



# FHFA PROGRESS REPORT

on the Implementation of FHFA's Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac

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Division of Conservatorship

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## INTRODUCTION

The Federal Housing Finance Agency (FHFA) was established by the Housing and Economic Recovery Act of 2008 (HERA) and is responsible for the effective supervision, regulation, and housing mission oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank System, which includes 12 Federal Home Loan Banks (FHLBanks) and the Office of Finance. The agency's mission is to ensure that these regulated entities operate in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac (together, the Enterprises).

On May 13, 2014, FHFA issued the *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* (2014 Conservatorship Strategic Plan), which sets forth three strategic goals for the conservatorships:

1. **MAINTAIN**, in a safe and sound manner, foreclosure prevention activities and credit availability for new and refinanced mortgages to foster liquid, efficient, competitive, and resilient national housing finance markets;
2. **REDUCE** taxpayer risk through increasing the role of private capital in the mortgage market; and
3. **BUILD** a new single-family securitization infrastructure for use by the Enterprises and adaptable for use by other participants in the secondary market in the future.

At the same time, FHFA also published the *2014 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions* (2014 Conservatorship Scorecard), which established FHFA's expectations for Enterprises activities to further each strategic goal. FHFA also assigned the following weights to each strategic goal under the 2014 Conservatorship Scorecard: **Maintain** (40 percent), **Reduce** (30 percent), and **Build** (30 percent). This Progress Report summarizes major Enterprise activities in 2014 toward achieving FHFA's conservatorship expectations under the Scorecard. Unless noted otherwise, all dates in this report refer to 2014.

The initial section of the report describes Enterprise initiatives in 2014 in support of the objective of maintaining credit availability and foreclosure prevention activities in a safe and sound manner. Those initiatives include work to enhance the Enterprises' selling Representation and



Warranty Framework, updates to their servicer eligibility standards to reflect new market conditions, efforts to expand access to mortgage credit for creditworthy borrowers, and activities to encourage greater lender participation in the secondary market. Other efforts undertaken in 2014 aimed to encourage more eligible borrowers to participate in the Home Affordable Refinance Program (HARP), assess and develop new plans for loss mitigation strategies, implement a pilot Neighborhood Stabilization Initiative, and develop new ways to reduce the costs to borrowers and the Enterprises of Lender Placed Insurance (LPI). The section also details the continued support the Enterprises provided to the multifamily mortgage market in 2014.

The second section of the report covers Enterprise activities in 2014 to reduce taxpayer risk by increasing the role of private capital in the mortgage market. That discussion reviews the expanded volume and types of transactions by which Fannie Mae and Freddie Mac have transferred single-family mortgage credit risk to the private sector and continued the reduction of their retained portfolios, with a focus on the sale of their less liquid assets. The Enterprises also took steps to ensure the stability of their mortgage insurer counterparties. Further, the Enterprises continued current programs that share multifamily mortgage credit risk with private-market lenders and investors while exploring possible ways to expand the types and volume of such risk transfers.

The third section of the report describes the Enterprises' continued progress in 2014 to build a new infrastructure for their single-family securitization functions that will be adaptable for use by other secondary market participants in the future. Those activities include ongoing work to develop the Common Securitization Platform, a new effort begun last year to develop a single Enterprise mortgage-backed security, and continued work to build more consistent and uniform mortgage data standards for use by the Enterprises and other market participants.

### **MAINTAIN**

The first objective of FHFA's 2014 Conservatorship Strategic Plan is to maintain credit availability and foreclosure prevention activities in the housing finance market in a safe and sound manner. Achieving that objective will provide liquidity and access across different market segments of creditworthy borrowers, sensible and appropriate loss mitigation options when borrowers fall into economic distress, and affordable rental housing options. This section describes activities undertaken by the Enterprises in 2014 in support of those priorities.



### I. Access to Mortgage Credit for Creditworthy Homebuyers

The 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would work to increase access to mortgage credit for creditworthy borrowers, consistent with the full extent of applicable credit requirements and risk management practices. In fulfillment of that expectation, the Enterprises have been working to 1) improve their selling Representation and Warranty Framework; 2) develop servicer eligibility requirements that address unique risks associated with the various servicer business models present in the marketplace today; 3) develop recommendations for ways to increase access to mortgage credit for creditworthy borrowers; and 4) encourage greater participation by small lenders, rural lenders, and state and local housing finance agencies.

**Selling Representation and Warranty Framework.** FHFA and the Enterprises made substantial progress on updating and clarifying the Representation and Warranty Framework (Framework) during 2014, and these efforts build on the agency's past work to refine the Framework. The Framework provides Fannie Mae and Freddie Mac with remedies—such as requiring a lender to repurchase a loan—when they discover that a loan purchase does not meet their underwriting and eligibility guidelines. In updating and clarifying the Framework, FHFA's objectives are to continue to support safe and sound Enterprise operations, encourage lenders to reduce their credit overlays that restrict lending to some creditworthy borrowers, and complement the agency's efforts to strengthen the Enterprises' quality control process.

FHFA launched its efforts with the Enterprises to update the Framework in 2012, and the first improvements went into effect for loans sold or delivered on or after January 1, 2013. These improvements relieved lenders of certain representation and warranty obligations related to the underwriting of the borrower, the property, or the project for loans that had clean payment histories for 36 months. Although these changes resulted in more certainty, lenders continued to express concern about the ambiguity of the Enterprises' monitoring and credit/collateral enforcement standards, the life-of-loan exclusions to the repurchase relief granted on underwriting representations and warranties, and the dispute resolution process.

To address those concerns, FHFA and the Enterprises conducted broad industry outreach to discuss ways to improve the Framework so that lenders would be more likely to engage in normal lending activity. As a result of the discussions, in May FHFA and the Enterprises announced further refinements to the Framework that became effective beginning in July. The Enterprises now notify lenders directly of relief when it is granted, which occurs at the earlier of the borrower fulfilling the payment history requirement or when the Enterprise concludes a



quality control review satisfactorily. The payment history requirement for granting relief now allows no more than two 30-day late payments in the 36-month period. The changes also eliminated automatic repurchases following rescissions of mortgage insurance coverage. Instead, the Enterprises review such mortgages for eligibility and allow alternatives to repurchase when the loans meet Enterprise standards.

