LESSONS LEARNED FROM MORTGAGE MARKET TURMOIL

James B. Lockhart III
Director, OFHEO
44th Annual Conference on Bank Structure and Competition
Chicago, IL
May 16, 2008

Thank you, Charlie, for that introduction. It is a pleasure to be here today to speak to this highly regarded conference on financial institutions and their regulation.

To set my remarks in context, I often like to start with a chart that gives some perspective on the size of the two government-sponsored enterprises (GSEs) that the Office of Federal Housing Enterprise Oversight (OFHEO) regulates—Fannie Mae and Freddie Mac. The Federal Reserve Banks have a giant balance sheet that is being put to good use today. And, of course, the U.S. government's balance sheet is much larger. The combined credit market footprint of Fannie Mae and Freddie Mac rivals the liabilities of the Fed and the U.S. government. At the end of March, those two housing GSEs had credit outstanding of $5.3 trillion, including debt of $1.6 trillion and guaranteed mortgage-backed securities (MBS) of $3.7 trillion (Chart 1). That was equal to the publicly held debt of the U.S. government, of which over $600 billion was not so publicly held by the Fed. Adding in the twelve Federal Home Loan Banks, which would also be included in the regulatory reform legislation I will discuss later, the combined credit of the housing GSEs totaled $6.5 trillion. Over the last year, those 14 institutions' participation in the mortgage markets and support of the housing sector has been vital. But there are many lessons that market participants, including the housing GSEs, must learn from the current market turmoil.

Lessons Unlearned from Previous Market Turmoil

Unfortunately, many of those lessons should have been learned years ago from previous blow-ups. The most fundamental lesson is: what goes up too far goes down too far. In

other words, bubbles burst. Another lesson, as I heard Jamie Dimon say recently, is that mortgage securities are risky and that there is a long list of financial firms that have had problems with those securities, including problems related to model, market, credit, and operational risks. A key lesson from the savings and loan crisis that was ignored was not to lend long and borrow short, as structured investment vehicles (SIVs) did. Another lesson ignored is that in bull markets investors and financial institutions tend to misprice risk, which can result in inadequate capital when markets turn.

The lack of transparency all along the long chain of mortgage financing is, in retrospect, mystifying. From low- or no-documentation "liar loans" and no escrow accounts, all the way through constructing and rating MBS, collateralized debt obligations (CDOs), and "CDOs squared"—it is hard to comprehend. A new lesson that should be learned is that putting subprime mortgages, which almost by definition need to be worked, into a "brain dead" trust makes no sense.

Another lesson is that overreliance on sophisticated, quantitative models promotes a hubris that has frequently caused serious problems at many financial institutions. As a former partner in a risk management software and consulting firm, I believe management judgment—common sense, if you will—must act as a check on, and sometimes must override, those models. Financial institutions need both. Management decisions must be informed, not dictated, by models. Looking at the junkyard of previous periods of financial turmoil, the common theme is that pushing the envelope too far, often with the aid of models, eventually leads to problems.

Long Term Capital Management was the landlord of our risk management firm in Greenwich, Connecticut. I hasten to add that, despite our efforts, they were never a client. Their models did not capture the correlation of risks on the downside. Their name was right. Financial institutions should be run for the "long term," but their strategy and models failed during a short-term problem. As chair of a corporate pension committee in 1987, I still remember the failure of portfolio insurance.

But financial institution risk is not all about institutions; it should be about people—investors, borrowers, and—in the mortgage market—homeowners. I am proud to say that over the last six-plus years I have been involved in President Bush's push for the Ownership Society—first as the principal Deputy and Chief Operating Officer (COO) at the Social Security Administration with the key responsibility of working for Social Security reform, and now at OFHEO trying to balance ownership with the safety and soundness of the secondary mortgage market. In "Bush 41", running the Pension Benefit Guaranty Corporation (PBGC), we struggled to find a similar balance between promoting defined-benefit pensions and protecting their safety and soundness.

