FHFA's First Anniversary and Challenges Ahead
James B. Lockhart,
Director, Federal Housing Finance Agency

National Press Club
Washington, DC
July 30, 2009

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Thank you all for being here today. Today marks the first anniversary of President Bush signing the Housing and Economic Recovery Act of 2008 (HERA), creating that same day the Federal Housing Finance Agency. It took years to get to that very small early morning Oval Office signing ceremony. As I left the Oval Office last, President Bush told me that it was now up to me. It turned out that I needed a lot of help. I thank all of you who helped support GSE reform over the years.

Starting a new agency upon signing was very unusual, but there was a great sense of urgency. I promised Chairman Frank that we would stand up the agency quickly, pulling together the former Office of Federal Housing Enterprise Oversight, Federal Housing Finance Board, and mission team from the Department of Housing and Urban Development. And I am pleased today to report to him and to you that we did it, quickly and effectively. Despite the unanticipated conservatorship of two of the largest financial institutions in the country and the turmoil in the housing market and economy, the FHFA team is working together to meet many challenges.

This morning, I would like to take a few minutes talk to you about some of the things FHFA has accomplished this past year and some of the challenges we face. From the very beginning, I have stressed a results-oriented approach to our work. As of today, we have 425 employees, and I can tell you, these are people who have worked many long hours for the past year knowing that we have an extremely important mission: to provide effective supervision, regulation and housing mission oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market. **(SLIDE 2)** I have been especially pleased to see how well the

FHFA, Fannie Mae, Freddie Ma,c and FHLBank teams have worked together to tackle our first year challenges, and I have no doubt that they will continue to do so.

Everything we are doing at FHFA makes a difference, and in the past year, we have also made history. The obligations of all the housing GSEs – Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks – are $6.6 trillion, close to the entire public debt of the United States. **(SLIDE 3).** The Enterprises alone own or guarantee 56 percent of the single family mortgages in the U.S**.**

FHFA Accomplishments Since HERA

Let's turn here and take a look at some of our accomplishments since HERA passed, especially in the past six months. **(SLIDE 4)** I think you will agree that we have accomplished a lot in a very short time**:**

- We have combined the personnel and financial systems of two separate organizations and established an infrastructure for FHFA, including systems, procedures, and policies that serve as the foundation for accomplishing the mission of the agency.
- We are working effectively with the Enterprises as their conservator, even as we continue to oversee them as their regulator. Just after conservatorship, we announced the appointment of new boards of directors for both Enterprises and we worked with those boards recently to refill CEO positions at both Fannie Mae and Freddie Mac.
- We have been working with the 12 FHLBanks regarding valuing their private-label MBS, an issue that has significant consequences for them. As they adopted early the new other-than-temporary impairment rules, we worked with them on the adoption of a common platform for accounting.

- FHFA has been on the leading edge of the executive compensation issue, curbing golden parachute payments far in advance of recent congressional attention while ensuring appropriate compensation for all employees.

- We have smoothly transitioned to a new Administration and a new Federal Housing Finance Oversight Board, which I chair. The other members are the secretaries of Treasury and HUD, and the SEC Chairman.

- FHFA staff were instrumental in working with the Treasury Department and the rest of the Obama Administration, the Enterprises, other regulators and the private sector to develop and implement the Homeowner Affordability and Stability Plan, to address the problems of foreclosure prevention and people with "underwater" mortgages, with the aim of keeping people in their homes whenever possible.

- FHFA has a seat at the critical tables—the Financial Stability Oversight Board (TARP) and the President's Working Group on Financial Markets. I am also pleased to work with President Obama's Administration, especially Secretaries Geithner and Donovan and the National Economic Council Chairman Summers, on stabilizing the mortgage market and the Making Home Affordable program, which built upon our streamlined mortgage program.

- After welcoming the HUD Mission team employees into the agency in January, we began a thorough evaluation of the existing housing goals and have developed new, more feasible goals for 2009 for Fannie Mae and Freddie Mac. Similarly, we are working on an affordable housing program rule for the FHLBanks. Both are critical parts of our agency's mission.

- We have published our first strategic plan, our first human capital plan, and the first combined *Performance and Accountability Report*, which won Association of Government

Accountant's coveted Certificate for Excellence in Accountability Reporting award. Those accomplishments are unprecedented in the first year of a federal agency.

- We are developing and issuing the many regulations, guidance, and reports required by HERA to ensure a stable and effective secondary mortgage market. One of these requirements is an annual *Report to Congress*, which for the first time summarizes the annual examinations of the Federal Home Loan Banks.

This is a very brief listing. When we called for accomplishments from the divisions and offices within FHFA, it was gratifying to see scores of entries on the lists. And I think it's important to note that we have not been doing all these things in a vacuum. Instead, because of the challenging state of the economy and housing in particular, our agency does its work in the glare of a global spotlight. Our activities as an agency in the past year have more significance, require more coordination, and are watched more by outside parties than ever before. The last 12 months have been action-packed and have set us on the right path. As I said, we have accomplished a lot, but we have much more to do.

As you know, the present for a first anniversary is paper. I can tell you that we have produced a lot of paper for this anniversary as required by HERA. As you will hear from the panel that follows me, that paper is very useful. (**SLIDE 5**) Today we also are releasing three of the 13 reports HERA requires the agency to produce in the first year, including a study of Enterprise guarantee fees and another on FHLBank securitization. We are also publishing six new regulations relating to the GSEs, including the final 2009 affordable housing goals and an ANPR on the duty to serve provisions in HERA. These reports and regulations add to the six reports and 14 final or proposed regulations that FHFA has already published in the last year. Collectively, these studies and regulations are extremely important to the future of the secondary mortgage market.

Of course, our focus and energy is always on stabilizing the mortgage market. At FHFA, we have a four-pronged strategy **(SLIDE 6)** to help stabilize the mortgage market. First, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks must support the market in a safe and sound manner. Second, we are working with our government partners to get mortgage interest rates down. Third, we are working with the Enterprises and other groups to set best practices for the whole mortgage market. We are all keenly aware of how badly underwriting and other practices slipped from 2005 to 2007. Finally, we are actively working with the Administration, Treasury, HUD, banking regulators, and the GSEs on foreclosure prevention to help homeowners in trouble.

<u>**The Housing Market**</u>

I have been a lifelong student of American history, and I always feel it helps to look back to understand where we came from before we talk about where we are headed. One of the key catalysts of the current economic crisis has been falling house prices after their remarkable growth since 2000. American homebuyers started to believe that house prices could only go up. Prices did not rise forever, as this chart shows. **(SLIDE 7)** From January of 2000 through May 2006 (peak), the more volatile S&P/Case-Shiller house price index rose by approximately 105 percent only to fall by 32 percent since then. The less volatile FHFA House Price Index, which reflects Fannie Mae's and Freddie Mac's books of business, peaked later, and has since declined about 11 percent from the peak. Our index started to show signs of bottoming out this year. It is up 0.3 percent for the first five months. Case-Shiller just reported its first up month in nearly three years. Although that increase was not seasonally adjusted, the rate of decline in its seasonally-adjusted series has clearly lessened.

As house price appreciation and rising interest rates reduced housing affordability, low documentation Alt-A, interest-only loans, and adjustable-rate mortgages (ARMs) proliferated. Subprime market share tripled to more than 20 percent of the market. Lenders accepted more loans with higher loan-to-value (LTV) ratios and lower borrower credit scores. A growing share of borrowers took out second loans at origination to cover down payments. The credit risk of new mortgages rose substantially without increasing mortgage rates, mortgage insurance premiums, or guarantee fees enough to compensate for the heightened risk.

For years Fannie Mae, Freddie Mac, and FHA had set the standards for prudent mortgage underwriting and credit practices. Those standards were adopted by the private, prime jumbo market, and largely prevailed until the ascendance of the private-label securities market. From 2005 to 2007, the private market—driven primarily by the Wall Street distribution model, rating agency criteria, and over-enthusiastic investors—lowered the credit bar. Eventually, in response to declining market share and pursuit of higher profits and fulfillment of affordable housing goals, Fannie Mae and Freddie Mac began to follow suit not only lowering their own underwriting standards, but also buying hundreds of billions worth of triple-A-rated subprime and Alt-A private label securities (PLS). Fannie Mae and Freddie Mac did not create the housing price bubble, but their procyclical actions further inflated the bubble, despite our regulatory efforts to curtail their growth.

Falling house prices, financial strain on borrowers tied to inappropriate mortgages, and the recession caused rapidly growing defaults. **(SLIDE 8)** Over the past two years, serious delinquencies of 90-days or more have risen across the board. For subprime mortgages, serious delinquencies are almost 25 percent. They are far lower at Fannie Mae and Freddie Mac at about 2.8

to 3.7 percent, which is even lower than the prime market at 4.7 percent or the whole market at 7.2 percent. However, serious delinquencies across all categories are continuing to rise.

Although Fannie Mae and Freddie Mac have a combined 57 percent share for mortgages outstanding, that accounts for only 22 percent of serious delinquencies. On the other hand, private label securities, which are 13 percent of mortgages outstanding, account for 42 percent of serious delinquencies. As these high levels of delinquencies triggered downgrades in the private label securities, it has presented significant challenges for investors, including Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Currently 65 percent of the carrying value of private label securities in the FHLBank system are below investment grade, downgraded or on negative watch (**SLIDE 9**). This compares to only 20 percent in those categories at the end of 2008.

The combined Fannie Mae and Freddie Mac PLS holding are much worse, with 84 percent currently downgraded, which compared to 62 percent at year-end. Unlike the FHLBanks, the Enterprises were large buyers of the "goals rich" subprime PLS. In retrospect it was a perversion of the goals process for them to get credit for mortgages that were designed to fail.

<u>Challenges Facing the FHLBanks</u>

Although the FHLBank System is sound and the joint and several guarantee is strong, PLS are not the only challenge facing the Federal Home Loan Banks. The FHLBanks have not escaped the problems in the economy and FHFA has been carefully monitoring all 12 FHLBanks and the Office of Finance. (**SLIDE 10**).

