Statement of Melvin L. Watt
Director, Federal Housing Finance Agency

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"Oversight of the Federal Housing Finance Agency's Role as Conservator and Regulator of the Government Sponsored Enterprises"

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Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for inviting me to testify before the House Financial Services Committee today.

Since I last testified before this Committee, Fannie Mae and Freddie Mac (the Enterprises) have marked their 10th anniversary under the conservatorship of the Federal Housing Finance Agency (FHFA). This has been a conservatorship of unprecedented scope, duration and complexity. FHFA has worked to appropriately manage and oversee the Enterprises under these unprecedented circumstances, and FHFA's efforts, along with those of the Enterprises' boards of directors, managements and employees, have yielded substantial improvements to the U.S. housing finance system and reforms to Fannie Mae and Freddie Mac as well as significant dividends to U.S taxpayers. I can assure you that these Enterprises are significantly different today than they were ten years ago.

I want to take this opportunity to thank Tim Mayopoulos, CEO of Fannie Mae, and Don Layton, CEO of Freddie Mac, for their leadership of each company during this protracted period of conservatorship and through this period of change and uncertainty. As has been recently announced, Tim will be stepping down as CEO later this year and Don will do the same in the second half of 2019. Both Tim and Don have served with distinction in their current roles and their vision and leadership have been invaluable. I have worked with Tim and Don, and with their boards, to ensure that there is a comprehensive and successful process in place for selecting new leadership at each Enterprise, and I am confident that the existing boards and senior leadership teams are well positioned to manage the transition leading to and following Don and Tim's exit.

While FHFA has made good decisions, both as their conservator and as their regulator, about how to manage the Enterprises in their present state, it is still the case that it remains absolutely essential for Congress and the Administration to enact housing finance reform legislation. As I said during my nomination process in 2013, and as I have come to understand and repeated even more vigorously throughout my tenure as Director, conservatorship is not sustainable. The fact

that conservatorship has yielded substantial reforms and progress in the way the Enterprises operate does not diminish or lessen the importance of completing housing finance reform.

Earlier this year, after repeated requests from members of Congress, I forwarded to the Chairs and Ranking Members of both the Senate Banking Committee and the House Financial Services Committee a document entitled "Federal Housing Finance Agency Perspectives on Housing Finance Reform" (the Perspectives Document). As I indicated in our Perspectives Document, we consider the perspectives expressed to be "responsible, balanced, viable and important to consider" and I am happy to answer any questions members of the Committee may have about them. However, after leaving Congress to become Director of FHFA, I have never viewed my role as expressing opinions on or trying to exert influence over what role, if any, the Enterprises will play in the housing finance system after conservatorship. So I think it is extremely important for me to plainly and unequivocally reiterate my view that it is the responsibility of Congress, not FHFA, to decide on housing finance reform. I hope you will do so as expeditiously as possible.

In discussing FHFA's work to manage the Enterprises while they are in conservatorship, I believe it is helpful to revisit the first public remarks I made as Director at the Brookings Institution in May 2014 in which I explained my approach this way:

> In making decisions about the future strategic direction of the Enterprise conservatorships, the principle we are following is how best to fulfill our obligations under current law. This means, first and foremost, that we must ensure that Fannie Mae and Freddie Mac operate in a safe and sound manner. It means that we'll work to preserve and conserve Fannie Mae and Freddie Mac's assets. And it means that we'll work to ensure a liquid and efficient national housing finance market. Our job at FHFA is to balance these obligations, and that's a message I'll come back to throughout my remarks.
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> Another way of stating the principle that will be guiding us is that FHFA is focused on how we manage the present – the present conservatorships of the Enterprises and the present housing finance market under the present statutory mandates.

In my time leading FHFA, everything has tied back to this bedrock principle of following the statutory mandates that Congress enacted and managing the Enterprises in the present.

These statutory obligations motivated the concern I shared in my testimony last October that the capital buffers for the Enterprises were scheduled to reduce to zero as of January 1, 2018. I

expressed my concern that zero capital buffers would almost certainly lead the Enterprises to have to make additional draws of taxpayer support that could potentially result in negative consequences for liquidity and market stability. As you are aware, since that testimony the Secretary of the Treasury and I were able to address those concerns by reinstating a $3 billion capital reserve buffer for each Enterprise through a letter agreement that modified the terms of the Senior Preferred Stock Purchase Agreements (PSPAs). While both Enterprises were required to make small draws of taxpayer support in the last quarter of 2017 as a result of revaluations of their deferred tax assets following the passage of the tax legislation last year, I am confident that the modest buffer adjustments agreed to with Secretary Mnuchin will avert the need for the Enterprises to make additional draws of taxpayer support in the future in the absence of some extreme or exigent circumstances.

