



**Statement of**

**Patrick Lawler  
Chief Economist  
Federal Housing Finance Agency**

**Before the  
Congressional Oversight Panel**

**“TARP’s Impact on Financial Stability”**

**March 4, 2011**

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Chairman Kaufman and members of the Panel, thank you for the invitation to present FHFA’s perspective on the impact of the Troubled Asset Relief Program (TARP) on the economy and the financial sector. I understand this is the last hearing to be held by this Panel prior to the issuance of your final report on TARP and we hope our testimony this morning will help inform your report. You asked us to focus on the following broad areas:

- The impact of TARP on financial stabilization and recovery in the U.S. economy and financial sector;
- Fannie Mae and Freddie Mac’s responsibilities with respect to TARP; and
- The Federal Housing Finance Agency’s interaction with Treasury with respect to the Enterprises and the federal government’s initiatives to promote financial stability.

**The Impact of TARP**

My agency, the Federal Housing Finance Agency (FHFA), regularly reviews the impact of the TARP, as the FHFA Director is a member of the Financial Stability Oversight Board, which was created by Congress to help oversee TARP and review its effects on the economy. TARP was created when financial markets were in the midst of a crisis. Collectively, TARP programs injected capital into the banking system, invested in other systemically significant failing institutions, supported various securities markets and developed a variety of foreclosure prevention approaches. These actions made important contributions to reestablishing financial stability. As the Oversight Board concluded, without TARP, the severity of the crisis and its impact on the economy would have been materially greater.

The sharp deterioration of the subprime mortgage market began in early August of 2007. Most large financial institutions experienced sharply diminished access to credit. Indicators of the market’s increased reluctance to provide funding, such as the spread between LIBOR and overnight index swap rates and the cost of credit default swaps for large commercial and investment banks became highly elevated, and they spiked in September 2008 after Lehman Brothers collapsed. Under such conditions, the ability of non-financial firms to obtain funds through normal channels was threatened. Early TARP actions helped stabilize markets and limit the damage to the economy.

Given the origins of the crisis in housing finance markets, the conservatorships of Fannie Mae and Freddie Mac were designed from the start to maintain access to funds for the production of sound new mortgages. To assist borrowers who were struggling to make payments on poorly structured and unaffordable loans, FHFA worked with the Treasury, HUD and others to develop a Streamlined Modification Program (SMP) for GSE mortgages in the fall of 2008. In early 2009, the Home Affordable Modification Program (HAMP) for GSE and non-GSE mortgages, was developed that uses TARP funds to create additional incentives for borrowers and servicers

to participate. At the same time, the Home Affordable Refinance Program (HARP) was developed, outside of TARP, to facilitate refinances of GSE mortgages in areas where house prices had declined and mortgage insurance companies had restricted their support for home lending. Lower payments for borrowers in such areas can reduce their likelihood of defaulting. Also outside of TARP, FHFA worked with the Treasury on methods of aiding the funding of state housing finance agencies.

In all cases, FHFA has been guided by its responsibilities as conservator of each Enterprise to limit activities to those that make business sense, are safe and sound, and are consistent with the Enterprises' charters and with the goals of conservatorship. These programs have benefited the Enterprises by mitigating risks and reducing both direct losses on loans where foreclosure is avoided, and indirect losses on properties where housing markets are stabilized, which reduces defaults on other loans. Later in this testimony, I will describe effects of HAMP and HARP in greater detail.

With these and other programs, including notably the Federal Reserve's large program for purchasing mortgage securities, the cost of mortgage borrowing declined both absolutely and relative to yields on reference Treasury securities (figure 1). Cheaper financing and foreclosure prevention programs helped stabilize house prices as measured by FHFA almost immediately and within a few months by others measures (figure 2). Serious delinquencies continued to rise sharply in 2009 as the recession worsened, but they have since eased somewhat (figure 3). Inventories of houses currently for sale, coupled with shadow inventories of houses recently withdrawn from sale or currently held by distressed borrowers and at risk of foreclosure are very high in portions of the country. Continuation of the recent price stability or resumption of gains cannot be safely assumed, but lower unemployment rates would help considerably.

### **Fannie Mae and Freddie Mac's TARP Responsibilities**

The Enterprises have significant responsibilities with respect to TARP through the Making Home Affordable (MHA) programs from their foreclosure avoidance programs for mortgages on their own books, as well as from their roles as MHA Agents.

#### *HAMP/HARP Programs*

MHA and related programs are funded by TARP. These programs, along with comparable MHA programs at the Enterprises, were intended to help financially struggling homeowners avoid foreclosure by modifying loans to a level that is affordable for borrowers now and sustainable over the long term. For some homeowners who could not achieve affordability through loan modifications, MHA programs provided other alternatives to foreclosure, such as short sales or deeds-in-lieu.