FHFA prioritized providing greater clarity around the life-of-loan exclusions used in the Framework during 2014, and the Enterprises announced further improvements in this area in November. Specifically, those changes 1) limit repurchase requests under the life-of-loan exclusions to significant matters that impact the overall credit risk of the loan; 2) modify the life-of-loan exclusions for misrepresentations and data inaccuracies to incorporate a significance test; 3) clarify the requirements for requesting repurchase related to compliance with applicable laws and regulations; and 4) provide lenders a list of unacceptable mortgage products. The changes provide all parties with greater clarity about when the life-of-loan exemptions apply and when they do not. These revisions also maintain and support safe and sound Enterprise operations and are consistent with FHFA's broader efforts to ensure that the Enterprises place more emphasis on upfront quality control reviews and other upfront risk management practices.

FHFA also started efforts in 2014 to develop an independent dispute resolution program that could be used as a last step, in certain circumstances, to resolve disputes between lenders and the Enterprises. This would enable lenders to dispute a repurchase request by allowing them to request a neutral third party to determine whether there was a breach of the selling representations and warranties that justifies the repurchase request. Currently, FHFA and the Enterprises are engaged in outreach activities with a variety of lenders and dispute resolution providers to solicit their input on the initial design of the dispute resolution process.

### **Compensatory Fees for Extended Foreclosure Timelines and Servicer Eligibility Standards.**

The 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would address servicing-related issues that have had or may have had an impact on access to mortgage credit for creditworthy homebuyers. FHFA and the Enterprises have received feedback from industry and other stakeholders that increases in the cost of servicing delinquent loans could affect the future pricing and availability of mortgage credit to certain borrowers. As a result, FHFA and the Enterprises worked during 2014 to analyze and address two servicing-related issues in order to foster a deep, liquid, and stable housing finance market.

First, FHFA and the Enterprises worked to refine the foreclosure timeline and compensatory fee framework associated with the Servicing Alignment Initiative (SAI) announced in April 2011.



These efforts aimed to provide updated foreclosure timelines that reflect recent historical experience with foreclosure processes at the state level and to reduce servicer burden related to the management of compensatory fees where appropriate. The foreclosure timeline and compensatory fee framework is a way for the Enterprises to hold servicers accountable for providing timely loss mitigation and foreclosure prevention alternatives to borrowers, as well as appropriately completing foreclosures where necessary. Under SAI, servicers are not assessed compensatory fees for completed home retention and foreclosure alternatives solutions. However, delinquent loans that are not resolved through a home retention or foreclosure alternative solution are subject to compensatory fees if they are not resolved within the published state foreclosure timelines, including allowable delays.

In November, FHFA and the Enterprises released a revised state foreclosure timeline methodology, which incorporates updated foreclosure timeline data, that increased timelines in a majority of states and gave servicers a set of tools to help them manage compensatory fees more effectively. In certain states where there are significant delays in foreclosure processes, the Enterprises have temporarily suspended invoices for compensatory fees until there are sufficient observable foreclosure sales to inform state-level timelines. Additionally, the Enterprises have increased the monthly aggregate invoice threshold to \$25,000. As a result, smaller servicers with fewer delinquent loans may avoid foreclosure-timeline-related compensatory fees altogether. Taken together, these changes substantially reduce compensatory-fee costs across the servicing industry while maintaining the accountability structure of the overall foreclosure timeline and compensatory fee framework. Moreover, it is important to recognize that the Enterprises will continue to operate their servicer oversight and performance monitoring programs to ensure that servicers are fulfilling all of their servicing responsibilities.

In order to provide servicers and borrowers with more ways to avoid foreclosure where possible, the Enterprises also provided servicers with enhanced loss mitigation and foreclosure prevention alternatives for severely delinquent loans subject to the compensatory fees. These options include expanding Streamlined Modification eligibility to include borrowers greater than 720 days delinquent and increasing borrower foreclosure alternative incentives for deed-in-lieu transactions in certain states where timelines are extremely long.

Second, FHFA and the Enterprises have worked to enhance the Enterprises' minimum servicer eligibility standards in order to strengthen and provide clarity about the Enterprises' counterparty standards for servicers. FHFA anticipates that this will eliminate a source of uncertainty in the servicing transfer market, which would contribute to FHFA's objective of improving access to credit for creditworthy borrowers. During 2014, FHFA and the Enterprises worked together to



define the scope and objectives of this initiative, including work related to financial requirements and operational considerations. FHFA and the Enterprises examined the differences between the Enterprises' existing servicer eligibility standards and current servicer business models, resulting in FHFA's recent release of proposed new minimum financial eligibility requirements for the Enterprises' Seller/Servicers. FHFA anticipates that the Enterprises will finalize enhanced minimum servicer eligibility standards in 2015, following outreach and input from the servicer industry and other stakeholders.

**Providing Targeted Access to Credit Opportunities for Creditworthy Borrowers.** The 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would work to increase access to mortgage credit for creditworthy borrowers. In December, Fannie Mae and Freddie Mac announced purchase guidelines that enable creditworthy borrowers who can afford a mortgage, but lack the wealth to pay a substantial down payment plus closing costs, to obtain a mortgage with a three percent down payment. These purchase guidelines provide an important but targeted access-to-credit opportunity for creditworthy individuals and families. Additionally, the Enterprises' product offering focuses on first-time home buyers and requires borrowers to be owner-occupants.

To appropriately manage the Enterprises' risk, the Enterprises' purchase guidelines emphasize strong underwriting standards and do not allow the kind of risk layering that occurred in the years leading up to the housing crisis. First, the purchase guidelines for these loans include compensating factors and risk mitigants—such as housing counseling, stronger credit histories, or lower debt-to-income ratios—to evaluate a borrower's creditworthiness. Second, like other loans purchased by the Enterprises, the loans must have full documentation and cannot include 40-year or interest-only terms. Third, the 97 percent loan-to-value (LTV) ratio loans must be fixed-rate and cannot have an adjustable rate. Fourth, the products will leverage the Enterprises' automated underwriting systems. Finally, like other loans with down payments below 20 percent, these loans require private capital credit enhancement, such as private mortgage insurance.

