**Delivery Limits Methodology**

We recognize there is significant ongoing interest in the extent to which lenders are subject to delivery limits when doing business with Fannie Mae and a desire for clarity into Fannie Mae's process for determining the amount of the limits. Below we provide information relating to these questions.

Fannie Mae focuses on providing liquidity to a wide range of housing and mortgage market participants, including large, medium, and small institutions. There have been very significant market changes that have occurred over a short period of time. In the last 12 months, many large institutions have pulled back from their role as aggregators, and as a result, Fannie Mae is seeing significant increases in the business it receives directly from medium and smaller institutions. We value the business we receive from medium and smaller institutions, both bank and non-bank customers, and view this business as very important to our mission as a liquidity provider.

This increase in business poses challenges for Fannie Mae, including increasing our counterparty risk exposure. Many of these newly approved lenders are unfamiliar to us and do not have a track record with Fannie Mae by which to gauge loan profile and performance of their future deliveries. As a matter of prudence, we need to ensure that all of our customers have the financial strength to stand behind the loans they sell to us.

Fannie Mae requires that every approved customer have the capacity to meet our eligibility requirements and fulfill its contractual obligations. We assess each customer's ability to meet its obligations in order to manage our relationships in a prudent manner. Our counterparty assessment includes a number of factors, including the customer's expected delivery profile, actual performance, and financial strength. We use a number of risk management tools to address our counterparty exposure and, where appropriate given these factors, we have imposed volume limits on deliveries we receive from a very limited number of customers, both on bank and non-bank customers.

This is not a new policy for Fannie Mae. Fannie Mae has always monitored the strength of its counterparties and, where prudent, implemented limits on deliveries, required collateral or mandated recourse in order to appropriately manage counterparty risk.

For existing customers, we have instituted delivery limits when their selling and servicing volume, and therefore our potential exposure, have increased sharply, while their counterparty strength has not kept pace. This is the triggering event. As an illustration, below are three case studies of lenders that have delivery limits based on significant growth in delivery volume and modest to no growth in net worth.

- *Lender A* – In May 2011, our monthly acquisition volume was $4.7 million. In May 2012, it was $89.7 million, which represents an approximate 2000 percent increase. During that same period, the lender's net worth decreased from $3.5 million to $3.3 million.

- *Lender B* – In May 2011, our monthly acquisition volume was $1.9 million. In May 2012, it was $133.4 million, which represents an approximate 6000 percent increase. During that same period, the lender's net worth decreased from $6.6 million to $6.4 million.

- *Lender C* – In September 2011, monthly delivery volume was approximately $20 million. A year later, it had grown to $860 million, which represents an approximate 4000 percent increase. During that same period, the lender's net worth had increased from $51.7 million to $92.1 million.

The vast majority of our lenders have not experienced this type of growth in delivery volumes, particularly relative to their financial capacity, so we have not, to date, seen the need to implement delivery limits on a broad basis. In fact, only a small percentage of the more than one thousand lenders who have delivered loans to Fannie Mae in 2012 are subject to delivery limits. When we do establish a delivery limit for an existing customer, we engage the customer in a discussion about their business needs and have worked with the customer so that they understand the delivery limit and how it was derived. We also engage these institutions on actions that they can take to obtain a higher delivery limit or to avoid a limit altogether.

Additionally, for certain new customers where we have not yet evaluated the institution or have historical performance to review, we may institute a delivery limit until such time that we can make an informed determination of the institution's financial strength and performance. It is our expectation that most new customers will migrate to a higher delivery limit or no delivery limit once we have completed a full counterparty review and evaluated their performance.

Fannie Mae takes a number of factors into account when determining whether to institute a delivery limit for a lender and the amount of the limit. These are discussed below.

## Counterparty Assessments

The comprehensive nature of our counterparty analysis and the unique risk profile of counterparties make providing a universal methodology of our counterparty analysis to the market very challenging. Assessing our counterparties and exposure is a complex task and from time to time, we adjust and modify the tools that we use.

Fannie Mae assesses the financial strength of its individual counterparties based on a number of factors. Net worth is only one factor in determining the financial strength of a lender and, delivery limits are not placed on an institution based exclusively on its net worth. We evaluate counterparties using proprietary scorecards that assess each lender's financial strength across the categories of Capital Adequacy (including net worth), Asset Quality, Earnings, Liquidity, and Sensitivity to Market Risk. We have specific scorecards for different counterparty types and we recalibrate the scorecards as needed.

In addition, our credit analysts may adjust these assessments based upon a number of qualitative factors including strength of management, operational performance and other risks such as regulatory action or pending litigation.

If a delivery limit is imposed on any particular counterparty as a result of our finding that its delivery volumes increased above their financial capacity, the size of the limit is based on the assessment of the particular lender, with stronger counterparties having higher limits than weaker counterparties.

For independent mortgage banks, it is crucially important that institutions submit their financial and other required information timely and accurately through the Mortgage Bankers Financial Reporting Form process. We regularly see instances where our assessment of a counterparty's financial strength has been negatively impacted due to an inaccurate data submission by the lender. For depository institutions, we review financial statements available through SNL Financial.

## Delivery Profile/Performance

In determining whether to impose a delivery limit (and the amount of such a limit), we also take into account the type of business the counterparty does with Fannie Mae and our estimate of the counterparty's risk exposure associated with that business mix. For example, as it relates to independent mortgage banks, we evaluate the following types of risk:

- Repurchase Risk and recourse liability on single-family loans sold and/or serviced by the counterparty
- Settlement Risk on Early Funding Products
- Settlement Risk on MBS hedging activities

The amount of a delivery limit is a function of both existing risk exposures and exposures estimated to arise due to future activity. For example, all other factors being equal, the delivery limit will be lower for a counterparty with outstanding repurchase requests than a counterparty without outstanding repurchase requests. This is because outstanding and unpaid repurchase requests are an existing exposure. That being said, outstanding repurchase requests that have not been through an appeals process are not alone a trigger for a delivery limit.

We review the existing and future risk exposure on a regular basis and make adjustments based upon the most recent data available. For example, a delivery limit on a lender with whom we have had the opportunity to review underwriting processes and underwriting quality would typically be higher than the limit for a new counterparty with whom we have no experience.

## Conclusion

As indicated above, we believe that prudent counterparty risk management allows us to fulfill our mission of providing liquidity to all market segments while ensuring we do not expose ourselves to unreasonable risk. As we refine our methodologies for assessing counterparties and our exposures, we intend to continue to work with industry participants to inform them about our counterparty assessment practices.