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Thank you for having me here this morning. I am pleased to talk with you about the recent past, current state, and future path of housing finance in the United States. Certainly part of this tale is one of risk management failures and of numerous risk management challenges today. I will focus my remarks particularly on Fannie Mae and Freddie Mac. These are the specialized institutions established by Congress to connect national and global capital markets to local mortgage lenders around the country.

My agency, the Federal Housing Finance Agency, or FHFA, was created in July 2008 to oversee Fannie Mae and Freddie Mac, as well as the twelve Federal Home Loan Banks. In establishing FHFA, Congress combined two existing regulatory agencies, transferred some authorities from the Department of Housing and Urban Development, and gave this new regulator greater powers and responsibilities than existed across the predecessor agencies. While many of these new authorities and responsibilities were designed to curb excessive risk-taking and to give the new regulator more authority to act, the legislation came far too late to stem the housing crisis or the collapse of Fannie Mae and Freddie Mac. Indeed, less than six weeks after being created, FHFA placed Fannie Mae and Freddie Mac into conservatorship. Since that time, FHFA has been both the conservator and regulator of Fannie Mae and Freddie Mac, or the Enterprises as I will refer to them from here on. These operations have been made possible by the financial backing of the U.S. Treasury, backing authorized by Congress in 2008 and implemented through Treasury's

Senior Preferred Stock Purchase Agreements with each company. To-date, these agreements have resulted in more than $150 billion being drawn from Treasury by the Enterprises.

As background, let me first describe the relevant economic, institutional, and legal framework. I will then review the current state of the conservatorships, followed by a review of the risk management challenges FHFA faces today as conservator.

The country began the new century in the midst of a prolonged period of rising house prices, including house price increases from 2003 through 2006 that were quite extraordinary in many parts of the country. House price growth exceeded its long-term trend and much of the public policy focus in the 1990s and 2000s was geared toward promoting homeownership.

While there were many elements to what was happening, I will mention just two. First, the use of home equity to finance household consumption or other investments increased the leverage on household balance sheets. Cash-out refinances of first mortgages and equity withdrawals through second mortgages or home equity lines of credit increased the monthly debt obligations of many households while exposing them, and mortgage lenders, to potential losses if house prices and / or employment turned down.

Second, rising house prices combined with efforts to increase home ownership rates fed a desire to find ways to make homeownership more affordable. This led to a combination of changes in home financing, including weakening credit standards and the emergence of so-called "affordability products" designed to reduce the apparent cost of homeownership. Some of these products were sold to unwitting consumers or marketed in fraudulent or deceptive ways that masked the risks to borrowers. Efforts to make mortgage financing "more affordable" through subsidies and financing gimmicks may have been largely self-defeating as financing schemes that reduced initial borrowing costs helped feed the continued growth in house prices.

As house prices continued to soar, mortgage borrowers and mortgage investors collectively came to rely upon further increases in house prices, and an ability to easily refinance, in making their credit decisions. Of course, when the music stopped and house prices suddenly began falling, the risks inherent in these practices and products became clear.

The resulting toll on our economy, and individual and national wealth, has been substantial. The impact on countless families has been tragic. The government responded with numerous interventions and programs designed to bring stability and liquidity to financial markets and major financial institutions, support for housing markets and for borrowers with troubled mortgages, and economic stimulus to promote economic activity and employment. The results have been mixed. On the one hand, a catastrophic financial meltdown was averted but the country has gone through, and is struggling to recover from, a deep and prolonged recession marked by persistent unemployment and unprecedented mortgage delinquencies and foreclosures.

Despite these serious problems, reasons for hope include the increasing strength of the economy and recent reductions in unemployment. Bad subprime loans and overpriced housing markets were our principal problem four years ago, but high unemployment rates have been the source of most recent defaults.

Policy actions aimed at assisting troubled homeowners and stabilizing house prices appear to have had some success**.** FHFA's house price index shows that prices have fallen 16 percent from their highs nationally, but less than a third of that decline has come in the past two years. Other price indexes show even more dramatic moderation in that time. These programs have not solved all our mortgage market problems as one can see from the latest delinquency data, which show 8.6 percent of all mortgages are currently 90 or more days delinquent or in process of foreclosure. This is an improvement from a year earlier, when the rate was close to 10 percent, but it still indicates a large backlog of unresolved problems.

