1-27-2010

Kenneth Rosen Follow Up From Thomas Greene

Thomas Greene

Federal National Mortgage Association (Fannie Mae)

January 27, 2010

Via FedEx
Dr. Kenneth T. Rosen
Chairman
Rosen Consulting Group
1995 University Avenue, Suite 550
Berkeley, CA 94704

Re: Financial Crisis Inquiry Commission Hearing on January 13, 2010

Dear Dr. Rosen:

On January 20, 2010, Chairman Angelides and Vice Chairman Thomas sent you a letter thanking you for testifying at the January 13, 2010 hearing and informing you that the staff of the FCIC might be contacting you to follow up on certain areas of your testimony and to submit written questions and requests for information related to your testimony, which are listed below. Please provide your answers and any additional information requested by February 26, 2010.

1. You testified that Wells Fargo was a good example of a bank that properly aligned its risk and lending/underwriting practices. In your opinion and according to default and delinquency data, what other institutions managed this relationship properly? Please provide supporting data.

2. Please provide data regarding when FHLMC and FNMA began acquiring subprime and Alt-A loans, and data regarding the amount of subprime and Alt-A loans they reported on their financial statements between 2003 and 2009, if you have such data.

3. Please provide the best data you have on the contour of loans made by CRA and non-CRA regulated institutions.

4. Please provide data on the loan portfolios of Fannie Mae and Freddie Mac, if available.

5. Please provide the 80-page Federal Reserve paper about risk layering that you mentioned in your testimony.

The Commissioners and staff of the FCIC sincerely appreciate your continued cooperation with this inquiry. If you have any questions or concerns, please do not hesitate to contact Chris Seefer at (202) 292-2799, or cseefer@fcic.gov.

Sincerely,

Thomas Greene
Executive Director

cc: Phil Angelides, Chairman, Financial Crisis Inquiry Commission

Bill Thomas, Vice Chairman, Financial Crisis Inquiry Commission

Fannie Mae and Freddie Mac Single-Family Alt-A and Subprime Exposure

Fannie Mae's book of business totaled $2.8 trillion,[1] of which $258.8 billion or 9.3% of loans were classified as Alt-A, and $7.6 billion or 0.3% of loans were classified as subprime, however, loans with a FICO score of less than 620 represented $112.3 billion or 4.0%. Fannie Mae defines subprime as loans that were originated by a lender or a sub-division that specialized in subprime. Generally speaking, subprime loans are higher risk instruments where the borrower has a FICO score of less than 620, therefore I believe that it is more appropriate to assume that Fannie's subprime exposure was 4.0%.

Including all higher-risk loans such as negative-amortizing, interest-only, high loan-to-value, and others, Fannie Mae's exposure totaled $857.9 billion or 30.7%.

Freddie Mac's book of business totaled $1.9 trillion,[2] with Alt-A making up $156.1 billion or 8.2% of loans. Loans with a FICO score of less than 620 represented $69.3 billion or 3.7%.

Including all higher-risk loans such as negative-amortizing, interest-only, high loan-to-value, and others, Freddie Mac's exposure totaled $425.5 billion or 22.4%.

Single-Family Mortgage Portfolio, Higher-Risk Loans ($ Billions)

	Total Book [1,2]	Alt-A	FICO <620	LTV >90%	FICO ≥ 620 < 660	Interest-Only	FICO < 620, LTV >90%	Negative-Amortizing	Sub-prime	Option ARM	Sub-Total [3]
Fannie Mae	$2,795.9	$ 258.8	$ 112.3	$264.3	$ 236.5	$ 189.3	$ 24.6	$ 14.6	$ 7.6		**$ 857.9**
% of Total Book		9.3%	4.0%	9.5%	8.5%	6.8%	0.9%	0.5%	0.3%		**30.7%**
Freddie Mac	$1,896.0	$ 156.1	$ 69.3	$143.6	$ 152.5	$ 137.2	$ 12.9			$ 11.2	**$ 425.5**
% of Total Book		8.2%	3.7%	7.6%	8.0%	7.2%	0.7%			0.6%	**22.4%**

[1] Fannie Mae's book of business includes all single-family conventional guaranty loans. It excludes non-Fannie Mae securities held in portfolio and those Alt-A and subprime wraps for which Fannie Mae does not have loan-level information. Loan-level information was available for approximately 99% of the single-family conventional guaranty book of business.

[2] Freddie Mac's total book includes all unpaid mortgage loans in the single-family portfolio.

[3] Loans with multiple product features are included in all applicable categories. The subtotal is calculated by counting a loan only once, even if it is included in multiple categories.

Sources: Fannie Mae and Freddie Mac. Data as of September 30, 2009.

Fannie Mae - Analysis of Risk Characteristics
February 12, 2010

Starting in 2004, Fannie Mae began increasing its exposure to higher-risk lending instruments. The table below illustrates the company's increased activities in ARMS (adjustable rate mortgages), Alt-A loans, and higher LTV (loan-to-value) loans, between the years of 2004 and 2007. Loans with FICO scores of less than 620 (the general definition of subprime) remained constant around 5-6%.

In 2003, 10% of volume was comprised of ARMS, this more than doubled to 22% in 2004. In 2006, 10% of volume had LTV greater than 90% compared with 16% in the following year. In 2005, 16% of the company's volume was in Alt-A, which increased to 22% in 2006. These percentages represent the company's total single-family business volume during each year, with loan characteristics as of time of acquisition.