The Enterprises' purchase guidelines for the 97 percent LTV ratio loan product provide a responsible approach to improving access to credit while also furthering safe and sound lending practices. Both Enterprises expect to purchase only a small amount of these loans each year compared to their overall loan purchase volume, and FHFA will be monitoring the ongoing performance of these loans.



**Working with Small Lenders, Rural Lenders, and Housing Finance Agencies.** Following the expectation in the 2014 Conservatorship Scorecard, both Enterprises worked in 2014 to expand their partnerships with small lenders, rural lenders, and housing finance agencies (HFAs) and to strengthen their understanding of how the Enterprises might be able to better serve these entities. In support of small and rural lenders, in the first quarter the Enterprises issued lender guidance clarifying a number of property and appraisal requirements for dwellings in small towns and rural areas. The lender guidance focused on the key issues of appraiser selection, property eligibility, and acceptable appraisal practices. The clarifications were as follows:

- **Appraisal Selection** - The Enterprises made it clear that lenders are not required to use the services of an appraisal management company when ordering an appraisal. Lenders may order appraisals directly from appraisers they know to have the experience and competency for the assignment as long as they can demonstrate safeguards to isolate collateral evaluation processes from influence or interference from mortgage production incentives.
- **Property Eligibility** – The Enterprises’ enhanced guidance to lenders also addresses acceptable property characteristics, zoning, and present land uses. The Enterprises require that a property be primarily residential in nature and use, but clarified that other secondary uses are allowed, including agricultural and other uses typical of rural communities. Enterprise guidance also extends to unique property types with examples as to what is acceptable for delivery to Fannie Mae and Freddie Mac. These include property types such as log homes, geodesic homes, and earth-berm homes, among others. In all cases, the appraiser must demonstrate market acceptance and marketability for these property types.
- **Acceptable Appraisal Practices** –The Enterprises’ expanded guidance also provides additional detail on addressing specific appraisal problems often found in rural markets. This includes the use of distant comparable sales, dated sales, and dissimilar properties. It also addresses how to balance the sales comparison analysis when data are limited and/or dissimilar by isolating dominant subject features using comparable sales with similar dominant features. Appraisers were instructed to use the best sales available, but in all cases to explain the reasoning behind the sales selection and discuss the current market conditions to provide a proper understanding of the subject market.

Further, as part of its ongoing effort to serve the affordable housing market and provide liquidity to small towns and rural areas, Fannie Mae revised its Selling Guide in September to allow for



the delivery of Department of Housing and Urban Development (HUD)-guaranteed Section 184 mortgages and Department of Agriculture Rural Development (RD)-guaranteed Section 502 loans as standard instead of negotiated-only products.<sup>1</sup> In support of working with HFAs, Fannie Mae piloted expanded partnerships with county-level HFAs, which expanded beyond its traditional state-level approach.

## II. Loss Mitigation and Foreclosure Prevention Activities

FHFA's 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would continue to refine and improve key loss mitigation and foreclosure prevention activities, as well as develop neighborhood stabilization strategies for hardest hit communities. Since the onset of the foreclosure crisis, an unprecedented number of borrowers have found themselves at risk of foreclosure and in need of foreclosure prevention options. As directed by FHFA, the Enterprises have completed approximately 3.4 million foreclosure prevention actions (including home retention modifications, short sales, and deeds-in-lieu) since the start of the conservatorships in September 2008. Nearly 2.8 million of these actions have helped homeowners stay in their homes, including 1.7 million permanent loan modifications. The Enterprises' efforts during 2014 in these and related areas are detailed below.

**HARP Outreach.** The Home Affordable Refinance Program (HARP), introduced in 2009 as part of the Administration's Making Home Affordable program, is a key way in which Fannie Mae and Freddie Mac support the strategic goal of ensuring credit availability for refinanced mortgages. HARP gives borrowers whose mortgages are owned or were securitized by either Enterprise and who have little or no home equity the opportunity to refinance into mortgages with more affordable payments. In light of initial experience with the program, FHFA modified HARP in several ways in 2011, including removing the 125 percent LTV ratio ceiling, waiving certain representations and warranties, and extending the end date for HARP to the end of 2013. In April 2013, FHFA extended HARP through 2015. Also in 2013, the Enterprises announced a change to the HARP eligibility date requirement, making a mortgage's eligibility subject to the note date rather than the date of Enterprise acquisition of the loan.

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<sup>1</sup> The HUD Section 184 Indian Home Loan Guarantee Program guarantees mortgages specifically designed for American Indian and Alaska Native families, Alaska Villages, Tribes, or Tribally Designated Housing Entities. Section 184 loans can be used, both on and off native lands, for new construction, rehabilitation, purchase of an existing home, or refinance. The RD Section 502 program guarantees loans to low-income individuals or households in rural areas that are used to acquire, build (including funds to purchase and prepare sites and to provide water and sewage facilities), repair, renovate, or relocate a home.



The 2011 changes led to a surge in program activity throughout 2012 that resulted in more than one million HARP refinances in that year, an amount equal to activity over the prior three years. As of year-end 2014, HARP refinances since program inception totaled nearly 3.3 million. However, FHFA estimates that, as of September, as many as 650,000 more borrowers were HARP-eligible and had an incentive to refinance (depending on interest rate and home price increases).

The 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would analyze and pursue opportunities to encourage take-up by the remaining HARP-eligible borrowers. In response, the Enterprises reviewed their respective HARP programs and related processes to determine if potential impediments exist that keep currently eligible borrowers from taking advantage of the program. Also, FHFA updated its HARP outreach campaign in June by releasing an interactive online map indicating the number of estimated “in-the-money” borrowers eligible for HARP in every zip code, county, and metropolitan statistical area in the country. The HARP outreach campaign focuses on leveraging community leaders and other trusted advisors to share information about HARP as a way to reach the remaining HARP-eligible homeowners. During 2014, FHFA held HARP outreach events in Chicago in July, Atlanta in August, Detroit in October, and Miami in December.