Our statutory obligations also drove the goals included as part of our 2014 Conservatorship Strategic Plan. These strategic goals were expressed in three words: MAINTAIN. REDUCE. BUILD. I would like to take this opportunity to discuss how FHFA's activities during my tenure as Director have aligned with these strategic goals.

Reducing Fannie Mae and Freddie Mac's Risk Exposure

I'm going to go a little out of order and will begin my discussion with our REDUCE strategic goal, which has focused on de-risking the Enterprises. I want to start here because the ways the Enterprises have reduced their risk exposure during conservatorship have produced significant changes to their business models. It's also a good way to start this discussion because it's so central to how we as an Agency think about balancing our objectives of safety and soundness, on the one hand, with ensuring housing finance market liquidity, on the other hand.

In my Brookings remarks in May 2014, I described the philosophy of the REDUCE strategic objective in this way:

> We have reformulated this goal so that it no longer involves specific steps to contract the Enterprises' market presence, which could have an adverse impact on liquidity. Instead, the REDUCE goal focuses on ways to scale back Fannie Mae and Freddie Mac's overall risk exposure. This approach allows us to meet our mandates of upholding safety and soundness and ensuring broad market liquidity.

This is absolutely how we have proceeded in our activities across the board to reduce the Enterprises' risk. We've done this primarily by reducing their retained portfolios, maturing their credit risk transfer (CRT) programs, and finding ways to reduce their counterparty risk. In

addition to these efforts, which I discuss more below, I should also note that the Enterprises' guarantee fees have increased two and a half times since 2009, are now set at appropriate levels, and we review them regularly.

The Enterprises have dramatically reduced the size of their retained portfolios as they are required to do under the PSPAs with the Treasury Department. The retained portfolios have reduced in size by over 70 percent since 2009, and the Enterprises are both now below the $250 billion requirement under the PSPAs. This reflects a core reform of the Enterprises' business models during conservatorship, and each Enterprise now earns more income from its core guarantee business than it does from its retained portfolio. The Enterprises' portfolios are no longer used for arbitrage purposes, which introduced significant risk to the Enterprises. Instead, the Enterprises now use their retained portfolios primarily to support their core business operations, including aggregating loans from small lenders to facilitate securitizations through their cash window operations and holding delinquent loans in portfolio so investors can be made whole while also helping servicers facilitate loan modifications that minimize Enterprise losses and help borrowers stay in their homes whenever possible.

Another critically important step taken to reduce the risk exposure of the Enterprises has been the development of their credit risk transfer programs. Under FHFA's direction, the Enterprises first started conducting CRT transactions for single-family mortgages in 2013. In developing these programs, the Enterprises leveraged existing business practices to transfer credit risk on multifamily mortgages, Fannie Mae by using the Delegated Underwriting and Servicing (DUS) to share credit risk with lenders and Freddie Mac using the K-deal capital markets structure to transfer credit risk to investors.

In the last four-plus years, the Enterprises' single-family CRT programs have grown dramatically. In this time, the CRT programs have evolved from pilot transactions to becoming a core part of the Enterprises' day-to-day business operations. In 2013, the Enterprises transferred a portion of credit risk on $90 billion of single-family mortgages with a risk in force of $2.2 billion. In 2017, that increased to transferring a portion of credit risk on $689 billion of single-family mortgages with a risk in force of $20.6 billion. Through the end of June of 2018, there had already been CRT transactions on over $350 billion. A portion of credit risk has been transferred on more than $2.47 trillion of UPB since the credit risk program was started in 2013. The Enterprises now transfer a meaningful portion of credit risk to private sector investors on at least 90 percent of their targeted, fixed-rate, single-family mortgage acquisitions. Any assertion that private sector investors are not significantly involved in housing finance today and in taking risk ahead of taxpayers is a completely inaccurate assertion.

In developing the Enterprises' CRT programs, FHFA has worked with Fannie Mae and Freddie Mac to build and expand a diverse investor base that increases the likelihood of having a stable

CRT market through different housing and economic cycles. With this focus in mind, the Enterprises have developed a suite of different CRT products, including debt or note issuances, lender risk-sharing transactions, reinsurance products, senior-subordinate transactions, and front-end transactions. These transactions complement one another as well as the Enterprises' additional credit enhancement requirements.

