Address by Edward J. DeMarco
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New England Mortgage Bankers 22nd Annual Conference
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Thank you, Kevin, for that kind introduction. I am delighted to be here this morning and honored to be the opening speaker. This is the 22nd year of this conference, and I'm told that it has grown to be the second largest of its kind for mortgage banking professionals—second only to MBA's national convention, which is actually coming up in just a little less than two weeks.

I have a number of things I'd like to talk with you about this morning. I would like to begin with a short introduction to the Federal Housing Finance Agency, including a review of some of our major accomplishments this past year and the challenges we face today. I will then review the state of the marketplace today and its challenges and progress. Then I am going to try to round things out with a few comments on the future of the secondary market.

FHFA

Since FHFA has only been around for just over a year, I thought I would begin with a brief introduction of the agency. On July 30 last year, President Bush signed the Housing and Economic Recovery Act (HERA), which created the Federal Housing Finance Agency. As many of you know, FHFA came into being by combining the old Office of Federal Housing Enterprise Oversight (OFHEO), the Federal Housing Finance Board (FHFB), and a small group of staff from HUD. FHFA is responsible for overseeing the safety and soundness and mission activities of all the housing GSEs – Freddie Mac, Fannie Mae, and the 12 Federal Home Loan Banks.

In the midst of all the market turmoil of the past year, at FHFA we have been busy building a new agency with a single identity. Our staff has devoted long hours to working through the housing crisis and its implications for all the housing GSEs we oversee. We have accomplished a lot in our 13-plus months. For example:

- We are working effectively with the Enterprises – Fannie Mae and Freddie Mac – as their conservator, even as we continue to oversee them as their regulator.
- 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 the new other-than-temporary impairment rules, we worked with them on the adoption of a common platform for accounting.
- FHFA staff was instrumental in working with the Treasury Department, the rest of the Obama Administration, and others to address the problems of foreclosure prevention and people with "underwater" mortgages, with the aim of keeping people in their homes whenever possible. I will talk more about that in a few minutes.
- We have set new, more feasible affordable housing 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 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 have published our first strategic plan, our first human capital plan, our first Performance and Accountability Report, and our first annual Report to Congress.
- We have issued numerous regulations, guidance, and reports to Congress as required by HERA, and we continue to work on more.

(**SLIDE 2**) In short, we are a relatively small but very busy agency. We are focused on our mission, which is 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.

FHFA's Current Priorities and Challenges

Today, I see three priorities for the housing GSEs, and hence three supervisory priorities for FHFA.

First, as the country continues to work through the housing market collapse, I am looking to the efforts of all the housing GSEs to provide ongoing support to the mortgage market, consistent with their mission and charters. For the Enterprises, this means continuing to provide a secondary market outlet for mortgages, including mortgages that meet the Enterprises' affordable housing goals. For the FHLBanks, this means making advances and carrying out their Affordable Housing and Community Investment programs.

Second, the housing GSEs each have challenges in remediating identified weaknesses and further strengthening various aspects of their operations or risk management practices that have been stressed in this housing crisis. As financial institutions focused on housing finance, each of them has direct and indirect exposure to the record level of serious mortgage delinquencies. Our oversight of their response to these conditions is core to our mission and our view of their safety and soundness.

Third, the housing GSEs each have important roles to play in preventing avoidable foreclosures and providing programs that assist the housing market recovery. The Enterprises are implementing the loan modification and refinance programs under the Administration's Making Home Affordable program, and evaluating other areas of support such as for State Housing Finance Agencies. The FHLBanks are implementing the troubled homeowner refinance assistance available through our recent AHP regulation.

Thus, FHFA's challenge in the months ahead is to carry out our supervisory responsibility to promote financially safe and sound operations at the Enterprises and the FHLBanks while overseeing their activities that provide for affordable housing and assist the market recovery.

The State of the Market

Let me turn here and talk a bit about the market. One of the key catalysts of the current economic crisis was falling house prices after the remarkable increases that began in 2000. When house prices did begin to fall, the speed, the nationwide scope, and the depth of the decline surprised almost everyone.

(SLIDE 3) As this chart shows, from January of 2000 through the May 2006 peak, the S&P/Case-Shiller house price index rose by approximately 105 percent—only to fall by 31 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.

Recently, each index has shown the first signs of some bottoming out of house prices. The FHFA index is up 0.5 percent for the first seven months of this year. And in June, Case-Shiller reported its first up month in nearly three years.

During the boom, as house price appreciation and rising interest rates reduced housing affordability, low documentation Alt-A, interest-only loans, and adjustable-rate mortgages 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. As opposed to making a down payment, a growing share of borrowers took out second loans at origination. Consequently, 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.

