

**WRITTEN STATEMENT OF**  
**ROBERT J. LEVIN**  
**BEFORE THE**  
**FINANCIAL CRISIS INQUIRY COMMISSION**  
**HEARING DATE: APRIL 9, 2010**

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Mr. Chairman, Mr. Vice Chairman, and Distinguished Commissioners, thank you for providing me the opportunity to appear before you today to assist the Commission in examining the causes of the financial crisis. I am happy to provide whatever assistance I can and will do my best to answer all your questions to the best of my ability.

I was privileged to work at Fannie Mae in a wide variety of positions from 1981 until my retirement in August 2008, prior to the takeover of Fannie Mae and the imposition of the conservatorship. Thereafter, at the request of the newly-appointed CEO, I continued to work as an advisor to senior management for about six months. During my 27 years at the company, I worked with many fine individuals and organizations, including mortgage lenders, community groups, housing organizations and other stakeholders, to help Americans achieve the dream of home ownership and affordable rental housing.

My pride at the contributions of Fannie Mae to homeownership and affordable rental housing over the past decades has understandably been overshadowed by the economic meltdown and other events that give rise to this hearing. I know that the Commission is charged with understanding how and why these events came to pass. I am happy to share my perspective on these issues with you, as I did with your staff members prior to this hearing.

Fannie Mae was engulfed by an unprecedented decline in home prices and resulting dislocations in the housing markets that were truly catastrophic. After years of steady home price appreciation, some people foresaw a correction, but few if any anticipated the unusually rapid and devastating destruction of real estate values that occurred. In hindsight, if we and the

industry as a whole had been able to predict the nature and extent of the changes to the market, it is clear that we all would have conducted our business differently during this period. Because Fannie Mae, unlike other financial institutions, was restricted by its charter to one class of assets, Fannie Mae took the brunt of the crisis head on. At the same time, the global economy was in the midst of a liquidity and credit crisis that devastated capital markets and resulted in increased unemployment. This extraordinary upheaval in the mortgage market and the economy placed stresses on Fannie Mae that would have been difficult for the company to withstand regardless of any business decisions that preceded the crisis.

As the Commission is aware, Congress created Fannie Mae as a private company with a public purpose to serve the secondary mortgage market. As such, we had a variety of important stakeholders: the Congress that created us, our mission and safety and soundness regulators, private shareholders, debt and MBS investors, mortgage lenders, housing organizations and others.

As a private company, Fannie Mae raised capital from investors and sought to provide them with a competitive rate of return.

As a company with a public purpose, Fannie Mae sought to ensure the liquidity of the mortgage market and to promote affordable housing, which included meeting government-mandated housing goals.

The housing goals were set forth in Fannie Mae's charter act. Some of the goals related to our single-family business. Some related to our multi-family business. In general, certain goals required that a specified percentage of our business be for families at lower income levels and other goals required that a specified percentage of our business be located in certain places in the country that were considered underserved. Our mission regulator raised these goals from

time to time, and they frequently required levels of affordable housing and underserved market business that were higher than what our market was naturally producing. This required the company to engage in affirmative efforts, including outreach programs and application of different underwriting and pricing standards, to create business to help us meet the goals.

As a company operating in the secondary mortgage market, Fannie Mae purchased and securitized mortgage loans created by lenders. The degree of influence Fannie Mae had on the types of loans that lenders originated fluctuated depending on market conditions and the availability of alternative sources of capital for these lenders. When Fannie Mae was one of the principal sources of capital in the mortgage market, Fannie Mae's influence was greater. When other sources of capital were more plentiful, as in the period prior to the beginning of the crisis, Fannie Mae's influence was diminished.

As a private company with public purposes restricted to the secondary mortgage market, Fannie Mae was a fairly unique entity. We took both our duties to our private shareholders and our public missions very seriously. Throughout much of my time at Fannie Mae, the organization was able to balance successfully its potentially conflicting objectives. However, this became more difficult when the markets experienced significant change and during periods of great stress in the system.

The growth in the last decade of the private-label mortgage-backed securities market is one such change that had a significant impact on the mortgage markets and Fannie Mae. Private-label securities, or "PLS" for short, are mortgage-backed securities issued by entities other than Fannie Mae, Freddie Mac, or GNMA. PLS financed three main types of mortgage products: subprime, Alt-A and jumbo loans.

