

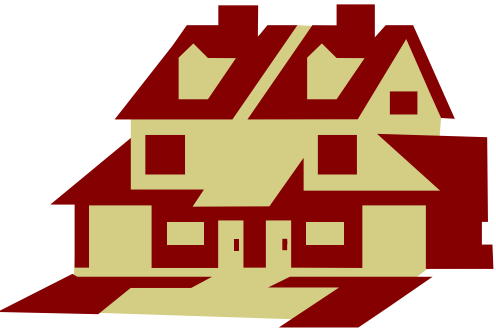
Addressing The Risks In The Housing GSEs



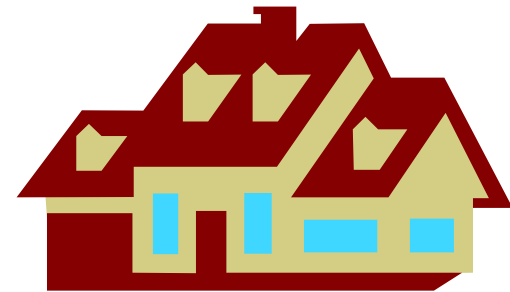
**James B. Lockhart III, Director
Office of Federal Housing Enterprise Oversight
Predictive Methods Conference
Dana Point, California**

June 11, 2007

OFHEO's Mission



To promote housing and a strong national housing finance system by ensuring the safety and soundness of Fannie Mae and Freddie Mac.



OFHEO's Strategic Goals



1. Enhance supervision to ensure the Enterprises operate in a safe and sound manner, are adequately capitalized and comply with legal requirements.
2. Provide support for statutory reforms to strengthen our regulatory powers.
3. Continue to support the national policy of an efficient secondary mortgage market which promotes homeownership and affordable housing.

Matters Requiring Significant Supervision



- Both Enterprises suffered through years of mismanagement and underinvestment in infrastructure which facilitated earnings manipulation.
- They have not been regular timely filers of audited financials for four years. They should be timely filers by early 2008.
- Both Enterprises are spending billions on remediation.
- Although some progress has been made, significant issues remain:
 - data integrity
 - internal controls
 - accounting and operating systems
 - risk management

Enterprise Risk Management Focus



- ERM focuses on understanding and managing risk, not eliminating it, in order to increase returns.
- ERM requires a top down and bottom up strong risk management culture.
- ERM is a problem solving framework that focuses on making good business decisions.

Safety and Soundness Regulation



- The purpose of safety and soundness regulation of financial institutions is to prevent excessive risks of failure. The goal is to avoid failures which may have substantial costs to customers, markets, other institutions and the financial system.
- These powers are especially important when market discipline is weakened by legal or inferred guarantees.
- ERM helps focus regulators on allocating resources to key supervisory tools:
 - capital standards
 - examinations
 - enforcement powers

OFHEO'S ERM Supervision

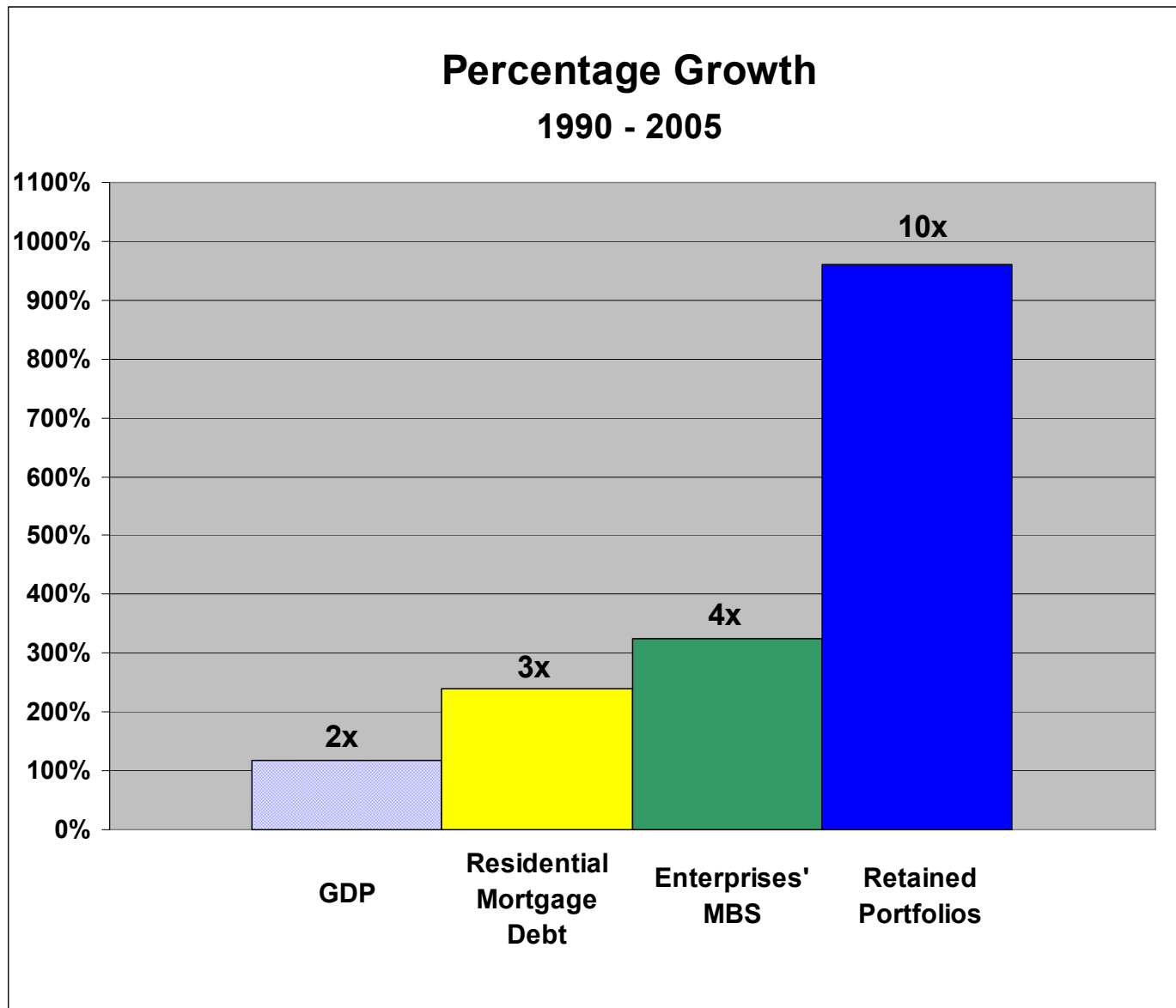


- Consent orders with OFHEO required:
 - Enterprises to hire Chief Risk Officers
 - Directors and management to get more involved in risk management

- Risk management improvements at the Enterprises include:
 - Operational, credit and market risk teams
 - Starting to collect data including operational losses
 - Model validation improving
 - New products review

- The Enterprises are developing economic capital measures derived from existing models.