As the current mortgage market crisis began to develop in the summer of 2007, the FHLBanks played a critical, countercyclical role. From June 2007 to September 2008, secured loans to members, called advances, increased from $640 billion to over $1 trillion. While liquidity sources for many large and small banks were drying up, the FHLBanks stepped up and provided much needed liquidity. Had it not been for the FHLBanks' provision of liquidity into the capital markets, the current crisis undoubtedly would have been worse.

In the last nine months, advances to members have fallen 27 percent largely due a rise in deposits at member banks and to the emergence of new federal liquidity programs, such as the Term Auction Facility and the Temporary Liquidity Guarantee Program, increased use of the Fed's discount window, and some return of liquidity in financial markets. The expansion and contraction of FHLBank advances demonstrates that the FHLBanks unique capital structure has the ability to meet demands for liquidity on the part of member financial institutions while having the portfolio flexibility that enables the FHLBanks to shrink without untoward consequences.

I have already mentioned the FHLBanks' exposure to private label securities, which varies considerably among the FHLBanks**.** This has impacted their retained earnings, accumulated other comprehensive income (AOCI) and GAAP capital. At March 31, 2009, the FHLBanks held $64 billion of private-label MBS. These securities had a fair value of $49 billion, or 76 cents on the dollar. Because of the deterioration in the PLS market, the FHLBanks took total charges for other than temporary impairment in the first quarter of $5.2 billion, of which only $516 million was due to credit factors and almost $4.7 billion was due to non-credit factors, which is recorded in AOCI.

(SLIDE 11) The FHLBanks' aggregate AOCI at quarter end was $7.4 billion, compared with total retained earnings of $5.1 billion. AOCI exceeds retained earnings at six FHLBanks – Boston, Pittsburgh, Atlanta, Chicago, San Francisco, and Seattle.

FHLBank management and Boards of Directors are exercising prudence and judgment in making capital distribution, including dividend decisions. FHFA is developing a framework for supervisory decisions on capital distributions and examination staff will closely monitor negative earnings, low and volatile market value of equity measures, negative AOCI, and projected losses related to OTTI.

FHFA, in conjunction with the FHLBanks, is also studying the merits of establishing an insurance fund for the FHLBanks. The purpose of the insurance fund would be to insure the timely payment of principal and interest on FHLBank obligations, facilitate FHLBank mergers and/or provide capital assistance to undercapitalized FHLBanks.

And finally, the FHLBank System faces challenges to ensure more consistency in disclosures and accounting. Inconsistent measurements and application of GAAP can affect investors' confidence. In an excellent move, the FHLBanks have developed a strong, common OTTI process for the second quarter of 2009 to ensure timely SEC filing by the individual FHLBanks and dissemination of the combined financial report for the FHLBank System by the Office of Finance. The consistency of the combined statements prepared and issued by the FHLBanks' joint office, the Office of Finance, needs to be strengthened while ensuring that individual FHLBank boards retain their responsibility for the FHLBank's financial statements. FHFA will be issuing a notice of proposed rulemaking to expand the Office of Finance board of directors to all 12 FHLBank presidents from only two today, and up to five independents, from only one.

Challenges Facing the Enterprises

Let me turn now to the challenges facing Fannie Mae and Freddie Mac. I do not need to tell you that in the current economic environment their condition and function is critical. The Enterprises together own or guarantee $5.4 trillion in outstanding mortgages. This next slide shows the history of the mortgage market over the past 12 years with the Enterprises in gold, FHA/VA in green, and others in blue. **(SLIDE 12)** From 1997-2003, Fannie Mae's and Freddie Mac's market share of mortgage originations—that top line—gradually grew to almost 55 percent. From 2004-

2006, the private mortgage market predominated, and Fannie's and Freddie's business sank pretty dramatically, with their market share dropping below 35 percent because of their accounting problems and our resulting extra 30 percent capital requirement and portfolio caps. Then as the private market started to freeze up in 2007, Fannie's and Freddie's market share took off—up to nearly 73 percent in 2008 and the first quarter of 2009. Despite all that gyration in market share, their actual business, in gold, has remained reasonably stable over the last five years. On the other hand, FHA/VA has grown rapidly in size and market share to now 22 percent. Over the long term, this high GSE and government share is unhealthy.

Because mortgage assets were considered very safe, the 1992 law that established OFHEO required the agency to deem the GSEs adequately capitalized at extremely high leverage rates. By statute, the Enterprises could leverage mortgage credit risk as much as 200 to 1 and market risk could be leveraged almost 50 to 1. We knew this was absolute folly. Recognizing the systemic risk of Fannie Mae and Freddie Mac, OFHEO worked for many years to obtain legislation to give us greater authority over their capital requirements and the size of their portfolios. It was my top priority from my first day on the job in 2006. Although HERA came much too late to prevent the conservatorship of the Enterprises, it did pave the way for the Treasury Department to provide financial backing to the GSEs so they could continue to support the housing market through this turmoil.

As we all now know, some mortgage assets were not safe and the credit risk they took on was large. I have already mentioned the $167 billion PLS book, which through the first quarter has produced $69 billion in OTTI and market losses. FHFA is closely watching the Enterprises' management of credit exposure in this environment. (**SLIDE 13**) It is important that the Enterprises set aside adequate loss reserves and in the last year their loss reserves have continued to increase by more than their credit losses, widening the gap between them. Fannie Mae's allowance for loss reserves was $42 billion at the end of the first quarter and Freddie Mac's was $23 billion. The Enterprises must also ensure there are appropriate resources to staff the asset management function, and step up their use of early risk detection tools. The Enterprises must do more to monitor their maturing loan exposure, and given the growing REO inventories, they need to develop programs to better handle them.

By early September, it was clear that there was no other choice than conservatorship if the Enterprises were going to continue to fulfill their mission of providing stability, liquidity, and affordability to the market. We made that tough decision working closely with the Treasury Secretary and the Chairman of the Federal Reserve. But I am confident that if we had not taken the conservatorship action, the Enterprises would have had to pull back dramatically from the market, which would have accelerated the downward spiral and caused a far greater financial crisis.

(SLIDE 14) Because HERA made it possible for the Treasury to support the Enterprises, the Enterprises did not pull back dramatically from the market. Treasury's $200 billion Senior Preferred Stock facility for each company provided *an effective guarantee* of the Enterprises' debt and mortgage-backed securities by ensuring that each Enterprise has a positive net worth. $85 billion has been drawn so far. Two additional facilities were also implemented when the conservatorships began. Under the first, Treasury has purchased $161 billion of their mortgage-backed securities and has made it clear it will continue to be an active buyer. The third facility is a liquidity facility for Fannie, Freddie, and the FHLBanks, but it has never been tapped.

The Federal Reserve Board also is building upon the Treasury's support to reduce mortgage rates. In November last year, the Fed announced it would purchase up to $500 billion in Fannie

Mae, Freddie Mac, and Ginnie Mae MBS—and this was upped to $1.25 trillion in March. It has purchased $682 billion. In a second program, the Federal Reserve had originally announced a commitment to purchase up to $100 billion in Fannie Mae, Freddie Mac, and Federal Home Loan Bank debt. That was raised to $200 billion, and to date, the Federal Reserve has purchased $105 billion in Fannie, Freddie, and Federal Home Loan Bank notes**.** In total, the investments have exceeded $1 trillion out of an indicated commitment of over $2 trillion.

(SLIDE 15) These efforts have, for the most part, had a very positive impact on mortgage rates. Rates on 30-year mortgages dropped below five percent for nearly three months earlier this year before rising temporarily to nearly 5.4 percent before returning to approximately 5.2 percent. The bounce-back slowed the refinance boom we saw in March and April, but as investor confidence is restored, mortgage rates could move lower again.

We recognize that FHFA's duties as conservator means just that, conserving the Enterprises' assets. This is our top goal. One of the reasons that Fannie Mae and Freddie Mac have so many problems is that they had a short-term profit maximization focus. As conservator, we must avoid that trap and focus on longer-term results. In particular, with $5.4 trillion of mortgage exposure, stabilizing the housing and mortgage markets is by far the best way to conserve assets. That is why preventing foreclosures that destabilize families and neighborhoods is so important. Over the long term, effective mortgage modifications, refinancings and even short sales will save the Enterprises many billions of dollars. They must also continue to buy and guarantee single family and multifamily mortgages in a safe and sound manner. We are working with them on facilitating single and multifamily warehouse lending, new approaches to low income housing tax credits and and mortgage insurance.

Stabilizing the housing market through the Homeowner Affordability and Stability Plan is one of the biggest challenges that they currently face. (**SLIDE 16**) Fannie Mae and Freddie Mac play a role in both the Home Affordable Refinance Plan (HARP) and the Home Affordable Modification Plan (HAMP), which together could reach 7 to 9 million homeowners to help them stay in their homes. Fannie Mae also has an important role as administrator of the program and Freddie Mac an equally critical role in program compliance. This is a massive undertaking which is already reaping benefits for American homeowners. Currently 34 servicers participate in the HAMP and over 370,000 trial modification plans have been extended to borrowers with over 200,000 loans entering the trial period, 108,000 of them owned by Fannie Mae and Freddie Mac. Since March 2009, Fannie Mae and Freddie Mac have refinanced over 2 million loans, 56,000 of them through the HARP. That though is just a start. Hearing the heartbreaking stories about foreclosure and its effects on families and neighborhoods, you know the importance of this effort to keep families in their homes and the significant challenge the Enterprises face with the Administration in addressing this growing problem.

Supporting housing affordability continues to be a key mission of the Enterprises. In the single family area it has become very difficult to do so as the mortgage insurers have continued to shrink their presence. As a result, multifamily lending has become a very important challenge. The Enterprises are working to stabilize the multifamily market by keeping it liquid, supporting affordable rental housing and keeping to clear and consistent credit principles. (**SLIDE 17**) As of March 2009, the Enterprises' combined multifamily portfolios have grown to $340 billion, and their market share is growing rapidly up from 34 percent in 2006 to 84 percent last year.