Fannie Mae and Freddie Mac began to follow suit in response to declining market share and pursuit of higher profits. The Enterprises not only lowered their own underwriting standards, but also bought hundreds of billions worth of triple-A-rated subprime and Alt-A private-label mortgage-backed securities (PLS). The FHLBanks also joined in, with many of them purchasing PLS.

Clearly, we must, and we are, returning to more prudent lending standards. The credit bar that was lowered earlier this decade is being returned to a higher level, as it should.

(SLIDE 4) While the credit quality of new mortgages continues to improve, we still have a long way to go to work through the mortgages made in recent years. Once house prices began to plummet, defaults began to rise, and those numbers began increasing rapidly as house prices sank further. Over the past two years, serious delinquencies of 90-days or more have risen across the board. More than 1 in 4 subprime mortgages today is seriously delinquent. Among subprime ARMS, nearly 40 percent are seriously delinquent.

While mortgages in the prime world are performing better, the numbers are still astounding. Today, 5.4 percent of all prime loans are seriously delinquent. While the numbers are lower at Fannie Mae and Freddie Mac – ranging from 3.1 percent at Freddie Mac to 4.2 percent at Fannie Mae, these delinquency rates are disturbing both in their magnitude and in that we do not yet have a meaningful sign of their growth abating. Certainly rising unemployment has contributed to defaults as people have lost incomes and the employment situation adds to the uncertainty regarding future delinquencies.

Although Fannie Mae and Freddie Mac have a combined 57 percent share of mortgages outstanding, that accounts for only 25 percent of serious delinquencies. On the other hand, private label securities, which are 12 percent of mortgages outstanding, account for 34 percent of serious delinquencies. As these high levels of delinquencies triggered downgrades in private label securities, it has presented significant challenges for investors, including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. As of June 30, 57 percent of the carrying value of private label securities in the FHLBank system had been downgraded or placed on negative watch. This compares to only 16 percent in those categories at the end of 2008.

The combined Fannie Mae and Freddie Mac PLS holdings are much worse, with 90 percent currently downgraded, which compared to 62 percent at year-end. Unlike the FHLBanks, the Enterprises were large buyers of subprime PLS. In retrospect, it appears more and more that the housing goals process should not have allowed them to get credit for mortgages that were designed to fail.

Challenges Facing the FHLBanks

The FHLBanks have not escaped the problems in the economy and FHFA has been carefully monitoring all 12 FHLBanks and the Office of Finance. As the current mortgage market crisis began to develop in the summer of 2007, the FHLBanks played a critical, countercyclical role.

(SLIDE 5) From June 2007 to September 2008, secured loans to members, called advances, increased from $640 billion to more than $1 trillion. When 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 year, advances to members have fallen 30 percent largely due to 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.

While the FHLBanks have successfully accomplished their mission of adding liquidity to mortgages held by their member institutions, as I've already reviewed, they have their own challenges resulting from past investments in private label MBS. FHLBanks with such exposure continue to work through those issues. FHFA has been working closely with the FHLBanks to improve the measurement and reporting of these investments.

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.

(SLIDE 6) The Enterprises together own or guarantee $5.5 trillion in outstanding mortgages. Fannie and Freddie basically have two businesses: (1) guaranteeing residential and multifamily mortgage-backed securities—that blue swath on the graph; and (2) investing in whole mortgage loans and MBS, including their own—here shown in green. In 2006, we capped the growth of those portfolios after discovering serious accounting and internal control problems at the Enterprises. As part of the conservatorship, the cap has been raised to $900 billion for each this year, although they are well below the cap, and their MBS guarantee business continues to grow with no restrictions, which is necessary to help them support the market and fulfill their missions.

From 1997-2003, Fannie Mae's and Freddie Mac's market share of mortgage originations 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 shares took off—up to about 75 percent for single family and about 84 percent of the multifamily market. At the same time, FHA/VA has grown rapidly in size and market share to 22 percent.

Let me pause here and say a few words about the Enterprises and conservatorship.

Conservatorship

By early September last year, 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 Chairman Bernanke of the Federal Reserve. 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 7) As part of the conservatorship action, the Treasury Department established three facilities using its HERA authorities to ensure that Freddie and Fannie remained active in supporting the mortgage market. These facilities are the senior preferred stock purchase investments in each company to ensure their solvency; an MBS purchase program; and a credit facility providing lender-of-last resort funding to all the housing GSEs. This considerable Treasury backstop has in turn enabled Freddie and Fannie to play a critical role in bringing some measure of stability to the mortgage market and, in particular, has assured that lenders continue to have an outlet for new mortgage production.

This slide shows the utilization of these facilities. To-date, the Enterprises have drawn $96 billion under the senior preferred stock purchase agreement out of the allocated $400 billion. In addition, Treasury has purchased $181 billion of the Enterprises' mortgage-backed securities. The liquidity backstop facility for Fannie, Freddie, and the FHLBanks has not been utilized.