**Loss Mitigation Strategies and Neighborhood Stabilization.** Since the start of the foreclosure crisis, FHFA has worked with Fannie Mae and Freddie Mac to develop programs that help borrowers stay in their homes. As the foreclosure crisis has persisted, FHFA has continued to work with the Enterprises to enhance their loss mitigation tools that support home retention, when appropriate, and minimize credit losses to the Enterprises and taxpayers. Since 2008, FHFA has launched various programs and initiatives aimed at creating common, consistent, and simplified approaches for loss mitigation.

Under the Servicing Alignment Initiative (SAI), the Enterprises have developed aligned delinquency management standards for loan servicing. Since that time, FHFA and the Enterprises have continued to improve these servicing standards. In 2012 and 2013, FHFA continued to enhance and align Fannie Mae and Freddie Mac servicing policies. For example, FHFA announced streamlined and enhanced foreclosure alternatives, the Standard Short Sale and Deed-in-Lieu and the Streamlined Short Sale and Deed-in-Lieu; addressed documentation challenges associated with traditional modification programs by announcing the Streamlined Modification; aligned the Enterprises on servicing guidelines for borrowers affected by



nationally-declared disasters; and ensured consistency with mortgage servicing rules issued by the Consumer Financial Protection Bureau (CFPB).

FHFA and the Enterprises continued to assess and develop new loss mitigation strategies in 2014. During the past year, FHFA and the Enterprises completed reviews of and made enhancements to requirements related to foreclosure alternatives, unemployment forbearance, and rate-reset notifications. In July, the Enterprises announced expansions to their home retention solutions for Standard and Streamlined Modification that enable certain eligible borrowers with mark-to-market (MTM) LTV ratios below 80 percent to modify their loans. Further, FHFA and the Enterprises assessed and published enhancements for Servicemembers Civil Relief Act compliance.

In addition, as part of the Neighborhood Stabilization Initiative (NSI), FHFA worked with the Enterprises to develop pre-foreclosure home retention solutions and post-foreclosure strategies for hardest hit areas. NSI, which FHFA announced in May, supports FHFA's strategic goal of continuing to refine and improve servicing and foreclosure prevention standards. Through this effort, FHFA has selected the City of Detroit and Cook County, IL for pilot programs.

The three primary goals of the NSI are to 1) increase the number of families able to stay in their current homes through loan modifications; 2) effectively match distressed properties with responsible non-profits for property renovation and resale; and 3) assist distressed communities in executing their building demolition plans. The pre-foreclosure strategies include deeper loan modifications, such as MyCity Modification, as well as targeted resolution efforts that might include the conveyance or sale of delinquent notes to a national non-profit if modification efforts are unsuccessful. MyCity Modification targets post-modification payment reductions of approximately 60 percent for certain eligible borrowers in the City of Detroit, Michigan and Cook County, Illinois. The Enterprises published their My City Modification terms for Detroit in June and for Cook County, Illinois in December.

Post-foreclosure strategies involve partnering with non-profits earlier in the Enterprises' REO sales process to help speed neighborhood recovery. Although the Enterprises' inventory of real estate owned (REO) properties is approaching pre-crisis levels in some states, in certain areas of the country it continues to increase or remains near historic highs. Some particular markets have large concentrations of distressed and low-value REO properties as well as large volumes of loans that have been delinquent for more than a year that are likely to result in foreclosure if loan modification efforts are unsuccessful. Those markets present various challenges, including high vacancy rates, weak for-sale markets, and steep home-price declines. To address those



challenges, the Enterprises are partnering with community organizations, a national non-profit, and local governments to make timely and informed decisions about the best treatment of individual properties.

**Non-Performing Loan Sales.** FHFA's expectation is that the sale of severely delinquent loans through non-performing loan (NPL) sales will result in more favorable outcomes for borrowers, while also reducing losses to the Enterprises and, therefore, to taxpayers. In August, Freddie Mac closed a pilot sale of \$596 million of seriously delinquent NPLs to private investors. The loans included in this sale were serviced by Bank of America and, on average, were more than three years delinquent at the time of sale.

In March 2015, FHFA announced enhanced requirements for future sales of NPLs by Freddie Mac and Fannie Mae. The enhanced requirements include bidder qualification, modification, and reporting requirements.

**Lender Placed Insurance.** When borrowers fail to remain current on their hazard insurance for loans guaranteed by Fannie Mae or Freddie Mac, which often coincides with a borrower being unable to pay the mortgage, the Enterprises require servicers to buy hazard insurance on the borrower's behalf to protect the property. That coverage is known as "lender placed insurance" (LPI). High costs associated with LPI have raised concerns about certain features or practices associated with LPI policies, including the use of servicer-affiliated insurance companies and servicer receipt of commissions or other LPI-related payments from LPI carriers. FHFA took several steps in 2013 to address those issues, including directing the Enterprises to prohibit the use of affiliated insurance companies and commissions or other LPI-related payments to servicers from LPI carriers.

The 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would continue to develop options to further reduce LPI costs for borrowers and the Enterprises. Accordingly, in 2014 the Enterprises provided comment, analyses, and data on a number of options for reducing LPI costs. FHFA and the Enterprises are now seeking input on them from multiple stakeholders, including state insurance regulators, federal regulators, servicers, insurance providers, and consumer advocates.



### III. Multifamily Credit Guarantee Business

To further the strategic goal of maintaining the presence of Fannie Mae and Freddie Mac as a backstop for the multifamily mortgage market while not impeding the participation of private capital in the multifamily finance market, the 2014 Conservatorship Scorecard continued the loan production caps on each Enterprise's multifamily business at the levels set in 2013. The Scorecard also excluded from those caps certain mission-related finance activities, including financing for subsidized affordable housing, manufactured housing communities, and small multifamily properties (those with between 5 and 50 units), so as not to constrain the Enterprises' ability to support underserved segments of the multifamily market.

Due to a competitive market environment and a predominance of private capital sources, the Enterprises' combined share of new multifamily originations was less than one third of the market in 2014, as it had been in 2013, down from 43 percent in 2012. This level is close to their average market share in the years before the financial crisis that began in 2008. The reduction in the Enterprises' combined multifamily market share in the last two years demonstrates the counter-cyclical role they have played in the multifamily market. Each Enterprise's total multifamily activity for the year (\$28.9 billion for Fannie Mae and \$28.3 billion for Freddie Mac) did not exceed the Scorecard's production caps.

