

REDACTED VERSION

APPENDIX

APPENDIX TABLE OF CONTENTS

	<u>Page</u>
UST00533645	A1
Letter from Elizabeth M. Hosford, Department of Justice, to Brian Barnes, Cooper & Kirk (July 12, 2017)	A2
Letter from Brian Barnes, Cooper & Kirk, to Elizabeth M. Hosford, Department of Justice (July 25, 2017)	A6
Letter from Elizabeth M. Hosford, Department of Justice, to Brian Barnes, Cooper & Kirk (Aug. 1, 2017)	A8
FHFA00070607	A11
FHFA00038592	A29
Declaration of Mario Ugoletti	A30
FHFA00077771	A40

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

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

- [REDACTED]
- While he told us he would be directing Freddie Mac to provide same streamlined refinancing benefits to <80% LTV current borrowers that apply to >80% HARP 2.0 borrowers, he no longer thinks the benefits of doing so are worth the costs.
 - He has reduced from a major new initiative to a small pilot a rebuild-equity refinancing program for current underwater borrowers. Since he viewed the at-scale program to counter moral hazard of a GSE HAMP-PRA program, shrinking this initiative may signal FHFA's decision not to do principal reduction.
 - He is losing interest in REO-to-Rental, saying that the GSE retail REO execution is so efficient and attracting good prices, it's not worth the resources and efforts to do bulk sales.
 - His schedule for rep and warranty reform for new books of business has also slipped. While he has announced his intention to direct the GSEs to adopt new reps and warrants featuring 36 month liability for material violations other than fraud, there is no time table for this.
 - Through weeks of negotiating terms of possible amendments to the PSPAs, he never questioned the need to adjust the dividend schedule this year. Since the Secretary raised the possibility of a PR covenant, DeMarco no longer sees the urgency of amending the PSPAs this year. He has raised two competing reasons for this new position: (1) the GSEs will be generating large revenues over the coming years, thereby enabling them to pay the 10% annual dividend well into the future even with the caps; and, (2) instituting a net worth sweep in place of the dividend will further extend the lives of the GSEs to such an extent that it would remove the urgency for Congress to act on long-term housing finance reform. He now sees the PSPA amendments as a backdoor way of keeping the GSEs alive—getting to an Option 3-type plan without the need for legislation.
- [REDACTED]



U.S. Department of Justice

REK:KMD:EHosford
154-13-465

Civil Division
Telephone: (202) 616-0332
Elizabeth.Hosford@usdoj.gov

Washington, DC 20530

July 12, 2017

BY EMAIL

Brian Barnes
Cooper & Kirk, PLLC
1523 New Hampshire Ave. NW
Washington, D.C. 20036

Re: *Fairholme Funds, Inc. et al., v. United States*, No. 13-465C (Fed. Cl.)

Dear Mr. Barnes,

In an effort to meet our joint obligation to confer in good faith about discovery issues, we write in response to your June 26, 2017 email requesting that the Government reconsider its assertions of privilege for 38 documents that we continue to withhold as privileged. According to your email, based on “the privilege log descriptions and other materials the Government produced, [plaintiffs] think these documents may be sufficiently related to the central issues in the case that Fairholme’s need overcomes the qualified privilege.” Email from Brian Barnes to Elizabeth Hosford, June 26, 2017.

As we advised on June 12 and June 16, 2017, we already re-reviewed our privilege log using our best judgment. Nonetheless, pursuant to plaintiffs’ request, we have again reviewed the documents identified in your June 26 email.

I. Department of the Treasury (Treasury) Documents

With respect to the Treasury documents identified in your June 26 email, the privilege log indicates that those documents reflect predecisional deliberations concerning modifications to the PSPAs. As you know, the Third Amendment modified or added several provisions to the PSPAs that are unrelated to the net worth sweep. For instance, UST00061151 is an email chain between Mary Miller and Tim Bowler reflecting predecisional deliberations regarding the phrasing and import of contract provisions that were ultimately adopted in Sections 5.4 and 5.11 of the Third Amendment to the PSPAs (Transfer of Assets and Annual Risk Management Plans). Moreover, UST00377912, UST00378962, and UST00384425 reflect predecisional deliberations concerning potential PSPA modifications under consideration by Treasury, but which were ultimately not incorporated in the Third Amendment.

UST00061154 is an email chain, most of which has previously been produced to plaintiffs. *See* UST00061156. The top email in the chain reflects Treasury's predecisional deliberations regarding the proposed capital reserve provision in the Third Amendment. Because that email gives no meaningful insight into the motivations behind the switch from a fixed to a variable dividend, and its release would likely "stifle honest and frank communications within the agency," we have properly withheld it. *In re United States*, 2017 WL 406243, at *4 (quoting *Coast States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 866 (D.C. Cir. 1980)), *5. However, given that plaintiffs already have the earlier email in the chain, we will produce a redacted version of UST00061154.

Further, although we believe that the redacted portion of UST0081727 reflects predecisional deliberations, we have decided to withdraw our privilege assertion and produce an unredacted version of that email.

II. Federal Housing Finance Agency (FHFA) Documents

Your June 26 email also identifies 32 FHFA documents, 16 of which we will continue to withhold, in whole or in part, as privileged. These 16 documents generally fall into one of three categories: modifications to the PSPAs unrelated to the net worth sweep; FHFA's supervisory role over the GSEs; and matters entirely unrelated to the Third Amendment.

A. Modifications To The PSPAs Unrelated To The Net Worth Sweep

We will produce FHFA00038593 with the August 13, 2012 email sent by Mario Ugoletti redacted. Mr. Ugoletti's email reflects agency views on PSPA provisions that are unrelated to the net worth sweep: Section 5.4 (Relating to Transfer of Assets) and Section 5.11 (Annual Risk Management Plans). We are also withholding FHFA00105865, which reflects agency staff views concerning a proposal for reduction of GSE assets that was ultimately adopted in Section 5.7 of the Third Amendment (Relating to Owned Mortgage Assets).

We will produce FHFA00038592 with the top email redacted. The top email reflects agency staff views regarding the PSPAs in general and contains no mention of the net worth sweep. The email also references agency considerations relating to deferred tax assets, which the Federal Circuit determined were "too remote from the central issues in the case." *In re United States*, 2017 WL 406243, at *6-7.

B. FHFA's Supervisory Role Over The GSEs

FHFA00070475 and FHFA00070477 comprise an email and an attached redline of a draft Asset Quality Conclusion Letter containing analysis by agency examination staff relating to GSE asset quality. Neither the email nor the attachment mention the net worth sweep. Although we will produce the charts reflected on pages FHFA00070477, FHFA00070489, and FHFA00070490, the analysis is subject to the deliberative process and bank examination privileges. FHFA00077749 is part of the same email chain and FHFA00077751 also constitutes an attached redline of a draft Asset Quality Conclusion Letter. We will produce FHFA00077751 with the same redactions as FHFA00070477.

We are also withholding four documents subject to the bank examination and deliberative process privileges that concern GSE losses and deferred tax assets because the Federal Circuit determined that such matters are “too remote from the central issues in the case,” and, in any event, such information is available in public filings. *In re United States*, 2017 WL 406243, at *6-7. See FHFA00073824 and FHFA00073922 (emails reflecting agency staff views relating to GSE allowances for loan losses); FHFA00075629 (Analysis Memorandum prepared by agency examination staff regarding accounting policies applicable to reserves for credit losses). In addition, we will produce a redacted version of FHFA00072776, which comprises draft meeting notes prepared by the FHFA Office of Chief Accountant. The redacted text reflects agency deliberations regarding a proposed reversal of a valuation allowance against Fannie Mae’s deferred tax assets and is predecisional with respect to that proposal.

FHFA00043777 is an email chain reflecting agency staff views on estimates of run off of non-core assets and accounting issues relating to PSPA dividend payments. Because the email chain does not “actually discuss[] the net worth sweep provision central to this case” or provide “insight into the motivations behind that provision,” we have properly withheld it. *Id.* at *5.

C. Matters Unrelated To The Third Amendment

Four additional documents identified in your June 26 email reflect predecisional deliberations concerning matters unrelated to the Third Amendment. Because the information contained in these documents is “too remote from the central issues in the case and its probative value [is] too weak to warrant disclosure,” *id.* at *7, we are continuing to withhold them.

FHFA00073923 reflects predecisional deliberations regarding FHFA’s response to statements in an Office of Inspector General report concerning GSE trading in derivatives.

FHFA00045470 is a draft statement prepared in connection with testimony from Mr. DeMarco before the Senate Committee on Banking, Housing, and Urban Affairs concerning FHFA’s oversight of the GSEs and the Federal Home Loan Banks. The draft reflects agency staff views regarding matters unrelated to the Third Amendment, such as GSE executive compensation.

FHFA00068184 reflects agency staff views on possible Questions and Answers for an October 23, 2008 congressional hearing.

FHFA00051264 was properly redacted. The redacted material reflects agency staff views regarding a Bloomberg News article discussing GSE reform proposals.

