



# Basel III Endgame Proposal

## Responses to Banking Agencies Inquiries

July 2024

# Follow-up Inquiries

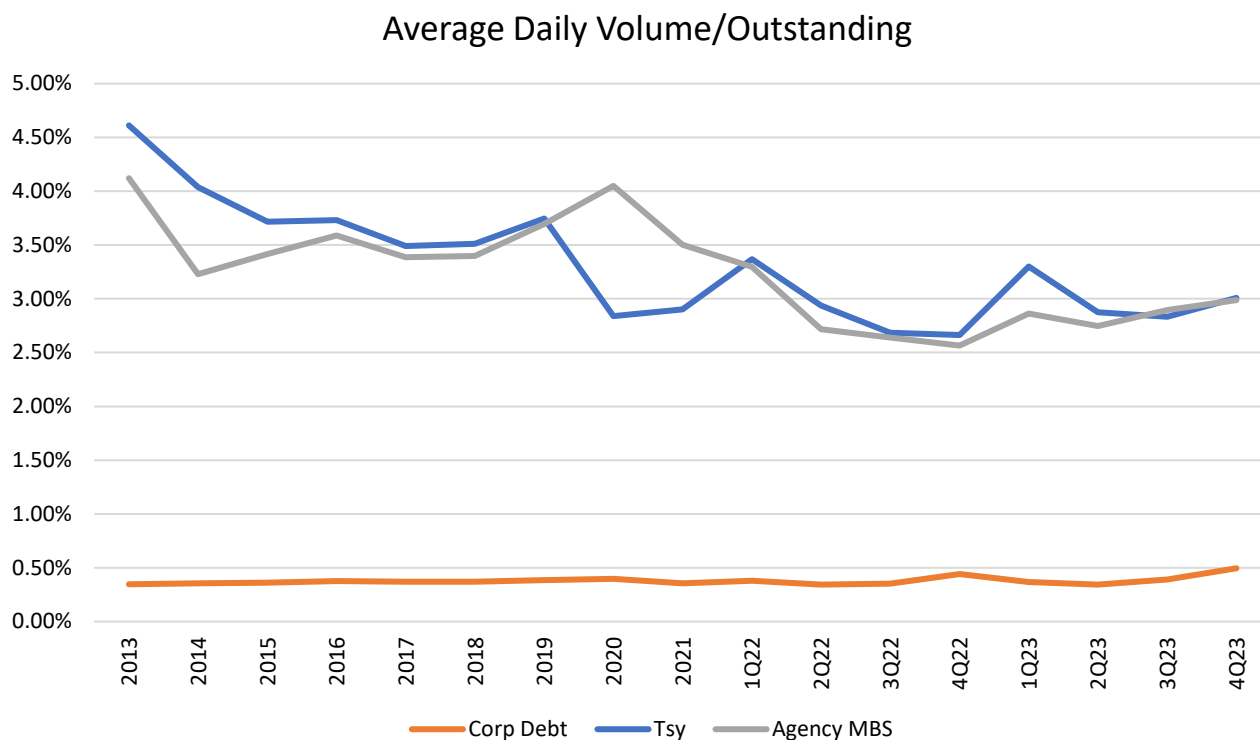
- On May 7, 2024, Fannie Mae met with staff of the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System (collectively, the “Banking Agencies”) and the Federal Housing Finance Agency concerning the comment letter submitted by Fannie Mae on the Basel III Endgame proposal, dated January 12, 2024.
- The Banking Agencies made the following inquiries:
  1. Compare the liquidity pricing of Fannie Mae and Freddie Mac (collectively, the “Enterprises”) mortgage-backed securities and debt to corporate debt.
  2. What are Fannie Mae’s obligations to Connecticut Avenue Securities® (“CAS”) investors if there is a loss on a loan with mortgage insurance in the reference pool of a CAS securitization, and the mortgage insurer becomes insolvent and fails to pay Fannie Mae the claimable insurance amount?
  3. Compare credit losses on CAS securitizations to credit losses on private label securitizations not issued by the Enterprises or Ginnie Mae and comprised mostly of non-QM loans (“Non-QM PLS”).



# Inquiry 1—Agency MBS

**Inquiry:** Compare the liquidity pricing of Fannie Mae and Freddie Mac mortgage-backed securities and debt to corporate debt.