HERA and the Future of Fannie Mae and Freddie Mac

We are reminded daily that the current economic environment has had very real effects on families as job losses and plummeting home values have put enormous pressure on people and caused millions to lose their homes. That is why I am so proud of the work Fannie Mae, Freddie Mac and the FHFA teams have done on the development of the refinance and modification programs in the Making Home Affordable plans. President Obama has stated clearly his Administration's intent that the Enterprises will continue to play a key role in helping the mortgage market recover. The Administration has announced it will make a proposal to Congress in February 2010 on the roles of Fannie Mae, Freddie Mac and the Federal Home Loan Banks in the marketplace as well.

I think it is crucial that, before deciding among the wide variety of possible legal and ownership structures for the GSEs, we ask ourselves, "What do we want the secondary mortgage market to look like?" In other words, we have to confront the future of the secondary mortgage market, which will, I believe, shape the other decisions. That has to be the first principle as we **(SLIDE 18)** evaluate the options for Fannie Mae's and Freddie Mac's future.

A second principle is that the Enterprises or any successors should have a well-defined and internally consistent mission based on their fundamental role in the mortgage market. Their mission activities should not require excessive risk taking as it did in the past.

The third principle is that there should be a much clearer demarcation of the respective roles of the federal government and the private sector in the secondary mortgage market. Any federal risk-bearing should be provided explicitly and at actuarial cost. The old hybrid model of private, for-profit ownership underwritten by an implicit government guarantee allowed the Enterprises to become so leveraged that they posed a large systemic risk to the U.S. economy.

The fourth principle is to create a regulatory and governance structure that ensures risk taking is prudent and based upon sound insurance principles. Capital requirements should be strong and countercyclical. Strong governance, underwriting and risk-based pricing will be needed.

The fifth principle is that housing finance should be subject to supervision that seeks to contain both the riskiness of individual institutions and the systemic risks associated with housing finance. Our recent experiences have driven home how important safe and sound practices in housing finance are to the stability of the entire financial system and the U.S. economy. Going forward, we should seek to better monitor and prevent the buildup of excessive risk caused by imprudent practices and the ripple effect on the entire economy. FHFA's membership in the newly proposed the Financial Services Oversight Council will be an important step to do that.

Countercyclical Policies

I cannot over emphasize the need for countercyclical policies. **(SLIDE 19)** There are three primary reasons to shift our regulatory framework towards countercyclical policies: first, to curb asset price bubbles and dampen credit cycles. Second, to improve the odds that an institution can survive a crisis; and third, to reduce actions on the part of distressed financial institutions that hurt the broader economy and individuals. Often a financial institution in distress will seek to sell off assets and reduce risk exposures. Those actions can result in "fire sales" that compound distress in the financial sector and in credit crunches that reduce the availability of credit to sound borrowers and choke off economic activity. We need new policies that strengthen the ability of financial institutions to withstand distress by encouraging or requiring them to build up capital reserves in good times instead of having to rebuild capital in bad times. Such policies include cyclically varying capital requirement provisions for loan losses, retained earnings levels, and credit risk pricing. Another approach would be to automatically recapitalize financial institutions in the face of unusually high losses.

(SLIDE 20) This graph shows periods over the last 20 years when house prices were below trend (1990 to 2001) and then a period when real house prices moved rapidly above trend. One way of making capital requirements more countercyclical would be to reduce them as real house prices fall below trend and increase them as real house prices rise above trend. This approach could allow individual financial institutions to survive credit losses from falls in house prices, limit bubble formations, and lessen the contraction of mortgage credit as house prices fall.

Potential Structures

With those principles in mind, we can consider issues related to the structure of the Enterprises. Whatever option is chosen, the U.S. financial system will continue to require a vibrant secondary mortgage market, including the functions currently performed by the Enterprises.

(SLIDE 21) There are three basic options for the future structure of Fannie Mae and Freddie Mac: government agency, improved GSE, or fully private firms. The first option would be the equivalent of nationalizing the Enterprises. My career has included work with several private-sector insurance companies and several government insurance programs. What I have seen is that government insurance programs are high risk, and full of moral hazards. It is often difficult in a political environment to calculate or charge an actuarially fair price, avoid mission creep, and keep federal risks from increasing. Therefore, I am opposed to nationalization. Nevertheless, I recognize that there are some risks, such as Social Security longevity risk, that are too big for the private sector. Mortgage catastrophic risk may be one such risk. A possibility would be for the government to provide catastrophic reinsurance to the secondary mortgage market funded by actuarially sound premiums paid by participating companies. Such a program could also serve as another countercyclical tool if structured properly.

The second alternative would be two new and improved GSEs, building upon HERA. A public utility model could be established. A cooperative ownership similar to that of the Federal Home Loan Banks has also been suggested. Extreme care would have to be taken to prevent the inherent conflict always present in the GSE model—the tension between private profit and public purpose.

A third option is to establish purely private-sector firms to supply liquidity to mortgage markets with or without government catastrophic reinsurance. Private firms could offer the benefits of greater competition such as improved operational efficiency and increased benefits to consumers. Others have suggested private sector mortgage exchanges as an alternative.

It is crucial that we get the restructuring done right for the U.S. and world economies and all present and future homeowners and renters. The new structures must be designed to reduce risks rather than magnifying them, as they did in the past. Top policymakers in Congress and the Administration will have to address the complex issues and work together to find the best solution.

In the meantime, we must continue to do our critical job, strengthening Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, and helping to stabilize the housing market, thereby the GSEs' finances and the U.S. economy. All of us – FHFA and GSE employees, market participants, and the government –must continue to work together so that on our second anniversary we can celebrate that recovery.

Speaking of anniversaries, I started my government career 40 years ago in the Navy, becoming an officer on the deck of a nuclear ballistic submarine. Twenty years later, when I was sworn in by Elizabeth Dole as the head of PBGC, she said that experience would help me navigate the rough seas of underfunded pensions. Well, the experience helped there and at other troubled seas in my government career -- Social Security, OFHEO and now FHFA. Like the mortgage world, I truly know what it is like being “underwater” for a long time. The financial markets escaped “crush depth” last Fall. My submarine surfaced every time and so will the mortgage market.

Thank you. I will be happy to answer any questions you may have.

FHFA's First Anniversary and Challenges Ahead

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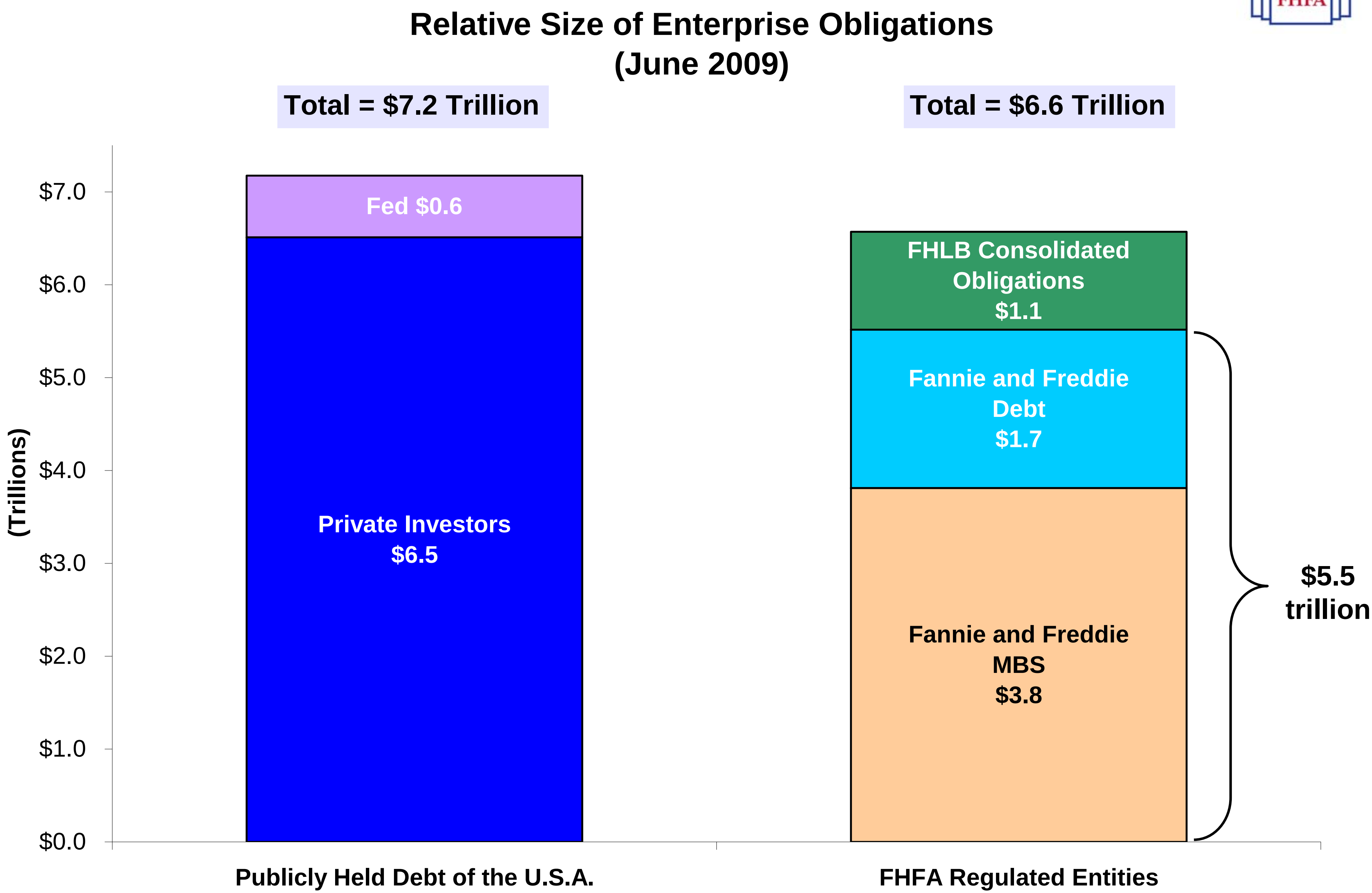
FHFA's Mission

Provide effective supervision, regulation, and housing mission oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market.