Back then my father, a concerned citizen, was corresponding with the White House to promote a similar uniting theme of creating a "Successful Society". A fundamental principle was education, especially financial literacy, which is a very important long-term goal. When financial literacy is lacking, financial products should be kept simple. That is why the optional Social Security personal accounts that were proposed when I was at Social Security were modeled after the simple, low-cost, 401(K)-like Thrift Savings Plan for government employees. We had learned an important lesson from the "mis-selling" scandals in the United Kingdom in which individuals had been allowed to "opt-out" of pension schemes.

Unfortunately, that lesson was not learned in the mortgage industry. Mortgages got too complicated for individuals to understand the risks. Even with simple products like 30-year loans, less financially literate homeowners sometimes fail to exercise their prepayment options. Efforts to promote financial literacy must be increased. In the meantime, a lesson to be learned is that complicated, risky mortgages should not be marketed to people who do not understand them.

Now turning to Fannie Mae and Freddie Mac, there are also some very important lessons to be learned from the current mortgage crisis, which some have called the worst since the Depression. From my perspective, the most important lesson is that those two GSEs do fulfill a very important role in the mortgage market, which means that they require a

strong regulator. Not only should that lesson be learned, but it should be applied immediately. To provide a context for discussing that lesson and others, I will first review the performance of Fannie Mae and Freddie Mac and the actions taken by OFHEO to ensure their safety and soundness in recent years.

The Housing and Mortgage Lending Boom and Enterprise Risks

Fannie Mae and Freddie Mac grew rapidly during the housing and mortgage lending boom that began after the 2001 recession. During that boom the Enterprises' combined share of residential mortgage debt outstanding reached its peak in 2003 (Chart 2).

That growth slowed after Freddie Mac in 2003 and Fannie Mae in 2004 had to begin restating their earnings following the discovery of serious accounting, control, and other management weaknesses. In response to those discoveries, OFHEO increased the Enterprises' minimum capital requirements to 30 percent more than the statutory minimum requirements. In 2006, we imposed limits on the size of their retained mortgage portfolios. The purpose of those actions was to create incentives for the Enterprises to remediate their weaknesses as rapidly as possible while limiting the risk they posed to taxpayers and the financial system. OFHEO also made sure that any private-label MBS that the Enterprises purchased for their portfolios almost always carried the highest credit ratings and took steps to inhibit the expansion of their holdings of securities backed by subprime mortgages.

In retrospect, those supervisory constraints had the important benefit of limiting the growth of the Enterprises' retained mortgage portfolios and the credit risk posed by their holdings of private-label MBS backed by subprime and nontraditional mortgages. If the limits had not been in place, Fannie Mae and Freddie Mac almost certainly would have had larger retained portfolios and fared far worse in recent quarters.

Nonetheless, the house price and mortgage lending boom tended to increase the risks of Fannie Mae and Freddie Mac in several ways that are not difficult to discern today, but were not widely appreciated during the boom.

First, home price appreciation during the boom raised the average homeowner's equity in his or her house, facilitating widespread equity withdrawals via cash-out refinances and home equity loans. Despite that borrower behavior, the Enterprises reported steadily improving current loan-to-value (LTV) ratios on mortgages they had previously purchased or guaranteed. At the same time, the risk of a sizable house price correction increased, especially after interest rates began rising in late 2005 and the housing sector weakened. That was true not just for properties financed with subprime and other nontraditional mortgages, whose prices appear to have appreciated especially rapidly, but also for properties financed with the prime conventional loans in which Fannie Mae and Freddie Mac specialize.

As nontraditional lending boomed, the Enterprises purchased more Alt-A and interest-only mortgages and accepted more loans with higher LTV ratios and lower borrower credit scores, but their pricing of those transactions often did not fully compensate for heightened credit risk. A growing share of borrowers whose first mortgages the Enterprises purchased also took out second, "piggyback" loans, yet the Enterprises did not have complete information on those seconds and could not fully reflect the actual total LTV ratios in their guaranty fee pricing. Further, despite the growing risk of a house price correction, the pricing models of Fannie Mae and Freddie Mac assumed that house prices would continue to grow at their long-term trend. In sum, market developments and the Enterprises' responses increased their mortgage credit risk to a degree that was not fully offset by higher capital or fee income.

