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The 2019 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac

United States: Federal Housing Finance Agency (FHFA)

THE 2019 STRATEGIC PLAN FOR THE CONSERVATORSHIPS OF FANNIE MAE AND FREDDIE MAC

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Division of Conservatorship

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Executive Summary

September 6, 2019, marked 11 years since the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (Fannie Mae and Freddie Mac, respectively, and together the Enterprises) were placed into conservatorships in the middle of the financial crisis of 2008. A root cause of the housing finance crisis was imprudent mortgage credit risk backed by insufficient capital. This fundamental problem remains unresolved today. Therefore, our nation's mortgage finance system is in urgent need of reform.

The Enterprises have only grown more dominant in our housing finance system since entering conservatorships. They are inarguably undercapitalized for their size, risk, and systemic importance. Their on-going, indefinite conservatorships result in far-reaching government influence over the nation's housing finance system, creating an unlevel playing field to the disadvantage of taxpayers, homeowners, borrowers, and renters. Only Congress can enact the structural reforms necessary to fix the flaws in the current model. However, as conservator of the Enterprises, the Federal Housing Finance Agency (FHFA) has significant statutory authority and the responsibility to implement critical reforms, such as restoring capital levels at the Enterprises and ending the conservatorships, that will produce a stronger and more resilient housing finance system.

This 2019 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (Strategic Plan) provides a framework for how FHFA intends to guide the Enterprises in accordance with statutory mandates. Premised on a new vision for reform that builds from the current realities of conservatorship toward a better housing finance system, the Strategic Plan will benefit:

- Taxpayers, by ensuring that the Enterprises should never need another bailout;
- Homeowners, borrowers, and renters, by supporting market stability and ensuring mortgage credit availability for affordable housing through the economic cycle; and
- Investors, by ensuring America's secondary mortgage market is strong and resilient.

FHFA is also releasing a new 2020 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (Scorecard) that aligns tactical priorities and execution at the Enterprises to the Strategic Plan and serves as an essential tool in holding the Enterprises accountable for its effective implementation. The three broad objectives of this new Strategic Plan and Scorecard are to ensure that the Enterprises:

1. **Focus on their core mission responsibilities to foster competitive, liquid, efficient, and resilient (CLEAR) national housing finance markets that support sustainable homeownership and affordable rental housing;**

2. **Operate in a safe and sound manner appropriate for entities in conservatorship; and**

3. **Prepare for their eventual exits from the conservatorships.**

The vision for reform articulated and advanced in the new Strategic Plan and Scorecard is well aligned with the housing reform plans developed by the United States Department of the Treasury (Treasury) and the United States Department of Housing and Urban Development (HUD). On September 5, 2019, pursuant to the Presidential Memorandum issued March 27, 2019, Treasury and HUD released comprehensive plans (the Administration's Reform Plan) containing legislative and administrative reforms to build a more resilient housing finance system that protects taxpayers and access to sustainable mortgage funding. Many of the recommendations call for collaboration by FHFA, Treasury, and HUD. For instance, on September 27, 2019, FHFA and Treasury signed a letter agreement enabling the Enterprises to collectively retain up to $45 billion in capital, a critical first step toward restoring the Enterprises to sound financial condition.

FHFA shares the goals of the Administration's Reform Plan to protect taxpayers and define a limited role for the federal government while promoting competition in our nation's housing finance system. FHFA is committed to working with Treasury and HUD to cement further reforms. To the greatest extent possible, FHFA will pursue administrative reforms, legislative reform, and reform of the conservatorships simultaneously. At the same time, as the independent regulator and conservator of the Enterprises, FHFA will fulfill its responsibilities under the Housing and Economic Recovery Act of 2008 (HERA) by pursuing the three primary objectives of the new Strategic Plan and Scorecard summarized below.

First, the Enterprises must always focus on their core statutory mission to foster competitive, liquid, efficient, and resilient (CLEAR) national housing finance markets that support sustainable homeownership and affordable housing, including affordable rental housing. At all times the Enterprises must operate squarely within the limits of their charters and remain cognizant that their role of providing access is most needed by smaller mortgage market participants and community lending institutions. To foster competition that serves consumers, the new Strategic Plan and Scorecard aim to provide a level playing field for all market participants such that success depends on running a better business rather than special regulatory and statutory advantages.

