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Before the House Subcommittee on Housing and Community Opportunity
Hearing on "H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008"

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Chairwoman Waters, Ranking Member Capito and members of the committee, I appreciate the opportunity to be here today to describe Fannie Mae's foreclosure prevention practices. I will also share with you our view on how loan servicing practices can best be directed to reducing foreclosures that are damaging families, neighborhoods and local economies across the country.

I will begin my testimony with a somewhat detailed discussion of Fannie Mae's loss mitigation and foreclosure prevention practices. As I do, I will address the specific issues you've asked me to testify about, and hopefully explain the underlying business philosophy behind our loss mitigation strategies.

Fannie Mae has been investing in mortgage credit for 70 years, through multiple up and down housing cycles, and the collective knowledge and expertise from those many decades are reflected in our loss mitigation practices. Underlying all our efforts in this area is a simple principle: As a holder of mortgage credit risk, our interests are in fact closely aligned with the borrower's.

When a borrower runs into a period of financial difficulty, allowing the borrower to keep their home while they work through the difficulty is, in almost all cases, the best possible outcome — both for the borrower and for Fannie Mae. When that outcome is not achievable, our goal remains to prevent a formal foreclosure, which is usually the worst outcome for the borrower and for the well-being of the surrounding community. Our foreclosure prevention practices are not only good business practice, but we believe they align very closely with the mission embodied in our Congressional Charter to be a stabilizing force for housing.

Our loss mitigation efforts are undertaken in close partnership with our loan servicers, who have the most direct and meaningful contact with borrowers having difficulty making their monthly payments. I'd like to outline the way in which our servicing relationships operate, and how our policies and tactics around foreclosure prevention are working today.

First, Fannie Mae continuously monitors and measures servicer loss mitigation activity. For Fannie Mae, that means granting servicers as much leeway as possible to prevent a foreclosure, while at the same time monitoring and rewarding their activities to make sure foreclosure prevention is occurring in accordance with our policies.

To accomplish this, we lay out the results we want and then work with servicers to come up with the best possible tactics to achieve them. For our purposes, we do not require a standard software solution for workout. Rather, Fannie Mae leverages a combination of monthly servicer score cards and on-the-ground presence to ensure foreclosure prevention performance and compliance.

Fannie Mae staff routinely visits the offices of our largest servicers, who together handle more than 80 percent of our loan portfolio, to be on site to make sure they are following best practices in foreclosure prevention. When they don't, we require changes. For instance, in nearly all cases our servicers have added staff and increased service levels in response to our requests. When servicers are not performing at the level Fannie Mae expects, we will remove their delegated foreclosure authority until their loss mitigation practices improve.

Our policies are broadly outlined in our Servicing Guide, which delegates a large portion of the decision-making to servicers themselves. But the Guide is only part of the story. We can and do work with servicers every day to work through problem loans that fall outside our guidelines. Results are what we are after, not just following a guidebook. And we measure results, not just compliance with the guide.

Our close monitoring of servicers, setting targets for their results, and the regular feedback we receive from them, has led to some important changes in our policies. For instance, since the market turmoil began last summer, servicers have requested 18 operational changes, including enhanced authorities, to resolve problem loans without prior approval from Fannie Mae. We have granted all 18. These changes have helped streamline the process and empowered servicers to resolve problems more quickly.

Second, we offer cash incentives to servicers to pursue alternatives to foreclosure. We also pay foreclosure and bankruptcy attorneys to reach out directly to delinquent borrowers. As many have reported, borrowers don't necessarily respond to letters from a servicer, but may respond to a letter from an attorney. And we pay the attorney to prevent foreclosures, not just conduct them.

Third, we pursue a variety of ways to work with a delinquent borrower to prevent a foreclosure. Broadly, they are:

1. A loan modification, where terms of the loan are renegotiated to lower the interest rate, convert an adjustable rate into a fixed rate, or extend the life of the loan, for example.
2. A repayment plan, where a borrower makes up the past-due payments over time, usually less than 12 months.
3. A forbearance, in which we agree to reduce or suspend loan payments for a period of time.
4. A pre-foreclosure or "short" sale. Here, a servicer works with a borrower to sell the home and use the proceeds to pay off the loan, even if the proceeds are not

enough to settle the entire balance. We have begun revamping our delegations to servicers that will allow them to conduct more short-sales.

5. A deed-in-lieu of foreclosure, where a borrower signs over title to the property to Fannie Mae without the expense of a foreclosure.

At Fannie Mae, we have recently introduced a sixth option, which we call HomeSaver Advance™. It offers borrowers experiencing a temporary financial hardship an advance of past-due mortgage payments in exchange for a separate, unsecured loan.

Each one of these options has advantages and disadvantages. All are analyzed against individual borrower willingness and ability to pay.