Second, subprime, Alt-A, and other nontraditional mortgages and the private-label MBS they backed were relatively new and untested financial products whose performance in a period of rising interest rates and low or negative house price appreciation was quite uncertain. Grade inflation in credit ratings of structured securities has been evident for

some time, and we have seen numerous previously highly-rated private-label MBS downgraded over the past year. Thus, those securities posed credit risk as well as the risk of fair value losses due to falling market prices. Those risks were not fully reflected in the Enterprises' initial pricing. At mid-year 2007, before the start of the current market turmoil, Fannie Mae and Freddie Mac together held $257 billion in private-label MBS backed by subprime, Alt-A, and home equity mortgages. By the end of the first quarter of this year, that total had declined to $206 billion.

Third, the growing risk of a house price correction and the risks posed by subprime and nontraditional mortgages also affected the servicers, mortgage insurers, bond insurers, and even the derivatives providers that are major counterparties of Fannie Mae and Freddie Mac. Thus, the Enterprises' counterparty credit risk increased as well.

Fourth, the models Fannie Mae and Freddie Mac use to manage risks were increasingly inadequate. Mortgage product and other financial innovation, globalization, and changes in investor and borrower behavior were increasing the likelihood of market outcomes that the Enterprises' models did not anticipate. Further, the models are designed to project ultimate credit losses, not potential near-term fair value losses, stemming from shifts in demand and market illiquidity, which are increasingly reflected on balance sheets and in earnings statements.

Enterprise Performance and Risks in the Recent Market Turmoil

Those increased risks became evident after the mortgage market turmoil began last August. Fannie Mae and Freddie Mac reported large losses in the third and fourth quarters of 2007 and the first quarter of this year. Specifically, Fannie Mae reported $7.1 billion in losses in those three quarters, while Freddie Mac reported losses of $3.8 billion on top of losses in three of the previous four quarters (Chart 3). In response, and with vigorous encouragement from OFHEO, each Enterprise has raised substantial amounts of capital starting in November of last year.

Those capital infusions, which could total over $25 billion after Freddie Mac completes its announced common and preferred stock issues, have allowed the Enterprises to maintain capital cushions above regulatory capital requirements and to be a source of strength for mortgage lending and the housing sector. By guaranteeing MBS backed by conventional mortgages with balances up to the conforming loan limit, they have ensured that the largest segment of the primary mortgage market has continued to function smoothly. They have also provided liquidity to the secondary market by purchasing MBS for their retained mortgage portfolios.

In the second half of 2007 and the first quarter of this year, Fannie Mae and Freddie Mac guaranteed $831 billion in MBS and purchased $178 billion in whole loans and MBS for their retained portfolios. During the first quarter, the Enterprises' activity represented 68 percent of all single-family mortgages originated, up from nearly 35 percent in the second quarter of 2006 (Chart 4). In March, issuance of MBS guaranteed by the Enterprises represented 84 percent of all MBS issuance, up from about 33 percent in June 2006. As a result of their higher market share, mortgage credit risk is becoming more concentrated at the Enterprises.

Congress recognized the contribution of Fannie Mae and Freddie Mac in the Economic Stimulus Act of 2008, which raised the conforming loan limits in high-cost areas of the country through the end of this year. The Enterprises have begun to use that new authority, which will further boost their market share this year. Congress and others have also urged the Enterprises to do more subprime refinancings and loan modifications.

At the same time, Fannie Mae and Freddie Mac have continued to be a point of vulnerability for the financial system because they are so highly leveraged relative to their risks. Each Enterprise's core capital—comparable to Tier 1 capital for banks—represents less than 2 percent of the sum of its mortgage assets and guaranteed MBS (Chart 5). Given Fannie Mae's low and Freddie Mac's negative fair value of equity, their fair value leverage is extreme. With that leverage, the Enterprises could pose significant risk to taxpayers as well as to financial institutions and other investors that invest in and

count on the liquidity of their debt and guaranteed MBS. Such leverage has also limited the ability of Fannie Mae and Freddie Mac to fulfill their mission of supporting secondary mortgage market stability and liquidity in good times and bad.

