# Freddie Mac CEO Donald H. Layton Discusses First Quarter 2019 Financial Results

*As Prepared for Delivery*

Good morning and thank you for joining us to review our financial and business performance in the first quarter of 2019.

As you probably know, this will be my last such call, as I retire on June 30, when David takes over.

I will first review the quarter's specifics and then—as I look back on seven years as Freddie Mac's CEO—give some high points of what I call "reform while in conservatorship" for both Freddie Mac and for the housing finance system more generally.

The first quarter generated comprehensive income of $1.7 billion dollars, up 13 percent from the prior quarter. This is in line with the range we have produced quarterly for some time now. And, as with all financial institutions, we measure earnings versus the capital employed to generate them. In conservatorship, we use what is called CCF—the conservatorship capital framework. Our return on that conservatorship capital—known as ROCC—was 12.7 percent. That's a good level.

Behind this bottom line are the key drivers of our performance.

- First, our guarantee book of business is growing nicely, up 5 percent from the prior year—4 percent for Single-Family and 14 percent for Multifamily. And this continues a trend of our growing faster than our main competitor.
- Second, our credit quality continues to be strong.
  - The Single-Family delinquency rate was down to 67 basis points, the lowest since 2007, even though it is still burdened by legacy assets from before 2009, including relief refinancing loans. Excluding those legacy assets, the delinquency rate is just 22 basis points, a low level reflecting strong underwriting and a long-term trend of improving house prices since they bottomed in 2011.
  - Multifamily continues to have a near-zero delinquency rate of just 3 basis points. Its non-delegated underwriting business model has produced excellent credit results for some time now. In fact, the number of foreclosed properties we currently own is zero.
  - And all these credit statistics are "gross"—meaning they do not take into consideration our credit risk transfer program and the reality that losses would only partially affect Freddie Mac's bottom line. More on this later.
- Third, with a $2.2 trillion dollar balance sheet, we are very much subject to financial market conditions. We have worked hard to provide strong transparency regarding the impact of market volatility on our bottom line. In Q1, the result was very low, less than $100 million dollars. This compares very favorably to an earnings reduction of $600 million dollars the prior quarter when markets were unusually volatile.

- Fourth, as a GSE, we are very focused on risk and the capital needed to support it. Between our emphasis on CRT, our long-term effort to dispose of legacy assets beyond simply waiting for run-off, and strong house price appreciation, we continue to steadily reduce our aggregate conservatorship capital required. It was down 10 percent in the last year—that's $6.1 billion dollars less of taxpayer backing needed to support our risks. And last, all of us at Freddie Mac work here to support the company's mission to provide liquidity and stability to the primary mortgage market, and also to make home possible on a safe and sound basis for as many people as we can. Last quarter, we again delivered on that mission, financing nearly 450,000 homes for families to own or rent.

Add it all up, and Freddie Mac is now a well-run financial institution that produces good earnings without undue volatility, steadily reducing the taxpayers' exposure to our risks and fulfilling our Congressionally-mandated mission.

Now let me sit back and reflect on seven years at the heart of America's housing finance system. I stated publicly when I joined Freddie Mac that I was doing so as a public service, to help improve our mortgage system both specifically at the company and more generally by working with government officials. The GSE conservatorship was unprecedented in size and scope—no one knew how long it would last or quite what it would look like.

What I can say now is that conservatorship has been the vehicle for major reform of Freddie Mac, the GSEs and even the housing finance system more broadly.

For Freddie Mac, how things have changed!

- First, competitiveness. We are now a regular competitive company, helping our customers and the industry catch up to other consumer finance markets in using technology and improving efficiency. Our IT investment budget is now about two-and-a-half times what it was when I arrived.
    - There is no more duopoly or cartel mindset. Our organization now competes and competes hard, but always with proper requirements for safety and soundness. David started this more competitive business model long ago in Multifamily, where Freddie Mac's GSE market share by percent has increased in the last decade from the mid 40's to the mid 50's. In Single-Family, the market share percentage has gone up in my tenure from the mid-30's to the low 40's, and recently even higher. In fact, we had some things break our way in March, and our market share was either just below or just over 50 percent, depending upon which exact measure you prefer.
- Second, we have broken the cycle of over-dependence upon the taxpayer for support. Our mortgage-related investment portfolio is down approximately $400 billion, or two thirds, since I arrived, and is now fully dedicated to supporting the guarantee businesses. In 2018, under CCF we estimated the capital required by our balance sheet to be approximately $50 billion dollars. That's down about two-thirds, a very major improvement, from our estimated capital requirement in 2013, as measured by the predecessor to CCF. Part of this was a good housing market, part of this was aggressively disposing of legacy assets—an activity that was non-existent until 2013 when I set it as a target and appointed