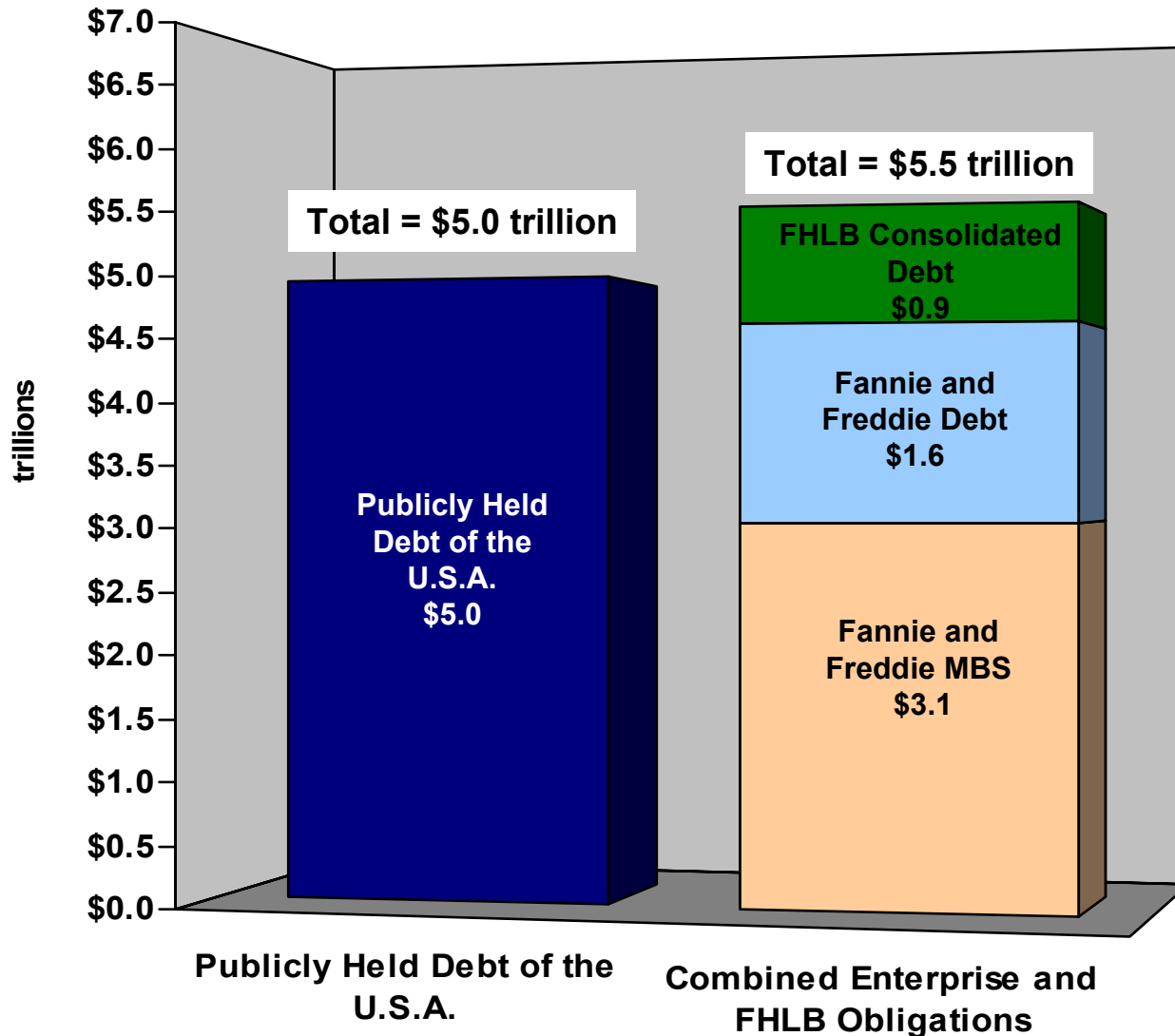
Enterprises Grew Too Rapidly



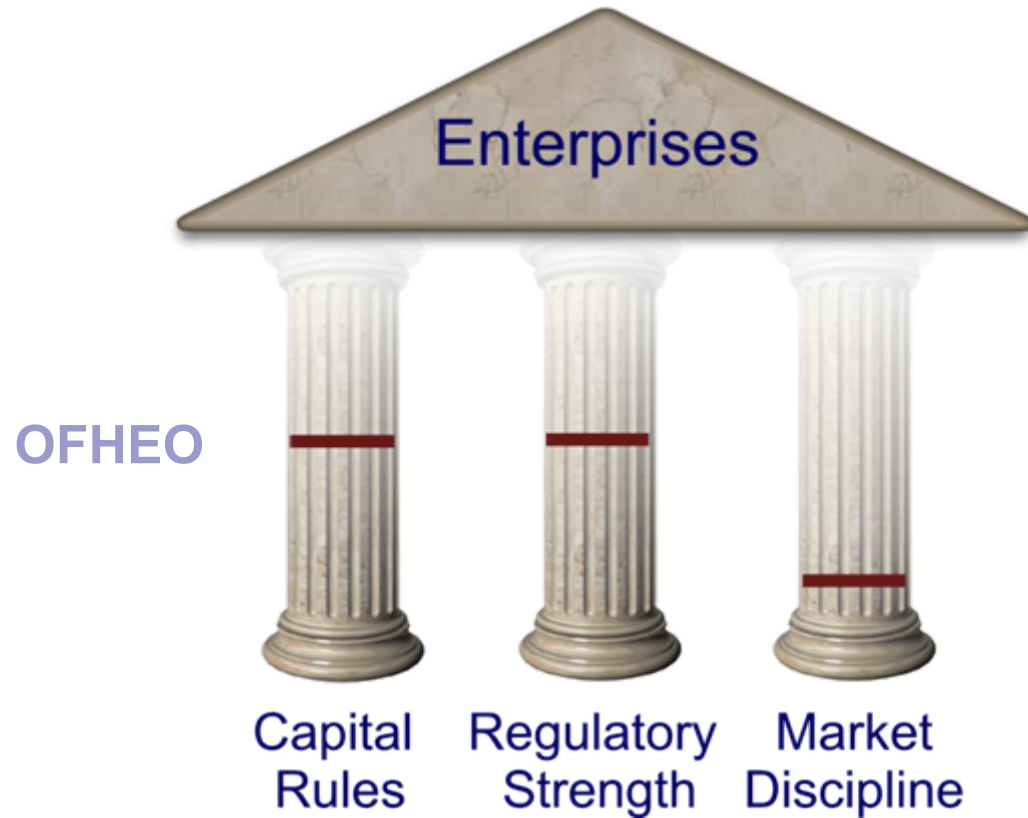
The Housing GSEs are Huge



Relative Size of Enterprise Obligations
(March 2007)