OFHEO recently took several steps that enhanced the ability of Fannie Mae and Freddie Mac to expand their retained mortgage portfolios in a prudent manner. We did so in light of each Enterprise's considerable progress in remediating accounting, control, and other management weaknesses identified by special examinations conducted by OFHEO. The Enterprises will use that capacity to provide stability and liquidity to the market and to enhance their earnings and capital positions going forward.

Specifically, effective March 1st, OFHEO removed regulatory caps on the size of the Enterprises' retained mortgage portfolios after they produced timely annual financial statements for the first time in four years for Fannie Mae and six years for Freddie Mac. Despite that action, the markets knew the Enterprises did not have the capital to make large purchases for their retained portfolios. Three weeks later, in response to the market turmoil, we lowered their minimum capital requirements from 30 percent to 20 percent above the 2.5 percent statutory minimum capital requirement, in exchange for commitments by each Enterprise to raise significant additional capital. Those actions created an opportunity for Fannie Mae and Freddie Mac to add as much as $200 billion of MBS to their portfolios. The Enterprises' portfolio purchase commitments nearly doubled in March from the level in February.

Last week OFHEO lifted its two-year-old consent order with Fannie Mae. We also agreed to reduce Fannie Mae's minimum capital requirement further, to 15 percent above the 2.5 percent statutory minimum, upon the Enterprise's completion of the sale of at least $6 billion in equity, which will further enhance Fannie Mae's ability to support the secondary market by expanding its retained mortgage portfolio. On Wednesday, Freddie Mac agreed to raise $5.5 billion in equity, and we took similar actions. Those actions were designed to make the capital ratios of the Enterprises more countercyclical while creating incentives for them to raise more capital.

In taking those actions, OFHEO had to strike an appropriate balance between the objective of enabling Fannie Mae and Freddie Mac to perform their mission during a period of weakness in housing and mortgage markets, and the objective of limiting the risk the Enterprises pose to taxpayers and the financial system. The Enterprises' very high leverage made striking that balance quite a challenge. The combination of OFHEO's actions, the Fed's and J.P. Morgan Chase's actions with respect to Bear Stearns, and the Fed's new liquidity facilities had the desired effect of quickly reducing MBS-to-Treasury spreads (Chart 6) although they still exceed prior market spreads by 100 basis points.

In addition to raising capital through stock offerings, Fannie Mae and Freddie Mac have also responded to their recent losses by tightening their underwriting standards, increasing the fees they charge for guaranteeing MBS, and lowering the prices they pay to purchase whole mortgages. Those actions, while positive from a safety and soundness perspective because they will help the Enterprises recapitalize and finance more new business, could tend to be pro-cyclical and exacerbate the current weakness in housing and mortgage markets, if taken to extremes.

Lessons from the Recent Experience of Fannie Mae and Freddie Mac

That review of the experience of Fannie Mae and Freddie Mac in recent years suggests three key lessons that should be learned and applied immediately. The first is about pro-cyclical behavior during the credit cycle. When financial institutions practice and their supervisors allow overly liberal underwriting standards and mis-pricing of risks during a credit and asset boom, the build-up of risks makes it more likely that, during the inevitable correction, institutions will experience solvency problems and tighten underwriting standards more than warranted by credit considerations alone. An important issue for supervisory agencies is how to create incentives for institutions to behave in a less pro-cyclical manner without interfering with their ability to earn reasonable returns on capital.

That lesson is particularly relevant to supervision of Fannie Mae and Freddie Mac. The Enterprises' statutory mission is to provide liquidity and stability to the secondary mortgage market at all points in the credit cycle. They are expected, as a matter of public policy, to maintain sufficient financial strength to make business decisions throughout the credit cycle that are relatively unconstrained by solvency or liquidity problems. To do so, they should limit their risk exposures and build up sufficient capital, relative to their risks, in periods of housing and mortgage market expansion, to be able to absorb losses and maintain sufficient capital while expanding their activities during contractions in the housing sector or the broader economy. That will be good for their mission and their shareholders.