In 2014, the Enterprises implemented several financing initiatives designed to support underserved segments of the multifamily market. Freddie Mac announced a specialized program to purchase fixed-rate, permanent loans on small multifamily properties, which are an important source of affordable, market-rate rental units. Freddie Mac also began purchasing permanent loans on manufactured housing rental communities and, as an alternative to its tax-exempt bond credit enhancement programs, began purchasing bonds with affordable housing set-asides that are issued by state HFAs. Fannie Mae also expanded its support for tax-exempt bonds by financing them with Fannie Mae mortgage-backed securities, which improves bond liquidity. Together, these initiatives are examples of the Enterprises' efforts to fulfill their statutory mandates to serve all markets.

### REDUCE

The 2014 Conservatorship Strategic Plan focuses on reducing taxpayer risk by increasing the role of private capital in the mortgage market. To further that objective, the 2014 Conservatorship Scorecard expressed the expectation that the Enterprises would 1) expand the volume and types of transactions that transfer single-family mortgage credit risk from the



Enterprises to the private sector; 2) continue the ongoing reduction of the Enterprises' retained portfolios, with a focus on the sale of their less liquid assets; 3) take steps to ensure the stability of the mortgage insurance companies that are important Enterprise counterparties; and 4) continue current Enterprise programs that share multifamily mortgage credit risk with private-market investors, while exploring how to expand the types and volume of such risk-transfer transactions. This section describes Enterprise activities in 2014 in each of those areas.

### I. Credit Risk Transfers for Single-Family Credit Guarantee Business

The 2014 Conservatorship Strategic Plan's goal of reducing taxpayer risk builds on the Enterprises' previous risk transfer efforts. Under the 2013 Conservatorship Scorecard, FHFA expressed the expectation that each Enterprise would conduct risk transfer transactions involving single-family loans with an unpaid principal balance (UPB) of at least \$30 billion. The 2014 Conservatorship Scorecard tripled the required risk transfer amount, with the expectation that each Enterprise would transfer a substantial portion of the credit risk on \$90 billion in UPB of new mortgage-backed securitizations. FHFA also expected each Enterprise to execute a minimum of two different types of credit risk transfer transactions. FHFA required the Enterprises to conduct all activities undertaken in fulfillment of these objectives in a manner consistent with safety and soundness.

During 2014, the two Enterprises executed credit risk transfers on single-family mortgages with a UPB of over \$340 billion, which is well above the required amounts.

**Issuance of Debt Equivalent to Credit-Linked Notes.** The primary way that the Enterprises have executed single-family credit risk transfers to date has been through debt-issuance programs. Freddie Mac transactions are called Structured Agency Credit Risk (STACR) notes, and Fannie Mae transactions are called Connecticut Avenue Securities (CAS). Following the release of historical credit performance data in 2012, each Enterprise has issued either STACR or CAS notes that transfer a portion of the credit risk from large reference pools of single-family mortgages to private investors. These reference pools are comprised of loans that the Enterprises had previously securitized to sell the interest rate risk of the loans to private investors. The STACR and CAS transactions take the next step of transferring a portion of the credit risk for these loans to investors as well. Each subsequent credit risk transfer transaction is intended to provide credit protection to the issuing Enterprise on the mortgages in the relevant reference pool.



Each Enterprise's note-issuance program, like its entire risk transfer program, is still in its early stages. Fannie Mae and Freddie Mac both offered new products in 2014 and plan more innovations for 2015. In addition, in 2014 Freddie Mac released loan-level data on actual credit losses for the first time, in preparation for eventually selling credit risk based on actual rather than defined losses. FHFA expects that Fannie Mae will follow suit in 2015. These data releases build upon the Enterprises' initial release of historical credit performance data in 2012. Additionally, Fannie Mae worked with an investment bank to issue a 'front-end' credit risk transfer transaction backed by about \$1 billion of mortgage loans.

Although the Enterprises have separate note-issuance programs, the notes sold by each Enterprise are substantially similar in structure to one another. Although modest differences in the Enterprises' offerings will likely persist, it is in their mutual interest to maintain a similar structure going forward in order to attract similar classes of investors.

In general, the STACR and CAS transactions are structured as debt issuances that effectively mimic a credit-linked note structure, both of which eliminate counterparty risk to the Enterprises. Under the credit-linked note structure, the Enterprises sell bonds that synthetically represent a principal and interest payment on some portion (for example, generally between three and four and one-half percent) of a reference pool of loans. In instances where the credit losses on the mortgages in the reference pool exceed a preset level, the principal of the outstanding notes is reduced, which largely reimburses the Enterprise for a portion of the actual credit losses on the pool. In existing Enterprise note-issuances during 2014, the Enterprises have retained the first-portion of credit losses, which is sized to represent a conservative estimate of expected losses, with investor exposure to credit losses following the Enterprises. The Enterprises have also continued to hold the risk of catastrophic credit losses on these loans.

Recently, Fannie Mae and Freddie Mac have both issued debt securities that reference mortgages with LTV ratios over 80 percent, in addition to and separate from their issuance of securities referencing loans with LTV ratios from 60 to 80 percent. In these transactions, the securities are structured into two or three tranches, each reflecting a different level of credit risk. (The less risky tranches are rated by credit rating agencies, with the least risky tranche, at a minimum, receiving a rating of investment grade.) The size and number of the tranches can vary with each securities offering and depend, in part, on what is necessary to achieve the investment grade rating for the least risky tranche(s). Both Enterprises also have committed to maintain a minimum 5 percent interest in each tranche of each deal, which is designed to align the interests of the issuing Enterprise and investors.



The risk transfer securities sold by the two Enterprises are very similar but not identical. They can differ in terms of the amount of credit protection sold, for example up to 3 percent versus up to 4.5 percent for similar collateral. They also can have different defined loss severity schedules. Both the amount of credit protection sold and the defined loss severity schedules also differ between the offerings that transfer risk on mortgages with LTV ratios from 60 percent and 80 percent and those that transfer risk on loans with LTV ratios above 80 percent. These schedules will continue to evolve in the future to appropriately reflect the credit quality of the collateral and market conditions.

