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Federal Housing Finance Agency Announces Revised Goals for Fannie Mae and Freddie Mac Conservatorships

The Federal Housing Finance Agency ("FHFA") has published an updated strategic plan ("Plan") setting forth its conservatorship objectives for Fannie Mae and Freddie Mac (the "Enterprises").

The Plan sets forth three strategic goals:

- Build a new infrastructure for the secondary mortgage market;
- Reduce the Enterprises' dominant position in housing finance and simplify and shrink their operations; and
- Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

The Plan emphasizes that (i) the Enterprises remain essential for the operation of the U.S. housing finance market, (ii) there is no reasonable alternative to the Enterprises currently in sight, and (iii) the Enterprises' taxpayer-funded losses are so large (currently $180 billion) that they cannot be repaid in any foreseeable scenario. The Plan seeks to maintain the operations of the Enterprises while the development of a parallel private sector securitization structure is pursued.

Build a New Infrastructure

The FHFA believes that a series of initiatives must be pursued in order to develop a private sector securitization channel:

- *A single securitization platform* that could serve as a market utility, with an open architecture to support multiple issuers of mortgage-backed securities and a wide array of securities and mortgage structures;
- *A standardized pooling and servicing agreement* to replace the Enterprises' current Servicer Participation Agreement, including (i) transparent servicing requirements that address servicers' responsibilities to borrowers and investors in a variety of situations and (ii) a compensation structure that promotes competition and takes account of actual servicing costs and requirements;
- *Detailed, timely, and reliable reporting* of loan-level data to investors at the time a security is issued and throughout a security's life; and
- *Sound and efficient document custody and electronic registration* that observes local property law requirements and enhances mortgages' liquidity.

Reduce the Enterprises' Dominant Position

The FHFA's second goal is to reduce the Enterprises' dominance of the housing finance markets gradually and in a safe and sound manner.[1]

- *In the single-family mortgage credit guarantee business*, the gradual shift of credit risk to private investors can be pursued

[1] In February 2011, the Administration released its report to Congress on reforming the nation's housing finance markets, in which it presented three general options but did not endorse any specific actions. *See DechertOnPoint*, [Administration Report Offers New Directions for the Federal Role in Housing Finance] (February 2011).

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by (i) increasing the Enterprises' guarantee fees closer to the levels required by private capital investors to support the risk, (ii) developing alternative securities structures that provide for loss sharing, and (iii) expanding reliance on private first-loss mortgage insurance to cover a portion of the credit risk.

- *In the multi-family mortgage credit guarantee business*, in which the Enterprises' market share has grown but does not dominate the market as in the single-family field, the Enterprises will undertake a market analysis of the business' viability if privatized without government guarantees and with pricing adjusted to attract and retain private capital.

- *In the capital markets*, in which the Enterprises are currently required to reduce their retained mortgage portfolios 10% per year, the depressed market value of some mortgage-backed securities makes it increasingly difficult to continue to divest assets without incurring substantial and otherwise avoidable losses. The Enterprises need to retain their in-house capital markets expertise, notwithstanding pressure on compensation, or to retain third-party investment managers, which would facilitate downsizing but may be more expensive.

Maintain Foreclosure Prevention and Credit Availability

In addition to continuing to purchase or guarantee approximately $100 billion of home purchase and refinance mortgages each month, the Enterprises have significant responsibilities as part of government efforts to reduce foreclosures. To accomplish these objectives, the Plan recommends:

- *Implementing* (i) the Home Affordable Refinance Program, (ii) the Servicing Alignment Initiative[2] to institute loss mitigation measures at the first sign of borrower distress, (iii) the use of short sales, deeds in lieu of foreclosure, and deeds for lease, and (iv) the conversion of REO properties into rental units;[3]

- *Clarifying* the Enterprises' policies regarding mortgage originators' representations and warranties and their enforcement; and

- *Resolving* outstanding mortgage putback requests.

Conclusion

The FHFA has taken a broad view of the needs of, and political realities governing, the U.S. housing finance market. It has prominently subtitled the Plan "The Next Chapter in a Story that Needs an Ending" and stated that only Congress can write the final chapter for the Enterprises. Whether the Plan will serve as an outline for that chapter, and how the story ends, remain to be seen.

■ ■ ■

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2 The Servicing Alignment Initiative is a multi-part effort led by the FHFA to establish consistent policies and processes for the servicing of delinquent loans owned or guaranteed by the Enterprises.

3 On February 1, 2012, the FHFA announced the pilot phase of the REO Initiative, developed by the FHFA in conjunction with the Department of the Treasury, the Department of Housing and Urban Development, the FDIC, the Federal Reserve Board, and the Enterprises. The REO Initiative is intended to allow qualified investors to purchase pools of foreclosed properties for the purpose of renting them out for a specified number of years.

Contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the authors listed.

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