



Federal Housing Finance Agency

Constitution Center
400 7th Street, S.W.
Washington, D.C. 20024
Telephone: (202) 649-3800
Facsimile: (202) 649-1071
www.fhfa.gov

May 1, 2012

The Honorable Elijah Cummings
Ranking Member
Committee on Oversight and Government Reform
U.S. House of Representatives
2235 Rayburn House Office Building
Washington, D.C. 20515

The Honorable John F. Tierney
U.S. House of Representatives
2238 Rayburn House Office Building
Washington, D.C. 20515

Dear Ranking Member Cummings and Representative Tierney:

Having just received a copy of your letter regarding principal forgiveness, I wish to convey my disappointment with this letter, the failure to contact FHFA to address your concerns, and the release of selective elements of the proprietary and confidential materials you received. The agency's letter of April 12, 2012, provided the documents responsive to your request. Additionally, we offered to continue our dialogue with both of you.

I strongly disagree with any characterization of FHFA's work or motives as anything but in keeping with the professionalism expected of this agency. FHFA has endeavored to provide responses to your requests relating to principal forgiveness pilot programs in a timely fashion. In order to fully inform the public record, I am releasing the agency's April 12, 2012, letter including the summary of the pilot programs that was attached. Throughout FHFA's communications with you and the Committee, we have focused on getting to the facts and the supporting information and analytics in what is a most important matter for homeowners and taxpayers.

I would note that since 2009 FHFA has approved multiple pilot programs to look into the various alternatives to principal forgiveness. These occurred even before the Treasury Department instituted its HAMP Principal Reduction Alternative. These approvals certainly do not reflect any pre-determined view on my part.

The documents from Fannie Mae and Freddie Mac (the Enterprises) provided to you reflect an open and robust interest in this topic, enthusiasm for meeting the goals of finding a workable approach for a pilot program and adherence to review of ideas from all sides, including gathering data and undertaking its analysis. In sum, as noted in the agency's transmittal letter, while principal forgiveness pilots were developed, at the end of the day there was not full agreement to proceed at the Enterprises or their counterparties. Further, pilot programs themselves are

experimental and go through discussion and review prior to deployment and once deployed must be reviewed prior to any full implementation of a broad program. At the corporate level, taking into account staff perspectives and experience, the pilots were not pursued or were terminated. As noted in our letter to you and your letter to me, operational concerns were a key determining factor in not pursuing or ending the pilot programs.

The fact that FHFA continues to consider principal forgiveness alternatives, including recent HAMP program changes initiated by the Treasury Department, belies any ideological tilt on our part, but rather a strict analytical-based approach to gathering and evaluating data to determine what options best fit within the legal constraints that fall upon this agency as conservator for the Enterprises. FHFA continues its analysis and continues its discussions with the Treasury Department.

I believe we agree on two important points: FHFA has a duty to ensure the Enterprises provide assistance to troubled homeowners and FHFA has a duty to conserve the assets and property of the Enterprises so as to protect taxpayers. How best to accomplish these separate goals, especially in light of the uncertainties associated with initiating a principal forgiveness program, is a challenging policy question. Such a policy question, especially as it has to do with public funds being taken from one group of citizens to provide a benefit to another group of citizens, should be determined by Congress. In the absence of clear legislative direction, however, FHFA will continue to make determinations in how best to accomplish both of these goals after careful analysis of the facts and other information available to us and the multiple legal responsibilities placed upon us.

Yours truly,



Edward J. DeMarco
Acting Director

xc: The Honorable Darrell Issa



Federal Housing Finance Agency

Constitution Center
400 7th Street, S.W.
Washington, D.C. 20024
Telephone: (202) 649-3800
Facsimile: (202) 649-1071
www.fhfa.gov

April 12, 2012

The Honorable Elijah Cummings
Ranking Member
Committee on Oversight and Government Reform
U.S. House of Representatives
2235 Rayburn House Office Building
Washington, D.C. 20515

The Honorable John F. Tierney
U.S. House of Representatives
2238 Rayburn House Office Building
Washington, D.C. 20515

Dear Ranking Member Cummings and Representative Tierney:

In response to your letter regarding concerns about the Federal Housing Finance Agency's (FHFA) analysis of principal forgiveness and forbearance in mortgage modifications and a related request for documents, the Acting Director asked that I gather the responsive materials and provide a summary for you.

FHFA has collected documents responsive to your request and this production reflects the materials from Fannie Mae and Freddie Mac that relate to the pilot programs. The documents from Fannie Mae and Freddie Mac (Enterprises) contain confidential, proprietary, non-public information and would not be released by FHFA or the Enterprises. Please notify FHFA if any of these documents are intended to be released in whole or in part.

