3. Federal Agency and Government Sponsored Enterprises

Chapter 3

Federal Agency and Government Sponsored Enterprises

Ginnie Mae, Fannie Mae and Freddie Mac are three organizations that are often collectively, but inaccurately, referred to as "agencies". In fact, of the three, only Ginnie Mae is an agency that is fully backed by the U.S. government, while Fannie Mae and Freddie Mac are Government Sponsored Enterprises ("GSEs"). All three were chartered to support mortgage lending in the United States through their enhanced funding and securitization programs. Through their respective functions, Ginnie Mae, Fannie Mae and Freddie Mac all help to channel capital into our housing markets by providing secondary market investors with more secure investment options. As well, Fannie Mae and Freddie Mac provide additional liquidity to the markets by purchasing mortgages and mortgage-related securities from primary market institutions.

Agency securities are "Exempted Securities" within the meaning of the Securities Exchange Act of 1934 and also exempt from the registration requirements traditionally imposed on a corporation's debt by the Securities Act of 1933. These exemptions do not infer tax exemption, however, and the interest earned on securities issued by Freddie Mac, Fannie Mae and Ginnie Mae is subject to federal, state and/or local income tax.

Creation of Mortgage-Backed Securities

Programs provided by Ginnie Mae, Fannie Mae and Freddie Mac support the creation of single-class and multi-class MBS. Both types are typically issued through mortgage lender swap transactions whereby a lender exchanges pools of mortgages for MBS. In a typical MBS, principal and interest from underlying mortgage loans are passed through to the certificate holders, less a fee for servicing the mortgage loans and a fee for the agency or GSE "guaranty". The guaranty refers to the timely payment of principal due on the underlying mortgage loans and interest at the MBS pass-through rate to the certificate holders, even if payments on the underlying mortgage loans have not been received; thus the agency or GSE assumes the credit risk of borrower defaults on the underlying mortgage loans, as well as any risk arising from a default or bankruptcy of the seller and servicer of the loans.

Ginnie Mae, Fannie Mae and Freddie Mac also support multi-class MBS, such as collateralized mortgage obligations ("CMOs"), certain grantor trust certificates, and stripped mortgage-backed certificates ("SMBS"). CMOs are a vehicle by which an issuer can structure interest and principal payments on mortgage loans or mortgage-related securities (including MBS) into separately tradable interests. The Tax Reform Act of 1986 allowed mortgage securities pools to elect the tax status of a Real Estate Mortgage Investment Conduit ("REMIC"). Since that time most new CMOs have been issued in REMIC form, and as a result the two terms are often used interchangeably. The term REMIC as used in this chapter, however, refers only to the subset of CMOs that take the REMIC tax status. SMBS operate in a manner similar to CMOs, though they are typically used to create tranches that pay only principal or only interest.

Mortgage-Backed Securities may be backed by a variety of mortgage types. Ginnie Mae, Fannie Mae and Freddie Mac securitize primarily single-family, conventional, fixed- or adjustable rate, first lien mortgage loans, or mortgage-related securities backed by such loans. They also securitize loans insured by the Federal Housing Administration ("FHA"), loans guaranteed by the Veterans Administration ("VA") or the Department of Agriculture's Rural Development ("RD"), manufactured housing loans, and multifamily mortgage loans. Original maturities of either 15 or 30 years are typical on conventional single-family and multi-family fixed-rate mortgages. Adjustable Rate Mortgages (ARMs) generally have 30-year maturities.

1. **Fixed Rate Mortgages** - The majority of fixed-rate mortgage loan purchases provide for equal or level monthly installments of principal and interest.
2. **Balloons** - Balloon mortgages have large "balloon" payments due 5, 7, or 10 years after origination, but they have monthly payments based on longer (e.g., 30-year) amortization schedules.
3. **Adjustable Rate Mortgages (ARMs)** - ARMs have interest rates that are adjusted up or down at specified intervals. New mortgage rates are calculated using formulas that are based on changes in predetermined indices such as LIBOR, cost-of-funds indices, constant maturity Treasuries, etc. GSEs may also purchase more complex ARMs that permit negative amortization as well as "reverse mortgages" that provide for periodic installments of principal to be paid to the borrower.
4. **Hybrid ARMs** - Hybrid ARMs have a fixed interest rate for a period of time (usually 3, 5, 7, or 10 years) and then change to an adjustable rate.