Basel II Pillars



OFHEO, Fannie Mae and Freddie Mac have a long way to go

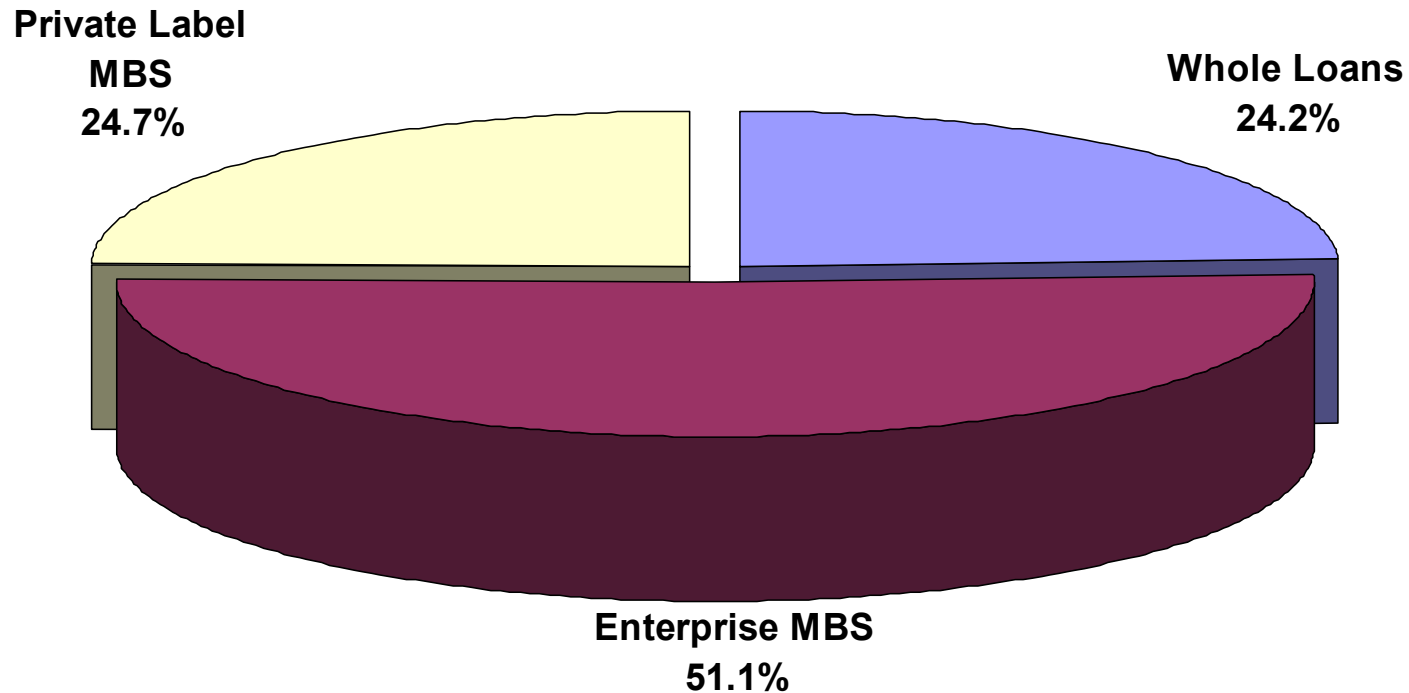
New, Stronger Regulator Needed



- More bank regulator-like powers
- Strength through combining the GSE regulators (OFHEO and FHFB)
- Mission and new product authority (HUD)
- Stronger independence – litigation and budget
- Ability to strengthen capital requirements
- Clear guidance to regulate portfolios

