Remarks

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

Before the National Association of Realtors®

Housing Policy in 2013: Challenges, Opportunities and Solutions: A Real Estate Symposium

Washington, DC

May 15, 2012

Thank you for the opportunity to be here today. We all are cautiously optimistic that the signs of stabilization, and in some places, strength, that have begun to emerge in various housing markets are true signals that a long-awaited recovery is taking place. Yet we also know that there are many challenges and risks still facing housing today that continue to require our attention. This afternoon, the focus of my remarks, and I believe the panel to follow, will touch on the challenges of the present as a gateway to looking to the future.

I will start with a brief review of FHFA's responsibilities as Conservator of Fannie Mae and Freddie Mac and of a few current topics in real estate. The majority of my remarks will focus on the work FHFA is doing to prepare for the housing finance system of the future.

FHFA as Conservator

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."

From the outset, FHFA stated that the goals of the conservatorships were 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.

Today, FHFA is balancing three responsibilities: preserve and conserve assets, ensure market stability and liquidity, and prepare Fannie Mae and Freddie Mac for an uncertain future. While the long-term course of housing finance is being debated and ultimately determined, FHFA meets these responsibilities by overseeing these companies' management of, and limiting cost to taxpayers from, their $5 trillion position in the market.

Current Issues

In contrast to how they are sometimes portrayed, Fannie Mae and Freddie Mac, or the Enterprises as I will refer to them, are playing a leading role in providing assistance to homeowners. Wherever possible, FHFA, Fannie Mae, and Freddie Mac seek to avoid foreclosure for it is well understood that foreclosure typically causes more harm to borrowers, neighborhoods and investors alike than do the various foreclosure alternatives that so many of us have been promoting.

Let me put the efforts of Fannie Mae and Freddie Mac with regard to foreclosure prevention in some context for you.

On a nationwide basis, Fannie Mae and Freddie Mac own or guarantee 60 percent of the mortgages outstanding, but they account for only 29 percent of seriously delinquent loans, obviously a much lower proportion than their share of the market.

Even though the Enterprises have a smaller share of seriously delinquent loans than other market participants, they account for just over half of all Home Affordable Modification Program, or HAMP modifications. Between HAMP modifications and their own proprietary loan modifications, Fannie Mae and Freddie Mac have completed more than 1.1 million loan modifications since the fourth quarter of 2008.

Loan modifications are not the solution for every troubled borrower. In addition to the 1.1 million loan modifications done by Fannie Mae and Freddie Mac, together, the two companies have done over 1 million foreclosure prevention transactions with troubled borrowers. These range from forbearance plans for the unemployed or those facing temporary income disruptions, to repayment plans for those in need of some time to catch up, to short sales and deeds-in-lieu of foreclosure for those lacking the ability or the desire to stay in their home. Altogether, that makes more than 2.2 million families with troubled mortgages backed by Fannie Mae or Freddie Mac that have avoided foreclosure through these measures.

We have also made great strides in improving mortgage servicing standards. The Servicing Alignment Initiative (SAI), which FHFA announced last year, focuses servicers' resources and attention on moving all borrowers into alternatives to foreclosure, quickly, efficiently, and aggressively. The Initiative aligned the requirements of the Enterprises to remove inconsistencies that could cause servicers confusion and delay.

Importantly, under SAI, the focus is on reaching out to borrowers from the first missed payment. The sooner a borrower can be contacted, their situation assessed, and an appropriate remedy offered, the better the chance for a successful outcome. The servicing requirements we have put in place under SAI represent an important advancement toward workable national servicing standards. Because of our coordination with the banking regulators and the network of state attorneys general last summer, the servicing requirements in the recent 49-state attorneys general settlement line up well with the SAI servicing standards.

Not every troubled borrower is going to benefit from a loan modification but SAI also speaks to other foreclosure avoidance options. One such option is a short sale.

I know that improving the short sales process is a matter of great interest to Realtors, and we appreciate your support for the work that FHFA has been doing in this space. My team has noted to me that they are very appreciative of the insight and expertise that Realtors have provided to FHFA. I understand that there have been several meetings, where you have shared your experience, helping us better understand exactly what's happening at the ground level and what program changes would expand the use of this critical loss mitigation tool.

The timeline changes that we announced in April are a preliminary step to enhancing short sales. For anyone not familiar with these changes, which take effect in June, they basically aligned servicer decision timelines and borrower communication requirements. Once the servicer receives a complete borrower short sale application and purchase offer, a decision is required within 30 days. If additional time is needed, the servicer must provide weekly updates, but in no case may a decision be delayed beyond 60 days.

These initial steps will be followed by more significant program changes, to address the long-standing inefficiencies in the process. A short sale is complicated by two fundamentals:

1. the number of parties who will sustain losses as a result of the transaction, and
2. the subjectivity surrounding the two sources of cash that will help offset losses to these parties – the value of the property and the borrower's own assets, should there be any.

