assessed and what level of funding is appropriate. The fee could be assessed on (1) all MBS explicitly guaranteed by the USG, (2) all securitized MBS, or (3) all mortgages originated. This question is discussed in detail in a separate memo. FHA will continue to provide credit to lower-income and first time home buyers.

Single Family Conforming Loan Standards: In the February 2011 Housing Reform White Paper, the Administration signaled that down payments would need to be higher and loan sizes would need to be smaller for future "conforming" loans. We will need to determine what specific conforming loan standards/limitations should apply to government liquidity and securitization funding support for single family loans. The narrower the range of products offered by PMGs, the easier it will be for regulators, investors and market participants to track the risks that the PMGs are taking. Similarly, more complex products provide greater opportunities for firms to arbitrage capital requirements and take on unseen risks. Limiting the types of products offered can reduce excessive risk taking, but needs to be balanced against the possibility that it will hinder the ability to obtain shorter duration mortgages during periods of cyclically high rates. We will also need to consider the interplay between the PMG conforming loan standards and the FHA conforming loan standards and how differences (if any) will influence FHA market share and government risk.

Multifamily Conforming Loan Standards: Government liquidity and securitization funding support for the multifamily market should be limited to (i) non-luxury (class B and C[4]) properties for lower- and middle-income renters, including small unit properties (5 - 49 unit properties), (ii) the development and preservation of affordable properties, and (iii) properties in underserved communities. Class A luxury properties would not be eligible.

Regulators should set minimum prudent multifamily mortgage product and underwriting standards, including: maximum LTVs, minimum debt service coverage, amortization periods, interest rate features and tenure restrictions.

Limit FHA and FHLB system as a provider of subsidized financing: Absent parallel reforms, FHA and the FHLBs would become relatively cheap sources of mortgage financing if GSE successors are required to hold Basel III equivalent levels of capital.

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[4] Class A properties represent the highest quality buildings in a market. They are generally the best looking buildings with the best construction, and possess high quality building infrastructure. Class B properties are generally a little older, but still have good quality management and tenants. Class C properties are the lowest classification of an office building. They are very old buildings, are located in less desirable areas and need extensive renovation.

FHA: FHA reform will ensure that FHA has a more targeted single family footprint in normal times (from 30 percent+ today to, ideally, 10 - 15 percent in normal markets). The FHA footprint should be reduced through higher pricing and greater restrictions on eligible borrowers (changes in loan limits and perhaps means testing). The maximum FHA combined loan-to-value (CLTV) cap should be reduced to 95 percent (down from 97.5 percent today). Further reforms, such as converting FHA into a government corporation to increase flexibility and independence, can also be considered. FHA would support affordable multifamily housing, especially for construction and rehabilitation properties, federally assisted properties, and smaller properties through risk-sharing, as well as serving as a back-stop in times of market stress.

FHLB system and Covered Bonds: Taxpayer exposure and potential systemic risk should be reduced by structural reform. The February 2011 Housing White Paper included specific FHLB reforms such as establishing advance caps, returning to single-district membership, and imposing portfolio restrictions on investment securities. As a funding alternative to advances for large institutions (who have sufficient access to capital markets), covered bond legislation could be included as part of FHLB reform. The key open question is how covered bonds should be treated in receivership and the relationship to the Deposit Insurance Fund (DIF).

Fee for Service Master Servicing Model: Future PMGs could follow a fee for service model at a rate determined by the private market. As the holder of credit risk, the PMGs will retain master servicing rights and contract back servicing to sub-servicers, such as the originator, independents, special servicers, etc. A fee for service model will reduce the presence of MSRs on originators' balance sheets, as well as align incentives with credit investors. GSEs can migrate to a fee for service model in the near-term, which will change the industry model in advance of broader reform.

National Servicing Standards and Borrower Bill of Rights: Basic servicing standards will be set through (i) global settlement process underway, (ii) CFPB, (iii) further regulatory action and (iv) specific legislative recommendations as part of the reform process.

Lien Priority: First lien enforcement rights should be increased and the Garn–St. Germain Depository Institutions Act of 1982 should be repealed and/or modified so that Second Liens cannot be incurred without either (i) permission of the First Lien or (ii) falling inside the original LTV of the First Lien, 80% of current value, or the original balance of the First Lien at time of origination.

Foreclosure Laws: Establish model foreclosure rules for states. While this is still an open item, Treasury staff continues to work on the best way to implement this reform.

Mortgage Title Registry: We would like to develop a national mortgage title registry system to upgrade or replace the Mortgage Electronic Registration System (MERS) and develop statutory requirements that support such a system. The new system would be funded by industry participants.

Tax Code/MID: We recognize the government supports housing through the tax code, primarily through the mortgage interest tax deduction. This plan does not consider changes to the tax code, but this is an area that should be explored in a subsequent discussion regarding fiscal and tax policy.

Areas for Further Analysis

In addition to developing further policy recommendations around other key parts of the reform plan, the following questions and topics are areas which will require further analysis and discussion, in particular with the Federal Reserve, FHFA, and the FDIC as the plan is developed:

1) Description and consideration of how the securitizer will handle TBA pooling and rules around the TBA market.
2) Analysis of the interplay of proposed reforms with existing regulatory structures and arrangements, including how Basel 3 capital standards will be applied to PMGs and the implications of the 5% leverage ratio.
3) How will firewalls, conflict of interest, and cross-subsidization be managed by BHCs with a PMG subsidiary?
4) Discussion on how the resolution of a failing PMG will be handled, including the role of various regulatory agencies and interplay between other affiliates of a BHC.
5) What limitations on risk based pricing and ability to selectively offer guarantees should be required? Should there be any form of duty to serve beyond CRA?
6) Further analysis and consideration of structure and application of the USG explicit reinsurance guarantee, including how to set and apply the fee, how the reserve fund will be managed (including what to do with any excess funds over time), budgetary treatment and regulatory structure
7) Consideration and explanation of how the proposed system will perform and respond at various points over the economic/business cycle, including a discussion of how best to design the system to be counter-cyclical.
8) Expected market shares of PMGs over time in both a steady and stressed market environment.
9) Additional analysis discussing QRM/QM/Conforming Loan standards, including QRM versus PLS market share over time under both a steady state and under stress.
10) Description and consideration of how small, medium and large financial institutions will participate in the proposed market mortgage system and how market access would work for first time home buyers, move-up borrowers and investor properties.
11) Description and consideration of the source of equity and debt capital for PMGs and the composition of their capital structure.
12) Comparison to alternative market structures, such as a new duopoly, a New York Fed type Co-op, or Federal Reserve run system, as well as models proposed through congressional legislation (such as the Miller-McCarthy national utility, Campbell-Peters PMG model, and Isakson bill).
13) Description and consideration of how the proposed system will impact the cost of mortgage financing for borrowers, including a comparison to other proposed mortgage reform plans.
14) Discussion of how monoline PMGs will be competitive with affiliated PMGs.

EXHIBIT 29

From: Chepenik, Adam
Sent: Thursday, March 01, 2012 12:02 PM
To: Roberts, Benson; Graves, Donet (Don); Auer, LanceDisabled; Kim, Moses (Walter); Sacco, GeorgeDisabled; Rosen, Katheryn; Dworkin, David; Hidalgo, Bibi; McRaith, Michael
Cc: Bowler, Timothy; Foster, JeffDisabled; Mlynarczyk, Beth
Subject: Millstein Housing Reform Presentation
Attachments: Millstein Housing Finance Reform Materials (021412).pdf

Hi everyone,

Cap markets thought it would be helpful to circulate some of the best internal housing presentations and papers to everyone.

We will send that material to you as soon as possible.

In the interim, we attached the Millstein report that was mentioned during our last meeting.

SENSITIVE / PRE-DECISIONAL

____
Adam B. Chepenik, CFA
Senior Policy Advisor
Department of the Treasury | Office of Capital Markets
1500 Pennsylvania Avenue, NW | Washington, DC 20220
202-622-2534 (w) | 301-346-2006 (m) | 202-622-2027 (f)

February 14, 2012

Housing Finance Reform – Restructuring the Government's Role

Note

We may purchase and sell securities, derivatives and other instruments issued by one or more entities which are the subject of this report and may currently or in the future provide advisory, investment banking and other securities related services to such entities and to investors in the securities issued by such entities.

- Millstein & Co., LLC

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I. Proposal Review

Proposal Summary

- **The most realistic way forward for policymakers on housing finance reform is built upon two key elements**
  1. To provide a housing finance system that can support a strong U.S. economy while protecting taxpayers, we propose that the government sell reinsurance on safe mortgages with private markets first in line for losses
  2. To pave the way to that system without risking another recession and while repaying taxpayers for past support, we propose reorganizing, recapitalizing, and privatizing Fannie Mae and Freddie Mac

✓ **Restarts private markets**

- Provides a smooth path to a new system in which the private sector plays the leading role, there is sufficient private capital to absorb losses in most situations, and taxpayers are compensated for providing an unavoidable public backstop
- We must accept that private markets alone *do not* and *will not* have sufficient capital to support our housing system

✓ **Ends the conservatorships**

- Obligations to MBS and Agency debt holders are met, non-core businesses are wound down, and newly-chartered, adequately-capitalized Fannie and Freddie provide a bridge to a new, more stable housing finance system

✓ **Repays taxpayers**

- Privatization allows Treasury to recoup over $150 billion of taxpayer investments in Fannie and Freddie

✓ **Protects our economy**

- Avoids a sudden reduction in mortgage credit that would depress house prices and risk another recession
- Provides the most expedient path to recovery

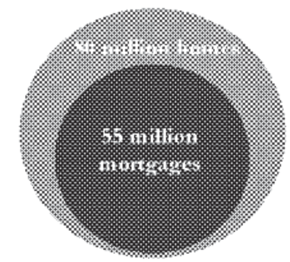
✓ **Ensures affordability**

- Housing credit can normalize, remain available during times of stress, and the 30-year fixed-rate mortgage will still exist

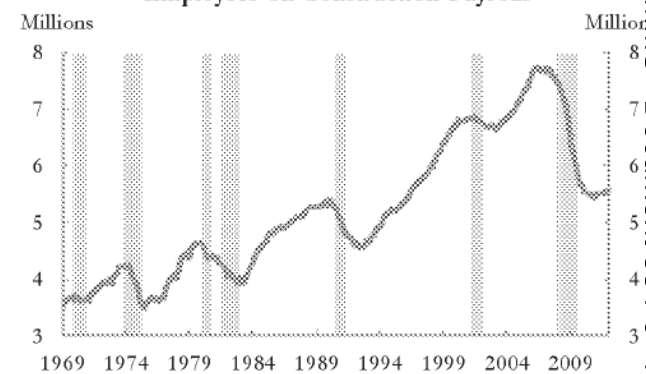
Housing Finance Is Critical to the U.S. Economy

- **If mortgage credit were not widely available, the dream of homeownership would be unfulfilled for most Americans**
  - Over two thirds of America's homes have a mortgage
- **The U.S. economy suffers if mortgage credit is not available**
  - Home construction usually leads the U.S. economy out of recessions and provides jobs for millions of Americans
  - Stagnant growth in housing continues to slow our economy, and a dysfunctional mortgage market exacerbates the problem
- **The most valuable asset of many Americans—their home—depends on mortgage credit**
  - Without financing, demand for homes and house prices would plummet
  - Americans have already lost over $7 trillion of wealth in their homes since 2006, and the middle class has been hit the hardest
  - Another large drop in household wealth would shrink consumption and provide another headwind to economic recovery

U.S. Housing Market

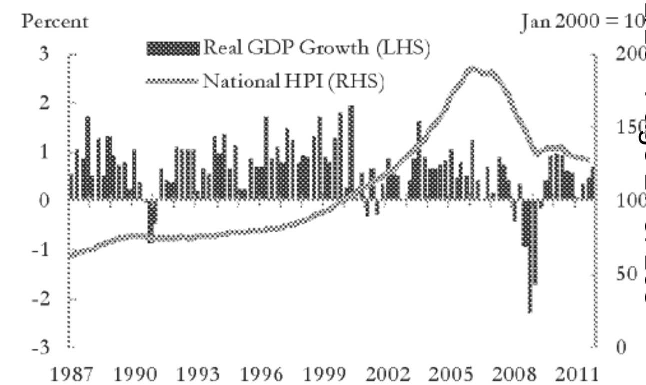


Employees on Construction Payrolls



Source: Bureau of Labor Statistics.
Notes: Gray bars indicate recession periods.

House Prices and GDP Growth



Source: Bureau of Economic Analysis; S&P/Case-Shiller.

Time For Action Is Now

Three years after the housing bubble burst and the government placed Fannie Mae and Freddie Mac into conservatorship, the housing market remains alarmingly fragile

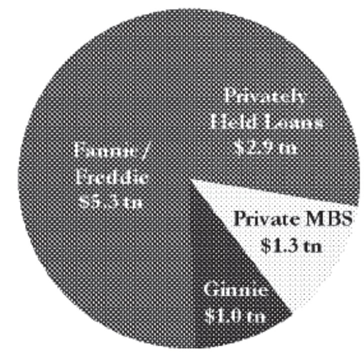
- **The tenuous state of the housing market remains an imposition to broader economic recovery**
  - Sluggish income growth, stubbornly high unemployment and overcorrection in lending standards have made it difficult for households to buy homes, despite historically low interest rates and the massive correction in house prices
  - The unprecedented destruction of household wealth with the financial crisis brings an associated reduction in consumption
  - Limited access to mortgage credit puts downward pressure on demand and therefore house prices
  - The current imbalance between supply and demand and negative equity in many homes could lead to a "death spiral" of defaults and reduced house prices
    - The foreclosure process inflicts non-quantifiable damage on taxpayers and can create "deadweight losses," which benefit no one and negatively impact house prices
  - The inability for borrowers to refinance at today's historically low rates mutes monetary policy transmission
- **Uncertainty over the housing market and the government's role in mortgage finance begets uncertainty in the jobs markets and in the future for the economy, and vice versa**
- **The futures of Fannie and Freddie are inextricably linked to these issues**
  - Laying out a plan for Fannie and Freddie and the government's role in housing finance going forward could bring some much-needed confidence back into the housing market and, by extension, the economy more broadly

Meanwhile, The U.S. Housing Finance System Is on Life Support

- **In 2008 the government effectively nationalized housing finance**
  - Fannie and Freddie were placed in conservatorship, along with exposure to over $5 trillion residential mortgages—half our nation's total
  - Treasury promised to provide an unlimited amount of capital to allow them to "meet their debt obligations and honor their guarantees", and it has invested over $150 billion in the companies to keep them going
  - The Federal Reserve and Treasury have purchased nearly $1.5 trillion of mortgage securities guaranteed by Fannie and Freddie to keep markets liquid
  - The Federal Housing Administration, Department of Veterans Affairs, and Ginnie Mae dramatically expanded their mortgage programs
- **Today the government accounts for over 90 percent of new mortgages in the U.S.**
  - Most banks are making home loans only because the government guarantees them against default
  - That guarantee is also necessary for investors to continue buying mortgage-backed securities, which ultimately fund the majority of U.S. home purchases
- **Even with significant government support and low mortgage rates, lenders and investors are skittish and housing credit is not widely available**

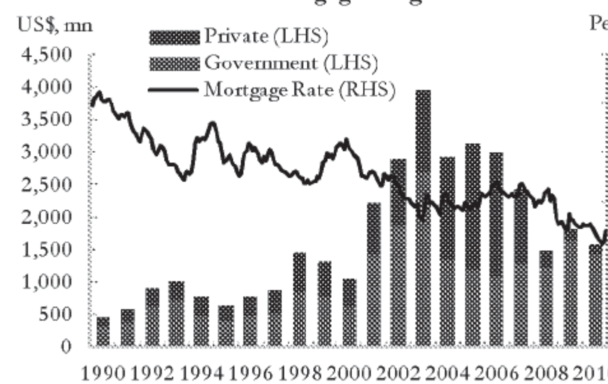
- **Three years after nationalizing housing finance, the government still has no viable long-term plan for Fannie and Freddie or to facilitate the return of private capital to this important market**

Exposure to Residential Mortgages Outstanding, 2010



Sources: Federal Reserve Board; Inside Mortgage Finance.
Notes: One-to-four family mortgages. Does not include multifamily mortgages. Fannie/Freddie estimate reflects MBS they guarantee and loans in their portfolio.

U.S. Residential Mortgage Originations and Rates

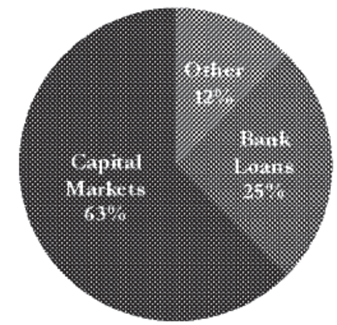


Sources: Federal Reserve Board; Inside Mortgage Finance.
Notes: One-to-four family mortgages. Does not include multifamily mortgages.

The Government Cannot Abandon Housing Finance Completely

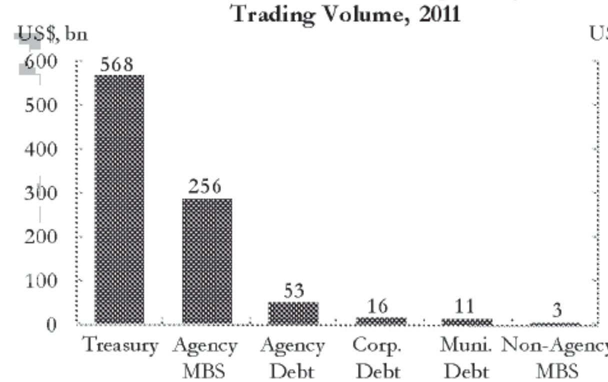
- **Our housing finance system depends on credit provided by non-bank investors who will disappear if the government abandons the market**
  - Domestic and foreign investors provide more than half the funds that ultimately go to homebuyers to finance the purchase of a home
  - Government insurance against loss from default on residential mortgages has facilitated the growth of this funding source and has made the market for Fannie and Freddie mortgage-backed securities (MBS) one of the biggest and most liquid credit markets in the world
  - Without a government guarantee against default, investor appetite and funding for residential mortgage securities would be substantially reduced
  - Without deep and liquid capital markets to fund residential mortgages, home prices would fall sharply and household wealth would shrink, hitting middle-class homeowners the hardest
  - Going forward, a purely private system of housing finance would be susceptible to more frequent booms and busts
- **Previous attempts in the U.S. to rely on purely private mortgage markets failed, and the alleged success of such systems abroad is a myth**
  - In each instance, the government stepped in and backstopped major mortgage finance institutions
- **Unless we are willing to suffer a severe recession and reduction of housing credit, the government will continue to backstop the mortgage market**
- **Policymakers' choice is whether to make that backstop explicit and appropriately priced, or to perpetuate implicit guarantees and bailouts**

Sources of Funding for Residential Mortgages Outstanding, 2010



Sources: Federal Reserve, Inside Mortgage Finance.
Notes: Bank loans include loans retained by commercial banks and savings institutions.

U.S. Bond Market, Average Daily Trading Volume, 2011

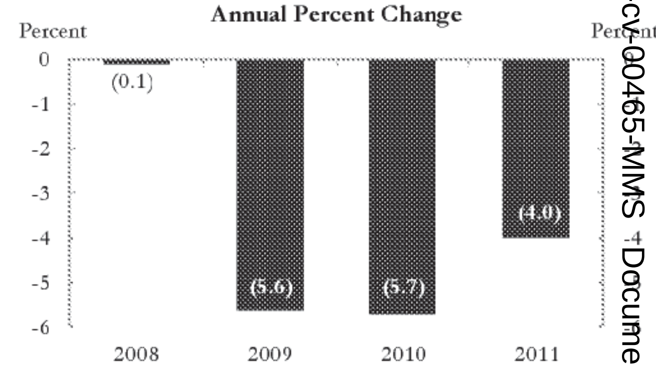


Source: SIFMA.

In the Transition, We Must Be Realistic About The Availability of Private Capital

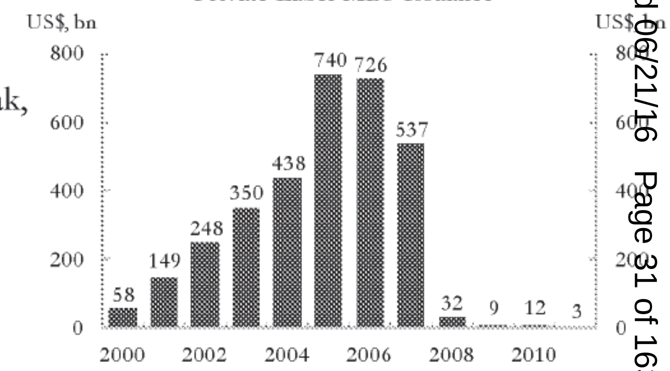
- **The financial crisis revealed that most institutions providing housing credit were grossly undercapitalized**
  - When home prices dropped precipitously, many proved to be insolvent
  - The government intervened and provided capital backstops to the banking system and to Fannie and Freddie
  - Without that backstop, half of U.S. mortgage financing would have disappeared
- **Today there is still not enough private capital to support our housing market**
- **Banks cannot replace Fannie and Freddie**
  - They are deleveraging and reducing mortgage risk to repair their capital, and they will soon face additional capital requirements from Basel III, forcing further diversification away from mortgage lending
- **Private mortgage insurers cannot replace Fannie and Freddie**
  - With less than $10 billion of capital today and $17 billion of capital at their peak, they do not have sufficient funds to step in, nor will they anytime soon
- **Private-label MBS markets cannot replace Fannie and Freddie**
  - Severely diminished today, at their peak they provided less than $800 billion of credit for new originations

Real Estate Loans Held by Commercial Banks, Annual Percent Change



Source: Federal Reserve.

Private-Label MBS Issuance



Source: SIFMA.

- **Recapitalizing and privatizing Fannie and Freddie is the most realistic path forward for the government to reduce its footprint in the mortgage market, leveraging the infrastructure already in place and under government control**

Reform Criteria – A Path to Restarting Private Mortgage Markets

- **Any sensible exit by the government from the status quo must meet five objectives**

  1. **Protect the economy**
     - A rapid withdrawal of government support for mortgage credit will drive down house prices and destabilize the broader financial system
  2. **Fulfill the government's promise to holders of Fannie and Freddie MBS and debt securities**
     - These are the same investors that fund Treasury debt
     - We cannot afford to undermine the credibility of the full faith and credit of the United States, given our mounting debt burden and continuing borrowing needs
  3. **Provide an explicit, appropriately-priced government backstop for qualified mortgage products, not entities**
     - The government should regulate financial entities involved in mortgage credit, not underwrite balance sheet risks
  4. **Ensure adequate private capital**
     - Private mortgage insurers and securitizers must be adequately capitalized to absorb all losses in most downturns, protect the government against losses on its backstop, and avoid the need for future government bailouts
  5. **Protect taxpayers**
     - Taxpayers should be repaid for supporting the housing market to date and during the transition to a new system

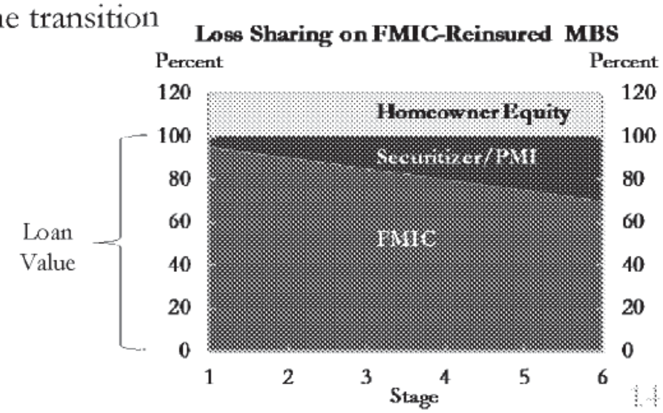
- **The end state and transition are equally important and must be realistic**
  - Acting on thought exercises about theoretically ideal end states untethered to current market realities could lead to massive economic dislocation and further government losses

Create a Federal Mortgage Insurance Corporation (FMIC)

- **The FMIC would have three functions**
  1. Establish standards for qualifying mortgage products and practices
  2. Reinsure MBS comprised of mortgages that meet stringent underwriting and disclosure criteria
  3. Supervise participating MBS securitizers and private mortgage insurers for safety, soundness, and capital adequacy
- **The FMIC's mandate would be to ensure stable credit for the housing system and to protect taxpayers against loss**
  - No affordability goals
- **The FMIC would be an independent agency**
  - It must be insulated against political interference on the model of the Federal Deposit Insurance Corporation (FDIC)
- **Nature of FMIC's reinsurance and fees**
  - Securitizers and private mortgage insurers (PMIs) are first in line to cover losses in MBS pools reinsured by the FMIC
  - For a fee, the FMIC would guaranty incremental shortfalls in MBS payments
  - Reinsurance fee would be determined by reference to private insurance markets and adjusted to smooth transition to the new system, address stress in financial markets, and recoup losses over time, like other successful government insurance programs
  - Similar to FDIC Deposit Insurance Fund, fees collected by the FMIC would be placed in a reserve fund that builds over time
- **Conditions for FMIC reinsurance**
  - Available for qualified MBS from any securitizer that meets the FMIC's minimum capital standards, subjects itself to the FMIC safety and soundness regulations, provides limited warranty on underwriting, and pays reinsurance fee
- **Successful precedent**
  - Terrorism Risk Insurance Act and FDIC

FMIC Transition Plan

- **Start up**
  - The FMIC could be capitalized with revenues from a portion of guarantee fees charged by Fannie and Freddie
  - Revenues from the 10 basis point increase in their guarantee fees required by the Temporary Payroll Tax Cut Continuation Act of 2011 is a sensible starting point
    - This could be a deficit neutral transaction using scoring that applies to other Federal guarantee programs
  - In exchange the FMIC would reinsure all outstanding Fannie and Freddie MBS, which would fulfill the government's commitment to owners of those securities and provide market stability through the termination of the conservatorships
- **Creating a competitive, efficient marketplace**
  - The FMIC would offer reinsurance on qualified MBS on equal terms to Fannie, Freddie and all securitizers and PMIs who meet their regulatory criteria
  - FMIC regulations would improve transparency in the mortgage origination, securitization and enforcement process by establishing nationwide standards as the quid pro quo for its guarantee
  - To preserve the To-Be-Announced market, the SEC would continue the current exemptions to Regulation AB in favor of all securitizers deemed sound by the FMIC
- **Scaling the government's role over time**
  - Private mortgage insurers do not have sufficient capital to underwrite all conforming loans currently in existence, which is why a recapitalized and re-chartered Fannie and Freddie is necessary in the transition
  - The price of the FMIC's guarantee will determine how much of the MBS universe the government reinsures as Fannie and Freddie's existing guarantee book rolls over
  - The FMIC could scale down its role and exposure over time by increasing the attachment point for the private sector's loss share
- **Regulation**
  - FHFA staff with appropriate expertise would join the FMIC



Reorganize, Recapitalize, and Privatize Fannie Mae and Freddie Mac

- **To allow for a smooth transition, the government should reorganize, recapitalize, and privatize Fannie and Freddie**
  - Fannie and Freddie are the "only game in town" for mortgage credit, so their reorganization is the critical bridge to a more balanced housing finance market

- **The government must take advantage of their in-place infrastructure, dominant market position and favorable government financing in conservatorship to rebuild their capital base to protect the FMIC against future losses, to put an end to the conservatorships and to privatize them in order to get Treasury's invested capital back**

1. **Immediately raise the guarantee fees (g-fees) that Fannie and Freddie charge on MBS to build capital**
   - Raising g-fees to more market rates, while also streamlining refinancing opportunities for the entire book of guaranteed mortgage in this historically low rate environment, not only would serve to build capital faster to protect taxpayers from future loss, but also could provide a significant economic boost more broadly
     - Increasing g-fees could also accelerate the normalization of underwriting standards—particularly tight today—which would broaden the base of available mortgage credit for consumers
   - Raising g-fees, which compensate for credit risk, to a level that can achieve market rates of return would attract ("crowd in") competition from private capital for FMIC-reinsured MBS and create conditions where new private label securitization products might flourish
   - The FHFA is currently examining what g-fee increases are warranted in order to reflect the risk of loss and cost of capital allocated to similar assets held by fully private regulated financial institutions, an exercise that should result in significantly higher guarantee fees going forward

2. **Eliminate the dividend on the outstanding Treasury Preferred Stock so that Fannie and Freddie can use revenues from the increased g-fees to rebuild their capital base and protect taxpayers from future losses**
   - Initially, the existing Treasury Preferred should be converted into a non-cumulative preferred stock
   - The FHFA projects that Fannie and Freddie will start to out-earn their dividend obligations to Treasury starting in 2013
   - It makes more sense to use earnings to build capital towards a long term solution for our nationalized housing finance problem than for short-term initiatives unrelated to solving the government's housing problem

Fannie and Freddie Recapitalization Plan (cont'd)

3. **Refocus on core guarantee businesses and wind down the "retained portfolios" of mortgages and mortgage-related securities**
   - Fannie, Freddie and the Federal Reserve should coordinate to manage the wind-down in order to maximize value to taxpayers, and mitigate conflicts with ongoing guarantee businesses
4. **Build reserves at the FMIC to protect taxpayers from future losses**
   - Remit revenues from a portion of the g-fees charged by Fannie and Freddie to the FMIC in exchange for reinsurance on all of their MBS outstanding, allowing the FMIC to begin to build its reserve fund
5. **Terminate the FHFA conservatorships once Fannie and Freddie have sufficient capital to give the FMIC comfort that, together with amounts on deposit in its reserve fund, the government is adequately protected against losses on outstanding MBS that the FMIC has reinsured**
6. **By the time the conservatorships are terminated, the Financial Stability Oversight Council (FSOC) should designate Fannie and Freddie "covered financial companies," subject to enhanced supervision by the Federal Reserve**
   - As beneficiaries of the FMIC's reinsurance, the new Fannie and Freddie would also be regulated primarily by the FMIC for safety and soundness
7. **Install ordinary, non-politicized corporate governance by re-chartering Fannie and Freddie as Delaware corporations**
   - No special privileges would continue going forward (e.g., the right to borrow from Treasury), nor would certain policy-oriented burdens (i.e., affordable housing mandates or "goals" apart from those generally applicable to all financial institutions, such as Community Reinvestment Act requirements)
8. **Recover the taxpayers' investments**
   - After transforming Fannie and Freddie into profitable, adequately capitalized go-forward entities, Treasury can convert its preferred stock to common stock and divest its stake over time into the public equity markets
   - The liquidity of common stock positions in profitable, well capitalized entities will allow Treasury to recover its investments in Fannie and Freddie far more rapidly than waiting for its preferred stock to be redeemed over time
   - Treasury is using this strategy today to divest its ownership stake in AIG

Recapitalization and Privatization Analysis

- **In its baseline projection, the FHFA expects Fannie and Freddie to out-earn the dividends they owe to the Treasury Department for its support**
  - As Fannie and Freddie become profitable, it makes sense to build capital in order to establish them as well-capitalized PMIs during the FMIC transition and, in the subsequent privatization process, give taxpayers a chance to recover all of Treasury's investment in their Preferred Stock
  - If the dividend on Treasury's Preferred Stock were suspended, Fannie and Freddie would be able to build Tier 1 Capital of over 8% by YE 2016, which would provide a substantial cushion against loss on the FMIC's reinsurance of their outstanding MBS securities
  - Higher g-fee income replaces earnings from investment portfolios over time
- **A large-scale refinancing program with higher g-fees that still allows borrowers to take advantage of historically low rates would accelerate the transformation of Fannie and Freddie's earnings and capital**
  - Would also support housing activity more broadly through lower potential default rates and a corresponding positive impact on house prices
- **The analysis at right demonstrates that, with market-based g-fees and investment portfolios sized solely for liquidity purposes, Fannie and Freddie could have the earnings power to provide taxpayers with enough value to repay Treasury's net cash investments in the two entities**

FHFA ESTIMATED UST PREFERRED DRAWS

$ billions	3Q 2011 Total Draw	3Q 2011 Total Divs	FHFA Baseline 3Q11-2014 Incr. Draw	FHFA Baseline 3Q11-2014 Incr. Divs
Fannie	$113	$17	$38	$45
Freddie	72	15	5	24
Total	185	32	43	69

Note: FHFA October 2011 projections adjusted for 3Q11 results.

