**The Conservatorships of Fannie Mae and Freddie Mac:**
**An Update on Current and Future Operations**

**Remarks as Delivered**

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## Introduction

Thank you for inviting me back to speak with you again.

Four years ago, Fannie Mae and Freddie Mac -- which I will refer to as the Enterprises -- were placed into conservatorship. We celebrated that anniversary last week. One year ago, I spoke at this conference of the challenges facing the Federal Housing Finance Agency (FHFA) in carrying out its conservatorship responsibilities, and our plans for the future activities of the Enterprises.

Today, I am very pleased to be back with a progress report and a look ahead at the next phase of the conservatorships.

I am cautiously optimistic that the signs of stabilization -- and in some places, strength -- that have started to emerge in various housing markets are signals that the housing market is beginning to recover. Yet we also know that there are many challenges and risks still facing housing today. I would like to begin with a review of how we are responding to some of these challenges and will then review where we are headed.

## Foreclosure Prevention

Let's start by considering foreclosure prevention efforts. Foreclosure typically causes more harm to borrowers, neighborhoods, and investors alike than the alternatives. So we have been focusing a lot of our efforts on preventing mortgage foreclosures and reaching borrowers in distress.

Fannie Mae's and Freddie Mac's foreclosure prevention activities, including loan modifications and short sales, have helped over 2.3 million borrowers avoid foreclosure since the inception of the conservatorships. Of the nearly 2 million of these actions has resulted in the borrower retaining their home, with the majority of those as a result of a loan modification.

## Loan Modifications

Let's talk about modifications. For borrowers who have the willingness – but not necessarily the ability – to meet their financial obligations, the Enterprises have developed a suite of loan modification tools, including the Home Affordable Modification Program, or HAMP.

These loan modification options provide households experiencing a decrease in financial resources with the opportunity to meaningfully reduce their monthly mortgage payments without having to lose their homes.

Through either HAMP or other modification programs, Fannie Mae and Freddie Mac have helped more than 1 million families obtain a loan modification since the start of the conservatorships. Both Fannie and Freddie have used HAMP as the first option for troubled borrowers. Under HAMP, an affordable payment is achieved by taking specified steps to bring troubled borrowers' monthly payments down to 31 percent of their gross monthly income.

Payment reductions result from reducing the interest rate, extending the loan term, or forbearing principal. This last approach is often misunderstood. Servicers can provide principal forbearance down to 115 percent of the property’s current market value or as much as 30 percent of the unpaid principal, whichever is greater. The forborne principal is set aside and no interest is charged on it. Principal forbearance has become an important part of loan modifications for underwater borrowers, increasing from 11 percent of all modifications in 2010 to 26 percent last year and 31 percent to date so far this year. This approach allows the Enterprises to reduce borrowers’ monthly payments while preserving some upside for taxpayers for successful modifications.

**Short Sales**

For some borrowers, selling their home – even for less than their outstanding loan balance – remains the best option. For them, we recently announced steps to align and consolidate existing short sales programs into one program. This streamlining will enable lenders and servicers to more quickly and easily qualify eligible borrowers for a short sale. Starting in November, homeowners with an Enterprise mortgage suffering from an eligible hardship – such as death of a borrower or co-borrower, divorce, disability or relocation for a job – can sell their home in a short sale even if they are current on their mortgage.

We are also making it easier for our military families with Enterprise loans to honor their financial commitments when they are ordered to move as part of their duty. Such orders often require quick moves and can create hardship for military homeowners who are underwater on their mortgages and therefore cannot sell their homes. We have modified the rules so that these homeowners can sell their home in a short sale even if current and Fannie Mae and Freddie Mac will not pursue a deficiency judgment or cash contribution or promissory note from members of the military who have received a change in duty station.

In April, we announced that the Enterprises would implement accelerated timelines to review and approve short sale transactions. And these new timelines became effective in June.

By moving short sales forward expeditiously, we will help homeowners avoid foreclosure, reduce taxpayer losses, and help stabilize communities.

**Enhanced Refinance Opportunities**

Our efforts to support refinancing, especially for underwater and near-underwater borrowers, are also a key tool in foreclosure prevention. To that end, in 2009, FHFA introduced the Home Affordable Refinance Program, or HARP, to provide opportunities for such borrowers to refinance existing Fannie or Freddie mortgages.

Although more than 1 million loans were refinanced through this program from inception to late last year, we wanted the program to reach more borrowers and recognized that changes were needed. Indeed, when I was here last year, I spoke about our ongoing efforts to make this program more effective. Then, in late 2011, we revamped HARP to remove various frictions that had inhibited greater participation.