Public U.S. Debt vs. Housing GSE Obligations



Sources: Fannie Mae and Freddie Mac Monthly Volume Summaries, TreasuryDirect.gov, Federal Reserve H.4.1 Release.

FHFA Recent Accomplishments

- Developed new agency infrastructure
- Continue to supervise FHLBanks' safety and soundness
- Continue to supervise Enterprise safety and soundness under conservatorship
- Executive compensation with "golden parachute" regulation
- Transition to new Administration and Oversight Board
- Making Home Affordable Program
- Housing goals and rules for all housing GSEs
- Published agency strategic plan, human capital plan, *Performance and Accountability Report* (which won CEAR award)
- HERA-required reports including first annual *Report to Congress*
- Published other Regulations: Prior Approval for Enterprise Products (NPR), Capital Classifications for FHLBanks (Interim Final), Reporting of Fraudulent Financial Instruments (NPR), Portfolio Holdings for the Enterprises (Interim Final), Flood Insurance (Final)

HERA-required Reports and Regulations Released Today

Studies:

- *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2007 and 2008*
- *Federal Home Loan Bank Securitization Study*
- *Notice of Study of FHLB Advances and Interagency Guidance on Nontraditional Mortgages*

Regulations:

- Duty to Serve Underserved Markets for the Enterprises ANPR
- 2009 Enterprise Transition Affordable Housing Goals Final Rule
- Federal Home Loan Banks Mortgage Refinancing Authority Interim Final Rule
- Board of Directors of the Federal Home Loan Bank System Office of Finance Regulation NPR
- Capital Classifications and Critical Capital Levels for FHLBanks Final Rule

FHFA's Four Stabilization Strategies

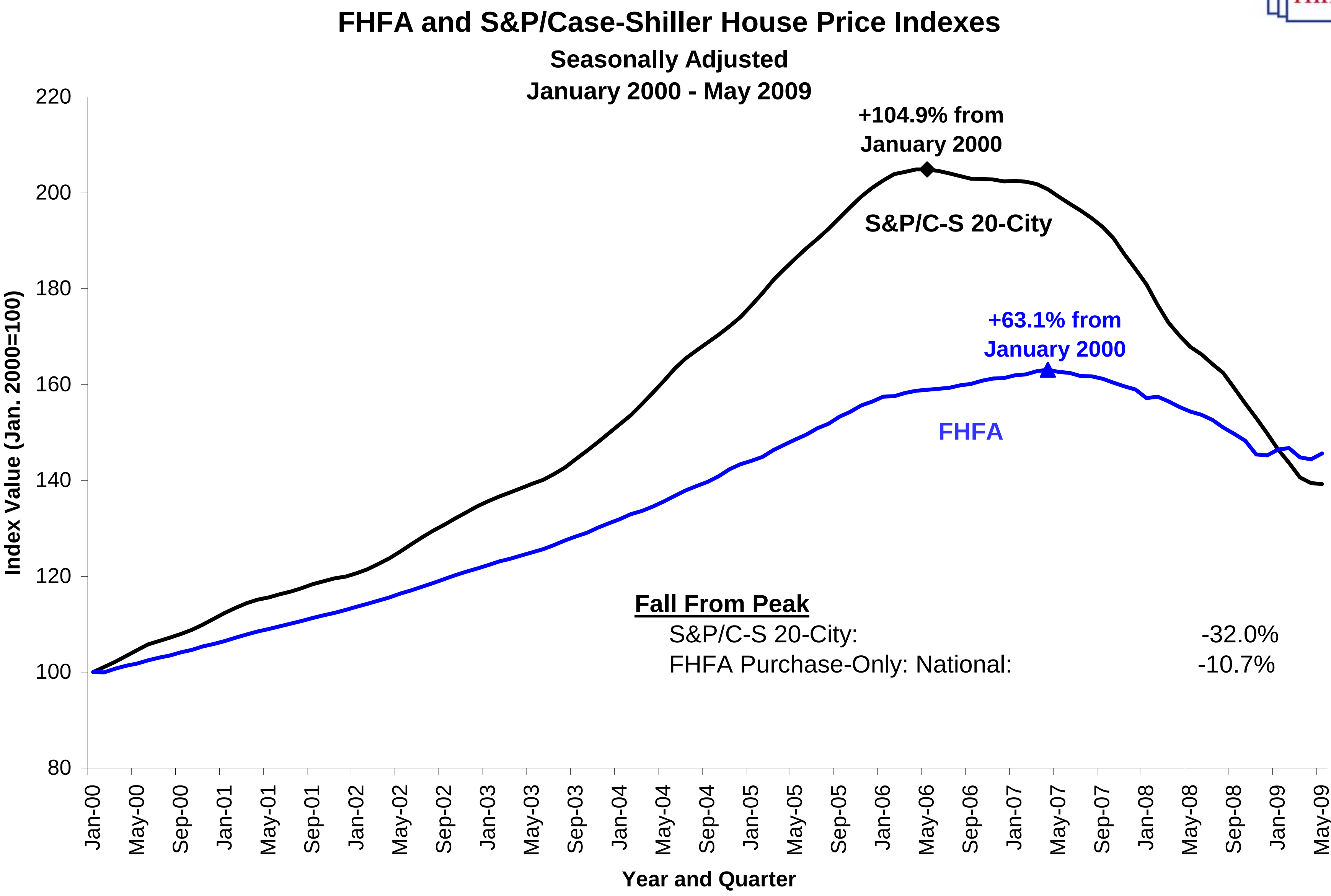
1. Ensure Fannie Mae, Freddie Mac, and the Federal Home Loan Banks provide liquidity, stability, and affordability to the housing market in a safe and sound manner

2. Work with government partners to reduce mortgage rates

3. Work with the Enterprises to set best practices for the mortgage market

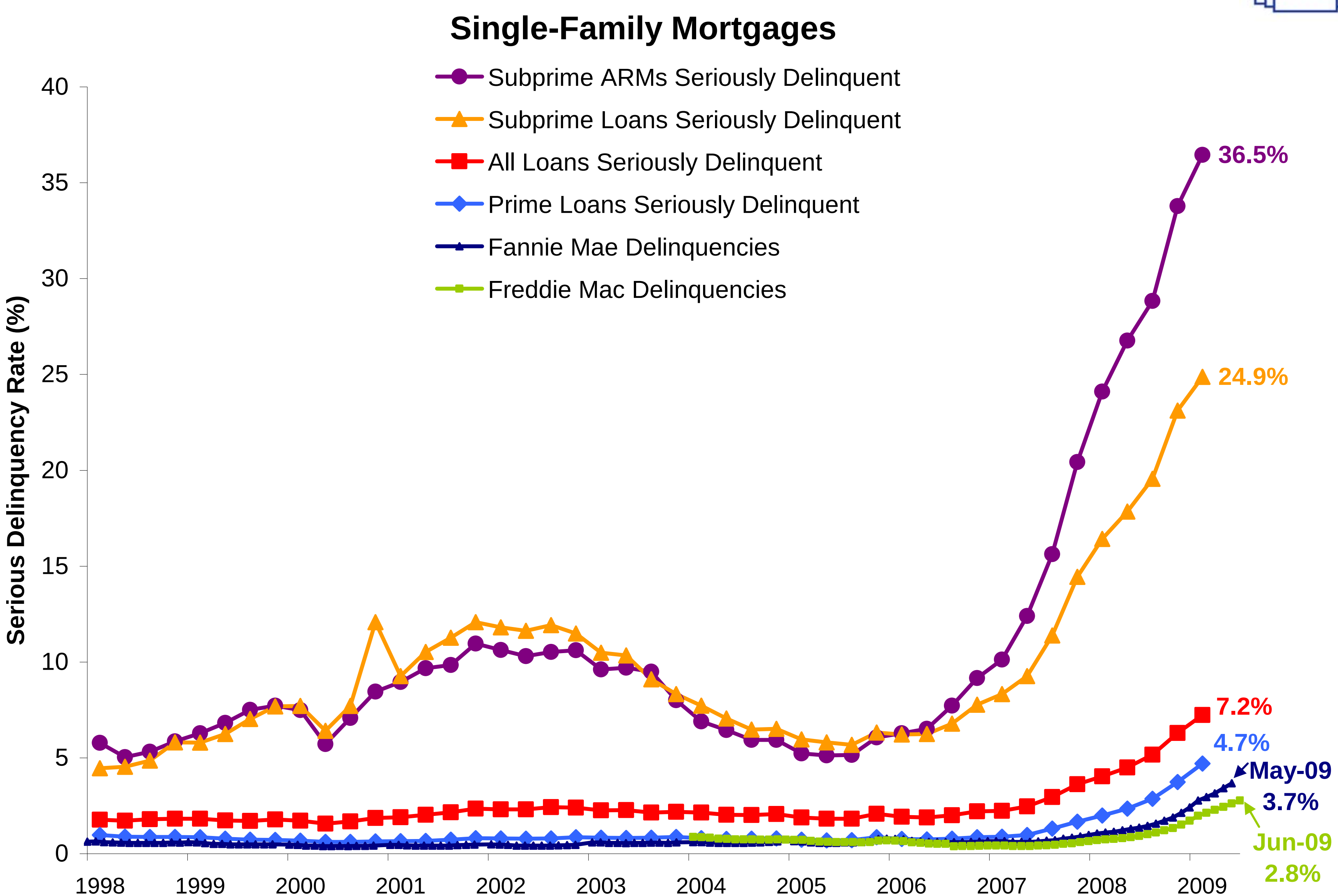
4. Prevent foreclosures through affordable modifications and refinancings

