Testimony of Michael J. Williams
President and Chief Executive Officer, Fannie Mae

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Chairman Neugebauer, Ranking Member Capuano, members of the Committee, thank you for inviting me to speak with you today about the Federal Housing Finance Agency's (FHFA) oversight of Fannie Mae, the company's current condition, and the company's financial outlook.

As Fannie Mae has been the recipient of unprecedented taxpayer investment, I understand why Congress is interested in these issues and I appreciate the importance of these issues to both Congress and our country. As the Chief Executive Officer of Fannie Mae, I am responsible for ensuring that we fulfill our important mission of sustaining and repairing the nation's housing finance system while, at the same time, acting as good stewards of the taxpayer's investment in our company.

FHFA's Oversight of Fannie Mae

Let me begin by discussing how we work with FHFA, our regulator and conservator, to manage the resources we have received and to operate the company effectively as conservator. When Fannie Mae was placed in conservatorship, FHFA succeeded to all of the rights of the shareholders, the board of directors, and the management. Accordingly, we understand that FHFA has the right to determine the company's goals and activities in conservatorship.

Upon conservatorship, FHFA determined that, given the limited resources of the agency, the most prudent way for it to fulfill its responsibilities in conservatorship was to replace the Chief Executive Officer and the Board of Directors at the company, which it did. FHFA worked closely with us to put in place a new executive leadership team. The people running Fannie Mae today are not the people who ran it prior to conservatorship.

FHFA delegated specified authorities to the new Board and the new management team, retaining certain key decisions for itself as conservator. Under FHFA's delegations, management is responsible for day-to-day operations of the company, subject to the oversight of our Board of Directors. FHFA as conservator has the authority to rescind or modify at any time the delegations of authority to management and the Board. FHFA has directed us to focus on the company's core business, and not to undertake new products or new activities. In addition, pursuant to the delegations and our senior preferred stock purchase agreement with the Treasury, FHFA and Treasury must approve certain types of actions. For example, FHFA, in consultation with Treasury, must approve any compensation arrangements for senior management.

All of this is a very significant change from the way the company operated prior to conservatorship. While FHFA and its predecessor, the Office of Federal Housing Enterprise Oversight (OFHEO), was our prudential regulator in the days before conservatorship, FHFA has a much more active role in overseeing the management and operations of the company today.

We are required to seek FHFA's input and approval on a much wider range of issues than before. FHFA maintains a continuous presence at our company, and there is constant communication between the two organizations. It is a credit to the leadership of both FHFA and Fannie Mae that we have successfully transitioned to this new relationship in short order and with little disruption.

Of course, another big change between today and the company before conservatorship is that the taxpayer is our principal investor. In accordance with conservatorship, we do not operate the company for the benefit of private shareholders as we did in the past; instead, we run the company with the interests of the entire housing finance system in mind and seek to protect taxpayer interests. However, this is not to suggest that we have become a government agency. In accordance with the Housing and Economic Recovery Act, Fannie Mae is a private business using private-sector talent, skills, and experience to achieve our goals. However, while still a private sector company, Fannie Mae is not operating "business as usual." As I have indicated, much has changed. But we are using our people — among the most knowledgeable and experienced in housing finance — to address the many challenges facing the company and the housing finance system, which we believe will create value for our primary investor, the U.S. taxpayer.

We have taken a number of actions to strengthen the company and limit losses on the legacy book of business that was acquired before conservatorship. We are making necessary strategic investments to minimize future losses, and have significantly reduced expenses in other areas. These are exactly the actions that we believe will enable us to achieve the goals of conservatorship and protect taxpayer's interests.

An Assessment of Fannie Mae's Current State

Let me briefly provide context on the role Fannie Mae plays in today's market. During uncertain economic times, funds for mortgages tend to dry up as banks and other investors who supply financing flee the market. This was evident at the beginning of the housing downturn when the private label securities market literally vanished after reaching an historic share of the market during the run-up. The departure of liquidity stalls mortgage lending, which in turn negatively impacts construction, home sales, and financing for apartments. As the government has recognized with its very large investments in Fannie Mae and Freddie Mac, a prolonged failure of mortgage lending would have a devastating ripple effect on the nation's economy.

