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Thank you. I am very pleased to be the speaker today for this Public Policy Luncheon, especially after the very enjoyable reception last evening. I have quite a few things to talk with you about today.

FHFA has been extremely busy over the past months. For example, we have issued numerous proposed and final regulations, including recently published final rules allowing community development financial institutions to become members of the Federal Home Loan Banks and requiring Fannie Mae and Freddie Mac to report to FHFA anytime they discover they have purchased or sold a fraudulent loan or financial instrument. We've also published a proposed rule to promote the inclusion of women and minorities in all activities at Fannie, Freddie, and the Federal Home Loan Banks.

Of course, the key focus of FHFA with regard to Fannie Mae and Freddie Mac is conservatorship. Two weeks ago, I sent a letter to the leadership of the House and Senate banking committees outlining the current state of the conservatorships. Among the topics I covered was the critical work being done in loan modifications and loss mitigation. As I emphasized in the letter, loan modifications, and other loss mitigation activities will be a key focus in 2010 for Fannie Mae and Freddie Mac and for FHFA as their conservator and regulator. Those activities are central to the purpose and goals of the conservatorships. I will return to these issues and to other matters covered in my letter in a few minutes. But I would like first to explain how the conservatorships operate and then give you a brief overview of where things stand with Fannie and Freddie, or "the Enterprises," as we frequently refer to them. I also want to talk with you a bit about the Federal Home Loan Banks.

Conservatorship Operations

The purpose of conservatorship is to preserve and conserve each company's assets and property and to put the companies in a sound and solvent condition. The goals of the conservatorships are to help restore confidence in the companies, enhance their capacity to fulfill their mission, and mitigate the systemic risk that contributed directly to instability in financial markets.

As conservator, FHFA has the powers of the management, Boards, and shareholders of the Enterprises. However, the Enterprises continue to operate as business corporations. For example, they have chief executive officers and Boards of Directors, and must follow the laws and regulations governing financial disclosure, including requirements of the SEC. Like other corporate executives, the Enterprises' executive officers are subject to the legal responsibility to use sound and prudent business judgment in their stewardship of their companies.

FHFA has made clear since the beginning of the conservatorships that the Enterprises would continue to be responsible for normal business activities and day-to-day operations. FHFA continues to exercise oversight as safety and soundness regulator and has a more active role as conservator. While FHFA has very broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations. Instead, FHFA reconstituted the Boards of Directors at each Enterprise and charged the Boards with ensuring normal corporate governance practices and procedures are in place. The new Boards are responsible for carrying out normal Board functions, but they remain subject to review and approval on critical matters by FHFA as conservator. The Enterprises are large, complex companies, and this division of responsibilities represents the most efficient structure for carrying out FHFA's responsibilities as conservator.

In my view, maintaining and strengthening the private sector disciplines associated with each Enterprise's corporate infrastructure promotes the goals of the conservatorships and maximizes the government's options in a post conservatorship world, including the opportunity to gain some return for taxpayers in a resolution of these companies. Any preservation of value in the Enterprises is directly related to maintaining the value of the intangible assets of these companies, including their human resources and business platforms.

The Enterprises operate with an uncertain future, one that will be the source of much public debate. As conservator, I believe it is critical to protect the taxpayer interests in the Enterprises by ensuring each company has experienced, qualified people managing the day-to-day business operations in the midst of this uncertainty. Any other approach puts at risk the management of more than $5 trillion in mortgage holdings and guarantees supported by taxpayers through the Treasury's senior preferred stock purchase investment.

Let's look at what is being done by the Enterprises today.

Foreclosure Prevention and Loss Mitigation

Conserving the assets of the Enterprises requires, first and foremost, minimizing their credit losses from delinquent mortgages. This is and will remain the central goal of FHFA and the Enterprises.

FHFA also operates under a statutory mandate in the Emergency Economic Stabilization Act of 2008 (EESA)—the same legislation that established the TARP program—to implement a plan aimed at maximizing assistance to minimize foreclosures. That mandate specified loan modifications and tenant protections as part of the intended program and established a monthly reporting requirement for FHFA.

Each month we report on a spectrum of Enterprise loss mitigation activity in our *Foreclosure Prevention and Refinance Report*, which you can find on our Web site. For loan modifications, we also report on modification terms, including term extensions and rate reductions.

Even before the Making Home Affordable program was in place, both Enterprises offered foreclosure alternatives such as repayment plans, forbearance, short sales, and deeds in lieu of foreclosure. The Enterprises continue to find successful foreclosure alternatives with their distressed borrowers more often than they have foreclosed.

The Enterprises' participation in MHA is a critical step to minimizing their credit losses because a loan modification is often a lower cost resolution to a delinquent mortgage than foreclosure. Since the Enterprises own or guarantee about half the mortgages in the country, efforts like MHA that provide stability to borrowers also serve to restore stability to housing markets, which directly benefits the Enterprises by reducing credit exposure. The Enterprises also act as agents for Treasury in implementing the MHA loan modification program.