Agency MBS activity, measured by average daily transaction volume normalized for amount outstanding, is on par with the Treasury universe. Both are significantly higher than Corporate Debt.



Sources: SIFMA, eMBS

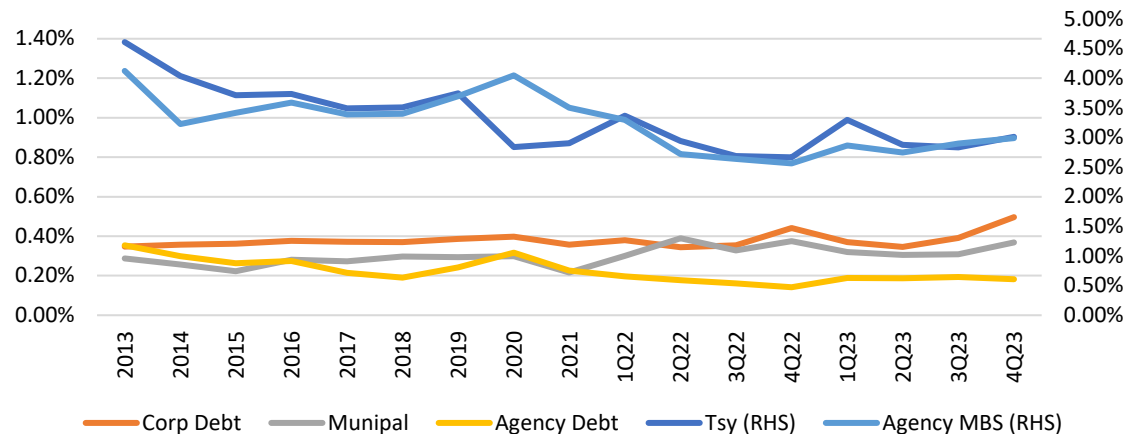


# Inquiry 1—Unsecured Agency Debt

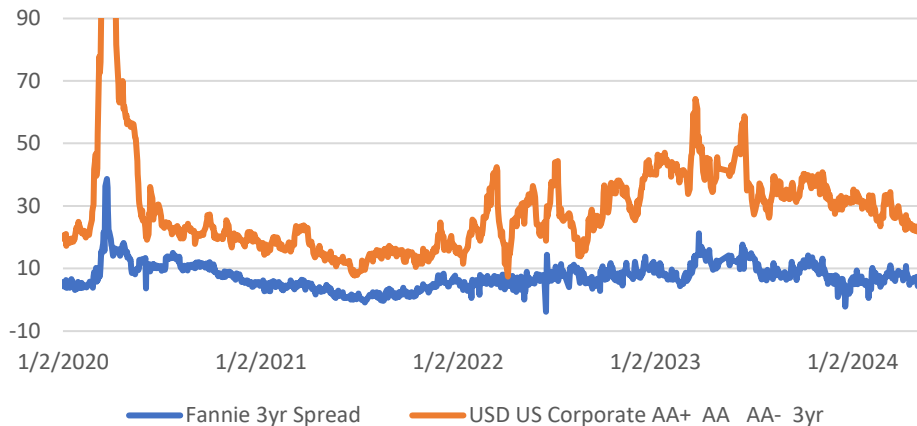
**Inquiry:** Compare the liquidity pricing of Fannie Mae and Freddie Mac mortgage-backed securities and debt to corporate debt.

- Agency debt trades less frequently than other major fixed income asset classes. Qualitatively, lack of supply and buy/hold nature of some investors contribute to lower activity (as measured by chart 1).
- However, status as a Government Sponsored Enterprise creates demand for Agency product at a slight spread to matched-maturity US Treasuries when compared to similarly rated corporate debt (chart 2, 3).