HYPOTHETICAL FUTURE GSE ANALYSIS

$ in billions	Fannie	Freddie	Total
Size of Guarantee Book	$2,542	$1,558	$4,100
Net Guarantee Income, % of Book	0.55%	0.55%	0.55%
Guarantee Income	**$14**	**$9**	**$23**
Size of Investment Book	$150	$150	$300
Net Investment Income, % of Book	0.90%	0.90%	0.90%
Investment Income	**$1**	**$1**	**$3**
Size of Multifamily Book	225,000	160,000	385,000
Net Investment Income, % of Book	0.60%	0.60%	0.60%
Multifamily Income	**$1**	**$1**	**$2**
Normalized Provision Rate	(0.05%)	(0.05%)	(0.05%)
Normalized Provisions	**($1)**	**($1)**	**($2)**
Tax Rate	30.0%	30.0%	30.0%
Net Income	**$11**	**$7**	**$18**
Assumed Valuation Multiple	10.0x	10.0x	10.0x
Implied Market Capitalization	**$108**	**$71**	**$179**
Treasury Ownership	85.0%	85.0%	85.0%
Treasury Share	**$92**	**$60**	**$152**
% of YE 2012E Net Investment	*105%*	*119%*	*110%*

- **As government accounting has not contemplated any recovery of Treasury's Preferred Stock investments in Fannie and Freddie, selling common equity stakes into the public markets could represent <u>$152 billion in net deficit reduction</u>**

Transition Timeline

- Draft legislation for FMIC, Fannie and Freddie recapitalization plan and broader housing finance reform

- Pass drafted legislation
- Complete conversion of outstanding Treasury Preferred to new non-cumulative preferred stock in order to relieve Fannie and Freddie of the dividend

- Stand up FMIC
- Allow Fannie and Freddie to build capital
- Implement broader legislation and rule writing

- Raise g-fees
- Wind-down portfolios

2012 | 2013 | 2014-2015 | 2016 | 2017-2020 | 2021+

- Terminate conservatorships
- Convert all preferred stock to common stock at a valuation that provides Treasury full recovery of net cash investment
- In concert with the conversion, conduct an equity rights offering to public investors in order to accelerate Treasury repayment
- Impose go-forward regulatory regime under FMIC and FRB

- Divest remaining Treasury common stock position in the public equity markets over time

- FMIC monitors the housing market on an ongoing basis to prevent future instability through potential adjustments to credit standards

II. Reforming Housing Finance – Fundamentals

Summary – Fundamentals of Housing Finance

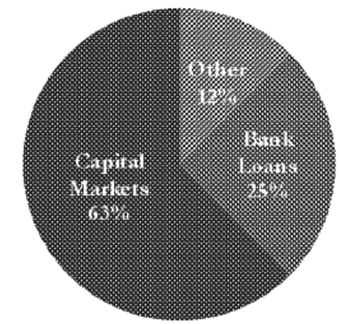
In this section of the proposal, we describe three fundamental attributes of a healthy housing finance system

- **Market structure**
  - Securities markets are essential to housing finance, providing roughly two thirds of funding for home loans
    - Banks and other lenders cannot substitute for the housing credit that securities markets provide
  - To keep most investors in the housing market, mortgage securities cannot expose them to a risk of homeowner default
  - If mortgage securities investors withdrew significantly, the economy would suffer
- **Market liquidity**
  - Attracting private investors to mortgage markets depends to a large degree on the liquidity of those markets; that is, the ease with which buyers and sellers can find each other and conduct transactions at any point in time
  - Markets for government-guaranteed mortgage securities are currently extremely liquid
  - A significant decrease in that liquidity will cause many domestic and foreign investors in mortgage securities to flee
- **Market stability**
  - Housing finance reform should ensure availability of mortgage credit during times of stress, avoid contributing to housing booms, and reduce the government's footprint in the market

Market Composition

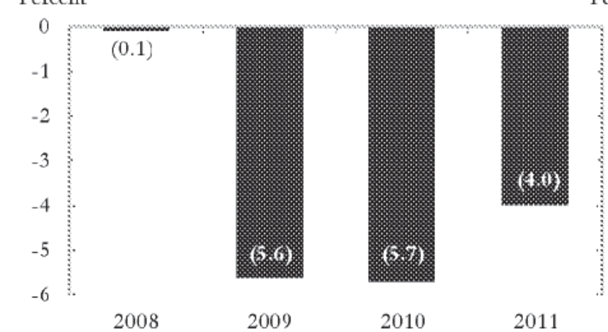
- **Capital markets are essential to U.S. housing finance**
  - Securities investors provide nearly two thirds of housing credit
  - Home loans are transformed into securities marketable to investors through a process called securitization
    - Loans from banks and other originators are pooled to create mortgage-backed securities (MBS)
    - Investors in MBS purchase rights to principal and/or interest payments on the pool of loans
    - Loan originators, such as banks, are essentially reimbursed for the mortgages they underwrite
  - Securitization can separate credit risk—possible default by homeowners—from market risk—the risk that interest rate changes or prepayments could lower the value of a loan
  - Most MBS investors will not accept the risk of homeowner default (credit risk)
  - Securitization thus provides a vehicle for capital markets to expand the pool of U.S. mortgage funding
- **Banks do not have the capacity to finance the entire housing market**
  - Accounting for only 25 percent of housing credit today through retained loans, banks are reducing mortgage risk to repair their capital, and they will soon face additional capital requirements from Basel III, forcing further diversification
    - Commercial banks have reduced their real estate loan portfolios by 15 percent or approximately $600 billion since 2007
  - If banks had to fund more of the housing market, it would mean less financing for businesses and other consumption, slowing the U.S. economy

Sources of Funding for Residential Mortgages Outstanding, 2010



Sources: Federal Reserve, Inside Mortgage Finance.
Notes: Bank loans include loans retained by commercial banks and savings institutions.

Real Estate Loans Held by Commercial Banks, Annual Percent Change

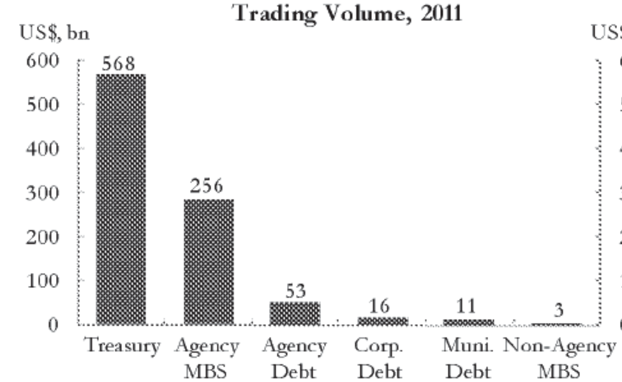


Source: Federal Reserve.

Market Liquidity

- **Attracting private investors to mortgage markets depends to a large degree on the liquidity of those markets**
  - Liquidity refers to the ease with which an asset can be purchased or sold
  - Many investors won't participate in a market if transaction costs are high or if prices move substantially when as asset is sold
- **Markets for U.S. mortgage securities are currently extremely liquid**
  - Only U.S. Treasury securities are traded more
  - The U.S. mortgage market is also the largest in the world
    - There is more mortgage debt outstanding in the U.S. than in all other countries combined
  - This liquidity attracts domestic and foreign investors, which fund so much of U.S. housing

U.S. Bond Market, Average Daily Trading Volume, 2011



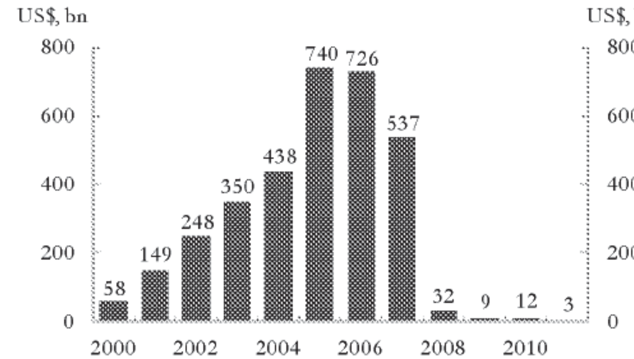
Source: SIFMA.

- **The To-Be-Announced (TBA) market is the most important secondary market for residential mortgages**
  - Contracts to purchase or sell conforming MBS to be delivered in the future on mortgage pools not yet identified
  - Consumers can lock in rates cheaply because lenders can pre sell mortgages and hedge against market risk cheaply
  - The TBA market also serves as a benchmark for other mortgage markets and pricing
  - This public good exists because products and processes are standardized, and the SEC grants exemptions from disclosure requirements in Regulation AB to Fannie, Freddie, and Ginnie Mae
  - Investors in TBA markets are willing to take on market and prepayment risk, not credit risk
- **As it changes the nature of its role in housing finance, the government should facilitate continued market liquidity**
  - Must take into account the nature of private investors who will finance the new system

Market Stability

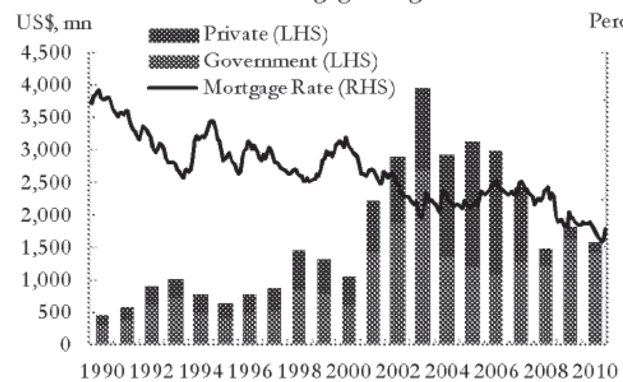
- **Mortgage markets can have a powerful impact on the economy**
  - House price booms and busts are frequently associated with large swings in economic growth and financial instability
  - Credit conditions and household leverage, along with income and population growth, drive house prices
  - Credit markets and household debt management tend to be pro-cyclical: During boom times, as the value of housing collateral increases, credit is widely available and higher leverage seems sustainable, feeding the boom, but when the bubble bursts, creditors retrench and households de-lever and default, further depressing house prices
  - We witnessed this phenomenon in the recent financial crisis, which plunged our economy into a deep recession
- **Purely private mortgage markets evaporated during the recent crisis**
  - Private-label MBS issuance collapsed from a peak of $740 billion in 2005 to $3 billion in 2011
  - Private mortgage insurers have had most of their capital wiped out
- **By nationalizing housing finance in 2008, the government prevented the housing system—and our economy and financial system more broadly—from collapsing**
  - Support for Fannie and Freddie, substantial increases in the loan guarantee programs at the Federal Housing Administration and Department of Veteran Affairs, and expansionary monetary policy have kept mortgage markets alive and rates low after private channels seized up
  - However, government support has required large taxpayer commitments, there is no clear plan for it to exit from its current dominant position in the market, and private mortgage markets remain moribund

Private-Label MBS Issuance



Source: SIFMA.

U.S. Residential Mortgage Originations and Rates



Sources: Federal Reserve Board; Inside Mortgage Finance.
Notes: One-to-four family mortgages. Does not include multifamily mortgages.

III. Reforming Housing Finance – Government's Role

Summary – The Government's Future Role in Housing Finance

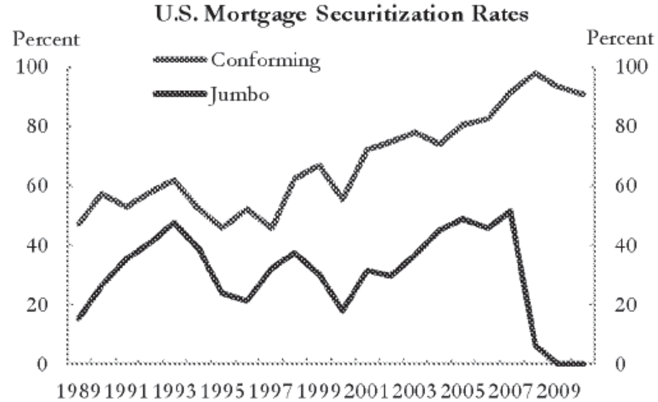
In this section of the proposal, we lay out the government's future role in housing finance

- **A cornerstone of the proposal is to create a Federal Mortgage Insurance Corporation (FMIC), which would provide an explicit guarantee behind private capital—that is, reinsure privately underwritten and guaranteed mortgages—for a fee that appropriately reflects risk**
  - It is unrealistic to expect that private markets can provide a stable source of financing for such an important sector of our economy without government support—it will exist, either implicitly through government support for banks or explicitly
  - However, private markets should bear losses in all but the worst of times, and the government should price its reinsurance appropriately to reflect its risk
  - This element of our proposal is a variation on the third option proposed by Treasury in its white paper, as well as proposals from economists Cliff Rossi, Phillip Swagel, and Mark Zandi, and from the Mortgage Bankers Association
  - The proposal is also consistent with other Federal programs, such as the Terrorism Risk Insurance Program and Federal Deposit Insurance, which cover potential market failures and are set up to recover costs over time—minimizing moral hazard through activity restrictions and supervision and minimizing possible taxpayer losses
  - Where our proposal differs is in the transition to the government's role as reinsurer: The fastest, lowest cost, and least disruptive way forward is to use Fannie and Freddie as they are restructured and privatized
- **The FMIC would also establish standards, promote transparency, and regulate participating securitizers and private mortgage insurers to facilitate an efficient and stable market**
- **To restart private-label securitization markets, new rules of the road need to be established**
  - Disclosure, servicing, and foreclosure
- **Housing affordability**
  - Affordability goals should be met by other Federal and state programs—not the FMIC or re-chartered Fannie and Freddie

Government Guarantee – Rationale

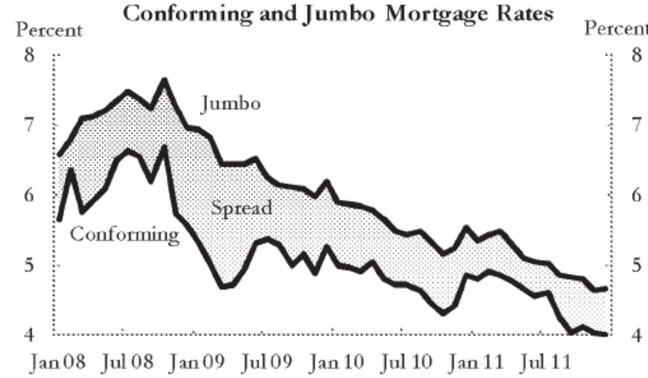
- **U.S. housing credit would shrink significantly without some form of government guarantee**
  - Most investors who currently support the mortgage securities markets do not want to face credit risk
    - They are conservative investors, like pension funds, or foreign investors who are too far removed from the underwriting process to accurately gauge the probability that a given homeowner will default, much less dozens of homeowners responsible for loans in an MBS pool. Credit ratings have proven unreliable. Without effective insurance against credit risk, most MBS investors will take their money elsewhere.
  - The private mortgage insurance (PMI) industry is far too small to replace current government guarantees on home loans
    - The PMI industry has less than $10 billion in capital and continues to shrink. If they underwrote insurance on the $4.4 trillion of MBS currently guaranteed by Fannie and Freddie, a minor dip in housing prices would wipe them out. Current investors in Fannie and Freddie MBS know this and would either charge much higher prices or stay on the sidelines.
  - Investors in private-label mortgage securities will not make up the difference
    - The small size, wide spreads, and relatively low securitization rate of the jumbo loan market demonstrate the lack of demand for mortgages securities without a government guarantee

U.S. Mortgage Securitization Rates



Sources Inside Mortgage Finance.

Spread Between 30-Year Conforming and Jumbo Mortgage Rates



Sources Bloomberg, Freddie Mac, BanxQuote.

Note: This section draws in part from Levitin, A., "Problems in Mortgage Servicing from Modification to Foreclosure", Testimony Before the Senate Committee on Banking, Housing, and Urban Affairs, Nov. 2010; Zandi, M. and Cris deRitis, "The Future of the Mortgage Finance System," Moody's Analytics special report, Feb. 2011.

Government Guarantee – Rationale (cont'd)

- **If there is a large shock to the housing system—like we experienced in 2007-08—the government will intervene**
  - It is irresponsible to pretend otherwise. The alternative is to risk an economic depression. Better to structure and price an explicit guarantee appropriately *ex ante* than to bail out the system *ex post*, thereby validate an implicit guarantee that engenders moral hazard, and either write off the cost of intervention—adding to fiscal deficits—or go through contortions to try to recover it fairly and without disrupting markets
- **Foreign countries with material mortgage markets do not operate without either an explicit or implicit guarantee**
  - The lauded covered bond markets in Denmark and Germany proved to be implicitly guaranteed: In October 2008, Germany established a bail out fund for its banks, and Denmark guaranteed all deposits and senior debt issued by banks
- **Previous attempts to rely on purely private mortgage securities markets in the U.S. failed**
  - Poor underwriting, misaligned incentives, lax regulation, and investors' inability to judge credit quality undermined them
  - Some economists argue that a government guarantee is not necessary for mortgages because private investors will impose discipline on originators, but U.S. history suggests otherwise

1870s and 1880s	1900s	1920s	2000s
Credit Foncier model where originators issued debt backed by their mortgage pools and investors assumed credit risk	New York title guarantee companies originated mortgages, insured them, and sold participation certificates backed by them	Single-property real estate bond backed by a single building and used to finance large construction projects	Private label mortgage securities
Failed because originators violated their underwriting standards and adversely selected collateral[(1)]	Failed because companies violated their underwriting standards and were poorly regulated and thinly capitalized	Failed because of poor underwriting. Led to Trust Indenture Act of 1939	Failed because of poor underwriting and regulation, and the inability of investors to evaluate credit risk

(1) There is evidence of similar adverse selection in prime jumbo securities issued in 2005 and 2006, the height of the recent bubble. *See* Elul, Ronel, Working Paper No. 09-21/R, Securitization and Morgage Default, Federal Reserve Bank of Philadelphia, Working Papers, 2011 (finding that securitized prime jumbo loans defaulted at rates 20 pereent higher than seemingly comparable non-securitized loans).

Government Guarantee – Rationale (cont'd)

- **Mortgage rates would increase significantly without a government guarantee**
  - Zandi and deRitis estimate mortgage rates in three different housing finance systems: nationalized, fully privatized and a hybrid model where the government provides reinsurance and the private sector stands in a first loss position, similar to what we propose below
  - Under a likely set of assumptions regarding required returns, they calculate that rates would be nearly 90 basis points higher in the fully privatized system than in they hybrid system—a difference of $118 per month for a typical borrower[(1)]
  - Choosing a fully privatized system over a reinsurance system would lead to a 375,000 annual decline in home sales, an eight percent decline in home prices, and a one percent decrease in the homeownership rate
  - Boyce estimates that rates would increase between 100 and 250 basis points without any government guarantee[(2)]
- **The U.S. economy and financial system would be less stable without a government guarantee on housing credit**
  - Private mortgage credit would disappear during times of stress, freezing home buying and construction
  - Without rigorously enforced underwriting criteria, the system will be susceptible to booms and busts like we just experienced. A secondary guarantee contingent on sound underwriting creates a financial incentive that is much more reliable than regulatory enforcement on its own
  - More housing risk would sit on the balance sheets of our largest banks, and they would have fewer sources of financing. These institutions have already proven to be a potent threat to financial stability
  - The pool of mortgage securities eligible for purchase by the Federal Reserve would shrink, constraining monetary policy
  - The 30-year fixed-rate mortgage would disappear. Shorter-term mortgage products would expose homeowners to the volatility of the business cycle, likely exacerbating downturns

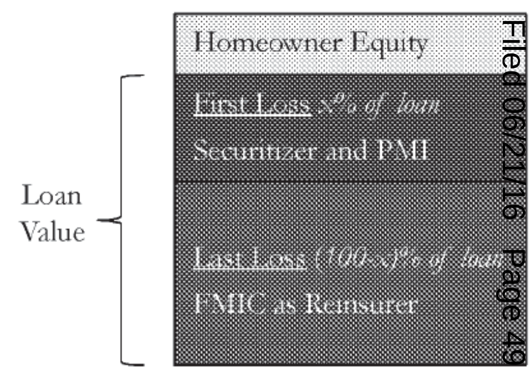
(1) They assume that private financial institutions require a 25 percent return on equity, the government requires a four percent return on equity, the private sector in the hybrid model absorbs the first three percent of losses, and in a privatized system there would be a 10-basis point liquidity risk premium and 25-basis point financial market premium. Both hybrid and private systems would be required to hold sufficient capital to withstand a 25 percent decline in house prices. Prior to the financial crisis, the mortgage system was capitalized to handle only a 10 percent decline. Simply moving to a more appropriate capitalization regime would increase rates by 30 basis points, according to the authors. For the monthly mortgage payment calculation, they assume a $200,000 fixed-rate 30-year loan at a six percent rate.

(2) Boyce, A., "Americatalyst: Ideas to Move the Market Forward", Absalon Project, Nov. 2011.

Government Guarantee – Structure Overview

- **Congress should establish a Federal Mortgage Insurance Corporation (FMIC) that would have three functions**
  - Reinsure MBS comprised of mortgages that meet stringent underwriting and disclosure criteria
  - Establish standards for qualifying mortgage products and practices
  - Supervise participating MBS securitizers and private mortgage insurers for safety and soundness
- **The FMIC's mandate would be to ensure stable credit for the housing system and to protect taxpayers against loss**
  - No affordability goals
- **The FMIC would be independent**
  - It must be insulated against political interference on the model of the Federal Deposit Insurance Corporation (FDIC)
- **Nature of FMIC's reinsurance**
  - Securitizers and private mortgage insurers (PMIs) are first in line to cover losses in MBS pools
  - For a fee, the FMIC would cover incremental shortfalls in MBS payments
  - The FMIC could increase the attachment point for the private sector's share of losses over time, while ensuring that investors are completely protected against credit loss
    - One way to structure this would be to require the securitizer and/or PMI to hold sufficient capital to cover up to a specified percentage of the loan value, but if they fail to meet that obligation, the FMIC would make securities holders whole[1]
  - Similar to the FDIC Deposit Insurance Fund, reinsurance fees collected by the FMIC would be deposited in a reserve fund that builds over time

Loss Sharing

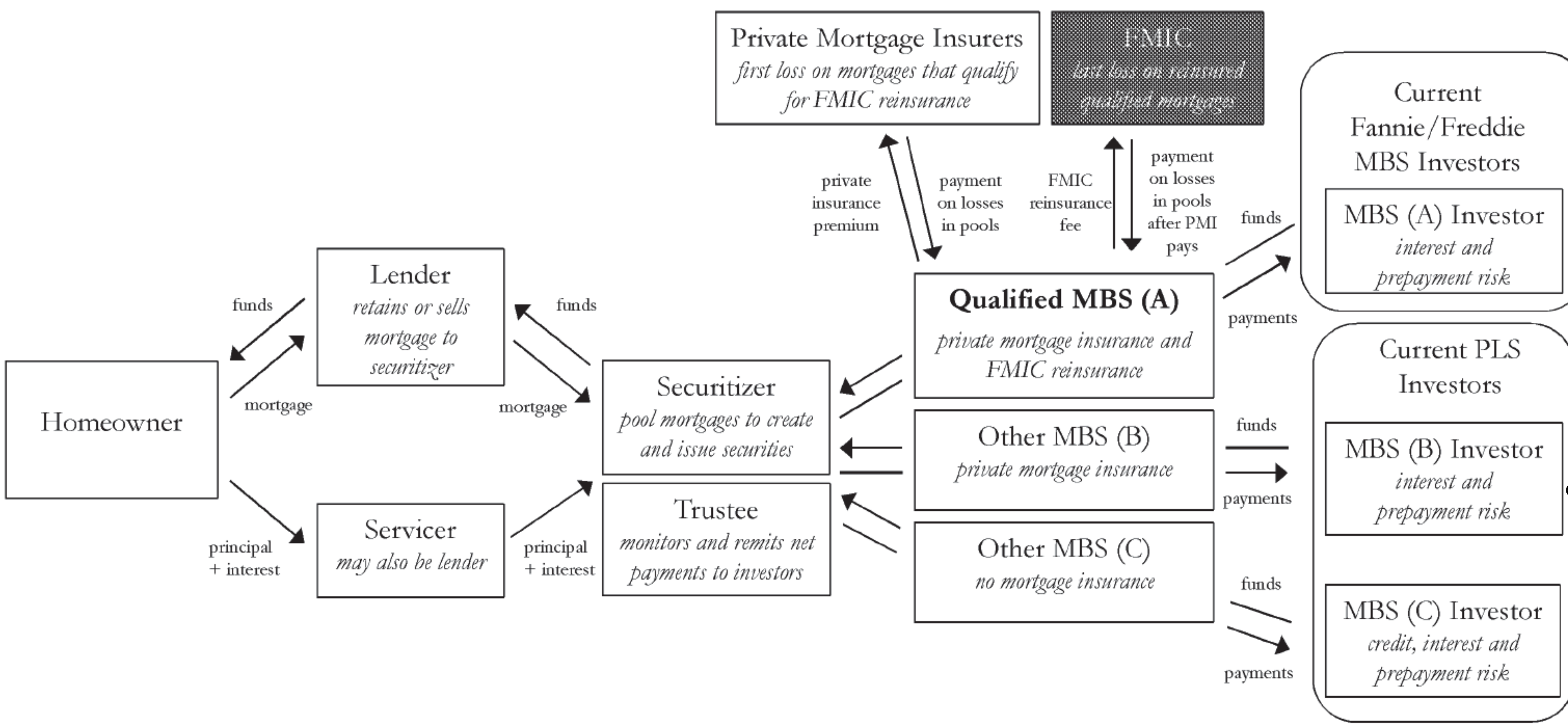


- **Conditions for FMIC reinsurance**
  - Available for qualified MBS from any securitizer that meets the FMIC's minimum capital standards, subjects itself to the FMIC safety and soundness regulations, provides limited warranty on underwriting, and pays reinsurance fee

(1) This would allow for a smooth transition to a better-capitalized PMI industry, which has very little capital today. A PMI would need to hold adequate capital against only a portion of the mortgage value, rather than 100 percent of its value. That would allow private sector to insure more credit for a given level of capital. But the FMIC could increase the required coverage and associated capital burden on the private sector over time.