Second, safety and soundness are paramount while the Enterprises are in, and as a condition to exit, conservatorship. Risk at the Enterprises must be appropriately calibrated to the thin capital cushions currently in place, in order to protect taxpayers and our nation's entire financial system. The new Strategic Plan and Scorecard support the Enterprises prudently serving the market, while beginning to orient them toward a more countercyclical role that ensures financing across the economic cycle without needlessly crowding out private market participants. New Enterprise activities during conservatorship should be limited and clearly aligned to core guaranty activities, to reducing risk, and to supporting the objective of exiting conservatorship. Competition between the Enterprises during conservatorship, or between the Enterprises and government-supported lending programs, must be limited and responsible in order to protect taxpayers, borrowers, and underserved communities.

Third, ending the conservatorships requires restoring the Enterprises to fully privately-owned entities capable of and committed to operating in safe and sound financial condition and in accordance with the statutory purposes stated in their charters. Therefore, the new Strategic Plan and Scorecard emphasize the need for the Enterprises and FHFA to prepare for a responsible exit from the conservatorships, following a roadmap with clear and appropriate milestones. A fundamental precondition to ending the conservatorships is that the Enterprises build their capital to levels commensurate with safety and soundness. Returning decision making to private capital that both earns the rewards and bears the risks of the Enterprise businesses will protect taxpayers and support market discipline that serves homeowners, borrowers, and renters. A strengthened and independent FHFA will work to ensure that the Enterprises and any additional secondary market participants have the capital reserves, risk management practices, corporate governance standards, operational capabilities, and regulatory oversight that are appropriate for financial institutions of their risk, size, and systemic importance.

Many of the reforms outlined in the new Strategic Plan and Scorecard will help address our nation's affordable housing crisis. For example, compared to the duopoly of Fannie Mae and Freddie Mac, moving toward a more competitive secondary mortgage market – in which the same rules and regulations apply equally to all – would better serve borrowers and renters. Competition more effectively delivers market-affordable prices with customer satisfaction and continual innovation to improve product quality.

Competition also promotes long-term efficiency, by ensuring that mismanaged and inefficient firms do not survive, and market discipline by assuring that no institution is “too big to fail.” A qualified mortgage (QM) rule that works for all market participants originating responsible loans, and without special “patches” for the Enterprises, would support greater competition that ultimately serves borrowers and expands access to credit.

However, solving our nation’s critical housing affordability challenges will require looking beyond the secondary mortgage market and addressing the true cause of this crisis: namely, the significant shortage of housing supply. This is a national problem with local roots. The supply of housing is determined primarily by the cost and availability of land, labor, and building materials, as well as by local and state government policies. Rent control is perhaps the most thoroughly studied example of local policy that unquestionably limits the supply and lowers the quality of housing. But it is far from the only such policy impediment to affordable housing.

In recent years, proliferation of state and local mandates, fees, zoning and land-use restrictions, building codes, and permitting requirements have led to muted growth in single-family housing supply and rapidly rising asset prices. The burden of these local and state policies is borne disproportionately by low- and very low-income Americans who are most in need of affordable housing. This crisis will not be solved until state and local governments lower the barriers that make it harder and more expensive to build and deliver new affordable housing in their communities. Therefore, the Scorecard that accompanies this Strategic Plan encourages the Enterprises to play a role in supporting such reforms, recognizing that ultimate action rests with local and state governments.

This Strategic Plan benefits from and builds upon progress that has been made over the last 11 years, aided by the efforts of the Enterprises and the dedicated staff of FHFA. Housing markets have recovered, delinquencies and foreclosures have declined substantially, and loans with very high-risk features such as “low doc” are no longer acquired by the Enterprises. The creation of the Uniform Mortgage-Backed Security (UMBS) and the development of the Common Securitization Platform (CSP) have ushered in a new era of improved liquidity and uniformity in the mortgage-backed security market to support the 30-year fixed rate mortgage. The transfer of Enterprise interest rate and credit risk to private sources of capital is allowing private capital to play an increasing role in the system.

