FAIRHOLME

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FOR IMMEDIATE RELEASE

FAIRHOLME CAPITAL MANAGEMENT

November 13, 2013

FAIRHOLME CAPITAL MANAGEMENT ANNOUNCES PROPOSAL FOR PURCHASE OF INSURANCE BUSINESSES FROM FANNIE MAE AND FREDDIE MAC

Private Investors Would Commit Approximately $52 billion of Capital as First Members of a Competitive Industry

Insurance Business Plan Requires No Government Support

Proposal Allows for Orderly Liquidation of Historical Assets of Fannie Mae and Freddie Mac

MIAMI, FL – Fairholme Capital Management ("Fairholme") today announced that it has submitted a proposal to relevant federal government officials for the purchase by private investors of the mortgage-backed securities insurance businesses of the Federal National Mortgage Association ("Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie").

The proposal answers the bipartisan call for significantly more private capital in the mortgage market, and is intended to facilitate legislative reform of any political stripe. In particular, the proposal:

- Brings approximately $52 billion of private capital to support credit risk on more than $1 trillion of new mortgages without market disruption;
- Demonstrates reform is possible, even without a Federal guarantee, by having investors commit to bear risk now;
- Allows for the liquidation of Fannie and Freddie, ending their Federal charters and special status, without losing the value of operating assets critical to the mortgage market;
- Reduces systemic risk by separating new underwriting from the legacy investment books of Fannie and Freddie;
- Preserves Government options for affordable housing initiatives and counter-cyclical liquidity – but using tools other than Fannie and Freddie; and
- Ends the unsustainable Federal conservatorship.

The centerpiece of the proposal is the establishment of two new, State-regulated private insurance companies to purchase, recapitalize, and operate the insurance businesses of Fannie and Freddie. The new companies would have no Federal charter or special status, and the names "Fannie" and "Freddie" would be retired and never used again. The legacy book of investments and insurance in existence on a specified cut-off date would be wound down over time, with the proceeds used to fully repay the U.S. Treasury for its investments in the companies as well as provide a fair profit on that investment. The new companies and their private owners would earn profits only from the new business written by the State-chartered insurers after the cut-off date.

The companies would be capitalized with approximately $34.6 billion in exchange for preferred stock in the entities, and at least $17.3 billion of new capital raised from preferred stockholders in a rights offering. The two new companies would operate a conservative business plan and would be regulated by State insurance authorities as well as applicable Federal agencies. All capital received in the conversion of preferred stock of Fannie and Freddie, along with attributable profits, would be retained by the new companies as locked-in capital for a minimum of five years to support writing new insurance. No dividends or distributions would be paid using that capital during this initial five year period.

The new companies would require no subsidy or support from the United States Government to begin profitable business immediately. However, the business model of the new companies would be compatible with a Federal reinsurance program or other Federal intervention in the market. The new companies could be cornerstone participants in a reinsurance program along the lines contemplated by proposals under discussion in the Senate, if that is the result of the legislative process now underway. Alternatively, the new companies could serve as cornerstone participants in a new, competitive market with less Federal involvement, such as proposals being contemplated in the House, putting their private capital at risk to achieve the best possible pricing and availability for mortgage borrowers under those parameters.

"We know that many people in and outside of government are working on the redesign of the mortgage market, and trying hard to get it right for America," said Bruce R. Berkowitz, Managing Member and Chief Investment Officer of Fairholme Capital Management. "This proposal answers the broad bipartisan call for private capital in a way that can advance reform from concept to a viable, sustainable solution. Fannie and Freddie's business model was not consistent with insurance industry best practices. However, in this country we fix valuable businesses by restructuring; we do not simply throw them away. Fairholme is prepared to do its part to help effectuate this restructuring and to be long-term owners of the insurance businesses, without the need for any Federal assistance or special Federal status."

The proposal contemplates a number of conditions, including the support of the Federal Housing Finance Agency, the U.S. Treasury, and other investors in Fannie and Freddie. Fairholme has conferred with many investors who support this proposal. A copy of the proposal will be made available online at www.fairholmefunds.com.

Contact: George Sard or Paul Scarpetta, Sard Verbinnen & Co. 212.687.8080

ANSWERING THE CALL FOR PRIVATE CAPITAL

A PROPOSAL BY INVESTORS IN

FANNIE MAE AND FREDDIE MAC

TO PURCHASE AND OPERATE THEIR INSURANCE BUSINESSES

FAIRHOLME
Ignore the Crowd

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I. Bipartisan Call for Private Capital

THE CALL FOR PRIVATE CAPITAL

"[P]rivate capital should take a bigger role in the mortgage market. I know that must sound confusing to the folks who call me a raging socialist every day."

— President Barack Obama

"I think we can all agree that the private market should play a more substantial role in our housing finance system than it is currently. That said, we must be certain that any new system we design will actually attract private capital."

— Senator Tim Johnson, Chairman of the U.S. Senate Committee on Banking, Housing, and Urban Affairs

"Clearly, we need to move toward a more limited role for the federal government and bring private capital back into the housing market."

— Senator Mike Crapo, Ranking Member of the U.S. Senate Committee on Banking, Housing, and Urban Affairs

"Surely, we can find some way to come together on…removing the barriers to entry of private capital coming into this market."

— Jeb Hensarling, Chairman of the House Financial Services Committee

"Conditions must be created so that private capital will return in a substantial manner to the housing market."

— Timothy Geithner, Former Secretary of the U.S. Department of the Treasury

THE CALL FOR PRIVATE CAPITAL

"As we have made clear, this administration believes that private capital needs to come back — and that government's footprint in the housing market needs to be much smaller."

— Shaun Donovan, Secretary of the U.S. Department of Housing and Urban Affairs

"[W]e need to scale back the role of government in the mortgage market, and promote the return of private capital to a healthier, more robust mortgage market."

— U.S. Department of Treasury, *"Reforming America's Housing Finance Market"*

"Private capital should stand in front of the government to withstand market downturns."

— Timothy Mayopoulos, President and Chief Executive Officer of Fannie Mae

"[I]f we want a healthy housing finance system for the future, it's clear we must attract more private capital."

— Charles E. Haldeman, Former Chief Executive Officer of Freddie Mac

"I perceive a consensus among policymakers that we need to get private capital back into the market."

