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Before the Senate Committee on Banking, Housing, and Urban Affairs

On "Turmoil in the U.S. Credit Markets: Examining Recent Regulatory Responses"

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Chairman Dodd, Ranking Member Shelby and members of the Committee, thank you for the opportunity to testify on the Federal Housing Finance Agency's (FHFA) responses to the turmoil in the U.S. credit markets. I will begin by discussing the activities of the FHFA, as the regulator of Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks), including how we are addressing the foreclosure crisis, and then turn to my role as Board member to the Troubled Asset Relief Program (TARP) pursuant to the Emergency Economic Stabilization Act.

There is no doubt that the mortgage market pendulum swung extremely widely towards easy credit, poor underwriting, risky mortgages and even fraud. The market had to correct, but what I want to discuss with you today is how to prevent the pendulum from swinging too far in the other direction of too tight credit standards.

Fannie Mae, Freddie Mac and the 12 Federal Home Loan banks have played a critical role in dampening that pendulum swing. In mid-2006, when you approved my nomination, their market share of all new mortgage origination was less than 40%. The private label Mortgage Backed Securities ("MBS") created by Wall Street were beginning to dominate. By the third quarter of 2007, the excessiveness of these PLS were apparent to everyone and the housing GSEs support to the market became critical. They supported 92% of all mortgages originated in that quarter and continue to remain above 80%.

Update on FHFA Activities/Fannie Mae and Freddie Mac Conservatorships

While we will mark the formal transfer of all personnel to FHFA on Monday, October 27th, the work of the new agency is well underway and there is much going on. I will report on a few key matters here, particularly those that will have an impact on stabilizing the U.S. markets.

On Saturday, September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorships. This was not undertaken lightly. Despite considerable recent progress on the part of the Enterprises to rectify past problems, market conditions, compounded by a weak regulatory capital structure, overwhelmed those improvements. The result was that the Enterprises were unable to fulfill their mission of providing liquidity, stability, and affordability to the housing market. It was evident that regulatory action was needed.

Intense supervisory reviews in July and August led to the conclusion that the companies each presented critical safety and soundness concerns. We were convinced that we needed to act immediately before the conditions of the Enterprises worsened, and the markets for the Enterprises' securities became too unstable to permit normal business activity and threatened the financial health of other institutions. We consulted with Federal Reserve Chairman Bernanke and Treasury Department Secretary Paulson. Both concurred with FHFA that conservatorship needed to be undertaken.

The conservatorship was only possible because of the Housing Economic and Recovery Act of 2008 ("HERA") provision authorizing the Treasury Department to finance the GSEs. The three critical facilities put in place are:

1. A secured credit facility for Fannie Mae, Freddie Mac and the Federal Home Loan Banks. This facility has not been used.

2. A Treasury funded facility to buy Fannie Mae and Freddie Mac MBS. Treasury is actively buying MBS as are the two Enterprises. These purchases are designed to help reduce MBS spreads and mortgage rates.

3. The most important facilities are the $100 billion each Senior Preferred Agreements, which ensure that the Enterprises have a positive net worth. This facility is well over three times the statutory minimum capital requirements and lasts until all liabilities are repaid or it is exhausted. Effectively, it is a government guarantee of their debt and MBS. Under this facility, they can grow their portfolios by about $100 billion each, which will further support the market.

Conservatorship is intended to stabilize a troubled institution with the aim of maintaining normal business operations and restoring its safety and soundness. In this case, the goal is to help restore confidence in Fannie Mae and Freddie Mac, enhance their ability to fulfill their mission, and mitigate systemic risk. FHFA will act as conservator of the Enterprises until they are stabilized. The conservatorship and the access to credit from the U.S. Treasury provide an explicit guarantee to existing and future debt holders of Fannie Mae and Freddie Mac. FHFA appointed two new Chief Executive Officers and two new non-executive Chairmen, whom I worked with very closely over the last 7 weeks to help stabilize the mortgage market

Since Monday, September 8, FHFA examiners, lawyers, and other experts have been onsite continuously at Enterprise headquarters and locations of other key operations to ensure a smooth transition. Their role has been to reassure Enterprise employees about the continued business operations objective of the conservatorships, support the needs of the new leadership at the Enterprises, and facilitate resolution of questions and issues as they arise. I am pleased to report that we are finished with this transition period.