D. FHFA Documents To Be Produced

Although our re-review confirmed that our privilege assertions regarding the following FHFA documents were proper, in an effort to resolve plaintiffs’ questions without further motion practice, we will produce in unredacted form FHFA00031716, FHFA00031718, FHFA00043797, FHFA00050887, FHFA00070607, FHFA00072773, FHFA00072775,

- 4 -

FHFA00073836, FHFA00077677, FHFA00077771, FHFA00097400, FHFA00097403, FHFA00103555, FHFA00103576, and FHFA00106289.

In addition, we discovered that FHFA00050858 was previously provided to Treasury by FHFA in connection with negotiations regarding the Third Amendment. *See* UST00534621. Because we agreed to produce communications between FHFA and Treasury concerning the Third Amendment, we will produce both FHFA00050858 and UST00534621.

We will make a supplemental production in accordance with this letter as soon as possible. Please let me know if you have additional questions or comments.

Very truly yours,

/s/ Elizabeth M. Hosford
Elizabeth M. Hosford
Assistant Director
Commercial Litigation Branch

Cooper & Kirk

Lawyers

A Professional Limited Liability Company

Brian W. Barnes
(202) 220-9623
bbarnes@cooperkirk.com

1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036

(202) 220-9600
Fax (202) 220-9601

July 25, 2017

Elizabeth M. Hosford
Assistant Director
Commercial Litigation Branch
Department of Justice

Re: *Fairholme Funds, Inc., et al. v. United States*, No. 13-465C (Fed. Cl.)

Dear Ms. Hosford,

I am writing in response to your letter of July 12, 2017. In that letter, the Government agreed to produce an additional 22 documents after further review of a list of 38 documents Plaintiffs identified on June 26, 2017. Your letter also explained the Government's rationale for asserting privilege over the documents on Plaintiffs' list that the Government is still withholding. Your letter and our previous exchanges have greatly narrowed the scope of the parties' privilege disputes, but there are two remaining issues that Plaintiffs will raise.

First, the Government appears to have adopted an unjustifiably broad interpretation of the portion of the Federal Circuit's opinion that permitted it to withhold a 2008 FHFA document that discussed the Companies' deferred tax assets. *See In re United States*, 678 Fed. App'x 981, 990–91 (Fed. Cir. 2017). Specifically, Plaintiffs do not understand the Federal Circuit's ruling to permit the Government to withhold documents from after June 1, 2011 that concern the Companies' deferred tax assets and loan loss reserves. The Government's decision to withhold loan loss reserve documents in light of the Federal Circuit's treatment of the 2008 deferred tax assets document is especially unjustified given that the Federal Circuit specifically declined to overturn the Court of Federal Claims' ruling that Plaintiffs were entitled to several bank examination documents that discussed the Companies' "credit-related expenses." *See id.* at 992–93 (requiring production of FHFA00096631, FHFA00096634, and FHFA00096636). Plaintiffs request that the Government reconsider its position on this issue and produce the loan loss reserve and deferred tax asset documents from after June 1, 2011 that the Government is still withholding.

Second, Plaintiffs are troubled by the large proportion of documents on the June 26 list that the Government decided to produce upon further review. Moreover, some of the documents the Government only produced in response to Plaintiffs' list clearly should not have been withheld. Portions of FHFA00070607, for example, contain purely factual information not covered by any

applicable privilege. Similarly, FHFA00077677 and FHFA00077771 are documents that memorialize conversations between FHFA staff and the Companies' Chief Financial Officers regarding issues at the center of the parties' factual disputes. In light of Plaintiffs' need for those documents, they should have been produced without regard to the Government's qualified privileges.

To eliminate further privilege disputes, Plaintiffs propose that the parties use of the "quick peek" procedure authorized by Federal Rule of Evidence 502(d) with respect to a subset of the documents the Government is still withholding for privilege. Specifically, we propose using that procedure for documents on the Government's privilege logs created on or after May 1, 2012 and that the Government is withholding under the deliberative process privilege, the bank examination privilege, or both. We estimate that there are approximately 1500 such documents and that by working together the parties could complete use of the quick peek procedure in approximately one month.

I am of course available to discuss these issues and look forward to your response.

Sincerely,

/s/ Brian W. Barnes

Brian W. Barnes

Cooper & Kirk, PLLC



U.S. Department of Justice

REK:KMD:EHosford
154-13-465

Civil Division
Telephone: (202) 616-0332
Elizabeth.Hosford@usdoj.gov

Washington, DC 20530

August 1, 2017

BY EMAIL

Brian Barnes
Cooper & Kirk, PLLC
1523 New Hampshire Ave. NW
Washington, D.C. 20036

Re: *Fairholme Funds, Inc. et al., v. United States*, No. 13-465C (Fed. Cl.)

Dear Mr. Barnes,

We write in response to your letter of July 25, 2017. As you note, we have worked with you to resolve any outstanding discovery issues. To that end, subsequent to resolution of your November 2015 motion to compel, we re-reviewed the entries on our privilege logs, applying the guidance provided by the Federal Circuit and the Court of Federal Claims. During the course of our review process, we produced to Fairholme, in April and May of 2017, approximately 3,500 additional documents.

On June 26, 2017, you initiated a meet-and-confer process by requesting that we reconsider our position with respect to 38 specific documents on our privilege logs. In response, we elected to produce, in full or redacted form, two Department of the Treasury (Treasury) documents and 20 Federal Housing Finance Agency (FHFA) documents. Although our privilege assertions regarding these documents were well-founded, we produced these documents, based on the guidance provided by the courts, in the interest of minimizing ongoing disputes and facilitating an end to jurisdictional discovery.

Notwithstanding our production of over 3,500 documents since May, your letter contains two additional demands. First, you ask that we reconsider and produce documents, created after June 1, 2011, that discuss loan-loss reserves or deferred tax assets. As an initial matter, we can clarify that, contrary to your suggestion, we did not apply a categorical rule in withholding certain documents that refer to these two topics. Rather, we evaluated each privilege assertion on its individual merits. Nonetheless, as part of this meet-and-confer process, we will produce 17 additional documents, notwithstanding the inherently privileged communications contained therein. We will be producing these documents, a list of which appears below, by tomorrow.

- 2 -

Next, you state that you are “troubled” by our decision to produce, in whole or part, 22 of the 38 documents identified in your June 26 “meet and confer” letter. Consequently, you propose the use of a “quick peek” procedure to allow plaintiffs’ counsel access to a subset of the remaining privileged documents. We offer two responses:

First, our production of 22 additional documents in response to your “meet-and-confer” letter proves nothing beyond the basic wisdom of the meet-and-confer process. Our release of documents during the course of this process is not an admission that we were unjustified in previously withholding these documents. The meet-and-confer process encourages litigants to narrow and resolve discovery disputes. On the contrary, our decision to produce specific documents pursuant to this process stems from both prudential concerns and a good-faith effort on our part to finally adjudicate our motion to dismiss. As we explained in our July 12, 2017 letter, our response is in no way an acknowledgment that we do not consider the documents to be protected by privilege.

Second, we are not amenable to using a “quick peek” procedure for the subset of documents you suggest, or for any of the documents we continue to withhold as privileged. In our joint status report to the Court of Federal Claims on February 24, 2017, we detailed our objections to the use of this procedure to resolve privilege disputes in this case. ECF No. 359. Notably, subsequent to that status report, the court was “not convinced” that the “quick peek” procedure was appropriate at that time, and, instead, ordered us to “review [our] privilege log and, based on the court’s September 20, 2016 ruling on plaintiffs’ motion to compel as well as the Federal Circuit’s ruling on defendant’s petition for a writ of mandamus, produce any additional documents listed on [our] privilege log that are either (1) no longer privileged in light of both courts’ rulings or (2) despite being privileged must nevertheless be produced in light of both courts’ rulings.” ECF No. 360 at 2. In compliance with that order, we produced in excess of 3,500 documents. Given the comprehensive re-review of our log, the “quick peek” procedure is even less appropriate now than when you initially proposed it. Thus, our opposition to use of the procedure remains unchanged.

We find it baffling that our production of documents - rather than moving the litigation forward as the meet-and-confer process anticipates - instead seems to invite more delay and increased demands. We believe jurisdictional discovery must conclude and briefing on our motion to dismiss should now resume.

Please let me know if you have additional questions or comments.