— Edward Demarco, Acting Director of the Federal Housing Finance Agency

This Proposal Accomplishes Important Policy Objectives

- ✓ Brings approximately $52 billion of private capital to support credit risk on $1+ trillion of new mortgages without market disruption
- ✓ Demonstrates reform is possible, even without Federal guarantee, by having investors commit to bear risk now
- ✓ Allows Fannie and Freddie to liquidate without losing their value to the mortgage market
- ✓ Reduces systemic risk by separating new underwriting from the legacy investment books of Fannie and Freddie
- ✓ Preserves Government options for affordable housing initiatives and counter-cyclical liquidity — but using tools other than Fannie and Freddie
- ✓ Ends the unsustainable Federal conservatorship

II. Proposal

Proposal

Private investors purchase and operate the insurance businesses of Fannie Mae and Freddie Mac, immediately, with $52 billion of private capital and a business plan that is sustainable with or without a Federal reinsurance program

EIGHT STEPS

1. **Charter** State-regulated insurance companies
2. **Purchase** operating assets necessary to write MBS bond insurance
3. **Capitalize** insurers with approximately $52 billion, including $34.6 billion of restricted capital from conversion of existing preferred stock and $17.3 billion in new cash raised in a rights offering
4. **Repay** Treasury promptly, with a substantial profit
5. **Catalyze** reform, with or without legislation
6. **Enhance** stability and affordability during transition
7. **Validate** process
8. **Run-Off** old Fannie Mae and Freddie Mac, after which they cease to exist

STEP ONE: CHARTER STATE INSURERS

✓ **STATE-REGULATED INSURANCE COMPANIES ("NEWCOS")**

- Long history of oversight, stress-testing, and standard-setting
- No conflicting affordable housing mandate
- Subject to State insurance resolution regime; not too big to fail

✓ **NEWCOS WRITE BOND INSURANCE FOR MORTGAGE-BACKED SECURITIES**

- Traditional bond insurance structure promotes stability (no forced sales of non-performing mortgages)
- Prime, with a limited amount of income-verified subprime

✓ **PRIVATE SECTOR OWNERSHIP**

- Owned by holders of Fannie and Freddie preferred stock
- Private management and disciplined underwriting decisions
- Immediate new investment in technology, people, and systems
- Managed to target very high rating; capitalized and periodically stress-tested to withstand greater market downturn than 2008

Step One:
Charter State Insurers

(*continued*)

- ✓ **No Federal support**
  - No Federal charter
  - No entity-level guarantees
  - No political appointees
  - No tax exemptions
- ✓ **New names — "Fannie" and "Freddie" gone forever**
- ✓ **Robustly competitive marketplace**
  - NewCos compete with each other and new entrants
  - Common Securitization Platform opens front-end securitization infrastructure to all industry participants on fair terms
- ✓ **NewCos do not compete with U.S. Government**
  - U.S. Government programs left in place (FHA, FHLB, Ginnie Mae)

Step Two: Purchase Operating Assets

- ✓ **NewCos purchase mortgage insurance operations out of conservatorship**
  - Human capital
  - Intellectual property, and infrastructure
  - Other operating assets
- ✓ **NewCos start business from zero**
  - Underwrite new business and bear 100% of risk beginning on cut-off date (e.g., June 30, 2014)
  - Acquire no interest in guarantees written prior to cut-off date
  - Acquire no interest in retained investment portfolio
- ✓ **Existing Fannie and Freddie legal entities are left behind for the benefit of the U.S. Government and other stakeholders ("Run-Off Companies")**
- ✓ **Run-Off Companies retain Federal charter for limited purposes of winding down historical investments and guarantees**

Step Three:
Capitalize Insurers

- ✓ **Approximately $52 billion of capital raised from Fannie and Freddie preferred stockholders**
  - ~$34.6 billion of preferred stock exchanged for common equity of NewCos
  - Corresponding assets transferred to NewCo as start-up capital
  - ~$17.3 billion of new cash equity raised from preferred stockholders in a rights offering
  - Rights are transferable and can be sold by community banks and other small stockholders who cannot or do not wish to invest

- ✓ **Converted capital is restricted for a minimum of five years**
  - Used to write new business and ensure that private capital remains in place
  - No dividends or distributions to owners for five years, including from attributable profits

- ✓ **Very strong capital ratios result from both converting existing capital and raising new cash**
  - Target very high rating
  - Periodic stress tests to withstand greater market downturn than 2008

- ✓ **NewCos not too big to fail**
  - NewCos sized to leave room for other competitors
  - NewCos are significant market participants, but do not dominate the industry

STEP FOUR:
REPAY TREASURY

- ✓ **RUN-OFF COMPANIES MONETIZE EXISTING INVESTMENTS AND INCOME-PRODUCING GUARANTEES, INCLUDING GUARANTEES WRITTEN UNTIL CUT-OFF DATE**

- ✓ **WIND DOWN IS RELIABLY PROFITABLE**
  - Repays in 2014 all amounts invested by U.S. Treasury
  - Provide a fair profit to Treasury on its investment and through additional distributions shared 79.9% with Treasury and 20.1% with other common stockholders
  - Respects order of priorities under applicable law
  - Consistent with legislative proposals
  - Financial analysis to be independently reviewed and verified prior to closing

- ✓ **NEWCOS AVAILABLE TO ASSIST RUN-OFF COMPANIES AS NEEDED**
  - Can offer asset management services at lower cost than third-party asset manager, preserving employment of existing staff and utilizing expertise
  - Can provide stalking horse bids in competitive auctions to repackage and insure seasoned MBS on books of Fannie and Freddie, significantly accelerating their wind down and de-risking the Treasury's stake

Step Five:
Catalyze Reform

- ✓ **NewCos can start bearing risk of loss immediately without legislation**
  - FHFA has authority to sell relevant assets to the NewCos pursuant to 12 U.S.C. § 4617(b)(2)(G)
  - NewCos business model does not require any specific legislation
- ✓ **Putting private capital to work will catalyze reform**
  - Provides test case for viability of new market structure
  - Brings private discipline to development of origination, underwriting, and servicing standards
  - Funds investment in technology and infrastructure
  - Speeds implementation of the Common Securitization Platform
- ✓ **Success of NewCos can be ensured by very strong initial capitalization**
  - Highest capital ratios in the marketplace, together with meaningful restrictions on dividends and distributions
  - As NewCos demonstrate success, others will follow
- ✓ **Fully consistent with reform agenda**
  - Creates many options for Government to intervene in time of crisis or for macroeconomic policy objectives
  - Preserves role for Federal issuers and guarantors in specific areas (affordable housing, veterans, multi-family)