Percent of Fannie Mae Single-Family Business Volume [1]

	2002	2003	2004	2005	2006	2007	2008	YTD 3Q09[2]
Alt-A	**N/A**	**N/A**	**N/A**	**16%**	**22%**	**16%**	**3%**	**0%**
FICO <620	**6%**	**4%**	**6%**	**5%**	**6%**	**6%**	**3%**	**0%**
LTV 90.01-100%	8%	7%	10%	9%	10%	16%	10%	9%
LTV >100%	0%	0%	0%	0%	0%	0%	0%	14%
Total LTV >90%	**8%**	**7%**	**10%**	**9%**	**10%**	**16%**	**10%**	**23%**
Interest-only	1%	1%	5%	9%	9%	7%	4%	1%
Negative-amortizing	1%	1%	2%	3%	3%	0%	0%	0%
Other ARMS	7%	8%	15%	9%	5%	3%	4%	1%
Total ARMS	**9%**	**10%**	**22%**	**21%**	**17%**	**10%**	**8%**	**2%**
Serious Delinquency Rates [3]	0.57%	0.60%	0.63%	0.79%	0.65%	0.98%	2.42%	4.72%

[1] Percentages based on unpaid principal balance of loans at time of acquisition.

[2] YTD 3Q09 LTV percentages based on unpaid principal balance at the end of the period.

[3] Loans three or more payments past due. Percentages based on balance at the end of each period.

The following discussion is based on language found in the company's annual 10-K filings.

In the 2004 10-K, Fannie Mae defined Alt-A as:
"Alt-A mortgage" refers to a mortgage loan underwritten using more liberal standards such as higher loan-to-value ratios and less documentation of borrow income or assets.

In the 2005 10-K, Fannie Mae slightly modified this definition and added language regarding an increased propensity for default:
"Alt-A mortgage" generally refers to a loan underwritten with lower or alternative documentation than a full documentation mortgage loan and may include other alternative product features. As a result, ***Alt-A mortgage loans generally have a higher risk of default than full documentation mortgage loans.***

Based on this, it is clear that as early as 2005, Fannie Mae was aware of Alt-A's elevated default risk, yet the following year, 22% of their business was in this segment, +6% from the previous year.

In the 2006 10-K, Fannie Mae provided a more thorough explanation of Alt-A, defining low or no documentation loans, now commonly known as "liar loans", as "an increasing industry trend toward streamlining the mortgage loan underwriting process by reducing documentation requirements." This is a very benign and subdued description of these products.

Alt-A Loans: ***There has been an increasing industry trend towards streamlining the mortgage loan*** *underwriting process by reducing the documentation requirements and accepting alternative or nontraditional documentation. The industry generally refers to these loans as Alt-A. We usually acquire mortgage loans originated as Alt-A from our traditional lenders that generally specialize in originating prime mortgage loans. These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process. The majority of our Alt-A mortgage loans are fixed-rate, and the weighted average credit score of borrowers under our Alt-A mortgage loans is comparable to that of our overall single-family mortgage credit book of business. We estimate that approximately 11% of our total single-family mortgage credit book of business as of December 31, 2006 consisted of Alt-A mortgage loans or structured Fannie Mae MBS backed by Alt-A mortgage loans. This percentage increased to approximately 12% as of June 30, 2007.*

In the 2006 10-K, Fannie Mae also wrote that acquisitions of Alt-A and subprime loans were "generally" accompanied by credit enhancements. This does not coincide with data provided by the company in their most recent quarterly credit supplement. According to this information, just 37% of Alt-A loans and 33% of <620 FICO loans held in their single-family guaranty book of business, were credit enhanced.

2006 10-K:
Our acquisitions of Alt-A and subprime mortgage loans generally have been accompanied by the purchase of credit enhancements that materially reduce our exposure to credit losses on these mortgages. We closely monitor credit risk and pricing dynamics across the full spectrum of mortgage product types. We will determine the timing and level of our acquisitions of these types of mortgages in the future based on our continued assessment of these dynamics.

At the end of 3Q 2009, Fannie Mae's single family guaranty book of business had highest concentrations to loans written in 2009 (18%), 2007 (16%), and 2003 (15%).

Origination Year Concentrations [1]

	2002	2003	2004	2005	2006	2007	2008	Q3 2009
≤ 1999	31%	12%	7%	5%	4%	3%	2%	2%
2000	4%	1%	1%	1%	0%	0%	0%	0%
2001	27%	9%	6%	4%	3%	2%	2%	1%
2002	38%	25%	17%	12%	9%	7%	5%	4%
2003		53%	46%	36%	29%	22%	18%	15%
2004			23%	21%	16%	12%	10%	8%
2005				21%	20%	16%	13%	11%
2006					19%	17%	14%	11%
2007						21%	20%	16%
2008							16%	14%
2009								18%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

[1] Percentages based on unpaid principal balance at the end of each period.

It appears that subprime was never a significant portion of Fannie Mae's business. Loans with FICO scores of <620 consistently represented around 5-6% of volume. In 2008, this declined to 3% followed by 0% during the first three quarter of 2009.

Note: All information in this analysis pertains to Fannie Mae's single-family guaranty book of business. At the end of 3Q 2009, this book totaled $2.8 trillion compared with the company's total book of business of $3.2 trillion.