Very truly yours,

/s/ Elizabeth M. Hosford
Elizabeth M. Hosford
Assistant Director
Commercial Litigation Branch

Bates numbers of documents to be produced:

FHFA00072776
FHFA00038592
FHFA00059262
FHFA00076965*
FHFA00058551*
FHFA00045196*
FHFA00097400
FHFA00097403
FHFA00096836
FHFA00096838
FHFA00075786
FHFA00096864
FHFA00096867
FHFA00097406
FHFA00097408
FHFA00096608
FHFA00096872

* Produced with redaction(s)



Expected Loss Overview for FHFA

Leslie Deich
Shelley Klein

April 2012

FHFA.Overview.2012.04.13.v2.ppt

Confidential Commercial Information - Confidential Treatment and FOIA Exemption Requested

1



Key Takeaways

- The allowance reached its highest level in Q4 2011 and is expected to reduce to \$69B by year-end 2012
 - New models being implemented are likely to result in a further decline of the allowance as they will include recent history that reflects improved performance
- We believe the allowance as of year-end 2011 was appropriate
- Credit losses are expected to remain elevated through 2013 as delayed foreclosures from prior periods come through the pipeline; losses decrease in 2014 and 2015 as delinquencies are cleared through default or workout
 - The biggest risks to the current forecast are policy changes driving further decline in home prices



Agenda

Credit Loss Forecast

- Overview
- Loss Forecast Model
- Credit Forecast Drivers
- Analysis
- Sensitivities

Comparative Analysis

- Home Price Forecast Benchmark
- FAS 114 Methodology
- Guaranty Book of Business
- Credit Metrics

Key Takeaways



Credit Loss: Basic Calculation



Defaults

Count of Defaults
for 5-year period
(2011-2015):

1.46 million



Severity

Average Severity of Loss
(Avg. UPB * Avg. Severity):

\$168K * 40% = \$67K

=

Credit Losses

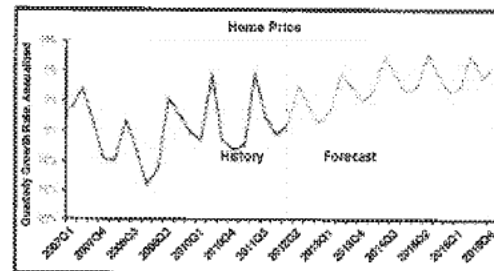
Total 5-year
Credit Losses:

\$98 billion
(approximately)

Defaults predicted using transition rates:

Monthly Transition Rates		Roll To					
		Current	30 DLQ	60 DLQ	90+ SDQ	Default	Prepay
Roll From	Current	0.97	0.01	0.00	0.00	0.00	0.01
	30	0.30	0.46	0.23	0.00	0.00	0.01
	60	0.10	0.15	0.35	0.40	0.00	0.00
	90+	0.02	0.01	0.01	0.93	0.03	0.00

Severity predicted using recent trends for REO and non-REO charge-offs, indexed to home price forecast, as well as recent trends for Foreclosed Property Expenses



February 2012 Base Forecast (December Book)

Confidential Commercial Information - Confidential Treatment and FOIA Exemption Requested 4



What is the Loss Forecast Model?

- The Loss Forecast Model (LFM) is a system of equations designed to predict the credit performance of Fannie Mae's Single Family book of business from a given point in time, including new loan acquisitions and modifications
- The LFM is built to mimic the actual life cycle of a loan, modeling the monthly transitions with discrete outcomes of either prepayment, default, or delinquency status
- The primary business application of the LFM is the SF Corporate Expense Forecast, a 5 year projection of Credit Loss and Credit Expense
- LFM has also been used to:
 - Evaluate solvency of MI companies
 - Quantify impacts of high touch servicers as part of their compensation
- LFM is needed when timing of loss and/or delinquency is required
- LFM is also used in many other internal reports and applications across the corporation



Top Drivers of the Credit Expense Forecast

Economic Drivers

Home price forecast

- The most important driver of the forecast, as it affects both the default volume and severity
- Peak-to-trough metric indicates overall decline, but long term recovery is key as well

Interest rate forecast (prepayments)

- Prepayments have little effect on credit results, as loans that are likely to default tend not to prepay

Book Profile

Delinquency status

- A key driver of default probability

MTMLTV

- Also a key driver of default probability, but also the key driver of severity

Actual Results

REO values, sale prices, expense rates, and inventory levels

- Recent actuals are a secondary driver of severity

Modeling Assumptions

Default speed (the rate at which SDQs are liquidated)

- Primarily affect the timing of credit losses
- Slower default speed pushes credit losses further into the future and increases the allowance in the near term

Business Outlook

Workout volumes

- A key driver of overall results, as workouts reduce defaults and therefore credit loss, but have an associated credit expense

REO sale volume

- Slower REO sales increase Foreclosed Property Expense (FPE)

rely on model on the longer term - not based

of the same degree default



SF Credit Loss and Credit Expense Forecast

LFM - 8/26/12

LFM - 8/26/12

total provision in Annual Stmt

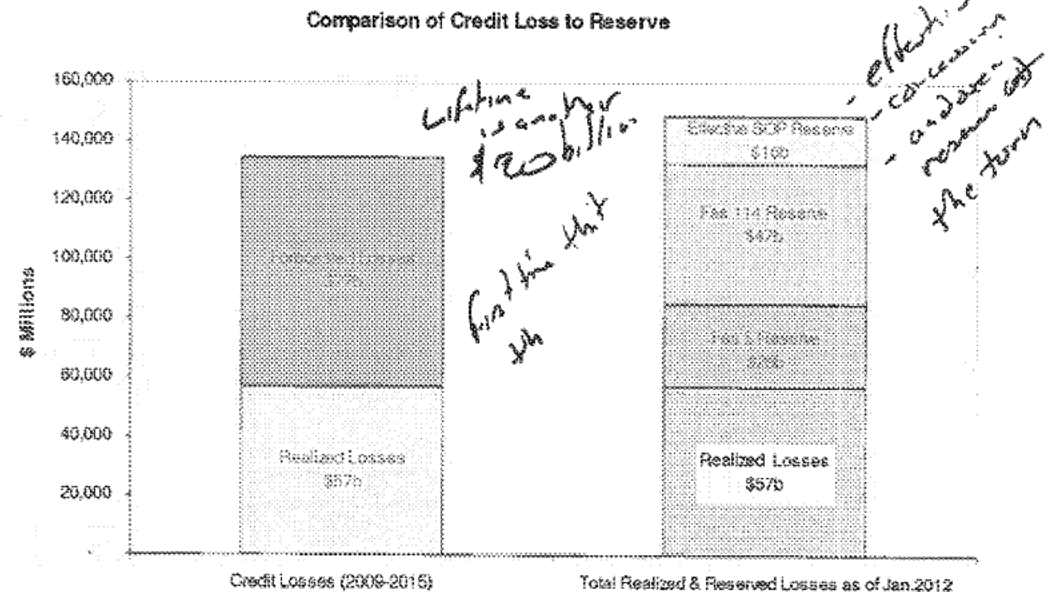
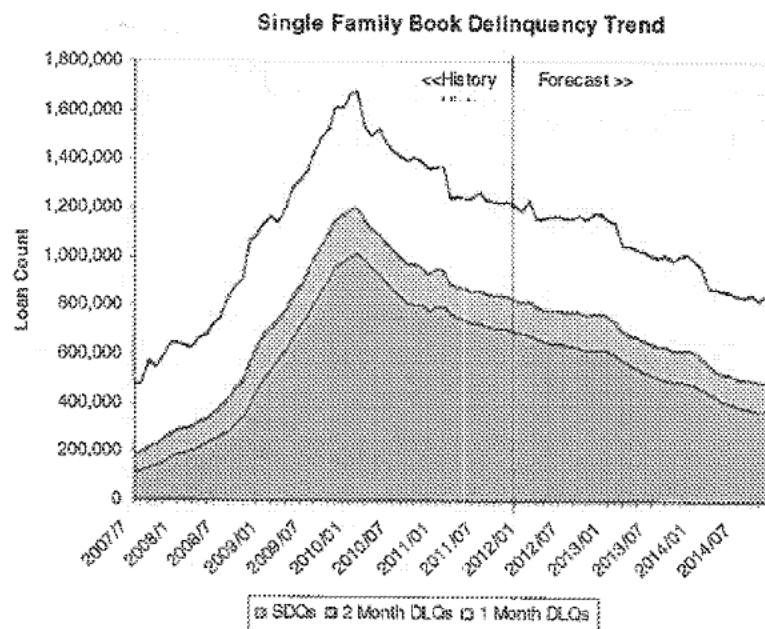
(Dollars in millions unless otherwise noted)	February 2012 Base Forecast (Dec Book)							2010-2014	2011-2015
	2009	2010	2011	2012	2013	2014	2015		
Charge-offs	12,064	20,407	17,038	18,679	21,818	16,603	11,156	94,545	85,294
Foreclosed Property Expense	1,182	2,658	1,890	2,276	3,274	3,061	2,212	13,159	12,713
Total Credit Loss	13,246	23,066	18,929	20,955	25,091	19,664	13,368	107,705	98,007
SOP 03-3 Charges, gross	20,241	177	116	52	51	54	65	451	339
Prior Year SOP 03-3 Contra	(722)	(2,033)	(2,042)	(2,142)	(2,258)	(1,573)	(1,062)	(10,048)	(9,078)
Impact of new HSA Loans	347	58	(568)	(11)	-	-	-	(521)	(579)
Incremental Provision	38,199	1,622	10,795	(6,708)	(11,698)	(14,217)	(11,511)	(20,207)	(33,339)
Total Credit Expense (Corporate)	71,310	22,890	27,229	12,146	11,186	3,929	860	77,380	55,349
Total Defaults (\$)	184,638	344,141	290,937	296,721	344,744	290,901	232,750	1,567,444	1,456,053

close to economic losses

Credit losses remain elevated through 2013 as delayed foreclosures from prior periods come through the pipeline; losses decrease in 2014 and 2015 as delinquencies are cleared through default or workout.