Government Guarantee – Structure Overview (cont'd)

- **Price for reinsurance could be derived from private insurance markets**
- **Reinsurance price and private sector's loss share can be adjusted to smooth transition to new system, address stress in financial markets, and recoup losses over time**
  - Price will determine how much of the MBS universe the FMIC reinsures
  - Private sector's loss share and required capital level will determine the government's exposure on FMIC-reinsured MBS



Note: "PLS" = private-label mortgage-backed securities.

Government Guarantee – Structure Details

- **Qualifying mortgages and MBS**
  - Originators must adhere to strict underwriting standards and appraisal requirements
    - Ability to repay should be based on verifiable income, employment, assets, liabilities, and credit scores
    - Minimum down payment to protect loan value and align incentives between borrower and lender
  - No second liens, which can impair borrowers' ability to repay and complicate modifications, if they are warranted
  - Qualifying home loans should be full recourse to borrowers, and in exchange for eliminating strategic defaults by homeowners, processes to restructure unsustainable mortgage debt should be streamlined
  - Structures for MBS (e.g., pools, tranches) should be standard and transparent down to the loan level
- **Securitizers**
  - To create MBS, a sponsor acquires mortgage assets and deposits them, either directly or indirectly through a depositor, into a limited purpose entity, which issues certificates backed by the mortgages that are eventually sold to investors. Either the sponsor or depositor owns the limited purpose entity. Our proposal treats sponsors and depositors as "securitizers."(1)
  - For MBS to receive FMIC reinsurance, the securitizer has to guarantee the performance of the pool and to back that guaranty with minimum capital as determined by the FMIC
- **Private mortgage insurance companies**
  - Insurers would be required to maintain minimum capital reserves
    - In the first stage, when they cover the first five percent of loss, reserves could be 30 percent or 1.5 points
  - Breaches of representations and warranties should be satisfied by PMIs first and quickly
  - PMIs can also act as securitizers, but if they do so, they must meet both sets of regulatory requirements
- **Pricing**
  - Private markets can inform reinsurance price if the FMIC conducts auctions and surveys non-conforming reinsurance fees
  - Losses from mispricing of the reinsurance could be recovered over time through fees

(1) Consistent with recent SEC rules related to representations and warranties in asset-backed securities offerings. *See* Release Nos. 33-9175; 34-63741; File No. S7-24-10.

Government Guarantee – Transition

- **Starting up the FMIC**
  - The FMIC could be capitalized with revenues from a portion of guarantee fees charged by Fannie and Freddie
    - The Temporary Payroll Tax Cut Continuation Act of 2011 (the Act) provides that revenues from 10 basis points of increases in guarantee fees imposed by Fannie and Freddie be remitted to Treasury to pay for the tax cut extension
    - Some of those revenues could be passed to the FMIC instead
    - In exchange the FMIC would reinsurer all outstanding Fannie and Freddie MBS. Once the conservatorship is terminated, new Fannie and Freddie would continue to provide primary/first loss insurance on its then existing MBS. This would allow the government to transition to its new role while making good on its promise to pay current holders of Fannie and Freddie MBS in full
  - This could be a deficit neutral transaction
    - The Fair Credit Reporting Act (FCRA) provides that the fiscal impact of Federal loan and insurance programs is a function of expected cash flows discounted at Treasury rates(1)
    - The Congressional Budget Office (CBO) estimated that Fannie and Freddie guarantees on new MBS will generate a positive surplus under FCRA accounting(2)
    - Reinsurance in exchange for additional guarantee fees—that is, some portion of 10 basis points above the Fannie and Freddie fees assumed by CBO—on the same MBS should provide a positive surplus
    - That positive surplus could offset the funding required for the Act
  - Over time, the reinsurance fee commensurate with those revenues could be adjusted as appropriate to reflect risk

(1) The Congressional Budget Office applies FCRA scoring, for example, to the Terrorism Risk Insurance Act. See CBO, Federal Reinsurance for Terrorism Risks: Issues for Reauthorization, 2007.

(2) Letter from CBO Director Elmendorf to Congressman Barney Frank, Sep. 16, 2010 (estimating that under FCRA mandatory outlays between 2012 and 2020 for Fannie and Freddie would be -$38 billion, a significant surplus).

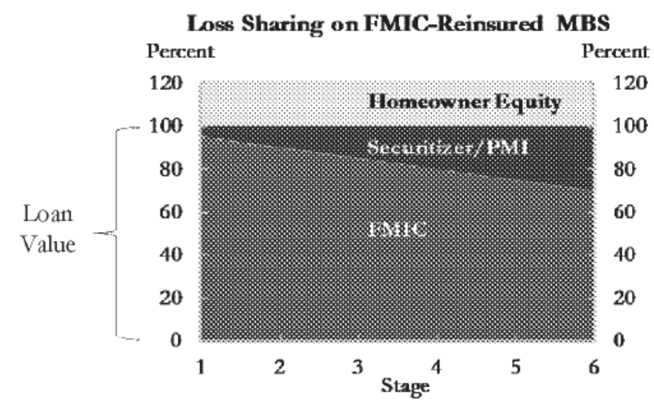
Government Guarantee – Transition (cont'd)

Creating a competitive, efficient marketplace

- The FMIC would offer reinsurance on qualified MBS on equal terms to all securitizers and PMIs who meet their regulatory criteria, including Fannie and Freddie
- To further competition and to preserve the TBA market, the SEC should offer exemptions under Regulation AB to securitizers whom the FMIC supervises and deems sound, and whose MBS is reinsured by the FMIC and meets the "good delivery guidelines" set by the Securities Industry and Financial Markets Association
- Compensation for and transparency into mortgage servicing needs to be reformed, as discussed in more detail below

Scaling the government' role over time

- Private mortgage insurers do not have sufficient capital to underwrite all conforming loans currently in existence, which is why a recapitalized and re-chartered Fannie and Freddie is necessary in the transition
- The price of the FMIC's guarantee will determine how much of the MBS universe the government reinsures as Fannie and Freddie's existing guarantee book rolls over. Initially, the price should be relatively low to make reinsurance attractive to many securitizers and PMIs. Other things equal, this should result in the reinsurance being attached to a large share of the MBS market. As the price increases, fewer securitizers and PMIs will find it economical to buy FMIC reinsurance. Competition from private reinsurers for conforming mortgages should increase as the FMIC fee increases
- The FMIC could also scale down its role and exposure over time by increasing the attachment point for the private sector's loss share.[1] For example, in the first stage the FMIC would require securitizers to hold sufficient capital or obtain private insurance to absorb the first five percent of loss on a conforming loan, and the FMIC would cover incremental losses. The example shows a targeted increase of the private sector's attachment point to 30 percent, but the path and target can be adjusted. Homeowner equity would always absorb the first 20 percent of price declines, although private mortgage insurance could also be used to cushion those losses



(1) Another way to decrease the footprint of the government in housing finance over time would be for the FMIC to offer insurance on the senior tranche of a conforming collateralized mortgage obligation, and to vary the size of the tranche relative to the loan value over time.

Government Guarantee – Precedent

- **The government has experience establishing successful, self-funded reinsurance programs to stabilize markets without strangling private activity, distorting prices, or promoting moral hazard**
- **Terrorism Risk Insurance**
  - The Terrorism Risk Insurance Act (TRIA or the Act) provides reinsurance against catastrophic losses on commercial property that a primary insurer realizes because of acts of terrorism
  - After 9/11, commercial property owners could not insure against terrorist risk at any reasonable price. Congress created TRIA to respond to this market failure through a loss-sharing structure and has extended the Act twice
  - The program succeeded in restarting private markets for terrorism insurance. But insurance provided through TRIA continues to backstop the system. Similar to our proposal for government reinsurance for qualified mortgages, private insurers are the first to absorb losses from a terrorist event. Specifically, the government pays 85 percent of insured losses above the primary insurer's 20 percent deductible. The primary insurer covers the remaining 15 percent. The primary insurer's share of losses under the reinsurance arrangement has increased over time.
  - Also similar to our proposal that recoups FMIC losses over time from previously mispriced reinsurance, the government recoups any outlays under TRIA through surcharges of up to three percent of annual premiums on all policyholders
- **Deposit Insurance**
  - The Federal Deposit Insurance Corporation (FDIC) insures bank deposits up to $250,000 per account. The objective of the deposit insurance program is to quell system-wide runs on banks during times of stress
  - As with terrorism, private reinsurers would be wiped out during such an event, so they cannot underwrite the risk
  - Also like the government under TRIA, the FDIC faces losses only after a given bank exhausts its resources to cover deposit accounts
  - The FDIC charges fees for this insurance to banks that vary based on their risk profile. It deposits those fees in a fund that builds over time and can be used to cover future losses. It also has the authority to recoup losses from the program over time if previously collected fees prove insufficient.
  - Since its inception in 1933 and despite significant payouts on its insurance programs during the Savings and Loan crisis and recent financial crisis, the FDIC deposit insurance programs have never resulted in taxpayer losses

Note: Another example is the Department of Energy's reinsurance program for qualifying student loans. The program generally insures lenders against borrower default for 98 percent of the outstanding loan principal. Lenders absorb the first two percent of losses.

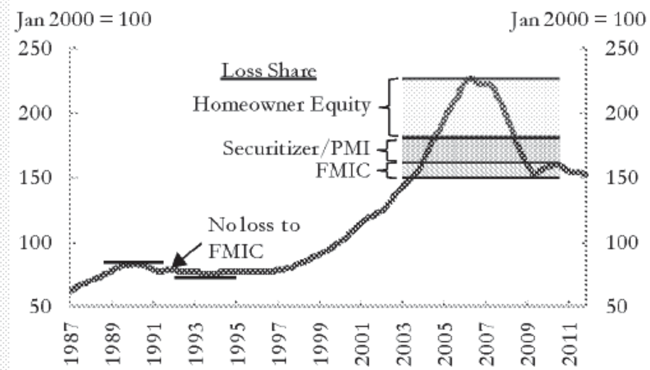
Government Guarantee – Implications

- **A government reinsurance program for mortgages represents a significant step towards a private marketplace**
  - Currently Fannie and Freddie insure against 100 percent of losses on the majority of mortgages issued in the U.S.
  - Under our proposal, conforming loans will still be 100 percent insured with a government backstop, but homeowners and well-capitalized private insurers would be forced to absorb losses before the FMIC would pay a dime
  - That means that private markets will absorb all losses in most situations. The government would assume the risk of an extreme shock to housing markets, like we recently experienced. And even then its exposure would be limited

Case Study – U.S. Subprime Crisis if FMIC Existed

- Starting in 2006, house prices in the U.S. fell sharply. The Case-Shiller 10-city composite index is now 33 percent below its peak.
- Under the proposed reinsurance regime and assuming prices on homes with conforming mortgages tracked the index, homeowners who bought at the peak would have absorbed the first 20 percent of the drop, equal to their down payments.
- The additional decline would eat into the value of the loan. Assuming that all underwater borrowers defaulted and securitizers and PMIs were required to hold capital equal to the first 10 percent of losses on the mortgage, they would have absorbed 8 percent of the total decline in prices.
- The FMIC reserve fund would have absorbed losses from the other 5 percent of price decline.(1)

Case-Shiller 10-City Composite Index



Sources: Case-Shiller, Millstein & Co.

- Mortgage rates for FMIC-conforming loans will likely be higher than current Fannie and Freddie conforming rates, more accurately reflecting the government's risk. But reinsurance will keep credit widely available
  - Zandi and deRitis(2) estimate that rates will rise 42 basis points if the government switches to a role of reinsurer, assuming private capital requires a 20 percent return on equity, the system is capitalized to a 25 percent decline in housing prices, and the FMIC requires a four percent return

(1) This example oversimplifies how losses on conforming mortgages would have been realized. Default rates would have varied geographically, temporally, and among borrowers of different credit quality. Transaction costs associated with modification or foreclosure could increase losses for the FMIC.

(2) Zandi, M. and Cris deRitis, "The Future of the Mortgage Finance System," Moody's Analytics special report, Feb. 2011.

Government Guarantee – Implications (cont'd)

  - Moreover, to encourage private market activity, the FMIC can lower the portion of the loan it reinsures over the medium term, and it can also increase the reinsurance fee over time to encourage competition in reinsurance
  - Competition among private securitizers and PMIs, which absorb the majority of risk in the proposed system, would encourage innovation, and their desire to avoid losses would encourage prudent practices
- **However, the proposal is realistic about the limits of private markets**
  - Most investors in U.S. MBS have no appetite for credit risk. Through a combination of FMIC reinsurance and regulation, our proposal removes it from conforming mortgages, allowing the large U.S. securitization markets to function
  - Only the government can afford to cover catastrophic risk in the housing market and to protect our economy
  - If the government abandons mortgage markets altogether, Zandi and deRitis estimate that rates will be approximately 120 basis points higher than they were prior to the crisis, and 90 points higher than they would be under our proposal [1]
- **The proposal also protects taxpayers**
  - The FMIC would deposit reinsurance fees in a reserve fund that builds over time and can cover commitments, base fees on private market prices, and recoup any losses from mispricing of the reinsurance fee over time
  - In a second loss position, the government would face risk only from extreme shocks, a "tail event" like we recently experienced
- **By requiring standard products and practices for conforming loans and by providing SEC exemptions for qualified securitizers, the proposal preserves the features necessary for a healthy TBA market**
  - The FHA, VA, and GNMA programs are insufficient to support the level of liquidity needed in the TBA market
- **Government reinsurance would also provide stability to housing markets**
  - Reinsurance ensures that mortgage credit is available in times of stress, when investors are less confident that securitizers and private mortgage insurers alone are sufficient to withstand all losses from borrower default
  - Standards for conforming mortgages would improve the quality of loans in the system

(1) Assuming the same required returns and capitalization against price declines applied above.

IV. Fannie Mae and Freddie Mac – Recapitalization to Privatization

Policy Options for Fannie and Freddie

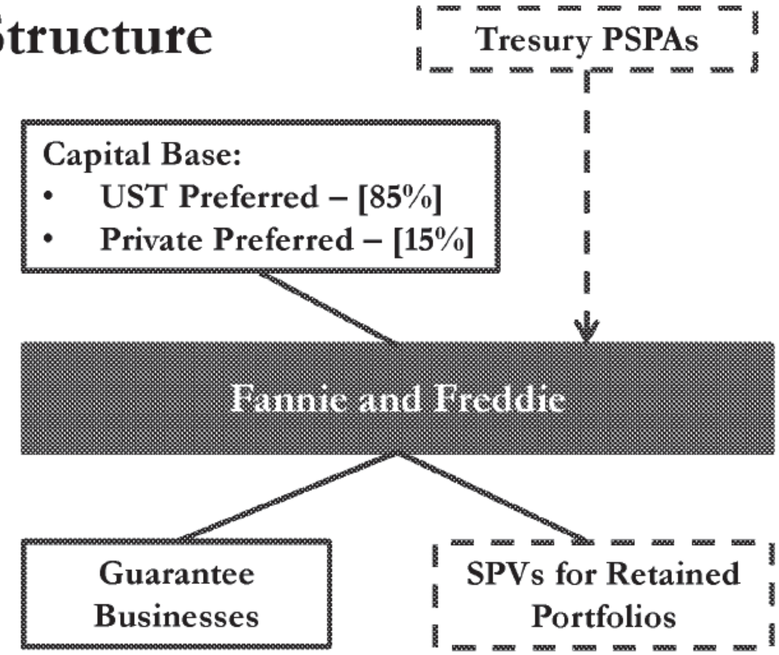
- **While alternatives have been batted about in public discourse on the fates of Fannie and Freddie, none provides a viable alternative to a carefully planned privatization of the entities**
  - Nationalize them? The alternative of remaking them as wholly-owned government agencies would increase the debt obligations of the USG to untenable proportions
  - Kill them? To propose to liquidate them risks adverse selection in the process, will create massive dead-weight losses (that benefit no one) and risks discontinuity in the supply of mortgage credit that could lead to a double dip in home prices and GDP, the worst of recessionary fears
  - Break them up? To break them up into smaller mortgage insurance entities would create inefficiencies that could imperil the credibility of the USG's guarantee of their outstanding debt and mortgage guarantees
    - Taking one integrated company and turning it into some number of smaller companies is fraught with operational risk
    - Additionally, historical "trust-busting" on such a scale involved the breakup of a particular holding company, not the "busting up" of the integrated operations of one company into several smaller companies
- **So the inevitable question: How to transition from Fannie and Freddie's balance sheets, whose solvency is currently supported by the Treasury Preferred Stock Purchase Agreements (PSPAs), to private companies, free and clear of conservatorship and capable of meeting their existing debt and mortgage guarantee commitments with a government guarantee that does not involve further cost to taxpayers?**
  - The only viable option is to reorganize and recapitalize Fannie and Freddie

Recapitalization to Privatization Plan – Considerations

The recapitalization to privatization plan as detailed would be one of, if not the largest undertakings in both public policy and corporate finance in modern history

- **Execution might take as many as three or four years to effectuate before the conservatorships could be terminated**
  - Full divestment of such a large common equity stake could take several years to complete, depending on market dynamics
- **However, the passage of implementing legislation would create the conditions under which private capital could plan to come back into the mortgage finance market as the FMIC defines the credit standards of its reinsurance, the related fees it must charge and the safety and soundness regulation to which any entity seeking its reinsurance would be subject**
- **In the meantime, this plan would allow for (1) a wind down of the retained portfolios in an orderly manner, (2) the build-up of Fannie and Freddie's capital base, and (3) the continuity of the government's guarantee of Fannie and Freddie MBS in a way that protects taxpayers against loss**
  - The plan also allows the government to unwind the conservatorships and its ongoing support of Fannie and Freddie's solvency without putting at risk the credibility of its commitment—now more than three years old—to leave legacy creditors unimpaired

Recapitalization to Privatization Plan – Structure



- **Contribute substantial portion of retained portfolios to special purpose vehicles (SPVs) to be separately managed to maximize recovery to taxpayers**
  - After determining parameters for go-forward investment portfolios for liquidity purposes, contribute balance of assets and funding to allow for orderly run-off
  - Wind down to be coordinated among Fannie, Freddie, and the Federal Reserve to increase efficiency, mitigate conflicts with the go-forward guarantee businesses and maximize overall recovery for taxpayers
- **Treasury PSPAs stay in effect through conservatorship for the entire entities**
- **Upon termination of the conservatorships, Treasury and private preferred shareholders convert to common equity**
  - UST preferred converts at a valuation that provides for full recovery of taxpayers' net cash investment
  - Private shareholders provide initial capital base into which Treasury can dispose of its common equity stake over time
  - In connection with the conversion, could raise substantial new private capital to improve overall capital levels at the reorganized entities or execute an equity rights offering—both of which would accelerate the repayment of Treasury's stake
- **Fannie and Freddie would be able to build Tier 1 Capital of over 8% by YE 2016 with a full conversion of estimated preferred outstanding at YE 2012 (over 10% by 2017)**
  - Without the Treasury dividend, assuming estimated annual combined earnings starting in 2013 of $24 billion, which is less than implied earnings from FHFA projections released in October 2011
  - Assumes no cash taxes over the period and deferred tax assets (DTAs) capped at 10% of Tier 1 Capital
  - Assumed risk-weighting of assets of 30%

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Recapitalization to Privatization Plan – Analysis Assumptions

- **Key Assumptions:**
  - Future guarantee books reduced 12% from current levels, which is conservative considering the recapitalized Fannie and Freddie should be in a position to retain market share
  - Reasonable market g-fee assumption (potential expansion depending on reserve and return requirements)
  - 10 basis point FMIC reinsurance fee
  - Multifamily book sized on modest growth of 5% above current level
  - Normalized expense assumptions
  - Normalized provision rate of 5 basis points, based on average historical loss rates
  - Reasonable 10.0x earnings multiple assumption based on expected cost of equity
- **Retained portfolios assumed substantially wound down to 60% of the current statutory requirement of $250 billion at each entity**
  - As the portfolios are reduced over time, their earnings are replaced with higher average g-fees on the guarantee books of business
  - Net interest margin (NIM) substantially reduced from current levels above 200 basis points due to assumed lower yielding, safer assets
  - Must maintain this level of portfolio for liquidity purposes and to purchase delinquent mortgages out of trusts

HYPOTHETICAL FUTURE GSE ANALYSIS

$ in billions	Fannie	Freddie	Total
% of total Guarantee book	62.0%	38.0%	100.0%
Size of Guarantee Book	$2,542	$1,558	$4,100
G-Fee	0.75%	0.75%	0.75%
Less: Reinsurance Fee	(0.10%)	(0.10%)	(0.10%)
Net G-Fee	0.65%	0.65%	0.65%
Expenses Net Other Income, % of Book	(0.10%)	(0.10%)	(0.10%)
Guarantee Income, % of Book	0.55%	0.55%	0.55%
Guarantee Income	**$14**	**$9**	**$23**
% of total Investment Book	50.0%	50.0%	100.0%
Size of Investment Book	$150	$150	$300
Net Interest Margin (NIM)	1.00%	1.00%	1.00%
Less: Hedging Costs	(0.10%)	(0.10%)	(0.10%)
Investment Income, % of Book	0.90%	0.90%	0.90%
Investment Income	**$1**	**$1**	**$3**
Size of Multifamily Book	225,000	160,000	385,000
Investment Income, % of Book	0.60%	0.60%	0.60%
Multifamily Income	**$1**	**$1**	**$2**
Normalized Provision Rate	(0.05%)	(0.05%)	(0.05%)
Normalized Provisions	**($1)**	**($1)**	**($2)**
Pre-Tax Income	**$15**	**$10**	**$26**
Taxes	30.0%	30.0%	30.0%
Net Income	**$11**	**$7**	**$18**
Assumed Valuation Multiple	10.0x	10.0x	10.0x
Implied Market Capitalization	**$108**	**$71**	**$179**
Treasury Ownership	85.0%	85.0%	85.0%
Treasury Share	**$92**	**$60**	**$152**
% of YE 2012E Net Investment	*105%*	*119%*	*110%*

Recapitalization to Privatization Plan – Refinancing

- **As of June 2011, 75% of Fannie and Freddie borrowers with a 30-year fixed rate mortgage have a rate of 5% or more, despite rates below that level for two years and current rates below 4.0%**
  - Experts note that prepayment speeds in the recent low rate environment are only one third of what they would expect under normal credit conditions, which suggests tens of millions of borrowers that have been unable to take advantage of historically low rates[1]
- **While large-scale refinancing programs have been controversial in the press, the potential economic benefit for taxpayers is substantial and the prepayment risk to MBS investors should be well understood[2]**
  - Refinancing can benefit the entire economy by providing borrowers an effective permanent tax cut through a new low interest rate
    - Depending on the size of take up rates, we estimate that more than 11 million borrowers could benefit from a refinancing program, with aggregate annual savings of over $30 billion, or more than $2,500 per borrower per year on average
  - Increased affordability should reduce potential defaults substantially and relieve downward pressure on home prices
  - Additionally, if structured appropriately, a refinancing program could be profitable for various other constituents including Fannie and Freddie (through increased g-fees applied as part of the program), servicers (through release of warranties on historical mortgages) and private mortgage insurers (through reduced likely defaults on participating borrowers as their mortgages become more affordable)
  - While MBS investors would carry the cost burden of the program, there should be ample demand for new MBS issued as part of the program as these securities would have reduced prepayment speeds going forward
- **A streamlined refinancing program with higher, more risk-appropriate g-fees could accelerate Fannie and Freddie's ability to build capital, repay taxpayers and reduce the size of their retained mortgage portfolios**
  - Increases guarantee book earnings, while reducing the size of the retained portfolios through prepayments on retained MBS

(1) For further discussion on refinancing potential, see Boyce, Hubbard , Mayer and Witkin, "Streamlined Refinancings for up to 14 Million Borrowers," 1/18/2012., http://www4.gsb.columbia.edu/realestate/research/housingcrisis
(2) For further discussion on the economic benefit of refinancing, see Tracy and Wright, "Why Mortgage Refinancing Is Not a Zero-Sum Game," 1/11/2012., http://libertystreeteconomics.newyorkfed.org/2012/01/why-mortgage-refinancing-is-not-a-zero-sum-game.html

Recapitalization to Privatization Plan – Refinancing (cont'd)

- **While recent steps have been taken to make the Home Affordable Refinancing Program (HARP) more accessible, several areas need to be addressed in order to maximize impact**
  - The program should be opened up to all Fannie and Freddie borrowers, not just those above 80% loan-to-value (LTV)
  - "Loan-level pricing adjustments" and "adverse market delivery charges" imposed by Fannie and Freddie on refinancings since 2009 should be eliminated
    - There is no economically reasonable argument for why they add incremental charges when refinancing credit risks they already guarantee
    - Due to the way mortgages are priced, these upfront charges make it more difficult to make the economics of refinancing work
  - Warranties on the old mortgages need to be extinguished upon the refinancing
    - The requirement that those warranties must be assumed by the new servicer simply deters competition among banks to refinance eligible borrowers, only to preserve a contingent claim of less value to Fannie and Freddie than the beneficial impact of getting a troubled borrower into a more affordable, less likely to default, loan
    - While some streamlining of warranty release has been implemented in HARP, they have not been waived for borrowers below 80% LTV
  - Closing costs need to be reduced to a minimum through streamlined and uniform operational standards between Fannie and Freddie
  - The playing field for existing servicers and new servicers has to be leveled, so that competition delivers the best rates to borrowers
    - Fannie and Freddie' loan files need to be opened up to all qualified servicers and procedural and substantive requirements for eligible refinancing should be identical for new and existing servicers.