The following describes more fully the structure of Ginnie Mae, Fannie Mae and Freddie Mac, their relationships to the U.S. government, and their specific programs.

A. Ginnie Mae

The Government National Mortgage Association, frequently referred to as Ginnie Mae, is a wholly owned government corporation within the Department of Housing and Urban Development ("HUD"). Ginnie Mae was created by Congress in 1968 for the purpose of extending affordable housing to low and moderate-income borrowers.

While Ginnie Mae does not issue, sell or buy securities, Ginnie Mae does help to increase the supply of credit available for housing by guaranteeing the timely payment of principal and interest on securities issued by "approved" mortgage lenders. Through the creation and sale of "passthrough" securities under Ginnie Mae's guarantee programs, investors' principal and interest payments are protected even in the event of a default on a mortgage in the underlying collateral pool or a default by the issuer or servicer. Ginnie Mae's guarantee is backed by the full faith and credit of the United States Government.

Issuance of Ginnie Mae Securities

There are approximately 330 active Ginnie Mae issuers, which are typically mortgage bankers, savings institutions or commercial banks. All qualified Ginnie Mae issuers are Federal Housing Administration ("FHA") approved lenders, have a net worth acceptable to Ginnie Mae and have demonstrated adequate experience, management capability and facilities to issue and service MBS.

Mortgage lenders must apply to Ginnie Mae for approval to issue securities under its programs and for its commitment to guaranty a specific amount of securities. An approved issuer originates or acquires mortgages that are either insured or guaranteed by the FHA, the VA, the RD, or the Department of Housing and Urban Development's Office of Public and Indian Housing ("PIH"). Qualifying mortgages are assembled into pools according to specific pooling criteria set by Ginnie Mae. Upon approval, Ginnie Mae authorizes its transfer agent to create and deliver Ginnie Mae-guaranteed securities. The issuer remains responsible for marketing and administering the securities and servicing the mortgage pools.

Ginnie Mae Pass-Through Programs

Ginnie Mae began issuing pass-through securities in 1970 under a program that is now known as Ginnie Mae I. Ginnie Mae II was introduced in 1983 to offer more flexibility to the issuers and investors. Securities issued under both of these programs carry the same Ginnie Mae guarantee of timely payment of principal and interest.

1. **Ginnie Mae I** - Ginnie Mae I MBS include several pool types, each of which securitizes different types of mortgages. All Ginnie Mae I pools are, however, based on single-issuer pools and are comprised of mortgages of the same type, with the same coupons (except for manufactured housing pools) and similar maturities. Each mortgage in a pool must bear an interest rate that is one-half of one percent (50 basis points) higher than the interest rate on the related security. For its role in administering the securities and servicing the Ginnie Mae I mortgage pools, the issuer typically collects a minimum fee of 50 basis points computed monthly on the outstanding balance of securities; this fee includes a 6 basis point guarantee fee that is collected by Ginnie Mae from the issuer as payment for its guarantee of the securities.

   Ginnie Mae I MBS feature a stated 45-day delay, with payment made on the 15th of each month. Single-family level -payment pools account for over 90 percent of production.

2. **Ginnie Mae II** - In 1983, Ginnie Mae introduced the Ginnie Mae II MBS in order to permit greater flexibility in the range of mortgage notes that may be pooled. While the Ginnie Mae I MBS is based on single-issuer pools only, Ginnie Mae II permits multiple-issuer pools as well as single-issuer pools. In addition, Ginnie Mae II allows issuers to package as little as $25,000 of mortgages in certain pools, significantly less than the $1,000,000 minimum required to issue under the Ginnie Mae I program. This allows smaller issuers to be accommodated. Under the Ginnie Mae II program, any pool must consist of only one of the following mortgage types:

   - Single-family level payment mortgages (FHA, VA,RD, PIH, orRD loans)
   - Single-family graduated payment mortgages (FHA or VA)

- Single-family growing equity mortgages (FHA or VA)
- Single-family adjustable rate mortgages (FHA or VA)
- Single-family hybrid adjustable rate mortgages (FHA or VA)

For its role in administering the securities and servicing the Ginnie II mortgage pools, the issuer collects a fee of 25 to 75 basis points computed monthly on the outstanding balance of securities; this fee includes a 6 basis point guarantee fee that is collected by Ginnie Mae as payment for its guarantee of the securities.