Today, Fannie Mae's role in funding the mortgage market has never been more important. We provide funding for more than 40 percent of the single-family market and almost 35 percent of the multifamily market. Since 2009, we have provided more than $2 trillion in mortgage funding that has helped approximately 6 million households to refinance. We have helped approximately 1.7 million homeowners purchase a home, and we have provided financing for nearly 1 million units of quality, affordable rental housing. Through our early funding program, we have also provided over $290 billion in short-term liquidity for small and medium-sized lenders so they can continue to meet the demands of their customers during unsettling economic times.

Banks — including many small and medium-sized lenders — simply would not continue lending on this scale without liquidity from Fannie Mae. I understand that Fannie Mae and the industry will be different in the future. I also recognize the need for responsible GSE reform. But Fannie Mae's role in today's market is absolutely critical, and fulfilling that role is the fundamental reason the government has invested so much to keep Fannie Mae functioning effectively.

To achieve the goals of conservatorship, it is imperative that we strengthen the company. As it relates to our financial position, we focus on two priorities. The first is building a new book of business with appropriately conservative underwriting standards that support sustainable homeownership. The new book, which consists of loans purchased or guaranteed since January 2009, is almost half of our overall book of business. These are high-quality loans that we currently expect to be profitable over their lifetime. This new business will continue to become a larger percentage of the company's overall book, while the pre-2009 loans will continue to become a smaller percentage of the overall book. As a result, we believe that the company will eventually return to operating profitably, before the payment of dividends to Treasury is taken into account, as I will discuss in a moment.

The second priority is to reduce credit losses on loans purchased prior to conservatorship. The substantial majority of the company's credit losses are on loans that were purchased or guaranteed between 2005 and 2008. We cannot reverse the decisions that were made in the past with respect to this book of business, nor can we change the fact that some of these loans have or will suffer losses. However, we can and will continue to manage these pre-conservatorship loans aggressively to limit taxpayer exposure. We have devoted substantial resources to reduce losses on these loans, and we have made measurable progress. Fannie Mae's serious delinquency rate is now 4.0 percent, which is nearly 30 percent below its peak in early 2010, and close to half of the industry average.

To meet these priorities and respond effectively to the housing crisis, the company has been required to make substantial investments in people and technology, and servicer oversight. For example, Fannie Mae built one of the nation's largest foreclosure prevention operations to help families avoid foreclosure, stabilize neighborhoods, and, in turn, limit credit losses. To date, we have helped nearly one million families avoid foreclosure, through an array of solutions. A credit operation of this size and scope previously had not existed at Fannie Mae or in the industry.

We work directly with distressed homeowners through a network of 12 Fannie Mae Mortgage Help Centers in hardest hit communities across the country to supplement the work of lenders. In addition to our brick-and-mortar efforts, we also offer innovative online tools such as KnowYourOptions.com and WaysHome to help homeowners find the right solution for their individual situation. Unfortunately, foreclosures are not always avoidable. When foreclosure is the only option, we help stabilize communities by properly maintaining and improving the properties we acquire, and selling them to new owners, giving preference to families who will live in them. Since the housing crisis hit, the volume of Real Estate Owned (REO) sales and execution handled by the company is eight times greater than pre-crisis levels. As a result of our efforts and investments, Fannie Mae is now able to process over 20,000 properties in a month, compared to 5,400 properties a month in 2008 when we entered conservatorship.

While we have and will continue to reduce headcount in some areas, the housing crisis required Fannie Mae to hire approximately 1,800 people – many of whom are limited term employees working in our credit loss reduction and Making Home Affordable (MHA)-related operations – to focus specifically on foreclosure prevention and loss mitigation. Since 2009, our ability to drive productivity in the credit loss management area has improved. The credit operations are delivering better results for less money in 2011 than in previous years.

Many different types of expenses relate to our efforts in foreclosure prevention and credit loss reduction. For example, Fannie Mae has invested more in advertising over the past two years. It's important to understand why we made this investment. Our advertising now is almost exclusively dedicated to foreclosure prevention and credit loss reduction initiatives. We learned soon after the housing crisis began that low awareness of potential solutions creates a strong barrier to families getting help. Through advertising, Fannie Mae educates borrowers about their options and helps them avoid foreclosure.