The Enterprises' comparable MHA programs, however, do not use TARP funds to support their lending and loan workout activities. While the Enterprises' comparable MHA programs include incentive payments to servicers and borrowers, the Enterprises pay the incentives rather than Treasury with TARP funds. Nevertheless, Fannie Mae and Freddie Mac's active involvement in homeownership preservation efforts is consistent with the conservatorships' goals of restoring confidence in the Enterprises, enhancing their capacity to fulfill their mission and mitigating the systemic risk that contributed directly to instability in financial markets. A key purpose of the

conservatorships is to safeguard each Enterprise's assets and property and to restore the Enterprises to a sound condition. This includes minimizing losses on the mortgages already on the books.

Even though they do not receive TARP funds, the Enterprises contribute significantly to overall HAMP loan modification program volume. Although the Enterprise mortgages represent roughly 33 percent of the total delinquent mortgages that are eligible for HAMP, the Enterprises represent 54 percent of total active HAMP trial and permanent modifications.

In 2010, the Enterprises completed 946 thousand foreclosure prevention workouts, a 120 percent increase over 2009's total and nearly 2 ½ times 2010's completed foreclosures of 392 thousand (figure 4). Approximately 88 percent of workouts are home retention actions, intended to help borrowers stay in their homes. Home retention actions include loan modifications, repayment plans, and forbearance plans. The remaining workouts are foreclosure alternatives, such as short sales and deeds-in-lieu of foreclosure. These alternatives are intended to reduce the severity of the Enterprises' losses resulting from a borrower's default while minimizing the impact of foreclosures on borrowers, communities, and neighborhoods.

The Enterprises focus on loan modifications as a primary workout solution for distressed homeowners. Borrowers are offered loan modifications through the MHA-comparable Home Affordable Modification program (HAMP) or through the Enterprises' proprietary non-HAMP loan modification programs. The Enterprises also offer repayment plans and forbearance plans to assist borrowers experiencing short-term financial difficulty, including unemployment. In addition to foreclosure prevention programs, the Enterprises use the Home Affordable Refinance Program (HARP) to help homeowners, whose property values have fallen, take advantage of historically low interest rates by refinancing their mortgages. Owner-occupants may refinance as much as 125 percent of their home's current value through any Enterprise-approved lender. As with all refinance activity, the volume of HARP refinance loans is affected by the interest rate environment.

FHFA reports monthly to Congress on the full range of Enterprise foreclosure prevention activities through the *Foreclosure Prevention / Federal Property Manager's Report*, the latest edition of which can be found on the agency's website.

While HAMP has not produced the volume of loan modifications the Treasury Department initially hoped for, we believe it has been instrumental in standardizing and streamlining the industry's modification process and in that way has contributed greatly to the sharp rise in non-HAMP modifications that has taken place over the past two years. The quality of the modifications also appears to have improved. Although it is still too soon to judge how successful those actions will ultimately prove to be, re-defaults of loans modified by the Enterprises have been much lower since the implementation of HAMP than previously (figure 5). The volume of HARP refinances has also been much less than the Treasury Department anticipated, but refinances outside HARP, many with a similar streamlined structure, have been ten times as large (figure 6).

### *Enterprises as Agents*

TARP funds are used by the Treasury Department to fund the MHA program administrative and compliance tasks performed by Fannie Mae and Freddie Mac as Financial Agents for the Treasury. Fannie Mae is Treasury's MHA Program Administrator and Freddie Mac is Treasury's MHA Compliance Agent. Treasury has budgeted nearly \$126 million for Fannie Mae MHA program administration expenses in FY 2011 and \$66.5 million for Freddie Mac compliance activity expenses in FY 2011.

As Treasury's MHA program administrator, Fannie Mae oversees the implementation and execution of MHA new and existing programs. Fannie Mae's role includes designing and implementing standardized MHA programs, serving as record keeper and pipeline manager and coordinating with the paying agent for disbursement of Treasury and Enterprise funded incentives. Fannie Mae provides guidance to borrowers and servicers, develops and maintains websites, systems, and program tools and trains servicers. Fannie Mae also continues to sponsor outreach events in some of the hardest-hit cities across America, maintains call centers, and issues reports to inform the public and government agencies about the program.

As Treasury's Compliance Agent, Freddie Mac conducts examinations and reviews of servicer compliance with the MHA published program rules and directly reports results to Treasury's Compliance Committee. Servicers reviewed are those who have executed Servicer Participation Agreements that are applicable to non-Enterprise loans. In cases of noncompliance, MHA Compliance consults with Treasury on appropriate courses of action, with Treasury having the final say on the content of reports to servicers and required corrective actions. Freddie Mac MHA Compliance also provides the Treasury Compliance Committee with advice, guidance and lessons learned to improve the operation of the program. Examinations and reviews are primarily conducted on-site at the servicers' operations.