In addition to this Treasury support, the Federal Reserve has been an active investor in GSE securities. 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. To-date, the Fed has purchased $885 billion, of which $813 billion has been Enterprise MBS.

In a second program, the Federal Reserve had originally announced a commitment to purchase up to $100 billion in Fannie Mae, Freddie Mac, and FHLBank debt. That was raised to $200 billion, and to date, the Federal Reserve has purchased $131 billion in Fannie, Freddie, and FHLBank debt obligations**.**

In total, Treasury and Federal Reserve investments in GSE obligations now exceed $1 trillion.

These efforts have had a positive impact on mortgage rates. Rates on 30-year mortgages dropped below five percent for nearly three months earlier this year before rising, and rates now are hovering around 5 percent.

Market Stabilization and Foreclosure Prevention

All these efforts speak to overall liquidity in the mortgage market, but let me now turn to the tremendous effort that has been targeted at helping individual homeowners with troubled mortgages.

On February 18, the Obama Administration announced the Making Home Affordable (MHA) Program. This program was broadly designed to stabilize the U.S. housing market and offer assistance to millions of homeowners by reducing mortgage payments and preventing avoidable foreclosures.

A key part of the program is the Home Affordable Modification Plan – a comprehensive $75 billion program to lower monthly mortgage payments for at risk borrowers, providing loan modifications on an unprecedented scale. More than 47 servicers are participating, including the five largest. Nearly 2 million households have been contacted by servicers to request financial information in anticipation of a modification offer. More than 570,000 trial modifications have been offered under the program and more than 360,000 trial modifications are underway.

The Home Affordable Modification Program, or HAMP, has three key components.

- Affordability - First, the program focuses on affordability. The program's aim is to give homeowners with troubled mortgages an opportunity to retain their homes by ensuring their monthly mortgage payment does not exceed 31 percent of their monthly income.
- Incentives – Under MHA, success payments to servicers, investors and borrowers both encourage loan modifications and keep the incentives of each group aligned.

- Industry standard – Given the massive scale of troubled mortgages, the program establishes a standardized approach to loan modifications that assists servicers in dealing with the enormity of the situation confronting them. The detailed guidelines used in making loan modifications give the mortgage industry a standard that can be applied both within and outside of the HAMP program. Thus, HAMP should help increase the number of modifications industry-wide by providing standardized modification guidance to servicers and lenders.

Under HAMP's loan modification guidelines, mortgage servicers must make the program available to all eligible borrowers, unless explicitly prohibited by pooling and servicing agreements.

Development of HAMP was truly a collective effort, and FHFA, Freddie Mac, and Fannie Mae, have each played critical roles in assisting the Treasury Department in developing and implementing this program. Freddie and Fannie are applying the HAMP program to their own mortgage books and as agents of the Treasury Department in extending the program to mortgages in PLS and in bank portfolios. Fannie Mae is the administrator of the program and Freddie Mac has responsibility for overseeing program compliance.

The loan modification initiative is a critical effort to combat the slide into foreclosure facing the many households in this country that are seriously delinquent on their mortgages. As I showed in an earlier slide, this is a considerable and growing problem, and the loan modification effort is a serious response to help those homeowners dedicated to preserving their home if given the opportunity through a more affordable mortgage payment.

In addition to the loan modification effort is the Home Affordable Refinance Program, or HARP. Under the umbrella of the Administration's Making Home Affordable program, HARP is an effort by FHFA with the Enterprises to enhance the opportunity for homeowners to refinance. For homeowners today who have mortgages owned or guaranteed by Fannie or Freddie, and who are current on those mortgages, HARP enhances the opportunity for those homeowners to reduce their monthly mortgage payment by taking advantage of the low mortgage rates in the market today.

While a 5 percent mortgage rate creates an inviting opportunity to refinance, in today's environment, many homeowners have been unable to do so. The decline in house prices has lowered the current loan-to-value ratio for many, and for some, putting them underwater on their mortgage. Combined with the limited availability of private mortgage insurance in the marketplace today, many homeowners have been unable to qualify for a refinance.

With HARP, these barriers have been addressed. Fannie Mae and Freddie Mac today will refinance mortgages they currently hold, even up to a current loan-to-value of 125 percent. For homeowners with a current loan-to-value ratio between 80 and 125 percent, Fannie and Freddie will refinance those mortgages without requiring additional private mortgage insurance. If there already is mortgage insurance on the existing mortgage, that coverage will carry forward to the new mortgage. If the existing mortgage did not have mortgage insurance, it will not be required in the new mortgage.