In addition, parts of the country are still hampered by numerous underwater borrowers, many houses for sale, and housing starts well off normal rates. One indicator of that is that while 26 percent of Freddie Mac's loans are in four states—California, Florida, Arizona, and Nevada—their share of loan losses in the fourth quarter of last year was 62 percent.

FHFA as Conservator of Fannie Mae and Freddie Mac

Let me turn more specifically to the secondary mortgage market and the role of Fannie Mae and Freddie Mac. The Housing and Economic Recovery Act of 2008, which created FHFA, specified two conservator powers, stating that the Agency may "take such action as may be:

(i) necessary to put the regulated entity in a sound and solvent condition; and
(ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." (Section 1367(b)(2)(D) as amended, of the Federal Housing Enterprises Financial Safety and Soundness Act)

At the beginning, FHFA stated that 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. Because the private mortgage securitization market had already vanished by this time and there were no other effective secondary market mechanisms in place, the Enterprises' continued operations were necessary for continued liquidity in the secondary market and for mortgage originations to continue.

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 boards are responsible for carrying out normal board functions, but they remain subject to review and approval on critical matters by FHFA as conservator. This division of responsibilities represents the most efficient structure for carrying out FHFA's responsibilities as conservator.

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. I will have more to say on that point later.

Over a year ago, I reported to Congress on the key steps FHFA was taking to accomplish the goals of conservatorship. Let me briefly review them here:

1. *Loan modifications and other loss mitigation efforts*

Conserving the assets of the Enterprises requires, first and foremost, minimizing their credit losses from delinquent mortgages. FHFA also operates under a statutory mandate in the Emergency Economic Stabilization Act of 2008 (EESA) – the same legislation that established the Troubled Asset Relief Program, or TARP – to implement a plan aimed at maximizing assistance for homeowners in order 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.

Since the establishment of the conservatorships, Fannie Mae and Freddie Mac have completed more than 760,000 loan modifications, of which 284,000 were Home Affordable Modification Program, or HAMP mods. They have also completed another half-million home retention actions, including forbearance and other repayment plans that have allowed families to retain their homes. Add to this some 180,000 short sales and deeds-in-lieu of foreclosure and together the Enterprises have completed more than 1.4 million actions that enable homeowners having difficulty with their mortgage payment to retain their home or avoid foreclosure.

The Enterprises' loan modification efforts are critical 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, loan modification efforts, including HAMP, also serve to restore stability to housing markets, which directly benefits the Enterprises by reducing credit exposure.

2. *Portfolio Reductions*

The terms of Treasury's preferred stock purchase agreements with the Enterprises require a 10 percent reduction in the Enterprises' retained portfolios each year. Over the past year and continuing today, the Enterprises are not big buyers or sellers of mortgages on their own account. The portfolios are gradually running off; the only material additions to the portfolios come from delinquent mortgages pulled out of Enterprise mortgage-backed securities after being four months delinquent.

3. *New Products*

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, FHFA is not permitting the Enterprises to offer new products or enter new lines of business. Their operations are focused on their existing core businesses and on loss mitigation. 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.

4. Affordable Housing

Support for affordable housing remains a core statutory requirement for the Enterprises. FHFA's approach to the Enterprises' affordable housing mandate while the companies are in conservatorship is to tie their affordable housing goals to the volume of affordable housing product actually produced in the primary market. FHFA intends for the Enterprises to reflect the overall market, but FHFA does not intend for the Enterprises to undertake economically adverse or high-risk activities in support of the goals, nor does it intend for the Enterprises' state of conservatorship to be a justification for withdrawing support from these important market segments.

Policymakers Look to the Future

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. It is important to understand that, from the beginning, the expectation has been that ultimate resolution of the conservatorships requires congressional action. The only outcome that FHFA may implement under existing law is to reconstitute the two companies under their current charters. While there is much disagreement about what the future path should be, there is near-universal agreement that the old model should not be followed.