As we seek to apply that lesson, an interesting question is whether Fannie Mae and Freddie Mac could have been a more countercyclical force during the recent house price and mortgage lending boom. As the largest buyers of private-label MBS, could they have brought a long-term view and more stability to a very liquid MBS market, for example? It is always easy to see clearly in hindsight, but given the Enterprises' balance sheets, they might have refrained earlier than September 2007 from purchasing AAA-rated private-label MBS backed by subprime and Alt-A loans that did not meet the bank regulators' guidances on subprime and nontraditional mortgages. Or they might have recognized that the global liquidity glut and strong foreign demand for MBS had inflated prices for private-label MBS above their long-term intrinsic values and refrained from investing as heavily in those securities. Either course of action might have helped to add some discipline and better risk-based pricing to the market.

A second lesson from recent experience is the importance of capital. Capital at individual institutions not only reduces their risk of experiencing solvency and funding problems and of contributing to financial market illiquidity, but also helps them avoid the need to retrench in bad times and miss what may be very attractive opportunities in weak markets.

Again, that lesson is quite relevant to Fannie Mae and Freddie Mac. Capital reduces the risks the Enterprises could pose to taxpayers and the financial system and enhances their ability to support the secondary mortgage market.

Those two lessons provide compelling arguments for a third: legislation needs to be enacted soon that would reform supervision of Fannie Mae and Freddie Mac and, specifically, give a new agency authority to set capital requirements comparable to the authority the bank regulatory agencies possess. The legislation that created OFHEO in 1992 requires the agency to set very low minimum capital requirements and greatly limits OFHEO's flexibility with respect to risk-based capital requirements. That approach, under which we operate today, has significant weaknesses.

- The 1992 Act prevents OFHEO from imposing truly risk-based capital requirements. OFHEO must use a stress test model that omits key Enterprise risks, including operational and basis risks; does not impose as severe an interest-rate stress in low-rate environments; and assumes a credit stress that is less onerous than the current one.

- The Act does not allow OFHEO to vary the severity of the stress used over the mortgage credit or house price cycles, making the current requirement pro-cyclical.

- OFHEO may not replace the now 16-year-old statutory requirements with alternative, more modern, economic capital models or even Basel II-type approaches.

Elements of Housing GSE Reform Legislation

Reform legislation passed by the House of Representatives last year and now scheduled to be voted on by the Senate Banking Committee Tuesday would create a new agency to regulate Fannie Mae and Freddie Mac that would have authorities comparable to those

possessed by the federal banking agencies, including broad flexibility to set minimum and risk-based capital requirements for the Enterprises (Chart 7). Other bank regulator-like powers of the new regulator would include receivership authority, independent litigating powers, removal from the Congressional budget process, and stronger oversight of Enterprise directors and officers.

Another important provision in that bill would give the Director of the new agency authority to establish standards by which the portfolio holdings of Fannie Mae and Freddie Mac would be deemed to be consistent with their mission and safety and soundness. In setting those standards, the Director would be required to consider the mission and risks of the portfolios. The Director would be able to make temporary adjustments in the standards in times of economic stress or market disruption.

Through regulation the Director could give Fannie Mae and Freddie Mac incentives to operate their retained mortgage portfolios in a countercyclical manner, consistent with their mission. In conjunction with appropriate capital requirements, standards with respect to Enterprise portfolio holdings could encourage them to build up capital in periods of housing and mortgage market expansion. The standards could be reduced during periods of mortgage market distress in order to allow the Enterprises to use that capital to support the liquidity and stability of the secondary mortgage market. The size of the liquidity portfolios of Fannie Mae and Freddie Mac and their capital requirements could also be varied over time to allow them to provide some countercyclical balance.