Federal Home Loan Bank Oversight

The counter-cyclical capital structure of the FHLBanks has allowed them to play a critical role in supporting financial institutions and mortgages lending over the last year. Their secured advances just reached one trillion dollars, up 58 percent from the $640 billion at June 30, 2007.

FHFA has been very busy carrying out mandates of HERA, for supervising the FHLBanks. We published a regulation implementing amendments to the Federal Home Loan Bank Act concerning the composition and election of boards of directors of the FHLBanks. The FHLBanks have begun elections to establish boards in line with regulation by January 2009.

As an early synergy of HERA combining OFHEO and FHFB, I approved the Federal Home Loan Bank of Chicago's "MPF Xtra" initiative. Under this agreement the Chicago FHLBank gathers conforming, fixed-rate mortgages from participating financial institutions, and then immediately sells them to Fannie Mae for securitization. This partnership provides an opportunity for smaller members to sell conforming mortgages to Fannie Mae at a competitive price and retain the mortgage servicing.

FHFA staff worked with the FHLBanks, the Treasury Department, and the Federal Reserve Bank of New York (FRBNY) to create the GSE Credit Facility using the authorities in HERA to promote financial market stability and liquidity. Establishment of the GSE Credit Facility enhances the safety and soundness of the FHLBanks by reducing the potential for illiquidity in the debt market. Although we do not expect the FHLBanks to use the facility, its existence provides assurance that they will be able to meet debt obligations in full as they come due, thereby mitigating rollover risk for investors in the FHLBanks' consolidated obligations. FHFA has also developed guidance for the FHLBanks to increase their daily liquidity positions. The liquidity and market risk areas have been critical in recent weeks, both for the Enterprises and the FHLBanks. We have seen here the benefits of collaboration in supervision that FHFA affords. Market risk experts from both supervision teams have been meeting and sharing market updates daily, which has enhanced our ability to monitor and to help the GSEs respond to the volatile market conditions. The mortgage market rally after the conservatorship has dissipated with the continuing turmoil in the market. Spreads have widened for the GSEs and many other issuers of securities. As confidence returns and investors understand the strength of the Treasury agreements, we would expect these spreads to narrow. Lower mortgage rates combined with falling house prices should help bring affordability back to the markets.

Another example of early collaboration among the supervision teams has been in accounting policy, where the accounting teams have worked together in moving towards a unified approach to assessing other than temporary impairments of market securities held by all the GSEs.

Affordable Housing, Mission and Loan Modifications

The new legislation, added the responsibility for the Enterprises' affordable housing goals and mission enforcement to the responsibilities of the safety and soundness regulator. The Federal Housing Finance Board already had responsibility for both areas of supervision for the FHLBanks. While FHFA has had these responsibilities over the Enterprises for only a short time, they ranked among our most immediate concerns in making the determination to place the Enterprises into conservatorship. A key reason for moving quickly to conservatorship was that the companies' abilities to serve their mission had been impaired. Ceasing new business activity and shedding assets was not acceptable.

As the companies operate in conservatorship, I have already instructed each new CEO to examine their underwriting standards and pricing, and they have begun to do so. Earlier this month, for example, Fannie Mae and Freddie Mac cancelled a planned doubling of an adverse market delivery fee, an action that should lower costs to potential borrowers. I expect any future changes to reflect both safe and sound business strategy and attentiveness to the Enterprise's mission.

Fannie Mae and Freddie Mac are critical to the secondary market for multifamily loans, and multifamily lending is critical to the affordable housing mission of the Enterprises. I am determined to ensure that in conservatorship both Enterprises remain dedicated to and actively involved in multifamily lending. Last month, I released a statement to all market participants that the Enterprises will continue to be a source of underwriting and financing for multifamily loans.