In the face of the recent drop in mortgage rates, and given that this program has just been expanded to go as high as 125 percent LTV, I would call this to the attention of all of you here. There is an opportunity today to help many more homeowners strengthen their own balance sheets by taking advantage of the HARP program.

(**SLIDE 8**) As with single-family, the Enterprises increasing presence in the multifamily market has been critical to that market segment. The Enterprises are working to stabilize the multifamily market by keeping it liquid, supporting affordable rental housing and keeping to appropriate credit principles in a troubled market environment.

As of this March, the Enterprises' combined multifamily portfolios had grown to $340 billion, and their market share has grown rapidly, from 34 percent in 2006 to 84 percent last year.

The Future

I have given you a pretty intense tour of the past and present state of the market. You may well be asking, "Yes, but what next? Where exactly are we headed in all this?" And I am sure many of you are trying to project into the future to figure out how Fannie and Freddie might change post-conservatorship and what this might mean for your business.

One of the inescapable but discouraging facts we have learned from this housing crisis is how many households either did not understand the mortgage loan they had taken or did not realize the magnitude of the risks to their personal financial situation if something went wrong and they could not manage high mortgage payments, or both. While most attention in the wake of this crisis has been on improving regulatory oversight of financial institutions, and strengthening financial institution balance sheets, we should not lose sight of these issues at the household level. All of us need to refocus our energies on helping improve financial literacy nationwide and building a solid foundation that leads to economic opportunity.

The damage of the housing crisis to millions of American families has been substantial. To keep it from happening again, lending institutions need to return to more prudent lending practices, and households need to improve their understanding of financial products such as mortgages and reduce the leverage in their balance sheets. Mortgage bankers can play a positive role in achieving those goals.

Let me conclude with a few words on the future of the U.S. mortgage market. That market may be seen at a macro level as a $12 trillion credit market that relies on the resources of global capital markets to supply that volume of financing to America's homebuyers and renters. At a micro level, though, the mortgage market is made up of millions of individual transactions that average about $200,000 apiece.

Since the global marketplace is not directly connected to any of those individual transactions, we need efficient conduits between local mortgage lenders, including mortgage bankers, and global capital markets to ensure that families have access to stable, low-cost credit to finance their dream of homeownership.

In the coming months, the country's policymakers will be focused on what we have learned from the problems of the past few years and how we should apply that learning to improving the future structure of housing finance in this country. In my view, the place to start the discussion centers on what the nation's goals are for the secondary mortgage market and what is the appropriate role of government in achieving those goals. These questions should come before discussion of particular companies or institutional arrangements. As we already know from proposals that have been put forward, there are multiple options for the future of the secondary mortgage market.

Whatever the outcome of the policy-making process, the country needs a vibrant, liquid, and efficient secondary mortgage market to support both single family and multifamily mortgage finance. I am confident we will find the answers to the questions before us, building upon the strengths of the existing system to create a more resilient system going forward.

Thank you again for inviting me and giving me this opportunity to speak with you this morning. I will be happy to take questions in the time we have remaining.

New England Mortgage Bankers Conference
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Acting Director