This progress is a rationale not for accepting, but for reforming, the status quo. The current strong economic conditions, coupled with the certainty that an unfavorable turn in the business cycle and housing market will someday come, argue for moving quickly to restore Enterprise capital and address the remaining vulnerabilities in our housing finance system.

In sum, the ambitious vision of this new Strategic Plan and Scorecard, combined with the framework for reform put forward in the Administration's Reform Plan, ensures that there will be no return to pre-2008 practices by the Enterprises. Turning this vision into reality will require the simultaneous pursuit of administrative action and legislative reforms, in conjunction with the new approach to operating the Enterprise conservatorships. Implementing comprehensive reform will take time and the coordinated action of FHFA, the Enterprises, Congress, and other federal agencies, including the Treasury and HUD. But after more than 11 years of the Enterprises in conservatorships, the time is long past due to build a truly competitive, liquid, efficient and resilient secondary mortgage market. Implementing the new Strategic Plan and Scorecard is an essential step toward that end. Together, they will reduce the role of government in the mortgage market, protect taxpayers, support sustainable homeownership and affordable rental housing, and foster a mortgage finance market that is stable and liquid through the cycle.

Introduction

In the 11 years since the Enterprises entered conservatorships, FHFA has played a critical role in stabilizing and restoring confidence in our mortgage finance system. However, 11 years is far longer than any financial institution conservatorship has ever lasted. Maintaining the Enterprises indefinitely as undercapitalized entities effectively under government control through the conservatorships is unwise as a matter of economic policy, contrary to the intent of the law, and unfair to American taxpayers, homeowners, and renters.

Therefore, FHFA is publishing a new Strategic Plan and Scorecard for the Enterprises that together lay out a carefully calibrated roadmap to build a national housing finance system that is competitive, liquid, efficient, and resilient across the business and the housing cycles. Ending the conservatorships of Fannie Mae and Freddie Mac is a central and necessary element of this new roadmap.

A History of the Federal Housing Finance Agency and the Conservatorships of Fannie Mae and Freddie Mac

In the summer of 2008, Fannie Mae and Freddie Mac faced a crisis. In the second half of 2007, the Enterprises reported a combined net loss of $8.7 billion.[i] By June 2008, with mortgage default rates and foreclosures rising across the country, their combined capital totaled just one percent of their mortgage credit risk exposure.[ii] Mounting losses, collapsing house prices, and a weakening economy raised concerns about the Enterprises' financial viability. Congress passed bipartisan legislation enhancing the ability of the federal government to take control of Fannie Mae and Freddie Mac with taxpayer support, and on July 30, 2008, the Housing and Economic Recovery Act of 2008 (HERA) was signed into law.

In HERA, Congress created a framework for Treasury to provide emergency financial support to the Enterprises. Through the Senior Preferred Stock Purchase Agreements (PSPAs) and their subsequent amendments, Fannie Mae and Freddie Mac each were provided access to over $200 billion of Treasury support. To date, the Enterprises together have received $191.5 billion in taxpayer-funded draws under the PSPAs. HERA also established the FHFA and granted the Agency's Director the discretionary authority to appoint FHFA as either conservator or receiver of the Enterprises and the Federal Home Loan Banks upon determining that any of these entities were in an unsafe or unsound condition or met other criteria. On September 6, 2008, the Director of FHFA exercised this authority and placed Fannie Mae and Freddie Mac into conservatorships.

HERA identifies only three lawful purposes of FHFA as either conservator or receiver – namely, "reorganizing, rehabilitating, or winding up the affairs of a regulated entity." The Agency's powers as conservator include taking "such action as may be (i) necessary to put the regulated entity in a sound and solvent condition; and, (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."[iii] By contrast, the powers of receiver are designed to achieve the Agency's two other purposes – "reorganizing" and "winding up" – in the event that a regulated entity is unable to return to financial viability. As receiver, HERA grants FHFA the powers to "place the regulated entity in liquidation and proceed to realize upon the assets of the regulated entity in such a manner as the Agency deems appropriate," or to "organize a successor enterprise."[iv]

In sum, FHFA is legally bound, as conservator or receiver, to direct its supervision and regulation of the Enterprises toward one of these three outcomes: (1) reconstitute the Enterprises into a successor entity or entities, (2) restore the Enterprises to a state of financial solvency and shareholder control, or (3) terminate the Enterprises and liquidate their assets. None of these three outcomes involve indefinite government control of Fannie Mae and Freddie Mac.