Interest rates on loans within any Ginnie II pool originated after July 1, 2003 must be at least 25 basis points but not more than 75 basis points above the interest rate of the pool. Prior to that date, loans packaged into a pool were required to be at least 50 basis points but not more than 150 basis points above the interest rate of the pool.

There are differences between the Ginnie Mae I and II MBS from the investors' perspective as well. Because mortgages are aggregated from multiple issuers to create larger pools, the Ginnie II program often offers greater geographic diversity for investors. Additionally, the Ginnie Mae II MBS features a central paying agent that consolidates all payments on Ginnie Mae II securities. This enables investors to receive a single monthly check that includes payments on all their Ginnie Mae II investments. The Ginnie Mae II MBS has a 50-day stated payment delay with payment on the 20th of each month.

Ginnie Mae Multiclass Securities

The Ginnie Mae Multiclass Securities Program, which packages Ginnie Mae I and Ginnie Mae II MBS in order to make them more attractive to investors, consists of Ginnie Mae REMICs, Ginnie Mae Platinum securities, Callable Trusts, SMBS.

1. **Ginnie Mae REMICS** - Ginnie Mae established its Multiclass securities program in 1994 with a REMIC offering collateralized by Ginnie Mae I MBS. Designed to bring a broader range of investors into the market for mortgage loans, REMICs structured using Ginnie Mae II MBS were introduced shortly thereafter in early 1995. The Multiclass program allows the private sector to combine and restructure cash flows from Ginnie Mae MBS into securities that meet unique investor requirements related to yield, maturity and call protection. REMICs may be comprised of whole mortgage loans, MBS or other CMOs. In contrast to traditional pass-through securities (Ginnie Mae I and II), the principal and interest payments on REMICs are divided into predefined payment streams that are arranged according to interest rates, prepayment characteristics, seniority or other characteristics. This enables issuers to create securities that fit the needs of a variety of investors. For instance, there are Ginnie Mae Multifamily REMICs that are structured to offer some prepayment protection by using multi-family loans that have five-year lock-out periods during which the loan may not be pre-paid. Ultimately, REMICs can be constructed to result in securities with short, intermediate or long-term maturities.

2. **Ginnie Mae Platinum Securities** - Ginnie Mae launched its Ginnie Mae Platinum security program in 1994. It allows a holder of a number of Ginnie Mae certificates with like coupons and original terms to maturity to deposit them into a Ginnie Mae Platinum Trust, and receive one

large-denominated Ginnie Mae Platinum Certificate in exchange for the numerous smaller certificates. The Platinum Certificate can be used in structured finance transactions, as collateral for repurchase agreements, as well as for general trading. The Ginnie Mae Platinum security streamlines the administration and accounting process for investors who own pools with small remaining principal balances.

3. **Callable Trusts** - Callable Trusts were created to allow investors to better manage prepayment risk and call redemptions at negotiated prices. Call features are attractive to issuers because they allow them to refinance their indebtedness in the event that interest rates fluctuate. Similarly, callable trusts offer higher initial yields than comparable non-callable bonds. Each trust consists of a pair of classes, designated A and B. Class A may be redeemed at the option of the holders of Class B. Callable Trusts may be used to back a REMIC to further customize securities as demanded by investors.

4. **SMBS** - In July 2004, Ginnie Mae introduced its first stripped security to the marketplace. The Stripped Mortgage-Backed Securities Trust program represents a mortgage pool's Interest-Only and Principal-Only cash flow components. The SMBS broadens the Ginnie Mae investor base, thereby increasing the liquidity and market demand for Ginnie Mae MBS; this ultimately leads to lower yields and borrowing costs for low and moderate income homebuyers.

