

**Speech**

# **Meeting the Challenges of the Financial Crisis**

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Thank you, Mary Martha, for the kind introduction. And thank you Women in Housing and Finance for inviting me back. You are performing an important service by organizing not only today's very timely symposium, but also the many public policy gatherings and task force meetings. Things have certainly changed a great deal since the first time I spoke to you almost three years ago or even the last time three months ago. I am particularly pleased to be able to update you on the groundbreaking changes in foreclosure prevention that should help restore this nation's economy. In recent meetings with the management teams of Freddie Mac and Fannie Mae and the Chairmen, Vice Chairmen and Presidents of the Federal Home Loan Banks, I have made the point that they have never had a more important and challenging role than they do today.

The biggest challenge we face is the stabilization of the housing market. Both the public and private sectors have begun to apply concentrated action to this pressing goal. **(SLIDE 2)** FHFA has a four-pronged strategy to ensure the housing government-sponsored enterprises (GSEs) meet this challenge and fulfill their mission of providing liquidity, stability, and affordability to the housing market. First, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks must continue to support the market in a safe and sound manner by providing liquidity and stability, with a special emphasis on affordable housing. Given the current predominant role the GSEs play in the nation's mortgage market, it is imperative that FHFA ensure their continued functioning and safety and soundness.

Second, we are working with our government partners to get mortgage interest rates down. Third, we are working with the Enterprises to set best practices for the whole mortgage market. Fourth, we are actively working on foreclosure prevention to help homeowners in trouble by providing affordable modifications and refinancing.

## **Setting the Scene**

**(SLIDE 3)** To set the scene, this slide shows the history of the mortgage market over the past 12 years. From 1997-2003, Fannie Mae's and Freddie Mac's market share of mortgage originations gradually grew to almost 55 percent. From 2004-2006, the private mortgage market predominated, and Fannie's and Freddie's business sank pretty dramatically, with their market share dropping below 35 percent. Then as the private market started

to freeze up in 2007, Fannie's and Freddie's market share took off—up to 73 percent in 2008. However, as you will note, that is a larger share of a much smaller market. The market share of mortgages insured by FHA/VA (Federal Housing Administration/Veterans Administration) has risen much more dramatically, from 3 percent in 2006 to 20 percent for 2008, but even more startling, to 35 percent in the fourth quarter of 2008.

During the boom times, virtually everyone involved in home mortgage lending—builders, borrowers, brokers, Realtors®, lenders, mortgage insurers, credit rating agencies, the Enterprises, other secondary market investors, and yes, us regulators—failed to fully appreciate the likelihood of a severe house price correction. Well, prices did not rise forever, as this chart shows. **(SLIDE 4)** From January of 2000 through July 2006 (peak), the more volatile S&P/Case-Shiller house price index rose by 106 percent only to fall by 27 percent since then. The less volatile FHFA House Price Index, which reflects Fannie Mae's and Freddie Mac's books of business, peaked later, and has since declined 10.9 percent from its peak.

**(SLIDE 5)** Not surprisingly, as house prices have fallen, serious delinquencies of 90-days or more have risen across the board. For subprime mortgages, serious delinquencies are 23 percent, and those subprime ARMs are 34 percent seriously delinquent. Serious delinquencies are far lower at Fannie Mae and Freddie Mac at about 2 percent, which is even lower than the prime market at 3.7 percent or the whole market at 6.3 percent.

Now turning to the four strategies, let me start with the safe and sound provision of liquidity, stability, and especially affordable housing:

## **Affordable Housing Mission and Goals**

For the first time, the Housing and Economic Recovery Act (HERA) which was enacted last July, added affordable housing and mission enforcement to the responsibilities of the safety and soundness regulator of Fannie Mae and Freddie Mac. In the near-term, the Enterprises have been charged with meeting the very ambitious goals set by HUD back in 2004. **(SLIDE 6)** For 2008, they fell short of these goals which were infeasible due to totally unanticipated market conditions. So as we set the annual housing goals for 2009 based on current market conditions, it seems likely that the income-based affordable housing goals for 2009 will look more like the goals HUD set in 2004 and 2005, plus incentives for loan modifications and refinancings. Beginning in 2010, HERA requires a wholesale restructuring of the affordable housing goals with four single-family goals and one multifamily special affordable housing goal.

HERA also requires, for the first time, that FHFA establish housing goals for the 12 Federal Home Loan Banks which have a significant role to play in affordable housing. HERA allows the Federal Home Loan Banks the ability, until July 30, 2010, to use subsidy funds from their Affordable Housing Program (AHP) to refinance low- and moderate-income households' mortgages.

## **Government Support for the GSEs in Conservatorship**

When I talked to you in December, I explained that HERA gave the Treasury Department authority to support Freddie and Fannie. **(SLIDE 7)** Treasury's Senior Preferred Stock facility, originally \$100 billion each but

now set at up to \$200 billion each, as part of the President's Homeowner Affordability Plan, provides an effective guarantee of the Enterprises' debt and mortgage-backed securities by ensuring the Enterprises have a positive net worth. This facility protects not only present senior and subordinated debt holders and MBS holders but also any future debt and MBS holders, with no expiration date. When the draws occur at the end of this month, \$60 billion will have been used.