House Prices Beginning to Stabilize



Note: For purposes of comparison, the FHFA purchase-only index has been re-based to January 2000=100 (the standard series is set so that January 1991=100)

Serious Delinquencies Rising Rapidly

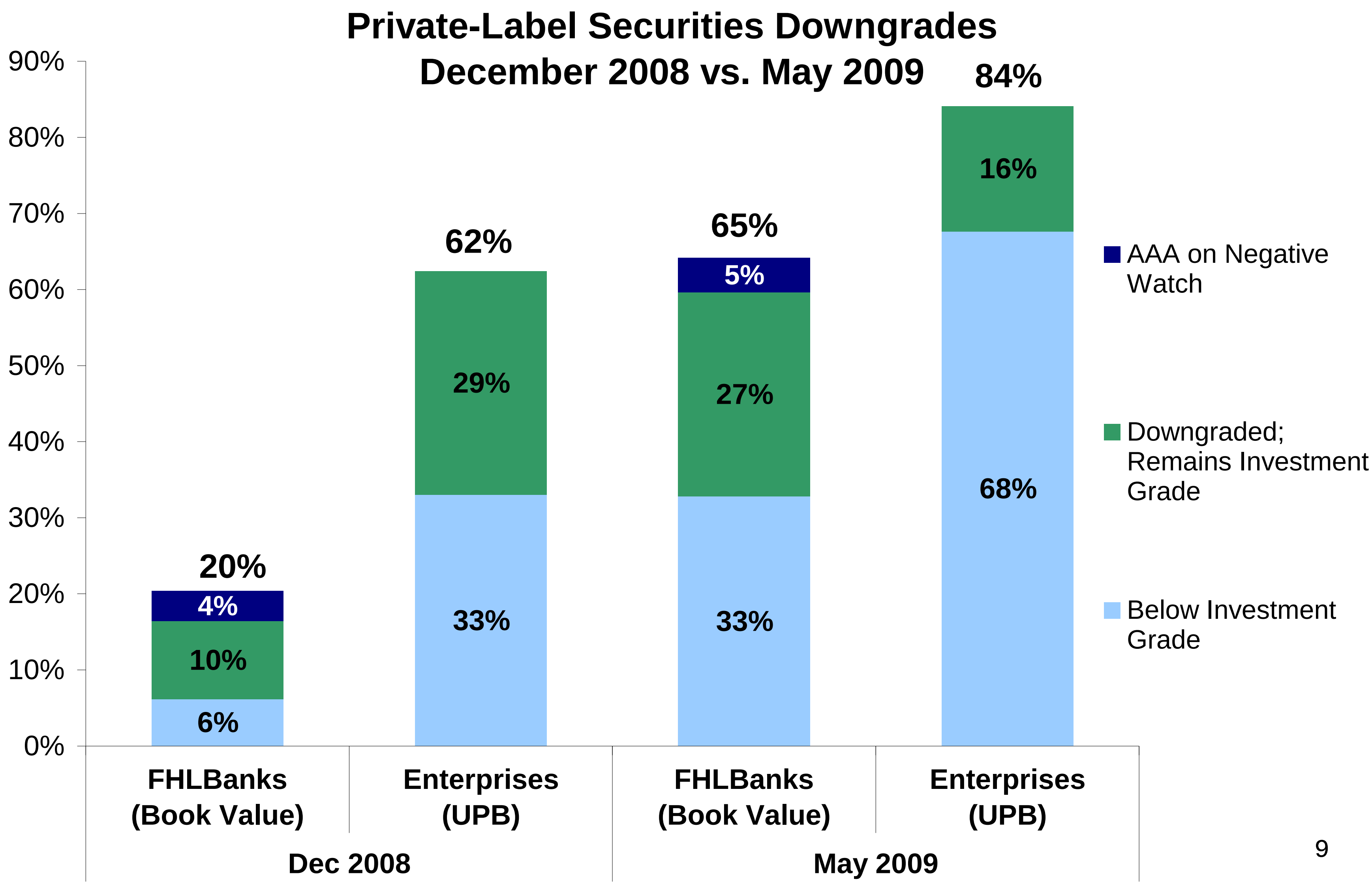


Sources: Mortgage Bankers Association, Fannie Mae, Freddie Mac.

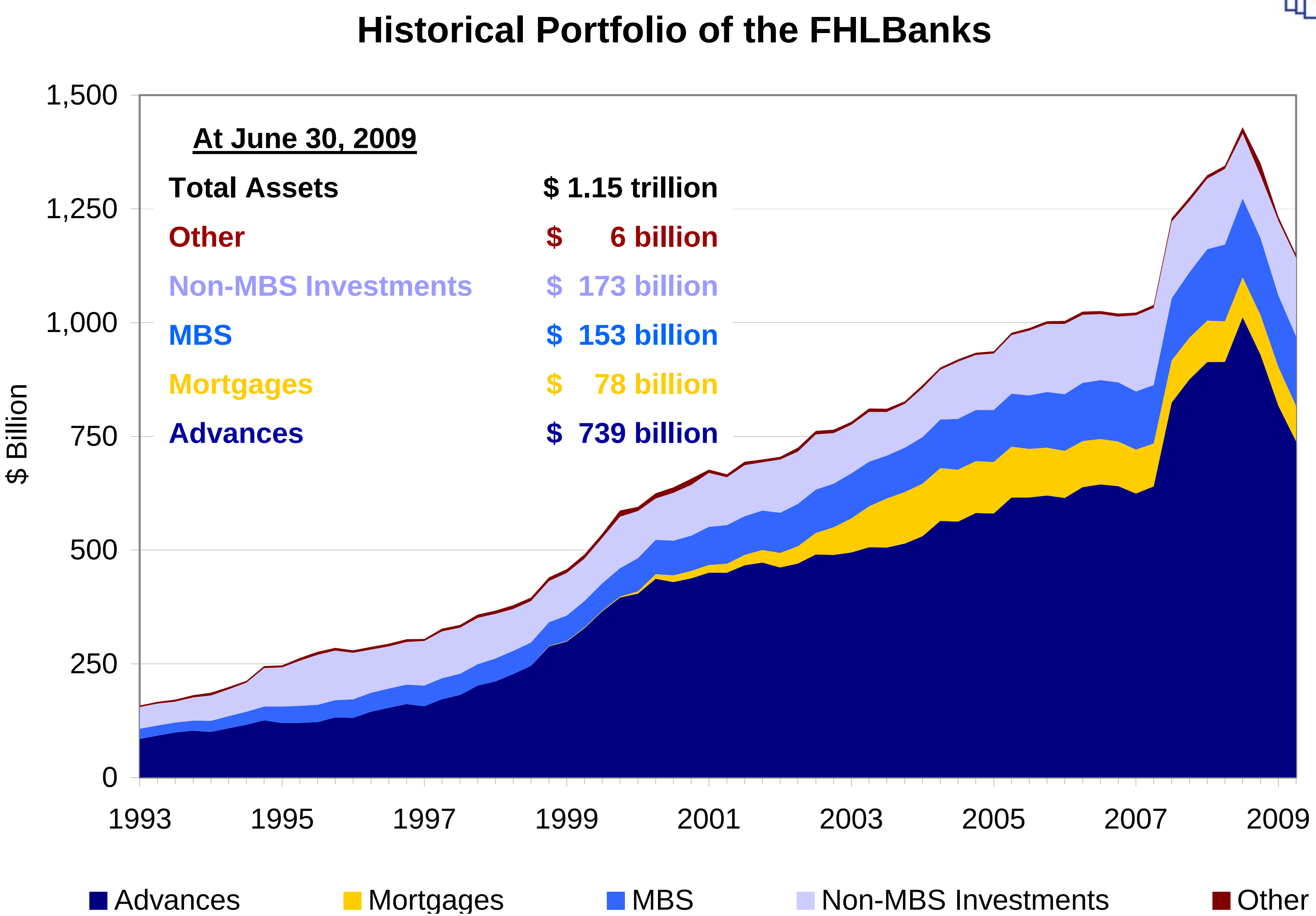
PLS Downgrades Continue to Rise

Total Holdings as of March 2009:

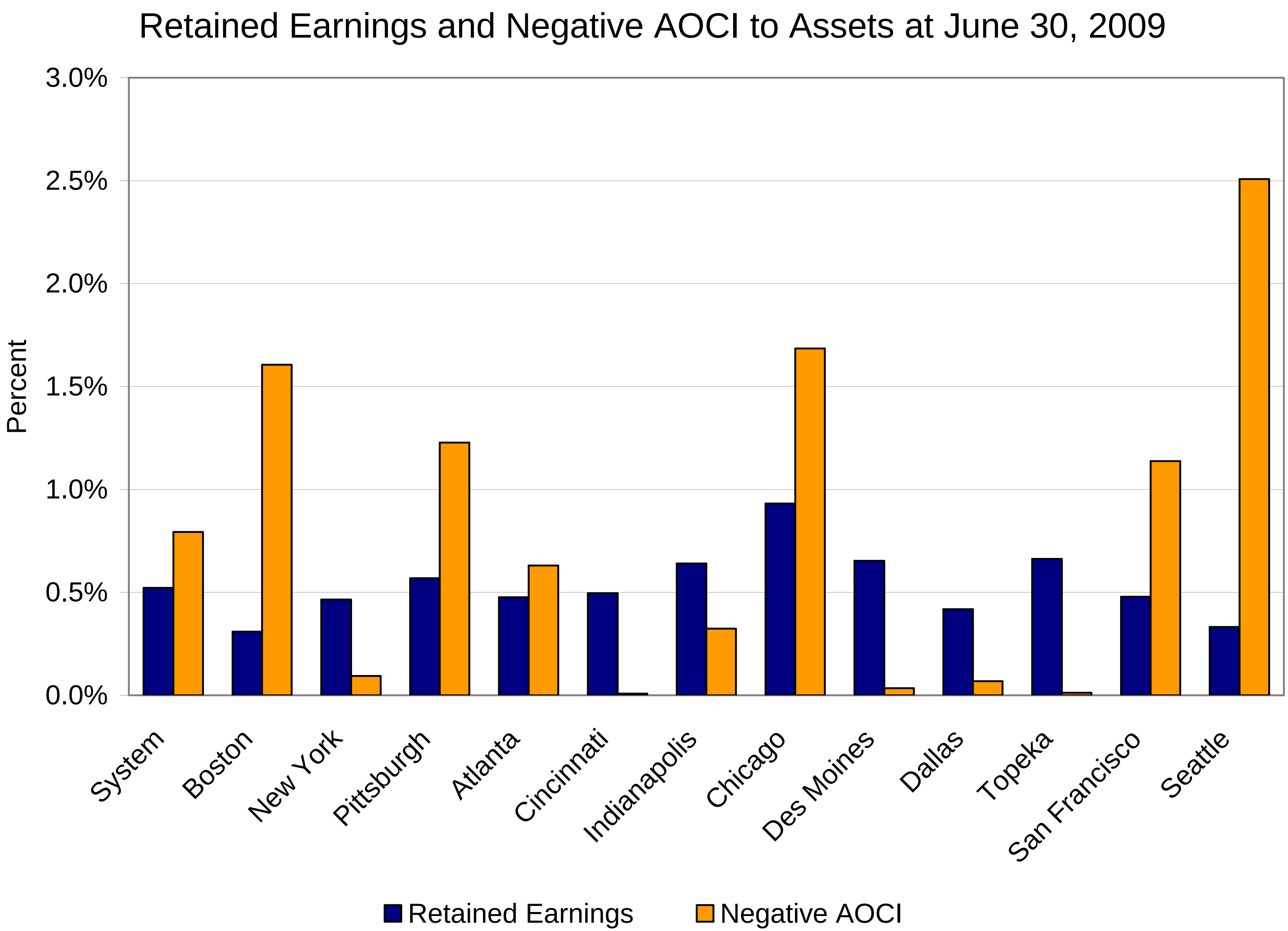
FHLBanks: $64 Billion — Enterprises: $167 Billion



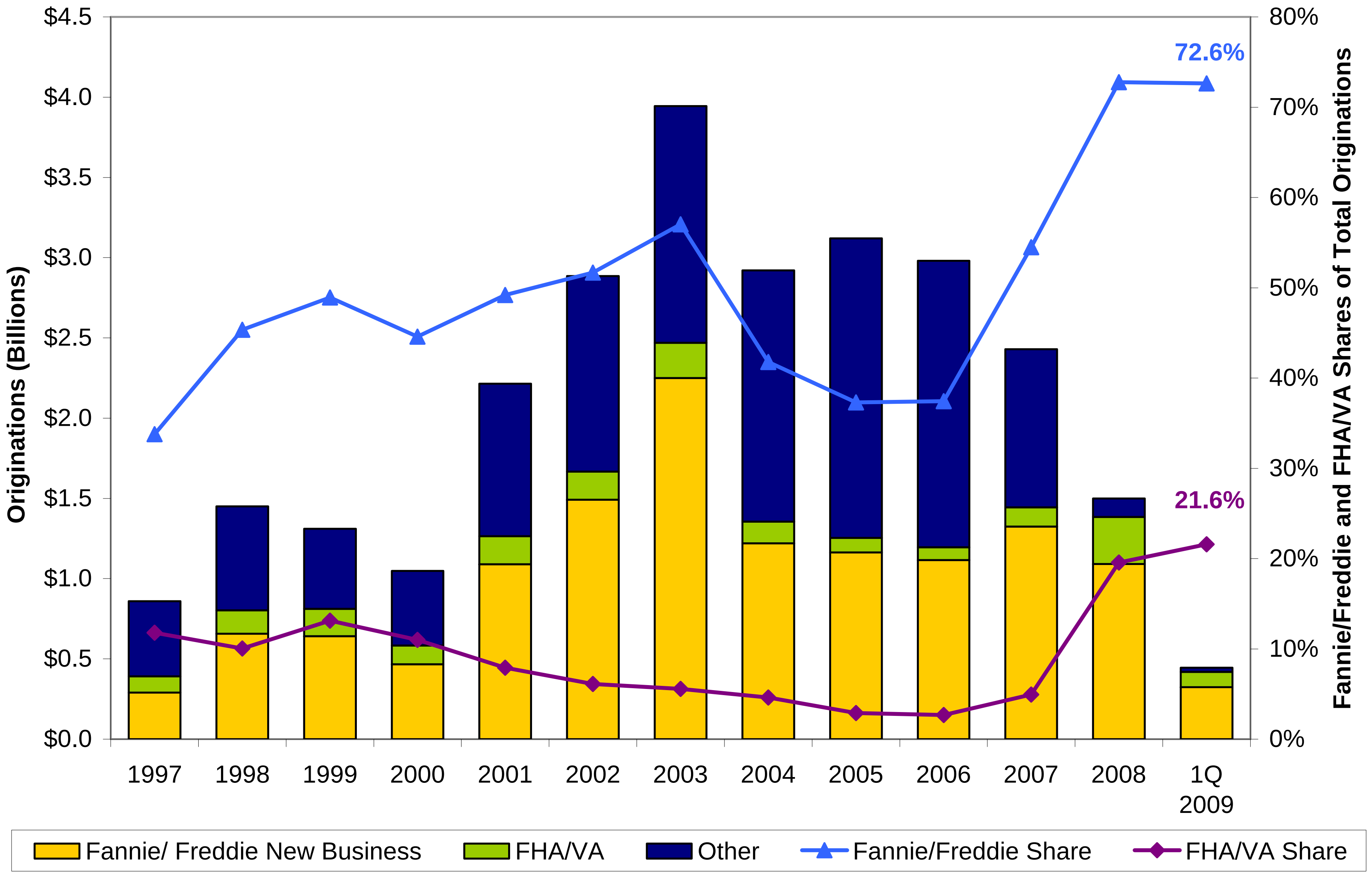
FHLBank Advances Peak in Third Quarter 2008



Write-downs Overshadow Retained Earnings



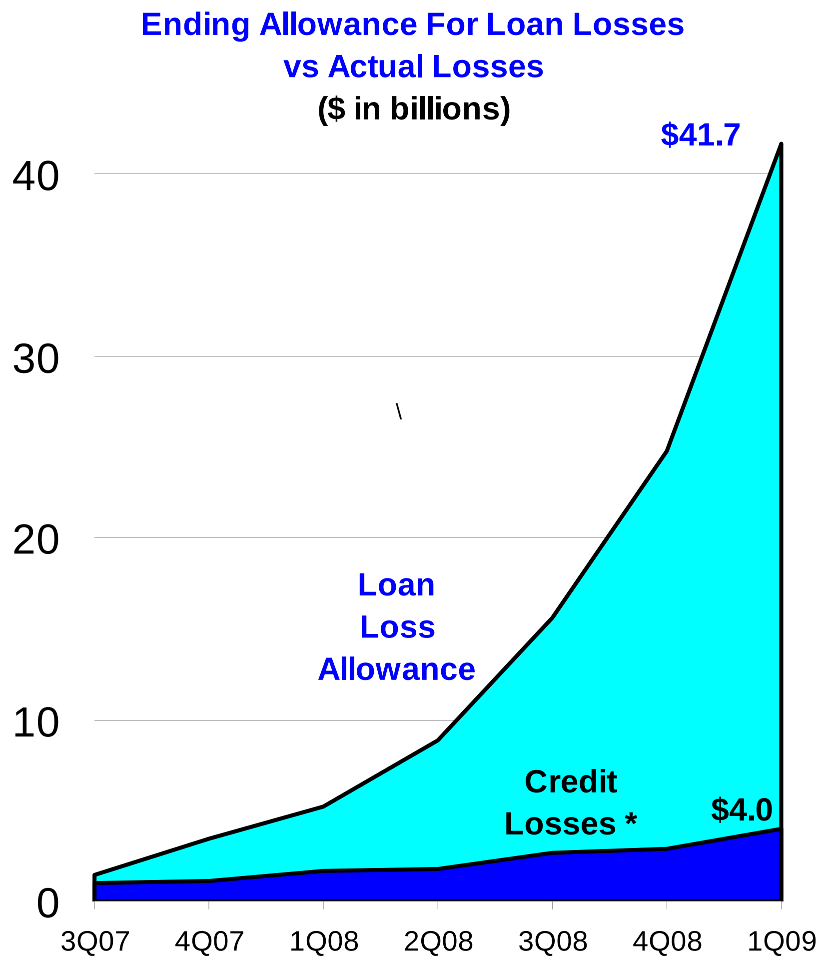
Enterprise and FHA/VA Shares of Originations



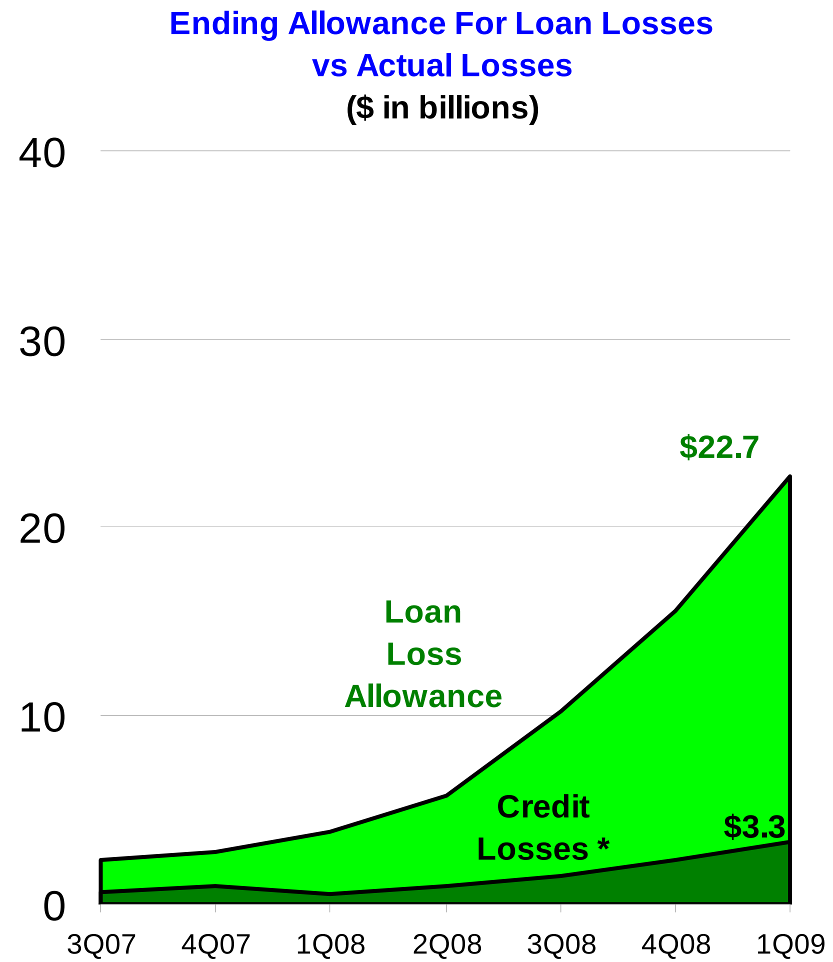
Sources: Inside Mortgage Finance, Enterprise Monthly Volume Summaries.

