Freddie Mac Fourth Quarter and Full-Year 2018 Financial Results Conference Call
February 14, 2019

Remarks of
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Chief Executive Officer

Good morning and thank you for joining us to discuss our fourth quarter and full year 2018 financial and business results. We appreciate the opportunity to review our performance with you, and look forward to your questions.

2018 was another excellent year for Freddie Mac. Ten years after the financial crisis, our transformed business model continues to produce solid earnings. That transformed model also helps us fulfill our mission of promoting liquidity, stability and affordability to the U.S. mortgage market. And, we now do so in an economically efficient manner that properly values the taxpayer's support of the company.

I'd like to accomplish two things with this morning's discussion:

- First, I'll cover our financial and business results for last year.
- Second, I'll describe how fundamental changes in our business model have strengthened Freddie Mac and the overall housing finance system.

In 2018, we saw increased comprehensive income, a higher return on conservatorship capital, continuing growth in the guarantee book, and strong momentum in our efforts to shift credit risk away from the taxpayer and toward the private sector.

Let's start with the bottom line numbers. For the full year, we earned comprehensive income of $8.6 billion dollars. Adjusting for significant items, our 2018 comprehensive income was $8.4 billion dollars, an increase of four percent over 2017.

Market sensitive items resulted in just a $0.5 billion dollar reduction in earnings for the year; almost all due to interest rate movements. Of note, quarterly volatility of income in 2018 was significantly reduced by having hedge accounting in place.

Looking at the balance sheet, we saw good growth in our guarantee book at five percent, which means we're participating fully in overall mortgage market growth. As of December 31, total guaranteed assets stood at $2.1 trillion dollars, compared with $2 trillion the year before.

Our credit quality still looks very good, with year-end delinquencies in the Multifamily book at virtually zero—just 1 basis point. Likewise, Single-Family's serious delinquencies are at the lowest levels in more than a decade at 0.69 percent. Looking just at our core Single-Family portfolio, which excludes relief refinance mortgages and mortgages acquired prior to 2009, our serious delinquency rate is even lower, at 0.22 percent. This reflects strong underwriting and also strong house price appreciation. And these numbers, please note, do not give effect to CRT transferring to private markets unexpected and, more recently, expected, losses that would result from these delinquencies.

In each of the past two quarters, I have updated you on a relatively new measure of how well we manage our business: ROCC, or return on conservatorship capital, which functions as a proxy during conservatorship for the return on equity calculation commonly used by financial institutions. For the entire year, we reported approximately a 15 percent return. While this is good, I should once again caution that, all else being equal, an actual ROE outside of conservatorship would likely be below this level. I won't go into the reasons for that now, but would be happy to address it in Q&A.

Nevertheless, our ROCC remains the only official metric to gauge whether we are earning a good return on behalf of the taxpayers' exposure to our risks. The strong return in 2018 demonstrates both our commitment to making business decisions that are in the best interest of taxpayers, and our belief that the company does capital management as well as some of the best-managed large financial institutions in the country.

Along with the effect of continued solid, underlying earnings, a key factor in achieving our strong return was the efficient use of our capital, including by reducing the risk that requires it. At year-end 2018 modeled capital, as defined by the conservatorship capital framework, had declined $11 billion dollars, or 16 percent, compared with year-end 2017. A variety of factors played a role in that decrease, including ongoing appreciation in home prices, our innovative legacy asset dispositions and our leadership in credit risk transfer across both the Single-Family and Multifamily business segments. I believe that a 16 percent reduction—which represents significantly less risk to the taxpayer—along with increased profits, is very good performance.

Partly through the extensive implementation of CRT, our Single-Family business reduced its conservatorship capital needed for credit risk on loans purchased during 2017 by approximately 60 percent, while our Multifamily business achieved an approximately 90 percent reduction. Note that we calculate those numbers based upon loan purchases from the prior year—reflecting that CRT is done almost always after a loan is purchased during a securitization pipeline period, which we standardize as 12 months for this calculation. Those are obviously very good results—for taxpayers and for the housing finance system.

I'd also like to point out that we generated a good level of earnings—$1.5 billion dollars—in the fourth quarter, a period characterized by highly unsettled markets.

Demonstrating our transformed business model's strength, our ROCC for that period was still above 10 percent, even in the face of that volatility.

All in, then, 2018 was a good year for us.

The strength we demonstrated in the fourth quarter—our ability to deliver a profit while supporting our mission under market pressure—did not happen by accident.