Removing the Enterprises from government control, either as conservator or receiver, is both a statutory authority and a statutory duty under HERA. The law charges the Director of FHFA with two "principal duties":

(A) to oversee the prudential operations of each regulated entity; and

(B) to ensure that [among other objectives]

i. each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls; [and]

ii. the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities).[v]

Fully satisfying these duties would eliminate, by definition, the primary reasons that the Enterprises were placed under government control in 2008. Congress authorized FHFA to take control of the Enterprises because they had incurred, and were likely to incur further, losses that would have prevented them from paying their obligations and thus posed substantial risk to global financial markets. By that same logic, HERA envisions that restoring the Enterprises to safe and sound financial positions would be chief among the conditions necessary for FHFA to end the conservatorships and effectively release the Enterprises from government control.

The current lack of capital at the Enterprises poses significant risk to taxpayers and the homeowners, borrowers, and renters who rely on a strong and stable housing finance system. For instance, in the Enterprises' 2019 annual Dodd-Frank Act Stress Test (DFAST), which is designed to determine whether they have the capital necessary to absorb losses resulting from adverse economic conditions. The DFAST modeled a scenario in which home prices decline by about 25 percent and commercial real estate prices fall by 35 percent. Under these conditions, the Enterprises forecasted combined total losses of $43.3 billion, which would wipe out their combined $11.2 billion in capital as of June 30, 2019.

The Enterprises, by themselves, cannot be blamed for these results. Fannie Mae and Freddie Mac have been operating under government control throughout the conservatorships. As such, their performance is determined, at least in part, by the government policies under which the conservatorships have been managed. For instance, the so-called net worth sweep required the Enterprises to pay out any excess capital beyond a modest cushion as a dividend to the senior preferred shares. Fulfilling HERA's statutory duty to maintain "adequate capital" at the Enterprises necessitates a different policy path that enables the Enterprises to build and earn a reasonable return on capital. Generating that return by charging adequate guarantee fees aligns with statutory mandates.[vi]

Taken together, (1) FHFA's statutory mandates, (2) the adverse impacts of continued government control of a very large segment of the U.S. housing finance system, and (3) the enormous financial risks taxpayers continue to face from backing Enterprises with very limited capital cushions, compel a fundamental shift in the implementation of the conservatorships. FHFA will act on its statutory mandate to put the Enterprises back into operation in a safe, sound, and solvent condition.

FHFA will perform its duties cognizant that Congress established Fannie Mae and Freddie Mac as private corporations whose "obligations, together with the interest thereon, are not guaranteed by the United States"[vii] and focused on the primary statutory purposes for which Congress chartered Fannie Mae and Freddie Mac:

> (1) to provide stability in the secondary market for residential mortgages;
>
> (2) to respond appropriately to the private capital market;
>
> (3) to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

(4) to promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.[viii]

A New Strategic Plan: Housing Finance Reform and The Final Chapter of the Enterprise Conservatorships

The Agency's end-state vision is for the Enterprises to return to operating as fully-private companies within a competitive, liquid, efficient, and resilient housing finance system, while a strengthened and independent FHFA ensures they have the capital reserves, risk management capabilities, corporate governance, and regulatory oversight that are appropriate for their size, risk, and systemic importance outside of conservatorship.

Therefore, the new Strategic Plan and Scorecard are motivated by a duty to end the conservatorships responsibly and to ensure the Enterprises operate appropriately while remaining in conservatorship until the milestones necessary for exit are achieved. The complete fulfillment of this end-state vision requires changes to the market, changes to FHFA as regulator, and changes to the Enterprises.

I. Changes to the Market: Competition + Equality Under the Law

Government policies have ensured that Fannie Mae and Freddie Mac operate as a duopoly and dominate our nation's secondary mortgage housing finance market. The Enterprises' charters grant them benefits and advantages unavailable to other financial institutions that cannot obtain such a charter. Moreover, any non-chartered institution operating in the secondary mortgage market must comply with a range of regulatory requirements from which the Enterprises are exempt.