STEP FIVE:
CATALYZE REFORM

(*continued*)

✓ **ALTHOUGH NEWCOS BUSINESS PLAN DOES NOT REQUIRE LEGISLATION, IT IS CONSISTENT WITH <u>ALL</u> REFORM PROPOSALS CURRENTLY UNDER CONSIDERATION**

- If there is a broad Federal guarantee or reinsurance program, NewCos would catalyze reform by underwriting to program guidelines and putting their private capital at risk ahead of the Federal Government
- If there is a fully private market, NewCos would catalyze reform as cornerstone investor and foster competition
- In hybrid markets, NewCos would do both – the business model and value of private underwriting expertise does not change

The nature of future Federal support is a question for Congress.
NewCos only require equal access and fair treatment.

STEP SIX:
ENHANCE STABILITY

- ✓ **NEWCOS ARE IMMEDIATE PARTNERS FOR A STRONGER AND MORE STABLE MARKET**
- ✓ **EXISTING SECURITIZATION MARKET IMPROVED BY DISCIPLINE OF PRIVATE CAPITAL**
  - For covered securitizations, the NewCos determine composition of pools, promulgate standards, and actively oversee origination, purchase of private mortgage insurance, servicing, and loss mitigation
  - Securitization function becomes administrative, not discretionary; interface with Common Securitization Platform is open to all competitors
  - NewCos oversight of servicing and trustee practices can inform future regulation
- ✓ **CONGRESS RETAINS OPTIONS: NO NEED TO COMMIT NOW TO AN UNTESTED MARKET STRUCTURE**
- ✓ **LEVEL OF FEDERAL SUPPORT CAN EVOLVE OVER TIME**
- ✓ **INTERIM FEDERAL SUPPORT CAN ALSO BE PROVIDED BY THE RUN-OFF COMPANIES ON A MARKET-WIDE BASIS WITHOUT CONGRESSIONAL ACTION**
  - An interim reinsurance program offered by the Run-Off Companies can avoid market disruption and allow them to earn extra revenue
  - As with any permanent reinsurance program, NewCos would underwrite to program guidelines and bear losses pursuant to the MBS waterfall

Step Seven: Validate Process

- ✓ **Proposal establishes a benchmark for the highest and best alternative for the Conservator**

- ✓ **Process is public and open to others to make superior proposals**

- ✓ **Financial markets understand logic of converting preferred stock to common stock in the continuing businesses**
  - Experienced investors are willing to take ownership risk and sponsor emergence
  - Already invested and understand company
  - Have first claim on business after Treasury's senior preferred stock

- ✓ **No dispute about unauthorized "nationalization"**
  - U.S. Treasury maximizes return on senior preferred <u>and</u> common stock in a manner consistent with legislative authority

Step Eight: Run-Off

- ✓ **Run-Off Companies liquidate retained investment book and guarantees in an orderly manner**
- ✓ **Run-Off Companies do not write new business in competition with private insurers**
  - Limited exceptions for agreed transitional activities
- ✓ **NewCos available to assist in prompt wind-down as needed**
  - Transition services
  - Insurance of retained securities
- ✓ **U.S. Government profits**
  - Return of full senior preferred stock investment, plus fair profit
  - 79.9% of surplus equity proceeds from orderly wind-down, expected to be significant
  - Fair fees for entity-level support and any interim reinsurance
- ✓ **At end of wind-down, Federal charters terminated; Fannie and Freddie cease to exist**

III. Transaction Structure

TODAY

Fannie And Freddie

Legacy Assets

Includes the retained investment book and guarantees on mortgages.

Mortgage Guarantee Operations

Includes human capital, IP, infrastructure, and know-how of operating a mortgage insurer.

Mortgage exposure currently held by Fannie and Freddie would become the Run-off Companies.

Preferred shareholders purchase operating assets and capitalize NewCos with $52 billion.

AFTER PURCHASE

Run-off Companies

"Fannie" and "Freddie" Legacy

Includes the same retained investment book and guarantees on mortgages.

Legacy companies retain Government charter.

NewCos

NewCos #1 and #2

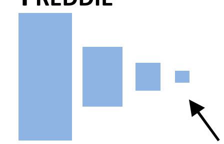
Includes human capital, IP, infrastructure, and know-how of operating a mortgage insurer.

The legacy books could be managed by the NewCos to eliminate market disruption.

$52 billion put to work writing new MBS insurance.

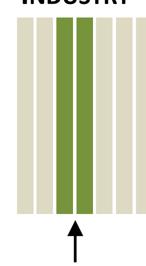
GOING FORWARD

"Old" Fannie and Freddie



Run-off Companies continue to shrink in size and influence over time.

Better Mortgage Industry



NewCos become one of many well capitalized MBS insurers.

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IV. Questions and Answers

Questions & Answers

Why now?

- ✓ Current arrangement is not sustainable
  - Fundamental conflicts of interest: U.S. Government is regulator, investor, underwriter, and advocate for housing
  - No capital formation is allowed
- ✓ Economic cycle may turn and leave U.S. taxpayer holding the bag
  - Current economic environment is supportive of private sector-led reform
- ✓ Now clear that U.S. Treasury will be fully repaid and earn a fair profit
  - By year end, Fannie and Freddie will have paid back <u>99%</u> of the total amount drawn from the U.S. Treasury
- ✓ Valuable assets of the guarantee businesses are deteriorating
  - Lack of investment in technology and systems
  - Public pronouncements to "kill" Fannie and Freddie leading to flight of human and intellectual capital
- ✓ Bipartisan interest in legislative reform based on attracting private capital

QUESTIONS & ANSWERS

(*continued*)

WHY PURCHASE THE EXISTING INSURANCE BUSINESSES?