Allowance for Loan Losses vs. Credit Losses

Fannie Mae



Freddie Mac



Credit losses: charge-offs, foreclosed property expenses, and SOP 03-03 losses.

Treasury and Fed Support Is Strong

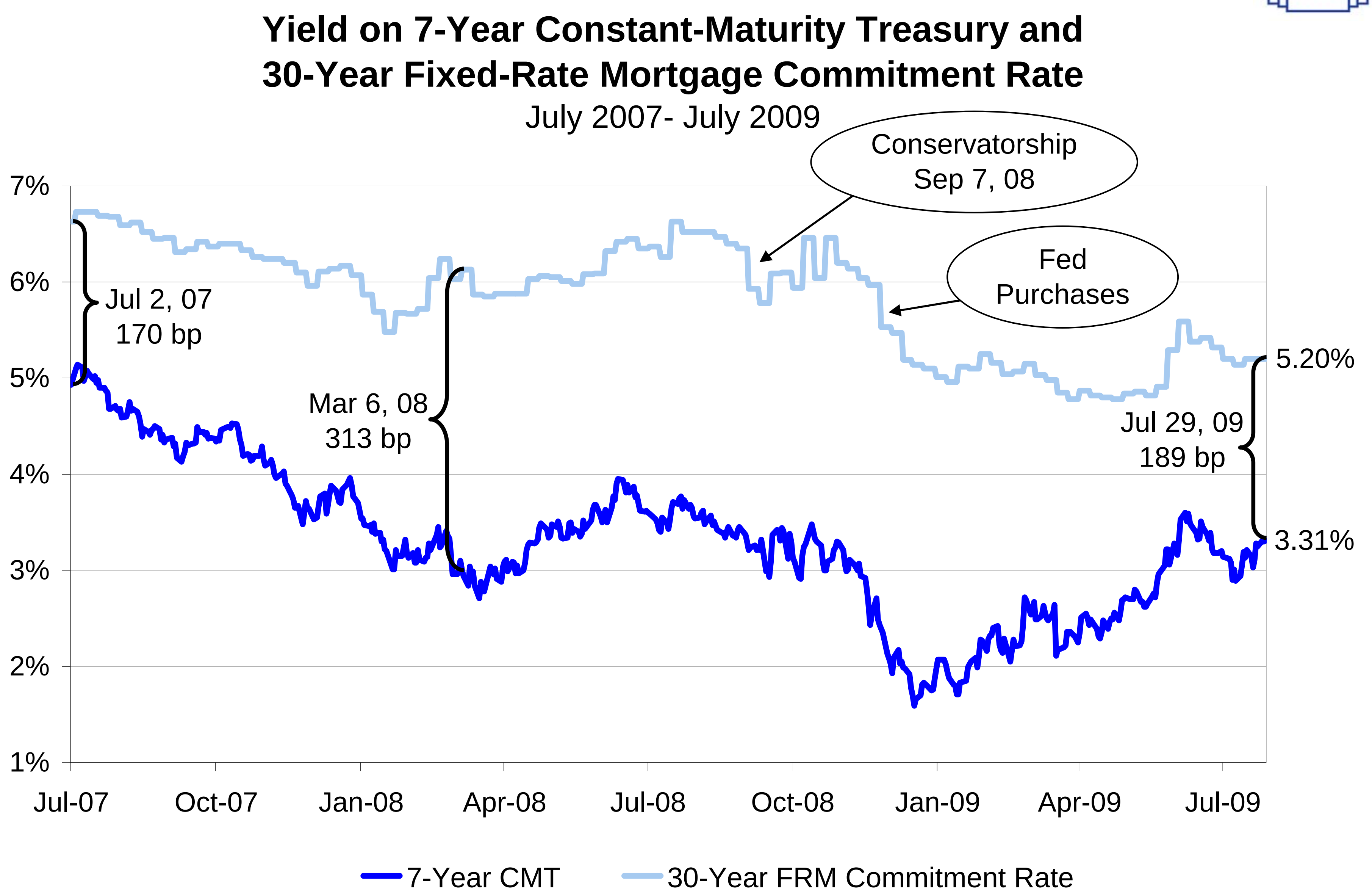
(in Billions)

	Available	Used	
Treasury:			
Senior Preferred	$400	$85	
Enterprise MBS	no limit	161	*
GSE Liquidity Facility	no limit	0	
Federal Reserve:			
Agency MBS	$1,250	$682	
GSE Debt	200	105	
Total:	**$2,011+**	**$1,033**	

data as of 7/28/2009

** included in available*

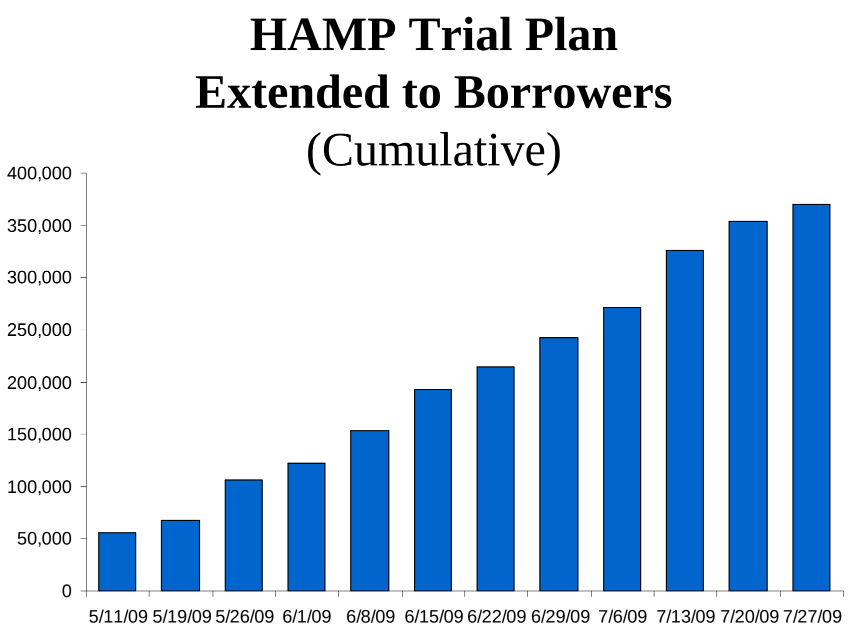
Mortgage Rates and Treasury Yields

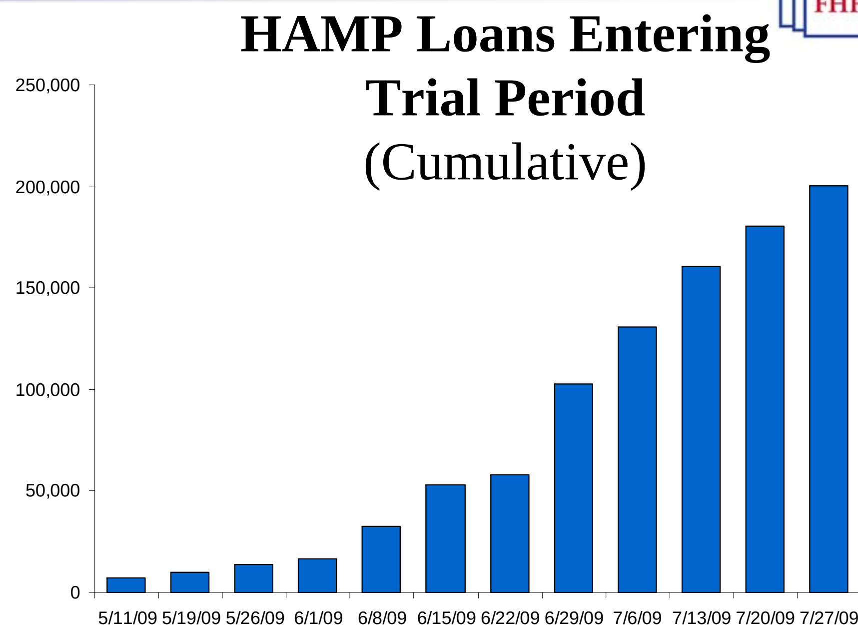


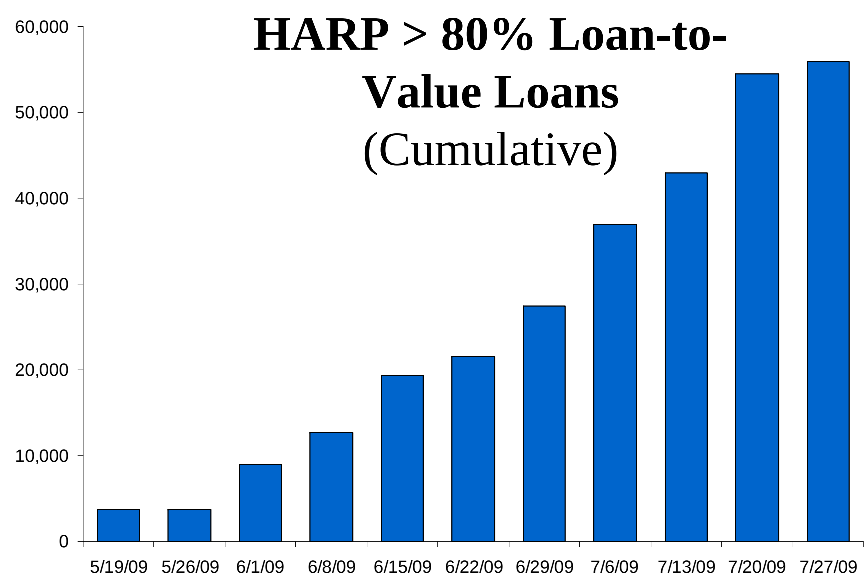
Sources: Freddie Mac, Federal Reserve Board.