Credit Losses Expected to Decline as Book Continues to Improve

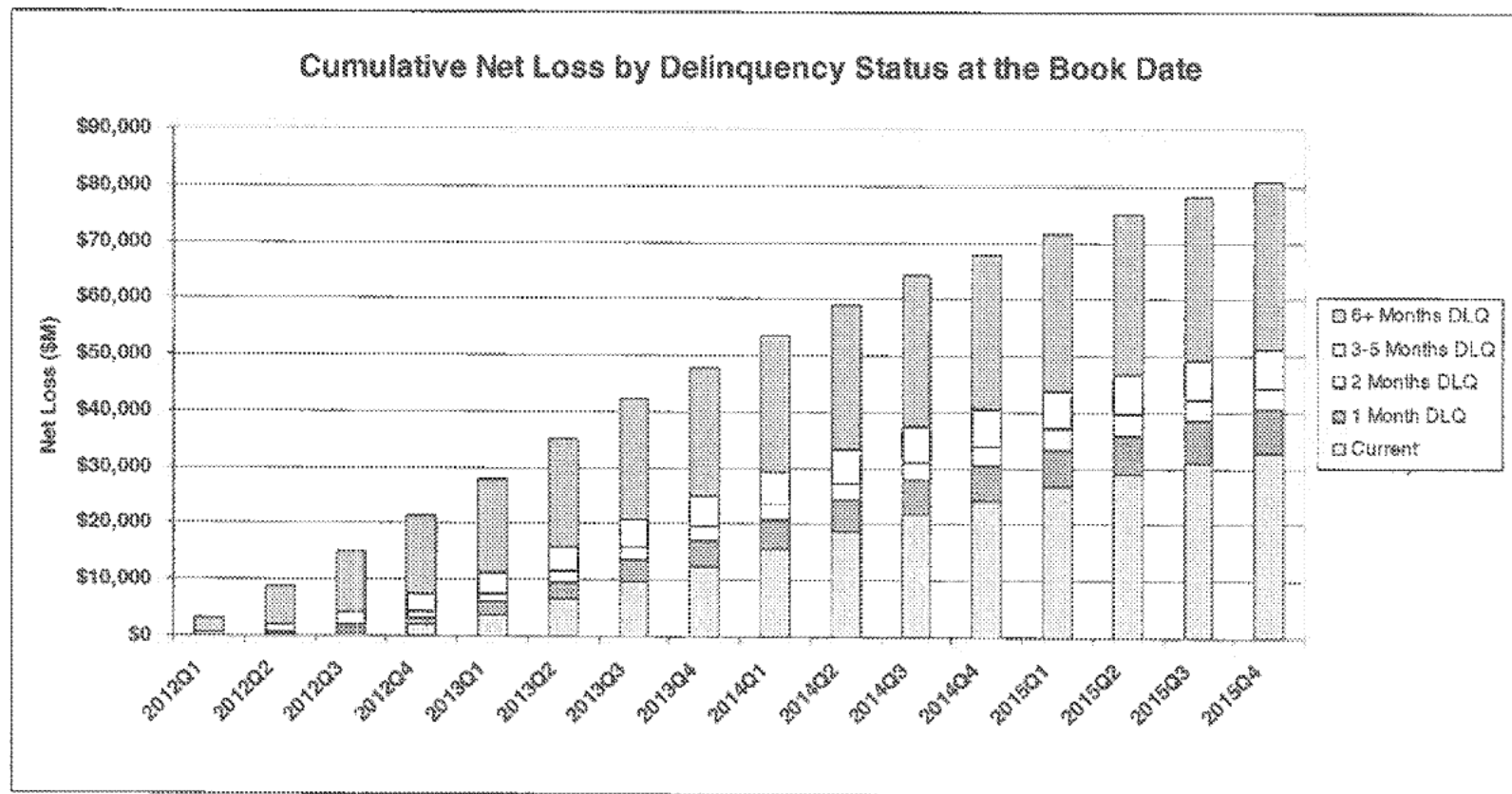


While SF Book delinquency status has consistently improved since January 2010, the allowance only recently peaked. Given forecasted credit losses, we believe Fannie Mae is adequately reserved.



SF Losses by Current Delinquency Status

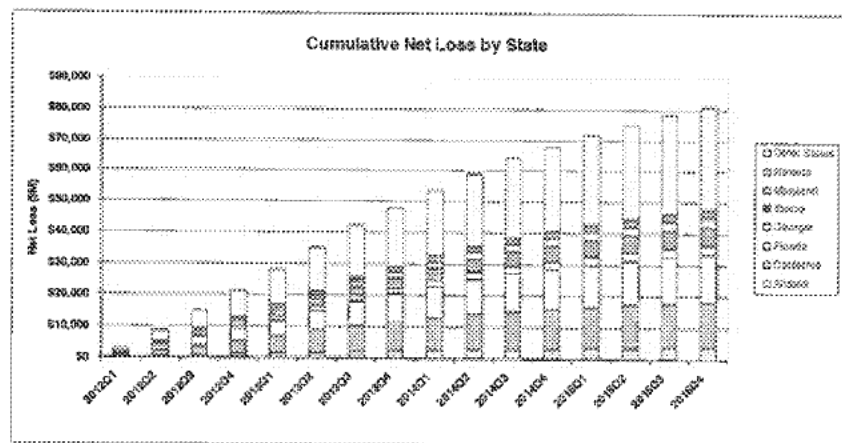
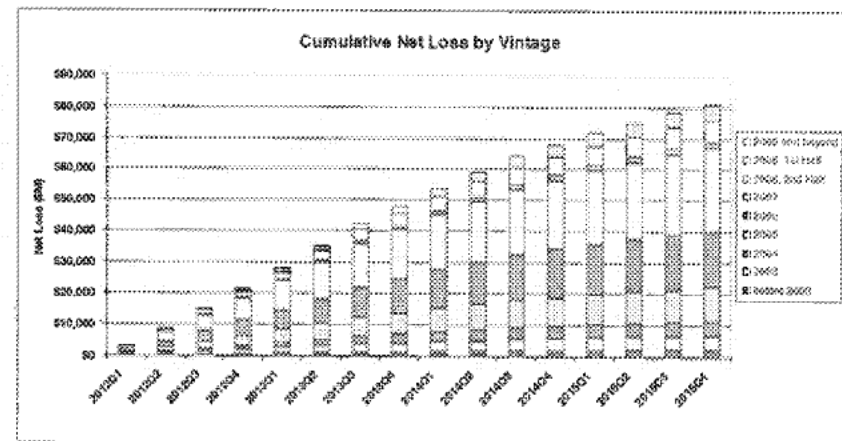
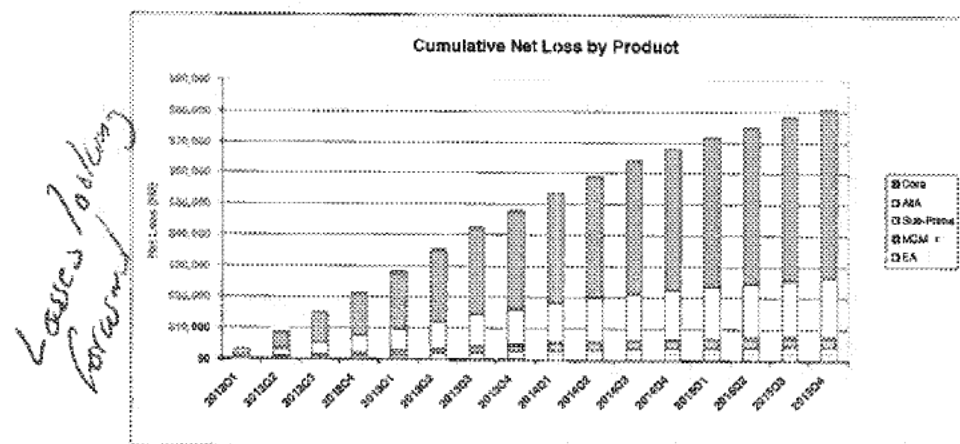
*LFM Ciphres
about 4/15
of
the
losses*



Approximately 41% of forecasted credit losses through 2015 come from loans that are not yet delinquent.