- ✓ Operating assets are valuable with new investment
  - Talented staff
  - Expertise
  - Relationships
  - Goodwill
  - Physical assets and infrastructure
- ✓ Private shareholders commit to substantial investment in technology and systems immediately
  - Capital investment and asset management would be led by private owners in a disciplined fashion
- ✓ Recreating these assets would take enormous amounts of both time and money
- ✓ Private investors see value
  - Day-to-day staff of insurance business is capable and experienced, especially in underwriting and loss mitigation
  - NewCos would have the ability to lead development and use of Common Securitization Platform and other open-market initiatives

QUESTIONS & ANSWERS

(*continued*)

COULD THE NEWCOS BE PROFITABLE WITHOUT FEDERAL GUARANTEES?

- Of course! A bond insurer does not need a Federal guarantee to be profitable
- Three truths:

  #1: Investors in mortgage-backed securities will pay for credit enhancement
    - Investors cannot assess default risk in diverse pools of mortgages
    - A bond insurance policy changes mortgage default risk to insurer default risk, which investors can assess more easily
    - With Federal reinsurance, default risk can be removed for investors altogether

  #2: Private owners make better underwriting decisions than any Federal agency
    - Government does not price risk as well as private investors
    - Government has competing objectives that harm underwriting standards over time

  #3: Private capital needs a fair return
    - A private insurer will set insurance premiums at a level that preserves capital and earns a fair return
    - Competition and regulation can prevent excessive returns

Federal support is not necessary for private capital to earn a fair return.

QUESTIONS & ANSWERS

(*continued*)

WHAT ARE THE NEWCOS' OPERATIONAL PRINCIPLES?

- ✓ The Golden Rules of Insurance:
  - Underwriting comes first
    - Discipline in pricing, underwriting, and claims resolution are fundamental
  - Maintain a Fort Knox balance sheet
    - Insurance liabilities must be fully recognized
    - Reserves must be solid
    - Balance sheet and reputation are what an insurer has to sell customers
  - Don't lose
    - Promises must be kept
    - There must be a margin of safety in all things
  - Think like a utility
    - Expect reasonable returns over time
    - Insulate underwriting process against short-term pressures
  - Ignore the crowd
    - Do what is right for the balance sheet, not what is popular – no matter the optics
  - Align interests with regulators
    - The interests of regulators and long-term owners are more or less the same
    - Manage, promote and compensate with an eye to these aligned incentives, not short-term gain

QUESTIONS & ANSWERS

(continued)

WHY STATE-CHARTERED INSURANCE COMPANIES?

- ✓ Mortgage guarantee business most naturally conceived as insurance
  - Allows transparent and accurate financial reporting
  - Financial risks can be prudently assessed and managed, and risk priced appropriately
- ✓ Never again "too big to fail"
  - State-chartered insurance companies have failed in the past
  - Resolution regime protects policy holders at the expense of private owners
- ✓ State insurance regulation would have prevented old Fannie and Freddie
  - Impossible for a regulated insurer to over-leverage with borrowed money
  - Regulator requires adequate reserves, investment diversification, oversight and stress-testing
- ✓ Regulator is independent from Washington
  - No incentive to relax standards for affordable housing or other policy goals
  - Minimizes perception of political risk among rating agencies and policyholders
- ✓ Compatible with appropriate Federal regulation

QUESTIONS & ANSWERS

(*continued*)

WOULD STATE INSURANCE REGULATION HAVE MADE A DIFFERENCE?

✓ Yes. A regulated insurance company could not be run like Fannie and Freddie
- Pricing – Insurers cannot deliberately underprice their product
  - Fannie and Freddie priced in response to inappropriate business and political pressures
- Reserves – An insurance company must keep adequate reserves to cover losses
  - Fannie and Freddie had virtually none
- Borrowed Money – Insurance companies cannot borrow money without regulatory approval, rarely granted
  - Fannie and Freddie borrowed trillions
- Size of Investment Book – Insurance companies must invest their float prudently
  - Fannie and Freddie invested amounts far in excess of their float, funded with borrowed money
- Diversity of Investment – Insurance companies have diversification requirements as well as credit requirements
  - Fannie and Freddie were invested in the same types of assets they underwrote, correlating risk

QUESTIONS & ANSWERS

(*continued*)

HOW CAN WE BE CERTAIN THE U.S. TREASURY WILL BE REPAID BY THE WIND-DOWN COMPANIES?

- ✓ The U.S. Treasury will have received 99% of what it invested in Fannie and Freddie by the end of 2013
  - Through 2013, Fannie and Freddie will have paid $185 billion compared to the $187 billion drawn from the U.S. Treasury
  - The U.S. Treasury will receive the remainder in Q1 2014
- ✓ The entire remaining value of the Run-Off Companies will be available first to provide a return to the Treasury and other shareholders
  - To the extent resolution proceeds exceed the amount due to the Treasury on its Senior Preferred Stock investment, distributions would be made in order of priority to other shareholders
- ✓ Financial review and independent confirmation of these assumptions would be a condition to the effectiveness of the NewCos purchases

QUESTIONS & ANSWERS

(*continued*)

WHY SELL TO PREFERRED STOCKHOLDERS?

- ✓ Investors are ready to commit private capital now
  - Willing to convert existing investments
  - Willing to inject new capital, increasing "skin-in-the-game"
  - Willing to forego dividends and distributions for five years
- ✓ Preferred shareholders include investors that:
  - Have a track record of investing in financial institutions successfully
  - Understand these businesses, are already invested, and have a patient, long-term perspective
  - Understand restructurings and how to help businesses return to reliable profitability
- ✓ Preferred shareholders are open to a conservative capital structure, which would ensure the credit health of the two firms during downturns
  - Restrictions are important as it signals to the market that the investors have a long-term time horizon
- ✓ The restructuring will be understood and perceived as fair
  - Conversion of fixed-income stakeholders into common shareholders is a tried-and-true restructuring tool
  - Solves the inherent conflict of attempting to satisfy both shareholders and a public mission
  - Rights offering to be transferable to protect investments made by community banks and small investors

QUESTIONS & ANSWERS

(*continued*)

WILL OTHER INVESTORS SUPPORT THE PROPOSAL?

