



Recent Accomplishments and a Look Ahead at the Future of Housing Finance

Remarks as Prepared for Delivery

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Introduction

Good afternoon. Members of the Exchequer club, thank you for inviting me to speak. It has been a very interesting year for the Federal Housing Finance Agency, and it's an honor to have this chance to discuss our accomplishments and goals as we prepare for an uncertain future.

As you know, four years ago, at the height of the housing crisis, the Housing and Economic Recovery Act, or HERA, created FHFA, and shortly thereafter Fannie Mae and Freddie Mac were placed under conservatorship. FHFA is also charged with supervising the 12 Federal Home Loan Banks, which are important sources of funds for nearly 8,000 community financial institutions across the nation.

Fannie Mae and Freddie Mac, also known as the Enterprises, are government-sponsored enterprises that were created to buy and guarantee mortgages, thereby providing liquidity to the home mortgage market. Acting as their conservator comes with some very specific legal responsibilities. We must preserve and conserve their assets, which translates directly into minimizing taxpayer losses; we must strive to ensure stability and liquidity in housing financing; and we must try to maximize assistance to struggling homeowners.

I believe the operations of Fannie Mae and Freddie Mac in conservatorship these past four years *have* maintained stability in housing finance and allowed the companies to fulfill their mission. But the poor business decisions and risk management that led to the conservatorships in the first place have resulted in enormous taxpayer losses. Furthermore, the success the companies have had in conservatorship would not have been possible without the backing of American taxpayers.

Today, I would like to provide you with a review of the important activities that FHFA and the Enterprises have undertaken in 2012. These activities reflect progress on the three strategic goals FHFA set forth for the conservatorships early this year: build a new infrastructure for the future, gradually contract the Enterprises footprint in the marketplace, and maintain focus on loss mitigation and market liquidity.

I will close with an overview of current projects to prepare for a future mortgage market and some thoughts on how policymakers might go about considering the task of rebuilding the housing finance system.

I. 2012 – A Year in Review

While there are signs that the housing market is improving in many areas, there is still a lot of work to do. I'll begin by reviewing the work FHFA and the Enterprises undertook in 2012 on loss mitigation and foreclosure prevention.

Loss Mitigation and Foreclosure Prevention

In contrast to how they are sometimes portrayed, Fannie Mae and Freddie Mac are playing a leading role in providing assistance to homeowners.

As conservator, FHFA's biggest challenge has been to avoid foreclosures and minimize losses to taxpayers on loans originated prior to conservatorship. Broadly speaking, we can group these loans into the following four groups:

- Borrowers unable to pay their mortgage but with an ability to pay a reduced amount and a desire to stay in their home;
- Borrowers unable or unwilling to pay any reasonable mortgage amount or lacking a desire to stay in their home;
- Borrowers able to pay their mortgage but unable to exercise their refinance option because of the decline in house prices; and finally,
- Borrowers able to pay their mortgage and able to refinance as in normal market conditions.

The first two groups posed immediate credit risk from default and foreclosure and the third group – those unable to refinance – posed a heightened contingent risk, including a risk that they will give up on their mortgage, leading to a default despite an ability to pay.

For borrowers in each of these four categories, Fannie Mae and Freddie Mac, working with FHFA as Conservator, have developed and implemented programs tailored to each of these circumstances. Each program is designed to reduce credit risk, or reduce losses from loan defaults, thereby reducing losses to taxpayers. 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.

Since conservatorship, the Enterprises' foreclosure prevention activities, including loan modifications and short sales, have helped nearly 2.5 million borrowers avoid foreclosure. Of this total, more than 2 million of these actions have resulted in the borrower retaining their home, with the majority of those as a result of a loan modification.

Foreclosure Prevention – Loan 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. The Enterprises also

offer loan modification alternatives to HAMP because there are many borrowers in trouble who do not qualify for, or have not been able to benefit from, HAMP.

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

Through either HAMP or other modification programs, the Enterprises have helped roughly 1.2 million families obtain a permanent loan modification. The pace of loan modifications has slowed in 2012; however, through August of this year the Enterprises have completed more than a quarter million loan modifications.

Besides loan modifications, borrowers facing more temporary setbacks, perhaps due to a medical condition or unemployment, have benefitted from repayment plans or other temporary forbearance. Since conservatorship, three-quarter of a million borrowers have benefitted from such support, and these efforts continued at about the same pace in 2012.

Foreclosure Prevention - Short Sales

For some borrowers, selling their home – even for less than their outstanding loan balance – remains the best option. For them, we have taken steps to align and consolidate existing short sales programs into one standard program. This streamlining enables lenders and servicers to more quickly and easily qualify eligible borrowers for a short sale.