As is evident by the documents attached, FHFA permitted and approved Fannie Mae and Freddie Mac testing principal reduction as a loss mitigation tool and evaluating whether it would reach more homeowners facing financial difficulties, result in improved loan performance going forward or provide better loss outcomes for each Enterprise. Consequently, both Enterprises engaged in developing pilot programs involving a principal forgiveness component. As you can see by the documents attached, pilot programs are by nature experimental and go through a process of proposal and review before they can be deployed, and then assessments and evaluations of the pilot are required prior to any implementation. Problems and issues at any stage can lead to the termination of the project. The documents reflect that Enterprise staffs worked diligently, across the companies, to provide their expertise in proposing possible pilot programs. In sum, the results of their efforts did not lead to full deployment of pilots or ended with early terminations. Had the pilots gone forward, the Enterprises would have conducted evaluations of their effectiveness before further action.

In 2010, Freddie Mac conceived a possible principal forgiveness pilot program, although it never went beyond concept stage.

Fannie Mae also devoted significant resources towards the development of three pilot programs, one of which you mentioned in your letter of February 8, 2012. These pilot programs, to the extent they were begun, ended due to complex operational issues involving system changes, accounting considerations and the interest level of Fannie Mae's partners. Attached for your convenience is a summary of each Enterprise's experience with these efforts.

If you have additional questions, please contact Peter Brereton, Associate Director for Congressional Affairs at (202) 649-3022.

With all best wishes, I am

Sincerely,

A handwritten signature in black ink, appearing to read "Alfred M. Pollard". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Alfred M. Pollard
General Counsel

Attachments— Summary of Materials
 Disk with Responsive Materials

cc: Honorable Darrell Issa

Summary of Materials

1. Freddie Mac-- Summary of Principal Reduction Pilot Program (Disk : File 1)

Freddie Mac did not deploy a pilot program. The proposal is attached the first document.

2. Fannie Mae— Summaries of Principal Reduction Pilot Program (Disk: Files 2-93)

A. Shared Equity Pilot Summary – Citibank

The shared equity concept originated in Fannie Mae's Corporate Strategy division. During Q3 2009, the Corporate Strategy team and Single Family business team identified an opportunity to test a shared equity concept based on internal and external research that indicated such a structure might make sense to address the negative equity issues and home price declines. Citibank had done an extensive analysis on their book of business and were identifying a number of concepts to test when Corporate Strategy approached them to partner in the test pilot. The discussions started as a concept on the acquisitions side of the Single Family business, but after assessment and discussion, it was brought to the National Servicing Organization (NSO) for evaluation as a potential loss mitigation strategy that could be tested. In late 2009, Fannie Mae teams began to work through the various structural options for the program, assessed the potential costs to implement the pilot, started a working group with Citibank, and began analyzing all of the issues related to bringing the concept to market, which would ultimately be named Shared Value. Fannie Mae approached the test cautiously and established early that no commitments would be made to participate in the program until a thorough analytical review and operational feasibility study could be completed.

Analysis continued through the end of 2009, with the Credit division sharing an overview of the Shared Equity concept (and the potential Citibank pilot), in December 2009, with the Credit Portfolio Management Committee, an advisory board made up of representatives from various functions including the NSO, Risk, Legal and Finance teams. The program continued to evolve into 2010 based on feedback from internal and external stakeholders. In early 2010, a program memorandum was distributed to the Federal Housing Finance Agency (FHFA) outlining the Shared Equity pilot with Citibank, including the pilot's purpose and approach (control and test groups). In April 2010, Fannie Mae conducted an additional review of shared equity with its

Risk Committee. Citibank subsequently shared some program information with its regulator, the Office of the Comptroller of the Currency in May 2010.

As components of the program were defined and shared with relevant parties, Fannie Mae continued its analysis into Q2 2010. Fannie Mae assessed impacts to internal systems and processes, including costs to re-engineer and/or allocate resources to support. The analysis and planning also included development of legal documents, consumer education and marketing materials. Fannie Mae also continued to assess impact as internal and external teams outlined potential qualifying loan populations, economic benefit, costs and the steps to process transactions.

Before operational testing was complete, the NSO determined that the resources at its disposal needed to be focused on newly developed modification programs, not for a potential pilot that would require strong operational support.

In July 2010, Fannie Mae decided not to move forward with the shared equity pilot in its original structure which would have had Citibank and Fannie Mae each committing 1,200 loans to create a test and control group, opting instead to proceed with an analysis of a more straight forward principal forgiveness option. Fannie Mae approached Citibank with an alternate proposal that would test principal forgiveness and introduced a control and test group concept to ensure results could prove a hypothesis about the program assumptions. In the end, Citibank opted not to move forward with the principal forgiveness pilot.