Each quarter, Fannie Mae and Freddie Mac receive performance assessments from the U.S. Treasury Office of Financial Agents for their work as Financial Agents, based on a number of quantitative and qualitative performance factors. Both Fannie Mae and Freddie Mac have consistently been rated by Treasury as meeting performance expectations.

### **FHFA – Treasury Interaction**

You asked us to describe FHFA's interaction with Treasury with respect to the Enterprises' and the federal government's initiatives to promote financial stability. In both the Bush and Obama Administrations, FHFA worked closely with the Treasury Department on critical issues facing the nation's economy brought on by the housing crisis, and the general financial and economic disruptions of the past few years. The interactions have been frequent and professional, respectful of our differing roles and legal responsibilities but collaborative toward our common goal to bring stability and liquidity to housing markets and to seek foreclosure alternatives wherever feasible.

The following list highlights some of the key FHFA – Treasury interactions and collaborations since FHFA's inception:

- The Housing and Economic Recovery Act of 2008 (HERA) created FHFA and gave FHFA the authority to appoint a conservator or receiver for the Enterprises. At the same

time, Section 1117 of HERA gave to Treasury the authority to provide financial support to the Enterprises by permitting the Secretary to purchase securities issued by an Enterprise on such terms and conditions as the Secretary may determine. This became the basis for developing the approach to address the deteriorating financial condition of Fannie Mae and Freddie Mac in September 2008 with the appointment of FHFA as conservator and Treasury establishing the Senior Preferred Stock Purchase Agreements that provided the necessary financial support for the conservatorships. It was also the basis for other temporary initiatives announced at the time that have since expired, including a backstop liquidity program to support all the housing Enterprises, if needed.

- HERA also created the Federal Housing Finance Oversight Board to advise the FHFA Director on strategies and policy. The Treasury Secretary is a member of this board.
- The Emergency Economic Stabilization Act of 2008 (EESA) that created TARP made FHFA a federal property manager responsible for maximizing assistance to homeowners, including encouraging the development of programs to minimize foreclosures while considering the net present value of such actions to taxpayers. Nearly identical language instructed the Treasury Secretary to prevent foreclosures through appropriate loan modification activity through TARP program. This formed the statutory basis for FHFA and Treasury to work together on an array of foreclosure avoidance activities, including the SMP, HAMP, and HARP, as discussed above.

As described previously in this testimony, FHFA's participation with HAMP has had two key components:

- FHFA directed the Enterprises to adopt HAMP in their own seller-servicer guides so that loan modifications of Enterprise loans followed the same protocols as for non-Enterprise loans. This approach was initially taken to simplify the new processes and procedures required of servicers in an effort to promote consistency for servicers and fairness of treatment for homeowners seeking a modification. As HAMP evolved, FHFA and the Enterprises have continued to provide input toward program modifications, and the Enterprises have implemented various modifications to HAMP that are consistent with the goals of the conservatorships.
- FHFA also permitted the Enterprises to serve as financial agents for Treasury in the implementation of HAMP. This action was in recognition of the Enterprises' unique role in the housing finance system and it resulted in the Enterprises' expertise being leveraged for the benefit of HAMP, thereby meeting the goals of EESA.
- You asked if this latter role affected the Enterprises' ability to operate and meet the requirements of the conservatorship. While these responsibilities added operational demands to each Enterprise, it is FHFA's view that HAMP promotes housing market stability and, with the Enterprises backing more than half the mortgages in the country, such stability benefits the Enterprises and thus supports the goals of conservatorship. In a few instances we discussed with Treasury

particular tasks or initiatives that might have been undertaken by an Enterprise but ultimately agreed not to go in that direction to avoid possible operational issues that could conflict with the goals of conservatorship.

- The FHFA Director is a member of the Financial Stability Oversight Board, as previously mentioned.
- The Dodd-Frank Act created numerous requirements for FHFA – Treasury interaction and collaboration on an array of activities and rulemakings designed to promote financial stability. The Act also made the FHFA Director a member of the Financial Stability Oversight Council, which is chaired by the Secretary of the Treasury.

Finally, Treasury and HUD recently released a white paper on housing finance reform. FHFA provided technical briefings to these agencies as they did research in preparation of this paper, but FHFA did not participate in the development of the proposal itself, as that was an Administration policy matter.