B. Fannie Mae

Fannie Mae (formally the Federal National Mortgage Association) was established by Congress in 1938 as a United States government agency for the purpose of increasing the availability and affordability of homeownership for low-, moderate-, and middle-income Americans. Having evolved over time to become a private, shareholder-owned company, Fannie Mae voluntarily registered its common stock with the Securities and Exchange Commission ("SEC") under Section 12(g) of the Securities Exchange Act of 1934, which has, since March 31, 2003, required the company to file its periodic financial disclosures with the SEC. Fannie Mae continues to operate under a federal charter, regulated primarily by the Federal Housing Finance Agency ("FHFA"), although the U.S. government does not guarantee, directly or indirectly, Fannie Mae's debt securities or other obligations.

Fannie Mae also purchases mortgage-related securities from primary market institutions such as commercial banks, savings and loan associations, mortgage companies, securities dealers, and other investors. Fannie Mae purchases loans directly from approved lenders to be held as investment for its own portfolio; or the purchased loans may be pooled and sold in the market by Fannie Mae.

To meet its consistent need for large-scale funding, Fannie Mae regularly issues debt securities in a wide range of maturities in the domestic and global capital markets. Large liquid issues of non-callable and callable debt are offered as often as monthly to fill the financing needs of many smaller deals. The debt issued under its "Benchmark Securities Program", however, is unsecured, separate and distinct from Fannie Mae's MBS programs, which are the focus of this section.

Fannie Mae Single Class Securities

1. **UMBS** – Fannie Mae will begin issuing UMBS in June 2019. This type of mortgage passthrough security is identical in structure to UMBS issued by Freddie Mac. Pools issued prior to June 1, 2019 may include fixed-rate mortgages that bear a range of coupons between 25 and 250 basis points above the pass-through rate of the securities. For pools issued after June 1, 2019, Fannie Mae will limit the allowable interest rate on a loan to 112.5 basis points above the pass-through rate of the pool. Fannie Mae UMBS have a payment delay of 55 days and are payable on the 25th of each month.

2. **Fannie Supers** - Fannie Mae also creates single-class MBS, "Fannie Supers or "Supers," which are pass-through certificates backed by pooled multiple single-class MBS and/or UMBS with similar characteristics and/or other pooled Supers with similar characteristics. Supers are issued in transactions in which a lender or investment banker exchanges pooled single-class MBS and/ or other pooled Super for newly issued Super certificates. Note that Fannie Mae Supers may contain UMBS issued and guaranteed by Freddie Mac.

3. **Fannie MBS** - Single-class Mortgage-Backed Securities typically are backed by groups of new or seasoned mortgages, where the mortgage terms and conditions are similar enough that they may be combined and assigned a unique pool number. Fannie Mae MBS have a payment delay of 55 days and are payable on the 25th of each month.

   With the launch of UMBS in June 2019, Fannie Mae MBS issued after that date will be collateralized by ARMS or non-TBA eligible fixed-rate loans. TBA eligible loans will be pooled in Fannie UMBS.

4. **Fannie Majors** - Another form of single-class MBS, referred to as "Fannie Majors", allows multiple lenders to pool mortgages and receive, in return, mortgage-backed securities representing a proportionate share of a larger pool. This type of single-class MBS security permits smaller lenders to securitize current production loans into potentially larger and more geographically diverse pools. Each lender can deliver as little as one loan into a Fannie Majors pool. 15-year and 30-year fixed-rate mortgages, as well as some adjustable-rate mortgages, are eligible under this structure, but mortgages that are pooled together must be of the same type.

5. **Fannie Megas** - Fannie Mae also creates single-class MBS "Fannie Megas" or "Megas" which are pass-through certificates backed by pooled multiple single-class MBS with similar characteristics and/or other pooled Megas with similar characteristics. Megas are issued in transactions in which a lender or investment banker exchanges pooled single-class MBS and/ or other pooled Megas for newly issued Mega certificates.

   After the launch of UMBS in June 2019, Fannie Megas will be used to resecuritize non-TBA eligible Fannie Mae securities.

6. **ARM MBS** - Fannie Mae's adjustable rate (ARM) MBS are securities backed by a pool of adjustable-rate mortgages that share the same index and other similar contractual features. The interest rate for ARMs is periodically adjusted on the basis of the movement of a specified index (e.g., LIBOR, CMT).

Fannie Mae Multi-class Securities

Fannie Mae issues multi-class MBS, such as REMICs, certain grantor trust certificates, and SMBS.