SF Losses by Vintage, Product, and State



- No expectations of shift in losses by vintage from prior forecast
- Top 7 losses by state over 5 years: FL, CA, AZ, NV, MI, NY, IL



Sensitivities of Single Family Credit Forecast

Single Family Credit Sensitivities (\$ in Billions)		Current Projections ²		Impact on Credit Losses (+ Increases Losses)	
		2012	2012-2015	2012	2012-2015
Current forecast of Single Family credit-related expenses					
Influenced by Management Actions	Modification Effectiveness ¹ : Increase effectiveness rate for existing and forecasted modifications to 49% ² (2012-2015 cumulative effective rate projection is currently 44%)	42%	44%	(\$1.2)	(\$3.6)
	Modification Volumes: Increase modification volume by 10%	122K	331K	(\$0.0)	(\$1.1)
	REO Execution: Increase of 2% in REO sales execution ratio (sales proceeds to carrying value)	98%	98%	(\$0.4)	(\$1.8)
	PLMS Execution: 500 basis point increase in sales execution for pre-foreclosure and third party sales	62%	66%	(\$0.5)	(\$2.1)
	NUC Recovery Rates: Increase recovery rate to 85% (2011-2015 cumulative recovery rate projection is currently 75%)	75%	75%	N/A	(\$2.2)
	Foreclosure Volumes: Accelerate REO Acquisitions (increase 2012 by 10% with corresponding 2013-2014 decrease)	208K	881K	\$1.6	\$0.3
Exogenous Factors	Default Expense: Increase REO default expense by 10% for foreclosure delays	\$11K	\$13K	\$0.2	\$1.0
	Home Price Index Sensitivity: National peak-to-trough decline to -31% and lower recovery from trough to the end of 2015 (current national peak-to-trough decline projection is -24% in Q1 2013)			\$1.4	\$22.0

¹ Mod Effectiveness is defined as % of defaults avoided by successfully completing a loan modification as opposed to taking no action.

² Sensitivity assumes existing and forecasted modifications from 2009 to 2015.

Note: Sensitivities are mutually exclusive.

Do not Add together

Refers Periods

Confidential Commercial Information - Confidential Treatment and FOIA Exemption Requested 11



Agenda

Credit Loss Forecast

- Overview
- Loss Forecast Model
- Credit Forecast Drivers
- Analysis
- Sensitivities

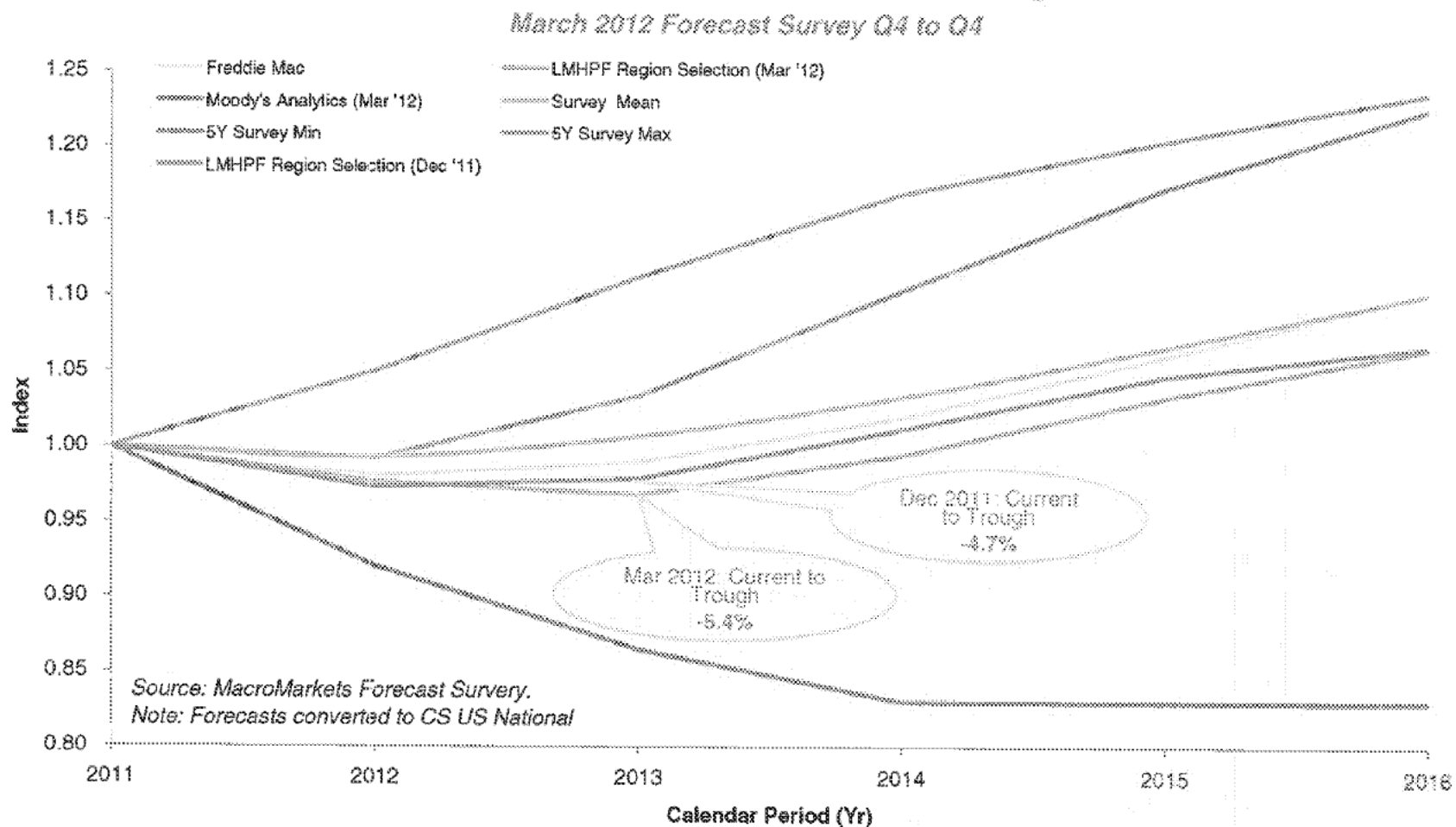
Comparative Analysis

- Home Price Forecast Benchmark
- FAS 114 Methodology
- Guaranty Book of Business
- Credit Metrics

Key Takeaways



Home Price Forecast Benchmarking



Forecast similar to Consensus in short run and pessimistic in the longer run.



Fannie Mae

External Benchmarks for FAS 114 Methodology

*2-3 billion
114
No Hops*

Individual entities

those of part

		Foreclosure Not Probable		Foreclosure Probable
	Measurement Approach	Horizon of Estimate	Type of Cash Flow Projection	Measurement Approach
FNMA	<input checked="" type="radio"/> Expected Loss	<input checked="" type="radio"/> Life of Loan <i>50 to 5 year bump input to 1 billion</i>	<input checked="" type="radio"/> Stochastic <i>50 to 5 year bump of</i>	Current collateral value less cost to sell
FRE	<input type="radio"/> Incurred	<input checked="" type="radio"/> Existing events and conditions	<input checked="" type="radio"/> Single Path <i>expansion</i>	NPV of incurred cash flows
Bank A	<input checked="" type="radio"/> Expected Loss	<input type="radio"/> Partial life	<input checked="" type="radio"/> Single Path	Unknown
Bank B	<input type="radio"/> Incurred	<input checked="" type="radio"/> Existing events and conditions	<input type="radio"/> Hybrid	Unknown

Key:

- TDR include Foreclosure*
- ☒ High contribution to increase in incremental allowance between FAS 5 and FAS 114 treatment.
 - ☐ Moderate contribution to increase in incremental allowance.
 - ☒ Low contribution to increase in incremental allowance.

Note: Incurred measurement approach refers to the methodology where reserve is held for loans that have already suffered the loss-generating event and no projection of future economic condition is used.

Our FAS 114 methodology is very conservative when compared to external benchmarks.



SF Guaranty Book as of December 31, 2011

	Fannie Mae	Freddie Mac					
		2011	2010	2009	2008	2007	2006
Balance (UPB \$Bn)	\$1,746	\$84	\$72	\$8	\$68	\$118	\$11
% of Portfolio	100%	5%	4%	0%	3%	7%	1%
Wtd Avg OLTV	72%	73%	74%	71%	77%	77%	88%
OLTV > 80 %	10%	4%	3%	2%	20%	18%	100%
Wtd Avg MTMLTV	80%	107%	120%	119%	93%	93%	108%
MTMLTV > 100%	20%	82%	69%	63%	37%	38%	24%
Wtd Avg FICO	735	718	720	711	587	642	713
FICO < 625	3%	4%	5%	4%	100%	0%	7%
% Fixed Rate	92%	64%	25%	0%	93%	92%	97%
% Primary Residence	91%	82%	64%	73%	80%	84%	86%
Origination Year							
2011	14%	0%	0%	0%	4%	5%	17%
2010	19%	0%	1%	0%	6%	6%	20%
2009	15%	0%	1%	0%	4%	6%	12%
2008	7%	8%	11%	0%	8%	8%	7%
2007	10%	30%	38%	2%	25%	20%	16%
2006	7%	27%	28%	11%	14%	14%	8%
2005	8%	19%	17%	59%	12%	14%	5%
2004 and Prior	17%	15%	3%	25%	27%	27%	18%
% Credit Enhancement	14%	13%	11%	15%	28%	26%	80%
SDQ Rate ¹	9.58%	11.87%	17.81%	20.49%	12.83%	8.42%	6.72%

Source: Fannie Mae 2011 10K Credit Supplement, page 25 - Single Family Credit Guarantee Portfolio Characteristics
1. Includes structured transactions where loan characteristics exist.