This year we announced that the Enterprises would implement accelerated timelines to review and approve short sale transactions, which became effective in June. And starting this month, homeowners with an Enterprise mortgage suffering from an eligible hardship such as death of a borrower or co-borrower or relocation for a job, can sell their home in a short sale even if they are current on their mortgage.

By moving short sales forward expeditiously, we will help homeowners avoid foreclosure, reduce taxpayer losses, and stabilize communities. We are pleased with the results so far in 2012, and are on pace to exceed results from previous years.

Foreclosure Prevention - Enhanced Refinance Opportunities

Our efforts to support refinancing, especially for underwater or near-underwater borrowers, are also a key tool in foreclosure prevention. The problems here are both practical and legal. Practically speaking, no lender is going to make a new mortgage loan for more than the property's current value. There was also a legal issue – Fannie Mae and Freddie Mac cannot purchase a mortgage above 80 percent loan-to-value without some form of third-party credit enhancement.

Doing nothing in this situation meant a heightened risk of future loss to the Enterprises, and hence taxpayers, because the probability of default for such borrowers is relatively

high and the loss given such default is also quite high. The risk management imperative was to identify a way for such borrowers to refinance and thereby benefit from the substantial reduction in interest rates. Such refinancing would recommit the borrower to their home and strengthen their household balance sheet either by giving them a reduction in their monthly payment or allowing them to shorten the term of their mortgage, thereby rebuilding equity in their home faster.

To assist such borrowers, in 2009, FHFA introduced the Home Affordable Refinance Program, or HARP, to provide opportunities for such borrowers to refinance existing Fannie Mae or Freddie Mac mortgages.

Although more than 1 million loans were refinanced through this program from inception to late 2011, we wanted the program to reach more borrowers and recognized that changes were needed. So in late 2011, we revamped HARP to remove various frictions that inhibited greater participation.

Those revisions, dubbed HARP 2.0, took several months to implement, and involved close coordination with the Enterprises, lenders, mortgage insurers, and other stakeholders.

Thanks to those changes, through September of this year, more than 700,000 borrowers have refinanced their loans through HARP 2.0. To put that into perspective, in the first nine months of this year, 75 percent more borrowers have benefitted from HARP than did in all of 2011. It is possible that the program could reach nearly a million borrowers, or more, by the end of this year. In addition, over 40 percent of HARP refinances in 2012 were to underwater borrowers, and an increasing percentage of HARP refinances in 2012 were for shorter term mortgages that help borrowers build equity faster.

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 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 taxpayers' risk from the financial support they provide the Enterprises.

Since last year, there have been two across-the-board price increases to G-fees, the first announced in late December 2011 that took effect in April and the second announced in late August that takes effect on Saturday. The first increase was an across-the-board 10

basis point increase. The second increase 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 could begin to incentivize private firms to increase their participation in the mortgage market. We intend to stay on that path with future increases.

The Enterprises have long operated without taking 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.

In September, FHFA released a paper for public input that outlines a pricing approach to better capture the costs associated with state and local policies. We are considering 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. The deadline for public input was Monday and we look forward to considering the various viewpoints received.

Representations and Warranties

Fannie Mae and Freddie Mac 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. That is, they did relatively few reviews of mortgages sold to them unless or until the mortgage went into default. Then, if they found the loan was originated outside the terms they had set, they could demand a repurchase.

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, resulting 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 – the representation and warranty model needed to be

improved. Lenders want more certainty about their risk exposure and the Enterprises want to ensure the quality of the loans delivered to them.

That is why in September FHFA and Fannie Mae and Freddie Mac announced that the companies are launching a new representation and warranty framework for conventional loans sold or delivered on or after January 1, 2013. 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.

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.

REO & Risk Sharing

As we seek to reduce the Enterprises' long-term risk exposure and place them in a more stable financial condition, we are examining various methods of risk sharing, including the expanded use of mortgage insurance and securities structures that allow for private sharing of risk.

We also continue to explore options for disposing of real estate owned, or REO, properties. In August 2011, FHFA announced a pilot REO initiative that allows investors to purchase pools of Fannie Mae foreclosed properties with the requirement to rent the purchased properties for a certain time. In July we announced that the winning bidders in the program had been chosen and recently we announced that the final transaction had closed. We are encouraged by the results and remain committed to pursuing similar efforts.

None of this progress has been easy, and substantial challenges remain. Both risk sharing and REO disposal are complex 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. We expect to continue making progress on risk-sharing options in the coming months.