Those revisions, dubbed HARP 2.0, included removing the 125 percent loan-to-value (LTV) cap, providing pricing incentives for borrowers to take out a shorter-term mortgage, clarifying lenders' representation and warranty obligations, and streamlining other aspects of the program.

The process of implementing HARP 2.0 took several months, and involved close coordination with the Enterprises, lenders, mortgage insurers, and other stakeholders.

But today, thanks to those changes, more than half a million borrowers have refinanced their loans through HARP already this year. To put that into perspective, in just over half a year, more than 100,000 more borrowers have obtained a HARP refinance this year than did all of last year. Based on the initial results of HARP 2.0, it is possible that the program could reach nearly a million borrowers, or perhaps a bit more, by the end of this year.

Since the program's inception in 2009, more than 1.5 million borrowers with loans owned by Fannie Mae and Freddie Mac have now refinanced through HARP. Of course, these are not the only refinances by Fannie and Freddie. They have refinanced more than 10 million loans since that time. Data suggests that this assistance is getting to the borrowers who need it most. In July, HARP refinances represented nearly 60 percent or more of total refinances in states hard-hit by the housing downturn Nevada, Arizona, and Florida – compared with 27 percent nationwide. In addition, HARP refinances for loans with LTV ratios greater than 105 percent accounted for more than half of HARP volume in June and July.

Today, we continue to meet with lenders to ensure HARP is helping underwater borrowers refinance at today's historical low interest rates. As we continue to gain insight from the program we will make additional operational adjustments as needed to enhance access to this program.

**Guarantee Fees**

As we work to restore prudent underwriting and risk-based pricing to a housing finance system that went badly off-track, we have been taking steps to improve the Enterprises' pricing of credit risk. Besides strengthening market practices, these steps also contribute to our stated goal of gradually reducing Fannie Mae's and Freddie Mac's footprint in the mortgage market. Since being placed into conservatorship, the Enterprises have steadily raised guarantee fees, which, over time, should gradually reduce taxpayer's risk from the financial support they provide to the two companies.

Even with these improvements, the Enterprises' pricing for credit guarantees remains less than what one would likely observe in a purely private, competitive market.

Now, when I spoke at this conference last September, I said the following:

> "… it is my view that a series of periodic, gradual price increases makes more sense than one or two larger price adjustments.
>
> So, in providing a peek ahead, I would anticipate the Enterprises will continue the gradual process of increasing guarantee fees. This will not happen immediately but should be expected in 2012, with some prior announcement as is typically done by each company."

That's what I said here a year ago.

Since then, there have been two such increases, the first announced in late December 2011 that took effect in April and the second announced two weeks ago that takes effect later this year. The first increase was an across-the-board 10 basis point increase. The second was designed to average 10 basis points across the companies' books of business but the actual increase will vary depending on loan terms and other factors.

These increases will move Enterprise pricing closer to what it would be were mortgage credit risk borne solely by private capital, and it could begin to incentivize private firms to increase their participation in the mortgage market. We intend to stay on this path with future increases.

The Enterprises have long operated by essentially providing credit guarantee pricing that did not take into account differences in doing business in different parts of the country. While this had benefits of broadly leading to a uniform mortgage price across the country, it also meant the Enterprises would be absorbing, but not pricing for, added credit risk associated with specific state and local policies.

FHFA will soon release a paper for public input that outlines a pricing approach to better capture the costs associated with state and local policies. In general, the approach will seek input on imposing an upfront fee on newly acquired single-family mortgages originated in states where the Enterprises are likely to incur default-related costs that are significantly higher than the national average.

**Representations and Warranties**

I would like to talk about reps and warrants, a pretty important topic. The Enterprises have long operated under a representation and warranty model that relied on monitoring at the back-end of the process after a mortgage defaulted or the borrower missed payments. While that model may have worked reasonably well in stable credit conditions, it did not work so well under stressed conditions. For example, it delayed recognition of deterioration in the quality of loan originations and that resulted in the Enterprises accepting large volumes of mortgages that had not been originated according to the contractual standard. Yet by concentrating loan quality reviews at the time the loan goes bad, the problems have been harder to correct and the losses have been greater than what may have occurred had the reviews been focused at the time of sale.

As the Enterprises have enforced their contractual rights through loan reviews and repurchase requests, there has been much discussion that the uncertainty with representation and warranty exposure may be affecting the willingness of lenders to extend credit.