Sales of Freddie Mac's STACR notes totaled just over \$4.9 billion in 2014. The \$4.9 billion represents credit risk protection on approximately \$106 billion in unpaid principal balance of mortgages acquired by Freddie Mac during the period from the first quarter of 2013 through the first quarter of 2014. The bulk of the sales, approximately \$3.3 billion, provided credit protection on reference pools of 30-year, fixed-rate mortgages with LTV ratios from 60 percent to 80 percent, which are not covered by mortgage insurance. The remaining nearly \$1.6 billion of notes provided credit protection on reference pools of 30-year fixed rate mortgages with LTV ratios from 80 percent to 95 percent, which are also covered by mortgage insurance. An August transaction was the first time Freddie Mac sold securities that referenced loans with LTV ratios over 80 percent.

Sales of Fannie Mae's CAS notes totaled \$5.8 billion in 2014, resulting in credit protection on \$210 billion of mortgages that were securitized from the fourth quarter of 2012 through the third quarter of 2013. Fannie Mae offered securities that provide credit protection on fixed-rate mortgages with LTV ratios from 80 percent to 97 percent. Three such transactions occurred in 2014, totaling approximately \$1.5 billion of the \$5.8 billion total issued. The remaining \$4.3 billion issued provided credit protection on fixed-rate mortgages with LTV ratios of 60 percent to 80 percent, similar to the STACR notes.

**Purchases of Insurance and Reinsurance.** Both Fannie Mae and Freddie Mac also made progress in 2014 toward developing risk-transfer programs that access the capital in insurance and reinsurance markets. Those transactions provided coverage at the pool level by a diversified group of counterparties. The Enterprises conducted four such transactions in 2014, some of which, for the first time, involved reinsurance companies. That is notable because reinsurers typically have books of business that are well diversified both geographically and by line of business, which means they represent a relatively stable source of private capital to which the Enterprises could transfer mortgage credit risk over the credit cycle.



Freddie Mac executed several diversified, pool-level insurance transactions that the Enterprise refers to as Agency Credit Insurance Structure (ACIS) transactions in 2014. Those transactions provided credit protection on more than \$20.4 billion of mortgages that were securitized in 2013 and 2014. Regarding the collateral used for these transactions, they draw from the same reference pools used for STACR transactions. Freddie Mac's transactions have all involved multiple counterparties, including primary insurers and reinsurers.

Fannie Mae executed its first pool-level, diversified insurance transaction in 2014. That transaction provided credit protection on more than \$6.4 billion of mortgages securitized in 2014. Unlike Freddie Mac, Fannie Mae used collateral that was different from the reference pools supporting CAS transactions and structured the payment of benefits to be based on actual losses rather than defined loss severity schedules, as employed with CAS, STACR, and ACIS transactions to date.

## II. Retained Mortgage Portfolios

Before the mortgage crisis, Fannie Mae and Freddie Mac accumulated very large portfolios of mortgages and mortgage-backed securities funded by unsecured debt issued by the Enterprises. As of March 31, 2009, Freddie Mac's retained mortgage portfolio was \$867 billion, and Fannie Mae's was \$784 billion. In large part, the Enterprises used their retained portfolios to hold investments on their books in order to generate income. However, the Enterprises' retained portfolios also exposed them to significant credit, asset liquidity and interest rate risks. Beyond leveraging their portfolios for investment purposes, the Enterprises also use their portfolios for core single-family guarantee business purposes such as aggregating loans through a cash window for individual loan purchases from smaller sellers and purchasing non-performing loans out of mortgage-backed securities to make investors whole and facilitate loss mitigation.

Further reducing the Enterprises' retained portfolios will continue to shift credit, asset liquidity, and interest rate risks from the Enterprises to private investors. The Enterprises made significant progress in reducing their retained portfolios during 2014, and both of the Enterprises are currently significantly below the 2014 cap of \$470 billion required by the Senior Preferred Stock Purchase Agreements (PSPAs). As of December 31, 2014, Freddie Mac's portfolio stood at \$408 billion, and Fannie Mae's was \$413 billion, for a combined reduction of \$131 billion in 2014.

As part of FHFA's requirement that the Enterprises further reduce their retained portfolios, the 2014 Conservatorship Scorecard directed each Enterprise to submit plans for approval to reduce



each retained portfolio to \$250 billion by December 31, 2018, as required by the PSPAs. FHFA required the Enterprises to include contingency plans to meet the 2018 PSPA objective even under adverse market conditions, such as rising interest rates or falling house prices. In developing these plans, FHFA also required the Enterprises to prioritize selling their less liquid portfolio assets, such as non-agency securities, in an economically sensible manner via a transparent sales process that is auction-based where appropriate. Lastly, as part of the planning process, FHFA also required each Enterprise to take into account how the sale of less liquid assets would impact both the overall market and neighborhood stability.

The Enterprises' activities to reduce their retained portfolios during 2014 included a variety of actions. For both Enterprises, most of the reduction during 2014 is the result of voluntary and involuntary prepayments. In addition, Freddie Mac and Fannie Mae transferred risk to private capital investors through the sale of more than \$16 billion of less-liquid assets by Freddie Mac and more than \$6 billion by Fannie Mae in 2014. For Freddie Mac, sales were predominantly private-label securities sold through an auction process. For Fannie Mae, about half went through an auction process.

### **III. Mortgage Insurance Master Policies and Eligibility Requirements**

The 2013 Conservatorship Scorecard established the expectation that the Enterprises would update and align counterparty risk management standards for mortgage insurers (MIs), including uniform master policies and eligibility requirements. An MI master policy sets the terms of business between an MI and a seller/servicer counterparty. Master policies are approved by state regulators and must be determined to be acceptable by the Enterprises. An Enterprise's MI eligibility requirements set the criteria and terms an MI must meet to insure loans that are eligible for purchase by the Enterprises. Work toward achieving those objectives continued under the 2014 Conservatorship Scorecard.