	Fannie Mae	Freddie Mac					
		2011	2010	2009	2008	2007	2006
Balance (UPB \$Bn)	\$2,762	\$182	\$130	\$9	\$88	\$185	\$18
% of Portfolio	100%	7%	5%	0%	3%	7%	1%
Wtd Avg OLTV	71%	73%	75%	71%	77%	77%	88%
OLTV > 80 %	10%	7%	8%	0%	22%	20%	100%
Wtd Avg MTMLTV	78%	101%	118%	101%	91%	92%	111%
MTMLTV > 100%	18%	43%	61%	48%	33%	33%	56%
Wtd Avg FICO	738	717	725	707	587	641	713
FICO < 625	3%	1%	1%	7%	100%	0%	7%
% Fixed Rate	89%	67%	31%	1%	80%	83%	89%
% Primary Residence	88%	78%	65%	69%	87%	84%	85%
Origination Year							
2011	16%	3%	2%	0%	5%	5%	16%
2010	19%	2%	4%	3%	5%	5%	15%
2009	17%	1%	3%	2%	4%	4%	9%
2008	7%	2%	8%	0%	8%	8%	9%
2007	10%	24%	33%	2%	25%	22%	21%
2006	7%	26%	25%	15%	14%	14%	19%
2005	7%	16%	16%	29%	11%	12%	9%
2004 and Prior	18%	25%	8%	45%	32%	30%	18%
% Credit Enhancement	14%	16%	17%	55%	28%	27%	72%
SDQ Rate ¹	9.81%	12.43%	15.27%	7.57%	13.47%	10.16%	8.08%

Source: NBS Servicing Optimization.



Credit Related Results Comparison

Overall Summary Information (i.e. Single Family/Multi-Family)

	Fannie Mae					Freddie Mac				
	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010
Allowance for Credit Losses (\$ Millions)	39,461	39,744	39,095	39,305	39,926	76,938	75,641	74,766	72,101	66,251
Guaranty Book of Business (\$ Millions)	1,899,718	1,932,034	1,942,344	1,950,250	1,916,299	3,037,549	3,037,381	3,066,961	3,086,136	3,054,488
Allowance / Book (bps)	208	206	201	202	208	253	249	244	233	217
Nonperforming Loans (\$ Millions) ¹	120,514	119,081	114,819	115,089	115,478	201,417	202,522	200,793	206,098	212,858
Charge-offs, Net (\$ Millions) ²	3,156	3,230	3,100	2,981	2,897	4,180	3,266	3,881	4,704	2,527
Credit Losses (\$ Millions) ²	3,236	3,451	3,127	3,238	3,114	4,217	3,999	3,403	5,192	3,209
Credit Losses / Book (bps) ⁴	17.0	17.9	16.1	16.6	16.3	13.9	13.2	11.1	16.9	10.5
Allowance/Nonperforming loans	32.74%	33.38%	34.05%	34.15%	34.57%	38.20%	37.35%	37.23%	34.98%	31.12%
REO Acquisitions (Nbr. of Properties) ³	24,763	24,385	24,799	24,709	23,777	47,323	45,260	53,771	53,599	46,083
Disposition of REO (Nbr. of Properties) ³	23,824	25,387	29,355	31,628	26,584	51,425	58,348	71,252	62,851	50,343
Ending Inventory (Nbr. of Properties) ⁴	60,555	59,616	60,618	65,174	72,093	118,788	122,890	135,978	153,459	162,711
SF SDQ (\$ Millions)	64,435	66,416	74,692	79,553	85,722	123,557	128,134	126,261	138,972	148,471
SF SDQ Rate ⁵	3.58%	3.51%	3.50%	3.63%	3.84%	3.91%	4.00%	4.08%	4.27%	4.48%
Complete Modifications	19,048	23,919	31,049	35,158	37,203	51,936	60,025	59,019	68,759	89,691
Completed Modifications / SDQ (Count)	5%	6%	8%	8%	8%	8%	8%	8%	9%	11%
SF Allowance/SF SDQ	60%	59%	51%	48%	46%	61%	58%	57%	51%	43%

Notes

¹ Includes TDR, HomeSaver Advance loans and loans more than 2 months delinquent (single family only).

² accrual policy change. FNM allowance without interest is 74,442. FNM Allowance / Book (bps), when excluding interest, is 245 compared to Freddie's 206.

³ FNM Net Charge-offs exclude the impact of acquired credit-impaired loans (SOP03-3) and losses on accrued interest.

⁴ REO counts include both single family and multifamily loans.

⁵ Calculated values.

⁶ Includes structured transactions.

- FNM's ALL/Book ratio has been higher than that of FRE mainly driven by (1) FNM has a worse book profile as indicated by higher SDQ rate; (2) FNM has a higher proportion of book under FAS 114 treatment and has a higher FAS 114 impairment rate than FRE; (3) different model sensitivities to book profile changes and economic conditions.
- Additionally, FNM completed modification volume is 2.5 x FRE's volume, resulting in higher FAS 114 reserves for FNM. FNM has been focusing on FNM specific modifications, while in general, Freddie is less active in modification activity due to a better book profile and different loss mitigation strategies. Additionally, FNM's modification activity has contributed to the decrease in its SDQ rate while FRE's SDQ rate has been increasing over the past few quarters.

Confidential Commercial Information - Confidential Treatment and FOIA Exemption Requested 16



Loan Loss Reserves by Collective and Individually Impaired

	Fannie Mae						FRE					
	QoQ Delta	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	QoQ Delta	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010
Collective Reserve - FAS5 (\$ Millions) ¹	-3.44%	24,115	24,974	27,537	28,911	31,094	-0.32%	28,922	29,015	28,849	28,957	26,640
Individual Impairment - FAS114 (\$ Millions) ^{1,2}	3.90%	15,346	14,770	11,558	10,394	8,832	2.98%	48,016	46,626	45,907	43,144	39,611
Total Allowance	-0.71%	39,461	39,744	39,095	39,305	39,926	1.71%	76,938	75,641	74,756	72,101	66,251
FAS114 / Total Allowance	4.64%	38.89%	37.16%	29.56%	26.44%	22.12%	1.25%	62.41%	61.64%	61.41%	59.84%	59.79%
Recorded Investment for FAS 114 (\$ Millions)	4.60%	62,707	59,952	48,652	44,443	39,142	2.08%	169,840	166,384	156,503	152,472	148,042
FAS114 Impairment / Recorded Investment for FAS 114		24.47%	24.64%	23.76%	23.39%	22.56%		28.27%	28.02%	29.35%	28.30%	26.76%

¹Includes reserves for accrued interest receivable and taxes and insurance.

²FRE excludes HAMP trials when reserving for individually impaired loans. FNM includes both HAMP trials and closed HAMP modifications in FAS 114 allowance calculations.

- FRE's total reserve decreased by approximately \$200M in Q3'11 driven by an \$800M decrease in their collective reserve which more than offsets a \$600M increase in the individually impaired reserve.
- Both FNM's and FRE's impairment rates stayed relatively flat over the last quarter.
- FNM's FAS 114/ALL ratio is significantly higher than FRE's not only as a result of higher modification volumes, but also because of FNM's booking of makewhole benefits for FAS 114 loans under FAS 5.



Key Takeaways

- The allowance reached its highest level in Q4 2011 and is expected to reduce to \$69B by year-end 2012
 - New models being implemented are likely to result in a further decline of the allowance as they will include recent history that reflects improved performance
- We believe the allowance as of year-end 2011 was appropriate
- Credit losses are expected to remain elevated through 2013 as delayed foreclosures from prior periods come through the pipeline; losses decrease in 2014 and 2015 as delinquencies are cleared through default or workout
 - The biggest risks to the current forecast are policy changes driving further decline in home prices

To: Satriano, Nicholas[Nicholas.Satriano@fhfa.gov]
From: Griffin Jr., James
Sent: Tue 8/14/2012 12:49:45 PM
Subject: Re: SPSPA Meeting

Nick,

There was not. I do not think there would be a going concern issue. There was a question about re-recording certain deferred tax assets that had been written-off. Jeff indicated both of the Boards had discussed this at the last meeting based on the view that they were going to be profitable going forward. I do not think that makes sense given the amendments are designed to demonstrate wind down. This is something we will need to work with the Enterprises and their auditors on.

Thanks,

Jim

----- Original Message -----

From: Satriano, Nicholas
Sent: Tuesday, August 14, 2012 12:37 PM
To: Griffin Jr., James
Subject: Re: SPSPA Meeting

Hi

Any discussion of reaching out to the auditors? Given the changes, should be fine.