By contrast, this Strategic Plan and Scorecard endeavor to inject into our nation's mortgage finance system two elements that are essential to fair and effective markets: competition and equality under the law. Competition more effectively delivers market-affordable prices with customer satisfaction and continual innovation to improve product quality. Competition also promotes long-term efficiency, by ensuring that mismanaged and inefficient firms do not survive, and market discipline by assuring that no institution is "too big to fail."

Competition's benefits materialize only when the governing laws, regulations, and requirements apply equally to everyone. Therefore, while seeking to make it easier for other financial institutions to enter and compete in the nation's secondary mortgage market, FHFA will strive to level the playing field toward the objective that all market participants abide by the same rules. In a competitive and fair secondary mortgage market, business success should rest on superior strategies and execution, rather than unique advantages and exemptions.

II. Changes to the Regulator

HERA made FHFA a stronger and more independent regulatory agency. FHFA has succeeded in overseeing the Enterprise conservatorships, but the Agency should be strengthened with additional regulatory and supervisory authorities for an eventual post-conservatorship environment. To ensure the Enterprises remain well-regulated and well-capitalized outside the framework of conservatorship, FHFA's supervisory capacity will need to be on par with that of other independent federal financial regulators. As such, FHFA recently asked Congress for the authority to grant enterprise charters to new market participants, the power to examine third parties that do business with its regulated entities, and the discretion to appropriately tailor risk-based capital requirements and leverage limits for the Enterprises and any other future guarantors of mortgage backed securities.

III. Changes to the Enterprises

Successfully exiting from conservatorship after more than 11 years of operating under government control will require changes to the Enterprises across a number of fronts. A significant challenge for the Enterprises is to operate appropriately while still under conservatorship and simultaneously rehabilitate the commercial mindset and capabilities that will be critical to their success outside of conservatorship.

The Enterprises need to demonstrate the commitment to utilize capital efficiently and effectively, earning returns sufficient to attract investors in the private capital markets. The Enterprises will need to avoid the imprudent practices of the past and instead focus on their core mission of fostering a competitive, liquid, efficient, and resilient secondary mortgage market that supports sustainable homeownership and affordable rental housing. A mission-focused, safer, and simpler business model in which the Enterprises' risk levels are prudent and supported adequately by their capital levels will facilitate their exit from conservatorship.

Importantly, going forward the Enterprises should serve a more countercyclical role in the market, consistent with their statutory mission to "provide stability to the secondary market for residential mortgages" and to "respond appropriately to the private capital market" without crowding it out.[ix] A strong capital base, prudent credit standards, and robust risk management form the foundation from which the Enterprises should provide countercyclical support to the market. This contrasts to the role of the Enterprises in the last crisis, which contributed to a historic bubble in housing prices, followed by a severe retrenchment in liquidity as losses mounted and the undercapitalization of the Enterprises and within the broader housing finance system became manifest.

Executing the Strategic Plan: A New Scorecard With 3 Key Objectives

The new Conservatorship Scorecard is the principal means by which FHFA aligns the Enterprises, and their joint venture Common Securitization Solutions, LLC (CSS), to the priorities of the Strategic Plan. FHFA's evaluation of Enterprise performance against the objectives identified in the Scorecard holds their management accountable for results. Whether, and to what extent, the Enterprises and CSS achieve the Scorecard's objectives will also determine their readiness to operate in a sound and solvent condition outside of government control as envisioned in their charters.

The Scorecard recognizes that ending the conservatorships is a process driven by achieving milestones that will take time to reach. Therefore, the Enterprises will have to operate responsibly and appropriately while in conservatorship, reflecting their fundamentally undercapitalized condition until remediated. The Scorecard balances the priorities of operating now and for the near-term future under conservatorship, while engaging in the foundational work necessary to exit responsibly.