B. Principal Forgiveness Pilot Summary – Wells Fargo

Phase 1

In November 2009, discussions began regarding a Wells Fargo Principal Forgiveness (PF) pilot. The preliminary hypothesis was that a proposed payment reduction achieved through principal forgiveness would outperform one achieved through rate reduction and term extension. Because negative equity is a factor in loan performance, it was assumed that principal forgiveness would improve the success rate of high mark-to-market loan to value ratio (MTMLTV) loan modifications.

In December 2009, an experiment designed to compare performance of loans with and without principal forgiveness was presented to Fannie Mae Senior Leadership and was then shared with teams within the NSO, Risk, Legal, Accounting, Operations and Technology groups for further analysis. The experiment details continued to evolve throughout the development, implementation, tracking and monitoring for the pilot based on feedback from internal and external stakeholders. In January 2010, a preliminary concept was shared with FHFA. In February 2010, the program was presented and approved at the Credit Portfolio Management Committee, an advisory board made up of representatives from various functions including the NSO, Risk, Legal and Finance teams. In February 2010, a detailed program outline was sent to FHFA. In March 2010, FHFA approved the program with no objection. On April 1, 2010, the Wells Fargo Pilot was implemented.

Fannie Mae monitored performance, including volume, of the Wells Fargo First Principal Forgiveness (PF) pilot. The pilot ran from April to June. Each month, Wells Fargo sent approximately 400 solicitation letters to borrowers who were newly 2-3 months delinquent for a total approaching 1,700 solicitations. The borrowers were separated into three groups:

- Population who received Wells Fargo's standard HAMP solicitation and were not being offered principal forgiveness during the pilot;
- Population who received solicitation that included messaging that borrower received 4% minimum principal forgiveness amount if the borrower was deemed eligible for HAMP; and,

- Population which received solicitation that included messaging that borrower would receive principal forgiveness at an amount to be determined if the borrower was deemed eligible for HAMP.

The take up rates (measured as right party contact rate, borrowers evaluated for HAMP rate, borrowers pre-qualified for HAMP based on stated docs rate, *etc.*) were statistically identical across all three groups. Only a handful of loans in all groups made it to the trial and even fewer became permanent modifications, which made it statistically impossible to test re-default rate differences between the regular HAMP and PF HAMP pilot.

Phase II

In order to test the post-modification of loans with principal forgiveness, a second PF Pilot was initiated. The Second PF pilot targeted borrowers that had already made trial payments and were about to convert to a permanent modification. This way the pilot would avoid the long timeline and fallout between the initial solicitation for HAMP and the trial. The pilot was to run until it accumulated around 300 borrowers in each of two groups:

- Population who received Wells Fargo's standard HAMP solicitation and were not being offered principal forgiveness during the pilot; and,
- Population who received Principal Forgiveness HAMP in their final HAMP modification (amount ranged from 4 - 30% of borrowers pre-mod unpaid principal balance based on MTMLTV and debt-to-income ratio).

From a systems perspective, this was an extension of Phase I and within the threshold of the First PF pilot, which received its approvals through Fannie Mae Credit Risk Portfolio Committee and FHFA. Accordingly, Fannie Mae was not required to conduct additional operational analysis. In December 2010, the Second PF pilot was approved by the Credit Risk group. In January 2011, the pilot launched and was expected to run for one or two months to reach the target population. In March 2011, Fannie Mae senior leadership decided to terminate the pilot because of an operational incident detailed below and a lack of programmatic controls in place to prevent such events from recurring. The pilot concluded with approximately 200 borrowers in each of the groups, sufficient to reach limited conclusions. In the eight months following termination, the percentage of borrowers current in the two groups have been very similar.

Note on Operational Incident (January 2011)

As part of the pilot, Wells Fargo was to forgive a portion of the unpaid principal balance (UPB) to reach a more affordable payment for a borrower. Wells Fargo was required to submit these loans through HomeSaver Solutions Network (HSSN), following the process designed for the Principal Forgiveness (PF) pilot, which included Wells Fargo manually entering the principal forgiven amount in the comments section of their recording software. Once submitted, the Fannie Mae Loss Mitigation team would update the case in the system and be able to evaluate the pilot's results. Due

to the manual nature of this process, Wells Fargo provided a list of loans where principal forgiveness was applied in order to reconcile its submissions. When reconciling loans using the list provided by Wells Fargo, the settlement team at Wells Fargo indicated there were errors. This prompted a review by the Fannie Mae team and meant that Fannie Mae had to validate the total population of loans where PF should have been applied or was applied erroneously. This failure added to the operational problems seen with the pilot program.