Changes to PSPAs

Let me say a few words about the 2012 changes to the Senior Preferred Stock Purchase Agreements – or PSPAs for short -- between the Treasury Department and the Enterprises. First established in 2008 when Fannie Mae and Freddie Mac were placed into conservatorship, the PSPAs were designed to provide market confidence that each Enterprise would maintain positive net worth and be able to support their outstanding obligations and continue providing liquidity to the mortgage market.

One of the key 2012 PSPA changes was to the way the Enterprises pay dividends to Treasury. Instead of paying the Treasury a 10 percent dividend on outstanding senior preferred stock, the Enterprises will pay Treasury with a quarterly net worth sweep, essentially a payment of income earned in the quarter. This change is important for continued stability as it eliminates the possibility of the Enterprises having to borrow from Treasury to pay dividends, which could have eroded market confidence in the Enterprises. This change also makes sure that everything the Enterprises earn is used to benefit taxpayers for their investment in those firms.

Another key change was the requirement to contract the Enterprises' portfolios at an annual rate of 15 percent -- an increase from the 10 percent annual reduction called for previously. This means that the portfolios will be reduced to \$250 billion four years earlier than previously scheduled.

II. Building a New Infrastructure and the Future of Housing Finance

Let me turn now to FHFA's effort to build a new infrastructure for the secondary mortgage market.

We know the nation will need a healthy and efficient secondary mortgage market regardless of the final resolution of the conservatorships. That is why we are developing a new framework -- one that will work for the Enterprises today, and also have broad application in the future.

The Enterprises' infrastructures are not the most effective when it comes to adapting to market changes, issuing securities that attract private capital, aggregating data, or lowering barriers to market entry.

That is why we seeking to establish a framework that can support the secondary mortgage market post-conservatorship, with or without government involvement, and attract more private capital to the market.

We have two goals that were outlined in a recently released white paper on a new securitization infrastructure.

First, the Enterprises' outmoded proprietary infrastructures need to be updated and maintained, and any such update should provide enhanced value to the mortgage market with a common and more efficient model.

In addition, this new infrastructure must be operable across many platforms, so that it can be used by any issuer, servicer, agent, or other party who decides to participate. The scope of this effort could be focused just on functions that are routinely repeated across the secondary mortgage market, such as issuing securities, providing disclosures, paying investors, and disseminating data. That is perhaps the minimum scope for this effort, and we look forward to comments on whether other items should be considered.

Second, we also put forth some broad ideas on creating a model pooling and servicing agreement. The pooling and servicing agreement is the legal document that lays out the responsibilities and rights of the servicer, the trustee, and others over a pool of mortgage loans. This is an area where additional market input will be exceptionally valuable, and we look forward to additional comments and further interaction with market participants in 2013.

Success in achieving these goals will provide a sound, efficient and flexible operating environment in the short term, and give policy makers a new foundation on which to build the mortgage finance system of the future.

III. Conclusion

I am cautiously optimistic that the signs of stabilization -- and in some places, strength -- that have started to emerge in certain sectors of the housing market are signals that it is beginning to recover.

Yet, we also know that there are many challenges ahead. In the four years since Fannie Mae and Freddie Mac went into conservatorship, we have made major strides towards rehabilitating the mortgage market and keeping borrowers in their homes, but there is still much to be done.

Today, the government touches more than 9 out of every 10 mortgages. With this in mind, it is essential that we transition the mortgage market to a more secure and sustainable and competitive model.

The conservatorships of Fannie Mae and Freddie Mac were never intended to be long-term solutions. They were primarily meant as a "time out" for the rapidly eroding mortgage market--an opportunity to provide some stability while Congress and the Administration decided on how best to rebuild our housing finance system.

It is vital to the long-term health of our country's housing and financial markets that our

elected leaders 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.

At the most fundamental level, the key question in housing finance reform is what, and how big, should the role of the federal government be? This is clearly where there are diverging political views, but we must start to think through this process.

Perhaps it will be easier to break this question up into component parts. One potential place to start is by clearly defining the role of the traditional government mortgage guarantee programs like the Federal Housing Administration (FHA). If policymakers begin with the role FHA should play in the future in terms of what borrowers would have access to this program, and what structural changes might be needed, than it should be easier to consider the government's role in the remainder of the mortgage market.

FHFA is taking a number of steps – whether it is increasing guarantee fees or pursuing risk sharing alternatives – that have the potential to transfer some credit risk to the private sector. We will continue to try to make progress in this area, but if policymakers are serious about limiting the government's role, more direct action may be needed to have significant near-term effects. And, elected officials must give direction on how to end the conservatorships.

Thank you.