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A Legal Update from Dechert LLP

FHFA Updates Its Strategic Plan - Charts Course for a New Securitization Infrastructure

The Federal Housing Finance Agency (FHFA) recently [released its strategic plan](#) for fiscal years 2013 through 2017 and an update of its planning to replace the infrastructure currently used by Fannie Mae and Freddie Mac (the Enterprises) to support mortgage securitization. [An infrastructure update](#) is part of the strategic plan as well, and the two documents together illustrate the dilemma of the FHFA as it attempts to plan for a future in housing finance that political leaders in Washington have yet to address.

The [strategic plan](#) includes four principal goals:

1. The safe and sound operation of the Enterprises and the Federal Home Loan Banks (FHLBanks);
2. To promote stability, mitigate risk and maintain access to funding in the housing finance market as currently operated;
3. As conservator of the Enterprises, preserve franchise value, minimize taxpayer loss and cooperate with the Administration to avoid borrower defaults on home mortgage loans; and
4. To prepare for a transition to a post-conservatorship housing finance market, by establishing appropriate standards and a single securitization platform to support multiple financing vehicles.

The first three goals are discussed in the strategic plan in terms of continued progress along the lines of current efforts. The fourth goal, which seeks to re-establish a secondary mortgage market that operates without government support, contemplates a transition to market-based leadership. As set forth in greater detail in the infrastructure update, this goal is more specific than the other strategic goals, yet, at this stage is only schematic.

Safe and Sound Operation

The FHFA is the prudential regulator of the FHLBanks and both prudential regulator and conservator of the Enterprises. In its strategic plan, the FHFA describes the full range of supervisory tools available to it to pursue its responsibilities. These tools include annual and targeted examinations of the regulated entities, horizontal reviews, rulemaking and policy guidance, quality assurance reviews and off-site monitoring, review of compensation and incentive policies and enhanced training of the FHFA's examination staff.

Stability of the Enterprises and Borrower Access to Mortgage Financing

The FHFA will work to support a shift of the credit risk in mortgage financing to the private sector while avoiding a disruption of the funding available to borrowers. As the FHFA notes in its strategic plan, the Enterprises have increased the fees they charge to guarantee securitized mortgages to better align them with market pricing and, as debate progresses over the transition of housing finance, the FHFA will seek to align the operations of the Enterprises. The FHFA also will work to promote home retention and foreclosure prevention and to develop alternative methods to dispose of foreclosed properties. In addition, the agency will seek to ensure equitable access to financing and financing services for all eligible borrowers and

institutions. The tools available to the FHFA to pursue these objectives include:

- The monitoring of housing markets;
- The promotion of actions by the Enterprises to maintain secondary market liquidity and by the FHLBanks to provide liquidity to their member institutions;
- Pursuant to the Dodd-Frank Act, participation with other members of the Financial Stability Oversight Council to identify and respond to risks to financial stability and oversee the regulated entities' adoption of new practices and standards in the use of derivatives;
- The promotion of changes to existing homeowner assistance programs to increase participation;
- The consideration of new programs tailored to local needs and conditions to dispose of foreclosed properties; and
- The oversight of the regulated entities' affordable housing programs and the promotion of equal access and minority inclusion.

Preserve Enterprise Assets

As of June 30, 2012, the Enterprises owned or guaranteed \$5.2 trillion of mortgages, and Enterprise programs supported a substantial majority of housing finance in the U.S. Maintaining the Enterprises' operations in conservatorship and market confidence in their continuing ability to support housing finance are critical to stabilizing housing markets and the value of outstanding mortgage-backed securities that are guaranteed by the Enterprises. The FHFA indicates that it will seek to provide clear guidance to the Enterprises' boards of directors and management and oversee their staffing; promote homeowner assistance programs; assist in the development of improved mortgage underwriting standards; direct the Enterprises to increase mortgage guarantee fees to reflect market pricing of risks and promote private risk-sharing; analyze and pursue the resolution of claims against securitizers; and reduce the Enterprises' investment portfolios and streamline their operations.

New Securitization Infrastructure

The FHFA acknowledges that there are significant public policy decisions that must be made regarding the roles of the government and the private sector in housing finance, and it states that it will examine a variety of options to reduce the Enterprises' role in the secondary mortgage market. However, the most specific elements of this goal are the efforts of the FHFA to build a single new securitization platform that can be used by both Enterprises and the private sector, employing a variety of investment vehicles, to be complemented by a new system for document custody, standardized data reporting and a new standardized mortgage pooling and servicing agreement.

As discussed in greater detail in the infrastructure update, despite the great uncertainties that accompany any current effort to predict or direct the direction of housing finance reform, the FHFA has attempted to describe and analyze schematically the steps included in the "lifecycle" of a mortgage obtained in the private market and sold in the secondary market. Based on this analysis, the FHFA has identified a core group of administrative functions that can provide a "platform" for a variety of securitization vehicles. The platform would feature open architecture, standard interfaces, interoperability both internally and externally and the ability to respond to scheduled and unscheduled information requests. These functions share the following characteristics, in order to facilitate wide usage:

- Straight-through, highly automated processing capable of handling large volumes with limited manual intervention;
- Rules-driven processing capable of being adjusted to accommodate changes in market conditions or policy;
- Accommodating market standards and supporting market and data transparency;
- The flexibility to serve many business models; and
- The ability for private parties to retain control of security selection, loan pooling, loan underwriting and other functions not currently performed by the Enterprises.

The eligible functions fall into two primary groups. At the time a mortgage-backed security is issued, the

platform would be used to perform the following:

- Ensure uniform formatting of reported data on underlying loans and validate that all submitted data are correct, complete and meet agreed-upon standards;
- Register securities, transfer ownership and remit proceeds;
- Transfer underlying loan information to the master servicer; and
- Make initial and periodic public disclosures regarding a security's characteristics.

The second group of functions would support ongoing mortgage servicing and bond administration. They would:

- Receive data and funds from primary servicers subject to standardized reporting and remittance dates;
- Verify that principal and interest payments are correct each reporting cycle and provide collateral and cash management;
- Remove loans, make approved loan modifications, transfer primary servicing and provide delinquency reports;
- Transfer ownership interests in notes and collateral and monitor and direct document custody;
- Monitor primary servicer performance; and
- Perform bond administration, including calculating and making distributions of principal and interest, providing investor reports and make market disclosures, supporting tax reporting, and investing funds as directed.

To accompany this platform, appropriate legal agreements, rules and allocations of responsibility would be drafted, including a framework for an effective payment and servicing agreement, selling and servicing guides and disclosure documents. In sketching the outline of a uniform securitization platform and accompanying agreements and standards, the FHFA has attempted to focus on those elements of the securitization process that it arguably can control, and to package them in a manner to encourage all market participants to use its version of those processes. While the FHFA acknowledges that it is not in a position to drive the transition to a new model of housing finance by being first to build the highway to reform, it does hope to attract substantial enough traffic to necessitate that highway being built.

[FHFA is requesting public comment on the infrastructure proposal by December 3, 2012.](#)

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