FHFA and the Enterprises made considerable progress toward developing the new MI master policies and eligibility requirements in 2014. The joint team developed standards for the master policies that served as the basis for the individual policies developed by each MI company. The Enterprises issued approval letters to each MI company for master policies that were approved by all state regulators. The new master policies took effect in October. In addition, FHFA released draft Private Mortgage Insurance Eligibility Standards (PMIERS) for Enterprise counterparties in July and requested public input on these draft standards. In developing the draft requirements, FHFA, Fannie Mae, and Freddie Mac solicited input from stakeholders, including state insurance commissioners and private mortgage insurers that are approved to do



business with either Enterprise. When finalized, the PMIERS will establish uniform requirements for MIs that are Enterprise counterparties. The new requirements will include financial standards that require MIs to demonstrate adequate resources to pay claims, standards for an MI's quality control processes, and performance metrics. Non-compliance with requirements or material deviations from the performance expectations will trigger Enterprise remediation.

#### **IV. Multifamily Credit Guarantee Business**

The 2014 Conservatorship Scorecard required each Enterprise to submit a study to FHFA that assessed the economics and feasibility of two issues: 1) adopting additional types of credit risk-transfer structures in its multifamily business and 2) increasing the amount of credit risk transferred in its current risk transfer structures, such as under Fannie Mae's Delegated Underwriting and Servicing (DUS) lender loss-sharing or Freddie Mac's K-Deal capital markets execution. The studies submitted by Fannie Mae and Freddie Mac demonstrated that each Enterprise's current multifamily business models already transfer significant amounts of credit risk to private market participants. The studies also determined that changing these models (such as by increasing the amount of DUS lender loss sharing or increasing the size of the unguaranteed securities in K-Deals) would not result in significant additional transfers of credit risk and would be disruptive to established lender relationships and business practices. Instead, the studies identified several potential ways to conduct transactions, similar to the single-family credit risk transfers, that would subsequently transfer portions of the credit risk from the guaranteed multifamily securities issued by the Enterprises. The 2015 Conservatorship Scorecard directs the Enterprises to assess the feasibility of identified risk transfer structures to determine their market acceptance, their cost and effectiveness at transferring risk, and the ability to support a larger scale of multifamily credit risk transfer activity.

### **BUILD**

FHFA's 2014 Conservatorship Strategic Plan and Conservatorship Scorecard continued to make building a new infrastructure for the securitization functions of the Enterprises an important priority. That effort includes ongoing work to develop the Common Securitization Platform (CSP) as well as a new initiative to develop a single Enterprise mortgage-backed security (Single Security). The 2014 Conservatorship Scorecard also required continued work to build more consistent and uniform mortgage data standards for use by the Enterprises and other market participants. This section reviews progress on those initiatives in 2014.



## I. Common Securitization Platform and Common Securitization Solutions

The Common Securitization Platform is being designed to provide new infrastructure for most of the Enterprises' current securitization functions for single-family mortgages, which is an important aspect of their business operations. The platform will consist of integrated hardware architecture and software applications to perform major aspects of the securitization process. When fully developed, the CSP will 1) verify certain aspects of the data related to a pool of mortgages; 2) support the issuance of mortgage-backed securities, either backed by pools of loans or by other securities; 3) publish required disclosures related to the securities and pools of loans, both at issuance and on an on-going basis over the life of the securities; 4) perform aspects of master servicing operations that are amenable to automation and straight-through processing; and 5) perform certain bond administration functions. In order for the CSP to be adaptable for use by additional market participants in the future, the CSP is leveraging industry standard interfaces, industry software and industry data standards wherever possible.

**Development of the Platform.** The 2014 Conservatorship Scorecard expressed FHFA's expectation that each Enterprise would continue working with FHFA, the other Enterprise, industry stakeholders, and the Enterprises' joint venture, Common Securitization Solutions, LLC (CSS), to build and test the CSP and to implement the changes necessary to integrate the Enterprises' related systems and operations with the CSP. The Enterprises made significant progress in 2014 on several key areas concerning these CSP priorities.

First, during 2014 each Enterprise designated staff to work on the project at the CSS location, and this team has been developing the technology and operational infrastructure of the CSP platform. In addition to the core CSP functionality described in the FHFA's prior Progress Reports, the Enterprises made progress on the following:

- Substantially developed the functionality for non-securitized whole loans (both to on-board such loans and to provide master servicing operations);
- Substantially developed the Master Servicing Operations module;
- Made significant progress in the development of the Bond Administration module and the ability to support both initial and ongoing disclosures;
- Built numerous new system interfaces, including interfaces related to pool and servicer reporting, collapsing pools, dissolving security requests, and servicer transfers; and



- Developed a data acceptance and data calculation service to support the functions performed in each of the CSP modules.

Second, the Enterprises and CSP teams have also made progress in testing aspects of the CSP and Enterprise integration with the CSP. Fannie Mae and Freddie Mac have organized their staffs with business operations and information technology expertise to develop and test the systems and processes needed to integrate with the CSP. As a result, testing by both Enterprises is underway and includes progress on the Master Servicing Operations and Bond Administration modules, to ensure that the CSP system's results match the results of each Enterprise's current system.

Third, the CSP team has also made progress on establishing a software development and testing environment that is independent of the Enterprises, along with the related information security and risk management and control policies, procedures, and processes.

Fourth, CSP efforts also included developing the security issuance, registration and settlement capabilities of the CSP. The CSP team is working with a bank partner to support the security issuance function. Specifically, the bank partner would support the CSP's connectivity to the Federal Reserve Bank of New York and the Depository Trust & Clearance Corporation for settlement processing, exchange of data, and reporting on the Enterprises' mortgage-backed securities.

Lastly, the Enterprises continue to develop their operational plans to integrate with the CSP. Both Enterprises have submitted integration plans to FHFA, which describe how each Enterprise will continue to connect with the CSP and use its services. The Enterprises are working with the CSP team to align on the detailed integration requirements, hand-offs, and timelines. FHFA continues to review the plans. A key area of focus is the adjustments needed to support the new Single Security initiative. During 2014, FHFA, the Enterprises, and the CSP team began the process of working to ensure that the CSP has the operational and system capabilities necessary to issue the Single Security.

**Common Securitization Solutions.** CSS is a joint venture owned by Fannie Mae and Freddie Mac, which houses and will ultimately operate the CSP. CSS was established in 2013 and efforts continue to develop its necessary corporate operations and systems. To further this effort, FHFA and the Enterprises worked in 2014 to finalize the CSS board structure and to name a Chief Executive Officer (CEO). As announced in November, the CSS's Board of Managers has a four-person membership, comprised of two members from each Enterprise, each with an equal



vote. The Board Chair will rotate between the Enterprises' Board members. FHFA is an active participant, attending Board meetings and providing its perspective as regulator and conservator of the Enterprises.