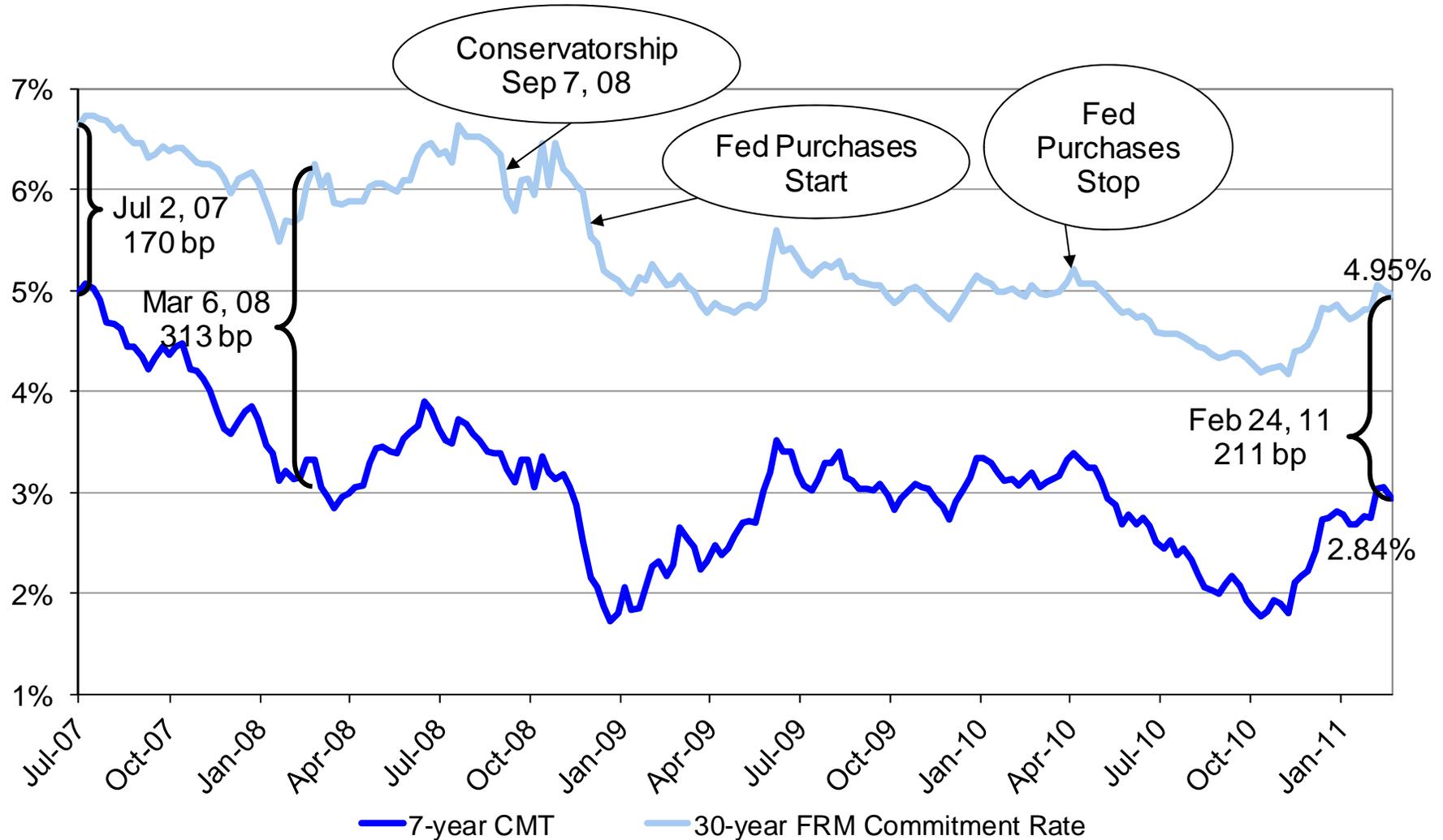
Thank you. I will be happy to answer your questions.