Portfolios Dominated by Own MBS

Enterprises' Combined Retained Mortgage Portfolios Year-End 2006

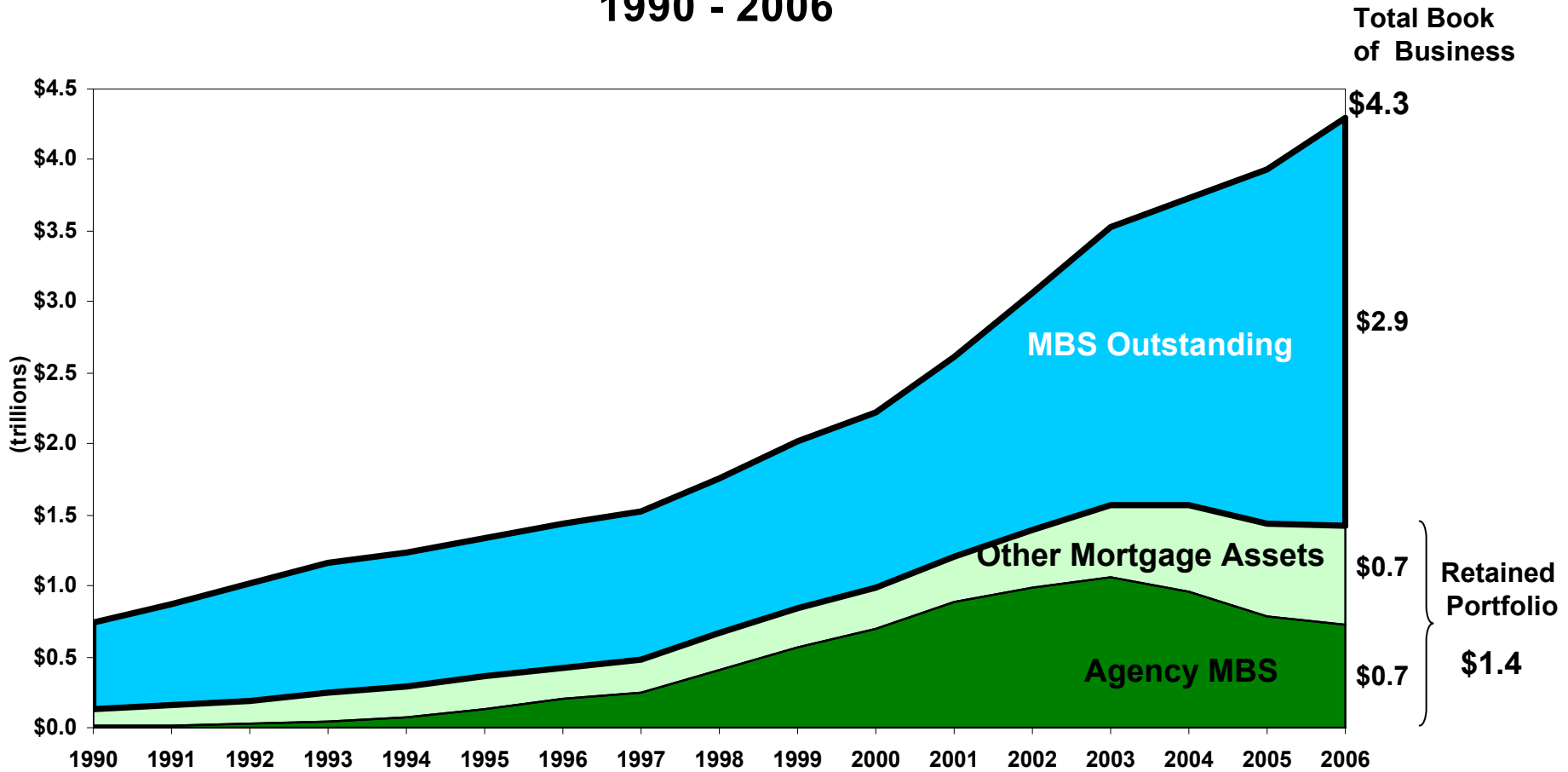


Contribution to Affordable Housing Goal Less Than 30%

Combined Book of Business Continues to Grow



Enterprises' Combined Total Book of Business 1990 - 2006



SIGNIFICANT CHANGES IN FIRST QUARTER

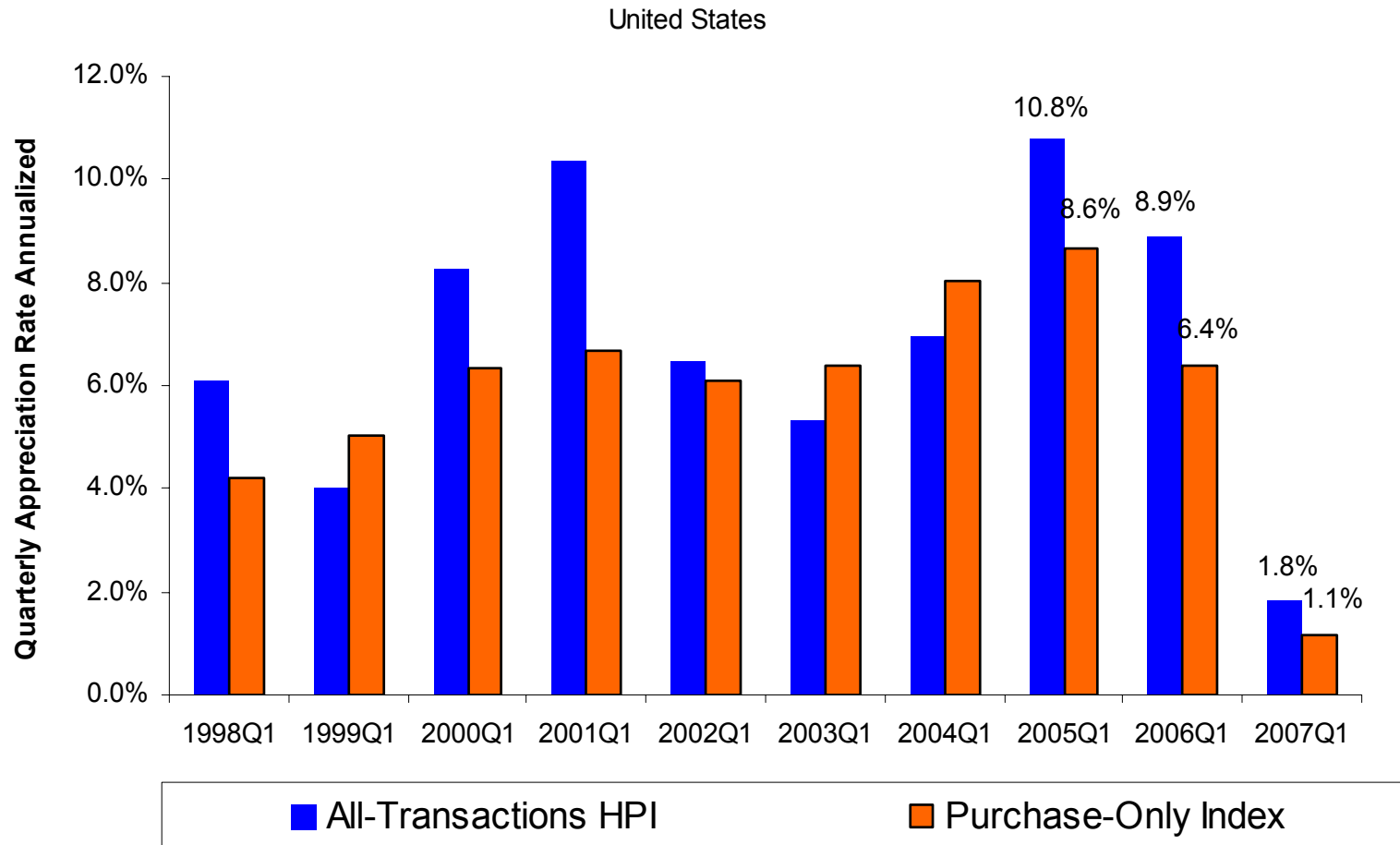


	Changes From:	
	<u>4Q '06</u>	<u>1Q '06</u>
Mortgage Originations	-6%	-4%
Enterprise MBS Issuance	12%	21%
Private Label Securities (PLS) Issuance	-2%	-5%
- Alt A	3%	29%
- Jumbo	27%	-13%
- Subprime	-17%	-23%
MBS Market Share	<u>1Q '07</u>	<u>2006</u>
- PLS	51%	56%
- Fannie & Freddie	46%	38%