Last month the Departments of Treasury and Housing and Urban Development (HUD) issued a white paper outlining three broad options for the future of housing finance generally and the secondary mortgage market in particular. The key issue in this debate is the role of the federal government in housing finance – to what extent and in what way is government support necessary to meet public policy objectives and to ensure a vibrant, liquid mortgage market?

For risk practitioners, a key consideration for the future state is how the level and form of government involvement affects the market risk assessments and risk management practices that may be employed by private sector participants. The characteristics of the government's role in housing and the institutional, regulatory, and legal framework put in place will define the degree of certainty that market participants have regarding their own risk exposure in housing finance, their ability to efficiently and effectively measure and monitor those risks, and their ability to underwrite and price in the marketplace commensurate with their risk. Risk is not the only relevant consideration here – effective market competition is also critical. The legal, regulatory, and institutional arrangements will help determine how competitive the primary and secondary markets are in the future, and that competitiveness will also affect the market's pricing, liquidity, and risk management practices.

The Conservator as Risk Manager

FHFA has several unprecedented risk management responsibilities on behalf of the taxpayers. Thirty months ago today the Enterprises opened for business for the first time in conservatorship. Now, two-and-one-half years into conservatorship, Fannie Mae and Freddie Mac remain at the center of the country's housing finance system. Yet that is going to have to change. As I have noted before, the Enterprises operating in conservatorship can not be a long-term solution. And as I will discuss shortly, the longer the future structure of our Nation's housing finance system remains uncertain, additional operational risks of conservatorship will continue to emerge.

With that uncertainty in mind, improving and simplifying the operations of the Enterprises is part of "preserving and conserving" assets. It is also consistent with the notion of "wind down" for the Enterprises, which the Administration and others have called for as a near-term goal in advance of legislation. Still, the ultimate transformation of the Enterprises and their market functions will depend in large part on the particular course Congress and the Administration take in housing finance reform.

This leaves FHFA with the responsibility to facilitate the wind down, conserve assets, and ensure market liquidity, including the Enterprises' $5.5 trillion position in the market, while the long-term course is determined. I would like to describe now how FHFA is balancing these responsibilities. I will begin with a broad view of operational priorities focused on the near-term and then consider what it means to conserve and preserve assets over a conservatorship period that may have a long run still ahead. I will then examine the risks and risk management approach we are taking in this endeavor.

1. *Operational Priorities: Preserving and Conserving, Ensuring Market Liquidity, and Winding Down – All at the Same Time*

The four steps I outlined earlier in my remarks that FHFA has been taking to accomplish the goals of conservatorship remain relevant today. It is important to keep the Enterprises focused on their existing core business, not venturing into new products or lines of business. This approach ensures ongoing liquidity in the mortgage market, preserves the Enterprises' core business processes, and generates earnings for the conservatorships, thereby benefitting taxpayers.

We are looking beyond just a holding pattern, though. Where appropriate and feasible, we are working with the Enterprises to make long-term improvements to the functioning of the housing finance system, improvements that should bring dividends down the road without regard to the particular form of housing finance reform. We have announced two such initiatives, each of which is now well underway.

Last May we announced that FHFA had directed the Enterprises to develop uniform standards for data reporting on mortgage loans and appraisals. This Uniform Mortgage Data Program is designed to improve the consistency, quality, and uniformity of data that are collected at the front end of the mortgage process. By identifying potential defects at the front end of the mortgage process, the Enterprises will improve the quality of mortgage purchases, which should reduce repurchase risk for originators. The initiative will be phased in over the course of this year and next.

Developing standard terms, definitions, and industry standard data reporting protocols will decrease costs for originators and appraisers. It will also allow new entrants to utilize such industry standards rather than having to develop proprietary systems to compete with other proprietary data systems already in the market. What Fannie Mae, Freddie Mac, or any future secondary market firm does with the data, of course, will be where market participants compete. Proprietary reviews of appraisal and loan information will depend on each firm's own unique business models and policies. But common data definitions, electronic data capture, and standardized data protocols will improve efficiency, lower costs and enhance risk monitoring.