The new agency created by the legislation would result from the combination of OFHEO with the Federal Housing Finance Board, which supervises the Federal Home Loan Bank System, and the mission oversight performed by the Department of Housing and Urban Development. The agency would be seen not just as Fannie Mae's regulator, or Freddie Mac's regulator, or the regulator of the Federal Home Loan Banks, but as the single federal agency responsible for the functioning of the government-sponsored portion of the secondary mortgage market. Since the housing GSEs combine to finance or

guarantee three-quarters of the nation's mortgages, the new regulator would largely oversee the secondary market.

With that broad responsibility, the agency could focus on enhancing the essential public purpose that all three housing GSEs share—promoting the flow of a reliable source of credit from global capital markets to home buyers—rather than on accomplishing that objective through a specific GSE or GSE structure. By overseeing a more diverse set of GSEs, the proposed single regulator would have a broader perspective, and more independence and objectivity as it assesses the activities and risks of any one GSE, than the situation of OFHEO or the Finance Board permits.

Disruptions to the mortgage market as have taken place the past ten months highlight the need for a prompt, coordinated government response to safety and soundness threats.

- A single regulator overseeing the government-sponsored housing finance system would have more robust and timely information than if that information continued to be divided among three agencies.

- Most of the nation's largest mortgage lenders are key counterparties to the Enterprises and the Federal Home Loan Banks. A single housing GSE regulator would more quickly identify emerging problems with such a counterparty and be able to assess the implications for all the housing GSEs more effectively than would separate regulators.

- A single regulator would give other government agencies—the Federal Reserve, the Treasury, and the Federal Deposit Insurance Corporation (FDIC), for instance—a single point of contact for information on conditions in the secondary mortgage market. Having a single housing GSE regulator working with the President's Working Group on Financial Markets would also facilitate a coordinated federal response to market disruptions.

Each of the housing GSEs is exposed to a set of financial risks common to mortgage finance activities—mortgage and counterparty credit risk, interest rate risk (including mortgage convexity risk), model risk, and operational risk. As the largest issuers of non-government debt, they also share liquidity or funding risks. The institutions need strong enterprise risk management to successfully perform their missions. The regulatory skills needed to oversee those risks are transferable and additive across the housing GSEs, and, thus, a single regulator could better leverage critical skills in those areas than can separate agencies.

A combined regulator could greatly enhance the government's ability to ensure that each housing GSE accomplishes its mission with respect to affordable housing. Although the GSEs have different programs and approaches in this area, the general regulatory knowledge that would be developed in a combined regulator would enhance oversight of that critical mission.

Conclusion

Congress created the housing GSEs with a common mission to support mortgage lending and housing markets throughout the credit cycle. Frankly, OFHEO, Fannie Mae and Freddie Mac were fortunate in recent years in that OFHEO's regulatory responses to accounting, control, and other management weaknesses constrained Enterprise growth and risk taking at the height of a boom, and those constraints have limited the magnitude of the Enterprises' losses in the subsequent downturn. Even so, those losses have been substantial. The legislation that is working its way through Congress would give the new GSE regulator broader powers and increased flexibility to ensure the safety and soundness of Fannie Mae and Freddie Mac and to apply the lessons I have enumerated, especially efforts to encourage the Enterprises' mission to support mortgage and housing markets throughout the credit cycle.

The present market turmoil has brought to a boil long-simmering policy issues related to the appropriate roles of the housing GSEs and the Federal government in supporting mortgage markets and the housing sector. Those issues include:

- the allocation of risk bearing between the public and the private sectors;
- the ability and willingness of shareholder-owned firms to act against financial services industry trends;
- the appropriate size and structure of GSEs; and
- the ability of the new housing GSE regulator to encourage countercyclical behavior in order to reduce the severity of credit cycles and their macroeconomic consequences in ways that do not shift risks to the public sector and increase moral hazard.

Over the past 44 years this conference has proven to be a primary venue to explore such policy issues and approaches to resolving them. On that note, I thank you for your attention. I would be happy to take questions.