The number of parties involved - from Fannie Mae and Freddie Mac, to mortgage insurers, to various types of subordinate lienholders – would all prefer to minimize their losses, to the extent possible. They protect their interests by negotiating each deal on the basis of the sales price offered and the amount of contributions that the borrower can make to cover some portion of the losses. What this means is that each of these parties would like to dictate two of the program parameters:

1. the method used to determine that sales price that is offered is acceptable, relative to the actual value of the property and the outstanding loan balance, and
2. the formula used to determine if a borrower has financial assets that can fill the gap and offset the losses.

To address these fundamental concerns, we are trying to develop policy that can be accepted by all parties, to eliminate the protracted negotiations and make very clear who is eligible for a short sale, under what terms, and what price is sufficient to make the deal work. In terms of timing, as indicated in our Strategic Plan for the Conservatorships, the aim is to complete policy decisions by the end of June, and to have new guidance drafted by the end of September.

We also have a critical loss mitigation strategy for underwater borrowers who have remained current on their mortgage. The Home Affordable Refinance Program, or HARP, provides refinancing opportunities to borrowers who might otherwise be unable to refinance due to house price declines. This program is directly targeted at the 75 percent of underwater Fannie Mae and Freddie Mac borrowers who are current on their mortgages.

Most recently, the Enterprises have upgraded their automated underwriting systems to process "HARP 2.0" applications from originators serving new customers, to ensure that borrowers can shop around to get a HARP refinance. Early market indications regarding the changes to HARP are quite encouraging. This is one of the most promising tools we have to assist underwater homeowners.

Looking to the Future

Virtually all of our collective attention the past three years has been focused on mortgages made in the past. But we can't just be looking back – it really is time for us to start thinking about, and working toward, a renewed and more vibrant housing finance system for the future.

At FHFA we are starting to prepare for that future.

In February I submitted to Congress a Strategic Plan for the next chapter of Conservatorship. You may find this plan on our website.

The plan sets forth three strategic goals:

1. **Build.** Build a new infrastructure for the secondary mortgage market.
2. **Contract.** Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations.
3. **Maintain.** Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

Achieving these strategic goals will fulfill the statutory responsibilities Congress assigned FHFA as Conservator and also prepare the foundation for a new, stronger housing finance system in the future. Although that future may not include Fannie Mae and Freddie Mac, at least as they are known today, this important work in conservatorship can be a lasting, positive legacy for the country and its housing system.

Properly implemented, this Strategic Plan should benefit all stakeholders, including:

- Homeowners, by ensuring continued emphasis on foreclosure prevention and credit availability;
- Taxpayers, by furthering efforts to limit losses from past activities while simplifying risk management and reducing future risk exposure;
- Market participants, by creating a path by which the Enterprises' role in the mortgage market is gradually reduced while maintaining market stability and liquidity; and
- Lawmakers, by building a foundation on which they may develop new legal frameworks and institutional arrangements for a sound and resilient secondary mortgage market of the future.

More broadly, I would like to see the mortgage market of the future become more competitive than it is today. We have seen a great deal of concentration in mortgage origination and in mortgage servicing in recent years. This has come, in part, at the expense of small and local banks and thrifts, institutions with both local market knowledge and direct and multiple relationships with borrowers. I think that policymakers need to think hard about where and how regulatory requirements contribute to this growing concentration in the marketplace, and what might be done to reverse this.

Let's take a closer look at the three strategic goals, especially the first two.

The first strategic goal – building for the future – recognizes that the country lacks the infrastructure for trillions of dollars in mortgage securitization in the absence of Fannie Mae and Freddie Mac. So the goal here is to have Fannie Mae and Freddie Mac start building that infrastructure so that it can continue to function even if they do not.

Central to achieving this goal is developing a new securitization platform for the future. For the platform to have long-term value it should have an open architecture that will permit multiple future issuers of mortgage-backed securities to access the platform and it should be flexible enough to permit a wide array of securities and mortgage structures. Since this platform could become a type of public utility that would outlast the Enterprises as we know them today, input from all market stakeholders will be sought.

The intended outcome of such an important infrastructure investment is to provide a sound securitization platform on which to rebuild the country's secondary mortgage market. The platform itself will be one way American taxpayers realize a return on their substantial investment in the Enterprises while also making it possible to retire the Enterprises' proprietary systems and programs from the marketplace. The platform will be designed to issue securities supported with or without a government guarantee.

It appears that whatever role the government decides to play, it will be looking to private market participants to absorb some portion of mortgage credit risk and all of the interest rate and prepayment risk. That is why two elements of building this securitization platform will be a clear and robust pooling and servicing agreement and loan-level disclosures that are regularly updated throughout the life of the security.