HOUSE APPRECIATION IS FALLING



ANNUALIZED RATE OF HOME APPRECIATION IN FIRST QUARTER

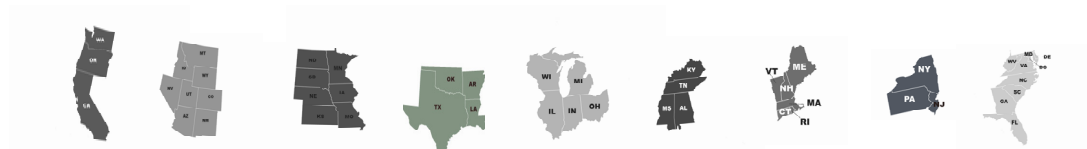
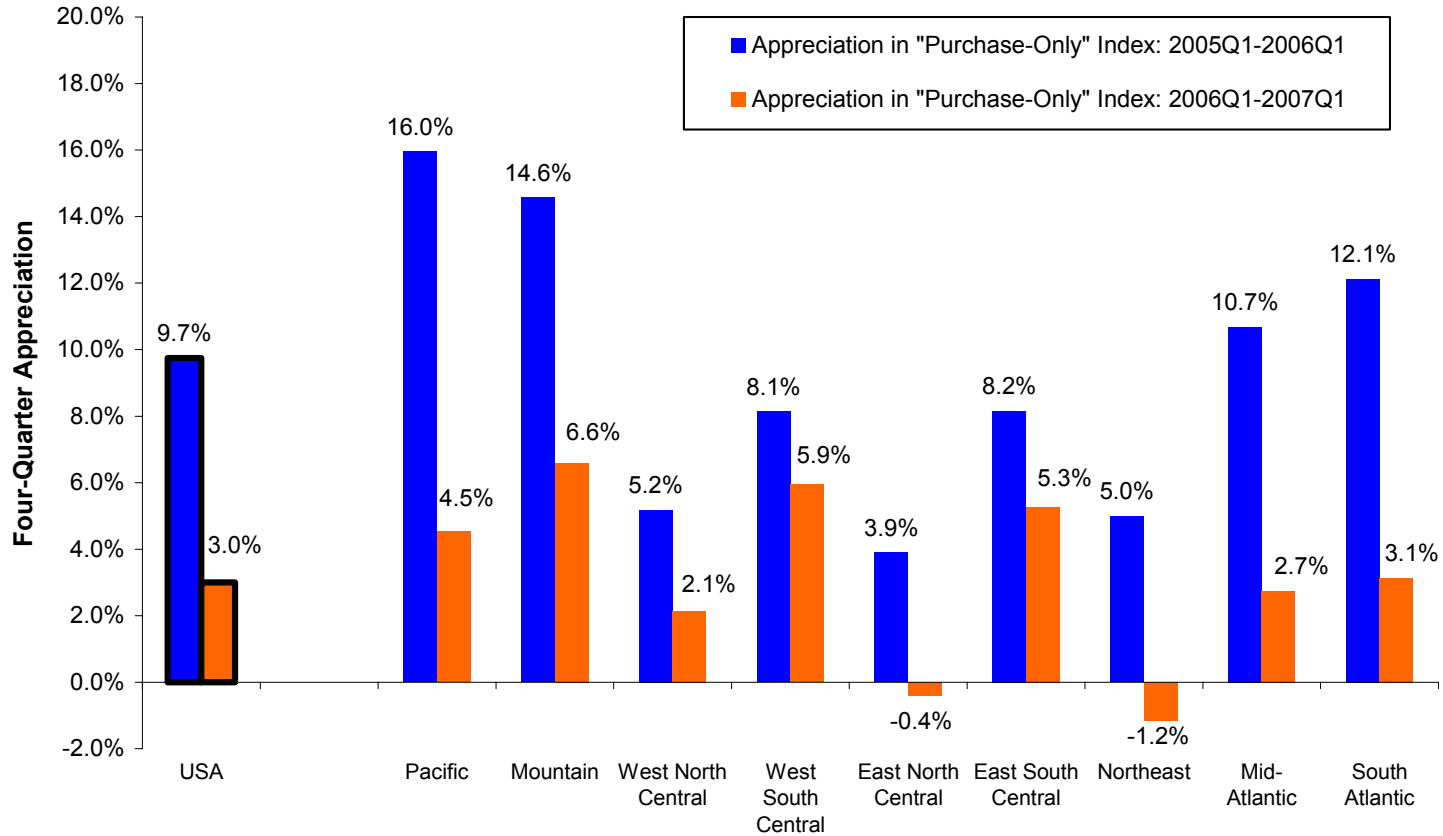


Note: The underlying quarterly rates compare prices in the first quarter against prices in the fourth quarter of that quarterly rate.

Appreciation Rates have Fallen Sharply



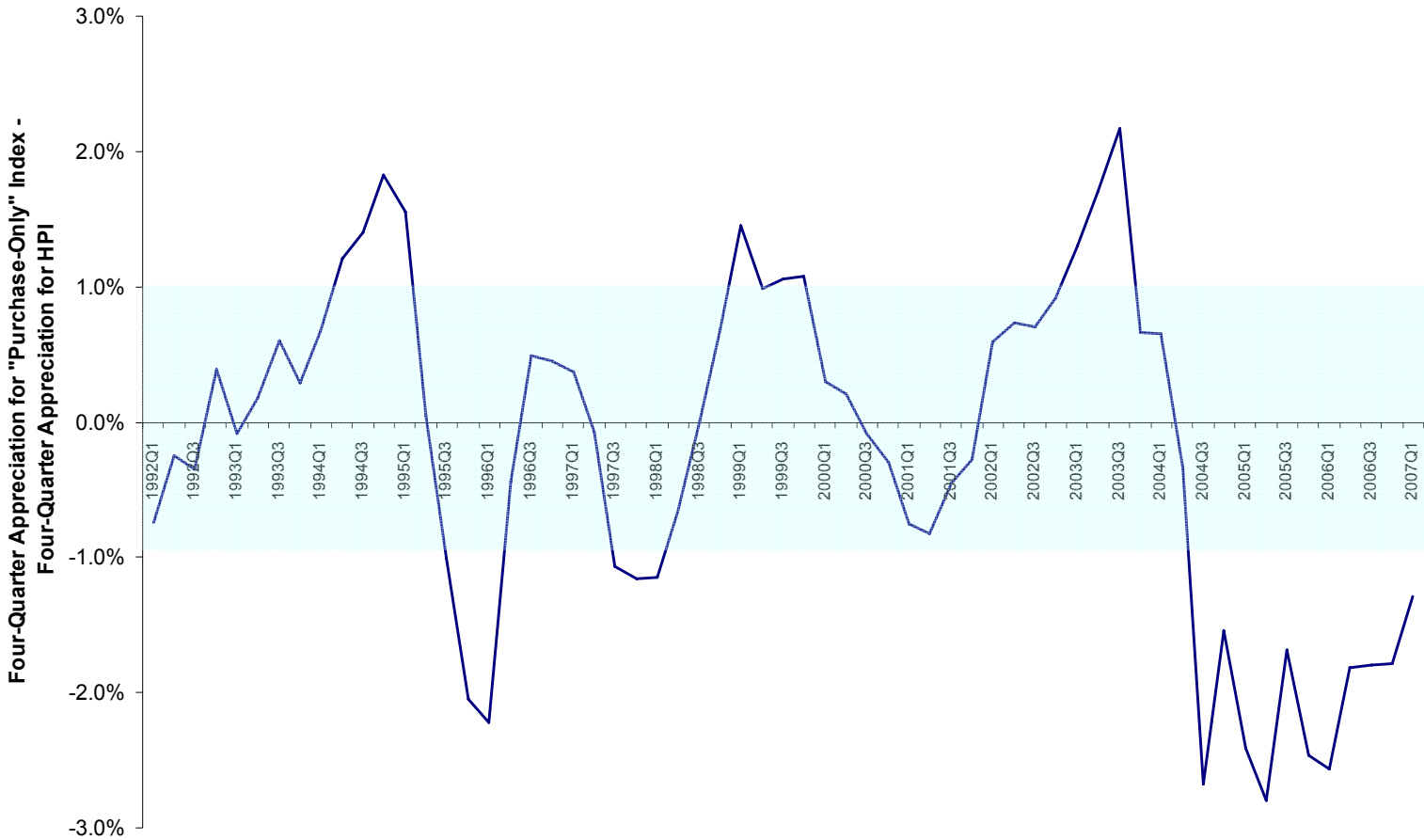
**FOUR QUARTER APPRECIATION RATES:
MOST RECENT YEAR vs. PRIOR YEAR**