I have communicated to each Enterprise the need for rigorous analytics in considering different forms of loss mitigation to ensure credit losses are being minimized. The Enterprises' current and future efforts surrounding foreclosure prevention will focus on mitigating losses, which is fundamental to FHFA's mandate to conserve assets. And where there is no available, lower-cost alternative to foreclosure for a particular defaulted mortgage, my expectation is the Enterprises will move to foreclose expeditiously.

Let me turn now to several specific issues concerning the Enterprises in conservatorship. I covered each of these in my recent letter to the Hill, which, by the way, is also available on our Web site. But I would also like to update a few of these items with new information since that letter.

Retained Portfolios

FHFA remains committed to the principle of reducing the Enterprises' retained portfolios as set forth in the September 2008 agreement with Treasury. FHFA does not expect the Enterprises to be substantial buyers or sellers of mortgages, with an important exception, and that is the Enterprises' purchases of delinquent mortgages out of guaranteed mortgage-backed security pools. Just last week, Freddie Mac and Fannie Mae each announced that it would purchase 120-plus days delinquent loans out of their mortgage-backed securities pools. This provides increased certainty to investors in those securities regarding prepayments, it returns this principal at par to the investors, thereby freeing up additional capital to invest in new mortgages, and it reduces costs to taxpayers. Of course, every effort will continue to be taken to minimize the Enterprises' ultimate credit losses from these delinquent loans, whether through a loan modification or some other form of loss mitigation.

Given the size of the Enterprises' current outstanding retained portfolios, and the potential volume of delinquent mortgages to be purchased out of guaranteed mortgage-backed security pools, it is my expectation that any net additions to their retained mortgage portfolios would be related to this activity. I also expect that other private parties will begin to invest in new Enterprise mortgage-backed securities as the Federal Reserve gradually withdraws its purchase activity.

New Products

HERA established a requirement that FHFA implement a public review process for any new products proposed by the Enterprises. In July 2009, FHFA published an interim final rule implementing this provision. So far, no new product submission has gone through this process.

After considering the statutory requirement and the goals of conservatorship, I have concluded that permitting the Enterprises to engage in offering new products is inconsistent with the goals of conservatorship, and I have instructed the Enterprises not to submit any such requests.

In view of the critical and substantial resource requirements of conserving assets and restoring financial health, combined with a recognition that the Enterprises operate today only with the support of taxpayers, I believe the Enterprises should concentrate on their existing core businesses, including minimizing credit losses.

I reached this conclusion as various proposals seek Enterprise involvement that, even if within charter limitations, could require large expenditures of funds, entry into new business lines with little prior experience, or dedication of personnel already operating in a stressed environment.
So, the Enterprises will be limited to continuing their existing core business activities. This type of limitation on new business activity is consistent with the standard regulatory approach for addressing financially troubled companies—and it is even more pertinent for the Enterprises given their uncertain future and reliance on taxpayer funds.

Affordable Housing Mission

This week, FHFA sent to the Federal Register for public comment a proposed rule regarding Enterprise housing goals for 2010 and 2011. This proposal carries out the comprehensive revisions to the housing goals required by HERA and offers what we view as creative and appropriate responses to the current mortgage market.

Before going into the details of the proposal, let me comment on how the rule interacts with the state of conservatorship. While the Enterprises are in conservatorship, FHFA expects them to continue to fulfill their core statutory purposes and that includes their support for affordable housing. One set of measures of the Enterprises' support for affordable housing comes through the housing goals, which Congress revised significantly in HERA.

The proposed rule would modify the housing goals structure established by HUD for 2005-2008, and subsequently extended and modified for 2009 by FHFA, in a number of ways. As required by HERA, it proposes three single-family home purchase goals: low-income families (27 percent of such mortgages financed by each Enterprise), very low-income families (8 percent), and families in low-income or high minority or disaster areas (13 percent). The proposed rule also contains goals for single-family refinance mortgages for low-income families (25 percent) and sets two multifamily goals.

The proposed rule differs from previous housing goal regulations in several important ways, most of which were mandated by HERA.

First, there would be no overall goals for 2010-2011 covering all of each Enterprise's mortgage purchases, as in the past. Rather, there would be four separate goals for purchases of single-family mortgages and two goals for purchases of multifamily mortgages.

Second, the proposed rule establishes separate goals for single-family home purchase mortgages and refinancing mortgages. This differs from past treatment, which combined such purchases for the overall goals.

Third, the proposed rule targets households with lower incomes. The past low-and-moderate income goals included families with incomes up to 100 percent of area median income (AMI). Under the proposed rule, the low-income home purchase and refinancing goals would include only families with incomes no greater than 80 percent of AMI.

Fourth, the low-income areas home purchase goal would be somewhat more targeted than the past underserved areas home purchase subgoal. For example, the new low-income areas housing goal includes families in census tracts with incomes up to 80 percent of AMI, compared to 90 percent of AMI in the prior subgoal.

Fifth, based on the language in HERA, the proposed rule would count only conventional loans for purposes of the housing goals. As a result, certain FHA loans that previously counted toward the goals, such as Home Equity Conversion Mortgages (HECMs), will no longer be counted.