- ✓ We believe so, if a transaction can be implemented promptly
- ✓ What's in it for preferred stockholders?
  - It allows preferred stockholders to invest in a new business at an attractive initial valuation
  - In a liquid market, investors who do not like the conservative NewCos business model will be able to sell to other investors who do
  - Although the risks of the NewCos business model are significant, preferred stockholders face these risks already
- ✓ What's in it for common stockholders?
  - The preferred stock is removed as a senior claim on the run-off value of Fannie and Freddie
  - The run-off of the historical assets is valuable and should generate significantly higher recoveries than litigation, so long as the terms can be arranged fairly
  - There may be an opportunity for common stockholders to purchase NewCos common stock, perhaps by allocating to common stockholders a portion of the rights offering or by their providing incremental capital
- ✓ What's in it for Treasury?
  - Transaction jump-starts successful private industry in MBS insurance
  - Full value of the Run-Off Companies would be available to fund payments due to Treasury
  - Treasury maximizes its control over the timing of run-off, and the value of its common stock position
  - NewCos may help accelerate run-off by securitizing seasoned mortgages in the legacy investment portfolio, privatizing the risk through the same private distribution channels used for new originations
  - Consistent with the rule of law and ends legal uncertainties surrounding conservatorship

QUESTIONS & ANSWERS

(*continued*)

WHEN CAN THIS BE DONE?

- ✓ With the support of the relevant parties, a transaction could be arranged by the middle of 2014
- ✓ A “cut-off” date would determine the date for transfer of business functions, e.g., June 30, 2014
  - All insurance business written prior to cut-off date would be retained by the old companies
  - Earnings would bolster the profitable wind-down of the legacy book
  - All insurance business written after cut-off date would be underwritten and priced by the NewCos
  - NewCos would bear entire risk of loss on new business immediately
- ✓ The timing of the transaction could be separate from, or coincide with, broader legislation
- ✓ The transaction could be implemented for both Fannie and Freddie simultaneously, or one of them could proceed first

Nothing contained in this presentation constitutes investment advice. No information or opinion contained in this presentation constitutes a solicitation, recommendation, or offer by Fairholme or its affiliates to buy or sell any securities, futures, options, or other financial instruments.

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November 13, 2013

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street NW
4th Floor
Washington, D.C. 20552-0003

Re: Private Offer to Purchase Insurance Businesses of Fannie Mae and Freddie Mac

Dear Mr. DeMarco:

I am writing to you in your capacity as Conservator for the Federal National Mortgage Association ("Fannie Mae" or "Fannie") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" or "Freddie") on behalf of Fairholme Capital Management ("Fairholme"). Fairholme is a value-oriented, long-term focused investment advisor with over 200,000 clients and approximately $11 billion in assets under management. Fairholme has longstanding experience investing in U.S. financial institutions: in fact, we were one of the earliest investors to support AIG after the 2008 economic crisis, ultimately helping to validate the restructuring plan implemented by the United States Treasury. All taxpayers, including Fairholme's clients, benefited from the value unlocked by the successful recapitalization of AIG. Indeed, the Treasury and the Federal Reserve earned $22.7 billion on their combined $182 billion of investments in AIG.[1] Nearly four years later, Fairholme remains the largest private investor in AIG.

We believe there is a similar opportunity to create value for the conservatorship of Fannie Mae and Freddie Mac while catalyzing reform of the companies and addressing the controversy around their continuing role in our economy. In furtherance of these goals, Fairholme is pleased to enclose for your consideration a proposal to establish private insurance companies to purchase, recapitalize, and operate the mortgage-backed securities insurance businesses of Fannie and Freddie. The proposal is summarized in the attached materials. It is not the only way to reform Fannie and Freddie. However, we believe it is a viable solution that would be supported by numerous market participants and advance FHFA's fiduciary duty to maximize the value of the assets in its custody without disrupting the mortgage origination or distribution processes that are vital to the housing market and the American economy.

[1] "AIG by the Numbers," United States Department of the Treasury, December 2012. Available at: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/aig/Pages/default.aspx

The proposal is politically neutral. It can be implemented consensually by your agency, as Conservator, and the existing investors of Fannie and Freddie (including the U.S. Treasury) with or without legislative action. In this respect, the proposal would provide private capital now to validate legislative reform of any political stripe without dictating the shape of that reform. We are private investors, not politicians. Under this proposal, we are prepared to provide meaningful capital to support new businesses that can earn a fair return in various regulatory and market environments.

It is worth emphasizing that we have no interest in purchasing the existing investment books of Fannie and Freddie. Similarly, we do not seek any continuation of the Federal charter of Fannie and Freddie (i.e., the "implied guarantee"), nor any continuation of the special rights and privileges that the companies enjoyed in the years leading up to the financial crisis. Our objective is to invest directly in the insurance businesses themselves. And we propose that they be responsibly managed as insurance companies with private owners bearing full risk of loss.

With respect to their insurance businesses, it is worth highlighting a few key business facts:

- The business of insuring non-jumbo mortgage-backed securities in the United States needs more private capital. Everyone agrees.
- Insurance is an attractive business. If the basic tenets of a regulated insurance business are followed, the company should generate reasonable and safe returns on capital deployed over the long-term.
- This type of insurance business is valuable in any reasonable market or regulatory structure. Government regulation and reinsurance (compulsory or voluntary) may affect a number of business questions, including the pricing and availability of mortgages and mortgage-backed securities. However, if there is a need for private capital, such private capital will earn a fair return.
- The assets needed to conduct this insurance business exist at Fannie and Freddie in the form of their talented staff, expertise, historical knowledge, intellectual property, and physical footprint. These assets have substantial value. It is a myth that the Enterprises are valuable only because of the Federal government's support. The Enterprises have assets that can support a profitable insurance business and provide vital services without a dime of public support.
- The current situation is not beneficial to anyone. Prolonged conservatorship is gradually destroying the value of the insurance businesses to new investors, resulting in capital depletion, inappropriate pricing of risk, and underinvestment in people and technology. And prolonged conservatorship is problematic for the Federal government, which will be left bearing the risk of poor underwriting decisions or future financial disruption without private capital at risk.

These are the reasons we have already invested. We propose to invest more. Fairholme currently holds approximately $2 billion liquidation preference of Fannie preferred stock and $1.5 billion liquidation preference of Freddie preferred stock, in addition to common stock of each institution. Our goal is to put our current investment and new money to work in order to be a long-term owner of the MBS insurance businesses trapped within Fannie and Freddie, and to help convince others to do the same.