people who knew how to do it well—but the part that may be the most impactful over the long term was the invention by Freddie Mac of modern GSE credit risk transfer.

- David began this way back in 2009 as a core component of a smart business model; in Multifamily, today over 80 percent of the CCF-capital required for credit risk on the entire book of business has been replaced by private market capital.
- In Single-Family, about 80 percent of the capital on new flow now comes from private markets; we only began using CRT in Single-Family in 2013 and it took time to ramp up. We estimate almost 40 percent of the total book's CCF requirement for credit capital is now provided by private markets, and that will grow substantially over time in the routine course of doing business.
- In Washington, there is much talk about trying to reduce taxpayer exposure to GSE risks and the need to bring more private capital into the market. In fact, we have accomplished both of those in very large amounts through CRT. We at Freddie Mac invented it, we are widely recognized as its biggest proponents, and we have executed to match our enthusiasm

And more broadly, the GSE system has benefitted from these and other changes, now being implemented through the FHFA at both companies.

- First, on June 3, we are scheduled to go to a single security, which means Freddie Mac and Fannie Mae will both offer a uniform mortgage-backed security. Forward trading of this security is already underway, and it is going well. This is a major and welcome change. It means more liquidity, ideally lower mortgage rates, more efficiency … and, in a possible future state, it enables more competition. Freddie Mac is a big—but by no means the only—beneficiary of this change, and we were the lonely proponents of it back in 2012 and 2013. It took a long time but it's now upon us, and we are feeling really good about that.
- Second, CRT is now regarded by virtually all outside commentators as a key feature to maintain in a possible future state. It is a major change in U.S. housing finance. Also, it is the only proven method of truly reducing the systemic concentration of $5 trillion dollars of mortgage risk in just two companies that are, by law, monolines. This helps overall U.S. financial stability.
- Third, working with the FHFA, we produced what are called eligibility standards for doing business with the two GSEs. One of these applies to mortgage insurers, which performed poorly in the 2008 Financial Crisis and needed to improve; the other applies to non-bank seller/servicers, which are a bigger share of the market and thus it's increasingly important that they remain safe and sound.
- And last, capital. The GSEs were long considered undercapitalized. In conservatorship, to make proper risk-reward decisions, Freddie Mac developed its own internal economic capital system in 2013 basing it on the capital concepts being applied to SIFIs. That was a first. Several years later, the FHFA—liking what it saw—developed its own SIFI-consistent system, which not surprisingly was quite similar to ours, and required both GSEs to use it for decision-making starting in 2017. It is the basis for much of the rulemaking now being proposed for the GSEs in the future. And it all started with us here at Freddie Mac.

So, let me close as I prepare to hand over the keys to David on July 1.

- First, I hope you can appreciate the major change and improvement in U.S. housing finance. It was at the heart of the two financial crises since World War II: the Thrift Crisis of the late 1980s and the more recent one a decade ago. It needed fundamental reform, and it is my belief that the conservatorship years have dramatically produced a lot of that reform. What happened before should not happen again. It really riles us when someone says, “nothing has changed in conservatorship.” That is totally and completely untrue.
- Second, we have gone from follower to leader among the GSEs. With people like David and our other senior leaders, we have been at the forefront of most of the major reforms these last seven years, including changing the mindset from duopolist to competitor. CRT is the most obvious example, but it’s not the only one.
- As I leave, I know the company will be in good hands with David at the helm. He did a fabulous job with Multifamily, which was ahead of the rest of the company on almost all major business model improvements before the rest of the system began to focus on them.
- And it is my fondest hope that the policy and political process—and the conservatorship itself—continues to build on all the good, solid, practical reform we’ve implemented over the last seven years.

Thanks for listening, and now to Q&A.