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PSPA Amendment Q&A

GENERAL:

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

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

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

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

[Adam] What does this agreement change and why?

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

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

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

Comment [BR3]:

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

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

Comment [BR4]: Should be first Q.

- *Accelerate the wind-down of the retained investment portfolios* - The required reduction rate for the retained investment portfolios will be increased to 15 percent from 10 percent per annum beginning at year-end 2013 until such time that each GSE's portfolio reaches a target $250 billion balance ($250 billion was set in the original PSPA).
- *Require an annual risk management plan be delivered to Treasury* - On an annual basis, each GSE will submit to Treasury a plan that details the steps it will take to reduce the financial and operational risk profile associated with both their mortgage guarantee and retained investment portfolio businesses in order to help protect taxpayers from future losses.

[Adam] How does the full income sweep operate?

- Beginning with the financial results as of 1Q 2013, and each quarter thereafter, all positive net worth above the Applicable Capital Reserve Amount at each GSE will be transferred to Treasury in the form of a dividend.
    - Net worth is defined as net assets minus net liabilities (per GAAP)
    - No dividends are paid when there is a net worth deficit or a positive net worth below the Applicable Capital Reserve Amount
- Over time, this will result in all positive net income generated by the GSEs is paid to the government and will likely exceed the amount that would have been paid if the 10% was still in effect. Furthermore, this amendment eliminates the circularity of payments and preserves for the GSEs their respective PSPA draw capacity.

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

- The PSPAs and their amendments constitute legally binding contracts between the GSEs and Treasury. Therefore, these amendments, like the rest of the agreements are a valid and legally binding obligation of the GSEs to fulfill.
- [If either party to the contract – the GSEs or Treasury – do not fulfill their obligations, they are enforceable in court.]
- There are laws of general applicability, such as bankruptcy and insolvency laws, that could supersede in court and limit enforceability. [However, these are limited in nature and typical of financial contracts between two parties.]

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

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

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

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

- These changes, in combination with other commitments by FHFA, such as gradually increasing guarantee fees, will help bring pricing in line with private market participants so that they begin to again take mortgage credit risk.
- As part of these changes, Fannie Mae and Freddie Mac will be required to submit a risk management action plan each year that will provide clear goals and timetables for the GSEs to reduce the risk of the mortgages they guarantee as well as their mortgages they hold as investments in their retained portfolios.
- We expect these plans to include ways that private sector will begin to take on some of the GSEs' mortgage credit risk. ~~can be sold or moved to the private sector in order to better protect taxpayers as well as attract private investors back into the market.~~
- ~~These changes should also help attract private investors back into the mortgage market. They help ensure that private mortgage investors, whose purchases of Fannie and Freddie mortgage-backed securities (MBS) are an important source of funding in the housing finance market, will continue to have confidence in their guarantees.~~

[Adam] When will these changes become effective?

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

Comment [BR5]: Or portfolio wind-down?

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

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

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

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

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

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

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

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

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

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

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

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

<u>FINANCIAL / TAXPAYER IMPACT</u>

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

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

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

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

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

Comment [BR9]: See above

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

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

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

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

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

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

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

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

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

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

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

HOUSING FINANCE REFORM

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

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

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

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

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

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

[Beth] How long is a reasonable transition?

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

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

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

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

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

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

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

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

<u>HOMEOWNER IMPACT</u>

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

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

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

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

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

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

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

- The GSEs are gradually raising guarantee fees to help restart the private mortgage market, shrink the government's footprint in housing finance, and protect the long-term interests of taxpayers.

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

- We will work to ensure, however, that the increases occur at a measured pace, allowing borrowers to adjust to the new market, preserving widespread access to affordable mortgages for creditworthy borrowers including lower-income Americans, and supporting, rather than threatening, the health of our nation's economic recovery.

IMPACT ON THE HOUSING MARKET AND THE GSES

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

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

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

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

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

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

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

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

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

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

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

- Both GSEs will be required to implement these changes.

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TIMING / STRATEGY

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

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

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

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

Comment [BR14]: How/why?

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

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

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

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

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

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

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

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

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

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

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

- Within the context of the Administration's goal of winding down the GSEs, we began exploring alternatives to the 10 percent dividend, knowing that the 10 percent dividend was likely to be unstable as the businesses were reduced.

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

- We have been evaluating the GSEs financial profile since conservatorship. It has remained an ongoing focus for us to help make sure that the GSEs have sufficient capital support.
- We don't comment on discussions between Treasury and independent regulators.