1. **REMICs** - Fannie Mae issues REMICs (for which it receives transactions fees) backed by single-class Fannie Mae MBS, UMBS, Supers, Megas, SMBS, classes from other REMICs or whole loans. These REMIC securities are generally guaranteed by Fannie Mae as to timely payment of principal and interest. Fannie Mae REMICs may include collateral groups that include Freddie Mac-issued UMBS or Supers. Fannie Mae REMICs direct the cash flows from the underlying mortgage loans or mortgage-related securities, and are issued as securities having several classes, also called "tranches", which among other things may have different coupon rates, average lives, repayment sensitivities and final maturities. In addition, the timing of payments may vary among the classes of REMIC certificates. For example, a REMIC class may receive payments for only a limited period during the life of the trust.
2. **SMBS** - Fannie Mae also issues guaranteed stripped mortgage-backed securities that are backed by Fannie Mae MBS, Supers, Megas, or even REMIC securities. SMBS are created by "stripping" or separating the principal and interest payments from the underlying pool of mortgages or other securities into classes of interest only and principal only securities, with each receiving a different proportion of the principal and interest payments.
3. **Structured Grantor Trusts** - Fannie Mae also issues guaranteed grantor trust securities that are generally multi-class and backed by other mortgage-related securities.

C. Freddie Mac

Freddie Mac (Federal Home Loan Mortgage Corporation) was chartered by Congress in 1970 with a public mission to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac continues to operate under its charter in conservatorship that began in September 2008, under the direction of the Federal Housing Finance Agency, as its conservator. Freddie Mac is not a government agency.

Freddie Mac purchases conventional, investment quality loans from mortgage lenders on single-family residences and multi-family structures. The company packages these mortgage loans into mortgage-related securities and guarantees payment of principal and interest on them. Increasingly, Freddie Mac is doing so through securities that are shifting a greater share of the credit risk to the private capital markets.

Freddie Mac issues various debt securities in the domestic and global markets in order to meet its funding requirements. Offered in both domestic and global markets, interest income to investors in Freddie Mac securities is fully taxable. The U.S. government does not guarantee Freddie

Mac's securities – debt or mortgage-related. Freddie Mac debt represents an unsecured obligation of the corporation, though, and must be viewed separately from its MBS, which are the focus of this section.

Freddie Mac Single Class Securities

Single-family mortgage loans are securitized by Freddie Mac in the forms of Mortgage Participation Certificates ("PC"), MBS, UMBS, and Supers which are then guaranteed by Freddie Mac as to interest and principal. Freddie Mac's guarantee is not an obligation of the U.S. government.

1. **UMBS** – Freddie Mac will begin issuing UMBS in June 2019. This type of mortgage passthrough security is identical in structure to UMBS issued by Fannie Mae. The payment delay for this security is 55 days, and it is payable on the 25th of each month. Existing TBA-eligible Gold PCs may be exchanged for UMBS through a Freddie Mac security exchange program. Effective for pools issued on and after June 3, 2019, Freddie Mac will limit the allowable note rate on underlying fixed-rate Mortgages in each UMBS and MBS Pool to no less than 25 basis points, but no greater than 112.5 basis points above the security Coupon.

2. **Freddie Mac Supers** - Supers are backed by pooled multiple single-class MBS and/or UMBS with similar characteristics and/or other pooled Supers with similar characteristics. Supers are issued in transactions in which a lender or investment banker exchanges pooled single-class MBS and/ or other pooled Supers for newly issued Super certificates. Note that Freddie Mac Supers may contain UMBS issued and guaranteed by Fannie Mae.

3. **Freddie Mac MBS** – Non-TBA eligible loans are securitized in Freddie Mac MBS. Freddie Mac will begin issuing non-TBA eligible MBS – with a 55-day payment delay – in June 2019. Existing non-TBA eligible 45-day Gold PCs may be exchanged for Freddie Mac MBS through a Freddie Mac security exchange program. Freddie Mac MBS are resecuritized in Giant MBS.

4. **Gold PCs** - Gold PCs, consisting of fixed rate, level payment fully amortizing mortgages. These PCs have a payment delay of 45 days meaning that Freddie Mac's distribution of principal and interest on or about the 15th of each month represents the funds due from borrowers on the first of the month prior. Issuance of Gold PCs will cease with the launch of UMBS on June 3, 2019.