The Scorecard is comprised of three sections intended to ensure that the Enterprises:

1. Focus on their core mission responsibilities to foster CLEAR national housing finance markets that support sustainable homeownership and affordable rental housing;

2. Operate in a safe and sound manner appropriate for entities in conservatorships; and

3. Prepare for their eventual exit from conservatorships.

I. Section 1: Foster a CLEAR National Housing Finance Markets

The objectives in Section 1 of the Scorecard are aimed at achieving CLEAR national housing finance markets. These objectives are squarely aligned with the core purposes of the Enterprises, outlined in their charters, to provide stability and on-going assistance to the secondary market for residential mortgages, increase the liquidity of mortgage investments, improve the distribution of investment capital, and promote access to mortgage credit throughout the nation.

Section 1 includes the continuing duty of the Enterprises to fulfill the statutory Housing Goal and Duty-to-Serve requirements. The Enterprises are expected to meet these mandates with mortgage programs that are sustainable and responsible, combined with effective outreach to underserved communities. Achievement through shortcuts, such as weak underwriting, simply puts vulnerable borrowers and communities at risk.

The continued effectiveness of the UMBS will remain a priority, given its successful launch in 2019 and now central role in providing liquidity to the mortgage market. The Enterprises will be expected to carefully monitor and maintain the cash flow alignment that ensures a well-functioning To-Be-Announced (TBA) securitization market. As necessary, additional steps to ensure alignment will be taken.

The implementation of the Credit Score Rule, finalized on August 13, 2019, will be a key priority and major undertaking for the Enterprises in order to fulfill the statutory requirements of Section 310 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018. The process of evaluating new and alternative credit scores within the secondary mortgage market begins in earnest and much work remains to be done in 2020 and beyond.

A number of critical on-going initiatives will also remain priorities in the Scorecard. First, the Enterprises will be required to operate their multifamily businesses under new caps announced September 13, 2019, that eliminate loopholes and provide ample support to the multifamily market without crowding out private capital. The new caps also significantly increase support for affordable housing over previous levels.

Another important initiative is continued preparations by the Enterprises for the anticipated phase-out of the London Interbank Offering Rate (LIBOR) as early as 2021. The Enterprises must continue to assess and reduce their exposures to LIBOR while developing products and financial contracts utilizing alternative reference rates, such as the Secured Overnight Financing Rate (SOFR), including for consumer adjustable rate mortgage loans. Ensuring consumers are well-informed about this important transition will be a priority.

The Enterprises will also continue to support the needs of lenders and borrowers dealing with the challenges of limited English proficiency. This on-going multi-year effort, when completed, will provide translated documents and other resources in five key languages that together cover the majority of limited English proficiency households. Finally, the Enterprises will implement a new, modernized Uniform Residential Loan Application (URLA) to facilitate gathering of the information necessary to underwrite the mortgage loan with greater accuracy and efficiency. In addition, a new consumer information form will allow lenders to voluntarily collect additional data, including with regard to Limited English Proficiency (LEP).

The Scorecard also directs the Enterprises toward the vital objective of developing a more competitive mortgage market through leveling the playing field and greater transparency. For example, supporting the development of a new QM standard equally applicable to all market participants and without special advantages for the Enterprises would be a significant advance toward this goal. Greater transparency around data that can enhance the role of the private sector, such as through more effective risk transfer, can also help to foster a more competitive market.

Finally, Section 1 also sets an objective for the Enterprises to find ways to leverage innovation and standard setting to support state and local governments in reducing the barriers to building and financing much needed ownership and rental housing. Only by addressing these state and local barriers can the challenges of affordable housing truly be solved, enabling families to choose the housing options that best fit their needs and means.

II. Section 2: Operate in a Safe and Sound Manner Appropriate for Conservatorship

Section 2 focuses the Enterprises on the heightened need for safety and soundness, reflecting both the reality of the inadequate capital cushions currently in place and the importance of building a robust capital foundation to successfully exit conservatorship and never again require taxpayer backing to remain solvent.

Section 2 directs the Enterprises to conduct comprehensive assessments of all major business activities in order to evaluate and reduce risk and complexity. In addition to reviewing and making adjustments to the risk profile, credit risk transfer (CRT) will continue to be a component of the Enterprises' approach to risk management. Continuing to transfer risk to private sources of capital both reduces risk to taxpayers and provides a measure of market discipline otherwise lacking under conservatorship.