More recently, FHFA announced the Joint Servicing Compensation Initiative. On January 18th, FHFA directed Fannie Mae and Freddie Mac, in coordination with FHFA and HUD, to consider alternatives for future mortgage servicing compensation for their single-family mortgage loans. The goals of the joint initiative are to improve service for borrowers, reduce financial risk to servicers, and provide flexibility for guarantors to better manage non-performing loans, while promoting continued liquidity in the To Be Announced (TBA) mortgage securities market.

Looking to the future, the Administration's white paper recommends a gradual transition to greater private capital participation in housing finance and greater distribution of mortgage risk to participants other than the government. Several of the approaches to this transition are things that FHFA has already been doing. In conservatorship the Enterprises have greatly strengthened their underwriting standards and improved the risk sensitivity of their pricing. The white paper calls for further steps in this direction. It also calls for a review of ways to bring greater private capital to the mortgage market, including increased down payments, expanded private sector risk-sharing, and further adjusting pricing to reflect as one can the pricing that would result in a more purely private-sector operated market. As I said, such steps are consistent with actions already taken in conservatorship and we are examining further options along these lines in support of a stable transition over time.

2. What to Preserve and Conserve and Why

I have made frequent references today to FHFA's statutory responsibility as conservator to "preserve and conserve the assets and property" of Fannie Mae and Freddie Mac. Let me be more specific – what are we preserving and conserving, why, and for whose benefit?

I find it useful to think about the Enterprises' assets and property as having four broad categories:

- The legacy, pre-conservatorship book of business, including investments, mortgages owned and mortgages guaranteed;
- The post-conservatorship book of new business;
- The business platforms, operations, and processes; and
- The people who work at the Enterprises – the human capital that run the business, manage the risk, and support the operations.

The first two categories define the tangible assets that exist today and the latter two define the intangible assets that create opportunities for undertaking profitable business tomorrow.

As conservator, FHFA stands in the shoes of the Enterprises' shareholders. Given the structure of Treasury's preferred stock purchase agreements with the Enterprises, the entity with the greatest economic interest in the Enterprises today is the taxpayer. Thus, we are preserving and conserving the assets principally for taxpayers so that they may realize the greatest possible return from these assets, whatever the final form of the companies' transformation ends up being. We do this with a clear expectation that Fannie Mae and Freddie Mac, as we have known them, will no longer exist. But we do not know when, or in what fashion, this will happen. Each company, in whole or in pieces, may be transformed in some fashion so that taxpayers realize value from this investment in the way lawmakers determine is in the country's best interest.

What we do know is that the single-family mortgage market in the United States is more than a $10 trillion market. A market of that size and importance will need efficient and effective secondary market mechanisms to connect global capital markets to local lenders and borrowers. The coming debate will be about what those institutional arrangements look like, what degree of government support or subsidy will be involved, and what degree and role of government oversight is desired.

Turning to the "why" question – why preserve and conserve these assets, I offer this: to protect taxpayers from further losses, to ensure market stability and liquidity, to give lawmakers options for the future, and to protect the future value of the Enterprises' intangible assets for future utilization and value recognition for the benefit of taxpayers and markets. Even though we do not know the future of the companies, it makes no sense to diminish, denigrate, or erode their tangible or intangible assets. As conservator, we oversee these assets so that value may be returned to taxpayers from them.

3. *Risk Management in Conservatorship*

Finally, let me turn to risk management issues in conservatorship. Having stated the rationale for preserving and conserving Enterprise assets, we must now acknowledge the numerous risk management challenges in undertaking this responsibility. The risks and challenges associated with each of the four categories of assets are unique, so I will take them one at a time.

First, for the legacy book of business – the mortgages acquired or guaranteed pre-conservatorship – the key risk is further credit losses from delinquent mortgages. FHFA and the Enterprises' boards of directors, senior management teams, and staff are focused on effective loss mitigation strategies to avoid foreclosure where practical and to minimize further credit losses through loan modifications and other loss mitigation strategies.