Under the proposal, two new State-regulated insurance companies would be established to own the operating assets of Fannie and Freddie that are relevant to the continuing insurance business. The new companies would be renamed. The trademarks “Fannie Mae”, “Freddie Mac”, and any derivative marks would be retired. The new companies would be capitalized with approximately $34.6 billion from Fannie and Freddie (received in exchange for preferred stock in the entities) and at least $17.3 billion of new capital raised in a fully-committed rights offering. The new companies would operate a conservative business plan that is limited to insuring pass-through mortgage-backed securities against the risk of default. They would be privately managed to maintain Fort Knox balance sheets, and regulated by State insurance authorities as well as applicable Federal agencies. All capital received in conversion of preferred stock of Fannie and Freddie, along with attributable profits, would be retained by the new companies for a minimum of five years to support writing new insurance. No dividends or distributions would be paid using that capital during this initial five year period.

The new companies require no subsidy or support from the United States Government to begin profitable business immediately. However, the business model of the new companies would be compatible with a Federal reinsurance program or other Federal intervention in the market. Indeed, the new companies would be in a position to be cornerstone participants in a reinsurance program along the lines contemplated by recent congressional proposals, if that is the result of the legislative process now underway, validating its commercial viability for other private investors. On the other hand, the new companies would also be in a position to serve as the cornerstone of a new market with less Federal involvement, putting their private capital at risk to achieve the best possible pricing and availability for mortgage borrowers under those parameters. Congress preserves every option. Fairholme asks only that if there is any Federal support, such support be made equally available to the new companies and their competitors in a manner that permits fair competition and reliable financial planning.

The new companies are not expected to replace everything Fannie and Freddie do today. They would be limited by State charter to insuring residential mortgage-backed securities against default. The investment business of Fannie and Freddie would be left behind. The front-end securitization process would be open to others via the Common Securitization Platform. The role of the Federal Home Loan Banks, Ginnie Mae, and other MBS conduits would likely be expanded. And even with respect to the core business of private MBS insurance, the new companies would not dominate their industry like Fannie and Freddie do today. Competition is essential to build the total value of the new industry, spread ownership broadly, and mitigate political risk. Fairholme believes limits on the size of the new insurers, perhaps set forth in their State law charters, are appropriate as a regulatory matter and in the long-term interests of the new insurers themselves.

The new companies would not acquire any interest in – or ability to profit from – assets purchased or insurance written while Fannie and Freddie had Federal charters. A cut-off date would be established (for example, June 30, 2014) and the legacy book of investments and insurance in existence on that cut-off date would be wound-down over time to fully repay the U.S. Treasury, as well as provide a fair return on that investment. Our analysis suggests that the U.S. Treasury will fully recoup its investment by 2014. Additional gains on the legacy book would be distributed as determined, with a fair profit to the U.S. Treasury on its Senior Preferred Stock investment and additional profit allocated to the common stock interests of the U.S. Treasury (79.9%) and common stockholders (20.1%). The new companies (and their private owners) would earn profits only from the business written by the State-charted insurers after the cut-off date. They would also bear all of the losses from underwriting after the cut-off date without any Federal assistance.

Fairholme believes that other stakeholders in Fannie and Freddie, large and small, will support this proposal. In particular, Fairholme believes a critical mass of Fannie and Freddie preferred stock owners would participate – by converting their existing investments and providing a portion of the $17.3 billion in new capital – if a transaction can be timely agreed and implemented. Time is of the essence for two reasons. First, the value of the insurance businesses is deteriorating while they are operated as Federal wards. The status quo is unsustainable and irresponsible when there is a feasible alternative. Technology and infrastructure need new investment; underwriting and cost management need new discipline; and the business teams need new leadership who are their champions and have viable future plans. Second, the date on which Fannie and Freddie will have fully repaid the U.S. Treasury is rapidly approaching. It may be more difficult to induce preferred shareholders to accept restricted capital (which under the proposal is locked into the new insurers for at least five years) once the U.S. Treasury has been fully repaid.

We hope our proposal provides an opportunity to align incentives in a manner that respects the political process. We know that many people in and outside of government are working on the redesign of the mortgage market in Washington, D.C., and trying hard to get it right for America. The situation is undoubtedly complicated from a political, budgetary, and regulatory perspective. We are experts in none of the above. But the past cannot be changed, even by the best minds in Washington. The future is our focus. The simple fact is that the insurance businesses of Fannie and Freddie still linger after five years under a conservatorship that has ceased to be necessary to protect the markets or consistent with the preservation of value. The time to get the businesses adequately and privately capitalized is now. We believe the proposal – with input from all key stakeholders on the details – may prove to be the best course of action available to the Conservator of these businesses, as well as to the U.S. Treasury.

We would be happy to discuss this proposal in further detail with you and your colleagues in the near future. Please do not hesitate to contact me at (305) 358-3000.

Yours sincerely,

Bruce R. Berkowitz
Managing Member

Cc: Jacob J. Lew
Secretary of the Treasury
United States Department of the Treasury

FANNIE MAE AND FREDDIE MAC
DISCUSSION TERMS FOR PURCHASE OF INSURANCE BUSINESSES

This Discussion Term Sheet (the "Term Sheet") describes the material terms of a purchase (the "Transaction") of the insurance businesses of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac" and, together with Fannie Mae, the "Enterprises") by holders of their Preferred Securities, leaving behind the existing book of mortgage investments and mortgage guarantees ("Legacy Assets") to be resolved in an orderly and profitable manner. This proposal is not intended as a commitment, nor is it an offer to purchase or sell securities or other assets. It describes a transaction structure that Fairholme Capital Management ("Fairholme") and other stakeholders in the Enterprises would support.

DISCUSSION TERMS

A. Purchasers

The Purchasers would be new financial guaranty insurance companies chartered under the laws of the State of [_____] ("NewCos"). One NewCo would acquire the Operating Assets (defined below) of Fannie Mae ("NewCo A"), and a separate NewCo would acquire the Operating Assets of Freddie Mac ("NewCo B").

The NewCos would be privately-owned and controlled. They would have no special status or charter under Federal law and would receive no Federal support, other than equal access to any future Federal reinsurance or similar program made available to other private market participants. The NewCos would pay all applicable Federal, State, and local taxes. They would have no political appointees on their Board of Directors or among their employees. They would be subject to the general policyholder protection and resolution regime for State insurance companies, along with any applicable Federal legislation.