Cheers,

Nick

----- Original Message -----

From: Griffin Jr., James
Sent: Tuesday, August 14, 2012 07:33 AM
To: Satriano, Nicholas
Subject: SPSPA Meeting

The meeting with Ed went well. The amendment is expected to be made public sometime on Friday. The Enterprises will be informed tomorrow of the changes and FHFA will work with them to ensure a consistent communication message.

Thanks

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

PERRY CAPITAL LLC,

Plaintiff,

v.

JACOB J. LEW, *et al.*,

Defendants.

Civil Action No. 13-cv-1025 (RLW)

FAIRHOLME FUNDS, INC., *et al.*

Plaintiffs,

v.

FEDERAL HOUSING FINANCE AGENCY,
et al.,

Defendants.

Civil Action No. 13-cv-1053 (RLW)

ARROWOOD INDEMNITY COMPANY,
et al.,

Plaintiffs,

v.

FEDERAL NATIONAL MORTGAGE
ASSOCIATION, *et al.*,

Defendants.

Civil Action No. 13-cv-1439 (RLW)

DECLARATION OF MARIO UGOLETTI

I, Mario Ugoletti, hereby declare, based on personal knowledge of the facts, as follows:

1. I am Special Advisor to the Office of the Director of the Federal Housing Finance Agency (“FHFA”), a role I assumed in September 2009. As Special Advisor, my responsibilities include advising FHFA’s Acting Director Edward DeMarco concerning the Senior Preferred Stock Purchase Agreements (“PSPAs”), described *infra*. Additionally, I serve as the primary liaison with Treasury concerning the PSPAs and any amendments to the PSPAs.

2. I was employed at Treasury from 1995 to 2009, serving as Director of the Office of Financial Institutions Policy from 2004-2009. In that capacity, I participated in the creation and implementation of the PSPAs.

3. FHFA is an independent federal agency with regulatory authority over the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (together, the “Enterprises”) and the twelve Federal Home Loan Banks (“Banks”). 12 U.S.C. § 4511.

4. On September 6, 2008, FHFA’s Director appointed FHFA as Conservator of the Enterprises, and on September 7, 2008 FHFA as Conservator of the Enterprises entered into two materially identical Senior Preferred Stock Purchase Agreements (together, the “PSPAs”) with the United States Treasury (“Treasury”)—one for Fannie Mae and one for Freddie Mac. The Amended and Restated Agreements dated September 26, 2008 and subsequent amendments are currently available at <http://www.fhfa.gov/Default.aspx?Page=364>.

5. The PSPAs were a last resort after it became apparent that no infusions of capital from the private sector were forthcoming to save the Enterprises. *See Oversight Hearing to Examine Recent Treasury and FHFA Actions Regarding the Housing GSEs Before the H. Comm. on Financial Services*, 110th Cong., at 5 (Sep. 25, 2008) (statement of James B. Lockhart III,

Director, Federal Housing Finance Agency), currently *available at* <http://archives.financialservices.house.gov/hearing110/lockhart092508.pdf> (“After substantial effort and communication with market participants, each company reported to FHFA and to Treasury that it was unable to access capital markets to bolster its capital position without Treasury financing. FHFA’s and Treasury’s own discussions with investment bankers and investors corroborated this conclusion.”). The PSPAs provided the market with assurances that Treasury would provide a backstop to the Enterprises. Absent the commitments of Treasury, the Enterprises would have collapsed. *See id.* at 5-6 (“In the absence of access to new capital, the only alternative left to the firms was to cease new business and shed assets in a weak market. That would have been disastrous for the mortgage markets as mortgage rates would have continued to move higher and, in turn, disastrous for the Enterprises as the prices of their securities would have fallen and credit losses would have increased.”); Timothy F. Geithner, Secretary, U.S. Dep’t of the Treasury, Written Testimony Before the H. Comm. on Financial Services (Mar. 23, 2010), currently *available at* <http://www.treasury.gov/press-center/press-releases/Pages/tg603.aspx> (“In 2007, the GSEs reported combined losses of over \$5 billion . . . The GSEs ultimately reported combined 2008 losses in excess of \$108 billion. . . . Both companies were severely undercapitalized and would not have been able to meet their obligations without the intervention and financial support of the government.”). With the PSPAs and the market assurance they provided, the Enterprises were able to remain in operation.

6. The PSPAs provided that the Enterprises would draw funds from Treasury against the Treasury commitment if the Enterprises exhausted all of their stockholder equity and had a negative net worth (defined as liabilities exceeding assets). If Enterprise liabilities exceeded assets, the provision for mandatory receivership in the Housing and Economic Recovery Act of 2008 (“HERA”) would be triggered. The PSPAs were designed so that the Enterprises could

draw funds from Treasury in amounts necessary to cure their negative net worth and bring their capital to zero. By the end of 2008, all shareholder equity had been exhausted and the Enterprises drew on the Treasury commitment to avoid mandatory receivership. *See* FHFA Data as of November 14, 2013 on Treasury and Federal Reserve Purchase Programs for GSE & Mortgage-Related Securities at 2, currently *available at* <http://www.fhfa.gov/webfiles/25784/TSYSupport%202013-11-13.pdf> (Freddie Mac draw of \$13.8 billion for third quarter 2008; Fannie Mae draw of \$15.2 billion for fourth quarter 2008).

7. The PSPAs gave Treasury an expansive bundle of rights and entitlements in exchange for the lifeline that Treasury provided, without which the Enterprises would have gone out of business. For example, Treasury received warrants to acquire 79.9% of the common stock of the Enterprises for a nominal payment. In addition, under the PSPAs, Treasury obtained Senior Preferred Stock that is senior in priority over all other series of preferred stock. The Treasury Senior Preferred Stock in each Enterprise had an initial face value of \$1 billion, which increases by any amount that the Enterprises draw from Treasury under the Treasury Commitment. Further, the Treasury Senior Preferred Stock has a liquidation preference so that Treasury has priority over any other preferred or common shareholders in the event of a liquidation — that is, Treasury is entitled to the value of its Senior Preferred Stock (face value plus any amounts drawn from Treasury by the Enterprises, without reduction for dividends or other amounts that the Enterprises might pay to Treasury) before any other shareholders — preferred or common — are paid anything in liquidation.

8. The Treasury Senior Preferred Stock also included payment obligations from the Enterprises to Treasury, commensurate with the enormous risks and financial commitments that Treasury assumed. The Enterprises were obligated to pay a 10% annual dividend together with a

Periodic Commitment Fee (“PCF”) that was “intended to fully compensate [Treasury] for the support provided by the ongoing Commitment.” Amended and Restated Agreements, § 3.2(b) (Sept. 26, 2008). The PSPAs provided that the amount of the PCF to be imposed beginning January 2010 “shall be determined with reference to the market value of the Commitment as then in effect.” *Id.*

9. The PSPA gave Treasury the right, in its sole discretion, to waive the PCF for a year at a time “based on adverse conditions in the United States mortgage market.” Treasury exercised this right to waive the PCF for 2010 and 2011, years in which the Enterprises had insufficient funds to pay even the 10% dividend, let alone an additional PCF, stating that “the imposition of the PCF at this time would not fulfill its intended purpose of generating increased compensation to the American taxpayer.” Periodic Commitment Fee Waiver Letters from Dept. of Treasury to FHFA (Dec. 29, 2010; Mar. 31, 2011; Jun. 30, 2011; Sept. 30, 2011; Dec. 21, 2011). It was clear by this time that, given the risks of the Enterprises and the enormity of the Treasury commitment, the value of the PCF was incalculably large.

10. Under the Second Amendment to the PSPAs (executed December 24, 2009), Treasury was obligated to commit any amount of funds necessary to maintain the Enterprises’ positive net worth through December 31, 2012, subject to an initial cap of \$200 billion for each of the Enterprises plus the amount of draws between January 1, 2010 and December 31, 2012. As of January 1, 2013, however, Treasury’s financial commitment cap became fixed: the amount

remaining available to Fannie Mae under the cap was \$117.6 billion, and the amount remaining available to Freddie Mac under the cap was \$140.5 billion.¹

11. By late 2011, analysts and key stakeholders, including institutional and Asian investors in the Enterprises' debt and mortgage backed securities (MBS), began expressing concerns about the adequacy of Treasury's financial commitment to the Enterprises after January 1, 2013, when the cap on Treasury's funding commitment would become fixed.

12. The principal driver of these concerns about the adequacy of Treasury's capital commitment were questions about the Enterprises' ability to pay the 10% annual dividend to Treasury without having to draw additional funds from Treasury, thereby eating away at the amount remaining available under the capped Treasury commitment. From the outset of the PSPAs, the Enterprises could not at times generate enough income to make these dividend payments.