Second, for the post-conservatorship book of business, the key risk management challenge is establishing appropriate underwriting standards and risk-based pricing. Since conservatorship, underwriting standards have been strengthened and several price increases have been initiated to better align pricing with risk. Refinement of underwriting standards, such as down payment requirements, and pricing, will continue to be a challenge for the companies in conservatorship. One of the obvious challenges, of course, is that government-supported mortgage activity constitutes nearly the entire mortgage market today. Having better data and an improved mortgage servicer compensation model, such as we are seeking through the initiatives I mentioned earlier, are also important steps in support of improved risk management of future business.

Third, for the Enterprises' business platforms, operations, and processes, there are multiple risk management challenges. FHFA and others have reported previously on the operational and risk management shortcomings that contributed to the Enterprises ending up in conservatorship in the first place. Both companies have been hard at work on remediating those deficiencies and much progress has been made.

Beyond that, how do you build for the future when you do not control the fate of the companies? A fundamental responsibility of a corporate board is strategic planning, preparing a company for the challenges and opportunities that lie ahead, and directing corporate investments in infrastructure and operations to maximize profit opportunities. For a company in conservatorship, and moreover, not likely to exist in its current form, thinking about whether and how to continue to invest in and develop infrastructure and operations presents some unique challenges.

Standing still is not the answer, and would be inconsistent with the goals of conservatorship. In particular, the mortgages guaranteed by the companies and backed by the taxpayer are 30-year assets. We need to continue to develop and maintain the infrastructure supporting these securitizations in order to preserve and conserve the value of those securities and enhance the overall control structure. On the other hand, some long-term investments in overhauling information technology and other infrastructure may not be appropriate. Finding the right balance is a key challenge.

Fourth, and finally, how does one preserve and conserve the value of a company's human capital in the face of an uncertain future? Whatever one may think of the culpability of past executive management at either company with regard to contributing to the need for conservatorship and the resulting taxpayer support, those issues are in the past. For the present, the boards, senior management, and staff at each Enterprise who have remained since conservatorship, or joined one of the companies since that time, should be acknowledged for the hard work that has been and is being done to fix each company's shortcomings, to develop and execute improved loan loss mitigation strategies, and to ensure the continued functioning of the country's secondary mortgage market.

The current state poses much uncertainty for Enterprise employees. They know their employer at some point will no longer exist, at least in its current form. Yet they understand that there is critical work to be done now, for the good of their company and for the good of the country's housing finance system. FHFA, in consultation with Treasury, has sought to establish and maintain an appropriate and competitive compensation system to attract and retain talent. Indeed, these points taken together are very much a positive for employees – they have jobs, good jobs, and jobs that are making a difference. They are being suitably compensated for their work. They should understand that and the rest of us should appreciate that. Still, the opportunity costs exist, and for some may become greater over time. Thus, recruiting and retaining executives and staff is one of FHFA's principal risk management challenges as conservator.

The current state also carries uncertainty associated with public debates about the Enterprises and their future, and how those debates play out among employees. For instance, Congress quite appropriately has been reviewing and debating the advancement of legal fees to certain former officers at one of the Enterprises. Such oversight is healthy, and I have presented the bases for the decisions FHFA has made as conservator in this regard. But such discussions also generate uncertainty among current employees that the current commitments made to them in compensation and related protections, including indemnification, are subject to change, *ex post*. As conservator, FHFA's obligation and intent are to ensure commitments made to employees are appropriate to the condition and goals of conservatorship and are fulfilled to the extent FHFA's authorities permit.

In this environment, leadership changes will continue to take place. The past month has seen several key executive-level departures at each company. We need to be able to continue to attract and retain executive-level talent to navigate the Enterprises through this period of uncertainty. For the duration of the conservatorships, we need to protect the taxpayer interests in the Enterprises by ensuring each company has experienced, qualified people managing the day-to-day business operations. 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 Agreements.

Concluding Thoughts

Time is not on our side. While a lengthy transition is likely inevitable and necessary, we need to begin moving ahead now to determine the future of our Nation's housing finance system. The risk management challenges I have just enumerated only get greater, not smaller, over time.

Finally, the future path of housing finance outside the legislative arena also remains uncertain. Certainly continued improvement in employment conditions and in mortgage servicing are two key factors in 2011 that would help shape improved outcomes.

Thank you.