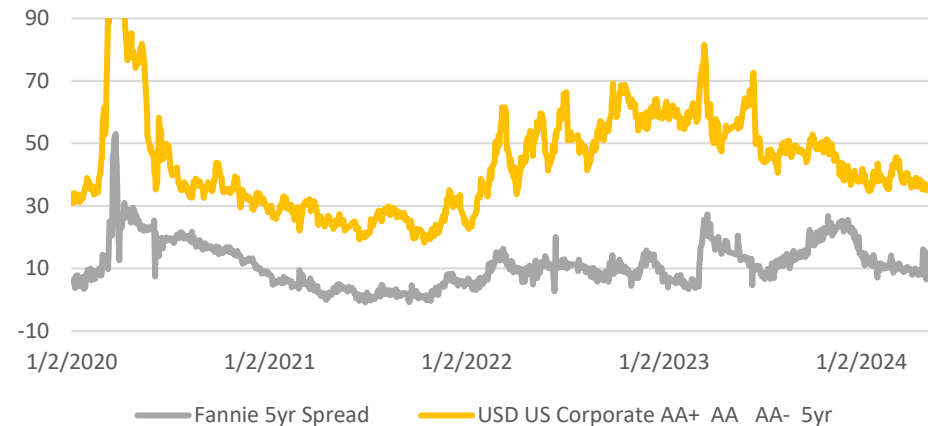
Average Daily Volume/Outstanding (Chart 1)



3yr Spreads to Matched Maturity Treasury (bps) (Chart 2)



5yr Spreads to Matched Maturity Treasury (bps) (Chart 3)



Sources: SIFMA, eMBS, Reuters, Bloomberg



# Inquiry 2—Payments to CRT Investors

Fannie Mae's comment letter on the Basel III Endgame Proposal includes the following excerpt:

*CAS securitization transfers only the credit risk for residential real estate loans in the reference pool. While Fannie Mae transfers credit risk to CAS investors, certain other risks associated with the residential mortgage loans in the reference pool are not transferred. For example, Fannie Mae retains the risk that lenders may have breached representations and warranties on the underlying loans. In addition, Fannie Mae does not pass on losses resulting from the inability of mortgage insurers to meet their payment obligations.*

- **Inquiry**: What are Fannie Mae's obligations to Connecticut Avenue Securities® ("CAS") investors if there is a loss on a loan with mortgage insurance in the reference pool of a CAS securitization and the mortgage insurer becomes insolvent and fails to pay Fannie Mae the claimable insurance amount?
- **Answer**: Under the CAS transaction documents, if a mortgage insurance policy is ineffective because of the insolvency of the mortgage insurance company, the full amount that would have been claimable from the mortgage insurer is credited to the CAS transaction as if it had been paid, thus preventing CAS investors from incurring losses due to mortgage insurer insolvency. Accordingly, the risk of such insolvency is borne exclusively by Fannie Mae.



# Inquiry 3—Compare CAS to Non-QM PLS

**Inquiry:** Compare credit losses on CAS securitizations to credit losses on private label securitizations not issued by the Enterprises or Ginnie Mae and comprised mostly of non-QM loans.

- Losses on CAS and Non-QM PLS securitizations issued since 2015 have been extremely limited and have been applicable only to the most subordinated tranches. Following the 2008 financial crisis, home prices have experienced sustained increases and losses on mortgage loans have been negligible.
- Nevertheless, differences in credit risk between CAS and Non-QM PLS can be analyzed by comparing cumulative default rates<sup>1</sup> of the loans underlying these securitizations.
  - Loans underlying Non-QM PLS have experienced higher cumulative default rates than loans underlying CAS securitizations issued since 2015, a period of positive home price appreciation and economic growth.
  - In fact, cumulative defaults for non-QM loans are multiple times higher than defaults for loans in Fannie Mae CAS securitizations.
- As discussed in Fannie Mae's comment letter, other features of CAS securitizations, as well as credit risk transfer securitizations issued by Freddie Mac, improve outcomes for investors, which are not present in Non-QM PLS securitizations, including strong servicing standards that address loss mitigation of defaulted borrowers, protective ongoing monitoring measures of servicers, and deep granularity and geographic diversity of reference pools.

<sup>1</sup>Default history for CAS securitizations is available at <https://www.fanniemae.com/data-dynamics>. Non-QM defaults are based on the universe of loans included in Non-QM private label securitizations; data is available from third-party data and analytics providers. Certain assumptions that are required to evaluate non-QM defaults, such as identifying loans removed from securitizations due to default instead

<sup>6</sup> of prepayment, are unnecessary for CAS given the granularity of the data provided by Fannie Mae.