44th ANNUAL CONFERENCE ON BANK STRUCTURE & COMPETITION
Lessons Learned from Mortgage Market Turmoil

JAMES B. LOCKHART III

DIRECTOR, OFHEO

May 16, 2008

1. The Housing GSEs are Huge

Relative Size of Enterprise Obligations (March 2008)

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

2. Enterprise Share of Mortgage Debt Outstanding

Enterprise Combined Retained Portfolios and Net MBS Outstanding as Shares of Residential Mortgage Debt Outstanding

50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%

46.6%
41.4%
29.3%
26.3%
20.3%
12.1%

1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007

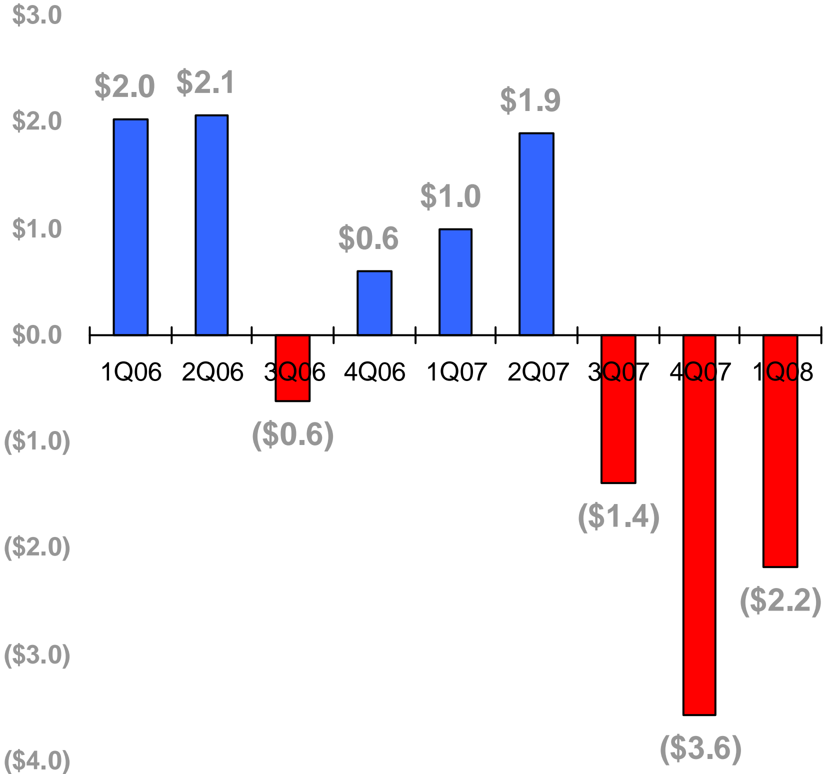
Retained Portfolio — MBS Outstanding — Total

Source: OFHEO based on data from Fannie Mae, Freddie Mac, and the Federal Reserve’s Flow of Funds.

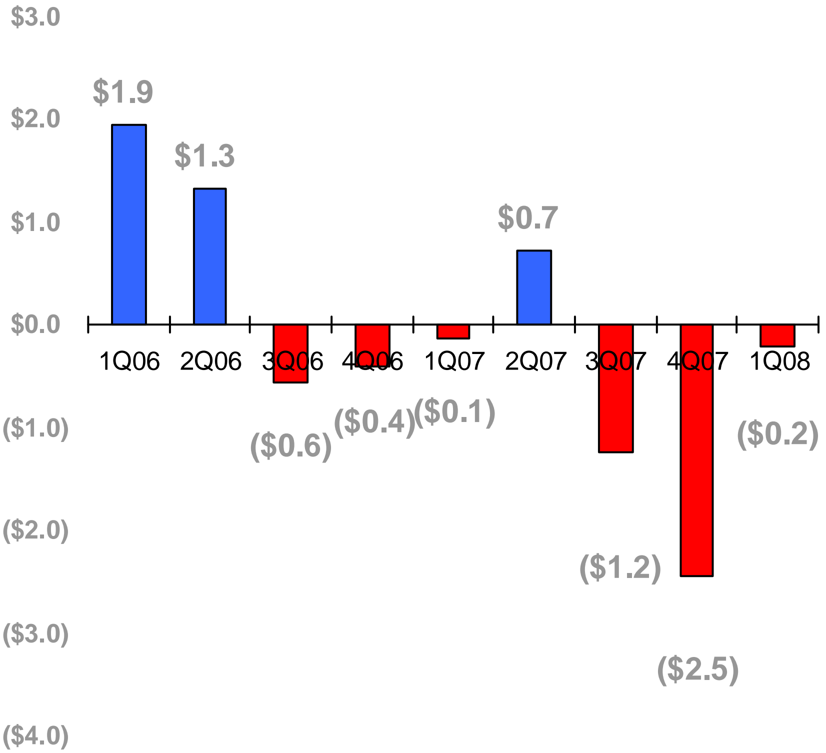
3. Quarterly Net Income for 2006, 2007, and 1Q 2008