For the market to reclaim the strength it once had – and to provide a cornerstone for the mortgage market of the future – it is vital we consider ways to improve the representation and warranty model. Lenders want more certainty about their risk exposure and the Enterprises want to ensure the quality of the loans that are delivered to them.

That is why tomorrow FHFA and Fannie Mae and Freddie Mac will formally announce that the companies are launching a new representation and warranty framework for conventional loans sold or delivered on or after January 1 of next year. This is a major step toward transitioning from the secondary mortgage market of the past to the secondary mortgage market of the future.

The objective of the new framework is to clarify lenders' repurchase exposure and liability on future deliveries. Under this framework, lenders will be relieved of certain repurchase obligations for loans that meet specific payment requirements.

For example, certain representation and warranty relief will be provided for loans with 36-months of consecutive, on-time payments. Lenders participating in streamlined refinance programs, including HARP, will be eligible for relief after an acceptable payment history of only 12 months following the acquisition date.

Importantly, in the new representation and warranty framework, the focus of the Enterprises' quality control reviews will be shifted earlier in the loan process, generally between 30 to 120 days after loan purchase.

The Enterprises will establish consistent timelines for lenders to submit requested loan files for review and they will evaluate loans to ensure a focus on identifying significant deficiencies. They will leverage data from the tools they currently use to enable earlier identification of potentially defective loans. And they will make available a more transparent appeals process for lenders to appeal repurchase requests.

Ultimately, better quality loan originations and underwriting, along with consistent quality control, will help maintain liquidity in the mortgage market while protecting the Enterprises from loans not underwritten to prescribed standards.

With better data and improved loan quality, we are providing a framework that will give lenders a higher degree of certainty and clarity around repurchase exposure as well as consistency around repurchase timelines and remedies. This is an important step in improving upon past business practices. But it is only a first step. As the Enterprises and market participants gain experience with this new framework, and as technology and automated processes develop, we expect additional improvements in this area.

In the end, focusing loan quality reviews on the time loans are originated and sold into the secondary market will improve market efficiency and safety and soundness. It will also provide greater certainty for borrowers, lenders, and investors that loans are being originated according to prescribed standards and that remedial actions are implemented timely when deviations from those standards emerge.

**REO & RISKSHARING**

Another tool at our disposal as we seek to reduce the Enterprises' long-term risk exposure and place them in a more stable financial condition is various methods of risk sharing. As I explained when we met here last year, FHFA is considering a number of alternatives, including the expanded use of mortgage insurance and securities structures that allow for private sharing of risk with the Enterprises.

We also continue to explore options for disposing of real estate owned, or REO, properties. You may recall that in August 2011, FHFA, Treasury, and HUD issued a Request for Information on methods to achieve this objective. While the Enterprises have considered various approaches to disposing of REO over time, this Request for Information represented an opportunity to review what has been done and consider new approaches.

After receiving literally thousands of submissions in response to the RFI, FHFA announced in February of this year a pilot REO initiative in hardest hit areas that allows investors to purchase pools of Fannie Mae foreclosed properties with the requirement to rent the purchased properties for a specified number of years. In July we announced that the winning bidders in the program had been chosen and just earlier today we announced that the first transaction has closed in Florida and we expect the other transactions to close in the coming weeks.

Now, none of this progress has been easy, and substantial challenges remain. Both risk sharing and REO disposal are complex, nuanced processes that require time to assess market opportunities, make operational changes, and develop proper risk metrics and controls. On both fronts we are working diligently and progress is being made. While we are not ready to make any announcements today we are moving forward steadily and expect to continue making progress on these initiatives in coming months.

**STRATEGIC PLAN**

Last September I spoke to this group about some of the long-term improvements to the functioning of the housing finance system that we were considering.

In particular, I mentioned four specific initiatives that we had already announced – Uniform Mortgage Data Program; Joint Servicing Compensation Initiative; Strategic Alignment Initiative; and enhanced loan level disclosures for Enterprise MBS – and I explained why these meaningful steps would improve housing finance and help us prepare for the future.

I also mentioned then -- and we have discussed today -- that further consideration should be given to guarantee-fee pricing and other forms of risk sharing so that the Enterprises' operations would better reflect what might be expected of them if they were private companies not operating in conservatorship. This was in the context of the statutory requirement we have as conservator to move the Enterprises toward a sound and stable financial condition.

Since then, we at FHFA formalized our thinking along these lines by issuing a Strategic Plan for the Enterprise Conservatorships in February of this year. The very next month, we followed that with the release of our Strategic Plan with a scorecard, to show how we were going about implementing this plan.

