Fannie Mae Fourth Quarter and Full Year 2017 Earnings Media Call Remarks

Adapted from Comments Delivered by Timothy J. Mayopoulos, President and CEO, Fannie Mae, Washington, DC

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Operator:
Welcome and thank you for standing by. At this time, all participants are in a listen-only mode. During the question and answer session, please press star-1. Today’s conference is being recorded. If you have any objections, you may disconnect at this time. Now, I’d like to turn it over to your host, Maureen Davenport, Fannie Mae’s Senior Vice President and Chief Communications Officer. Thank you. You may begin.

Maureen Davenport:
Thank you, and thank you all for joining the media call and webcast to discuss Fannie Mae’s fourth quarter and full year 2017 financial results. Please note that this call may include forward-looking statements including statements about the company’s future performance and actions, business plan, and strategy. Future events may turn out to be very different from these statements. The “Risk Factors” and “Forward-Looking Statements” sections in the company’s 2017 Form 10-K filed today describe factors that may lead to different results.

As a reminder, this call is being webcast and recorded by Fannie Mae and the recording may be posted on the company’s website. We ask that you do not record this call for public broadcast and that you do not publish any full transcript thereof. I’d now like to turn the call over to Fannie Mae’s President and Chief Executive Officer, Tim Mayopoulos.

Tim Mayopoulos:
Thanks, Maureen, and good morning everyone. Thanks for joining us for today’s call.

I’m pleased to update you on another solid quarter and another solid year. I’ll make some brief comments and then our Chief Financial Officer David Benson and I will open it up for your questions.

Let me start with the fourth quarter of 2017. Our business performance in the quarter was excellent with pre-tax income of $5 billion. Like many companies, however, our fourth quarter results were adversely impacted by the recent tax legislation.

We reported a net loss of $6.5 billion for the quarter and a comprehensive loss of $6.7 billion. This compares to net income of $3.0 billion and comprehensive income of $3.0 billion for the third quarter of 2017.

The primary driver of changes in our results for the fourth quarter was a $9.9 billion provision for federal income taxes resulting from the remeasurement of the company’s deferred tax assets. The Tax Act reduced the corporate tax rate from 35 percent to 21 percent, and accordingly this required us to write down the value of our deferred tax assets. As a result, we had a net worth deficit of $3.7 billion as of December 31, 2017, and we will require a draw from Treasury to eliminate this deficit.
This was an expected, one-time outcome of the tax bill and is not a reflection of our underlying business, which remains strong. Going forward, the impact of the lower tax rate will accrue to the benefit of our future net income.

Another important event that happened in the fourth quarter was the agreement with Treasury to revise the terms of Fannie Mae’s senior preferred stock. Under the terms of the agreement, Fannie Mae may now retain up to $3.0 billion in capital reserves. Once we are able to rebuild this capital cushion with future earnings, it will enable us to weather modest volatility in our quarterly results.

I would like to point out, however, that this does not constitute a comprehensive recapitalization event. While this will help us reduce the probability of requiring a Treasury draw in quarters where losses do not exceed the capital retained up to $3.0 billion, we recognize that by any reasonable standard, our company and the housing finance system it supports will require substantially more to be considered properly capitalized.

Looking at 2017 as a whole, I am very pleased with our progress. We paid $12.0 billion in dividends to Treasury in 2017, bringing our total dividends to taxpayers to $166.4 billion. This compares to the $119.8 billion in draws that we have received or expect to receive shortly. Our pre-tax income was $18.4 billion, very much in line with pretax income of $18.3 billion 2016. As we had consistently forecasted, we were profitable for the year. Our 2017 net income was $2.5 billion and our comprehensive income was $2.3 billion. Again, both of these reflect the effects of the recent tax bill.

More broadly, we are very proud of our 2017 business accomplishments. We continued to deliver innovative solutions to help our customers meet their biggest challenges. In our Single-Family business, we built on our Day 1 Certainty solutions. We’ve laid the groundwork for Single Source Validation, a solution that will allow lenders to validate borrower financial information with a single asset report, instead of two or three. This will cut time and cost out of the mortgage process for our customers and for their customers.

We are introducing an application program interface platform, also known as APIs, to make it easier for our customers to plug into our data and technology. We are cutting costs out of servicing mortgages and making life simpler for our servicers.

In our Multifamily business, we enhanced our delegations to our customers and achieved record volume as lenders and borrowers increasingly recognize the unique benefits of our Delegated Underwriting and Servicing model.

We strengthened our business model by continuing to grow our credit risk transfer program. Fannie Mae has transferred a portion of the mortgage credit risk on single-family mortgages with an unpaid principal balance of more than $1.2 trillion since 2013, measured at the time of the transactions. As a result, approximately 32 percent of the loans on the company’s single-family book were covered by a credit risk transfer transaction as of year-end.

And our revenue mix continued to change. Guaranty fees continued to drive a greater portion of our net interest income as the size of our mortgage investment portfolio declined.

Looking ahead, I’m excited about 2018. Our business fundamentals are strong and we expect to be profitable on an annual basis. We are in a very strong position to continue to deliver value to our customers with more innovations and tools to help them grow their business and serve more families. We will continue to focus on our customers and on building a stronger housing finance system for the future.

Now I’m happy to open it up for your questions.
Operator:
Thank you. At this time, if you are a reporter and would like to ask a question, please press star and then 1 on your telephone. All lines will be muted unless you are asking a question. One moment please. Joe Light, Bloomberg News, your line is open.

Joe Light:
Hi. Thanks for taking the question. I was wondering if you could talk a little bit about, I guess, how you telegraphed to investors and other partners, you know, this draw was coming, you know, whether they expressed any concerns as a result of the draw, or whether everybody kind of understood where it was coming from. And, I guess, whether there are any sorts of kind of potential fall-on effects or side effects from this happening that you haven’t talked about already. Thanks.