Two additional facilities were also implemented when the conservatorships began. Under the first, Treasury has purchased \$107 billion in mortgage-backed securities and has made it clear it will continue to be an active buyer. The second is an unlimited secured credit facility that acts as a liquidity backstop for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, but it has not been needed.

## **Reducing Mortgage Rates**

Two other critically important programs introduced by the Federal Reserve Bank in November are helping to reduce mortgage interest rates. Under the first, a facility of \$500 billion or more, the Federal Reserve Bank has purchased \$217 billion in Fannie Mae, Freddie Mac, and Ginnie Mae (Government National Mortgage Association) mortgage-backed securities (MBS) since the beginning of January. The second program is a purchase of up to \$100 billion or more in Fannie Mae, Freddie Mac, and Federal Home Loan Bank debt, of which \$47 billion has been purchased.

When you add this all up to over a trillion dollars, the U.S. government has made it critically clear to every investor that it is standing behind Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Indeed, we have seen that these programs have had a very positive impact on mortgage rates, which have fallen 150 basis points since conservatorship began (**SLIDE 8**) to 5.03 percent in Freddie Mac's latest weekly report. These lower rates provide an important opportunity to do two things—refinance and modify mortgages to help stabilize housing prices. As confidence is restored and the present large spread to Treasury rates is reduced, mortgage rates could move lower because spreads are still 140 basis points higher than when this started. We are also hoping lower rates will have a positive impact on the new buyers who have been on the sidelines waiting “for things to get better” before they buy.

Setting Best Practices (**SLIDE 9**) Now turning to the third strategy of instilling best practices in the mortgage market, FHFA's position has consistently been that Fannie Mae and Freddie Mac need to be the leaders in developing mortgage market best practices. They have to take a leadership role with all mortgage participants to never let the abuses of 2004 to 2007 recur. In 2007, Fannie and Freddie issued guidance letters to their lender customers focusing on nontraditional and subprime mortgages. Crafted by federal depository institution regulators and adopted by many state financial regulators, the program was designed to be a proactive way for the Enterprises to be sure sellers were clear what mortgages Fannie and Freddie would buy guarantee or accept in a private-label mortgage-backed security (PLS).

The Enterprises have led the industry in developing and implementing strategies to identify mortgage fraud, and reporting to the Department of the Treasury's FINCEN database. In late December, FHFA announced

Fannie Mae and Freddie Mac will implement a revised Home Valuation Code of Conduct, effective May 1, 2009. The code enhances protections for the independence of appraisers while maintaining lenders' ability to address unprofessional appraisal practices and ensure appraisal quality. The code also requires appraisal quality control testing, reporting on appraiser misconduct, and the creation of the Independent Valuation Protection Institute.

In January, FHFA announced it will require loan-level identifiers for loan originators and appraisers beginning January 1, 2010. If originators or appraisers have contributed to the incidences of mortgage fraud, these identifiers will enable the Enterprises to address the problem. Additional efforts to expand mortgage fraud prevention and detection are under consideration by the Enterprises and their industry partners, and I hope to be reporting on those soon.

## Foreclosure Prevention

Well before the conservatorship, we put pressure on the Enterprises to reduce preventable foreclosures through aggressive loan modifications. FHFA took several strong actions to ensure the maximum effort by the Enterprises to modify loans to prevent foreclosures and also took a leading role in efforts to address the foreclosure crisis in the PLS market. Fannie Mae and Freddie Mac and the Federal Home Loan Banks are the largest owners of PLS, with about \$250 billion of once-AAA mortgage-backed securities. **(SLIDE 10)** As this chart shows, of Fannie's and Freddie's holdings of \$ 178 billion, about 55 percent have been downgraded to junk levels. The average price continues to fall from the price of mid-\$60s reported at the end of December. These price falls and the other-than-temporary impairments have been a major destroyer of capital at the GSEs. The only good news is we had their portfolios capped in 2006 and 2007 when the worst of these securities were issued.

**(SLIDE 11)** I know I have shown you Jim's famous pie charts before, but I think they really illustrate the problem we are dealing with in this crisis. While Fannie Mae and Freddie Mac own or guarantee almost 31 million of the total 55 million mortgages, about 56 percent of all single-family mortgages, they only represent 20 percent of serious delinquencies. Almost the opposite, private-label mortgage-backed securities represent 15 percent of the mortgages but 50 percent of the serious delinquencies. If we are going to stabilize the housing market, we have to address that PLS 50 percent.