The Strategic Plan begins to lay out a series of initiatives and strategies that will improve current mortgage processes, inspire greater confidence among prospective market participants, and set the stage for an improved future system of housing finance.

The plan identifies three strategic goals for the next phase of the conservatorships:

- **Build** a new infrastructure for the secondary mortgage market;
- **Contract,** gradually, the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations; and
- **Maintain** foreclosure prevention activities and credit availability for new and refinanced mortgages.

In these three goals, the plan builds on many of the initiatives that I discussed with you last year and sets forth objectives that are consistent with FHFA's legal mandate and the policy direction that has emerged from the Administration and Congress.

Given that the document is a Strategic Plan and not a step-by-step guide, I want to mention some of the specific actions FHFA is taking to implement the plan. In particular, I want to focus on a couple of steps we are taking toward building a secondary mortgage market infrastructure.

A cornerstone of what we are seeking to build is a new securitization platform that could serve both Fannie and Freddie while in conservatorship -- and potentially serve the secondary mortgage market in a post-conservatorship world that has multiple issuers of mortgage-backed securities. In addition to the securitization platform, the new infrastructure would provide new standards for a variety of contractual agreements, rules and regulations of which the pooling and servicing agreement is a cornerstone.

In the Strategic Plan, we said that FHFA would determine how the Enterprises can work together to build a common securitization platform to replace their current systems. This analysis is well under way, as is analysis of a proposed model pooling and servicing agreement.

Now, given that the securitization infrastructure could serve as a utility that would outlast Fannie and Freddie as we know them, we are committed to seeking input from all market stakeholders. Consistent with this commitment, FHFA anticipates issuing in October a white paper on a new securitization infrastructure for public comment.

The Enterprises are working together with FHFA to develop this new infrastructure and identify issues that would benefit from such public input. However, we anticipate the actual building of the securitization platform to be a multi-year effort.

There may be some confusion between the securitization platform and the establishment of a single Enterprise security. Enterprise security performance has been a long standing issue in the market and the establishment of the conservatorships has affected this issue in various ways. Our immediate priority is a single, common platform not a single security.

I want to be clear about our Strategic Plan's vision for the future. I strongly believe in the value and importance of competitive markets. A common securitization platform may one day operate as a public utility that enhances liquidity, standardization, and transparency, which should promote a more competitive market. In our view, whatever the structure of the secondary mortgage market of the future, certain key functions will need to be performed. And in many cases, like developing data reporting standards, the standardization of such functions would provide benefits to the overall market.

As we prepare to transition to a new secondary mortgage market that will operate in a post-conservatorship world, we anticipate that Fannie and Freddie will maintain its own distinct securitization operations and continue to issue their own securities. And while Fannie Mae and Freddie Mac continue their respective corporate activities while in conservatorship, as Conservator, FHFA is thinking ahead to a secondary market with multiple firms competing to bring the capacity of global capital markets to finance individual mortgages around the country.

**Conclusion**

In the four years since FHFA established the conservatorships of Fannie Mae and Freddie Mac, we have made significant strides towards maintaining a functioning mortgage market, keeping borrowers in their homes, and remediating the problems that led to the Enterprises being placed in conservatorship.

But there is still so much to be done. Today, the government touches more than 9 out of every 10 mortgages. In practical terms, this means that taxpayers are accountable for 90 percent of mortgages in this country. It is imperative that we work to transition the mortgage market to a more secure and sustainable and competitive model.

The conservatorships were never intended to be a long-term solution. Coming as they did just two months before our last presidential election, the conservatorships were meant primarily as a "time out" for the rapidly eroding mortgage market – an opportunity to provide some stability while Congress and the Administration could figure out how best to address future reforms to the housing finance system.

It is vital to the long-term health of our country's housing and financial markets that Congress and the Administration seek to bring the conservatorships to a conclusion and to define the government's role and requirements for housing finance in the future.

Clearly there is no simple solution, and a number of fundamental questions will have to be answered in setting forth a new structure for housing finance. For instance: When it comes to housing finance in America, what, and how big, should be the role of the federal government? Or, to take the other side of the coin, what is the capability and capacity of private market participants to intermediate credit for single-family housing? Where do we think the market system requires prudential government oversight or limits? Are there public policy concerns about potential market failures and, if so, are those concerns about market stability and liquidity or about social policy goals regarding homeownership? Different concerns may require different solutions.

I hope the review I have provided of what we have accomplished this past year and our next steps with the conservatorships shows that we can restore private capital and competing institutions in the secondary mortgage market while renewing our country's vision of homeownership as part of the American dream.

Thank you.