# Figure 1: Mortgage Rates and Treasury Yields



## Yield on 7-Year Constant-Maturity Treasury and 30-Year Fixed-Rate Mortgage Commitment Rate

July 2007- February 2011

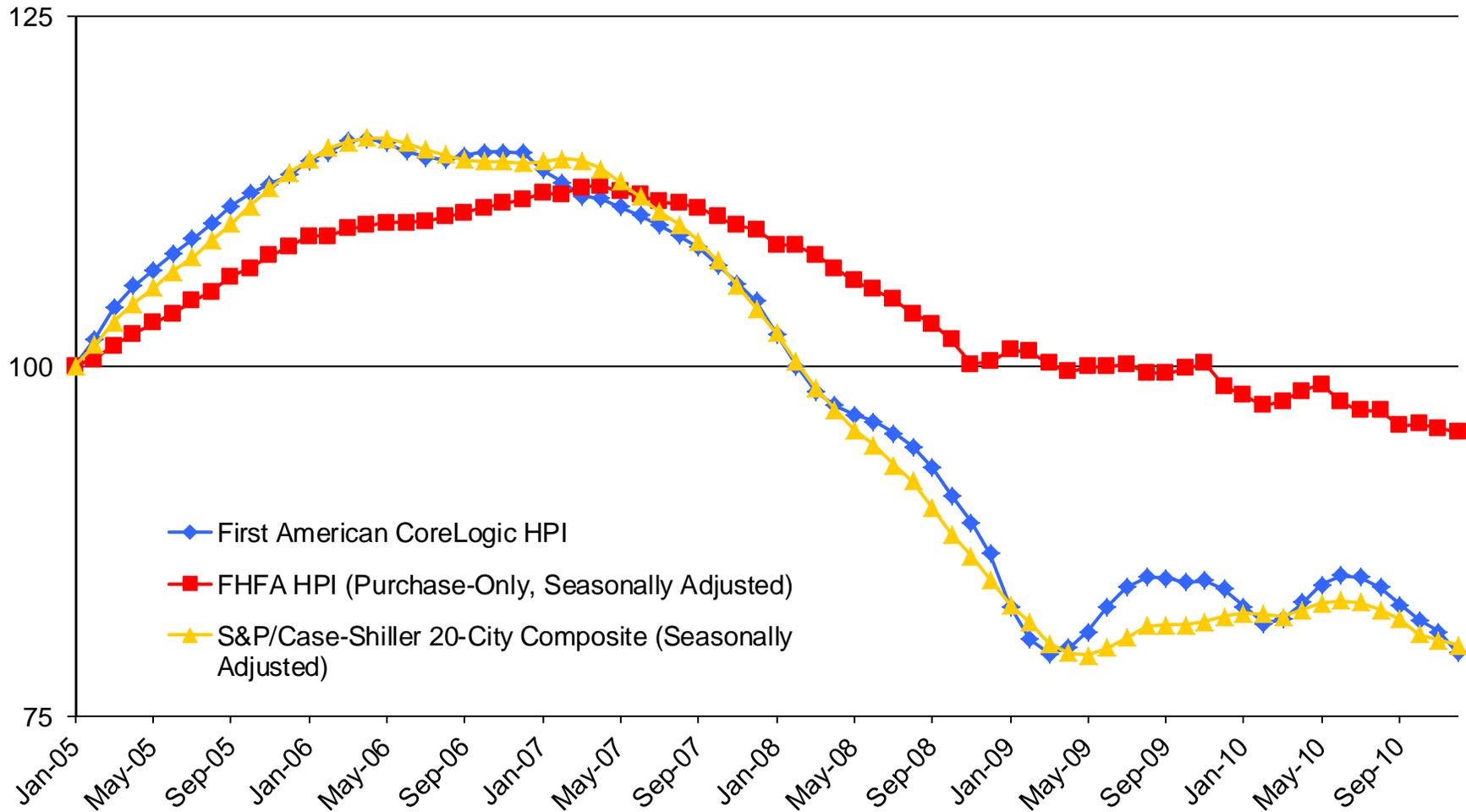


Sources: Freddie Mac, Federal Reserve Board.

## Figure 2: House Price Indexes, 2005 – Present



First American HPI, FHFA House Price Index, and  
S&P/Case-Shiller House Price Index  
Jan 2005 - December 2010