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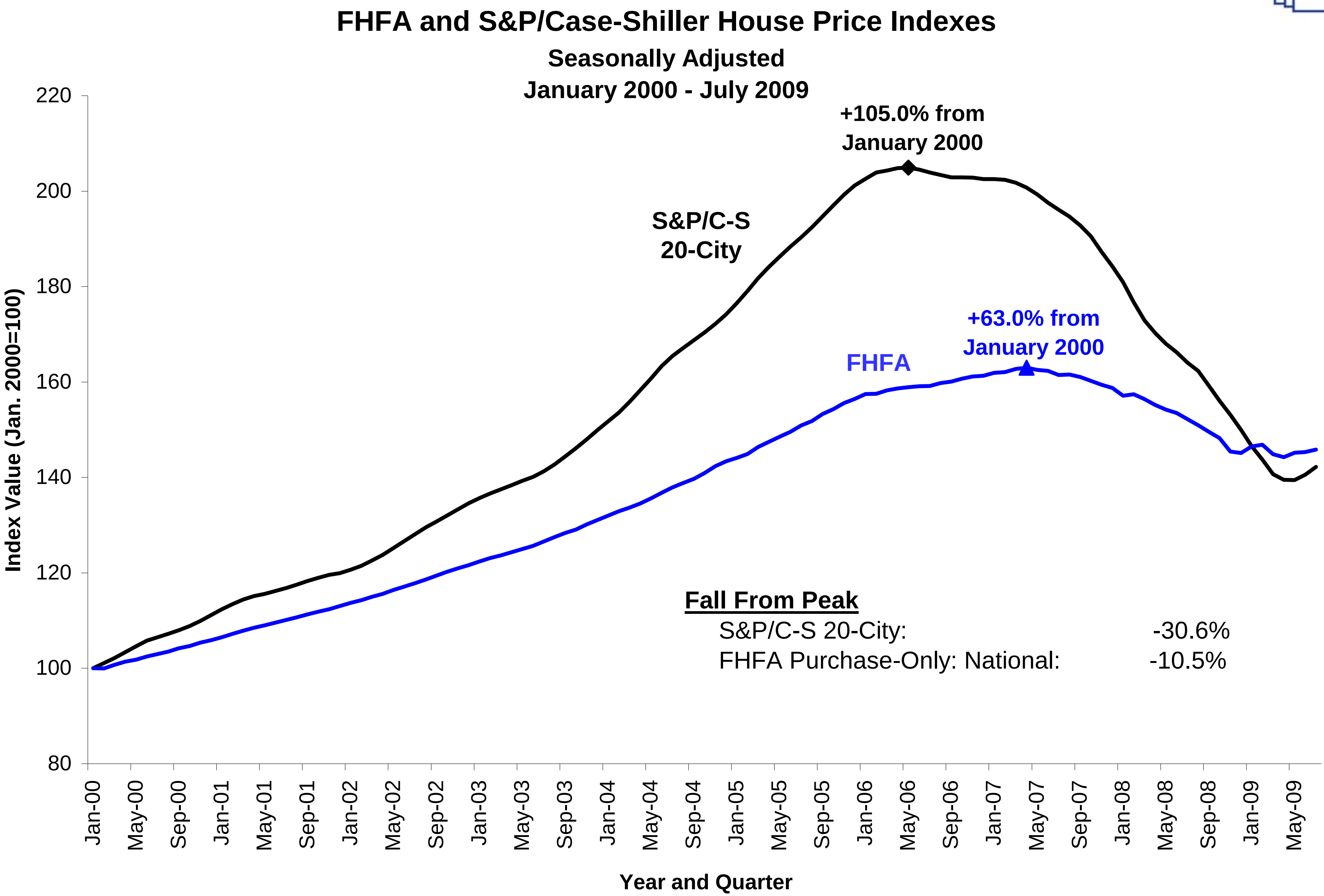
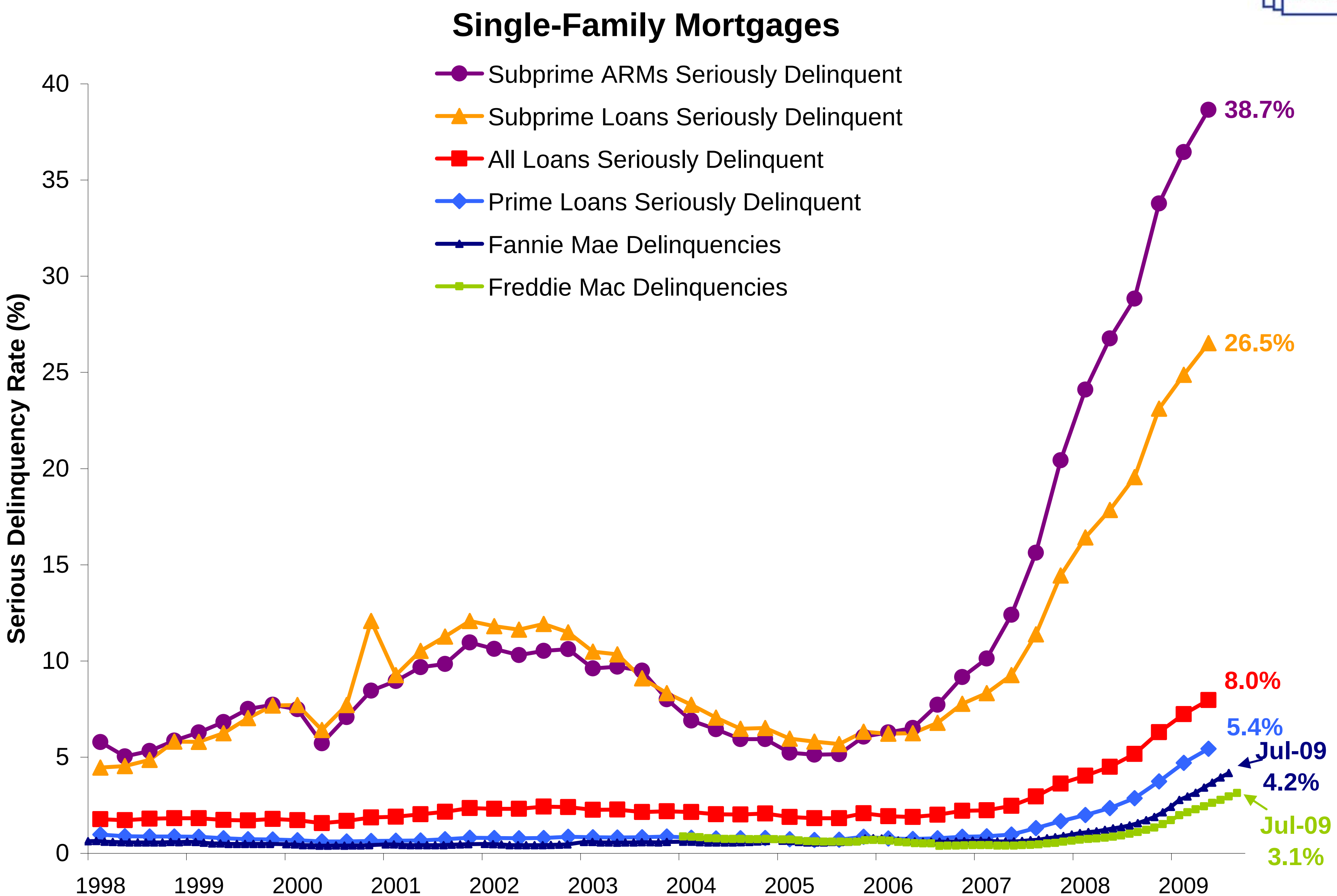
House Prices Beginning to Stabilize