In 2003, a year of heavy refinance activity, the size of the PLS market was about half the size of Fannie Mae's security issuances. In 2004, that relationship changed dramatically. The PLS market grew and Fannie Mae's shrank, and the dollar volume of PLS exceeded that of Fannie Mae MBS, and almost reached the level of Fannie Mae and Freddie Mac MBS combined. In 2005 and early 2006, that trend continued, with the dollar volume of PLS exceeding the MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae combined.

The PLS affected Fannie Mae's business in significant ways. First, our business activity relative to the overall market declined dramatically during this period of time. Second, many of the new products funded by PLS had features that attracted low-income borrowers, which threatened our ability to meet our mandated housing goals. Fannie Mae had never previously experienced market changes of the magnitude we were seeing in this period.

An article in 2006 in a publication called *Mortgage Banking* summarized the significance of these trends. The article stated: "A change in the mortgage-backed securities (MBS) market that began more than two years ago appears to have completely reshuffled the industry's deck of cards. Now, issuers of private-label residential MBS are holding the aces that were once held by the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. Once a junior -- but powerful -- player in the market, private-label residential mortgage-backed securities (RMBS) are now the leading force driving product innovation and the net overall volume of mortgage origination. Further, it appears that the new dominant role for private-label RMBS may be here to stay."

The PLS phenomenon and the resulting consequences for our business confronted Fannie Mae with critical strategic questions that included the following:

- First, were the changes in the market temporary or permanent?

- Second, would we best be able to deliver competitive returns to shareholders, stay relevant to customers, and meet our mission requirements by doing nothing new, or by increasing our participation in these markets to some degree?

These and related questions were the subject of continuous and serious discussion and in-depth analysis by the Fannie Mae management team and Board of Directors from 2004 forward. We addressed these issues in a series of dedicated strategic planning sessions as well as day-to-day discussions. We considered the credit risks in the new markets, our capabilities to manage the business, and the impact on our achievement of housing goals, our financial results and our strategic positioning in the marketplace.

As a result of these deliberations, the consensus of the Fannie Mae management team from 2004 to late 2005 was to maintain Fannie Mae's market posture, but to move forward by building the capabilities for change should we decide to make a change.

However, by the beginning of 2006, it became harder to justify a position of no change. The PLS market kept growing. Fannie Mae's volume of business relative to the market continued to decrease to a level where we were concerned about losing relevance in the marketplace. It seemed more likely that huge PLS and Alt-A markets might be permanent fixtures of the market, as opposed to temporary phenomena. And we also believed that we could mitigate our risks by investing only in certain less-risky segments of the new markets and by obtaining additional credit enhancements. These considerations led to a management consensus to expand Fannie Mae's already existing Alt-A business over time. In implementing this decision, management continued to attempt to minimize risk by utilizing underwriting standards that were more conservative than the standards prevalent in the market at the time. As a result,

although Fannie Mae's Alt-A book sustained disproportionate losses, it did perform better than the market, and sustained smaller losses than otherwise might have occurred.

Our minimal involvement in the subprime market consisted primarily of the purchase of the AAA-rated portion of PLS backed by subprime loans. These purchases contributed greatly to housing goal objectives. With the benefit of hindsight, had we anticipated the oncoming market meltdown, we would have been far less likely to expand our involvement into these non-traditional products.

We began to cut back our participation in the Alt-A market in 2007, after stresses appeared in the market and in our book of business. We tried to balance the pace of our withdrawal with our public mission to provide liquidity, a critical function as the PLS market dried up.

When the housing price crash began, the most recent vintages of MBS in Fannie Mae's book of business, which included the expanded Alt-A book, exhibited losses disproportionate to their percentages in the book. The loans made right before the crash lost their equity the fastest. The Fannie Mae Alt-A book performed better than the Alt-A market in general, but still had high delinquencies, in part because Fannie Mae's business had concentrations in California and Florida, which were among the states hit hardest by falling home prices.

In conclusion, an unprecedented decline in home prices, a high unemployment rate, and a global liquidity and credit crisis engulfed Fannie Mae and its only line of business – the secondary market for mortgages. The crises were centered on our market and our asset class, and we took the full brunt of the market crisis head on, which would have been difficult for the company to deal with under any circumstances. Although these factors by themselves had a

devastating impact on Fannie Mae, the losses were exacerbated by our increased participation in the new markets and by our attempts to meet our mission goals.

The Commission has been charged with an important and difficult task -- attempting to understand the causes of the financial crisis. I am happy to provide whatever assistance I can in this process.

Thank you.