Given the growth and total size of the CRT program, Section 2 calls for a comprehensive review of the program, including costs and benefits, to better inform future direction. This program is now more than six years old, providing credit enhancement on approximately $3 trillion of Enterprise guaranteed mortgage loans. It is therefore appropriate to look back and assess the program, develop lessons learned, and strengthen it for the future. And FHFA's direction to actively pursue sales of non-performing loans (NPL) and re-performing loans (RPLs) has the beneficial impact of both reducing risk and better preparing the Enterprises to attract private capital.

To support these risk management initiatives and many other critical business decisions and plans, Section 2 directs the Enterprises to strengthen their implementation of the Conservatorship Capital Framework (CCF). These efforts are important to decision making while under conservatorship and they prepare the Enterprises to manage and allocate real, private capital upon exit from conservatorship. Stewardship of capital and returns through the careful balancing of risk and reward, cost efficiency, and wise investments for the future are central to long-term success.

Section 2 also addresses mortgage servicing, which showed material weaknesses in the last crisis, by seeking to promote stability and ensure readiness for more challenging market conditions. While progress has been made in this area – for example, through enhanced loss mitigation and foreclosure prevention practices and aligning Enterprise directions to their servicers – the growth of non-bank servicers and evolving mortgage servicing business models necessitate continued scrutiny and advance preparations.

Section 2 focuses the Enterprises on their core operational and technology foundations, a necessity given the size and complexity of their businesses. The Enterprises should enhance their operations and systems to weather disruptive events resiliently and without loss of service to the mortgage market. In an era of heightened cyber risks, it must be a priority to protect the confidentiality of the extensive consumer and other data held by the Enterprises, and to ensure their integrity for the purposes of risk management, financial reporting, and other essential business activities.

In addition, legacy systems that are costly to maintain and lack robust controls should be modernized, including through adopting strategies to safely utilize the benefits of cloud computing. Finally, CSS must continue to maintain and update the recently implemented Common Securitization Platform (CSP) to ensure it reliably serves its core mission as the securitization platform for the Enterprises and potential future market participants.

III. Section 3: Prepare to Exit Conservatorships

Meeting the objectives of Sections 1 and 2 is necessary, but not sufficient, for the Enterprises to exit conservatorship. After more than a decade under government control, the Enterprises have appropriately adapted to operating within the framework of conservatorship. Now, they must begin preparations to once again operate in a safe and sound manner fully within the private sector. Toward that end, Section 3 instructs the Enterprises to support FHFA in the development and implementation of responsible, milestone-based plans to transition out of conservatorship, including capital restoration strategies and roadmaps.

An essential element of the Scorecard is to ensure coordination and alignment between FHFA, Treasury, and HUD in implementing the Administration's Reform Plan. The Enterprises will be required to support the evaluation and, where authorized by FHFA, implementation of recommendations put forward for consideration in the Administration's Reform Plan. A number of these recommendations may be critical elements of reform necessary to end the conservatorships responsibly.

Other activities recommended in the Administration's Reform Plan include coordinating with HUD to (1) address overlaps between the Enterprises' businesses and the Federal Housing Administration (FHA) in both the single-family and multifamily markets, (2) work with Ginnie Mae to identify and assess operational and other issues posed by authorizing Ginnie Mae to provide a federal guaranty on qualifying MBS, and (3) identify opportunities for enhanced federal coordination regarding counterparty risk.

A fundamental challenge to ending the conservatorships is the amount of capital the Enterprises require, attributable in part to their sheer size. As a result, Section 3 emphasizes the need for the Enterprises to carefully scrutinize and optimize their balance sheet exposures to focus on serving their core guaranty business with maximum capital efficiency. In addition, the Enterprises must enhance their ability to assess the returns on the capital necessary to support their assets and risks. The Enterprises must be able to assess whether the returns are commensurate with private market return thresholds, both because of the statutory mandate to do so and the imperative to transition the Enterprises to eventual private ownership.

The development of a post-conservatorship strategy and governance structure for CSS/CSP, currently organized as a joint venture of the Enterprises and under the oversight of a board of managers and FHFA, is an important element of any plan to exit conservatorship. This work will include an assessment of what further capabilities might be beneficial and commercially-viable for CSS to perform to foster a level playing field for market participants and greater competition.