In fact, since the financial crisis Freddie Mac has worked with its conservator to address the major challenges in the historic GSE business model. The fundamental changes we implemented have benefited everyone involved in housing finance – taxpayers, borrowers, renters, investors, seller/servicers … and Freddie Mac too.

For example:

- **First, our retained portfolio is a fraction of its former size**. We've addressed a large structural weakness in the former housing finance system: the unlimited-size of the subsidized discretionary investment portfolios that had historically generated profit largely independent of the guarantee business. Where Freddie Mac's retained investment portfolio once ballooned to more than $800 billion dollars, at the end of last December, it was just $218 billion, nearly a 75 percent reduction and well below the $250 billion dollar limit required by our Purchase Agreement with the U.S. Treasury. Today, we use the retained portfolio to support the guarantee business, for example by purchasing defaulted loans out of securitizations to facilitate modifications for homeowners, and to make good on our guarantee to investors.

- **Second, we have a capital framework that encourages risk-versus-reward discipline.** We developed a modernized GSE risk-based capital system over five years ago. It is patterned after the one applied to banking system SIFIs, which are required to show that they can weather a Fed-specified severely adverse stress scenario while retaining a going-concern buffer. We adopted that framework even before it became the basis for the conservatorship capital framework mandated by FHFA, which it strongly resembles. Today, the CCF framework gives us—and the taxpayers who support us—confidence that we are making taxpayer-friendly risk-reward decisions each and every day. It also helps us give taxpayers a decent return on their exposure to our risks.

- **Third, we have leveled the playing field for community banks and other small lenders**. At one time, more than 80 percent of Freddie Mac's guarantee business came from its

top ten customers, who enjoyed discounted guarantee, or "G," fees because of their large size. Working with FHFA, we have ended that practice, and today lenders of all sizes pay level G-fees.

We also maintain a very competitive cash window, which enables small lenders to access the global capital markets, even when selling us just one or two loans at a time. And we have dedicated more technology, customer support and other resources to smaller lenders since entering conservatorship.

As a result, approximately half of our Single-Family business now comes from outside our top ten customers, versus less than 20 percent prior to conservatorship.

Finally, and as previously mentioned, we have significantly reduced our exposure to systemically large amounts of mortgage credit risk. We do this primarily through programs that transfer risks from new loan purchases to private investors, and thus away from the U.S. taxpayer. In 2018, these included our STACR and ACIS programs in Single-Family, together with the pioneering credit risk transfer programs in Multifamily. We also have substantially reduced the concentration of credit risk found in our retained portfolio's less liquid assets, which are primarily credit impaired; it is now just 30 percent of the much-reduced total.

More broadly, to give you an idea about how far we have come in risk reduction: Once a year, FHFA publishes our stress test results, which estimate how much funding we would need to draw from Treasury under the Federal Reserve's "severely adverse" scenario. Back when we reported 2013 stress test results, that number was $93 billion dollars; and, even with a tougher scenario this past year, it declined by almost two-thirds to $35 billion. Now, that's risk reduction.

In addition to these structural reforms, like all financial services companies, we're in the midst of a digital transformation. One example is our focus on speed of execution with our customers. In Single Family, we are automating the income and asset verification process, which has traditionally been paper-based and slow—so costs are coming down and speed is increasing. In Multifamily, we are arranging digital communications with property inspectors via an app so days are squeezed out of the process. It's these types of efforts that are helping to bring the traditional time- and paper-intensive mortgage business into the digital age.

The payoff for these efforts shows up in our customer satisfaction scores, which are on par with top-performing financial services companies.

One thing that has not changed for us is our mission.

Last year, Freddie Mac provided $396 billion of liquidity to the U.S. mortgage market. Looking behind that number, we helped lenders fund more than 1.3 million single-family homes, with first-time homebuyers taking out nearly 46 percent of new purchase loans. We also helped fund nearly 866,000 multifamily rental units, with more than 90 percent affordable to low- and moderate-income families earning at or below 120 percent of the area median income.

Altogether, that means that in 2018, Freddie Mac made a difference in the lives of over 2 million families. And that's what inspires our people every day.

So, I will stop there with just one final thought: I'm proud of the improved GSE business model and of our transformation to a competitive, innovative company. It serves our customers and fulfills our Congressionally-mandated mission, all much more efficiently than in the past, and now treats taxpayers properly for their support of the company. I am proud that this happened on my watch, which is scheduled to conclude later this year, and that we at Freddie Mac led so much of it. In fact, the GSEs and FHFA now regularly get compliments in the housing finance policy community about how much the business model has improved during conservatorship. My colleagues at Freddie Mac and FHFA, past and present, should be feeling very good.

With that, I would be happy to take your questions.