5. **ARM PCs** - ARM PCs have coupons that are adjusted periodically, are paid on or about the 15th of the month, and are subject to a payment delay of 75 days. Freddie Mac ARM PCs are typically "WAC" ARM PCs, the coupon adjusts monthly to reflect changes in the weighted average of the mortgage coupons of the underlying mortgages. The PC adjustments are subject to the same adjustment caps, floors and ceilings as the underlying mortgages.

6. **Giant PCs** - Giant PCs are also issued by Freddie Mac to aggregate many smaller single-family PCs into larger pools, thereby creating a more liquid security. While Gold PCs will not be issued after June 3, 2019, Freddie Mac expects to continue issuing Giant PCs to resecuritize existing Gold PC holdings.

7. **Hybrid ARM PCs** - Hybrid ARM loans, which have an initial period in which their interest rate is fixed, may be pooled under the “WAC” ARM PC programs. Hybrid ARM PCs may also be pooled to create Hybrid ARM Giant PCs if they have the same initial period, initial cap up, initial cap down, periodic cap, index, adjustment period, lookback period, etc.

Freddie Mac Multiclass Securities

Freddie Mac issues a number of types of securities that divide the cash flows of underlying mortgages, PCs or other securities into classes with a variety of features to appeal to a range of investors’ requirements. Features include variations relating to:

- Expected maturities or weighted average lives;
- Whether holders are entitled to receive principal and interest, principal only (“PO”), or interest only (“IO”); and
- Whether the coupon (if any) is fixed or variable; and if variable, the index used to determine the new rate.

Freddie Mac’s multiclass mortgage-related securities include REMIC Certificates, Modified and Combinable REMIC Certificates, Stripped Giant Certificates, and Stripped Interest Certificates.

1. **REMIC Certificates** - Freddie Mac Real Estate Mortgage Investment Conduits (REMICs) are issued in series, with each series typically consisting of two or more classes customized to offer a variety of features, weighted average lives and prepayment rate sensitivities sought by investors. REMICs are backed by various types of Freddie Mac-issued mortgage security collateral. Freddie Mac has also introduced several innovations to the REMIC market, including Modifiable and Combinable REMICs (“MACRs”), Callable REMICs, and REMIC classes with guaranteed maturity dates. As of June 2019, Freddie Mac REMICs may include collateral groups that include Fannie Mae-issued UMBS or Supers.

2. **Modified and Combinable REMIC Certificates (“MACRs”)** are an optional feature of many REMIC series. MACRs allow investors in specified REMIC classes to exchange all or part of those classes for proportionate interests in different securities backed by the same cash flows from the original REMIC structure. MACRs have the same tranche types as standard REMICs.

3. **Stripped Giants Certificates** - Stripped Giants are resecuritized single-class securities (typically Freddie Mac Giant PCs or Gold Giant PCs) that are issued in classes, each of which is entitled to receive interest-only (IO), principal-only (PO), floating interest rate, inverse floating interest rate, or specified portions of principal and interest received on an underlying pool of securities. Stripped Giant classes are also typically Modifiable and Combinable Securities (“MACS”) that permit various exchange combinations.

4. **Stripped Interest Certificates** - Stripped Interest Certificates (also known as Excess Servicing IO securities) represent an interest in an interest-only strip associated with the

servicing of a pool of specifically identified loans. These securities amortize with the remaining loan balance and therefore have increased exposure to changes in actual loan prepayment rates.

RIDER 3-8A

GSE Conservatorships

Fannie Mae and Freddie Mac have been operating separately under the conservatorship of FHFA, their federal regulator, since September 2008. As conservator, FHFA succeeded to all rights, titles, powers and privileges of each GSE, and of any shareholder, officer, or director of the GSE with respect to the company and its assets. The conservatorships of the GSEs have no specificed termination date. The GSEs have continued to issue debt securities, single class MBS, and multi-class MBS during the conservatorship, and although the issuing GSE is under the conservatorship of a federal agency, such securities are not guaranteed by the United States and do not constitute a debt or obligation of the United States or any agency or instrumentality thereof other than the issuing GSE.