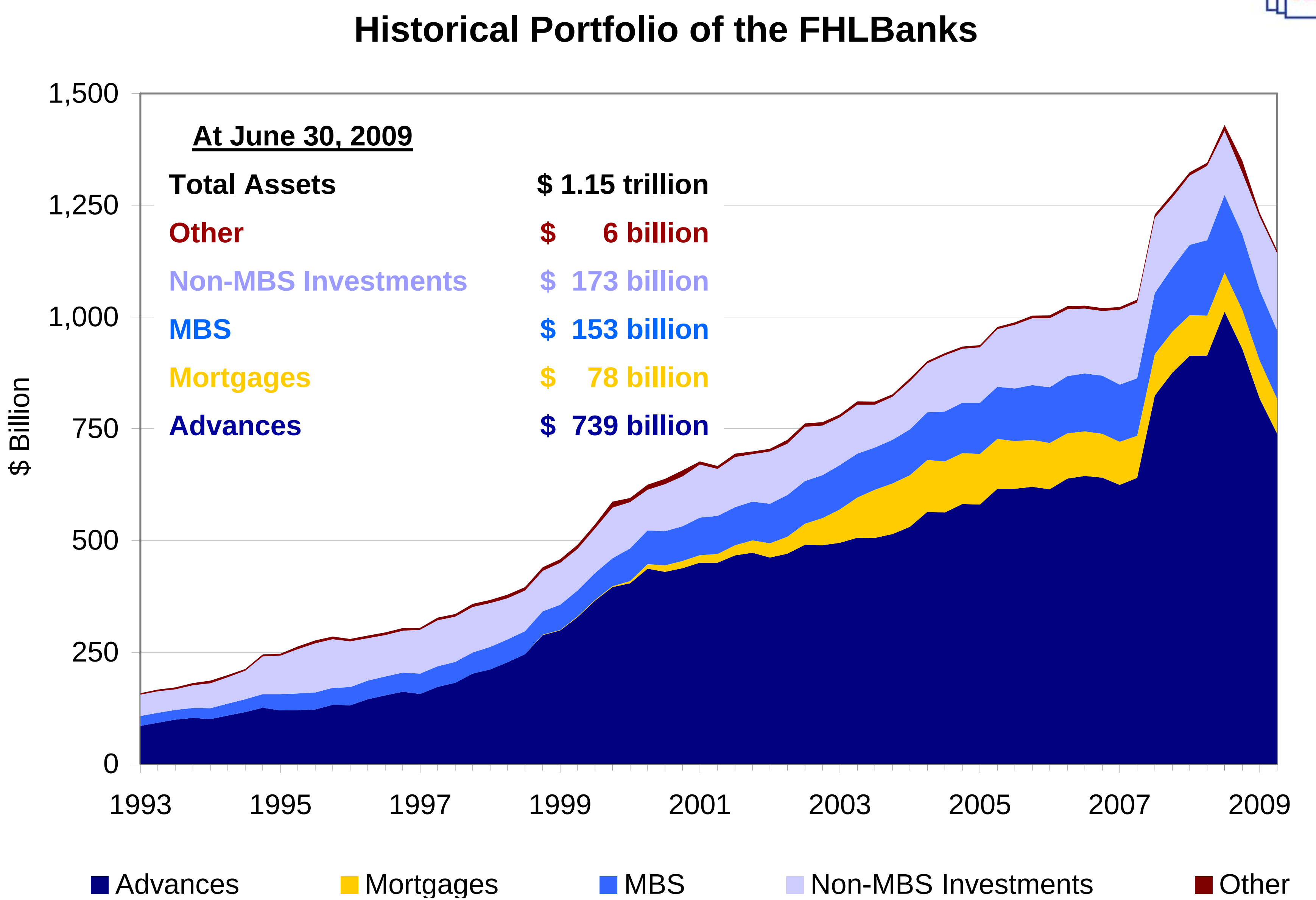
Note: For purposes of comparison, the FHFA purchase-only index has been re-based to January 2000=100 (the standard series is set so that January 1991=100)