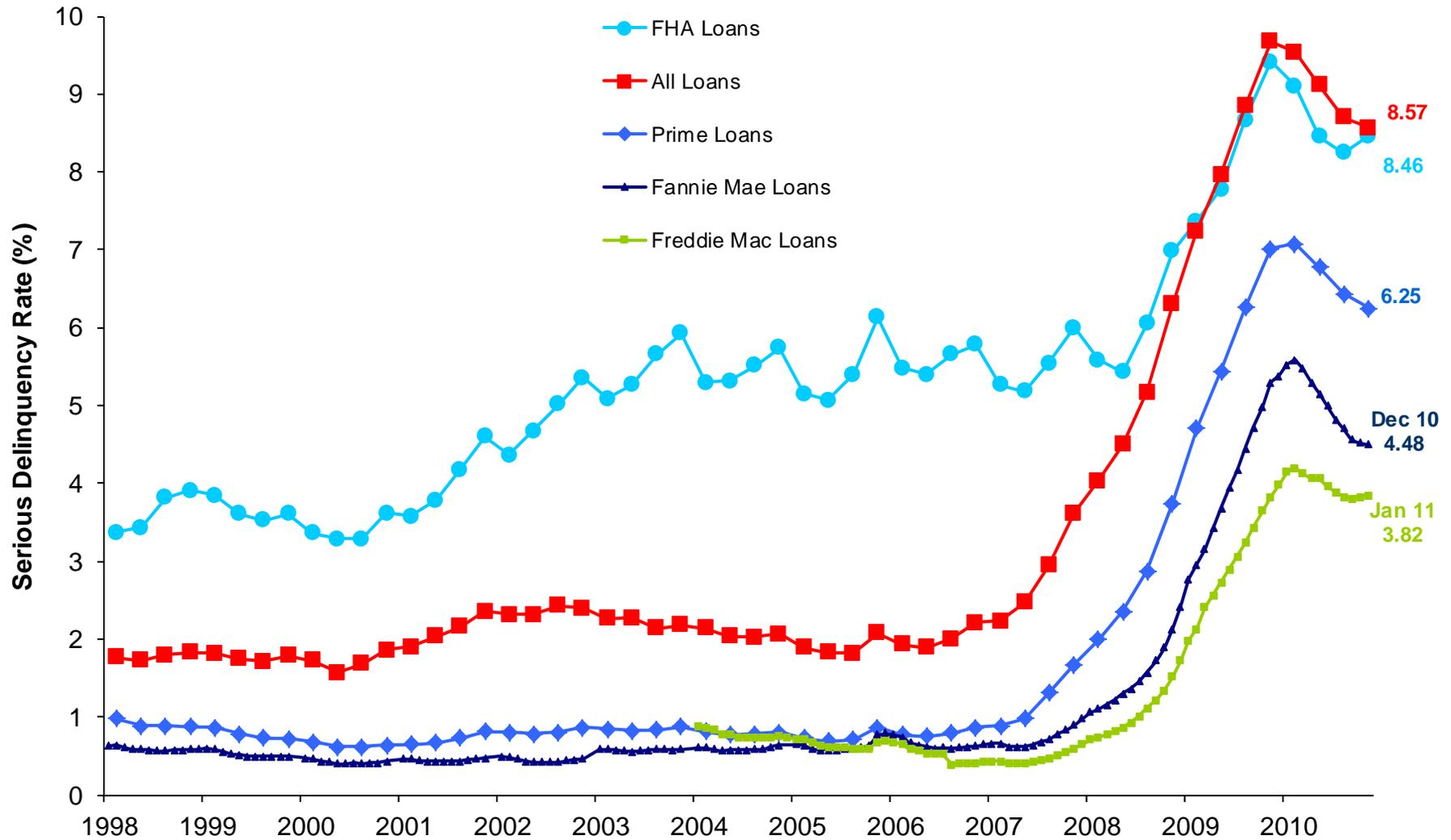
Note: For purposes of comparison, all three indexes have been re-based to equal 100 in January 2005.

Sources: FHFA, Standard & Poor's, First American.