Divergence In Price Indexes

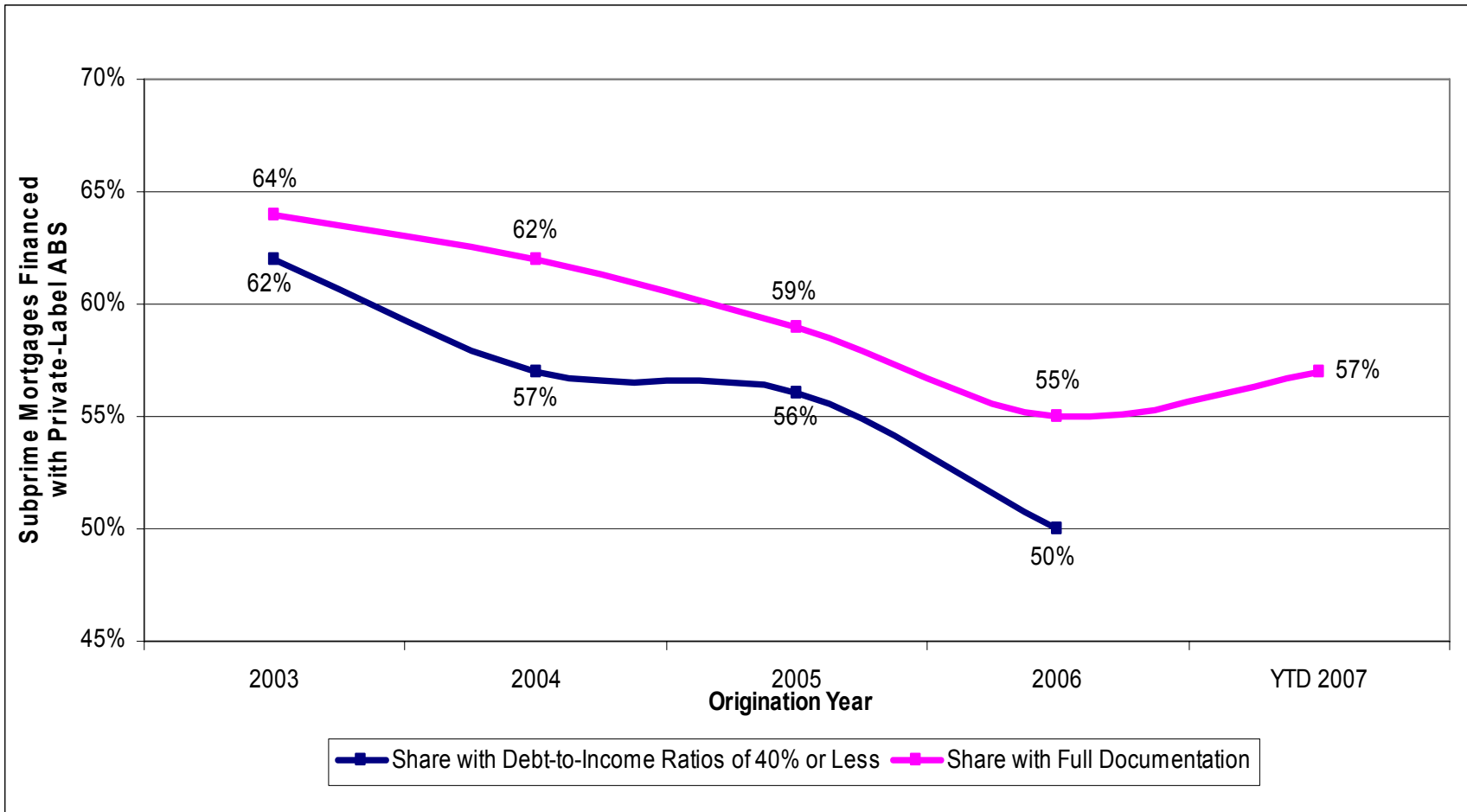


Difference in Four-Quarter Appreciation Rates between a "Purchase-Only" House Price Index and OFHEO's All-Transactions HPI



Source: OFHEO index estimates from 2007Q1 HPI Release.