13. The Enterprises drew funds from Treasury to pay the required 10% dividend back to Treasury. Of the \$188 billion the Enterprises drew from Treasury from the outset of the PSPAs (September 2008) to the execution of the Third Amendment (August 2012), \$45.7 billion was drawn solely to pay the 10% annual dividend back to Treasury. *See* FHFA, Data as of November 14, 2013 on Treasury and Federal Reserve Purchase Programs for GSE and

¹ Under the Second Amendment to the PSPAs, Treasury committed to provide each Enterprise the greater of: (i) \$200 billion or (ii) \$200 billion plus the Enterprise's cumulative draws for 2010, 2011, and 2012, less the Enterprise's positive net worth, if any, on December 31, 2012. Second Amendment to Amended and Restated Senior Preferred Stock Purchase Agreement, at 3.

For Fannie Mae, alternative (ii) provided the greater amount: \$200 billion + \$40.9 billion (cumulative draws for 2010-2012) – \$7.2 billion (positive net worth on December 31, 2012) – \$116.1 billion (total draws from 2008-2012) = \$117.6 billion.

For Freddie Mac, alternative (ii) provided the greater amount: \$200 billion + \$20.6 billion (cumulative draws for 2010-2012) – \$8.8 billion (positive net worth on December 31, 2012) – \$71.3 (total draws from 2008-2012) = \$140.5 billion.

Mortgage-Related Securities at 2, 3. Additionally, each time the Enterprises drew funds to pay the 10% dividend, the total amount of the Treasury draw increased, in turn increasing the amount of the next 10% dividend payment.

14. By mid-2012, the amount of the annual 10% dividend had grown so large—\$11.7 billion for Fannie Mae and \$7.2 billion for Freddie Mac—that it appeared unlikely that either of the Enterprises would be able to meet that amount consistently without drawing additional funds from Treasury. *See* Freddie Mac, Quarterly Report (Form 10-Q) at 10, 85 (May 3, 2012), currently *available at* http://www.freddiemac.com/investors/sec_filings/index.html (“Over time, our dividend obligation to Treasury will increasingly drive future draws. Although we may experience period-to-period variability in earnings and comprehensive income, it is unlikely that we will generate net income or comprehensive income in excess of our annual dividends payable to Treasury over the long term.”); Freddie Mac, Quarterly Report (Form 10-Q) at 10, 92 (Aug. 7, 2012), currently *available at* http://www.freddiemac.com/investors/sec_filings/index.html (same); Fannie Mae, Quarterly Report (Form 10-Q) at 11, 81 (May 9, 2012), currently *available at* <http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q12012.pdf> (“Although we may experience period-to-period volatility in earnings and comprehensive income, we do not expect to generate net income or comprehensive income in excess of our annual dividend obligation to Treasury over the long term.”); Fannie Mae, Quarterly Report (Form 10-Q) at 12-13, 83 (Aug. 8, 2012), currently *available at* <http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q22012.pdf> (same). Because the cap on the Treasury commitment became fixed on January 1, 2013, each dollar drawn from Treasury merely to repay the Treasury dividend was one less dollar available

to the Enterprises to draw in the event the Enterprise suffered losses due, for example, to a decline in the housing market or broader economic turbulence.

15. Market forecasts—which FHFA monitored—predicted that the Enterprises’ ongoing payment of the 10% dividend would completely exhaust Treasury’s funding commitment within ten years, leading to potential downgrades in the Enterprises’ credit ratings. Moody’s rating service opined that the 10% dividend payments would “eliminate Fannie Mae’s contingent capital by 2019 and Freddie Mac’s by 2022 . . . [even] assum[ing] that the GSEs are able to fully offset credit losses, which we believe is unlikely.” Moody’s, Sector Comment, “Plan To Raise Fannie Mae and Freddie Mac Guarantee Fees Raises Question of Support,” at 2 (Sept. 26, 2011). Moody’s stated that this “would be credit negative and prompt a review of [the Enterprises’] Aaa ratings.” *Id.* Likewise, Deutsche Bank observed that “diminishing Treasury support raises the risk that the agencies one day might face challenges in covering MBS losses” and that such a risk “becomes greater in a housing market catastrophe, such as the one that started in the US after 2006.” Deutsche Bank, *The Path of US Support for Fannie Mae, Freddie Mac*, THE OUTLOOK, Mar. 14, 2012, at 6.

16. FHFA shared the concerns that the 10% annual dividend to Treasury would reduce the amount of the Treasury commitment starting in 2013. Treasury also generated and provided certain forecasts to FHFA that were similar to those prepared by market participants.

17. These concerns about the adequacy of Treasury’s financial commitment undermined the purpose of the PSPAs to express financial support to holders of Enterprise debt (*i.e.*, bondholders) and mortgage backed securities. *See* FHFA Mortgage Market Note (Dec. 5, 2008), currently available at <http://www.fhfa.gov/webfiles/1241/mmnote084.pdf>. The strength of that support depends upon the Enterprises having a sufficiently large pool of available funds

from Treasury that will permit the Enterprises to continue to operate under adverse market conditions that may arise in the coming years.

18. To resolve these concerns, FHFA and Treasury agreed on the provisions that were incorporated into the Third Amendment, executed on August 17, 2012. The Third Amendment (1) eliminated the 10% annual dividend, (2) added a quarterly variable dividend in the amount (if any) of each Enterprises' positive net worth (above net worth values that were specified in the Third Amendment), and (3) suspended the PCF for as long as the quarterly variable dividend is in effect. The new dividend structure eliminated the risk that borrowings to make fixed dividend payments would lead to the exhaustion of the Treasury commitment.

19. These changes in structure did not change the underlying economics of the PSPAs. It was my belief at this time, given the size and importance of the Treasury commitment, that through the liquidation preference, fixed dividends, and the market value of the PCF, Treasury would receive as much from the Enterprises under the Second Amendment as it would under the Third Amendment. Thus, the intention of the Third Amendment was not to increase compensation to Treasury — the Amendment would not do that — but to protect the Enterprises from the erosion of the Treasury commitment that was threatened by the fixed dividend. The Third Amendment was therefore consistent with the intent of the original PSPAs to (1) fully compensate Treasury for the value of its financial support, without which the Enterprises would have been forced into receivership, and (2) protect the Enterprises and the national housing market.

20. At the time of the negotiation and execution of the Third Amendment, the Conservator and the Enterprises had not yet begun to discuss whether or when the Enterprises would be able to recognize any value to their deferred tax assets. Thus, neither the Conservator

nor Treasury envisioned at the time of the Third Amendment that Fannie Mae's valuation allowance on its deferred tax assets would be reversed in early 2013, resulting in a sudden and substantial increase in Fannie Mae's net worth, which was paid to Treasury in mid-2013 by virtue of the net worth dividend.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed this 17 day of DECEMBER 2013 at Washington, D.C.

By: 
MARIO UGOLETTI

*Special Advisor to the Office of the Director,
Federal Housing Finance Agency*

From: Satriano, Nicholas
Sent: Thursday, June 14, 2012 9:18 AM
To: Griffin Jr., James
Subject: FW: Highlights of Susan McFarland meeting 6/13/12 with Satriano and Galeano

Importance: High

Nicholas Satriano
FHFA – OCA
202.649.3450 office
202.420.9699 mobile

From: Galeano, Andre D.
Sent: Wednesday, June 13, 2012 7:44 PM
To: Satriano, Nicholas
Subject: FW: Highlights of Susan McFarland meeting 6/13/12 with Satriano and Galeano
Importance: High

fyi

From: Galeano, Andre D.
Sent: Wednesday, June 13, 2012 7:44 PM
To: Greenlee, Jon; Creel, Duane V.; Nichols, Nina
Subject: Highlights of Susan McFarland meeting 6/13/12 with Satriano and Galeano
Importance: High

Here are the Highlights

- As of now, FNM projecting \$5 billion in earnings for the quarter. This includes \$2 billion in derivative losses, which can fluctuate but will increase as rates decline. In addition, it is possible that FNM may take a negative provision of \$1 to \$2 billion in the reserves (this would increase income) due to lower than expected credit losses (this makes getting back to fnm on 180 day charge off all the more urgent). Lower expected losses caused by better than expected HPI, lower sdq, and better execution on REO sales.
- FNM does not expect to make any major assumption/accounting changes for Rep and Warrant issues and on MI claims.
- FNM has a meeting with BOA tomorrow in NY to engage the General Counsel of BOA more closely. Apparently, he has not been engaged previously and ostensibly may agree with some of fnm positions. FNM has booked \$5

billion in receivable from BOA of the \$7 billion in claims. If settlement occurs, then they would use settlement accounting. FNM is hearing a "5" handle on settlement from outside parties working on this. FNM thinks lifetime exposure on RW with BOA is low teens.

- Susan comfortable with draft accounting alignment letter.
- Accounting finance and finance control aspect on human capital – attrition in Greg Fink's space has lowest turnover in four years and lowest openings. Credit to greg's leadership and key folks on greg's team. Had some turnover. Leslie's group dries and drabs – developed a contingency plan- she has companies in place that FNM have used in the past .