Tim Mayopoulos:
Thanks, Joe, for the question. I think as some folks in the media have already noted, we have been telegraphing for months that this draw was a possibility – both as a result of potential volatility in our business but also specifically with respect to the tax legislation. So I don’t think anyone is surprised by this event. I don’t think our investors, whether they are our stockholders or whether they are investors in our mortgage-backed securities or credit risk transfer transactions, are surprised by these events and I wouldn’t expect it to have any impact in the marketplace.

Joe Light:
Thanks.

Coordinator:
Brad Finkelstein, National Mortgage News, your line is open.

Brad Finkelstein:
Hi. Thanks, Tim. Is Fannie Mae facing any further credit risk from the hurricanes in September or the California wildfires?

Tim Mayopoulos:
Thanks for the question. As you know, we took a significant provision in the third quarter with respect to the hurricanes, and we made some further adjustments to that in the fourth quarter that were relatively modest. I can turn it over here to Dave Benson, our CFO, who can give you the details on it. But it’s obviously a matter that we will continue to monitor as more data comes in and we actually see what the experience has been in these disaster-affected areas. But Dave, do you want to share details around that?

David Benson:
Sure. The provision we took in the third quarter was obviously the best estimate we could make at the time with very limited information and doing the best we could. We have received data throughout the quarter and looked at that data in the affected areas with Puerto Rico being the one that we had the least amount of information on at the time at the end of the third quarter, there was just a very modest impact for the fourth quarter. It was actually an improvement by about $100 million from what we had estimated in the previous quarter. So it was really a very small adjustment to the better, based upon the performance of what we’ve seen in the hurricane-affected areas. You asked about the wildfires. That wasn’t a significant material event for us.
And what about for going forward? Based on past experience, you’re not expecting a lot of your loans to grow to foreclosure situations. But just in case, what is Fannie Mae looking at here?

**David Benson:**
Yes, so, just from an estimation process, we’ve estimated what we believe is what kind of occurrence we may see both in delinquencies and ultimately defaults and foreclosures. As the data comes in, we would continue to reassess the provision that we’ve put against that, and we would make adjustments based upon how that data comports with what our initial estimates were, and we would update that each quarter. So, the answer is, we do expect to have some amount of that activity and that’s embedded in that estimate that we have booked for, you know, third quarter and the fourth quarter of last year.

**Brad Finkelstein:**
Alright, thank you.

**Operator:**
Doug Sword, CQ, your line is open.

**Doug Sword:**
Yes, thanks for taking the question. With a negative net worth of $3.7 billion and an agreement to keep a $3.0 billion reserve, won’t your draw on Treasury be $6.7 billion?

**Tim Mayopoulos:**
No, let me have Dave walk you through the arithmetic.

**David Benson:**
Right. So, the way it works is that we have a $3.7 billion deficit and the way the agreement works is that the FHFA Director would request of Treasury to basically replenish that specific amount to the zero level. So once the $3.7 billion comes in, we would have a zero net worth. For us to be able to achieve any capital reserves, we would have to have retained earnings. And so the way that would work is that when we have retained earnings in future quarters, we would be able to accrue a retained capital balance up to $3.0 billion. Anything that we earn in excess of that amount would need to be paid as a dividend to Treasury.

**Doug Sword:**
OK. So you’ve been making about $3.0 billion a quarter the rest of the year, so you should replenish that probably in a quarter or a little?

**David Benson:**
It sounds like you’re making a forecast on earnings, which I’ll allow you to do. But the answer is if we were to make $3.0 billion in the first quarter of this year, then that would then become our capital reserve. If we were to make more than that, we would pay out the excess of $3.0 billion as a dividend. And if we were to make less than the $3.0 billion but we were able to make a positive number, we would get to retain the entire amount of those net earnings in the first quarter, and then we would then look to the second quarter to be able to, to the extent that we had positive earnings, be able to keep up to the amount that would take us to a total of $3.0 billion in aggregate.

**Doug Sword:**
Great. Thank you very much.

**David Benson:**
Sure.
Operator:
Andrew Ackerman, The Wall Street Journal, your line is open.

Andrew Ackerman:  
Yeah, I guess I was just wondering if you guys could kind of spell out for us accounting simpletons what a deferred tax asset is.

Tim Mayopoulos:  
Sure. Again, Dave is the greater expert on this so I’ll let him do it.

David Benson:  
OK. The simple way to think about this is that you have the tax rules that tell you how to calculate what your earnings are from a tax basis, and those rules differ from what generally accepted accounting principles, or GAAP, would have us put out, and those are the numbers – the GAAP numbers – are what you see in our filings. So the deferred tax asset really is a difference between what the tax books show and what the GAAP books would show. You generally would accumulate these types of assets when you basically had greater earnings that showed up in the tax world than what you actually saw in the GAAP world.

An example of where that would come out is when we were building large reserves when the credit crisis was going on earlier in the decade, those types of losses that were being shown in our GAAP books were not losses that were actually being shown in our tax books. So, our tax books actually showed us being more profitable and therefore the difference between those tax books and what you were seeing in the GAAP is reflected in those deferred tax assets. But that’s one example of how you get differences that way. There are many other more complicated components that go into that, but that’s a simple way of thinking about it.

Operator:  
I show no further questions.

Tim Mayopoulos:  
OK. Well, thank you all for signing on this morning. We appreciate your questions and we hope you have a good day. We’ll talk to you in another quarter. Thanks very much.

Operator:  
This concludes today’s conference call. Thank you for participating, you may disconnect at this time.