# Figure 3: Serious Delinquencies Improving



## Single-Family Mortgages Jan. 1998 - Jan. 2011

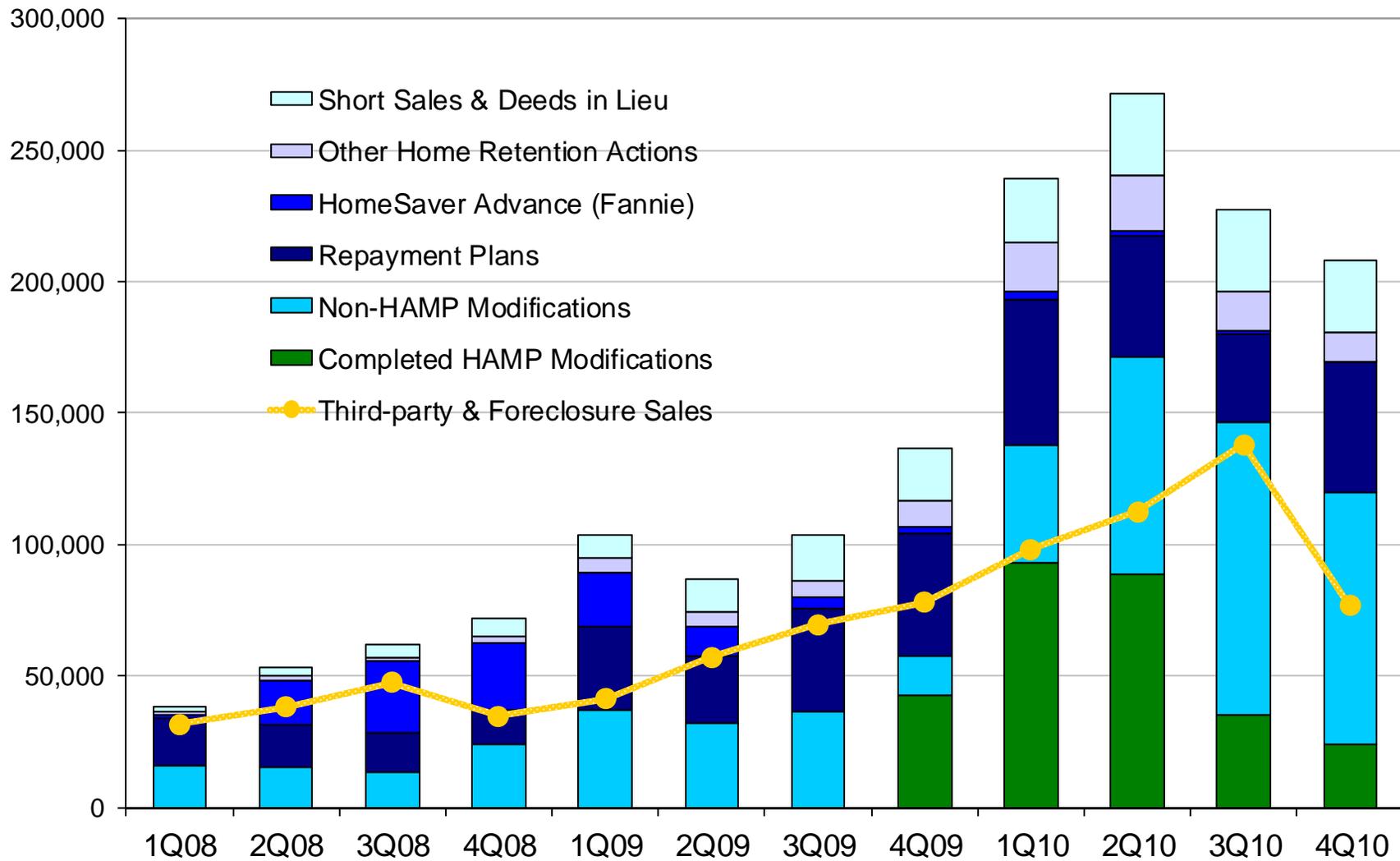


Sources: Mortgage Bankers Association, Fannie Mae, Freddie Mac.

# Figure 4: Foreclosure Prevention Actions Outpace Foreclosures



Enterprise Foreclosures and Foreclosure Prevention Actions by Type  
2008Q1 - 2010Q4

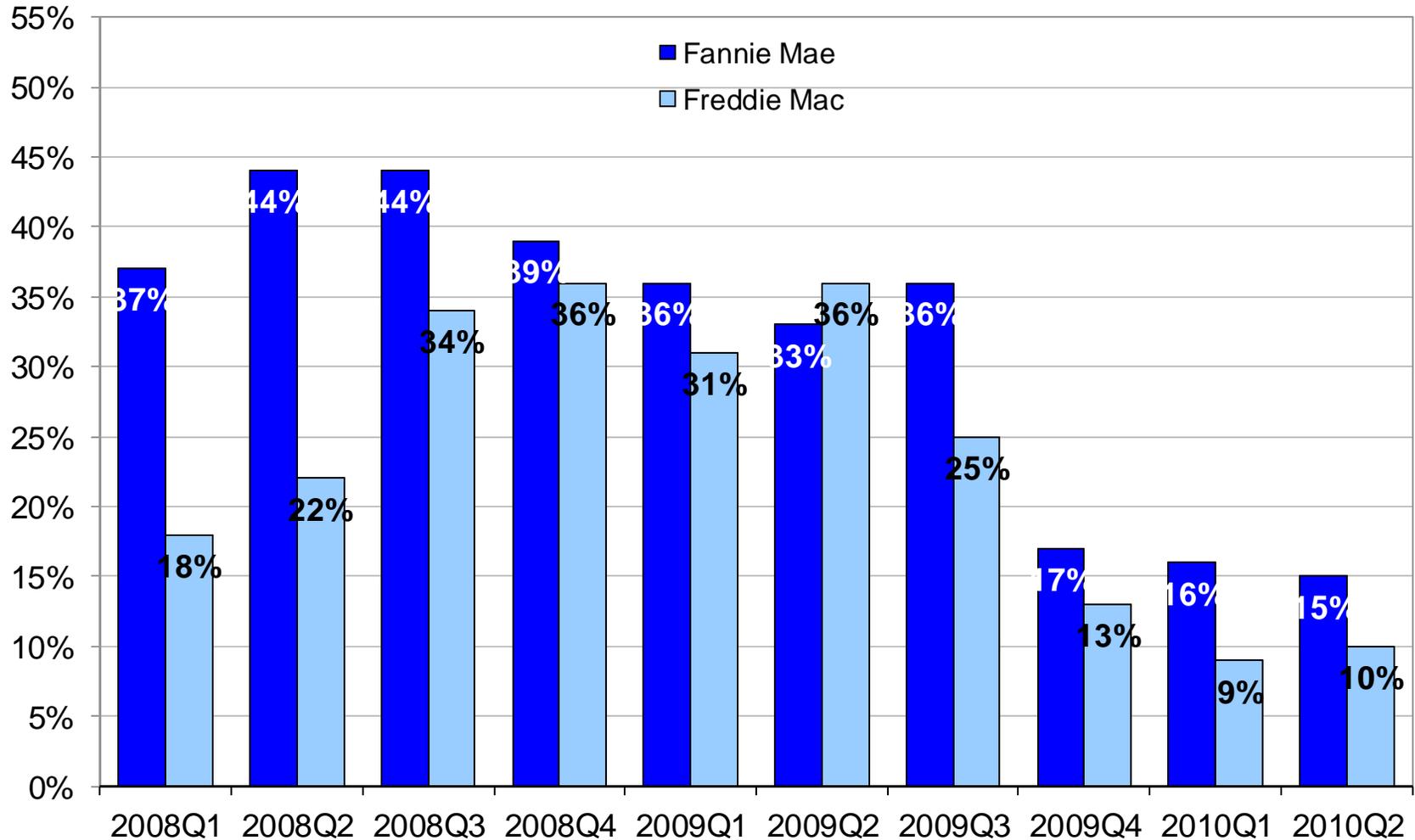


Source: FHFA.