Through 2006 Subprime Underwriting Deteriorated

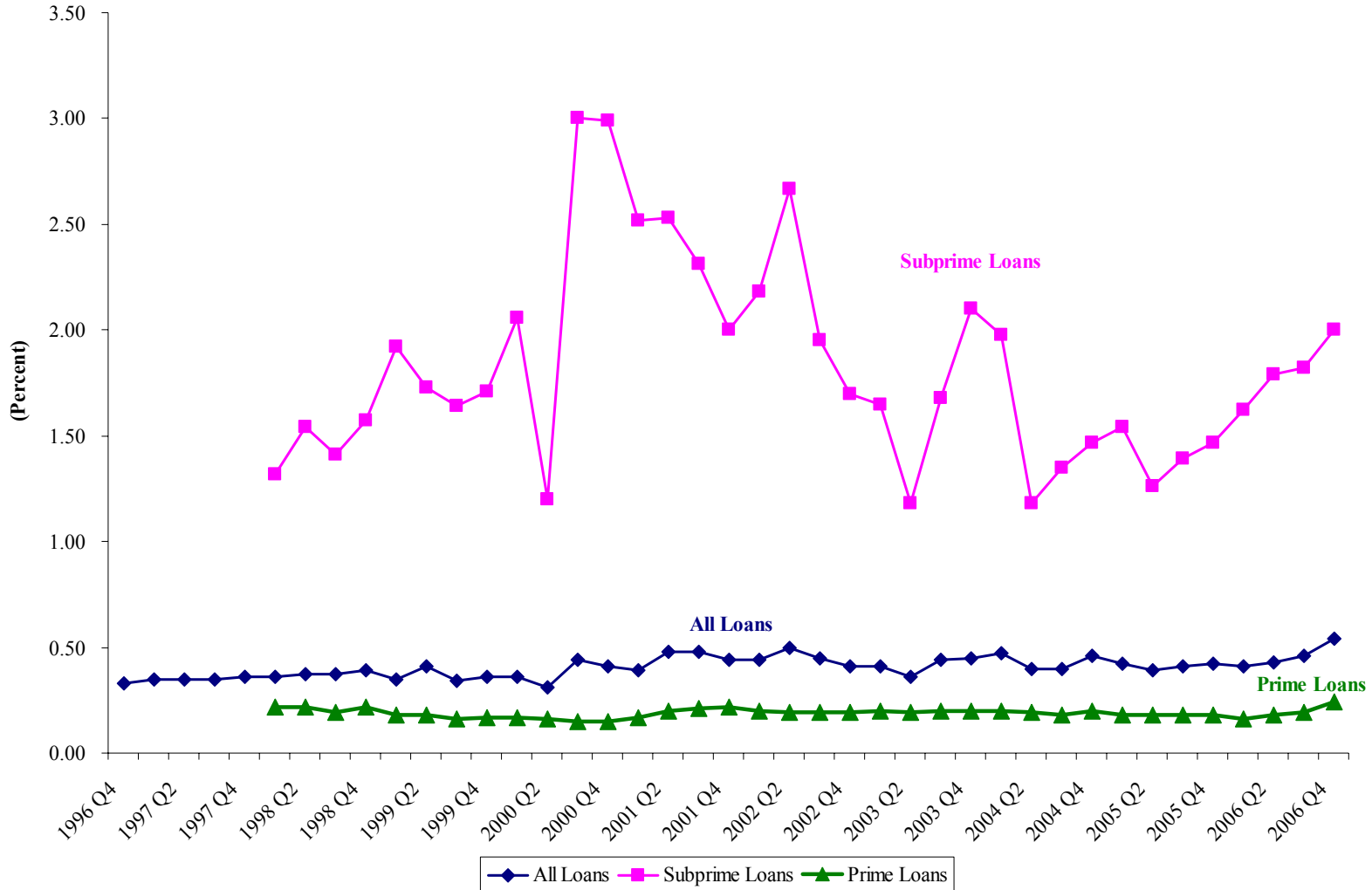


Source: OFHEO based on LoanPerformance.com data

Subprime Defaults Rising, but below 2000-2002 Levels



Foreclosures Started During Quarter: All Loans, Prime Conventional, and Subprime Conventional (Seasonally Adjusted)