Recapitalization to Privatization Plan – Refinancing (cont'd)

- **Due to the way that mortgages are priced at the closing table, the current mechanism for refinancing doesn't incentivize servicers to refinance their existing portfolio of serviced mortgages**
- **Due to Adverse Market Delivery Fees (AMDCs) and Loan Level Pricing Adjustments (LLPAs) charged by Fannie and Freddie, as well as onerous closing costs in the current process, servicers must place loans into high-coupon Fannie/Freddie MBS in order to make the proposition profitable, which results in higher primary mortgage rates**
- **Eliminating AMDCs/LLPAs and reducing closing costs by streamlining the refinancing process could make it profitable for servicers to underwrite refinancing activity, while also allowing Fannie and Freddie to charge significantly higher g-fees in order to build their capital bases and offering borrowers access to low rates**
  - Leveling the playing field and promoting competition among servicers is essential to ensure that borrowers receive the best primary mortgage rates
- **Based on the expectation that new mortgages will be priced so as to create 75 basis point of spread between the mortgage interest rate (4.25% 30-yr and 3.75% for 15-yr) and the TBA rate at which such mortgages are funded, the 75 basis points spread would be allocated as follows:**
  - 55 basis points to Fannie/Freddie as a g-fee
  - 7 basis points to Fannie/Freddie as a payment to release legacy warranties
  - 13 basis points for the servicer's fee

STATUS QUO BORROWER EXAMPLES

		Mythical Zero Point Borrower	~60th Percentile Borrower	"Streamlined" Refinanced Borrower	"Streamlined" Notes
	FICO/Loan-To-Value	700/80	699/75.01	699/75.01	
	AMDC	0.00	0.25	0.00	- *Eliminate AMDC and LLPAs*
	LLPAs	0.00	1.75	0.00	
	Loan	100.00	100.00	100.00	
	Costs	1.00	1.50	1.00	- *Assumes cleaner cost structure.*
	Total $ out	**$101.00**	**$103.50**	**$101.00**	
(a)	MSR Multiple	6.70	2.50	4.50	- *Multiple could be higher with improved regulatory regime*
(b)	Servicing, less G-Fee	0.13	0.25	0.13	- *Assumes 62 bps of spread between rate and coupon reserved for*
(c)=(a)*(b)	Mortgage Servicing Rights value	0.84	0.63	0.58	*G-Fee and R&W release payment to Fannie/Freddie.*
(d)	Points/Credits	0.00	(3.00)	0.00	- *No points on a refi.*
(e)	Bond price	101.47	108.94	103.09	
[(c)+(d)+(e)]	**Total $ in**	**$102.31**	**$106.56**	**$103.68**	
	Profit($ in-$ out)	*$1.31*	*$3.06*	*$2.68*	
	Memo: Rates				
	Actual Mortgage Rate	3.38	**6.00**	**4.25**	*Borrower gains access to lower mortgage rate*
	FNMA 30 yr Bond	3.00	5.50	3.50	
	Spread	**0.38**	**0.50**	**0.75**	
	Ratio of MSR to Profit	0.64	0.20	0.22	
	Net Cash For Mortgage Bank	$0.47	$2.44	$2.09	- *Profitable for Mortgage Bank.*
	Real Profit Margins	$1.31	$3.56	$3.26	- *Adjusts for estimted underpricing of MSR.*

Note: Servicers capitalize their fees upfront in the form of Mortgage Servicing Rights (MSRs) assets. Due to potential regulatory restrictions on MSRs on bank balance sheets, servicers are undervaluing the MSRs, which reduces profitability of servicing overall. With reduced servicing capacity in the post-crisis environment, this treatment of MSRs contributes to tight credit conditions for borrowers.

Recapitalization to Privatization Plan – Regulatory Considerations

- **Future regulatory roles should be clarified at the outset to allow agencies sufficient time to integrate**
  - The FHFA would continue to oversee Fannie and Freddie until the conservatorship is terminated
  - Upon termination of the conservatorship, the FMIC would assume primary supervisory authority for Fannie and Freddie as well as the FHLBs, FHFA staff will be transferred to the FMIC, and the FHFA will cease to exist
  - The FMIC would supervise new Fannie and Freddie for safety and soundness. When the FSOC designates the firms as SIFIs, the FMIC would coordinate with the Federal Reserve, which would impose heightened prudential standards
  - The FMIC will establish best practices for different parts of mortgage markets, including underwriting and appraisal requirements for conforming loans, as well as practices in servicing and the advance credit market
- **The treatment of existing Fannie and Freddie MBS, as well as MBS securities reinsured by the FMIC, under Basel III capital and liquidity requirements will have a significant impact on U.S. housing credit**
  - In the new capital regime, conforming FMIC-reinsured MBS should receive between a 0 and 20 percent risk weighting, the latter of which is currently applied to Fannie and Freddie MBS.
  - In the new liquidity regime, Fannie and Freddie MBS should be recognized as L1 assets at 100 percent (i.e., no haircut). The entity's MBS will continue to be 100 percent insured, with the new FMIC providing reinsurance in exchange for a fee. As a result, markets for these securities should continue to demonstrate the same liquidity they did during the financial crisis. Only U.S. Treasury and Japanese Government Bond markets were more liquid at that time
  - U.S. regulators have flexibility in enforcing Basel III requirements, and liquidity rules are still being debated internationally. Given the unique structure of U.S. housing finance, the conservative nature of conforming MBS under our proposed regime, and the importance of conforming MBS to housing credit and monetary policy, we encourage regulators to apply a minimal risk weighting to conforming FMIC-reinsured MBS and to treat conforming MBS as L1 assets

Precedent – Lessons from the Sallie Mae Privatization

- **The government has already successfully privatized a GSE: the Student Loan Marketing Association (Sallie Mae)**
- **Sallie Mae was created in 1972 to improve the student loan market by linking lenders to capital markets**
  - Sallie Mae issued debt securities and purchased student loans from originators. It also made FHLB-like loans to financial and educational institutions, enabling them to extend credit to students or purchase education-related loans. Loans from Sallie Mae to such institutions were fully collateralized by federally insured student loans, or Treasury or Fannie/Freddie debt
  - Unlike Fannie and Freddie, Sallie Mae did not guarantee student loans. The Department of Education reinsures primary insurers that meet government requirements. Sallie Mae was also smaller, with $50 billion in total assets
- **Objectives of the Sallie Mae privatization**
  - Congress's objectives were to maintain stability in the student loan market; avoid increasing taxpayer risk; meet obligations to bondholders; structure a transaction that would be neutral for the Federal budget and for existing investors and management; and ensure a level playing field among Sallie Mae's competitors
  - Sallie Mae's objective was to diversify, as government competition and restrictions threatened its core business
- **Privatization structure and process**
  - The Student Loan Marketing Association Reorganization Act of 1996 reorganized Sallie Mae under a holding company charter with GSE and non-GSE subsidiaries. The GSE subsidiary could continue purchasing student loans and issuing debt for 10 years, but all debt obligations had to be wound up through defeasance by 2008. FHLB-like lending was limited
  - Similar to what we propose for Fannie and Freddie, the privatization plan for Sallie Mae reduced its financing advantage over time, increased its capital requirements, and subjected it to state taxes to level the playing field with competitors
  - The transaction was budget neutral because the GSE subsidiary remitted an offset fee on purchased loans. The government also received stock warrants equal to one percent of the company's market value just before the Act went into effect. However, the exit fee was limited to avoid punishing investors needed to capitalize the newly privatized entity
- **Sallie Mae and student lending today**
  - Sallie Mae is completely private and education credit is abundant. However, the company is now the dominant private player in originations and servicing, which competitors attribute to economies of scale the company retained from its GSE days

Precedent – Restructuring the Government's Investment in AIG

- **At the height of the financial crisis in the Fall of 2008, the Federal Reserve Bank of New York (FRBNY) and Treasury (UST) provided massive capital and credit support to AIG in order to prevent a potentially catastrophic impact on the financial system that the company's failure would have had**
- **While the FRBNY initially provided an $85 billion, high interest rate credit facility to AIG in September 2008, UST and the FRBNY realized that they would have to restructure this investment several times in order to effectively support the company, the financial system and protect taxpayer capital already committed**
  - In November of 2008, UST invested $40 billion of TARP funds in cumulative preferred stock in the company and the FBRNY established Maiden Lane II and III in order to buy troubled assets from the insurer at discounted prices
    - The FRBNY's original credit facility availability was reduced to $60 billion and its rate was reduced by 5.5%
  - In March of 2009, UST and the FRBNY announced a restructuring that converted UST's cumulative preferred stock to non-cumulative preferred, as the accrual of the dividend adversely affected its profitability and threatened its credit rating (the keystone for an operational insurance business) was threatened
    - If downgraded, AIG could have been forced into a potentially disastrous disorderly liquidation process
    - At that time, the FRBNY announced a further $25 billion reduction in it's credit facility available to AIG in exchange for $25 billion of preferred interests in two non-core AIG subsidiaries slated for divestiture
- **Starting in 2009, AIG reorganized to focus on its core insurance operations**
  - Management was replaced
  - The troubled AIG Financial Products unit was wound down in an orderly fashion over time
  - The company devised a plan to monetize non-core assets over time to maximize recovery for taxpayers
    - Monetization of the two largest non-core assets was completed in November 2010, with the sale of ALICO to MetLife and the IPO of AIA on the Hong Kong Stock Exchange, which raised a combined $36 billion in proceeds

Precedent – Restructuring the Government's Investment in AIG (cont'd)

- **In January of 2011, a comprehensive recapitalization of AIG was competed that put the company on the path to eventual independence and taxpayers on the path for the full recovery of their investments in AIG**
  - All direct obligations to the FRBNY were repaid in full
  - UST retained $20 billion of preferred equity interests in non-core assets slated for monetization
    - AIG has subsequently made $12 billion of repayments on this preferred, and the remaining $8 billion is secured by asset values well in excess of that liquidation preference
  - UST converted its preferred equity interests in AIG into 92% of AIG's common stock
    - UST subsequently reduced its stake in AIG to 77% in a public offering of AIG shares in May of 2011 that recovered $5.8 billion for taxpayers
- **The AIG case demonstrates the wisdom of adapting to changing conditions and restructuring investments in order to protect value for taxpayers**
- **UST will likely realize a profit on its original invested capital as it opportunistically sells its remaining stake into the markets over time while AIG continues to improve upon reorganized operations and increases profitability**

V. Restarting Private Securitization Markets for Mortgages

Restarting Private-Label Securitization Markets

- **Section III addressed what is necessary to retain the majority of investment in U.S. housing, specifically investment that is unwilling to accept the risk of borrower default**
- **However, prior to the crisis some mortgage investors were willing to accept credit risk and forgo a government guarantee**
  - At its peak, private-label securitization (PLS) markets provided nearly $800 billion of funds
- **Today PLS investors are nearly extinct**
  - Last year less than $3 billion of PLS was issued
- **Attracting those investors back into housing markets would allow the government to shrink its role further**
- **Standing in the way are a host of legal defects, misaligned incentives, conflicts of interest, and opaque information**
- **The government can cure each of those impediments relatively easily and simultaneously improve the process for conforming FMIC-reinsured mortgages**
  - If authorized, the FMIC could facilitate many of these changes

Restarting Private-Label Securitization Markets – Disclosure

- **Loan-level information should be published for mortgages in all securitized pools**
  - Would allow investors, ratings agencies, and regulators to evaluate collateral and expected economic performance at the time of underwriting and over the life of a security
  - Freddie has taken a significant step in this direction, publishing online loan-level information at PC issuance and on a monthly basis for all securities issued after December 1, 2005. This supplements its daily and monthly pool-level disclosure. Disclosed information includes variables such as credit score, unpaid principal balance, and MSA
  - This demonstrates that such disclosure can be accomplished without violating privacy laws
  - Issuers, underwriters, and servicers already have this information for all securitized mortgages
- **Deal documents for all MBS should be disclosed**
  - Would increase liquidity after securities are sold, putting downstream investors on a level playing field
- **A new Mortgage Electronic Registration System (MERS) should be established**
  - A national electronic registry of liens and servicing for all mortgage participants
  - The information should be easily accessible and allow one to tie a servicer to a given lien, which would encourage competition for servicing and facilitate a variety of procedural issues
  - On behalf of PLS investors, a trustee could create financial incentives for borrowers to change to lower cost and/or better performing servicers, measured using data available in the new registry
  - State and municipal governments could share in the revenues generated by the new system to offset potential losses from local physical filings

Restarting Private-Label Securitization Markets – Disclosure

- **Additional disclosure to improve servicing**
  - Establish a national registry of potential servicers and a streamlined way to change if a servicer is performing poorly
  - Servicing fees should be disclosed, and trustees should be required to publish reports on MBS remittances that contain both summaries and loan-level information, consistent with privacy laws
  - State and municipal government could share in revenues from the new system
  - The FMIC should establish performance measures for servicers, and servicers should be required to publish data on those measures periodically

Restarting Private-Label Securitization Markets – Servicing

- **The FMIC should establish and enforce rules to eliminate conflicts of interest in servicing**
- **Addressing second liens**
  - Second liens inhibit modifications or principal reductions in troubled loans, and they generate conflicts between servicers—who frequently own second liens—and investors in MBS backed by first liens
  - The FMIC should bar owners of second liens from servicing first liens, which would also stimulate servicing competition
  - The FMIC should also require loan contracts for conforming mortgages to provide first lien investors with a right to approve any second lien that would lead to a combined loan-to-value ratio of a level consistent with FMIC down-payment requirements(1)
    - Borrowers can refinance the entire loan if the first lien holder does not approve
  - An online national lien registry would also make it easier to assess impediments to mortgage restructuring
- **Severing servicer relationships that undermine investor rights, increase transaction costs, and hurt borrowers**
  - Potential breaches of representations and warranties should be resolved promptly by independent third parties to protect investor rights and paid on an incentive basis
  - Servicers should not be allowed to mark up fees on third-party services related to foreclosure, and regulations should prohibit placement of contracts such as "force-placed" insurance with servicer affiliates

(1) This would require an amendment to the Garn St. Germain Depository Institutions Act of 1982, which prohibits lenders from exercising due-on-sale clauses in certain events.

Restarting Private-Label Securitization Markets – Servicing

- **Modifying servicer compensation**
  - Servicers have historically been overpaid to service performing loans and underpaid to service non-performing loans
  - The FHFA recently changed the incentive fee structure for servicers in its Servicing Alignment initiative, increasing rewards to quick resolution of troubled loans and penalizing servicers for slow resolution
  - The FMIC should evaluate the impact of those changes should be evaluated as it considers imposing a new fee-for-service standard in the new regime
- **Establishing uniform accounting policies and procedures for loan restructuring**
  - Must reflect actual economic impact of modified cash flows
  - If modifications involve principal forbearance, there must be recognition of economic losses that affect how cash flows are allocated within securitizations

Restarting Private-Label Securitization Markets – Foreclosure

- **There are a number of problems with current foreclosure processes**
  - Above we discussed a few of the incentive problems in servicing related to foreclosure that impose unnecessary costs on borrowers and reduce returns to MBS investors
    - For example, many trustees are closely affiliated with servicers, creating a potential conflict of interest with their duty to investors
  - There is also a class of convenience defects in foreclosures because of servicers
    - "Robosigning" has received much attention lately, but other cases include lost-note affidavits for documents that are not lost but require a nominal fee to access, intentionally altered documents and false notarizations, and failure to attach the note to a complaint
    - Servicer supervisors, Treasury, through its Making Home Affordability program, and state prosecutors should investigate these practices
  - Another problem with the foreclosure process is transfer of title for mortgages behind MBS
    - In a mortgage securitization, it is important that the note and mortgage be transferred to the trust; otherwise, the loan is not "bankruptcy remote" from the securitizers and originators, allowing their creditors to seize a security that had allegedly backed MBS purchased by third-party investors
    - If the notes and mortgages were not properly transferred, it would also prevent the trustee from having standing to foreclose on behalf of investors

Restarting Private-Label Securitization Markets – Foreclosure

- **The Trust Indenture Act should be amended to apply to MBS**
  - The Trust Indenture Act of 1939 (TIA) prohibits bonds from being offered for sale without a written agreement signed by the bond issuer and bondholders
  - TIA also provides a trustee with the authority to sell the bond issuer's assets to recoup bondholder investments, and it imposes standards and requirements on trustees
  - TIA was created after trustee fraud undermined investor interests in mortgage guarantee certificates, similar to MBS
- **Lawmakers should pass legislation proposed by Senator Brown and Representative Miller to amend the TIA**
  - H.R. 1783 would remove the exemption from the standards and requirements of TIA for MBS trustees, and it would also add language to TIA to make it easier for a subset of investors in a given MBS to amend pooling and servicing agreements for MBS or to change servicers
- **The FMIC should work with industry to establish standard pooling agreements with model representations and warranties as a non-waiveable minimum**
  - Legal terms should have the same meaning across documents
  - Homoegeneity and baseline assurances on the nature of underlying collateral will improve liquidity in secondary markets
  - However, representations and warranties should also expire after two years, incentivizing trustees and investors to diligence loans quickly and provide more certainty to all parties
- **A model non-judicial foreclosure law should be drafted and implemented**
  - System could be adopted by states over time, much like the Uniform Commercial Code

VI. Housing Affordability

Housing Affordability

- **Affordability goals should be met by the FHA, VA, GNMA, HUD, and state and local programs—not the FMIC, re-chartered Fannie and Freddie, or securitizers or PMIs subject to FMIC supervision**
  - In the run up to the recent financial crisis, Fannie and Freddie provided subsidies to lower-income, minority, and underserved borrowers in exchange for political favor that allowed them to build dominant positions in other markets and take on risk without appropriate oversight
  - To avoid conflicts of interest, the FMIC, re-chartered Fannie or Freddie, or newly chartered securitizers or PMIs subject to FMIC supervision should not be tasked with meeting affordability goals, beside generally applicable Community Reinvestment Act provisions
- **However, securitizers and PMIs benefiting from FMIC reinsurance could be forced to contribute funds to government affordability programs**
  - For example, HUD and state public housing agencies (PHAs) could use such funds to expand the oversubscribed Housing Choice Voucher Program, which provides a market-based subsidy to help pay the cost of renting private housing
    - The Government Accountability Office found the program to be more cost-effective than programs that build housing for low-income households, and the bipartisan, congressionally chartered Millenial Housing Commission described it as "flexible, cost-effective, and successful in it mission" and calling for its expansion
  - A 2004 study found that 40 percent of participating PHAs were turning away new applicants because of funding shortages, and according to one estimate, the HUD's FY2012 budget was $100 million short of being able to renew vouchers currently in use
  - This is a good example of where dedicated funds—but not business directives—from market participants who benefit from the new reinsurance regime could support housing affordability
  - The structure is similar to the Highway Trust Fund, where Federal fuel taxes fund road construction and mass transit
- **FMIC reinsurance will also continue to provide many of the positive benefits that Fannie and Freddie guarantees on conforming mortgages currently provide**
  - It will preserve popular products like the 30-year fixed-rate mortgage
  - It will also help equalize access to credit between rural and urban areas

Appendix – Housing Market Overview

U.S Household Credit Overview

- **There are approximately 80 million homes in the U.S.**
- **55 million of those homes have a mortgage**
- **The government is by far the largest source of mortgage credit through Fannie, Freddie, FHA and other programs**

U.S. MORTGAGE CREDIT BREAKDOWN

	1st Mortgage Assets		HELOC and 2nd Liens	
Holder	$	%	$	%
US Government	$5,856	62%	-	-
Commercial Banks	1,439	15%	678	75%
Private Label Securitizations	1,154	12%	19	2%
Savings Institutions	342	4%	71	8%
Credit Unions	239	3%	85	9%
Finance Companies	209	2%	52	6%
Individuals and Other	251	3%	-	-
Total	**$9,491**	**100%**	**$904**	**100%**

"HELOC" = home equity line of credit

- **The following details the breakdown of holder of mortgage-backed securities**

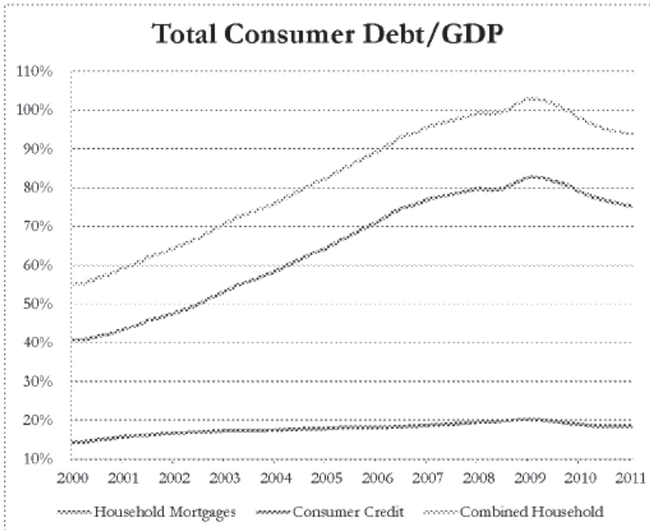
U.S. MORTGAGE SECURITIES HOLDERS

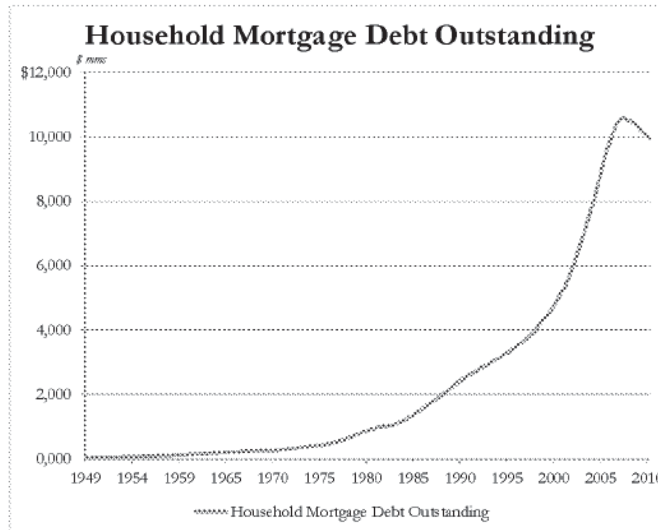
	Government Agency		Private Label Securities	
Holder	$	%	$	%
UST/Federal Reserve	$1,121	21%	-	-
Commercial Banks	1,094	20%	146	13%
Foreign Investors	786	14%	210	18%
Mutual Funds/Private Pensions	705	13%	198	17%
Fannie/Freddie/FHLBs	728	13%	180	16%
Pub. Pensions/State/Local Gov	286	5%	41	4%
Savings Inst./Credit Unions	268	5%	38	3%
Insurance Companies	212	4%	170	15%
Other	241	4%	172	15%
Total	**$5,442**	**100%**	**$1,154**	**100%**

Source: Inside Mortgage Finance.

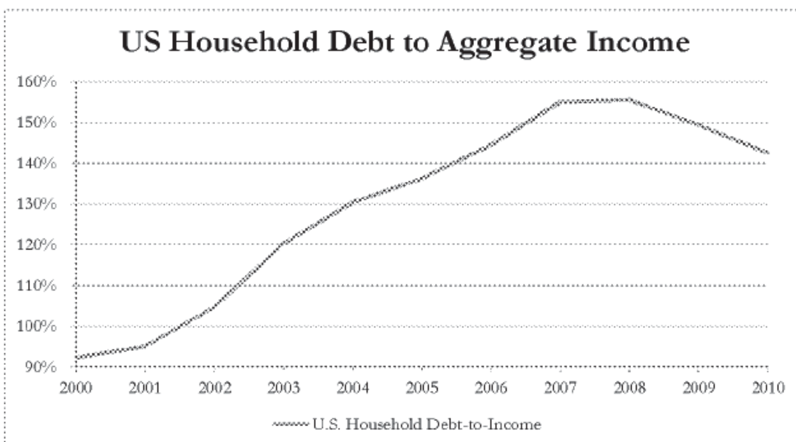
Boom-Time Trends in Household Finance

- Over the last decade, household credit expanded to unsustainable levels





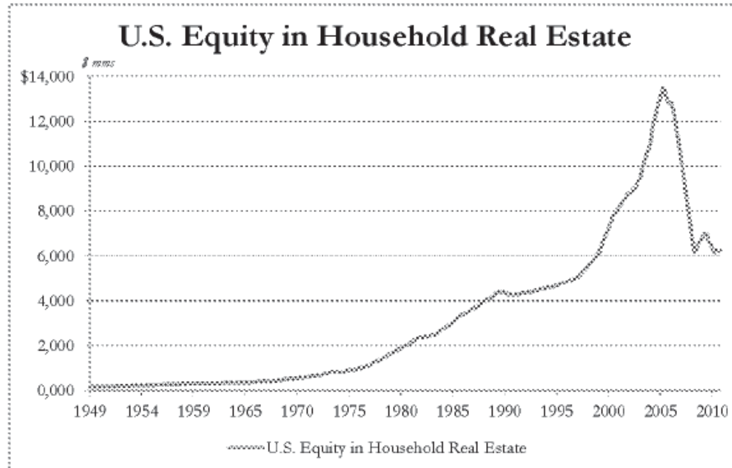
- Household debt to aggregate household income also increased dramatically

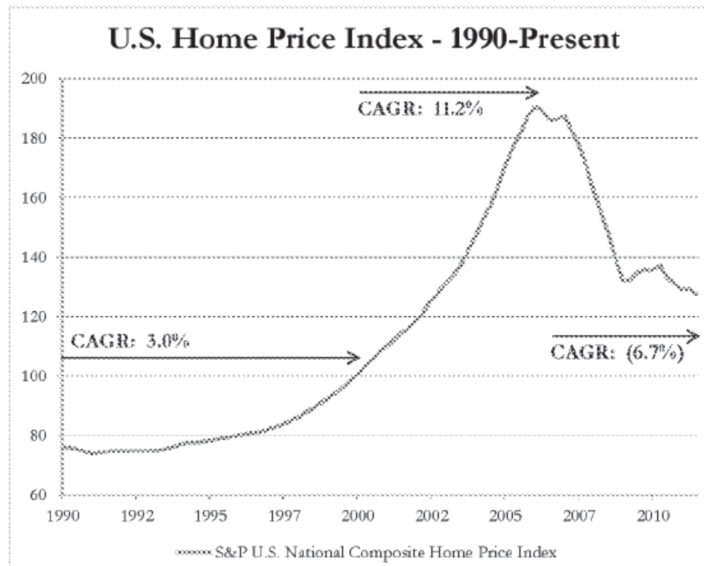


Sources: Federal Reserve Board Economic Data, Federal Reserve Bank of New York Quarterly Consumer Credit Report.

House Prices and Household Wealth

- **U.S. absolute home equity is currently worth $7.3 trillion less than peak valuations in early 2006**
  - U.S. house prices have declined 33% below their 2006 peak
  - From 2000-2006, house prices grew at more than 3.0x the average annual rate during the 1990s
  - Since peaking in 2006, house prices have fallen at 6.7% annually to date
    - Such a decline is unprecedented since the Great Depression
- **The massive reduction in household wealth has significantly undermined consumer confidence and household spending**
- **The middle class are particularly disadvantaged as home equity represents a larger proportion of its wealth than it does for both upper-income and low-income households**
  - Upper-income households are more likely to own other financial assets, while low-income households are less likely to be homeowners
  - From 2007-2009, the decline in home-equity for middle-income homeowners was 66% of average income in 2007, but only 36% for highest-income homeowners

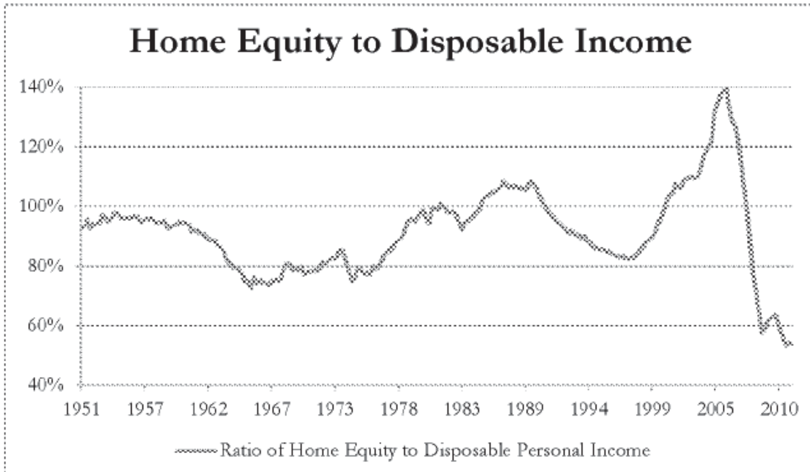




Sources: S&P, Federal Reserve Economic Data, Flow of Funds and Survey of Consumer Finances

House Prices and Household Wealth (cont'd)

- **The ratio of home equity to disposable personal income has dropped rapidly since 2006 to all time lows since such data has been recorded over the last 60 years**
  - The wealth effect of this loss of home equity is a significant drag on real GDP growth (~half a point or more)



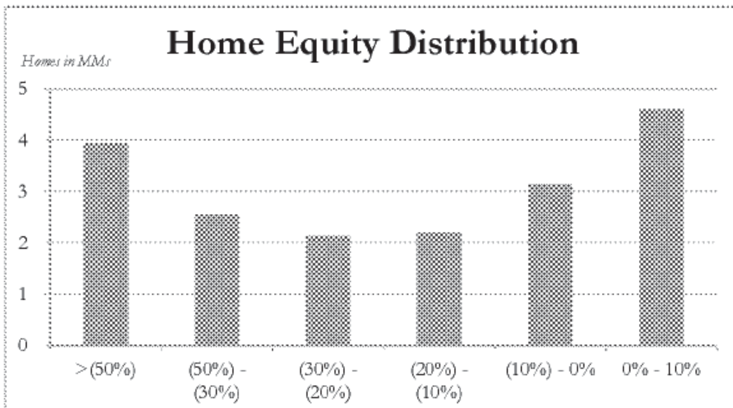
- **The drop in home prices is also adversely impacting the finances of local governments, which depend on property tax revenues tied to house values**
  - Budget cuts result in layoffs of government employee, which puts further pressure on the housing market
- **Downward pressure on home prices has caused widespread negative equity**
  - Various estimates put the number of underwater borrower between 11 to 14 million, or one out of every five borrowers, as there are approximately 55 million mortgages outstanding

Sources: Moody's, Federal Reserve Economic Data and Flow of Funds

Negative Equity

The large number of homeowners with "underwater" mortgages highlights the need to bring confidence back to the housing market, as some experts assert that loan-to-value (LTV) characteristics are critical to default patterns

- **Declining home prices could negatively threaten economic recovery further if they become a self-fulfilling prophecy**
  - Laurie Goodman of Amherst Securities has asserted that "LTV is the single most important predictor of default"
  - Significant negative equity reduces a borrower's financial flexibility, as they may be unable to refinance or sell their homes
  - Given the perilous state of home equity for what Moody's estimates to be as many as 14 million homeowners there is a risk of an onset of a "death spiral" in home prices (downward price movement causes more defaults, which begets lower prices)
  - By Moody's estimate, 6.5 million of those 14 million borrowers are underwater by more than 30%



- **With the onset of the financial crisis, only massive policy intervention broke the "death spiral" cycle**
  - Fannie and Freddie were placed in conservatorship with a net worth guarantee through the Treasury Preferred Stock Agreements, and FHA expanded its lending operations
  - Today, Fannie, Freddie and Ginnie are responsible for 90% of liquidity for new originations

Sources: Moody's, Amherst Securities Group LP and the Federal Reserve Board.