As noted in our annual report for 2007, Fannie Mae worked out more than 37,000 troubled loans last year. The majority, or about 70 percent, was loan modifications. Of these loan modifications, five-and-a-half percent consisted of changes that reduced an interest rate for a period of time that typically expires when a borrower can resume paying market-rate interest.

About 21 percent of our loan workouts were repayment plans, about 7 percent were short sales, and about 2 percent were deeds-in-lieu of foreclosure. As you can see from these statistics, our most widely used and effective means of loss mitigation is an actual modification of the terms of the loan.

The choices we make with our servicers and borrowers on the types of loan workout options we pursue are designed for the best long-term outcome. In other words, they are not designed to "kick the problem down the road." In fact, of the modifications, forbearances and repayment plans we made between 2001 and 2005, about 60 percent remained current or were repaid two years after they were done. Historically, only 9 percent of our workouts ultimately go into foreclosure.

The affordability standard we use when doing a loan workout is fairly straightforward. Our servicing guidance allow servicers to create an affordable plan whereby a borrower is required to have at least a $200 residual after projected monthly expenses are subtracted from projected income. The reworked loan needs to be sustainable, and it must allow for unexpected household expenses — a broken water heater is generally the term we use. The final outcome must meet a basic test: Can the borrower sustain the payments over the long term.

We believe our affordability standard provides the best framework for underwriting newly reworked loans. As I said, only 9 percent of loans that we work out go to foreclosure after two years. The Veterans Administration loan standards in this area are indeed different from Fannie Mae's. For instance, we believe the VA's debt-to-income test, while an acceptable underwriting standard, is unnecessarily restrictive for a loss mitigation framework. And its residual income requirement is too broad to allow for flexible loss mitigation, in that it does not allow a servicer to craft individual solutions for individual borrowers.

As I said in my opening, these loss mitigation practices reflect the long experience we have in preventing foreclosure. But they also are a reflection of the long-standing underwriting practices of Fannie Mae and the basic safety and sustainability of our loans. The vast majority of our business — close to 90 percent of our entire single-family mortgage book — is made up of prime, fixed-rate mortgages with strong credit scores and plenty of borrower equity.

Overwhelmingly, when our borrowers run into trouble, it is not a function of the loan they received. It is instead a temporary life event or hardship, such as a divorce, the loss of a job or a medical condition. Our loss mitigation practices are designed to help borrowers with those temporary hardships, and our experience has proven very effective.

However, as you know and as has been widely reported, foreclosures are a growing problem in regions of the country experiencing job losses and economic downturn. Fannie Mae is not immune from these trends. The number of properties acquired through foreclosure increased 34 percent in 2007 to more than 49,000. The properties were concentrated in the upper Midwest, particularly Michigan, Indiana and Ohio. We also saw a significant increase in foreclosures in regions where home prices are declining substantially, especially in California, Florida, Nevada and Arizona. Given the delinquency trends in our book, which are rising, we expect foreclosures to increase again this year. These foreclosures were not only a terrible outcome for borrowers in these states; they were a major driver of Fannie Mae's $2.1 billion net loss in 2007.

It is a key priority for Fannie Mae to reduce foreclosures, which is one reason why we have given more than $9 million to not-for-profit, independent counseling agencies to assist at-risk borrowers. It's also why last year we funded more than $13 billion in prime loans to refinance subprime loans to nearly 68,000 borrowers under our HomeStay™ initiative.

Before I close, I'd like to offer a few points on the legislation currently under consideration by this committee, specifically H.R. 5679. We share Congress's concern that the tide of troubled loans has made it more difficult for servicers to address the growing need of borrowers who want foreclosure alternatives.

My view on legislative remedies to this problem is informed by my own experience at Fannie Mae. We have dedicated the time, people and resources needed to work through tens of thousands of problem loans since the market turmoil began last year. As I said, we have an incentive to achieve the best possible outcome for a borrower in as little time as possible, and we enforce servicing practices geared toward that outcome. This involves active outreach to borrowers, making sure they have independent counselors available to them, and then making sure our servicers have all the tools necessary to prevent a foreclosure if a borrower is willing and able to stay in the home.

Loans are made one at a time, and loss mitigation happens one loan at a time. Creating a legislative standard for loss mitigation activities prior to a foreclosure may actually have the unwanted side effect of making solid loss mitigation activities, negotiated between a borrower and a servicer, less flexible. It would create an added cost on an already expensive process, and ultimately, we believe, make home mortgages more expensive.

I want to thank the committee again for inviting me here today. Foreclosure prevention is a key focus of our company, and we continue to seek out and implement new ways to keep troubled borrowers in their homes while the housing downturn plays out. I look forward to working with this committee and Congress as it seeks long-term solutions to prevent more foreclosures, stabilize the housing market, and promote sustainable homeownership. With that, I'd be happy to answer any questions the committee has about our loss mitigation activities and practices.

Thank you.