Also as announced in November, a CEO for the CSS has been selected. The CEO started in that month and is responsible for all CSS business, operational, and corporate functions.

### II. Single Security

FHFA's 2014 Conservatorship Strategic Plan includes the goal of developing a Single Security as part of the efforts to build a CSP. In order to advance the early stages of that multiyear initiative, FHFA issued a *Request for Input: Proposed Single Security Structure* in August that outlined the proposed structure of a Single Security to be issued and guaranteed by Fannie Mae or Freddie Mac. As described in the Request for Input, maintaining a highly liquid secondary mortgage market is a fundamental requirement for the success of the Single Security. In order to achieve maximum market liquidity, the proposed Single Security would leverage the Enterprises' existing security structures. The proposal would encompass many of the pooling features of the current Fannie Mae Mortgage-Backed Security (MBS) and most of the disclosure framework of the current Freddie Mac Participation Certificate (PC).

FHFA received 23 responses to the Request for Input, and the agency continues the process of assessing these submissions and meeting with stakeholders to gain additional feedback. FHFA plans to issue a separate update on the status of and next steps related to the Single Security initiative this year, and the 2015 Conservatorship Scorecard expresses the expectation that the Enterprises will finalize a Single Security structure in 2015. Throughout the multiyear process of developing and implementing a Single Security, FHFA and the Enterprises will continue to seek input and to work with stakeholders to achieve the goal of improving overall secondary mortgage market liquidity while mitigating any risk of market disruption.

### III. Mortgage Data Standardization

In 2010, FHFA directed Fannie Mae and Freddie Mac to initiate the Uniform Mortgage Data Program (UMDP), through which the Enterprises are collaborating with the industry to develop and implement uniform data standards for single-family mortgages. Implementation of those data standards will enable the Enterprises to capture more consistent and uniform mortgage data, help them acquire high-quality loans, and enhance their risk management capabilities.



The Enterprises implemented three key phases of UMDP prior to 2014: 1) The Uniform Appraisal Dataset (UAD), which standardized the data elements included in appraisal forms submitted electronically to the Enterprises and standardized key appraisal definitions; 2) the Uniform Collateral Data Portal (UCDP), which serves as a single portal for the required electronic submission of appraisal data files by lenders or their agents prior to delivering a mortgage to an Enterprise; and 3) the Uniform Loan Delivery Dataset (ULDD), which provided a common set of loan delivery data requirements applicable to each Enterprise's loan delivery process and business policies. The Mortgage Industry Standards Maintenance Organization (MISMO) Reference Model serves as the basis for the ULDD and UAD, resulting in consistent data mapping, enumerations, and definitions for appraisal and loan delivery data.

During 2014, FHFA and the Enterprises worked on three initiatives that build on previous UMDP efforts: 1) the Uniform Closing Dataset (UCD); 2) the Uniform Loan Application Dataset (ULAD); and 3) the Servicing Data Technology Initiative (SDTI). The UCD and ULAD projects are being conducted as part of UMDP. The SDTI project was a separate initiative that replaced the Uniform Mortgage Servicing Dataset (UMSD), which was a UMDP effort that the Enterprises concluded in 2013. Work on each of these three 2014 initiatives is detailed below.

**Uniform Closing Dataset.** The Enterprises began developing the UCD in 2012 after the CFPB published a proposed rule providing for Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z). FHFA began this initiative by facilitating discussions between the Enterprises and CFPB to ensure the dataset matched the intention of the rule. The Enterprises refined the UCD after CFPB published the final Integrated Mortgage Disclosures rule in November 2013. The dataset includes all data fields that appear on the Closing Disclosure form in addition to data fields to support the eligibility review of Qualified Mortgages. The Enterprises published the UCD in March, along with supplemental material in July. The Enterprises are currently analyzing different options for the collection of this data from lenders.

**Uniform Loan Application Dataset.** In consultation with FHFA and other Federal agencies, the Enterprises are working to update and reorganize the data collected on the Uniform Residential Loan Application (URLA) form, last updated in 2009. Changes in the mortgage industry—including in credit, underwriting, and eligibility policies and the regulatory environment—created a need for the Enterprises to reassess the information collected at the time of loan origination. As part of the update to the URLA form, the data collected is being mapped to the newer MISMO 3.x standard, which replaced the no-longer-supported MISMO 2.x standard. The goal of this effort is to standardize the URLA form and the data collection



requirements, and the initiative will include multiple phases over several years. During 2014, FHFA and the Enterprises focused on receiving and analyzing industry feedback on a preliminary version of the proposed form. FHFA and the Enterprises will continue to engage with stakeholders as the URLA initiative progresses and the data collection requirements are refined.

**Servicing Data Technology Initiative.** In 2014, FHFA partnered with the Enterprises on the Servicing Data Technology Initiative in order to 1) develop an understanding of current and anticipated mortgage servicing data and technology needs, including any inadequacies and gaps that currently exist; and 2) use the Enterprises' standard-setting role to engage industry in dialogue that would encourage technology improvements and expand data standardization.

The initiative included extensive industry outreach aimed at learning from servicers, technology vendors, and institutional investors about current and anticipated mortgage servicing data challenges and technology needs. FHFA and the Enterprises conducted 39 interviews with mortgage industry participants, each Enterprise's servicing group, and the CFPB. The interviews were used to better understand the data flows and dependencies over the life of a mortgage and to identify common themes across the servicing industry. The team also conducted an analysis of the root causes of the servicing industry's challenges with data and technology. The team leveraged the findings of the industry outreach and the root cause analysis to identify current and prospective future Enterprise activities that are addressing or could address the industry's challenges.

## CONCLUSION

This Progress Report documents the major activities of Fannie Mae and Freddie Mac in 2014 toward achieving the goals set forth in FHFA's 2014 Conservatorship Strategic Plan and 2014 Conservatorship Scorecard. FHFA welcomes public input on that progress from interested parties. Input can be submitted via email to [ConservatorshipStrategicPlan@fhfa.gov](mailto:ConservatorshipStrategicPlan@fhfa.gov).

