

FEDERAL HOUSING FINANCE AGENCY



NEWS RELEASE

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FHFA RESPONSE TO *THE NEW YORK TIMES* ARTICLE OF DECEMBER 21, 2008

Washington, DC - Despite the extensive documentation provided to the *The New York Times* regarding the Office of Federal Housing Enterprise Oversight's statements and actions that highlighted the risks faced by Fannie Mae and Freddie Mac and the shortcomings of the existing regulatory regime, the Times ignored the record of Director James Lockhart. Any review of OFHEO's actions and statements over the past two and a half years would reveal countless public warnings in speeches, testimony, news releases and media interviews, including some with *The New York Times*. The warnings detailed the inadequacies of Fannie Mae's and Freddie Mac's capital relative to their risk and identified the systemic risks they posed to the financial system. Director Lockhart also made repeated calls for Congress to provide the regulator with the authorities needed to ensure safety and soundness. In retrospect, by the time Congress enacted these reforms in July it was already too late.

The article was misleading and inaccurate in many places. The agency was not "adrift." Instead it has been focused on the business and structural weaknesses of Fannie Mae and Freddie Mac, including shortcomings in the regulatory structure, as the following actions show:

- In May of 2006, Director Lockhart released a hard-hitting report on the many problems at Fannie Mae and reached a tough consent agreement with the company.
- For the first time ever, the growth of both Fannie and Freddie's mortgage portfolio was capped. These actions prevented the Enterprises from significantly increasing their subprime and Alt-A private label mortgage-backed securities portfolios.
- Although the Enterprises held capital well above the legal "adequate capital" standard, the agency repeatedly stated that the existing standards were inadequate.
- The agency, along with President Bush and Secretary Paulson, repeatedly called for legislative reforms to increase capital requirements, reduce the size of the Enterprises' portfolios and enhance regulatory authorities, including broadened authority to impose a conservatorship or receivership.

- In December of 2006, OFHEO directed the Enterprises to establish much stronger underwriting standards on nontraditional mortgages and later issued a directive that extended that to all subprime lending.
- The agency repeatedly called for the Enterprises to raise more capital and not to increase dividends. They did raise \$14 billion of preferred stock in the fourth quarter of 2007. And despite what was reported Fannie Mae per their agreement raised another \$7.4 billion in equity in May 2008.
- When OFHEO agreed to relax, in part, the capital requirement surcharges in March 2008, the Enterprises had already guaranteed or purchased the loans that have been the source of their financial deterioration. The purpose of the relaxation was to prevent severe retrenchment by Fannie Mae and Freddie Mac at a time when the mortgage market was depending almost completely on them. The relaxation was only agreed to in the context of commitments by the Enterprises to raise substantial amounts of additional capital to support the mortgage market and to “maintain overall capital levels well in excess of requirements.”
- OFHEO strengthened its supervisory team and processes to focus on key risks, and the risk-management of the Enterprises was upgraded.
- Many actions were taken to stop them from being even more aggressive and launching risky new products.
- Freddie Mac’s inability to raise capital and the continuing deterioration in the mortgage market led to the decision to put the Enterprises into conservatorship in September. While the agency had authority to place the Enterprises in conservatorship earlier, the grounds for such action only became clear by late summer as the companies’ efforts to raise and maintain private capital collapsed. Moreover, the additional authority for the Treasury to inject funds that the legislation enacted in July provided made conservatorship feasible in this year’s precarious environment. Without the promise of new funds, Enterprise debt prices likely would have dropped, forcing significant write-downs by financial institutions and causing the kind of systemic problems the agency had consistently warned about.

Director Lockhart set forth many of these points in a speech to the Federal Reserve Bank of Chicago conference in May of 2008. “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. 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,” Lockhart said in his speech.

“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,” Lockhart also said in that speech.

Even when the reporters got the facts right there were omissions of key information. For example, Director Lockhart did work at a “software firm”, but the article failed to mention that it was a risk management software and advisory firm to major banks and insurance companies. The article mentioned Mr. Lockhart’s high school friendship with President Bush without mentioning his further academic career (Yale and Harvard Business School) or his 30 year career in financial services and government including leading the Pension Benefit Guaranty Corporation in a time of turmoil.

There is much research to be done, and history to be written, to understand all the causes and consequences of the current housing and financial crisis. It is unfortunate that Sunday’s *New York Times* article did not provide a broader, or more accurate, portrayal of what is a matter of public record.

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The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$6.2 trillion in funding for the U.S. mortgage markets and financial institutions.