Supply/Demand Imbalance

The housing bust has produced a significant supply/demand imbalance that will take years to work through and is only made worse through policy inaction

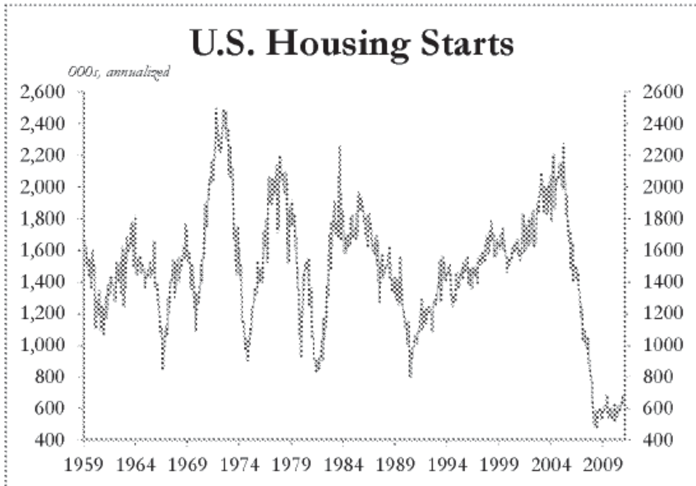
- **Housing starts are currently running at an annualized rate of 600,000 units per year, where a normalized rate in a well-functioning market is approximately 1.75 million units per year[(1)]**
  - Weakest pace of residential construction since World War II
- **Due to negative equity issues and the slow pace with which delinquent or foreclosed mortgages are working their way through the pipeline, Amherst Securities estimates that excess supply will take a protracted amount of time to work through and will continue to put downward pressure on home prices**
  - Amherst estimates that 8.3 million to 10.4 million homes are at risk for default over the next six years
  - Even assuming normalized demand drivers, such as household formation and home ownership assumptions, these potential defaults could create an aggregate 4.1 million to 6.2 million units of net supply over the period
- **The critical component of demand in the housing market is household formation, which has been negatively impacted by the depressed job market**
  - Household formation rates are currently less than 50% of the normalized rate of 1.2 million in a well-functioning market
- **The interdependent relationship between housing, jobs and the broader economy is undeniable**
  - Housing demand depends on household formation, which depends on jobs, and the job market is inextricably linked to the housing market as we've established
- **Status quo is more likely to create a "death spiral"**
  - Policymakers need to focus on creating a virtuous economic cycle by moving forward with housing finance reform

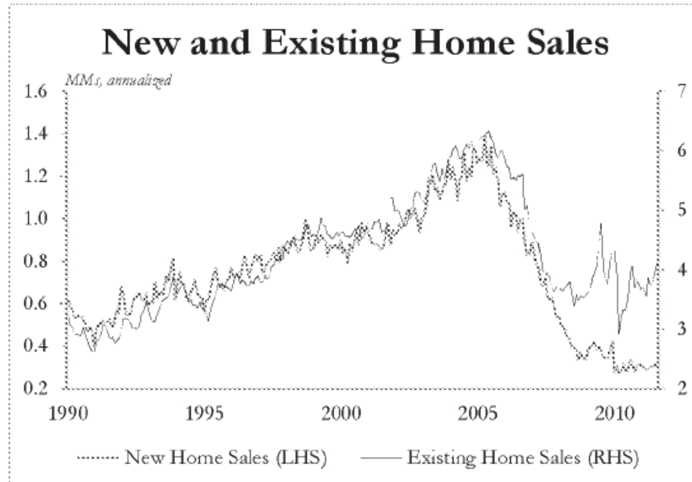
Sources: Amherst Securities Group LP and Moody's

(1) In recent testimony before the Senate Banking Committee, Mark Zandi of Moody's defined a well-functioning market as one consistent with an economy operating at full employment and growing at its potential rate.

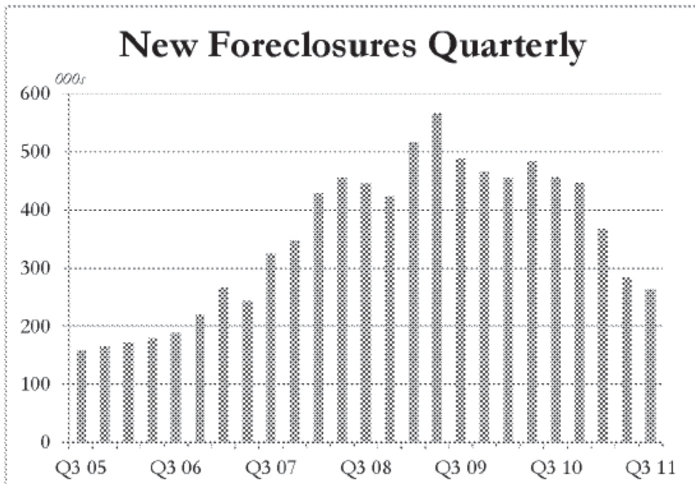
Supply/Demand Imbalance (cont'd)

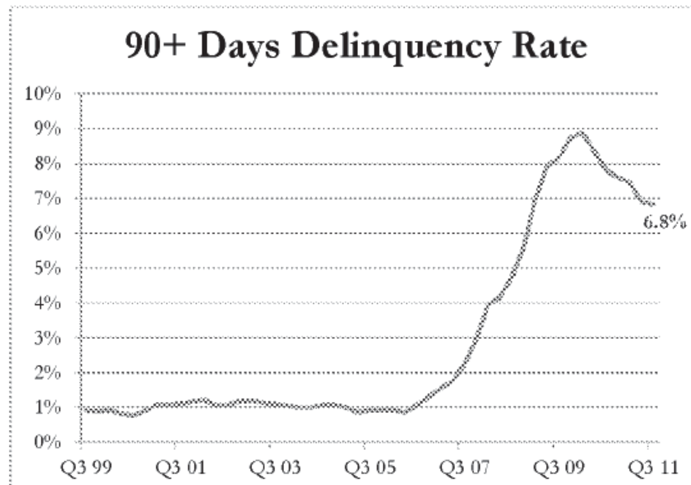
- Housing starts and home sales remain depressed





- Despite millions foreclosures over the past four years, delinquency rates remain elevated and borrowers remain at risk





Sources: Federal Reserve Board, Federal Reserve Bank of New York and NAHB.

Credit Tightening

In the face of a massive supply/demand imbalance and historically low interest rates, availability of credit to creditworthy borrowers appears to have overcorrected in reaction to the loose standards leading up to the financial crisis

- **While some adjustment in credit standards was warranted, onerous credit standards have come in many forms**
  - Larger required down payments
  - High upfront fees and interest rates
  - Stringent underwriting standards
  - Over-complicated documentation requirements and appraisal standards
- **Since June of 2007, 19% of the 55 million mortgage borrowers in the U.S. are at least 90 days delinquent or have defaulted and therefore do not qualify for a new mortgage based on payment history**
- **2009 and 2010 mortgage originations for Fannie/Freddie and banks demonstrated similar very stringent standards, including average FICO scores of 756-762 (~90th percentile) and average LTV ratios of 66-67%**
  - Banks are not filling the credit gap for borrowers that do not qualify for Fannie/Freddie loans
  - To fill the void, the FHA has taken on expanded market share, up to 35% of total government-backed volumes recently from just 10% in 2005
    - Question have been raised in policy circles regarding the FHA's financial health given it expansion in credit risk and potential lack of appropriate levels of capital going forward
- **Given the state of the markets, banks have rationalized servicing operations, thereby reducing overall origination capacity**
  - Additionally, banks are re-evaluating servicing operations in light of unnecessarily punitive capital treatment of mortgage-servicing rights (MSRs) under Basel III

Sources: Amherst Securities Group LP, Corelogic and the Federal Reserve Board.

EXHIBIT 30

From: Bowler, Timothy
Sent: Saturday, August 18, 2012 8:09 AM
To: james_m_parrott@who.eop.gov
Subject: Re: Great job

Thanks Jim

----- Original Message -----
From: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
Sent: Saturday, August 18, 2012 08:06 AM
To: Miller, Mary; LeCompte, Jenni; Stegman, Michael; Bowler, Timothy; Anderson, Matthew; Weideman, Christian; Moore, Megan; Chepenik, Adam; Dash, Eric
Subject: Great job

Team Tsy,

You guys did a remarkable job on the PSPAs this week. You delivered on a policy change of enormous importance that's actually being recognized as such by the outside world (or the reasonable parts anyway), and as a credit to the Secretary and the President. It was a very high risk exercise, which could have gone sideways on us any number of ways, but it didn't- great great work.

EXHIBIT 31

From: Bowler, Timothy
Sent: Friday, August 17, 2012 10:53 PM
To: james_m_parrott@who.eop.gov
Subject: Re: Re:

Yes

----- Original Message -----
From: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
Sent: Friday, August 17, 2012 07:05 PM
To: Bowler, Timothy
Subject: Fw: Re:

?

----- Original Message -----
From: Peter J. Wallison [mailto:PWallison@AEI.org]
Sent: Friday, August 17, 2012 07:05 PM
To: Parrott, Jim
Subject: RE: Re:

Incidentally, Jim, as the portfolios are wound down on an accelerated basis, are profits from that also paid to the Treasury as dividends?

Peter J. Wallison
Arthur F. Burns Fellow in Financial Policy Studies American Enterprise Institute
(o) 202-862-5864
(f) 202-862-4875

-----Original Message-----
From: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
Sent: Friday, August 17, 2012 6:55 PM
To: Peter J. Wallison
Subject: Re:

Thanks- helpful to hear that from you.

And lord knows it's not too late to talk to friends on the hill- they seem a bit misdirected.

Take care.

----- Original Message -----
From: Peter J. Wallison [mailto:PWallison@AEI.org]
Sent: Friday, August 17, 2012 06:43 PM
To: Parrott, Jim
Subject: RE:

Thanks, Jim. I'm sorry that I was out of touch here in Colorado most of the morning. I saw the Treasury press release, and responded to a call from Bloomberg, but did not have an opportunity to discuss my views with friends on the Hill. I thought this was the best move that could have been made under the circumstances. It removes the advantages of delay, which were on the side of F&F's boosters. Nice work.

Very best, Peter

Peter J. Wallison
Arthur F. Burns Fellow in Financial Policy Studies American Enterprise Institute
(o) 202-862-5864
(f) 202-862-4875

-----Original Message-----
From: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
Sent: Friday, August 17, 2012 6:01 PM
To: Peter J. Wallison
Subject:

Good comment in Bloomberg- you are exactly right on substance and intent.

EXHIBIT 32

From: Bowler, Timothy
Sent: Friday, August 17, 2012 3:42 PM
To: Parrott, Jim

I focused on contract and build....

FHFA identifies three strategic goals for the next phase of the conservatorships:

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

From: Parrott, Jim [mailto:James_M_Parrott@who.eop.gov]
Sent: Friday, August 17, 2012 3:20 PM
To: Bowler, Timothy
Subject: RE: Garrett Statement on Treasury Decision to Amend Terms of Fannie and Freddie Bailout

will call him, but this the right answer?

we've closed off possibility that they every go (pretend) private again and sped up the clock on the wind-down of their portfolio, all while increasing the stability of the market by removing concern that these guys run out of support before we have a place to which to transition.

from below seems like you'd want to give up on some or all of that to force Congress to make a decision. strikes me as mighty high risk (and pessimistic about the prospects that we, collectively, would want to sort this out).

From: Russell, Chris [mailto:Chris.Russell@mail.house.gov]
Sent: Friday, August 17, 2012 2:34 PM
To: Parrott, Jim
Subject: Re: Garrett Statement on Treasury Decision to Amend Terms of Fannie and Freddie Bailout

Preference is not to have two defacto public utilities with a $274 bill capital cushion

Where is the impetus now to deal with the issue? The dividends were initially set like that for a reason

In regards to them keeping additional profits, in my mind that is only an accounting issue, gov recoups now (per new method) or later when we liquidate them and then realize those gains for the taxpayer

As far as market perception, I don't think current yields on agencies indicate any additional concerns by investors - and I think it's a good thing if investors realize they won't always have 90 percent of mortgage market going through government, then there might be incentives for market participants to develop some new methods to get mortgages to investors

If I am a potential issuer now, what incentive do j have with a higher regulatory burden via dfa and higher costs vs gse's?? None

Does this make sense?

Sent from my iPhone

On Aug 17, 2012, at 2:05 PM, "Parrott, Jim" <James_M_Parrott@who.eop.gov> wrote:

> your preference would be to continue to have them pay a dividend that in any given month either requires them to eat into their headroom under the caps (after next year), scaring the hell out of the market, or pays less than their profits in that quarter, allowing them to recapitalize? idea being, I guess, that the former will force congress to act?
>
> **From:** Russell, Chris [mailto:Chris.Russell@mail.house.gov]
> **Sent:** Friday, August 17, 2012 1:57 PM
> **To:** Parrott, Jim
> **Subject:** Re: Garrett Statement on Treasury Decision to Amend Terms of Fannie and Freddie Bailout
>
> It MIGHT be net positive WHEN they r turning a profit
>
> But based on the discussions I had this morning with other experts in the field, the consensus is that this essentially removes any pressure points to do something eventually with them and puts it well after 16. As u well know, politicians sometimes don't act unless they are forced to
>
> Happy to talk with u on it whenever
>
> 202-870-8348
>
> Sent from my iPhone
>
> On Aug 17, 2012, at 1:37 PM, "Parrott, Jim" <James_M_Parrott@who.eop.gov> wrote:
>
>> must say that this caught me by surprise. we're not reducing their dividend but including in it every dime these guys make going forward and ensuring that they can't recapitalize.
>>
>> if there's any misunderstanding give me a shout- glad to loop you into cap markets folks to clarify.
>>
>> **From:** Rice, Adam [mailto:Adam.Rice@mail.house.gov]
>> **Sent:** Friday, August 17, 2012 12:52 PM
>> **To:** Rice, Adam
>> **Subject:** Garrett Statement on Treasury Decision to Amend Terms of Fannie and Freddie Bailout
>>
>> <image001.jpg>
>>
>> FOR IMMEDIATE RELEASE Contact: Amy Smith
>> August 17, 2012 Phone: 202-225-4465

Garrett Statement on Treasury Decision to Amend Terms of Fannie and Freddie Bailout

WASHINGTON, DC – Rep. Scott Garrett (R-NJ), Chairman of the House Financial Services Subcommittee on Capital Markets and Government-Sponsored Enterprises issued the following statement today after the Treasury Department announced a plan to reduce the dividend rate paid to the Secretary of the Treasury on senior preferred stock of Fannie Mae and Freddie Mac:

"Today's announcement from the Treasury Department is yet another example of the Obama Administration continuing to kick-the-can on important policy decisions instead of working with Congress to enact meaningful reform. The reduction of the dividend payments for Fannie Mae and Freddie Mac will ensure the American taxpayers remain on the hook for the bailout of these two failed institutions for the foreseeable future. The crony-capitalism that has become a centerpiece of the Administration's failed economic policy must come to an end. This decision is a slap in the face to the hardworking American taxpayers who deserve to be compensated and fully repaid for their dollars that fueled the government takeover of the mortgage twins. Instead of devoting time and energy towards prolonging bailouts, the Obama Administration should work with Congress to wind these companies down and create a new and sustainable housing finance system where taxpayers are not at risk."

###

EXHIBIT 33

From: Parrott, Jim <James_M_Parrott@who.eop.gov>
Sent: Friday, August 17, 2012 8:46 AM
To: Bowler, Timothy; Miller, Mary
Subject: FW: Nice - I like it

all the investors will get this very quickly.

From: Mary Goodman [mailto:Mary.Goodman@jaecredit.com]
Sent: Friday, August 17, 2012 8:45 AM
To: Parrott, Jim
Subject: Nice - I like it

Nice - I like it. The assessment I shared with my colleagues is below - FWIW.

*****
Key issues:

- Faster reduction of mortgage portfolios (not clear whether this implies net sales or whether would be consistent with runoff)
- Ends the payment of high-coupon dividends on USG pref shares – replaces that with a "full income sweep" quarterly – so no chance that GSEs recap themselves through higher earnings

This should have the effect of stretching out the $$$ which the USG has pledged in the backstops to the GSEs. The total $$$ amount on those backstops gets locked in at the end of this year. By ending the high-coupon dividend payments, Treasury reduces the "draws" on the backstops from any quarterly loss. So it leaves more money in the backstop to cover any future real losses that might materialize. (That money could also cover any losses that were materialized through some sort of future restructuring operation in coming years.)

The principle of 'full income sweep of all future earnings to benefit taxpayers" should lay to rest permanently the idea that the outstanding privately held pref will ever get turned back on.

From: Mary Goodman
Sent: Friday, August 17, 2012 8:35 AM
To: Robert Miller; Frederic Ryser; Daniel Gish; Randy Masel; Simon Park; Eugene Burger; Richard Labriola; Dylan Minert
Subject: Treasury Announcement

Treasury Department Announces Further Steps to Expedite Wind Down of Fannie Mae and Freddie Mac

8/17/2012
Page Content

Modifications to Preferred Stock Purchase Agreements Will Make Sure That Every Dollar of Earnings Fannie Mae and Freddie Mac Generate Will Benefit Taxpayers

Announcement Will Support the Continued Flow of Mortgage Credit during a Responsible Transition to a Reformed Housing Finance Market

WASHINGTON -- The U.S. Department of the Treasury today announced a set of modifications to the Preferred Stock Purchase Agreements (PSPAs) between the Treasury Department and the Federal Housing Finance Agency (FHFA) as conservator of Fannie Mae and Freddie Mac (the Government Sponsored Enterprises or GSEs) that will help expedite the wind down of Fannie Mae and Freddie Mac, make sure that every dollar of earnings each firm generates is used to benefit taxpayers, and support the continued flow of mortgage credit during a responsible transition to a reformed housing finance market.

"With today's announcement, we are taking the next step toward responsibly winding down Fannie Mae and Freddie Mac, while continuing to support the necessary process of repair and recovery in the housing market," said Michael Stegman, Counselor to the Secretary of the Treasury for Housing Finance Policy. "As we continue to work toward bi-partisan housing finance reform, we are committed to putting in place measures right now that support continued access to mortgage credit for American families, promote a responsible transition, and protect taxpayer interests."

The modifications to the PSPAs announced today are consistent with FHFA's strategic plan for the conservatorship of Fannie Mae and Freddie Mac that it released in February 2012. The modifications include the following key components:

Accelerated Wind Down of the Retained Mortgage Investment Portfolios at Fannie Mae and Freddie Mac

The agreements require an accelerated reduction of Fannie Mae and Freddie Mac's investment portfolios. Those portfolios will now be wound down at an annual rate of 15 percent – an increase from the 10 percent annual reduction required in the previous agreements. As a result of this change, the GSEs' investment portfolios must be reduced to the $250 billion target set in the previous agreements four years earlier than previously scheduled.

Annual Taxpayer Protection Plan

To support a thoughtfully managed wind down, the agreements require that on an annual basis, each GSE will – under the direction of their conservator, the Federal Housing Finance Agency – submit a plan to Treasury on its actions to reduce taxpayer exposure to mortgage credit risk for both its guarantee book of business and retained investment portfolio.

Full Income Sweep of All Future Fannie Mae and Freddie Mac Earnings to Benefit Taxpayers for Their Investment

The agreements will replace the 10 percent dividend payments made to Treasury on its preferred stock investments in Fannie Mae and Freddie Mac with a quarterly sweep of every dollar of profit that each firm earns going forward.

This will help achieve several important objectives, including:

- Making sure that every dollar of earnings that Fannie Mae and Freddie Mac generate will be used to benefit taxpayers for their investment in those firms.
- Ending the circular practice of the Treasury advancing funds to the GSEs simply to pay dividends back to Treasury.
- Acting upon the commitment made in the Administration's 2011 White Paper that the GSEs will be wound down and will not be allowed to retain profits, rebuild capital, and return to the market in their prior form.
- Supporting the continued flow of mortgage credit by providing borrowers, market participants, and taxpayers with additional confidence in the ability of the GSEs to meet their commitments while operating under conservatorship.
- Providing greater market certainty regarding the financial strength of the GSEs.

For a copy of the modification agreements for the PSPAs, please visit, link and link.

###

SHARE

EXHIBIT 34

Freddie Mac
We make home possible®

US Department of Treasury

August 9, 2012

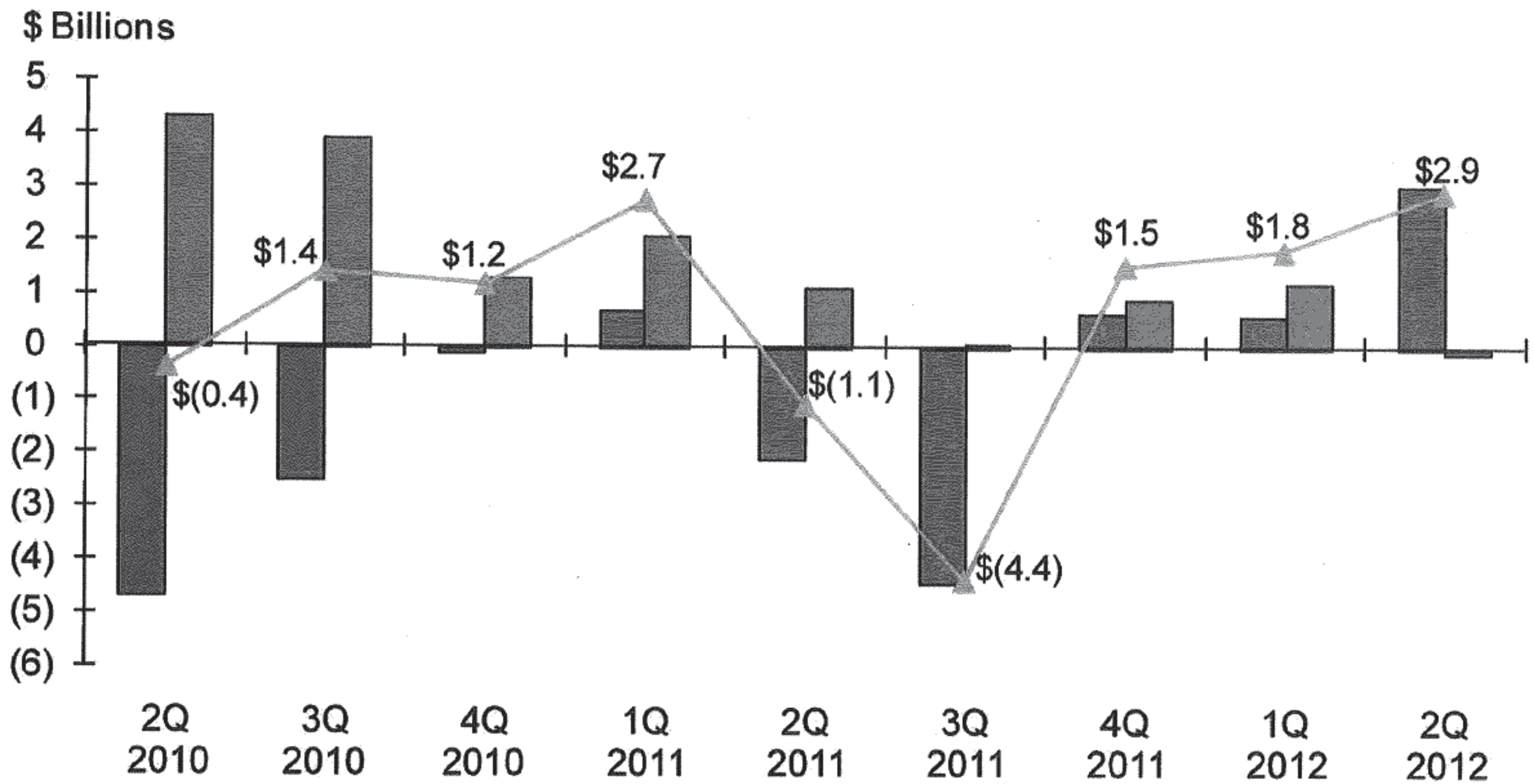
Quarterly net income and comprehensive income (loss)

Freddie Mac

($ Millions)	2Q 2011	1Q 2012	2Q 2012	2Q 2012 vs 1Q 2012
1 Net interest income	$4,561	$4,500	$4,386	($114)
2 Provision for credit losses	(2,529)	(1,825)	(155)	1,670
3 Net interest income after provision for credit losses	**2,032**	**2,675**	**4,231**	**1,556**
Non-interest income (loss)				
4 Derivative gains (losses)	(3,807)	(1,056)	(882)	174
5 Net impairment of available-for-sale securities recognized in earnings	(352)	(564)	(98)	466
6 Other non-interest income	302	104	229	125
7 Non-interest income (loss)	**(3,857)**	**(1,516)**	**(751)**	**765**
Non-interest expense				
8 Total administrative expenses	(384)	(337)	(401)	(64)
9 Real estate owned operations income (expense)	(27)	(171)	30	201
10 Other expenses	(135)	(88)	(165)	(77)
11 Non-interest expense	**(546)**	**(596)**	**(536)**	**60**
12 Income (loss) before income tax benefit	**(2,371)**	**563**	**2,944**	**2,381**
13 Income tax benefit	**232**	**14**	**76**	**62**
14 Net income (loss)	**(2,139)**	**577**	**3,020**	**2,443**
15 Total other comprehensive income (loss), net of taxes	**1,039**	**1,212**	**(128)**	**(1,340)**
16 Comprehensive income (loss)	**($1,100)**	**$1,789**	**$2,892**	**$1,103**

- **Line 2:** Provision for credit losses decreased in 2Q 2012 primarily due to lower estimated future losses due to the positive impact of an increase in national home prices.
- **Line 15**: The shift from total other comprehensive income in 1Q 2012 to total other comprehensive loss in 2Q 2012 primarily reflects the adverse impact of spread widening on non-agency AFS securities, partially offset by higher fair value gains on agency and non-agency AFS securities due to declining long-term interest rates.

Comprehensive income (loss)



A Net income (loss)

B Total other comprehensive income (loss), net of taxes[1]

C = A + B Comprehensive income (loss)

[1] Consists of the after-tax changes in: (a) the unrealized gains and losses on available-for-sale securities; (b) the effective portion of derivatives previously accounted for as cash flow hedges; and (c) defined benefit plans.