Serious Delinquencies Rising Rapidly

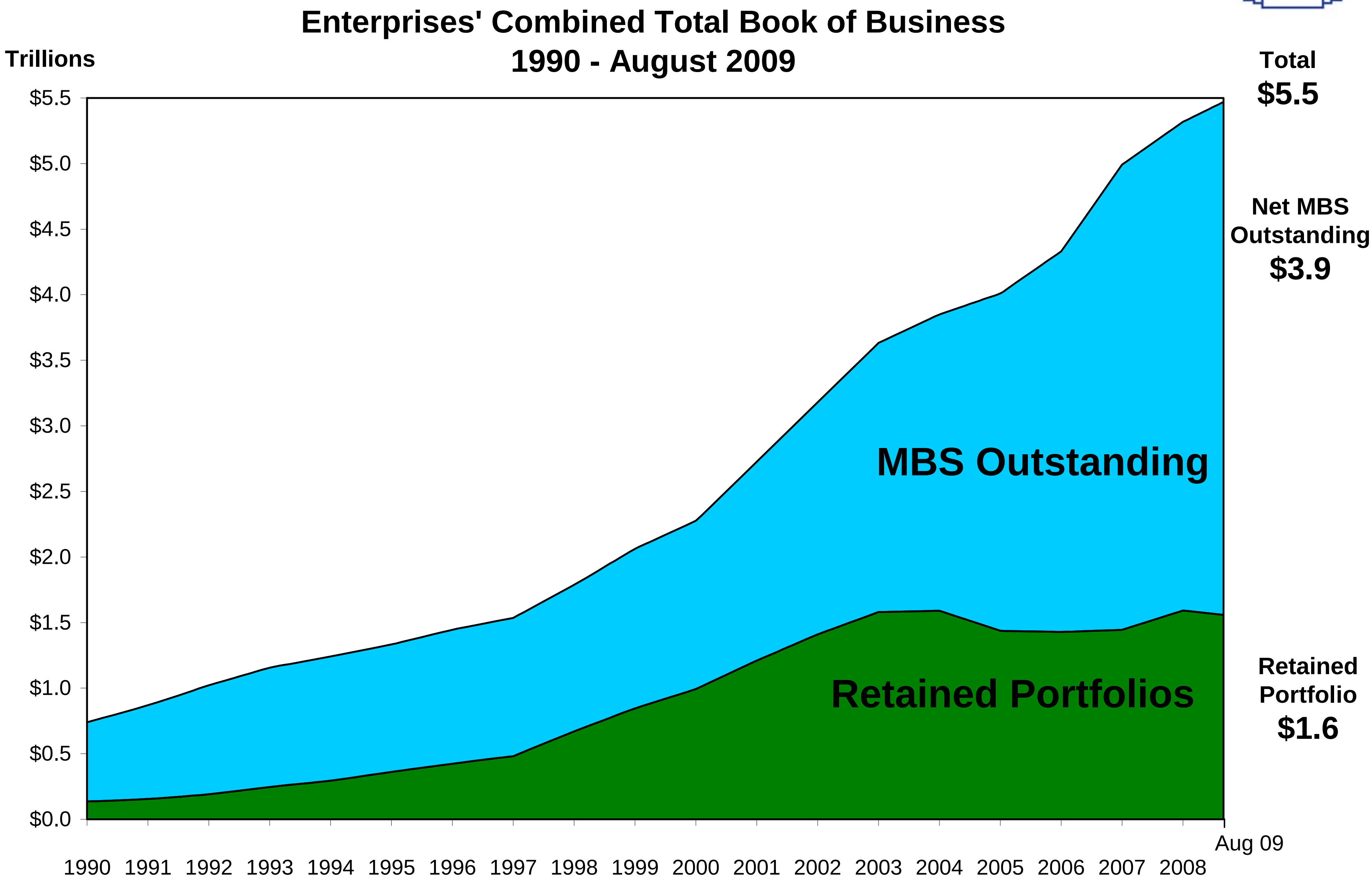


Sources: Mortgage Bankers Association, Fannie Mae, Freddie Mac.

FHLBank Advances Peak in Third Quarter 2008



Fannie and Freddie Continue to Grow



Sources: Fannie Mae and Freddie Mac 10-Q Statements and FHFA 2008 Report to Congress.