Enforcement of the affordable housing goals established for the Enterprises by the Congress, once HUD's responsibility, is now up to FHFA. While ensuring liquidity in the mortgage marketplace has necessarily been a primary focus in recent weeks and months, ensuring that low and moderate income persons and underserved areas have ready access to affordable mortgage loans remains a critical responsibility of the Enterprises. In the near-term, the Enterprises are charged with meeting the very ambitious goals set by HUD back in 2004, a year in which the mortgage market looked far, far different than it does today. In 2007, they missed two subgoals. Based on our discussions with the Enterprises, the miss may be larger in 2008, but we can expect that roughly half of the units financed this year will qualify for the low and moderate income housing goal, more than a third of those financed will qualify for the underserved area goal and more than one out of five units will qualify for the special affordable goal. With the Enterprises now in conservatorship, even if some or all of the goals set for this year by HUD are found to be unattainable, I will expect each Enterprise to develop and implement ambitious plans to support the borrowers and markets targeted by the goals. They know this and are acting accordingly.

The most critical components of stabilizing the mortgage market are assisting borrowers at risk of losing their homes and reducing foreclosures. Keeping people in their homes is critical, not only for their families and their neighborhoods, but also for the overall housing market. A more systematic approach to loan modification is essential. Well before the conservatorship actions, we had asked the Enterprises to accelerate their loan modifications with features that included a principal write-down or forbearance. As IndyMac Federal Bank services mortgages for both Enterprises, we have encouraged them and they have agreed to join the FDIC's loan modification program. I expect the ongoing work on loan modifications being done there, and with other seller servicers, to continue to be a high priority for the Enterprises, both as a matter of good business and as a matter of supporting the Enterprises' mission.

Through August 2008 of this year, the Enterprises completed a total of 130,971 loss mitigation actions which included 36,847 loan modifications. Year-to-date, modifications have averaged 4,606 per month versus 2,884 per month in 2007 -- an increase of 60 percent. For all loss mitigation actions completed, 92 percent resulted in borrowers being able to keep their homes.

The two new CEOs are committed to increase loan modification and foreclosure prevention activities. Both Enterprises are focused on addressing challenges to completing more workouts. Those challenges include successfully contacting the borrower, responding to the high volume of workout requests and offering modification terms that create an affordable payment. The

Enterprises have expanded resources internally and have added onsite personnel to assist in servicers' shops. Contracting with "on the ground" solicitors to go door-to-door to deliver borrower assistance materials and to speak with borrowers is making a difference. Both Enterprises have lowered the minimum interest rate and extended the maximum term for a loan modification. Fannie Mae has expanded workouts by providing bridge loans to delinquent borrowers in temporary difficulty (the HomeSaver Advance program), and targeting borrowers with as few as one missed payment. Both Enterprises are compensating foreclosure attorneys not only for completing the foreclosure, but for assisting borrowers with a workout. Finally, the Enterprises have delegated more authority to servicers to decision loss mitigation requests. As I stated, we need to have the Enterprises remain active in the markets and these actions that they have taken are aimed at keeping the market liquid and avoiding an over-tightening of credit.

This year, FHFA started collecting and publicly reporting on loss mitigation activities, which have been disclosed in our first and second quarter *Mortgage Metrics Reports.* Starting November 1, we will supplement these quarterly reports with monthly updates on loss mitigation activity. The quarterly report includes a loss mitigation performance metric that measures the number of loans worked out by the number of loans for which foreclosure was likely. Year-to-date, the results were 49 percent. While FHFA commends the Enterprises for their efforts, it is evident more can be done.

Loan servicers are a critical component to the loan modification process. The Enterprises have recently agreed to pay the servicers more for their loan modifications, and incentives have increased from an average of $450 to $750. In addition, they are working with servicers to develop and pilot new approaches for loan modifications. As these pilots are successful, they will be expanded.

Finally, I am pleased to report that on October 17th FHFA published a regulation in the *Federal Register* to implement Section 1218 of HERA, which provides temporary authority for the FHLBanks to use a portion of the subsidy money in the Affordable Housing Program to refinance mortgages for families at or below 80 percent of area median income. This regulation supports the refinance program in HERA's Hope for Homeowners program by permitting funding of additional principal write-downs or payment of closing costs. The use of such funds will ensure that a full range of federal assistance is available to homeowners quickly. We've discussed this initiative with the Federal Housing Administration, which is very supportive of the prospect of added support on this initiative.

Support of Treasury and Other Regulators

The Enterprises and the FHLBanks share the critical mission of providing stability, liquidity, and affordability to the housing market. During this difficult time in our financial markets, FHFA has been working with the Treasury Department, the Federal Reserve Board, the Federal Reserve Bank of New York, the Securities and Exchange Commission, and the federal banking agencies to monitor market conditions and coordinate regulatory activities. In particular, we have been assisting the Treasury Department as it develops ideas for its TARP. I serve as a director on the TARP Oversight Board. FHFA's role in TARP is discussed more fully below.