Home Affordable Is Ramping Up

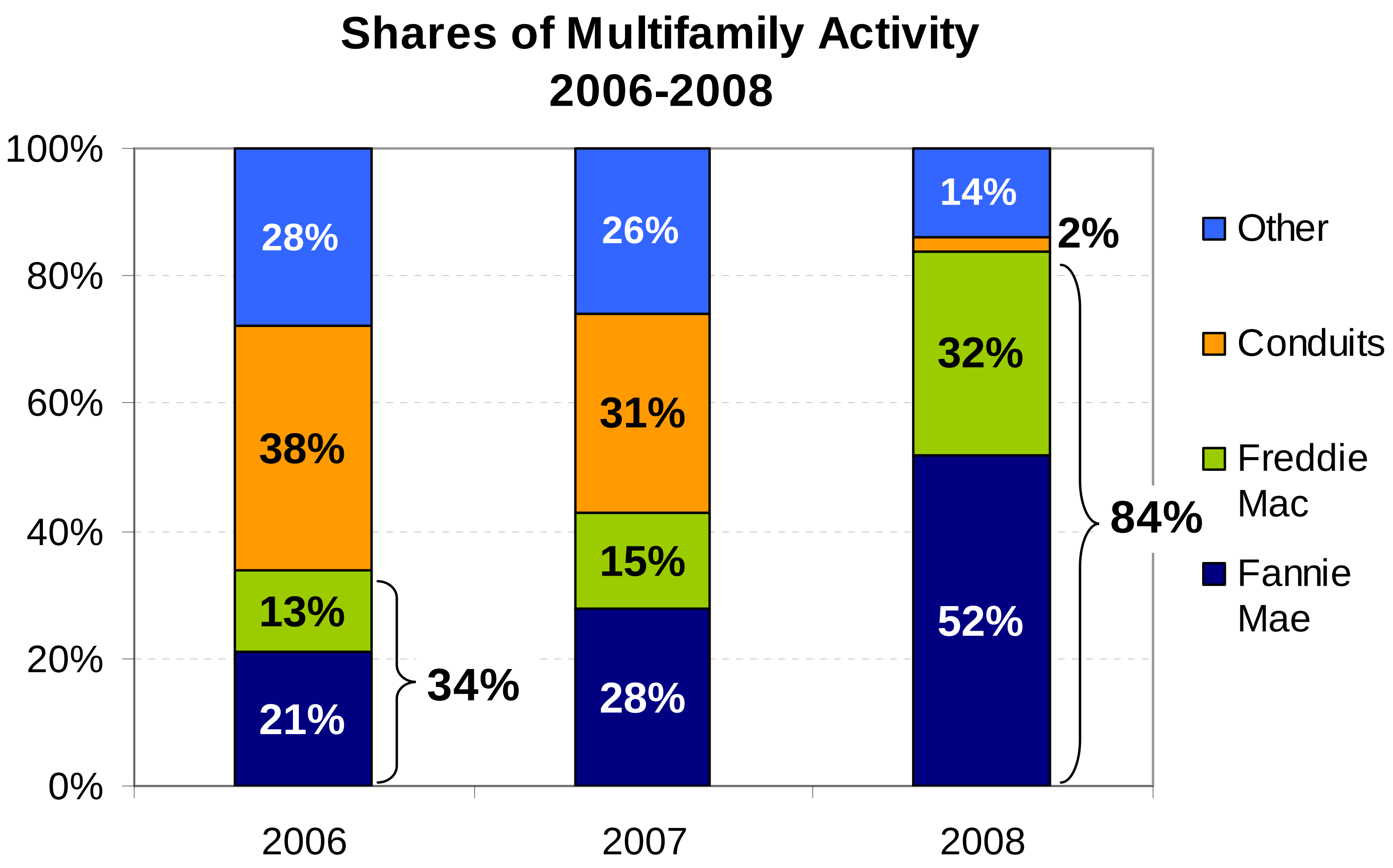
- Currently 34 participating servicers







Enterprises' Multifamily Share Growing Rapidly



Principles for the Future of the Enterprises

1. Decide what the secondary market should look like

2. Well-defined and consistent mission

3. Clear demarcation of private and public sector roles

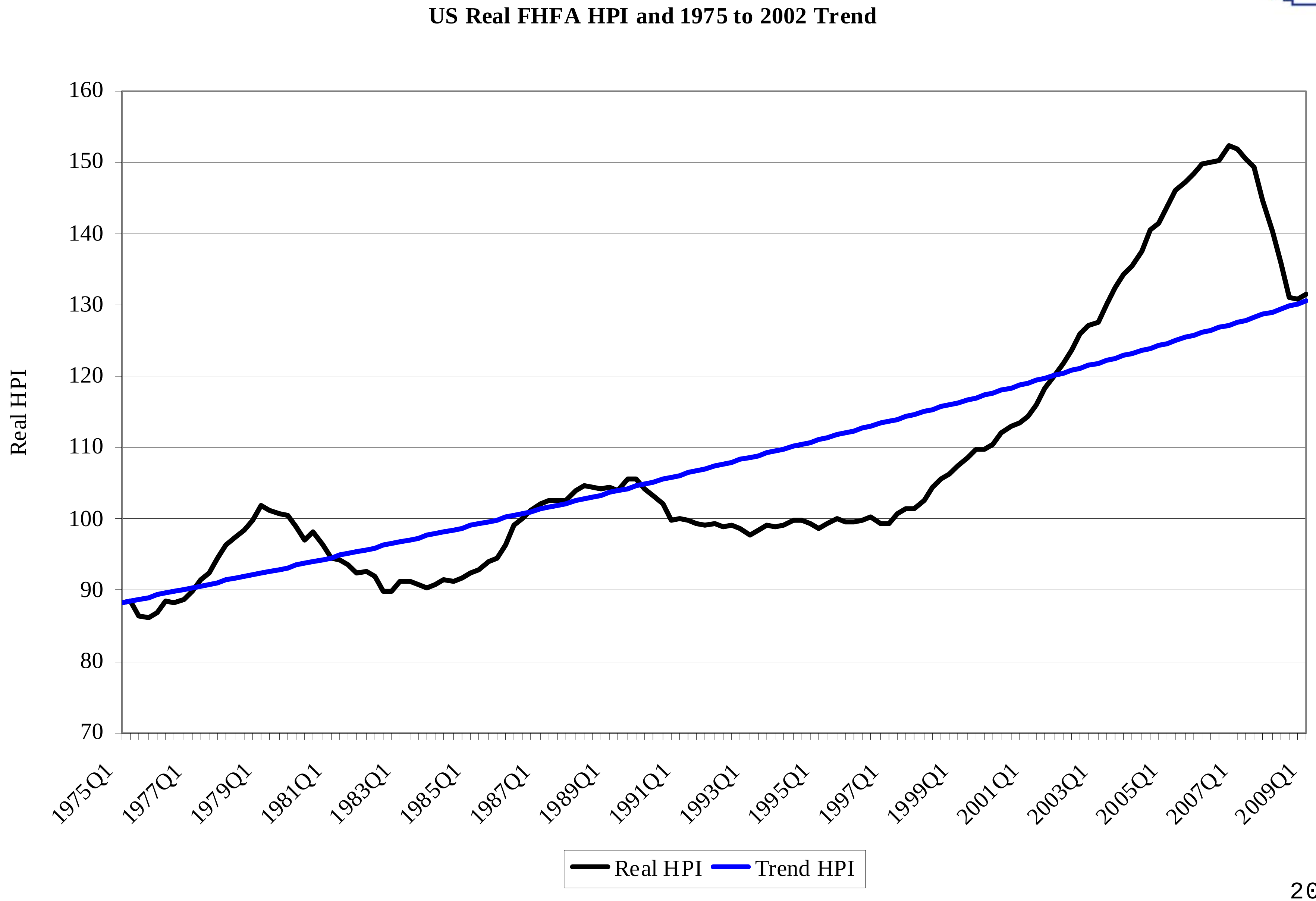
4. Regulatory and governance structure to ensure prudent risk taking based on strong insurance principles

5. Systemically prudent supervision that incorporates countercyclical capital to limit booms and busts

Why Have Countercyclical Policies?

- Curb asset price bubbles and dampen credit cycles
- Improve the odds that financial institutions will survive a crisis
- Reduce the occurrence of fire sales and credit crunches that hurt the broader economy and individuals

Countercyclical Capital Could Dampen House Price Shocks



Options for the Future of the Enterprises

- Nationalize or merge Enterprises with FHA or Ginnie Mae
  - Moral hazards of government insurance programs

- Improved GSE model building upon HERA
  - Variations include public utility model, government insurance for catastrophic risks, reduction in retained portfolios, and cooperative ownership

- Establish private-sector firms to supply liquidity to mortgage markets
  - With or without government catastrophic insurance

Congratulations – First Anniversary!

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