Both Enterprises reported significant net losses in the second half of 2007 and 1Q 2008, continuing a trend of volatile and unattractive financial results over the past several quarters.

Fannie Mae



Freddie Mac



Sources: Fannie Mae 2007 and 2006 Form 10-K; Freddie Mac 2007 Annual Report; Fannie Mae 2008Q1 10-Q; Freddie Mac 2008Q1 Information Statement Supplement.

4. Enterprise Share of MBS Issuance and Originations

Fannie Mae and Freddie Mac Combined Share of MBS Issuance and Mortgage Originations, January 2006 - March 2008

Enterprise Origination Share (Quarterly)
Enterprise MBS Issuance Share (Monthly)

90%
80%
70%
60%
50%
40%
30%

84.3%
68.0%
32.6%
34.7%

Jan-06 Feb-06 Mar-06 Apr-06 May-06 Jun-06 Jul-06 Aug-06 Sep-06 Oct-06 Nov-06 Dec-06 Jan-07 Feb-07 Mar-07 Apr-07 May-07 Jun-07 Jul-07 Aug-07 Sep-07 Oct-07 Nov-07 Dec-07 Jan-08 Feb-08 Mar-08

Q1 2006 Q2 2006 Q3 2006 Q4 2006 Q1 2007 Q2 2007 Q3 2007 Q4 2007 Q1 2008

Sources: Inside Mortgage Finance, Enterprise Monthly Volume Summaries.

5. Very High Mortgage Credit Leverage

Capital Measures as a Percentage of Mortgage Book of Business

2006 | 2007 | 2008Q1

		2006	2007	2008Q1
Fannie Mae	Core Capital	1.7%	1.6%	1.4%
Fannie Mae	Fair Value	1.7%	1.2%	0.4%
Freddie Mac	Core Capital	1.9%	1.8%	1.8%
Freddie Mac	Fair Value	1.7%	0.6%	-0.2%

2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
-0.5%

Sources: Freddie Mac 2008 Q1 Information Statement Supplement and Fannie Mae 2008 Quarter 1 10-Q.

6. Spreads between Yields on Enterprise MBS and Treasuries

Spreads Between Yields on Enterprise MBS and Treasuries

30-Year FRM TBAs Due June 2008 v. 5-Year CMT

Basis Points

375
350
325
300
275
250
225
200
175
150
125
100

5/15/2007
6/5/2007
6/26/2007
7/17/2007
8/7/2007
8/28/2007
9/18/2007
10/9/2007
10/30/2007
11/20/2007
12/11/2007
1/1/2008
1/22/2008
2/12/2008
3/4/2008
3/25/2008
4/15/2008
5/6/2008

Fannie Mae 5.5 Percent Coupon
Fannie Mae 6 Percent Coupon
Freddie Mac 5.5 Percent Coupon
Freddie Mac 6 Percent Coupon

Source: OFHEO based on data from Bloomberg.

7. Key Components of Legislation

- Flexibility to adjust capital requirements
- Other bank regulator-like powers, including receivership authority
- Stronger independence with respect to litigation and budget
- Clear guidance to regulate retained portfolios
- Strength through combining the GSE regulators (OFHEO and FHFB)
- Transfer of mission and new product authority from HUD to the new agency