In coordination with Treasury Secretary Paulson's efforts to add liquidity to mortgage markets, in September we directed the Enterprises to provide additional funding to mortgage markets through the increased purchase of mortgage backed securities. As the Enterprises increase their portfolios, and provide direct support to the mortgage market though ongoing securitization activities, our safety and soundness supervision of those activities, support for the conservatorships and oversight of the FHLBanks continues apace.

FHFA's Role in TARP

Let me now turn to a discussion of the TARP and FHFA's role. On October 3, 2008, the President signed the Emergency Economic Stabilization Act ("EESA"). The new law provides authority and facilities for the government to restore liquidity and stability to the financial system. In particular, the EESA authorizes the Treasury establish a TARP, to purchase troubled assets from financial institutions, as well as a Troubled Assets Insurance Financing Fund, or TAIFF, to guarantee troubled assets. Congress has authorized the purchase or guarantee of up to $700 billion of troubled assets (any guarantee premiums accumulated in the TAIFF offset the $700 billion).

The FHFA has a significant role to play under the EESA. As I said, I am one of five members of a Financial Stability Oversight Board established to ensure the implementation of EESA is consistent with the purposes of the act, in the economic interest of the U.S., and consistent with protecting the taxpayers. The Oversight Board is specifically charged with reviewing the TARP and TAIFF programs, including the financial agents appointed to implement them, the classes of troubled assets to be purchased, and the structure of vehicles used to purchase them, as well as their effect on promoting financial market stability, preserving home ownership, and protecting the taxpayers. The Board makes recommendations to the Secretary of the Treasury, reports any suspected illegalities to the new Special Inspector for the TARP or the U.S. Attorney General, and may appoint a credit review committee to evaluate assets purchased.

Foreclosure mitigation is an important objective under EESA. The objective applies to all federal agencies that hold troubled assets, including the FHFA as conservator of Fannie Mae and Freddie Mac. In this capacity, the FHFA is termed a federal property manager, as are the FDIC, with respect to mortgage assets held by bridge depository institutions, and the Federal Reserve Board, with respect to mortgage assets other than those held, owned, or controlled in connection with open market operations or as collateral for a current advance or discount. Treasury, FHFA, and the other federal property managers, must each implement a plan that maximizes assistance for homeowners to minimize foreclosures, encouraging mortgage servicers, considering net present value to the taxpayer, to use the HOPE for Homeowners program and other available loan modification programs. Loan guarantees and credit enhancements under the TAIFF insurance program may be used to facilitate loan modifications. The plans must consider troubled multifamily mortgages as well as those on single family homes. In modifications to multifamily mortgages, the plans must consider, where permissible, steps to allow renters who are current on their rent to stay in their homes, and endeavor to protect governmental rent subsidies and protections while ensuring smooth operations.

Where Treasury or the property managers own securities backed by residential loans rather than the loans themselves, and securities contracts may constrain the abilities of the servicer, they are encouraged to work to facilitate modifications of the underlying loans. Treasury is to coordinate with FHFA and other federal property managers to identify opportunities to acquire classes of troubled assets to improve the loan modification and structuring process. Treasury is specifically charged, where appropriate, to consent, while considering the effect on the taxpayer, to requests for loss mitigation measures arising under existing investment contracts.

Along with the other federal agencies, FHFA will report to Congress information on loan modifications and foreclosures. We have already been working with Fannie Mae and Freddie Mac to find new ways to prevent foreclosures, and we have begun reporting their foreclosure prevention activities publicly, as noted earlier.

In conclusion, FHFA and the 14 Housing GSEs that we supervise have a critical role in returning the mortgage markets to stability. It will take time, but I believe the many steps that have been taken including the creation of FHFA, the Fannie Mae and Freddie Mac conservatorships, the multiple actions by the Federal Reserve and TARP as well as strong actions to address the foreclosure crisis provide a solid foundation for creating that stable future for the mortgage and financial markets and most importantly, American homeowners, renters, workers and investors.

I look forward to working with this Committee and all of Congress in achieving this goal.

I would be pleased to answer any questions the Committee may have.