One recent enhancement will come from the Enterprises' development of a new structure for their Structured Agency Credit Risk (STACR) and Connecticut Avenue Securities (CAS) products. Originally structured as debt issued by the Enterprises, the new STACR and CAS structure will use notes issued by a bankruptcy-remote trust that qualifies as a real estate mortgage investment conduit (REMIC). CRT transactions under this new structure will eliminate the timing mismatch of the CRT coverage between the accounting recognition of credit losses and the accounting recognition of the benefit to the Enterprises. This is expected to increase Real Estate Investment Trust (REIT) participation in CRT transactions because the new structure will satisfy the asset and income tests for REIT investments.

FHFA has also used a number of methods to reduce counterparty risks faced by the Enterprises. We increased the eligibility requirements for private mortgage insurers who do business with the Enterprises by establishing Private Mortgage Insurance Eligibility Requirements (PMIERs 1.0). This required private mortgage insurers to have adequate resources to pay claims, even in adverse economic circumstances. We will soon be announcing updates to these requirements, called PMIERS 2.0. In a related effort to reduce counterparty risk, several years ago we also established financial requirements – net worth, liquidity, and capital standards – for non-bank Seller/Servicer counterparties.

With this same objective of reducing risk to the Enterprises by managing counterparty risk, we have also approved Enterprise pilots that allow Freddie Mac and Fannie Mae to select counterparties to provide mortgage insurance coverage for a subset of loans. Freddie Mac's initiative – Integrated Mortgage Insurance or IMAGIN – is a 12-month pilot limited to $6 billion in mortgage unpaid principal balance (UPB). Fannie Mae's initiative – Enterprise-Paid Mortgage Insurance (EPMI) – is also for a 12-month period and is limited to $8 billion in mortgage UPB. The respective pilots provide each Enterprise with a way to manage their counterparty risk while also experimenting with a mortgage insurance execution that benefits lenders and the Enterprises and has good potential for providing cost savings to borrowers. These pilots were fully reviewed by FHFA prior to being approved for pilot implementation, and they are fully consistent with the Enterprises' statutory requirements to obtain credit enhancement on mortgages with loan to value ratios of greater than eighty percent. *See* 12 USC 1717(b)(2), 12 USC 1454(a)(2).

These pilots, of course, will not supplant or replace traditional mortgage insurance provided through lenders and would remain a small percentage of total mortgage insurance provided. However, it is important that the Enterprises take prudent and responsible measures to explore ways to manage their counterparty risk with large business partners, especially where history has demonstrated that these counterparties have not been able to perform their contractual obligations fully in adverse economic times.

FHFA will continue to engage in significant industry and stakeholder outreach as we evaluate these pilots to ensure that the Enterprises have a range of tools at their disposal to address counterparty risk and to increase liquidity in the housing finance market. The Enterprises are working with lenders from a cross-section of the industry as part of these pilots, and FHFA will seek feedback from these and other lenders. As is the case for FHFA requirements for Enterprise guarantee fees, the mortgage insurance fees charged to lenders as part of these pilots do not involve volume discounts and the pilots provide a level playing field to lenders of all sizes. Additionally, FHFA and the Enterprises will continue to engage in significant dialogue with mortgage insurers as we evaluate these pilots. More information about the IMAGIN and EPMI pilots, including more details about their structure, are available on the Enterprises' respective websites.

Another recent step to manage counterparty risk is Freddie Mac's mortgage servicing rights (MSR) financing pilot. This program focuses solely on the servicing rights of single-family loans guaranteed by Freddie Mac. In recent years, an increasing number of Enterprise-guaranteed mortgages are being serviced by non-bank lenders. This raises a unique set of counterparty risks, as non-bank servicers do not have access to the same kind of widely-available, stable and low-cost funding as is the case for bank-affiliated servicers. This relative difficulty in obtaining funding can pose a significant risk to non-bank servicers that already face a number of significant risks, including interest rate risks in changing rate environments and default risks because they are required to continue to make principal and interest payments to investors on behalf of an Enterprise on loans that have become delinquent until the Enterprise purchases the loan out of the security after 120 days of delinquency. Not having access to adequate funding to meet these obligations could pose substantial risk to the Enterprises and to taxpayers and this provides a compelling basis for a pilot program carefully crafted to address this risk. Freddie Mac's pilot program seeks to stabilize its non-bank counterparties that service Freddie Mac-guaranteed loans. The pilot is approved for $1 billion of MSR financing to Freddie Mac non-bank counterparties who service loans guaranteed by Freddie Mac. FHFA and Freddie Mac will review the performance of this pilot before making any determination on whether to continue this funding or allow it to expand.