Sixth, mortgages financing rental units in single-family properties, which were previously included in the goals, would no longer be counted. FHFA will continue to monitor the Enterprises' purchases of such mortgages with regard to rental units in both 2-4 unit owner-occupied housing and investor-owned 1-4 unit rental housing.

Seventh, in the multifamily area, the goals would be based on the actual numbers of affordable dwelling units financed, rather than minimum dollar terms as has been the case in the past. The proposed rule establishes separate goals for Enterprise purchases of multifamily mortgages for low-income families (237,000 units for Fannie Mae and 215,000 units for Freddie Mac) and for very low-income families (57,000 units for Fannie Mae and 28,000 units for Freddie Mac). The Enterprises will also be reporting their funding of low-income units in small (5- to 50-unit) multifamily properties.

Finally, unlike past practice, the rule proposes to prohibit housing goals credit for mortgages in private label securities.

This proposed rule addresses the major changes to the goals regime required by HERA, and it breaks new ground as well. In the past, the Enterprises' housing goals were set prospectively by rule. That is, HUD established in regulation the target housing goal levels for future years. The approach set forth in FHFA's proposed rule utilizes prospective, or "benchmark" goals but also adds a market-based alternative measure for each single-family goal. This market-based assessment measures the Enterprises' single-family goals performance relative to the actual goals-qualifying shares of the primary mortgage market. Thus, an Enterprise can satisfy a particular goal if it exceeds the prospective (benchmark) goal level in the rule or if the goal category's share of the Enterprise's business for the year is at least as great as the category's share of the overall market.

Here's how this market-based approach would work. The proposed rule establishes a prospective (benchmark) low-income family goal of 27 percent. An Enterprise will satisfy this goal if 27 percent of the total number of purchase money mortgages acquired by the Enterprise that finance owner-occupied single-family properties meet the low-income standard. Alternatively, if the actual market share of purchase money mortgages to low-income families relative to all purchase money mortgages originated to finance owner-occupied single-family properties is some other percentage, then an Enterprise will also satisfy this goal if it achieves that actual market percentage.

You may find the proposed rule on our Web site. It will be published in the *Federal Register* shortly and there will be a 45-day public comment period. I would also add that yesterday we published a Mortgage Market Note that provides data on the history of the housing goals and their relationship to actual market shares.

HERA also mandated that FHFA develop housing goals for the FHLBanks and develop a "duty to serve" requirement for the Enterprises. We expect to release the proposed housing goals for the Federal Home Loan Banks and proposals for the Enterprises' duty to serve requirement soon.

The Federal Home Loan Banks

As you know, FHFA also oversees the Federal Home Loan Banks. One of the good news stories in the recent crisis is that the FHLBank System worked as it was designed, providing a substantial increase in its lending to member depository institutions as those institutions faced critical liquidity needs in 2007 and 2008, during the months of financial market upheaval.

Advances to FHLBank member institutions topped $1 trillion in October 2008. As alternative sources of liquidity emerged and the demand for liquidity receded, advances have retreated to less than $700 billion, but without significant adverse consequences for the FHLBanks. At the end of 2009, advances were $631 billion. This is down from the peak of $1.011 trillion as of September 30, 2008, but it is comparable to the pre-crisis level of $640 billion. The decline in advances reflects the decreased demand from the membership in the light of constant deposit growth and declining loan demand.

The biggest looming challenge for the Federal Home Loan Banks in 2010 remains the problems associated with private-label mortgage-backed securities. The extent of the challenge and its effect on profitability varies among the Federal Home Loan Banks. For example, two of the Federal Home Loan Banks have essentially no exposure to private-label MBS, whereas six reported a quarterly loss at some point in 2009 and four – the Federal Home Loan Banks of Boston, Pittsburgh, Chicago, and Seattle – recorded cumulative net losses through the first three quarters of 2009, due principally to credit losses on their holdings of private-label MBS. FHFA is keeping a close watch on these situations. What we see going forward is renewed emphasis on the basic advances business of the Federal Home Loan Banks, which will continue as a low-risk, low-return business, although likely at a smaller scale.

We also expect that the Federal Home Loan Banks will continue to serve their memberships in other ways while working to minimize private-label MBS losses. For example, we expect the System to continue its work to support affordable housing and community development. As I mentioned earlier, CDFIs are now eligible for FHLB membership, and this will expand the capacity of the Banks to support innovative efforts to provide affordable housing. Similarly, we are about to publish a proposed rule that will cover the use of community development loans by community financial institutions to secure advances.

Concluding Thoughts

The Federal Home Loan Banks and the Enterprises have several major challenges to face going forward, all stemming from issues ultimately related to bad loans during the period of lax underwriting standards earlier in the decade. But the current situation that has the Enterprises' operating in conservatorship cannot be a long-term solution. When the conservatorships and Treasury's financial commitment were established in 2008, Secretary Paulson described the arrangement as a "time-out" to allow policymakers to further consider the role of the federal government and the Enterprises in the future system of housing finance. There are a variety of options available for post-conservatorship outcomes, and I recognize the Administration and Congress have difficult and important decisions to make in the coming months on the future structure of the housing finance system.

Thank you for the opportunity to speak to you today. I would be glad to answer your questions.