Fannie Mae is also undertaking a number of initiatives that will make the industry stronger. For example, we are developing new tools and standards to ensure greater visibility into the quality of the loans that are delivered into the secondary market. The loan quality initiative will reduce future risks for lenders, investors, borrowers, and ultimately the taxpayers.

Another key aspect of our strategy to strengthen the industry is improving servicing standards and execution. In June 2011, with FHFA and Freddie Mac, we developed new standards for mortgage servicers. The new servicing standards are designed to result in earlier, more frequent, and more effective contact with borrowers to avoid foreclosures and mitigate losses. The standards also aim to improve servicer performance by providing monetary incentives for exceeding loan workout benchmarks and imposing fees on servicers for failing to meet loan workout benchmarks or foreclosure timelines. These efforts, the Loan Quality Initiative and the Servicing Alignment Initiative, represent important efforts we are undertaking now to build a sustainable housing finance system for the future.

We have executed on our business plans with careful attention to expense control, however, the work we are undertaking requires a large operation. In 2010, we incurred $2.6 billion in total administrative expenses. Fannie Mae undertakes a formal budgeting process each year that is approved by the Board and reviewed with FHFA. We look to manage all expenses prudently.

Fannie Mae evaluates all proposed expenses with an eye toward delivering long-term value. Since being placed in conservatorship, we have reduced expenses in many areas while investing in resources for areas of greatest need. Management made these decisions in consultation with FHFA. I take our decisions seriously. So far in 2011, core administrative expenses (that is, all of our administrative expenses except certain extraordinary expenses and costs associated with credit loss management) are down 16 percent from 2010. Core headcount is down by 10 percent from 2010. Personnel-related costs for employees and contractors are down by 14 percent in 2011, and we have eliminated positions at all levels of the company. The company has reduced the use of contractors by nearly 40 percent since 2008. Total compensation for contractors is also down by 30 percent since 2008. We expect headcount and total expenses to be under plan by the end of the year. Importantly, we are taking these actions while also remaining the single largest provider of funding to the market.

In short, I believe that Fannie Mae is fulfilling effectively its mission of providing critical funding to the mortgage markets, buying and guaranteeing high-quality loans pursuant to conservative underwriting parameters. As noted, we currently expect these loans will be profitable over their lifetime. We are also fulfilling our goal of managing the legacy book of business written prior to conservatorship, doing our best to reduce losses and minimize the taxpayer's exposure to these assets acquired in a different time. And finally, we are working hard to help families to avoid foreclosure when possible, and to stabilize communities that have been hit hard by the housing crisis. I am confident that, without the government's support of Fannie Mae, our housing finance system would be in much worse shape than it is today.

Financial Outlook

Finally, you have asked for my assessment whether Fannie Mae can eventually make money and repay taxpayers the immense investment they have made in the company. I believe that, over time, Fannie Mae can deliver value back to the taxpayer. However, I do not believe the company will be able to repay all of the taxpayer's investment due to our dividend payments to Treasury.

As you know, pursuant to our senior preferred stock purchase agreement with the Treasury, Fannie Mae is required to pay an annual cumulative dividend to Treasury of 10 percent on all funds advanced. To date, Fannie Mae has paid $17.2 billion to Treasury in dividends on the senior preferred stock and we expect to pay dividends to Treasury for years to come. Currently, our annual dividend obligation to Treasury is $11.3 billion, which exceeds our reported annual net income for any year since the company's inception.

According to FHFA's October 2011 report, *Projections of the Enterprises' Financial Performance,* Fannie Mae may have positive net income, before payment of the dividend, as early as 2013. This is because the new book of business we have been acquiring since 2009 is expected to be profitable, and the build up of reserves to cover losses on our pre-conservatorship book of business may be complete by then. Although we expect to eventually return to operating profitably before payment of dividends to Treasury, we do not expect to earn profits in excess of our annual dividend obligation to Treasury.

<u>Conclusion</u>

In closing, I am confident that we are making smart business decisions, reducing costs where appropriate, and investing where necessary to achieve the goals of conservatorship, and to contribute to building a strong, sustainable housing system for the future. I believe we have built a strong leadership team and organization that is executing on the key priorities established for the conservatorship. I believe that the nation's housing finance system has benefited greatly from the government's investment in Fannie Mae and that, if the company continues to exist in some form in the future, the company will continue to provide value for this investment over the coming years.

Thank you and I look forward to your questions.