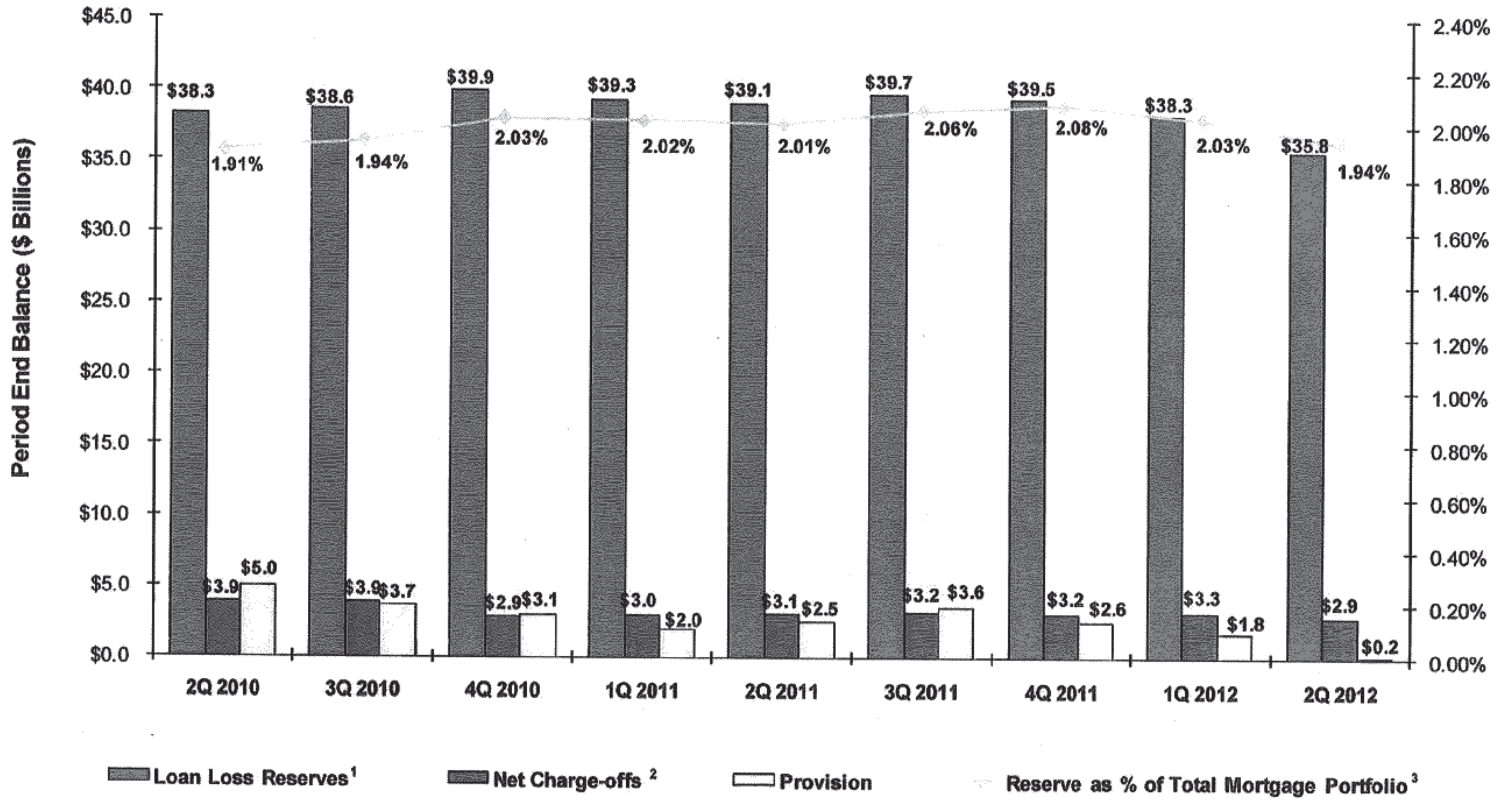
Total equity (deficit) and Senior Preferred Stock activity

Freddie Mac

($ Millions)	2Q 2011	3Q 2011	4Q 2011	1Q 2012	2Q 2012
1 Beginning balance - Total equity (deficit) / GAAP net worth	$1,237	($1,478)	($5,991)	($146)	($18)
2 Capital draw funded by Treasury	0	1,479	5,992	146	19
3 Net income (loss)	(2,139)	(4,422)	619	577	3,020
4 Total other comprehensive income (loss), net of taxes	1,039	46	887	1,212	(128)
5 **Comprehensive income (loss)**	**(1,100)**	**(4,376)**	**1,506**	**1,789**	**2,892**
6 Dividends paid to Treasury	(1,617)	(1,618)	(1,655)	(1,807)	(1,809)
7 Other	2	2	2	0	2
8 **Ending balance - Total equity (deficit) / GAAP net worth**	**($1,478)**	**($5,991)**	**($146)**	**($18)**	**$1,086**
9 Requested capital draw	$1,479	$5,992	$146	$19	$0
10 Aggregate liquidation preference of the senior preferred stock (including the current quarter's requested capital draw)	$66,179	$72,171	$72,317	$72,336	$72,336

Loan loss reserves

Freddie Mac



[1] Consists of the allowance for loan losses and the reserve for guarantee losses.

[2] Includes amounts related to certain loans purchased under financial guarantees and reflected within other expenses on the company's consolidated statements of comprehensive income.

[3] Total mortgage portfolio, excluding non-Freddie Mac securities.

expect material release of loan loss reserve in the future

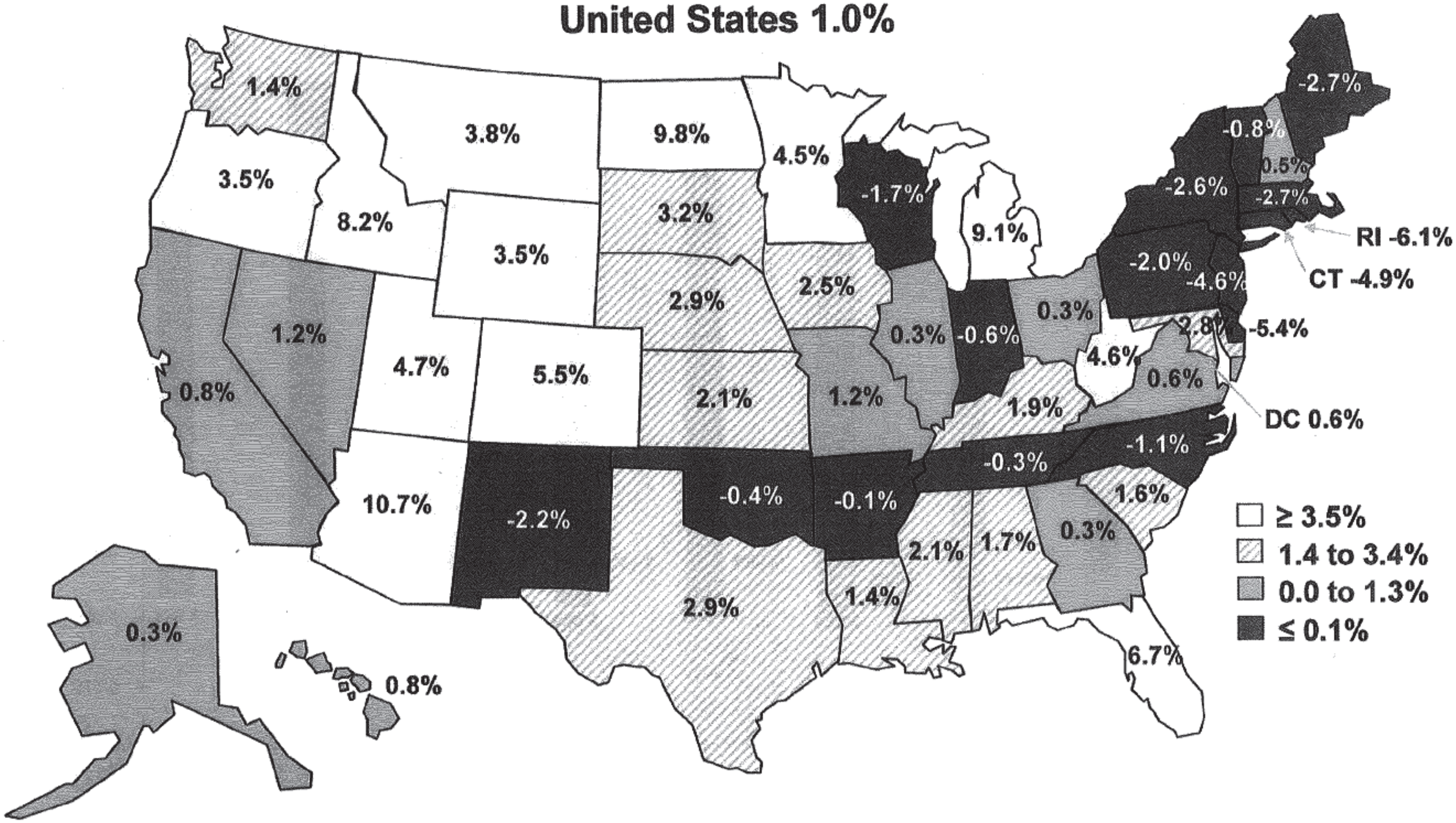
UST00532173

House Price Performance By State

June 2011 to June 2012[1]

Freddie Mac

United States 1.0%



[1] The Freddie Mac House Price Index for the U.S. is a value-weighted average of the state indexes where the value weights are based on Freddie Mac's single-family credit guaranteed portfolio.

Source: Freddie Mac

Office of the Chief Economist

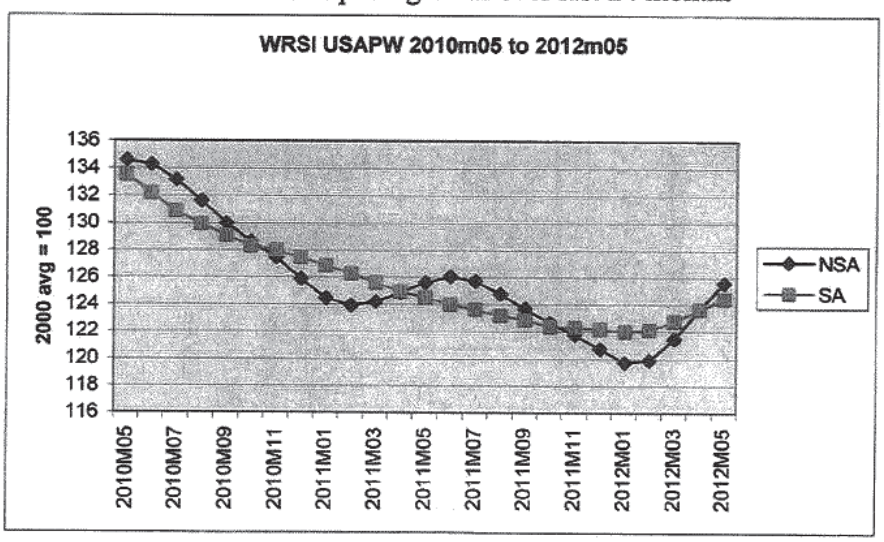
HPA Comparison Table **CONFIDENTIAL**

WRSI House Price Information	Not Seasonally Adjusted	Seasonally Adjusted	12-month Growth
Latest WRSI growth: May-June	1.4%	---	1.0%
WRSI growth: April-May	1.6%	0.6%	-0.0%

Other Recent House Price Information (Monthly Growth)	Not Seasonally Adjusted	Seasonally Adjusted	12-month Growth
Loan Prospector Growth: Jun-Jul	0.8%	0.7%	2.5%
Loan Prospector Growth: May-Jun	1.3%	0.6%	1.7%
Case Shiller 20 Metro: Apr-May	2.2%	0.9%	-0.7%
FHFA Purchase-only index: Apr-May	1.8%	0.8%	3.8%
CoreLogic National index: Apr-May	1.8%	---	2.0%
Expanded PW WRSI: May-Jun	1.8%	---	1.9%
Growth Excluding Distressed Sales			
CoreLogic non-distressed: Apr-May	2.3%	---	2.7%
WRSI: REOs removed, May-June	0.7%	---	-0.7%

WRSI State-Level Growth: Key States April-May	Not Seasonally Adjusted	Seasonally Adjusted	12-month Growth
AZ	0.6	0.0	9.9
CA	1.5	0.8	-0.9
FL	1.6	0.9	5.7
GA	1.8	0.7	-1.6
IL	3.2	1.8	-4.2
MI	4.5	2.1	6.3
NV	1.7	1.1	-0.6
NY	0.2	-0.2	-2.0
TX	0.6	-0.2	3.1
VA	1.8	0.6	-0.5

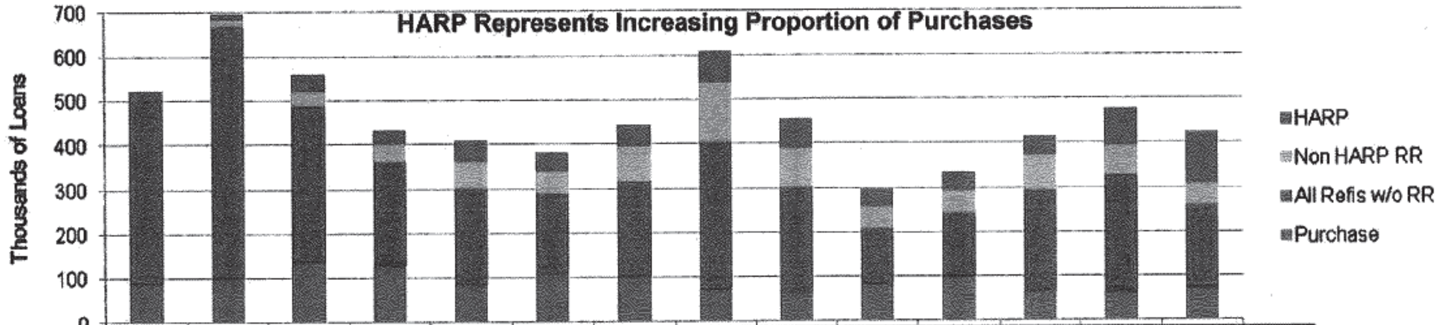
Chart of house price growth over last 24 months



HARP Program Details

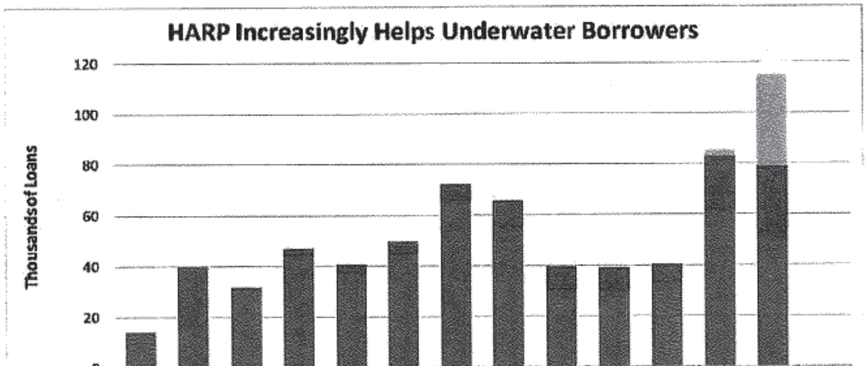
- Since inception, Freddie Mac has purchased over $147B of HARP loans, helping over 680,000 borrowers.
- Since 1Q09, Freddie Mac has purchased almost $995B in total refi's, helping approximately 5M borrowers.

30% → 15 yrs



	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	Total
HARP	0	14	40	32	47	41	50	72	66	40	39	40	85	115	680
Non HARP RR	0	14	29	40	61	50	81	133	87	50	51	79	67	50	791
All Refis w/o RR	434	569	352	234	214	179	212	332	237	125	140	229	264	185	3,706
Total Refis	434	597	421	305	322	270	343	536	390	214	230	348	416	350	5,178
Purchase	90	100	139	129	88	111	104	73	65	84	103	67	64	74	1,292

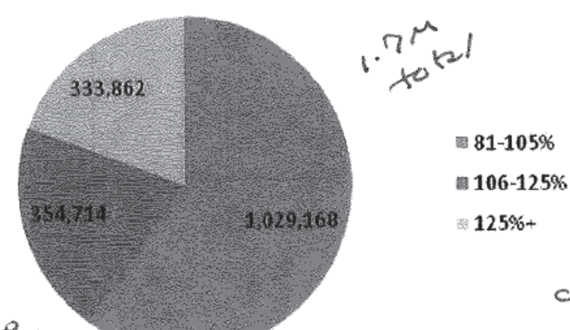
below 80 LTV not reflected here



	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	Total
>125	0	0	0	0	0	0	0	0	0	0	0	2	36	38
106 to 125	0	0	1	3	3	5	6	11	9	9	7	21	26	101
80 to 105	14	40	31	44	37	45	66	55	30	30	33	62	52	541
Total	14	40	32	47	41	50	72	66	40	39	40	85	115	680

June 2012 Loan Count
HARP Eligible Only

1.7M total



default rate on HARP refis far lower than from 20 → 10

open access

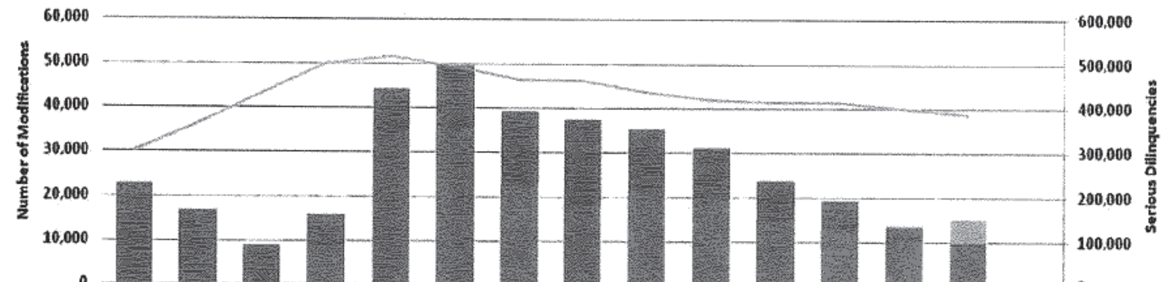
680,000

as much as 400,000 in 2012

HAMP Program Details

- Since inception of the HAMP program in 2Q09 through 2Q12, Freddie Mac completed 211K HAMP modifications.
- Freddie Mac completed 373K total loan modifications from 1Q09 thru 2Q12.

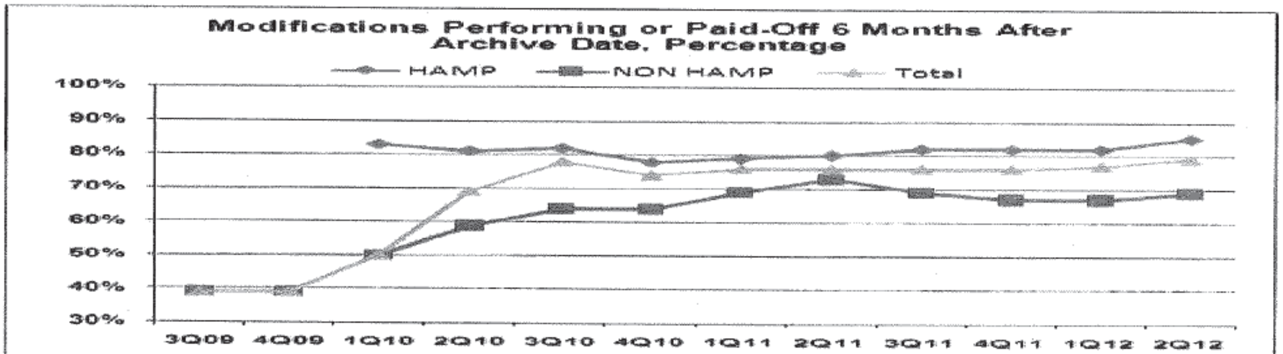
Loan Modifications (Approved and Settled)



	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	Total
SAI/STD	0	0	0	0	0	0	0	0	0	0	0	0	413	5,428	5,841
Classic and others	22,675	16,751	8,217	6,618	9,296	13,615	16,420	18,885	13,878	11,077	8,552	6,035	2,599	357	154,975
HAMP	0	0	532	9,131	34,937	35,954	22,845	18,364	21,409	19,862	15,132	13,139	10,665	9,357	211,327
Total	22,675	16,751	8,749	15,749	44,233	49,569	39,265	37,249	35,287	30,939	23,684	19,174	13,677	15,142	372,143
SD90+ / FCL	302,115	361,807	431,748	498,829	516,219	492,500	464,367	462,439	436,314	417,457	413,859	414,134	400,787	386,570	

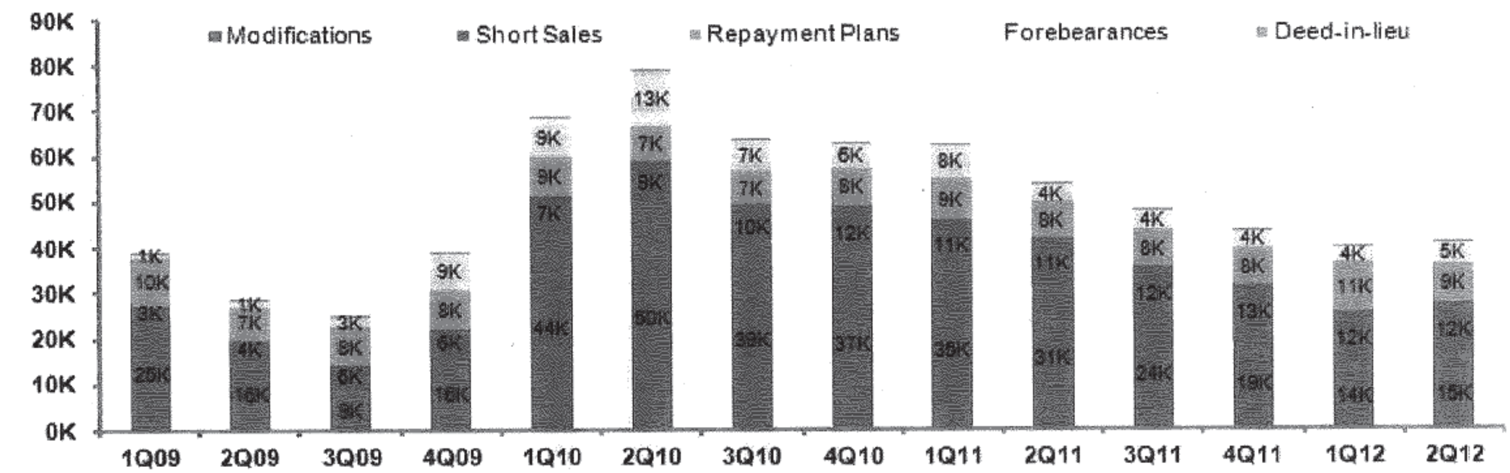
Note: As of the end of 2Q12, ~72% of the total seriously delinquent population is in foreclosure.

HAMP = Home Affordable Modification Program, Classic and others = Freddie Mac non-HAMP modification programs, SAI/STD = Servicing Alignment Initiative/ Standard Modification program



Foreclosure Alternatives

- Since 1Q09, Freddie Mac has helped nearly 700,000 borrowers avoid foreclosure



Home Retention and Foreclosure Alternatives, Count

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	Total
Modifications	25K	16K	9K	16K	44K	50K	39K	37K	35K	31K	24K	19K	14K	15K	373K
Short Sales	3K	4K	6K	6K	7K	9K	10K	12K	11K	11K	12K	13K	12K	12K	128K
Repayment Plans	10K	7K	8K	8K	9K	7K	7K	8K	9K	8K	8K	8K	11K	9K	118K
Forebearances	1K	1K	3K	9K	9K	13K	7K	6K	8K	4K	4K	4K	4K	5K	77K
Deed-in-lieu	0.1K	0.1K	0.1K	0.1K	0.1K	0.1K	0.1K	0.1K	0.1K	0.1K	0.2K	0.1K	0.2K	0.3K	2K
Total	39K	29K	25K	39K	69K	79K	64K	63K	63K	54K	48K	44K	40K	41K	697K

Security Performance - Background

Freddie Mac

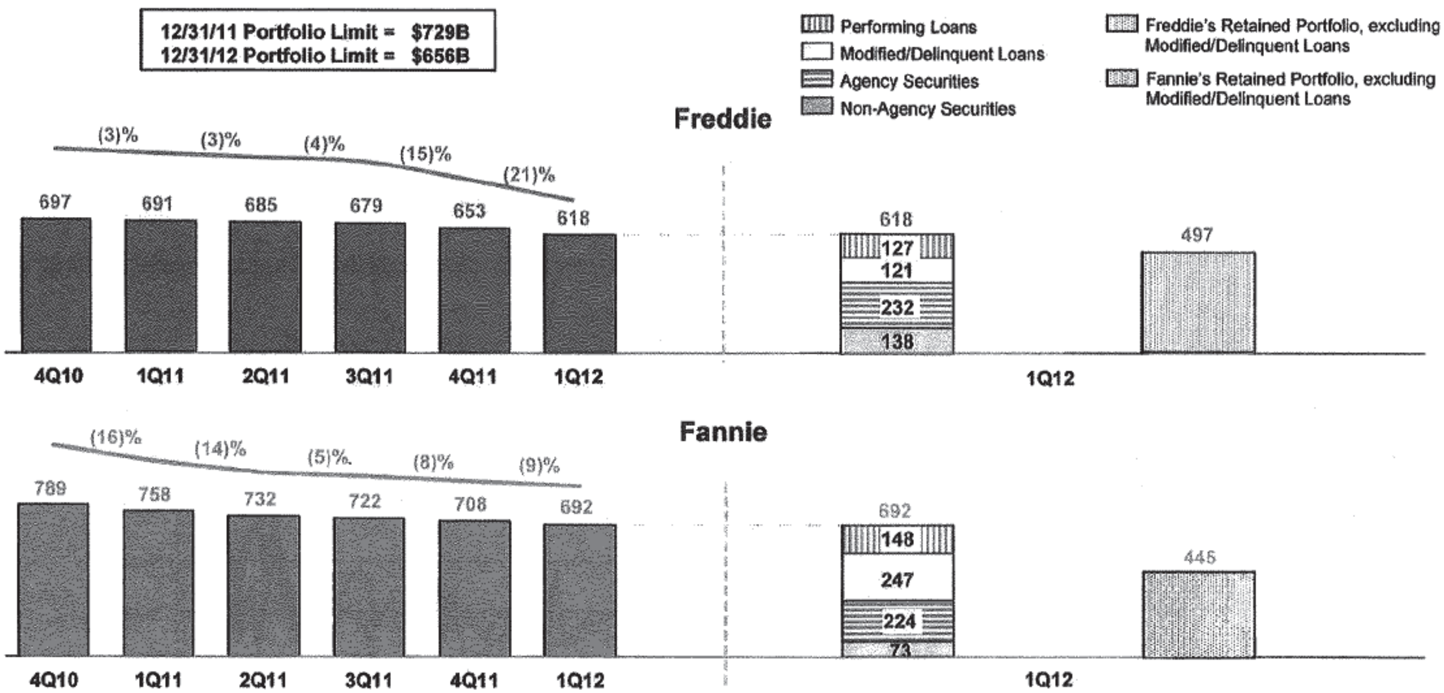
- Freddie Mac's security performance issues date back to 1990, when the Gold PC was introduced
- During that time, the market adopted Fannie Mae MBS as the benchmark security
- Over the last 20+ years, the market has priced the Gold / Fannie swap for prepayment and liquidity differences
- The recent decline in relative value of the PC has raised concerns as to the relevance of Freddie Mac

[redacted]

[redacted]

Freddie vs. Fannie Retained Portfolio: Balance and Composition

Retained Portfolio Balance and Composition
($ Billions)



- Freddie's retained portfolio has declined faster than Fannie's portfolio over the past two quarters, but prior to that Fannie's was running off at a faster rate.
- Freddie's overall retained portfolio is 12% lower than Fannie's, but excluding Modified/Delinquent Loans, Freddie's "earning assets" are 12% higher than Fannie's.

Market Confidence Issues

Freddie Mac

- The market is essentially saying they don't want [Freddie Mac] ...."There's no demand and artificial supply because Freddie is paying originators to make [Gold securities] " - Scott Simon quoted in Bloomberg article by Jody Shenn, June 26, 2012
- Given they're both government controlled .....they need to make Golds not trade like they're diseased" - Scott Simon quoted in Bloomberg article by Jody Shenn June 26, 2012
- Treasury/FHFA need to instill investor confidence regarding intermediate term outlook for Freddie Mac....A Fannie Mae only conventional market is not viable in the long run" - CSFB Research, July 2012
- Current market pricing ... puts Freddie Mac at a disadvantage, leading to reduced liquidity and trading volume in their TBA's, potentially leading to a vicious downward spiral as market share drops." Deutsche Bank research , 6 June, 2012.
- A near term solution that would ensure standardization involves originators being directed to deliver all assets to the GSE's through channels they currently use to deliver assets to Fannie Mae" ASF white paper on Single Agency Security July 2, 2012.