The NewCos would not use the marks "Fannie Mae", "Freddie Mac", or related materials. The marks would be retired and not used by any party again.

B. Business Plan

Each NewCo would be a true 'monoline' insurer and its business would be limited by State law charter to the private insurance of qualifying mortgage-backed securities against risk of default. Underwriting guidelines would be strict. Generally, single-family mortgage pools would require risk retention in the form of an 80% loan-to-value requirement (or 90% with appropriate primary mortgage insurance). Single-family mortgages would be limited to prime mortgages, with the possible inclusion of a small number of documented, income-verified subprime mortgages.

Underwriting guidelines for multi-family housing would be developed independently.

The NewCos would be organized, regulated, and managed to maintain the strongest practicable private balance sheet. To this end:

- the NewCos would be managed to preserve capital and provide a reasonable return on investment to owners;
- each NewCo would seek to maintain the highest rating by all applicable rating agencies;
- key underwriting criteria and the 'monoline' nature of the NewCos business would be incorporated in their State law charters;
- appropriate measures would be taken to ensure that underwriting criteria would be set independently of political influence;
- the primary regulator would be the State insurance authority;
- insurance documentation would be uniform and compatible with the Common Securitization Platform previously announced by the Enterprises (doing business as Common Securitization Solutions, LLC); and
- the NewCos would be subject to the resolution authority of their State insurance regulator, as well as any applicable Federal resolution regime.

The uniform insurance documentation would include the protections for the insurers set forth in Annex A, including the right of the insurer to pay principal and interest attributable to a non-conforming mortgage over time in lieu of replacing the non-conforming mortgage immediately (i.e., no acceleration against the insurer).

As provided in Annex A and discussed in more detail below, the business model of the NewCos would be designed to work with or without a broadly-available Federal reinsurance program.

C. <u>Acquired Assets</u>

The NewCos would acquire the following from the Enterprises by means of asset purchase:

- substantially all operating assets, including (a) trademarks and copyrights, (b) intellectual property rights, (c) systems and technologies, (d) tangible property rights, (d) business contracts and relationships, (e) human capital assets, (f) owned and leased corporate real estate assets, and (g) goodwill ("Operating Assets"), in each case other than those associated with the Common Securitization Platform and other exceptions to be agreed; and

- cash or marketable securities in the amount determined below ("Restricted Capital").

Restricted Capital would constitute part of the initial capital of the NewCos. All Restricted Capital – as well as attributable profits – would be retained by the NewCos and used in their business during the five years following the acquisition (the "Restricted Period"). To enforce this requirement, the NewCos would agree, during the Restricted Period, not to pay any dividend or make any distribution attributable to Restricted Capital.

D. Purchase Price and Rights Offering	The purchase price for the Acquired Assets would be paid in kind by the exchange and cancellation of Preferred Stock from participating holders ("New Owners"). The amount of Restricted Capital acquired by the NewCos would be based on the liquidation preference of Preferred Stock exchanged.[1] In addition to the Restricted Capital acquired in the purchase, the New Owners would fund the NewCos with new cash equity in an amount equal to 50% of the amount of Restricted Cash acquired. The New Owners' investment would be made in the form of a fully-underwritten offering with transferable rights. All initial equity in the NewCos would be pari passu common stock.[2] A minimum participation threshold for owners of Preferred Stock would be set to ensure success. Fairholme believes that market support will be very strong if the Transaction could be agreed and completed in the near term.

1 The amount of Restricted Capital available at the Purchasers would be equal to (x) the liquidation preference of the preferred stock held by participating New Owners in the applicable Enterprise plus (y) any unpaid dividends on that preferred stock from the first date the applicable Enterprise declared excess dividends to the United States Treasury after the August 2012 Net Worth Sweep.

2 Although the Purchasers would be prohibited from paying dividends attributable to Restricted Capital during the Restricted Period, they would be permitted to pay dividends to the extent of earnings attributable to the new cash equity investment. In other words, since the amount of Restricted Capital is two times the amount of new cash investment, each Purchaser would be permitted to pay out dividends equal to one-third of its earnings during the Restricted Period.

E. Retained Assets

A premise of the Transaction is the repayment of the U.S. Treasury's Senior Preferred Stock investment in full with a fair profit, which can be accomplished by leaving behind the Legacy Assets in designated successor companies ("Run-Off Companies"). The Run-Off Companies could then be resolved in a value-maximizing, orderly manner under the supervision of the Federal Housing Finance Agency ("FHFA"). To the extent resolution proceeds exceed the amount due to the U.S. Treasury on its Senior Preferred Stock investment, distributions would be made in order of priority to non-participating preferred stockholders and common stockholders (including the warrant held by the U.S. Treasury for the purchase of a 79.9% common equity interest in each Enterprise). The NewCos believe this approach would be fair to all stakeholders and provide the clearest signal to the market that the NewCos would be purely private companies.

F. Closing Date

The NewCos would begin to write business for their own account on a future closing date to be agreed upon — for example, June 30, 2014 (the "Closing Date"). All insurance business written prior to the Closing Date would be for the account of the Run-Off Companies. All insurance business written after the Closing Date would be for the account of the NewCos.

Although the NewCos generally would insure new issuance, the NewCos also would be in a position to insure seasoned MBS on the books of the Run-Off Companies, accelerating the run-off of the Run-Off Companies and removing risk from their balance sheets. The NewCos would do so at arm's length, presumably by making stalking horse bids at public auctions organized by the Run-Off Companies and/or FHFA.

G. Services Agreement

If the legacy assets are left in the Run-Off Companies, the NewCos could enter into an arm's-length services agreement (the "Services Agreement") with the Run-Off Companies pursuant to which the NewCos would provide such services as the Run-Off Companies request in connection with their orderly resolution. In such a scenario, the NewCos would serve as an agent at the direction of the Run-Off Companies (or the FHFA, as applicable) on a cost-plus basis for whatever reasonable term is required.

H. Full Employment

Subject to the continuation of the Services Agreement, the NewCos would offer continuing employment to the substantial majority of Enterprise employees and be responsible for related costs going forward (excluding legacy pension, OPEB, or similar liabilities).