Treasury and Fed Support Is Strong

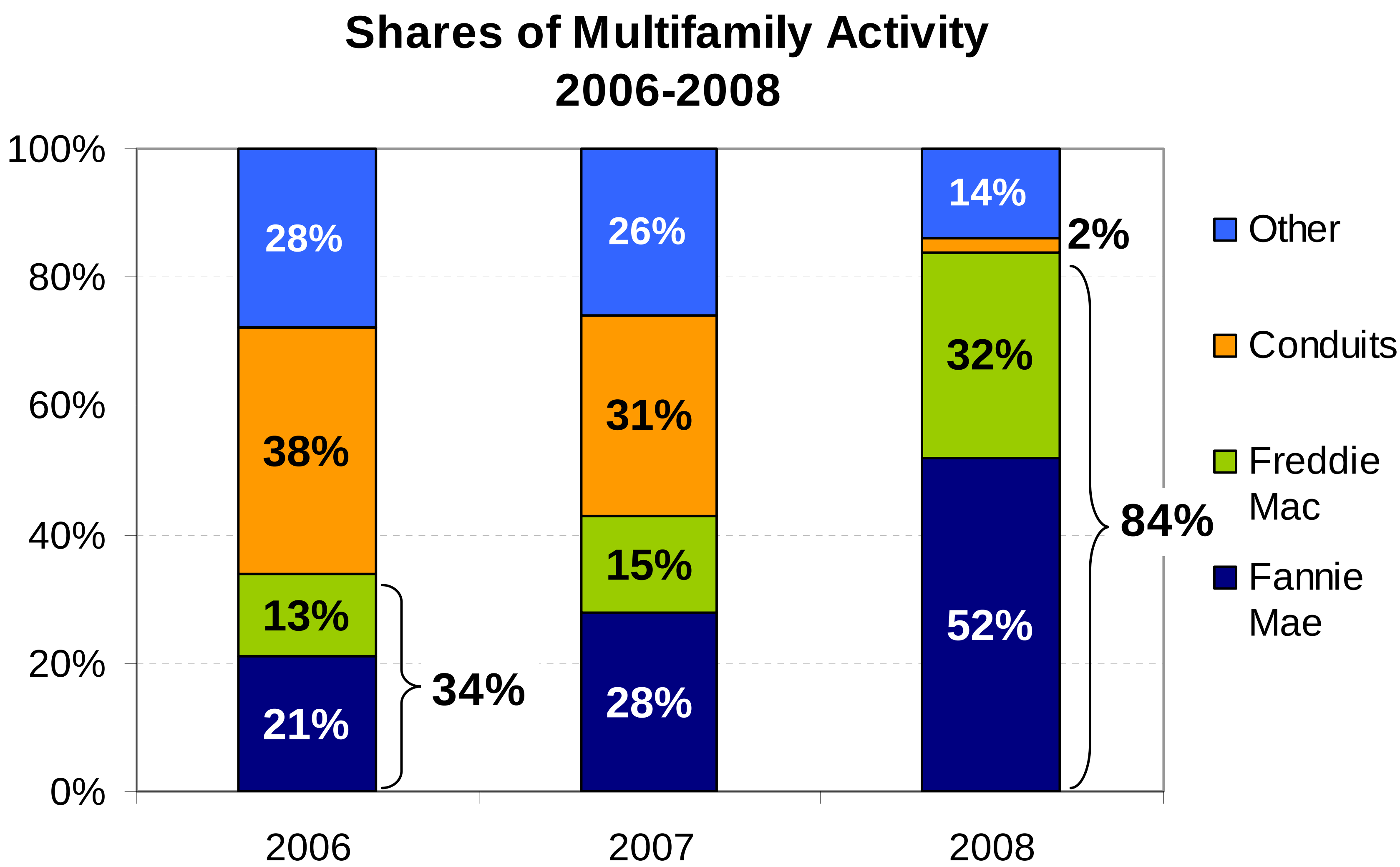
(in Billions)

	Available	Used
Treasury:		
Senior Preferred	$400	$96
Enterprise MBS	no limit	181 *
GSE Liquidity Facility	no limit	0
Federal Reserve:		
Enterprise MBS	$1,250	$813
GSE Debt	200	131
Total:	**$2,031+**	**$1,221**

data as of 9/28/2009

** included in available*

Enterprises' Multifamily Market Share Growing Rapidly



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ERRATA:

This document was originally posted on October 1, 2009. On November 17, 2009, a correction was made to slide 8.

The slide had incorrectly labeled the share of multifamily financing attributable to “Other” in 2008 as 18 percent, which resulted in the sum of all shares exceeding 100 percent. The slide now correctly shows that the “Other” share in 2008 was 14 percent.