RISK SHARING PROJECTS

Freddie Mac

- **Mortgage Insurers**
  - Background: industry distress
  - Mission concern: >80% capacity
  - Credit ratings upside: BBB?
  - Counterparty risk: inefficient capital structure
  - Conclusion: not appropriate for further investigation

- **Securitization**
  - STACR structure has potential (no counterparty risk, rifle-shot at cost-effective "slice of risk")
  - Issues:
    - 30 year vs. 15 year
    - Percentage of risk laid off
    - Ability to calculate cost of capital
    - Size of market
    - Accounting (esp. vs. PSPA draws) – volatility and cost
    - Timing vs. market appetite for mortgage credit risk
  - Conclusions: worth doing more homework, possible pilot transaction

Annualized Voluntary Turnover by Month

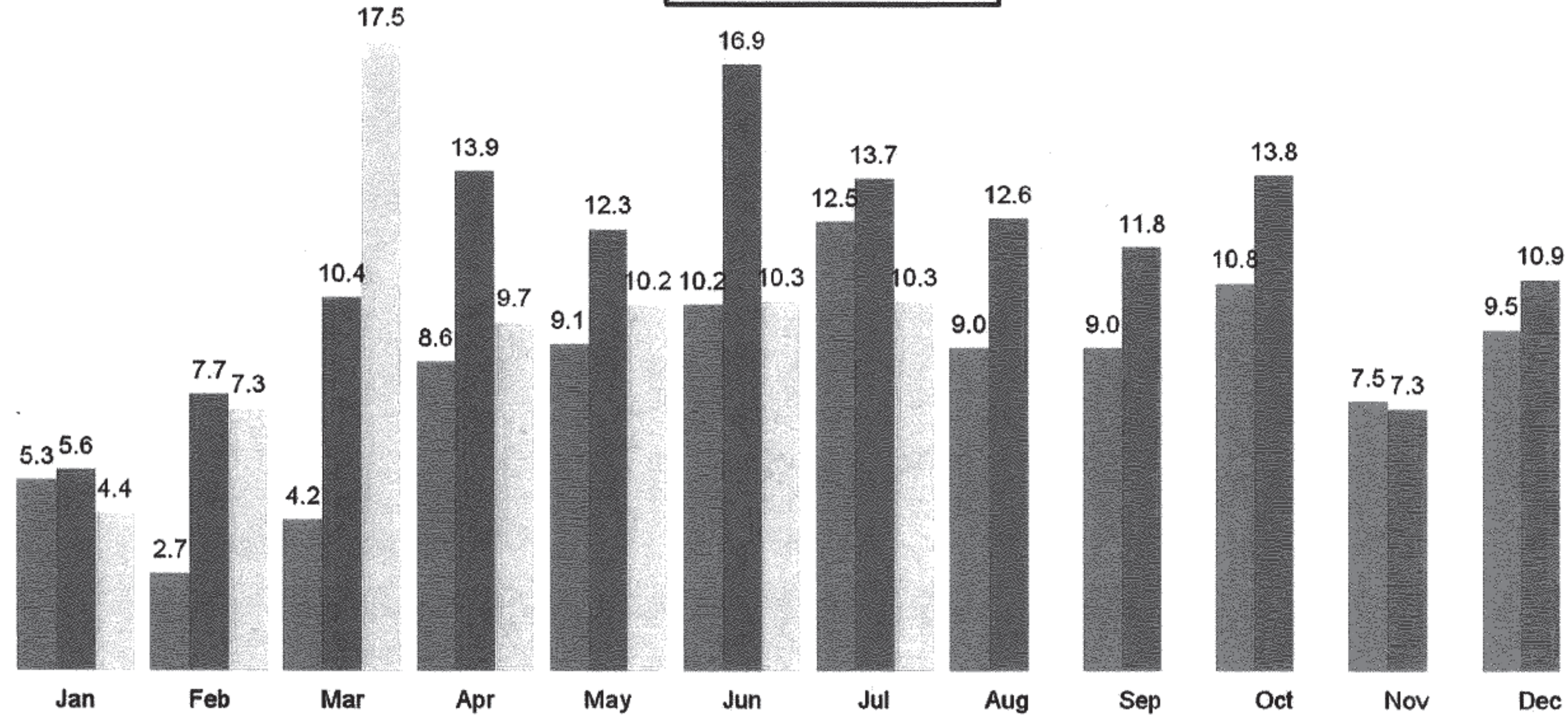
Percent

Annual rates	
2010	8.2%
2011	11.4%
2012 YTD	10.0%

Washington DC Unemployment rates

2010	6.3%
2011	5.8%
Current (May)	5.3%

2010 2011 2012



* Nonexecutive short-term incentives were paid in March 2010 and February 2011 and 2012

EXHIBIT 35

From: ExecSecProcessUnit
Sent: Tuesday, April 24, 2012 10:29 AM
To: TFG75
Cc: ExecSecProcessUnit; ExecSecStaff
Subject: California and Nevada Trip Notes
Attachments: _R LA and Vegas Trip Notes 2012-04-24.docx

Sir,

Please find pasted below and attached a note from U/S Miller regarding her recent travels to California and Nevada. Sam Valverde is available for any comments for questions that may arise.

NOTE FOR SECRETARY GEITHNER
DEPUTY SECRETARY WOLIN

FROM: Mary Miller, Under Secretary for Domestic Finance

SUBJECT: California and Nevada Trip Notes

I traveled to Los Angeles last week to meet with a variety of investment managers in advance of a speech in Nevada to the National Federation of Municipal Analysts and a meeting with the Nevada Hardest Hit Fund. I was accompanied by Bret Hester.

In Los Angeles, we met with equity and fixed-income portfolio managers and analysts from Capital Group, TCW, and Western Asset Management Company (WAMCO). All of the investors we met with asked a number of questions about both the progress and substance of regulatory reform implementation. They were interested in the implications for the financial sector in particular, both from the perspective of their investment decisions and from the perspective of how liquidity and capital commitments provided by their bank counterparties might be affected. They were also all very interested in the status of housing finance reform, and the capping of support under the Preferred Stock Purchase Agreements (PSPAs) at the end of this year. Finally, all were interested in our debt management strategy, including the possible issuance of floating rate notes, and plans for dealing with the fiscal cliff at the end of 2012.

<u>Regulatory Reform Implementation:</u>

The Capital Group team asked a number of questions about the bank stress tests. While noting that the Comprehensive Capital Adequacy Review (CCAR) is far more credible than the European Banking Authority stress tests, they questioned whether the CCAR is still overly countercyclical. They suggested that it would be useful to run a variety of more speculative scenarios and assess how the potential fallout from those scenarios might affect capital levels.

All of the investors that we met with expressed considerable concern about money market fund reform. TCW noted that it is closing its relatively small money market fund (approximately $100 million), due to both the marginal economics of running the fund in the current interest rate environment as well as uncertainty about upcoming regulatory changes. They noted that, unlike other mutual fund products where it is important to establish an investment track record for purposes of marketing, it would be relatively easy to restart a money market fund in the future because money market funds are sold on the basis of the reputation of the manager and their current yield rather than their track record.

WAMCO discussed the various money market fund proposals the SEC is reportedly considering and thought that the capital buffer offers the most promise for a workable solution. Their view is that the holdback proposal would have very negative implications for the industry. With respect to floating NAV proposals, they indicated that they would likely be able to maintain a significant investor base under such a scenario, but that other fund complexes would likely lose significant assets. They also noted that they thought one likely outcome of the reform proposals overall would be for a much more concentrated industry, centered around bank sponsors. WAMCO also noted that the SEC had signaled to WAMCO that the SEC was being pressured to push forward with reform by other regulators, the Federal Reserve in particular.

WAMCO also asked about the implications of financial regulatory reform with respect to financial institutions' willingness to commit capital and provide needed market liquidity. They noted that liquidity has decreased significantly from pre-crisis levels (although has recently showed signs of rebounding) and that dealers' inventory positions have shrunk meaningfully. They acknowledged that much of the reduced liquidity is attributable to the economic environment and firms' "damaged risk profiles" but asserted that reduced liquidity is also attributable to uncertainty about regulatory requirements. As one example, they pointed to the fact that all stand-alone proprietary trading desks have been shuttered and that alternative liquidity providers have not yet emerged. WAMCO also acknowledged, however, that the market is perhaps returning to a more normalized liquidity environment, and that the "instant liquidity" environment that prevailed in the decade leading up to the crisis did not necessarily reflect an optimal scenario. Finally, they noted that trading is increasingly dominated by a smaller fraction of the market; in other words, the most liquid issues and biggest names (e.g., Ford) are trading more frequently whereas less liquid issues are trading less.

We also briefly touched on Moody's anticipated downgrades of the banking sector. Capital Group indicated that they were not particularly concerned, but were avoiding the weakest names in the sector, which they identified as Morgan Stanley, followed by Goldman Sachs. They noted that bank funding models continue to strengthen, with more terming out of repo and less reliance on non-traditional repo. They also believe that strong deposit bases are helping to reduce banks' reliance on short-term funding. Investment banking operations are the exception to this general trend.

Housing Finance Reform:

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In addition to asking about the next steps on housing finance reform, TCW said that it is important to show action towards the goals set out in the White Paper. Their view is that either nothing is happening or the actions that are being taken are going in the opposite direction of the objectives set forth in the White Paper, such as the extension of higher conforming loan limits. While they acknowledged that is important for the housing market to heal before meaningful housing finance reform can proceed, they urged the government (collectively referencing Congress and the Administration) not to send "misleading signals."

The Capital Group team noted that it is challenging to attract new investors to housing-focused funds while so much uncertainty remains over what the market will look like in the future. As one example, they referenced the difficulty they had recently experienced in writing a prospectus for a new mortgage-focused fund because of the lack of clarity about how investment opportunities might evolve.

Debt Management / Fiscal Situation:

All of the investors we met with were concerned about a repeat of the debt-limit impasse from August 2011, focusing on the fiscal cliff at the end of 2012 when we will approach the debt limit, tax cuts will expire, and the automatic sequester will begin to take effect. The Capital Group inquired whether planning was already underway to allocate the cuts that will be required by the automatic sequester. Despite expressing concerns about the debt limit and the fiscal situation, the teams we met with indicated that these concerns were not currently reflected in their portfolios. The general consensus was that U.S. Treasuries remain the most attractive and safest option compared to other sovereign debt. The investment teams we met with were still concerned about tail risks in Europe and indicated they had been reducing their European exposure into recent strength in those markets.

The fixed-income investors were interested in Treasury's possible issuance of floating rate notes. They did, however, emphasize the importance of maintaining sufficient Treasury bill issuance to support market demand. TCW raised the idea of using a one- or two-year Constant Maturity Treasury (CMT) as the reference rate for a floating rate note, with the note trading at a negative spread to the CMT rate. With respect to making floating rate notes eligible for money market funds, TCW proposed either allowing the note to be puttable at a discount after, e.g., two years, or puttable at par after having been issued at a premium.

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They indicated that the housing market is so bleak that homeowners have been reluctant to seek assistance from the HHF that may only provide limited relief. For example, the prospect of $50,000 of principal reduction may not be enough to encourage homeowners who are hundreds of thousands of dollars underwater to participate. Additionally, they indicated that at least 90 percent of Nevada homeowners have mortgages backed by Fannie Mae or Freddie Mac and have therefore not been able to participate in the Nevada HHF's principal reduction program. The Nevada HHF is working on rolling out a new program as early as May that will work in conjunction with HARP to reach this broader universe of homeowners.

The Nevada HHF identified their second lien relief program as their most successful program to date. Their second lien program requires elimination, rather than just reduction, of any second lien. They indicated that their funds are able to leverage significant additional write-downs, with $16,500 of HHF assistance having facilitated the elimination of a second lien as big $130,000.

Note Clearance Sheet

Subject:	California and Nevada Trip Notes
Drafted:	Domestic Finance – Bret Hester, phone 622-1677
Approved:	Domestic Finance – Under Secretary Mary Miller (4/23/12)
Cleared:	Exec Sec – Sam Valverde (4/24/12)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

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Cleared:	Exec Sec – Sam Valverde (4/24/12)

EXHIBIT 36

Current as of 8/16/2012 at 10:51 AM
Sensitive and Pre-Decisional

PSPA Amendment Q&As

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KEY FRAMING / TALKING POINTS

- We are announcing steps to wind-down the enterprises more quickly and responsibly and make sure they are not allowed to recapitalize and return to the market in their prior form.
- First, we will increase the minimum amount by which they wind-down their portfolios from 10 percent to 15 percent a year, which will mean they hit their wind down target four years earlier than currently scheduled.
- Second, each year, both enterprises will have to submit to Treasury a detailed plan to reduce taxpayer exposure to the mortgage market, which will help us manage their wind-down thoughtfully and responsibly.
- And third, we are replacing the circular 10 percent annual dividend obligation with a quarterly sweep of all of their net income in that period, so that every dollar of profit they make goes back to the taxpayer. That full income sweep will mean that Fannie Mae and Freddie Mac *will be not be allowed* to retain their profits, rebuild capital, and return to the market in their prior form.
- In making these changes, Treasury is protecting the taxpayers' interest and supporting the continued flow of mortgage credit to households during a time of ongoing market stress.

And for capital markets folks:

- By reducing the GSEs' need to continue to borrow unnecessarily from the Treasury to pay the dividend, gradually chipping away at their caps, these changes will also enable the GSEs to provide consistent, reliable support to the mortgage market as we wind them down and transition to a new system in the years to come.

MOST CHALLENGING QUESTIONS

1. **Aren't you giving up a 10 percent dividend owed to taxpayers to prop up the GSEs?**
   - This is wrong. We are putting in place a better deal for taxpayers.
   - This is because, going forward, each of these entities pays the taxpayer back all the profit they make -- not just a 10 percent dividend.
   - Today, when a GSE loses money, it has to borrow money from Treasury to pay Treasury back – a circular process that isn't helping taxpayers. And when the GSEs make a profit, as they did last quarter, they don't have to pay all of that back to taxpayers.
   - The new arrangement changes that – it ends the shell game and makes sure that all profit goes where it should, to repaying taxpayers.
2. **You say you are requiring they pay back all profits, but the agreement creates a $3 billion reserve fund for the GSEs? Why?**
   - This agreement requires that the GSEs return all profits back to the taxpayer, period.
   - Over the next five years, a modest, temporary reserve account will protect taxpayers from having to inject more capital into the GSEs due to short term swings in earnings.

- But 100 percent of the funds in the reserve account, and 100 percent of the profit of these entities generate, will be returned to Treasury and ultimately to taxpayers.

3. **Why didn't you use your leverage in negotiating this arrangement to force the GSEs to do principal reduction?**

- As you know we have been aggressive and public in our position that the FHFA should allow the GSEs to provide principal reduction.
- While we remain adamant that that is the right position, and disappointed with FHFA's response to date, as an independent regulator and conservator of the two GSEs, FHFA is solely responsible for the ultimate decision whether the GSEs can participate or not.
- The PSPA amendments, which require the agreement of both Treasury and the FHFA, do not change that fact. We will continue to advocate for their participation, but it is ultimately up to FHFA.

4. **Does this change simply open the door to keeping the GSEs on perpetual life support rather than winding them down?**

- The opposite is true. With today's announcement, we are achieving three key things:
  - We are accelerating our commitment to responsibly wind down the GSEs and end forever their flawed model of privatized benefits and socialized losses;
  - By requiring the GSEs to increase the pace of reducing their retained portfolios from 10 percent to 15 percent per year, we are accelerating that wind down;
  - We are mandating the development of an annual plan that details the steps the GSEs will take to reduce their financial and operational risk profile
- 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.
- Reinforces the Administration's commitment to responsibly wind down these institutions and replace them with a system driven by private capital with lower risk to taxpayers.

GENERAL QUESTIONS

5. **What were the last terms of the Senior Preferred Stock Purchase Agreements (PSPAs)?**

- When the GSEs were put into conservatorship in 2008, Treasury entered into a Preferred Stock Purchase Agreement with each GSE in order to protect the housing market.
- In any quarter when the GSEs' assets were less than their liabilities, Treasury agreed to provide capital, in the form of senior preferred stock, to ensure the GSEs' solvency.
- The dividend rate on the senior preferred stock is currently 10% and will be changed to a "net worth sweep" as a result of the modification announced today.
- To date, Treasury has provided $116.2 billion of capital to Fannie Mae and earned $25.4 billion of dividends, and provided $71.3 billion of capital to Freddie Mac and earned $20.1 billion of dividends.

6. What does this agreement change?

- *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 Capital Reserve Amount.
- *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 (from a base amount of $650 billion at year end).
    - The annual cap will decline from $650 billion at year end 2012 to $250 billion in 2018 ($250 billion is the "wind down" target in the existing PSPA)
    - Under the existing agreement, the $250 billion cap will not be reached until 2022
    - *Note: the current retained portfolio size at Fannie Mae is $673 billion and the retained portfolio size at Freddie Mac is $581 billion (as of June 30, 2012).*
- *Require an annual taxpayer protection plan be delivered to Treasury* – In order to help protect taxpayers from future losses, each year the GSEs will submit 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
- *Suspend the Periodic Commitment Fee setting process* – Treasury will continue to suspend setting any Periodic Commitment Fee, which is an optional fee not utilized to date intended as an additional means to compensate taxpayers for the financial support that Treasury provides to the GSEs through the PSPAs. This fee is no longer relevant because the GSEs will now be paying all of their profits to Treasury.
- *Allow for more flexibility when making non ordinary course asset and property sales less than $250 million in fair market value without prior written consent from Treasury* – Previously, Treasury had to give prior written consent before the GSEs may sell any assets and properties outside of the GSEs' "ordinary course" of business. In order to facilitate a more rapid wind-down of the GSEs' legacy assets, the change will provide the GSEs and FHFA with the flexibility to sell blocks of assets under $250 million without Treasury's written consent.

7. When will these changes become effective?

- The amendment is effective immediately, and the dividend payment change first applies to the GSEs' financial results as of March 31, 2013 (i.e. the end of the first quarter).

8. What is the purpose, necessity and benefits of these changes?

- In making these changes, Treasury has sought to achieve two key objectives: (1) protecting the taxpayers' interest, and (2) ensuring the continued flow of mortgage credit to households during a time of ongoing market stress.
- The proposed modification has several benefits.
    - Taxpayers will receive every dollar of profit the GSEs make.
    - It reduces the risk of future draws under the PSPAs as future draws will only be needed to fund operating losses.

        - This eliminates the circularity associated with the GSE's drawing from Treasury in order to pay Treasury the 10 percent dividend.
    - Preserves remaining capacity for its original intended use – to support the financial capacity of the GSEs so they can continue providing mortgage finance to families**.**
    - Provides financial clarity for investors in the GSEs MBS & debt instruments.

9. How much PSPA funding capacity is remaining for each GSE?

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

10. Without this amendment, would the GSEs have become insolvent? If so, when?

- The GSEs' future earnings will depend upon a variety of factors, including the pace of repair and recovery in the housing market, the path of home prices, and how those firms our wound down.
- In some quarters, such as the most recent quarter, the GSEs have generated earnings greater than their 10 percent dividend, allowing them to retain profits.
- In other quarters, the GSEs have been unable to generate sufficient earnings to fully pay their 10 percent dividend – creating a circular practice where the GSEs use draws from Treasury to simply pay dividends back to Treasury.
- The changes will take both those issues off the table in a way that protects taxpayer interests and better supports the housing market.
- The modifications will ensure that all future positive earnings from the GSEs will be used to pay back taxpayers for their investment in those firms – and that Fannie and Freddie will not be permitted to rebuild capital as they are wound down.
- Additionally, the changes would reduce future PSPA draws and ensure that those draws are dedicated to supporting the housing market. That will help maintain the continued flow of mortgage credit during a responsible transition by providing the market with greater confidence about the GSEs' ability to meet their commitments.

11. How does the net worth sweep operate?

- Beginning with the financial results as of 1Q 2013, and each quarter thereafter, all positive net worth above a pre-set Capital Reserve Amount 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 or accrued when there is a net worth deficit or net worth is below the Capital Reserve Amount.
- Over time, this will result in all comprehensive income generated by the GSEs being paid to the government and thus the taxpayer.

12. Why not just lower the dividend rate to 5 percent and allow the GSEs to use earnings to pay back the capital Treasury has invested in them?

- Lowering the dividend percent paid would reduce the amount taxpayers are reimbursed for their substantial contribution made to support the GSEs.
- We made these changes to make sure that these entities pay the taxpayer every dollar of profit that they make.

13. Why can't the GSE simply use profits to buy back preferred stock from Treasury?

- Similar to reducing the dividend rate, this would have reduced the amount taxpayers are reimbursed for their substantial contribution made to support the GSEs.

14. How large is the Capital Reserve Amount and why does it exist?

- This agreement requires that the GSEs return all profits back to taxpayers.
- There is a modest, temporary Capital Reserve Amount is $3.0 billion in 2013 and will decrease by $600 million per annum until it reaches zero in 2018.
- The Capital Reserve Amount will provide a cushion against temporary swings in the GSEs earnings due to accounting and hedging practices (i.e. mark-to-market volatility).
- Inclusion of a modest, temporary buffer will protect the taxpayer from having to inject more capital into the GSEs due to quarterly losses that are driven by swings in earnings as result of mark-to-market volatility *(note: if Treasury has to inject funds due to mark-to-market volatility it will reduce the finite PSPA capacity going forward)*.
- The Reserve will fall over time in conjunction with the reduction in the GSEs investment portfolios, which historically have been the key drivers in earnings swings.
- 100 percent of the funds in the reserve account, and 100 percent of the profit that these entities generate, will ultimately be returned to taxpayers.

15. What information will be included in the "Taxpayer Protection Plan" that Fannie Mae and Freddie Mac submit to Treasury? What is the report's purpose? Are there any enforcement or accountability mechanisms?

- 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 risk in each of their core business segments.
- In the plan, the GSEs will lay out, in reasonable detail, specific goals, targets and timetables so both Treasury and their conservator, FHFA, have a clear understanding of how they will improve their management of risk.
- We expect the implementation of the plans will result in a number of meaningful steps that will reduce taxpayer exposure to the GSEs. These will likely include:
    - Working with private investors to syndicate a portion of the credit risk associated with their mortgage guarantees;
    - Selling complex securities in their investment portfolios;
    - Reducing their non-performing loan balances on a more rapid time table;

    - Shedding other "non-core" assets that were purchased prior to the enterprises entering into conservatorship.

- FHFA, as the GSEs' regulator and conservator, will oversee the implementation of the steps outlined in this report. In addition, each GSE will be required to assess the progress it has made in meeting the goals and timetables set forth in the previous year's plan.

16. Why are GSEs allowed to keep portfolios of $250 billion each in 2018 if they are to be wound down?

- Given the size of the current portfolios, transitioning to a balance of $250 billion in only six years represents a substantial reduction within a short timeframe.
- We do not believe it is necessary to change the $250 billion portfolio limit at this time.
- Through their portfolios, the GSEs provide critical functions and services to the mortgage market that will need to exist as long as they are in operation:
    - Purchasing multifamily loans that can't be securitized to make credit available to the multifamily sector;
    - Purchasing loans from community banks to facilitate lending;
    - Purchasing delinquent loans bought out of trusts.

17. What is the Periodic Commitment Fee? Has it ever been set?

- The Periodic Commitment Fee is an additional quarterly fee provided for in the original PSPA agreement that Treasury can charge the GSEs as compensation for the substantial taxpayer support provided by the PSPAs.
- Treasury may waive the quarterly Periodic Commitment Fee for up to one year at a time at its sole discretion based on adverse conditions in the mortgage market.
- To date, the fee has been waived by Treasury for two reasons:
    - The expected financial draws from Fannie Mae and Freddie Mac were in excess of dividends those firms pay back to taxpayers under the PSPAs; accordingly, setting a PCF would not produce any additional income for taxpayers.
    - Setting the PCF could place greater strains on the housing market recovery, which remains fragile.

18. How will this plan help families seeking mortgage credit, troubled homeowners, and the broader housing market?

- *Preserves available mortgage credit on reasonable terms* – Until the private sector reemerges as a significant source of capital to invest in mortgage credit risk, the GSEs will continue to serve as a critical provider of liquidity to first-time homebuyers and borrowers looking to refinance their loans into a lower rate.
- *Maintains market confidence in the GSEs' guarantee obligations* – By changing the former 10 percent dividend to a net worth sweep, this amendment helps preserve confidence in the market and retains borrowing capacity for future net operating losses.

- *Accelerates the sale of non-performing loans* – Selling non-performing loans to private market participants and their specialty servicers can provide greater assistance to troubled borrowers, which should help more troubled homeowners stay in their home.
- *Fuels the recovery of the housing market and the broader economy* – Preserving access to mortgage credit for creditworthy homebuyers helps reduce excess housing inventory in communities hit hardest by the housing downturn. Additionally, enabling ongoing refinancings at lower rates allows more money to be channeled to families' pockets, allowing them to pay off debt or allocate funds for other daily expenses.

19. How will these changes help bring private capital back to take credit risk in the mortgage market?

- This is the next step in the "wind-down" process. In combination with the goals laid out in FHFA's strategic plan for the enterprises, these changes will help bring private market participants back to the housing market in a more meaningful role.
- As part of the taxpayer protection plan, we expect the GSEs to shift credit risk associated with its mortgage guarantee business to private market participants (i.e. risk syndication). This will not only help protect taxpayers, but also provide a platform for private investors to once again take on mortgage credit risk.

20. Why does this agreement exclude a requirement for principal reduction? Did FHFA's decision not to accept Treasury's invitation to participate in HAMP PRA complicate this agreement on the PSPAs?

- As you know Treasury has been aggressive and public in its position that FHFA should allow the GSEs to provide principal reduction. We continue to help these homeowners by addressing troubled, non-performing loans.
- While we remain disappointed with FHFA's decision to not have the GSEs participate in the HAMP PRA program, we recognize that as an independent regulator and conservator of the two GSEs, FHFA is <u>solely</u> responsible for the ultimate decision of whether or not the GSEs may participate.
- Because the PSPAs are financial contracts between Treasury and the GSEs, through FHFA as their conservator, all changes to the PSPAs needed to receive support and agreement from both Treasury and FHFA.

21. What were the previous amendments to the PSPAs and why were those made?

- Over last several years Treasury has taken several steps to ensure the financial stability of the housing market.
- In September 2008, FHFA, as regulator of the GSEs, placed both into conservatorship.
- 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.

22. Why didn't Treasury and FHFA get this right in December 2009? Why must we revisit this issue again?

- In late 2009, Treasury took an important step to stabilize the GSEs and help ensure the continued flow of credit into the mortgage market.
- We believe that action was appropriate at the time.
- However, due to the inherent uncertainty of the market, the length of the necessary transition could not be predicted, nor were we able to foresee how the GSEs' financial profile would evolve.
- Given the GSEs improving operating performance and our goal to wind down the enterprises, we believe this change is appropriate today.
  - Potential for near-term earnings to exceed the 10% dividend.
  - Need for financial flexibility as the GSEs are wound down over time.

23. Can Treasury make further amendments to the PSPAs? If so, until when?

- Treasury and FHFA have authority to make changes to legal agreements, but changing amount of remaining capital support that is available to the GSEs would require Congressional approval.
  - *Note: Commitment 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.

24. What control and authority does Treasury have over Fannie Mae and Freddie Mac?

- Fannie Mae and Freddie Mac are in conservatorship, with FHFA as their conservator.
- Treasury has no operational control or authority over them.
- Notwithstanding Treasury's lack of authority or legal mandate over the Enterprises, we have a common interest in helping families and homeowners as well as protecting the taxpayers' interest in the GSEs.
  - *Note: Treasury and FHFA worked constructively to improve the HARP program that has led to nearly 500,000 streamlined refinancings over the past 9 months.*

25. What enforcement mechanisms ensure the GSEs will 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 valid and legally binding obligations.

FINANCIAL / TAXPAYER IMPACT

26. 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.
- All federal programs that provide direct support to the GSEs, including the Senior Preferred Stock Purchase Agreements (PSPAs), are shown on-budget.
- Taxpayers will receive all positive net worth from the GSEs. While limited in value at this time, Treasury also retains its ability to exercise its GSE stock warrants.

27. 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 $25.6 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 $141.8 billion – $90.6 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 we maximize proceeds returned to taxpayers.

28. How does this change impact existing preferred and common shareholders, including community banks? Does this mean their investments are worthless?

- The preferred and common shareholders of the GSEs do not have voting/governance 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 their financial positions.

HOUSING FINANCE REFORM

29. 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?

- No. The Administration remains committed to winding down the GSEs, as the PSPA revisions help accelerate/reinforce, and will continue to work with Congress in a bipartisan manner to identify a path forward on long-term housing finance reform.

30. Over how long a time period will the transition take place?

- Treasury supports a transition to a long-term housing finance system as soon as practical.

- We look forward to working with Congress to determine what that future housing system should look like and the steps needed to get there.