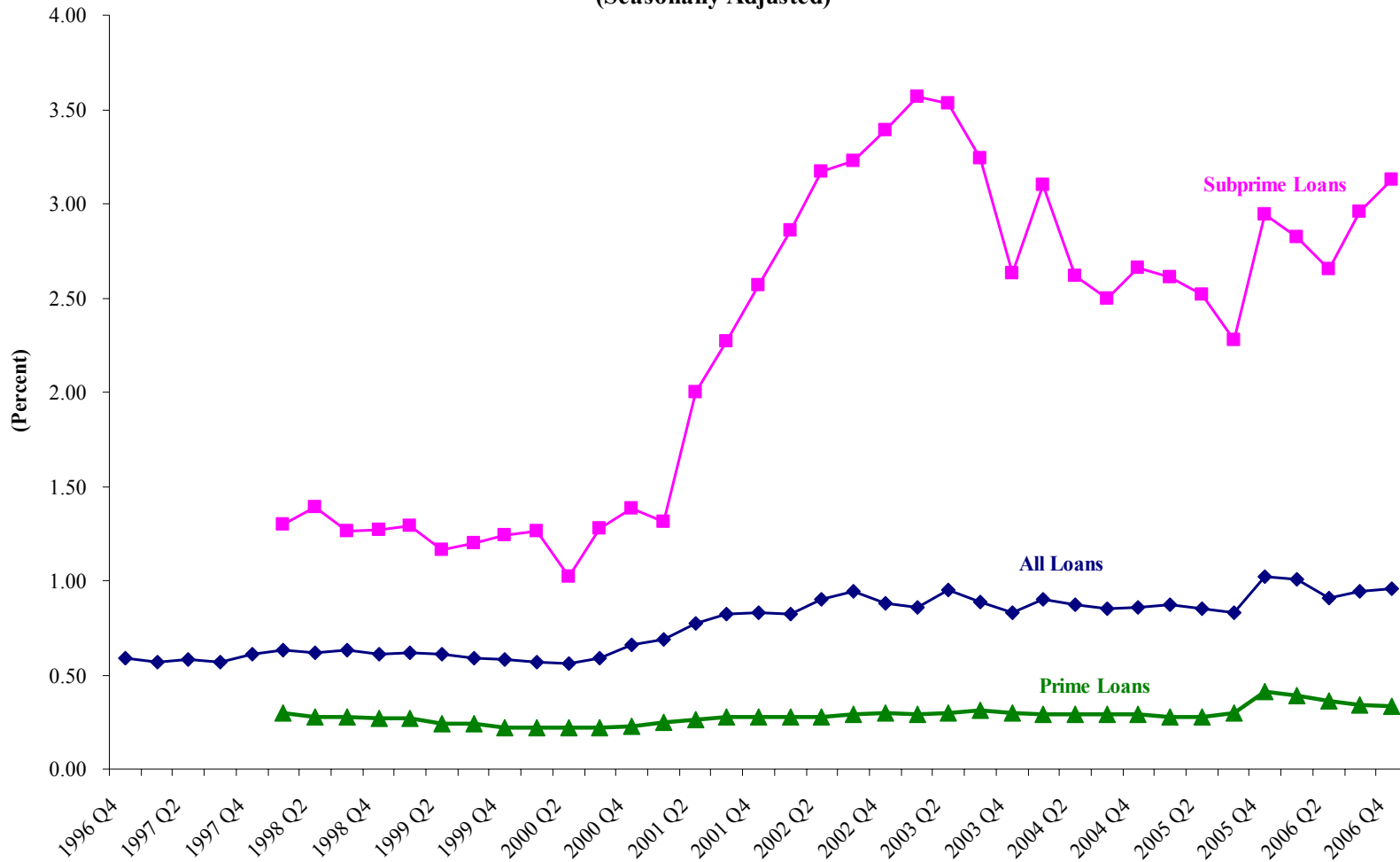


Source: Mortgage Bankers Association National Delinquency Survey

Subprime Delinquencies Approaching 2002 Levels



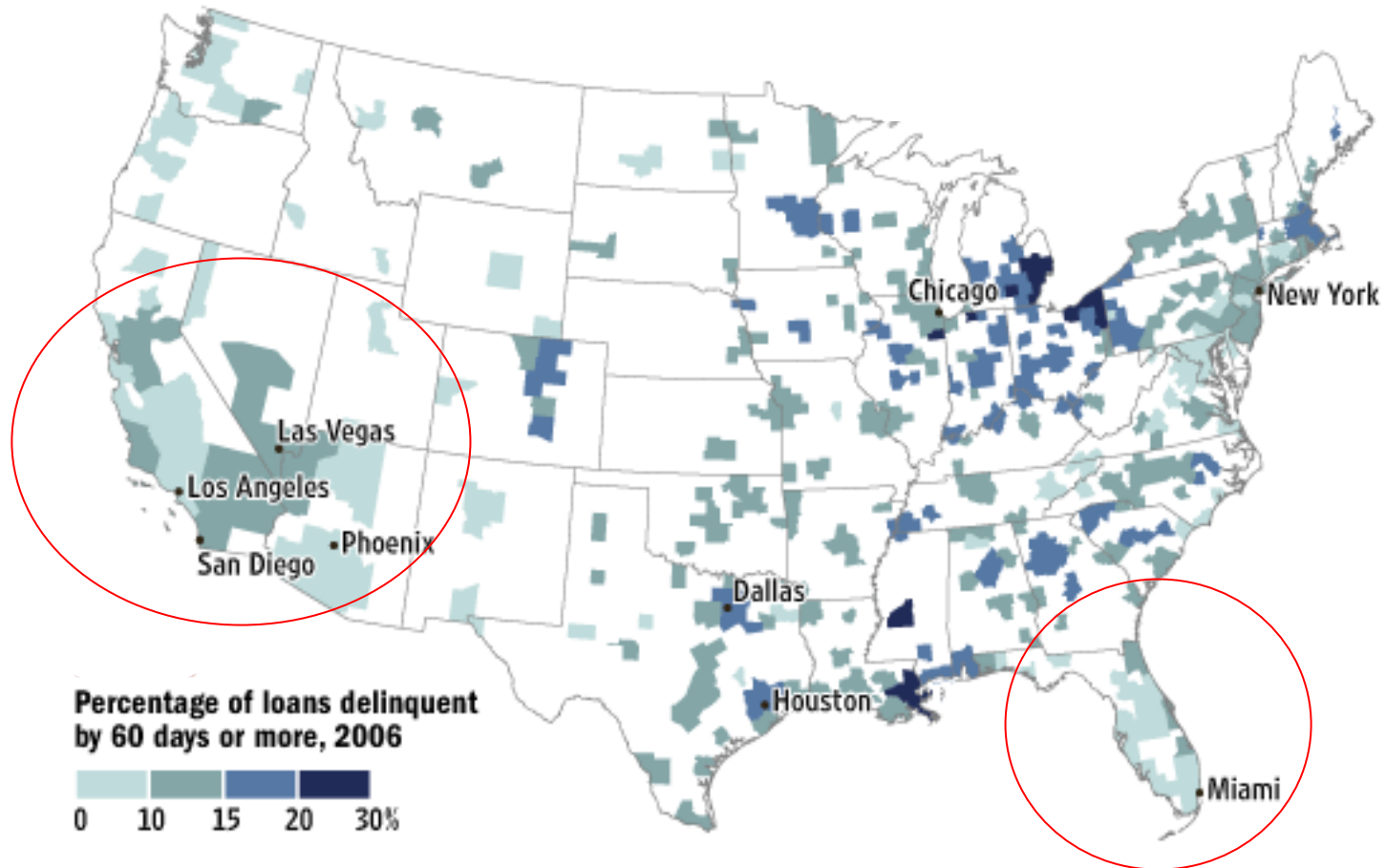
Serious Delinquency Rate: All Loans, Prime Conventional, and Subprime Conventional
(Seasonally Adjusted)



Note: Seriously delinquent loans are 90 or more days delinquent or in foreclosure processing.

Source: Mortgage Bankers Association National Delinquency Survey

Subprime Delinquencies in 2006



SUBPRIME MORTGAGES

Source: WSJ

Subprime Loan Market Size



- Subprime originations market share almost tripled from 7.2% in 2002 of total originations to 21.4% in 2006 (about \$600 billion)
- Total subprime outstanding \$1.5 Trillion (15% of total market)
- About 2.1 million subprime hybrid loans in Private Label Securities (PLS)
 - Estimated Debt to Income Ratios:
 - 30% are below 45% DTI (Fannie & Freddie Target and may not be subprime)
 - 30% are between 45% and 55% DTIs (Fannie & Freddie possible Target)
 - 40% are above 55% DTI (most will require modifications or be foreclosed)

Enterprises Subprime Activities



- Combined Fannie Mae and Freddie Mac own \$170 billion of subprime mortgages in AAA tranches of PLS
- Freddie Mac – “Home Possible”
 - \$20 billion over next 2 to 3 years
 - Approximately 130,000 mortgages
- Fannie Mae – “Home Stay”
 - \$10s of billions over next several years
 - Widening Underwriting Standards to “Expanded Approval”
- Both are expanding efforts to avoid foreclosures
- As still under consent agreements, safety and soundness will be a major concern
- OFHEO working with Enterprises on guidance for nontraditional and subprime mortgages including whole loans and their and other’s MBS and private label securities



www.ofheo.gov