# Figure 5: Re-Defaults of Modified Mortgages



**Sixty-plus Delinquency Rate of Modified Mortgages  
Six Months After Modification, by Modification Date  
2008Q1 - 2010Q2**



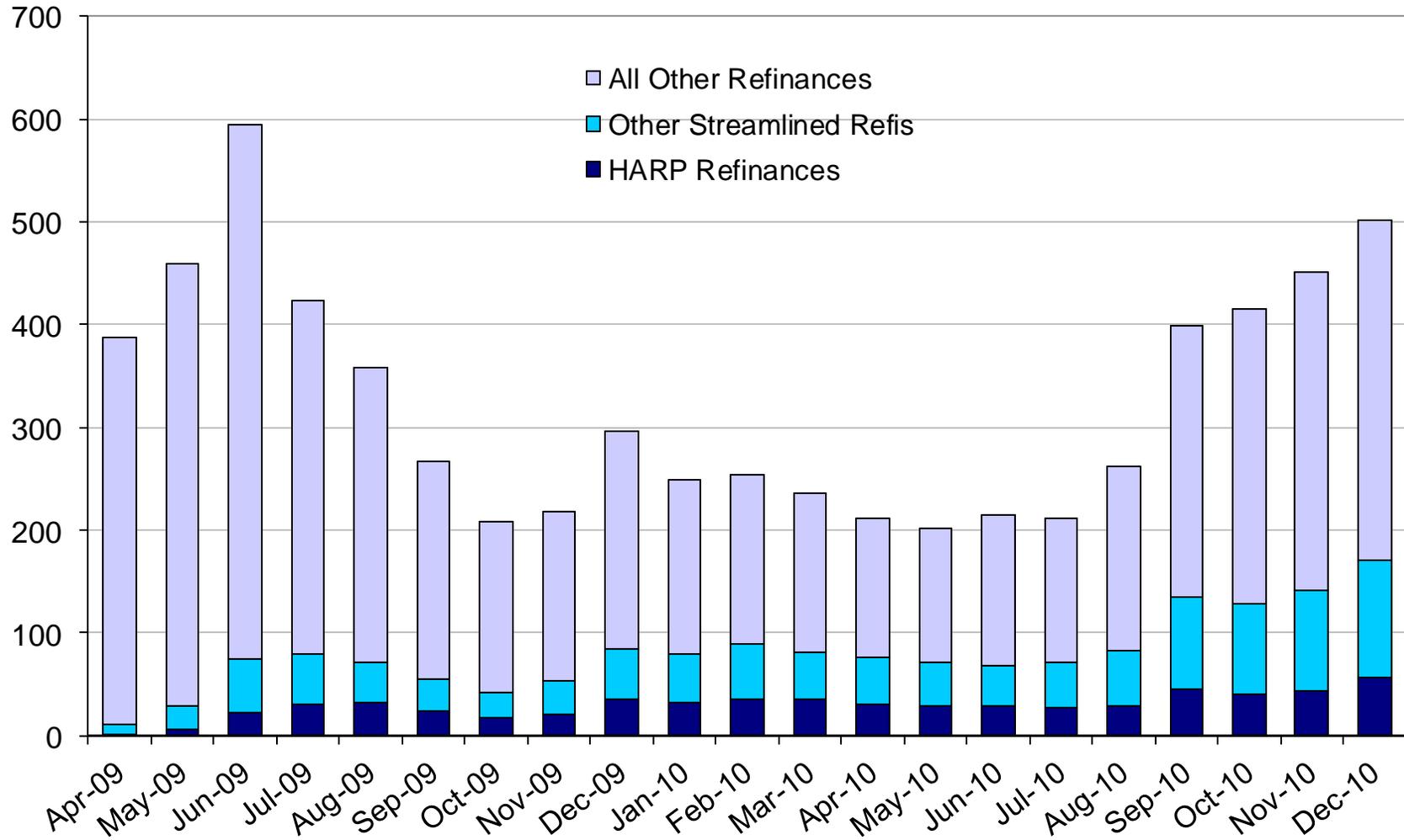
Source: FHFA.

# Figure 6: HARP and Enterprise Refinancing Activity



## Fannie Mae and Freddie Mac Mortgage Refinance Activity April 2009 - December 2010

Thousands



Source: FHFA.