31. When is the Administration going to submit a long-term housing finance reform plan?

- As Secretary Geithner has stated, we are continuing to work with members of Congress to identify a 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 ensure continued access to mortgage credit for American families, promote a responsible transition, and protect taxpayer interests.

HOMEOWNER IMPACT

32. Why are you giving up leverage with the GSEs by agreeing to make this change without further concessions? Why didn't you use this as leverage to get the GSEs to do more to help homeowners (e.g. principal reduction and/or greater opportunities to refinance)?

- The PSPAs have a very narrow but important scope – to strengthen and stabilize the financials of the GSEs.
- Treasury remains actively engaged with FHFA in exploring ways to help troubled homeowners and to facilitate streamlined refinancing activity for those that are current.

33. Will these changes in the PSPAs make it easier for families to buy a home? Will it lower avg. FICO scores or down payment 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 a still-fragile housing market.
- We are very attuned to the challenges faced by many families seeking to refinance or obtain a mortgage, especially lower-wealth and first-time homebuyers, and we are exploring ways to ease the situation.

34. FHFA recently announced plans to raise mortgage guarantee fees by year end. Why is it necessary to raise the cost of mortgage loans when the market is still struggling?

- Consistent with their strategic plan, FHFA made the decision to raise guarantee fees in order to help bring back private capital back to the housing market.

IMPACT ON THE HOUSING FINANCE MARKET AND THE GSES

35. How will the net worth sweep reassure investors in GSE obligations?

- This change will eliminate the potential for circularity associated with the GSEs requesting additional draws to cover dividend payments. This will make sure the finite amount of PSPA capacity is used only to support the financial stability of the GSEs.
- Given this change, we expect investors to remain confident in the financial stability and strength of the GSEs and be assured that the GSEs will meet their respective obligations.

36. 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?

- The employees of the GSEs have an important role to play in restoring the strength and vitality of the housing market and the stability of the GSEs.
- Through their continued dedication and hard work, these valued employees have made substantial contributions towards achieving these ends.
- By taking steps today to solidify the financials of the GSEs, we are enabling the employees to continue their efforts to meet these goals.
- The employees of the GSEs will play an important role in the transition to a reformed housing market that provides a sustainable source of mortgage credit for homeowners.
- As discussed earlier, the Capital Reserve is temporary in nature and exists to protect the tax payer against future GSEs draws.

37. Will accelerating the wind down of GSEs' retained portfolio adversely impact their operations or the housing market?

- No. In fact, it will put the GSEs on more sound financial footing by giving them the opportunity to reduce their troubled and more complex assets.

38. Will any of the changes affect Freddie Mac differently from Fannie Mae?

- Both GSEs will be required to implement these changes.
- The management of each GSE will tailor their strategies according to their own individual risk profiles and needs.

TIMING / STRATEGY

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

- We are seeking to balance our desire to wind down the GSEs as quickly as possible with the need to help ensure the continued flow of mortgage credit in a fragile housing market.
- Any changes to this system should be made with great care.
- These agreements will give mortgage market participants continued confidence that the GSEs will be able to fulfill their obligations.
- Any wind down will only be effective as part of a broader plan to reform the housing market, and that will require bi-partisan support.

40. Why make this change now, particularly after the GSEs had such a profitable quarter?

- We believe this is the appropriate time to take this step for two key reasons:
  - The change protects the taxpayers' interest in the GSEs by ensuring that they will be the full beneficiary of any profits that the GSEs generate;

  - The adjustment will make sure that future PSPA capacity is only used to support the financial stability of the GSEs.

41. Who were the parties that had to agree to this change? When did that happen?

- Treasury and FHFA, acting as conservator for the GSEs, agreed to the amendment.
- After extensive discussions between Treasury and FHFA, the formal document execution occurred on Friday, August 17.
- The GSE senior management teams were briefed by Treasury and FHFA before changes were executed.

EXHIBIT 37

BRIEFING MEMORANDUM FOR UNDER SECRETARY MILLER

Event: **Meetings with Freddie Mac and Fannie Mae Management Teams**
Date/Loc: Freddie Mac – August 9, 2012 at 11:00 AM, DIP Room
Fannie Mae – August 9, 2012 at 2:00 PM, DIP Room
Press: Closed
From: Timothy Bowler, Deputy Assistant Secretary for Capital Markets

Attached below are several key questions and areas for discussion we believe you should raise during your meetings with the Fannie Mae and Freddie Mac management teams tomorrow. Both Enterprises also plan to provide you with a status update on their financial position, including the most recent earnings results as well as human capital conditions at the GSEs.

KEY QUESTIONS/TOPICS TO DISCUSS

DISCUSS AT BOTH MEETINGS

Earnings

- We should receive an update on the GSEs' near and long-term financial forecasts, including additional forecasted PSPA draws in Q3 and Q4, expectations for future capital reserve takings or reserve releases, and potential increases in the delinquency rates on the GSEs' post-2008 books of business. We would also like to know how quickly they forecast releasing credit reserves and when they expect their reserve balances to stabilize.
- We would like the management teams to explain how each Enterprise utilizes derivatives to hedge their books of business and which holdings are the most volatile.
- We would like to know approximately how much of the reduction in credit losses this past quarter arose from the recent rise in home prices verses other factors. Do they foresee additional credit loss reductions in the third and fourth quarters?
- Both Enterprises recently decreased their debt issuance in the market (Debt outstanding at Fannie decreased 11% YTD; Freddie decreased 13% YTD). We would like to know what feedback they have received from market participants on this change.
- From the first to the second quarter, the overall single-family serious delinquency rates at both Enterprises declined. We would like to know whether they anticipate continued declines in this figure in the third and fourth quarters.

Management and sale of non-performing loans

- Treasury is supportive of reducing risk on the GSEs' balance sheets and finding ways to transfer servicing of NPLs from poorer performing servicers to special servicers as well as potentially executing outright sales. We would like to know what hurdles they see as that may prevent this effort from moving forward.

Single securitization platform & single security effort

- We would like a general update on how discussions are proceeding with FHFA and how Treasury can help to move the single securitization platform initiative forward.

DISCUSS WITH FREDDIE MAC ONLY

Credit risk syndication

- FHFA is preparing directives to the GSEs regarding a data release and transaction that will likely take place in Q4. Freddie expressed concern this initiative will not be profitable in the near term and may cost taxpayers money. They also expressed concern with releasing loan level information to the market.
- Treasury fully supports FHFA's credit risk syndication efforts and the release of adequate loan level information. We believe releasing this information is not only helpful for GSE risk syndication, but also for helping restart the private securitization markets. We also believe credit risk syndication efforts should be programmatic and not a single one-off transaction (Freddie Mac would like to start with one and may not commit to more).
- We would like to see whether Freddie would be able to move forward with an August announcement of the program initiative and loan level data release so that a pilot transaction can be completed in Q4.

REO-to-rental financing

- FHFA recently denied Freddie Mac's request to develop a debt guarantee pilot program to support scattered-site single family rental investment and long-term management. We would like to know how they plan to respond to FHFA's decision.

Human capital concerns

- We would like to know what the plans are for staff retention, new hiring and the progress of rebuilding the broader team at Freddie Mac.
- Freddie also recently announced a series of structural/personnel changes to their various lines of business. We would like to know how they believe this will improve efficiencies at the Enterprise and if Treasury should be aware of any further management changes that may occur in the near future.

DISCUSS WITH FANNIE MAE ONLY

Earnings

- The number of loan modifications and repayment plans/forbearances at Fannie decreased substantially this past quarter. We would like to know the main reason for this decline.

Future REO-to-rental efforts

- We would like to get an update on Fannie Mae's plans for additional bulk REO sales.

FREDDIE MAC MEETING PARTICIPANTS

Donald Layton - chief executive officer

Ross Jay Kari - chief financial officer

Jerry Weiss - executive vice president and chief administrative officer

Edward Golding - senior vice president of the models, mission & research division

Devajyoti Ghose - senior vice president of investments & capital markets division

Paul Mullings - senior vice president and interim head of single-family business, operations, and information technology

FREDDIE MAC BIOGRAPHIES

Donald Layton is **chief executive officer** of Freddie Mac. Layton has over 35 years of experience in financial services and as a corporate leader. He worked for nearly 30 years at JPMorgan Chase and its predecessors, starting as a trainee and rising to vice chairman and member of the three-person Office of the Chairman, retiring in 2004. More recently, from 2007 to 2009 he served as chairman and then CEO of E*TRADE Financial, which he shepherded through the financial crisis. Layton received simultaneous Bachelor and Master of Science degrees in economics from the Massachusetts Institute of Technology and a Master of Business Administration from Harvard Business School.

Ross Jay Kari was named **chief financial officer** of Freddie Mac in September 2009. In this position, he is responsible for the company's financial controls, accounting, investor relations, financial planning and reporting, tax, capital oversight, and compliance with the requirements of Sarbanes-Oxley. Additionally, he oversees the Investment and Capital Markets division and management of Freddie Mac's mortgage investment activities. Kari is a member of the company's management committee and reports directly to Chief Executive Officer Don Layton. Previously, Kari served as chief financial officer of Fifth Third Bancorp in Cincinnati, Ohio. From 2002 to 2006, Kari served as executive vice president and chief operating officer for another housing government-sponsored enterprise, the Federal Home Loan Bank of San Francisco. Kari spent a large portion of his career at Wells Fargo from 1983 to 2001, during which time he rose from senior financial analyst to executive vice president and chief financial officer. Kari received a Bachelor of Science degree in Mathematics and earned his MBA in Finance, both from the University of Oregon.

Jerry Weiss was named **executive vice president and chief administrative officer** in July 2010. Weiss manages the services and operations of Freddie Mac's Strategy; External Relations, including Government and Industry Relations, Public Relations and Corporate Marketing, Corporate Relations and Housing Outreach, and Internal Communications; Human Resources; and Models, Mission and Research organizations. Weiss has overall responsibility for managing the company's regulatory affairs and strategies and he serves as the company's senior executive liaison to the Federal Housing Finance Agency and the U.S. Department of the Treasury. Prior to Freddie Mac, Weiss was most recently first vice president and Global Head of Compliance at Merrill Lynch Investment Managers (MLIM) from 1990 to 2003. From 1982 to 1990, Weiss was with a national law practice in Washington, D.C., where he specialized in securities regulation, investment management, and corporate finance matters. Weiss graduated Phi Beta Kappa from the State University of New York at Binghamton with a B.A. in political science and earned his law degree from The George Washington University.

Edward Golding was named **senior vice president of the Models, Mission & Research Division** in September 2010. In this role, Golding is responsible for developing and implementing mortgage models that support business decisions, risk management and the financial statements. He also oversees the Office of the Chief Economist and the Mission and Strategy Division. Prior to that, in February 2007, Golding was named senior vice president of Equity Investor Relations, and later expanded to include Debt Investor Relations. In that position, Golding was responsible for communications of financial results to investors and Wall Street analysts. Golding joined Freddie Mac in 1989 as senior economist and has held various senior roles dealing with capital management, corporate strategy and economic analysis. Golding holds a Ph.D. in economics from Princeton University and an A.B. in Applied mathematics from Harvard College.

Devajyoti (Doc) Ghose is the **senior vice president of Freddie Mac's Investments & Capital Markets division** and the company's Treasurer. In this position, he is responsible for managing all of Freddie Mac's mortgage investment activities for the mortgage-related investments portfolio as well as the company's short- and long-term debt issuance. Previously, Ghose served in various senior positions at Freddie Mac in which he was responsible for managing the company's debt portfolio and the non-mortgage investments portfolio; maintaining the company's liquidity position; evaluating the risks and returns of Freddie Mac's guarantee fee business; developing hedging strategies for Freddie Mac's investment portfolio; and developing valuation models for various fixed income securities including mortgage-related products, debentures and interest-rate derivatives. Ghose holds a Ph.D. in econometrics from the University of California San Diego, a Masters degree in Economics from the Delhi School of Economics and a Bachelor's degree in Economics from St. Stephens College, Delhi.

Paul Mullings is **senior vice president and interim head of Single-Family Business, Operations, and Information Technology** at Freddie Mac. In this capacity, Mullings has broad responsibilities over the Single-Family line of business, including the administration, relationship and performance management of Freddie Mac Seller/Servicers; performance of Freddie Mac's guarantee book of business; and all sourcing, servicing and business operations. In addition, he is responsible for enterprise technology and the management of this vital corporate asset for all of Freddie Mac through support, project management and technological services. Mullings joined Freddie Mac in 2005 from JP Morgan Chase where he was senior vice president, manager Mortgage Finance, and Fair Lending executive at Chase Home Finance. Mullings is a Graduate of The Institute of Accounting Staff, London, England.

FANNIE MAE MEETING PARTICIPANTS

Timothy Mayopoulos – president and chief executive officer

Terry Edwards – executive vice president - credit portfolio management

David Benson – executive vice president - capital markets

Susan McFarland – executive vice president and chief financial officer

FANNIE MAE BIOGRAPHIES

Timothy Mayopoulos is Fannie Mae's **President and Chief Executive Officer**, and a member of the company's Board of Directors. As President and CEO, Mr. Mayopoulos is focused on ensuring that the company continues to manage its legacy issues effectively, while driving the company's contributions to creating a better housing finance system for the future. Under his leadership, Fannie Mae will continue to play an essential role in funding the market, assisting troubled homeowners, strengthening communities and repaying taxpayers' investment in the company.

Mr. Mayopoulos brings more than 25 years of experience to his new leadership post. He joined Fannie Mae in April 2009 as executive vice president, general counsel and corporate secretary and was appointed chief administrative officer in 2010. Since joining the company's executive management team, Mr. Mayopoulos has managed critical functions at the company, including its human capital strategy, communications and marketing, government and industry relations and the legal function. He has also provided leadership and oversight of the company's long-term strategy to drive operating excellence and strategic initiatives to improve the company and housing finance industry.

Prior to joining Fannie Mae, Mr. Mayopoulos was executive vice president and general counsel of Bank of America Corporation. Previously, he served in senior management roles at Deutsche Bank AG, Credit Suisse First Boston and Donaldson, Lufkin & Jenrette, Inc. Earlier in his career, Mayopoulos was in private practice. He is a graduate of Cornell University and the New York University School of Law.

Terry Edwards is Fannie Mae's **Executive Vice President - Credit Portfolio Management**. Reporting to the President and Chief Executive Officer, he has responsibility for Fannie Mae's foreclosure prevention and loss mitigation activities for its single-family book of business. In this capacity, Mr. Edwards leads the company's National Servicing Organization, its National Property Disposition Center, and its National Underwriting Center. His duties include executing the Making Home Affordable program, managing our Real Estate Owned (REO) and loss mitigation activities, ensuring collection and preservation of credit enhancements, as well as overseeing and managing our servicing guidelines and policies.

Mr. Edwards is former President and CEO of PHH Corporation, where he served for nearly three decades and in a variety of executive roles, including as President and CEO of PHH Mortgage, one of the nation's top ten mortgage servicers. Mr. Edwards holds a Master's degree from Loyola College and received his undergraduate degree from Iona College.

David Benson is Fannie Mae's **Executive Vice President - Capital Markets**. Reporting to the President and Chief Executive Officer, he is responsible for the company's balance sheet management, trading, and securitization activities serving both the single- family and multi-family mortgage markets. Mr. Benson is chairman of the Asset-Liability Committee and is responsible for managing the firm's interest rate, funding, and liquidity risks. He plays a leading role in managing our relationships with the fixed income and mortgage industry including institutional investors, financial institutions, government officials, and regulatory agencies. Previously, Mr. Benson was Senior Vice President and Treasurer responsible for the company's debt issuance, liability management, and liquidity management activities.

Prior to joining Fannie Mae in 2002, Mr. Benson was a managing director within the fixed-income division of Merrill Lynch & Co. For more than 14 years he held leadership positions in risk management, fixed-income and currency trading, debt syndication, and e-commerce based in New York and London.

Mr. Benson has a master of business administration from Stanford Business School, a doctor of medicine from Harvard Medical School, and a bachelor of science in psychobiology, summa cum laude, from the University of California, Los Angeles.

Susan McFarland is Fannie Mae's **Executive Vice President and Chief Financial Officer**, reporting to the Chief Executive Officer. She is responsible for financial management across the enterprise, including financial reporting and accounting, and for ensuring the highest standards of financial integrity. Ms. McFarland leads financial planning and analysis including resource allocation, modeling and analytics, the controller's office, strategic analytics & transformation, procurement, and economic and strategic research. She also plays a leading role in managing Fannie Mae's relationships with government and regulatory entities along with other financial services relationships.

Ms. McFarland has more than 25 years of experience in consumer and retail financial services. She joined Fannie Mae in July 2011 bringing with her a strong background in accounting, controls, operating finance, and IT financial systems.

Prior to joining Fannie Mae, Ms. McFarland was with Capital One Financial Corporation since 2002 where she led a 500-person team responsible for accounting, tax, procurement, and planning and helped transform a mono-line credit card company into a diversified financial services corporation. Ms. McFarland also served as Executive Vice President, Finance and Principal Accounting Officer and Executive Vice President and Corporate Controller – Capital

One Financial Corporation; Chief Financial Officer – Capital One Bank; and Chief Financial Officer – Infrastructure Finance.

Before joining Capital One, Ms. McFarland was with Bank One Corporation for more than 15 years serving as CFO for a variety of groups and divisions, including the retail bank. During her tenure at Bank One, she was instrumental in developing and implementing profit and loss statements for 1,800 banking centers including Web-based reporting and information tools. She began her career as a senior auditor at Deloitte & Touche.

Ms. McFarland has a bachelor of business administration in accounting from Texas A&M University and is a graduate of the Stanford University executive program.

Clearance Sheet

Event:	Meetings with Freddie Mac and Fannie Mae Management
Drafted:	Capital Markets – Adam Chepenik, phone 622-2534
Approved:	Housing Counselor – Michael Stegman (OK 8/8)
Cleared:	Capital Markets – Tim Bowler (OK 8/8)

EXHIBIT 38

From: Taylor, Mary Ellen
Sent: Thursday, August 09, 2012 5:46 PM
To: DeMarco, Edward
Subject: FW: Fannie & Freddie Profitable in 1H 2012; High-Five for FHFA
Attachments: 20120809 Fannie and Freddie Profitable - High-Five for FHFA.pdf

You won't be thrilled with Mary Beth's conservatorship timeline estimate, but do note the straightforward language of her last point (3.) below. MET

From: mary-beth.fisher@us.bnpparibas.com [mailto:mary-beth.fisher@us.bnpparibas.com]
Sent: Thursday, August 09, 2012 5:18 PM
To: mary-beth.fisher@us.bnpparibas.com
Subject: Fannie & Freddie Profitable in 1H 2012; High-Five for FHFA

Executive Summary

- **For the first quarter since Fannie and Freddie entered conservatorship in September 2008, both GSEs has a positive net worth at the end of 2Q12.**

- **Fannie and Freddie had net income of $5.1 bn and $3.0 bn, respectively (shown in Chart 3 of attached document). This was sufficient to cover their respective 10% dividend payments of $2.9 bn and $1.8 bn, on their Treasury preferred stock, and still leave each GSE with a positive net worth for the quarter. Therefore, neither Fannie or Freddie required any further preferred stock from the Treasury – the taxpayers - in 2Q12, leaving their cumulative draws unchanged at $116 bn for Fannie and $71 bn Freddie (shown in Charts 1 and 2 of attached document).**

- **They barely missed simultaneously having a positive net worth last quarter, when both had net income firmly in the black, but Freddie's dividend payment of $1.8 bn just eclipsed its earnings, requiring a draw of $119 million, while Fannie ended 1Q12 with positive net worth of $268 million.**

- **This convincing return to profitability in the first half of 2012 is the result of several factors, including:**

  1. Stable to rising home prices nationally have curtailed current and projected future losses at the GSEs;

  2. Delinquency rates continue to slowly decline, and both GSEs expect that loan loss reserves peaked in 4Q11.

  3. Fierce protection of the conservatorship mandate to minimize taxpayer losses by the FHFA has, well, minimized taxpayer losses. High-five.

Complete article attached above. Please feel free to contact me with any questions or feedback.

Mary Beth

Fannie & Freddie Profitable; High-Five for FHFA

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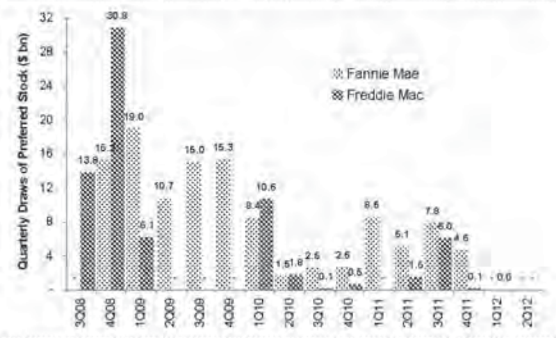
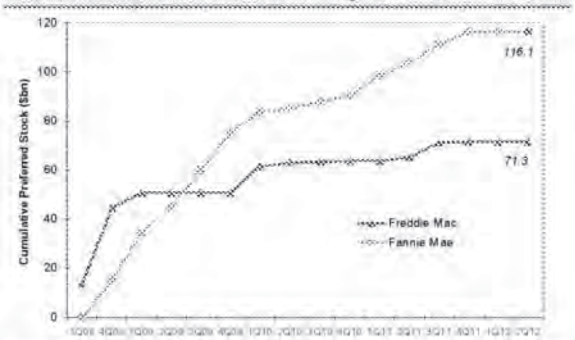
- **Fierce protection of the conservatorship mandate to minimize taxpayer losses by the FHFA has, well, minimized taxpayer losses. High-five.**

Chart 1: Quarterly Draws of Preferred Stock



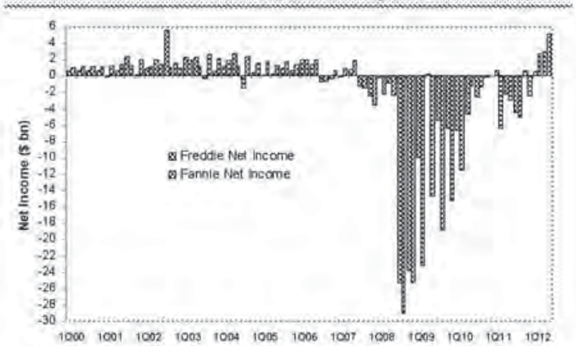
Source: BNP Paribas

Chart 2: Cumulative Treasury Preferred Stock



Source: BNP Paribas

Chart 3: Net Income (Quarterly, since 2000)



Source: BNP Paribas

Past the Trough of the Housing Crisis?

The housing crisis, as reflected by the net income of the GSEs – shown in Chart 3 – when both Fannie and Freddie reported negative net income. A few quarters of low and erratic earnings persisted, then came 3Q 2007, when the housing crisis fully took shape, and both GSEs – along with the broader housing market, then the economy at large –plunged into negative territory.

The modest uptick in housing prices in 2012, as indicated by both the FHFA's and Case-Shiller home price indices, also provides some evidence that the trough of the housing crisis might be behind us. We are far from projecting a rebound in home prices or a return to health for the mortgage market. What we do concern ourselves with here is how and whether this changes the end game for Fannie and Freddie.

The End Game a Long Way Off

As the housing crisis escalated, Fannie and Freddie together accumulated enormous losses, which eventually required their placement into conservatorship on 6 September, 2008.

As part of conservatorship, the GSEs were also provided a capital backstop in the form of Treasury preferred stock – similar to, but with more onerous terms than, the injections of capital into the US banks under TARP. What factors caused it to be more onerous?

1. The preferred stock injected into the GSEs has a 10% annual dividend compared to a 5% dividend on the TARP funds.

2. Furthermore, under the purchase agreement Fannie and Freddie are not permitted to redeem the preferred stock prior to termination of the Treasury's funding commitment.

The circumstances under which the Treasury's funding commitment will terminate are exceptionally limited and, practically speaking, would require them exiting conservatorship either via receivership, by returning to their prior incarnation as public-private hybrid companies or by the passage of GSE reform legislation.

We strongly suspect that GSE reform is on the back burner, possibly for several more years. Whatever the result of the November elections, in the aftermath Congress will have more pressing matters on its plate dealing with the fiscal cliff. Now that the GSEs are stable and – at least in a fashion – healthy, there is no immediate crisis.

The FHFA is taking the required steps to streamline the business models of the two GSEs, hoping to eventually diminish their role in the mortgage market and re-attract private capital. This is a slow process, and the return of private capital is complicated by the shifting and tightening regulatory regime on the banks and other financial service providers. We expect conservatorship to remain open-ended at least through 2015, as the FHFA continues executing its plan.

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BNP Paribas Global Fixed Income Website		www.globalmarkets.bnpparibas.com	
Bloomberg			
Fixed Income Research	BPCM	Market Economics	BPEC
Interest Rate Strategy	BPBS	Forex Strategy	BPFR

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EXHIBIT 39

From: Tagoe, Naa Awaa
Sent: Thursday, May 10, 2012 10:46 AM
To: Ugoletti, Mario
Subject: RE: GSE 1Q12 capital draws: Freddie $19 million, Fannie $0 (yes, zero)

Thanks.

From: Ugoletti, Mario
Sent: Thursday, May 10, 2012 10:11 AM
To: Tagoe, Naa Awaa
Subject: FW: GSE 1Q12 capital draws: Freddie $19 million, Fannie $0 (yes, zero)

FYI

From: Newell, Jamie
Sent: Thursday, May 10, 2012 9:26 AM
To: Ugoletti, Mario
Subject: FW: GSE 1Q12 capital draws: Freddie $19 million, Fannie $0 (yes, zero)

Not news to us but thought you might want to see recent market commentary from Paribas,
Jamie

From: mary-beth.fisher@us.bnpparibas.com [mailto:mary-beth.fisher@us.bnpparibas.com]
Sent: Wednesday, May 09, 2012 5:05 PM
To: mary-beth.fisher@us.bnpparibas.com
Subject: GSE 1Q12 capital draws: Freddie $19 million, Fannie $0 (yes, zero)

Quarterly and cumulative draws of preferred stock by Fannie and Freddie - shown in the attached 1-page pdf. Also caps on retained mortgage portfolios, debt, and pref stock available after 2012. All updated through 1Q 2012.

At the current quarterly "burn rate" of Treasury preferred stock - that is, within epsilon of zero - Fannie and Freddie's capital backstops of $125 bn and $149 bn, respectively, should last them quite a while after the unlimited period expires at the end of this year.

Their capital draws over the past two years have so far been below even the most optimistic scenario projections by the FHFA.

certain
functions and services for BNP Paribas may be performed by BNP Paribas RCC, Inc.

EXHIBIT 40

From: Ugoletti, Mario
Sent: Friday, August 17, 2012 1:55 PM
To: Brereton, Peter
Subject: RE: income sweep payments

There is no short answer, it is basically a variable dividend payment, the mechanism on paying down the liquidation preference is contained in the stock certificate (which is online somewhere) in sections 3 and 4:

Section 3 is optional pay down, really is not any, occurs when:

(1) Termination of the commitment, which occurs only at liquidation end date, the sellers liabilities have been paid off, or Treasury runs out of money.
(2) If dividends were paid in kind or the periodic commitment fee was imposed and added to the liquidation preference

Section 4 is the mandatory pay down

(1) The proceeds from any new issuance of capital stock must be used to pay down the liquidation preference.

Glad to discuss with him, Mario.

From: Brereton, Peter
Sent: Friday, August 17, 2012 1:00 PM
To: Ugoletti, Mario
Subject: FW: income sweep payments

Mario:

Is there a short answer to his question or some link that we can send him? Thanks.

From: Bright, Michael (Corker) [mailto:Michael_Bright@corker.senate.gov]
Sent: Friday, August 17, 2012 12:55 PM
To: Brereton, Peter
Subject: RE: income sweep payments

Thanks. How does the "liquidity preference" arrangement work?

From: Brereton, Peter [mailto:Peter.Brereton@fhfa.gov]
Sent: Friday, August 17, 2012 12:16 PM
To: Bright, Michael (Corker)
Subject: Re: income sweep payments

The dividend does not paydown the principal. The rest of the SPSA stands meaning that the taxpayer will be paid off only when Treasury exercises it rights under the liquidity preference of the senior prefeRred.

From: Bright, Michael (Corker) [mailto:Michael_Bright@corker.senate.gov]
Sent: Friday, August 17, 2012 11:47 AM
To: Brereton, Peter

Subject: income sweep payments

Peter,

Is the "net income sweep? money that goes to paydown principal or is it just basically a variable coupon payment? If the latter, are there mechanisms for paying down the principal of what the GSE's owe Treasury?

Thanks,
Michael