Section 3 also prioritizes remediation by the Enterprises of deficiencies identified through FHFA's supervisory oversight and by the Enterprises' own examinations and audits. Successful remediation of these identified material gaps will be one of the major milestones necessary to exit conservatorship. Strong oversight processes, combined with a culture of compliance and a commitment by the Enterprises to remediate deficiencies in a timely manner, are fundamental activities to ensuring a safe and sound financial institution post-conservatorship.

Finally, Section 3 calls added attention to the critical role of fair-lending risk assessment, monitoring, and oversight at the Enterprises, working with the FHFA's Office of Fair Lending Oversight. Fair lending is central to the principles upon which our housing finance system should operate and a requirement of law. Overt discrimination will never be tolerated, but factors such as the increasing availability of data and ever more sophisticated analytical tools and techniques, such as machine learning, require vigilance.

Conclusion

This Strategic Plan is a new direction for comprehensive reform of the housing finance system and the Enterprises. In some areas, it builds upon the foundations established by FHFA over the past decade, such as the development of the UMBS issued through the CSP and the expanded use of credit risk transfers to attract greater amounts and different sources of private capital. In other areas, this plan charts a new course, aligned with the recommendations of the Administration's Reform Plan. That new course aims to fulfill the mandates of HERA and restore the Enterprises to their proper role as fully-private, well-capitalized, and well-regulated financial institutions.

Turning this vision into reality will take time and a great deal of effort. Building the kind of resilient mortgage finance system contemplated in this Strategic Plan, as well as preparing FHFA and the Enterprises to operate successfully within it, are significant but achievable endeavors. To the greatest extent possible, FHFA will pursue administrative reforms, legislative reform, and reform of the conservatorships simultaneously.

As an independent regulator, FHFA will play a collaborative role with the Administration to develop and implement a plan to end the conservatorships of the Enterprises, working from the recommendations put forward by Treasury and HUD. FHFA has already begun working with Treasury to consider changes to the terms of the Senior Preferred Stock Purchase Agreements, including the so-called net worth sweep. This effort is critical to enabling the Enterprises to raise the capital necessary to significantly reduce the risk that the Enterprises will need taxpayer support to withstand an economic downturn.

FHFA will also continue to advocate for, and endeavor to inform, congressional action. While the powers and responsibilities of FHFA are limited to faithfully executing the laws, only Congress has the power to rewrite the law. Building a fully reformed, resilient, and sustainable housing finance system will require Congress to act. For instance, only Congress can equip FHFA with the same supervisory powers as other independent federal financial regulators. Likewise, only Congress can create an explicit government guarantee. While assisting Congress, FHFA will still move forward, as required under statute, to end the Enterprise conservatorships. FHFA looks forward to working with the Enterprises, Congress, relevant federal agencies, and all stakeholders to achieve the objectives detailed in this Strategic Plan and Scorecard.

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[i] "The Rescue of Fannie Mae and Freddie Mac," Federal Reserve Bank of New York, Staff Report No. 719, March 2015, page 9: https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

[ii] "The Rescue of Fannie Mae and Freddie Mac," Federal Reserve Bank of New York, Staff Report No. 719, March 2015, page 10: https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf.

[iii] 12 USC 4617(b)(2)(D).

[iv] 12 USC 4617(b)(2)(E) & (F).

[v] 12 USC 4513(a)(1).

[vi] For example, the Temporary Payroll Tax Cut Continuation Act of 2011, which expires in October 2021, charges the FHFA Director with increasing guarantee fees from 2011 levels such that "The amount of the increase required under this section shall be determined by the Director to appropriately reflect the risk of loss, as well as the cost of capital allocated to similar assets held by other private regulated financial institutions…" 12 USC 4547(b)(1)(B). See also 12 USC 1716(3), 1451 Note § 301(b)(3) (authorizing the Enterprises to earn a "reasonable economic return").

[vii] 12 USC 1455(h)(2) (Freddie Mac mandatory securities disclosure); 12 USC 1719(b), (d) & (e)(Fannie Mae mandatory securities disclosure).

[viii] 12 USC 1716 (Fannie Mae); 12 USC 1451 Note (Freddie Mac).

[ix] Ibid.