A standardized pooling and servicing agreement would replace the Enterprises' current Servicer Participation Agreement. We intend for it to correct the many shortcomings found in the pooling and servicing agreements used in the private-label mortgage-backed securities (MBS) market before the housing bubble burst. We also intend to solicit broad public input to build a better standard for the future. Such input from investors and a careful review of applicable Securities and Exchange Commission rules and best practices will be essential in this endeavor.

Work has already been underway on loan-level disclosures. The goal remains providing MBS investors with detailed, timely, and reliable loan-level data at the time a mortgage-backed security is issued and throughout the life of the security. Such transparency is a prerequisite for private capital to bear a meaningful portion of mortgage credit risk.

With the second strategic goal – contracting the Enterprises' footprint in the mortgage market – we want to gradually shift some portion of mortgage credit risk from the Enterprises to other market participants in a manner that is not disruptive to the current market. We also are looking to eliminate the direct funding of mortgages by Fannie Mae and Freddie Mac and to continue to shrink and simplify their operations while in conservatorship.

Achieving the second strategic goal will involve, among other things, some mix of continued, gradual increases in guarantee fee pricing, some greater reliance on private mortgage insurance, and a use of loss-sharing tools such as securitization structures that move some portion of mortgage credit risk away from the Enterprises.

There is a great deal of work involved in achieving these first two strategic goals, and each will take time to implement. While work on some aspects of these goals has been going on for a while, we have a long way to go.

Even with all the new work involved with the first two goals, it is important that no one at FHFA or at Fannie Mae and Freddie Mac lose sight of the third goal – continuing to ensure full effort is made to assist troubled borrowers and ensuring that market liquidity is maintained. Together, the Enterprises purchase or guarantee roughly $100 billion in home purchase and refinanced mortgages each month. Market confidence in the Enterprises' ongoing ability to provide this stable, liquid flow of mortgage-backed securities to investors is essential to stabilizing house prices and ensuring stability in the value of roughly $4 trillion in outstanding Enterprise mortgage-backed securities.

Other ongoing Enterprise activities that must be continued and enhanced include:

- Successful implementation of the HARP program, including the significant program changes announced in October 2011.

- Renewed focus on short sales, deeds-in-lieu, and deeds-for-lease options that enable households and the Enterprises to avoid foreclosure. Enhanced use of these foreclosure avoidance tools may have important benefits for borrowers, neighborhoods, and taxpayers.

Before closing, I want to mention several aspects of this Strategic Plan that concern work streams already in progress. These deal with activities surrounding mortgage origination and mortgage servicing.

With regard to originations, FHFA first announced the Uniform Mortgage Data Program in May of 2010, when we directed Fannie Mae and Freddie Mac to develop uniform standards for data reporting on mortgage loans and appraisals. The initiative is designed to improve the consistency, quality, and uniformity of data collected at the front-end of the mortgage process. By identifying potential defects as early in the origination and delivery process as possible, the Enterprises will improve the quality of mortgage purchases, which should reduce repurchase risk for originators.

Since that announcement nearly two years ago, we've made a lot of progress. On March 19, use of the Uniform Collateral Data Portal became mandatory, ensuring that all lenders are now submitting standard appraisal forms and appraisal data electronically, allowing Fannie Mae and Freddie Mac to evaluate the information in a more seamless and efficient manner. We're very pleased with the transition to the new tool and believe that the benefits of the standardized data and electronic transmission will be shared across the industry.

Last month, lenders began submitting using the new Uniform Loan Delivery Dataset file. Such electronic submissions using this system become mandatory in July.

We believe that this effort paves the way for the future, offering an integrated and efficient way for basic loan-level information to be made available to mortgage investors.

As we think about building for the future, national mortgage servicing standards and mortgage servicing compensation also are on our mind.

We need standardized, transparent servicing requirements that define mortgage servicers' responsibilities to borrowers and investors across a spectrum of issues including delinquent loan servicing, solicitation for refinance or loan modifications, and servicing transfers. I've already discussed our work on the Servicing Alignment Initiative, which works to this end.

We also need a servicing compensation structure that promotes competition for, rather than concentration of, mortgage servicing. Such a structure would take full account of mortgage servicers' costs and requirements, and consider the appropriate interaction between origination and servicing revenue. FHFA has published two discussion papers on this topic and we continue to work on it.

In closing, while FHFA will keep its focus on foreclosure alternatives, refinancing, and ongoing liquidity in the marketplace, it is time for policymakers to begin work in earnest on the future housing finance system. As I said, that system is not likely to include Fannie Mae and Freddie Mac, at least as we know them today. But it does require a legal and institutional framework that brings the power of global capital markets to the benefit of local lenders and borrowers around the country. Importantly, we must remember the importance of competition in the marketplace.

Thank you.