When I announced in November the new streamlined modification program (SMP) developed jointly with Treasury, HUD, Fannie Mae, Freddie Mac, and HOPE NOW's members, we were optimistic that it would make immediate inroads on the problem of increasing foreclosures across the country. It became clear pretty quickly that the program needed to be even more aggressive to reach more troubled borrowers. At the same time, the Enterprises suspended foreclosures and developed programs to protect renters living in foreclosed properties. FHFA's Foreclosure Prevention Report shows that for the first quarter of conservatorship, October through December, there were almost 24,000 loan modifications, an increase of 76 percent from the previous quarter. But in the face of millions of families facing the potential loss of their homes, much more has to be done.

FHFA understands the nation's deep concern over the human tragedies of the foreclosure crisis. Significant loan modifications are the best way to help the people involved, their communities, and the economy. We have not taken a position on the pending bankruptcy cramdown legislation, but I have said for a long time that forcing people into bankruptcy is the wrong solution. Aggressive loan modifications, including, as many PLS investors are now proposing, principal reductions, are the right solutions. Legislative changes to existing bankruptcy laws should be approached extremely carefully to avoid unintended consequences for individuals and for our weakened financial institutions. We have consistently advocated doing everything possible to give homeowners incentive to accept meaningful loan modifications rather than endure the hardships of bankruptcy.

## **Homeowner Affordability and Stability Plan**

That is why FHFA was pleased to work with the White House, the Treasury Department, the regulators and the Enterprises in the development of the Homeowner Affordability and Stability Plan. The plan is a major step in reducing preventable foreclosures and stabilizing the housing market. The Treasury Department estimates it will help 7 to 9 million families refinance or modify their mortgages. The plan aggressively builds on FDIC's and SMP's foreclosure prevention efforts with many people teed up to be quick beneficiaries. I know you heard Seth speak at length about the details of the overall program this morning, so I will give you some information about Fannie's and Freddie's key roles. **(SLIDE 12)**

In the Home Affordable Refinance initiative, Fannie Mae and Freddie Mac will provide access to low-cost refinancing for responsible homeowners with loans the Enterprises already own or guarantee. Because Fannie Mae or Freddie Mac already hold the credit risk on these mortgages, no additional credit enhancements, such as mortgage insurance, will be required. However, we expect existing mortgage insurance to be rolled over. The program guidelines will allow 4 to 5 million borrowers to be eligible for a refinanced mortgage with a current loan-to-value (LTV) of 80 percent to 105 percent. To make refinancing work, second mortgage holders will have to resubordinate those seconds. Of course, with lower payments on the primary mortgage, holders of seconds will be better protected.

Fannie and Freddie also are working directly with more than 3,000 loan servicers across the country to help implement the \$75 billion Home Affordable Modification plan. They estimate that several million of their own mortgages will be eligible for modifications over the next three years. Modifications need to be paired with the Federal Housing Administration's (FHA's) expanded and improved Hope for Homeowners program and the aggressive Troubled Assets Relief Program efforts to purchase second mortgages. As agents of the Treasury, Fannie Mae as administrator and Freddie Mac as compliance enforcer will play key roles in the implementation and ongoing oversight of the modification program. Given the Enterprises' role in the industry as leaders in establishing best practices, their involvement brings the necessary accountability to a federal program supported with taxpayer dollars.

## **Consumer Information**

To be successful, a major outreach effort will be needed which will be announced shortly. As I am sure you can imagine, there was a rush of consumers looking for information. Treasury set up the [www.financialstability.gov](http://www.financialstability.gov) Web site for the Making Home Affordable initiative. This site helps walk the consumer through the steps of what they need to know and what they need to do. It guides consumers to finding the answer to their most pressing question, “Am I eligible?”

For the refinancing initiative, homeowners need to find out whether their mortgage is owned by Fannie or Freddie. Both Enterprises have implemented Web forms that allow people to submit an online form to get a fast answer. One tester on the Freddie Mac site received results in 90 seconds. Not everyone will get results that quickly, but it is a simple way to get the information. Fannie and Freddie have also added extra staff to man phones because of the flood of calls that has been coming in to their main numbers, 1-800-7FANNIE and 1-800-FREDDIE. To date there have been half a million page views or calls. Hopefully, anyone struggling with their mortgage payments can find the information that will help them get into an affordable mortgage.

I will close here with a final note that all market participants have to be creative. We have to work together to help the U.S. economy and housing market recover. We all need to get behind Making Home Affordable and aggressively work at reducing foreclosures. That means everybody that touches primary and secondary mortgages including the Administration, Congress, regulators, lenders, servicers, investors, trustees, credit counselors, and homeowners. We need to arrest the downward spiral in the mortgage market and keep people in their homes. The fall in mortgage rates that the Treasury and Federal Reserve’s purchases have triggered are very important steps in stabilizing the mortgage market. **(SLIDE 12)** Housing affordability has reached an all-time high. The recently passed stimulus package, the new Financial Stability Plan, and the Homeowner Affordability and Stability Plan are all extremely important next steps to ensure recovery for the housing markets and the U.S. economy.