I. Investment in Technology	A portion of the proceeds of the rights offering would be earmarked for the improvement of technology and systems, including developing an appropriate interface with the Common Securitization Platform. Subject to discussion, a certain allocation from the rights offering may be made available to fund the Common Securitization Platform itself, provided that arrangements with respect to the Common Securitization Platform recognize the contributions made by the NewCos and allocate the cost and benefits of the platform equitably among the NewCos and future market participants.
J. Non-Competition	Except as agreed, the Run-Off Companies would not write new mortgage insurance coverage in competition with the defined business model of the NewCos. The parameters of the agreement not to compete would be defined narrowly and would not affect any other Federal agency or program.
K. Participation by Common Stockholders	In order to avoid any perceived unfairness to other stakeholders, the NewCos also would consider making a portion (between 10% - 20%) of the rights offering available to holders of common stock in the Enterprises, including the warrants held by the U.S. Treasury on an as-converted basis. Any rights issued to the U.S. Treasury would be sold to private investors, thereby providing parity treatment to the U.S. Treasury while avoiding any implication that the NewCos are owned, supported, or controlled by the United States Government.
L. Governance	Stockholder arrangements for the NewCos would be put in place by the New Owners. It is expected that the common equity of each NewCo would be broadly held and that no New Owner would control either NewCo. The Board of Directors of each NewCo and any affiliated companies would consist of a majority of independent directors. Bruce R. Berkowitz would serve as lead independent director on the Board of Directors of NewCo A, with other independent directors of the NewCos appointed by the New Owners.
M. Indemnification	The Enterprises would indemnify the NewCos and hold them harmless against any liabilities not assumed by the NewCos, including those arising from pre-Transaction activities and any challenges to the Transaction by other Enterprise creditors or stockholders. The Enterprises (acting through FHFA) would have customary rights as indemnitor to control litigation. Claims of the Enterprises against third parties for pre-Transaction activities would remain with the Enterprises.

N. <u>Implementation</u>	The purchase would be implemented by consensual agreement between the FHFA (as Conservator), the U.S. Treasury, the New Owners and other applicable stakeholders, and would include settlement of pending litigation. No legislative action would be required. The NewCos would consider utilizing the business reorganization provisions contained in Title 11 of the United States Code or another court process to implement the agreement and provide judicial oversight and due process to any concerned stakeholders.
O. <u>Competition and Regulation</u>	The Transaction would not be conditioned on any legislation. The NewCos would be structured and regulated to act independently as two participants in a competitive private insurance market. The NewCos assume that Federal regulation and/or support of the private market would be applied even-handedly and that any Federal reinsurance program or other financial support would be fairly priced for its costs and benefits: therefore, the Transaction proposed would not be conditional on – and need not wait for – any particular legislative outcome.
P. <u>Compatibility with Reinsurance Program</u>	Although not a condition to the Transaction, the NewCos business model would be compatible with a Federal reinsurance program or other efforts to maintain and expand a homogeneous mortgage-backed securities market by utilizing the Federal balance sheet for an appropriate fee. In the absence of Federal reinsurance legislation, the NewCos would also consider purchasing interim reinsurance from the Run-Off Companies in conservatorship if it were offered on a market-wide basis. An interim reinsurance program would permit immediate private underwriting and risk retention while minimizing disruption to the current mortgage-backed securities market. Interim reinsurance also could provide the Run-Off Companies and/or the U.S. Treasury with supplemental income (via the reinsurance fees), and provide a test case for a future Federal reinsurance program made available to other market participants. However, no Federal reinsurance program (permanent or interim) would be a condition to the Transaction.

Q. Next Steps

If the Transaction were to be pursued, Fairholme believes it could be implemented four to six months from the commencement of work in earnest. Important workstreams would include:

- formation of NewCos and design of business plan;
- rating agency discussions;
- identification of advisors and legal representatives for key stakeholder groups, including FHFA, Fannie, Freddie, U.S. Treasury, preferred stockholders, and common stockholders;
- negotiation of the asset purchases with FHFA, including the detailed lists of acquired assets;
- negotiation of the amount fairly and legally due on the U.S. Treasury's Senior Preferred Stock and independent financial review to confirm that U.S. Treasury would be fully repaid that amount from the Run-Off Companies (if not already repaid by the Closing Date);
- development of the details for the post-closing relationship between the NewCos, the Run-Off Companies, and FHFA, including terms for the Services Agreement and any interim reinsurance or use of the Federal balance sheet (for a fee) by NewCos;
- finalization of rights offering arrangements;
- identification of the directors and senior management team for each NewCo;
- outreach to address concerns of industry participants, community representatives, and other stakeholders; and
- coordination with Congress, led by FHFA, to ensure that the Transaction remains a catalyst for ongoing legislative reform initiatives.

ANNEX A

The uniform securitization and insurance documents would include the following general terms and protections for the financial guarantor:

- The 'pass-through' nature of agency mortgage-backed securities would be maintained. The insurance policy would be structured as bond insurance. The sole beneficiary of the insurance policy would be the holder of covered bonds.

- The bond insurer would be obligated to make principal and interest payments to address a shortfall from non-performing mortgages only to the extent necessary to ensure timely payment of principal and interest on covered tranches of securities.

- In the event that non-performing mortgages risk a default on a covered tranche, the insurer would control loss mitigation.

- In the event payment is made under the policy with respect to non-performing mortgages, the insurer would have the option – but not the obligation – to prepay amounts corresponding to non-performing mortgages. The insurer would not be required to replace non-performing mortgages, which could be left in the pool or removed by the insurer at its discretion.

- The insurer would have approval rights over all securitization participants and the terms of all documentation, as well as effective monitoring rights during the period in which it is at risk.

- The insurer would not purchase whole loans, but would identify securitization vehicles to do so and the servicer (or the Common Securitization Platform) would make purchases on behalf of the securitization vehicle. The securitization activities of the servicer would be administrative, not discretionary.

In the event that a Federal reinsurance product is introduced that invokes the full faith and credit of the United States:

- Reinsurance would be structured with a direct claim by the bondholder against the Federal reinsurer (or, alternatively, with a Federal agency as issuer), permitting the covered bonds to trade without credit risk.

- As between the Federal reinsurer and the private insurer, the private insurer would bear first risk of loss.

- Reinsurance would be made available to the NewCos and other qualified market participants on the same terms. The NewCos would maintain the requisite ratings and capital levels in order to qualify for participation in any such Federal reinsurance program and pay all applicable fees.