FHFA views the use of pilots as a sound approach to test new approaches to manage risks and address challenges faced by the Enterprises. Enterprise and FHFA staff do ongoing reviews

during the duration of a pilot followed by an after-action review after the pilot is completed. These reviews determine whether the pilot should be terminated or proposed for broader rollout. If a pilot is approved to be implemented after the evaluation is completed, participation is expected to be offered by the Enterprise to eligible market participants who were not involved in the pilot as soon as practicable.

Moving forward, we are working to put standards in place about the information the Enterprises will provide on new pilot initiatives, including the time or volume limitations of pilots. We are committed to providing transparency to the public and industry stakeholders, but must do so in a way that does not unduly disclose confidential and proprietary information.

Maintaining Housing Finance Market Liquidity and Access to Credit

The next strategic objective I will address is the MAINTAIN objective. As we have worked to responsibly de-risk the Enterprises in ways that I have described above and in other ways, we have also worked to responsibly support liquidity in the housing finance market. FHFA and the Enterprises began this effort by undertaking a multi-year process to revise and enhance the Representations and Warranties Framework. Our goal here was to reduce uncertainty in the lender community and, by doing so, to support access to credit throughout the Enterprises' existing credit boxes by making the representations and warranties process a more streamlined and upfront process.

We've also tried to tackle the fact that a subset of borrowers did not have enough savings for a large down payment and closing costs even though they had the ability to repay a loan. We allowed the Enterprises to launch a 3 percent down payment program for these potential borrowers if they can demonstrate the ability to repay a loan through compensating factors other than the amount of down payment they were able to make. Between 2015 and July 2018, the Enterprises have purchased more than 300,000 mortgages with a three percent down payment. The average loan amount has been about $189,000, about 90 percent of these borrowers are first-time homebuyers, and the weighted average credit score for these loans is 738. The Enterprises manage the credit risk of these loans by carefully considering compensating factors that have proven to be reliable indicators of ability to repay. FHFA and the Enterprises regularly monitor performance on these loans to ensure that they perform within appropriate risk tolerances and the current serious delinquency rate on these loans (90 days or more delinquent) is less than one half of one percent (approximately 0.40 percent).

To seek other ways that we can responsibly increase access to credit, we have also asked the Enterprises as part of our annual Conservatorship Scorecard process to conduct research and evaluate other ideas to test and implement in the marketplace with lenders and borrowers. As we

all know, there is not one solution that will successfully and responsibly address access to credit challenges. Instead, we've tried to systematically consider and evaluate the effectiveness and safety and soundness of multiple options. Using this approach, the Enterprises have made changes involving student loan debt, debt-to-income ratios, and the use of their automated underwriting systems to review applications for borrowers without a credit score. They have also pursued targeted pilots with lenders and other third-parties. For example, Fannie Mae is conducting two different Airbnb pilots. One is a 15-month pilot limited to one lender in Seattle for up to 50 loans where the lender will assist the borrower with a down payment based on the new homeowner's ability to rent out a room under Airbnb. This pilot is limited to individuals who purchase a home as a primary residence. The second pilot with select lenders runs through the end of 2018 and allows a borrower looking to refinance a mortgage on a primary residence to count eligible Airbnb rental payments as a part of income on the loan application. These pilots provide an opportunity to assess whether the approaches are valid ways to responsibly support access to credit.

FHFA and the Enterprises regularly assess these efforts and make further adjustments where appropriate. Additionally, for targeted loans included in CRT transactions, the Enterprises are able to not only reduce their credit risk, but also benefit from the assessment of underlying credit risk and pricing from private market investors.

Of course, one of our most significant efforts to ensure liquidity in the housing finance market has been implementing the Enterprises' statutory duty to serve requirements to serve three underserved markets: manufactured housing, affordable housing preservation, and rural housing. These obligations not only cover affordable homeownership, but also affordable rental housing in the designated markets. After a multi-year process of FHFA's work to finalize our regulation and evaluation guidance and the Enterprises' efforts to develop three-year Underserved Markets Plans, the Enterprises are now approaching completion of their first year of performance under those plans. Throughout this process, we have prioritized obtaining feedback from stakeholders about how Fannie Mae and Freddie Mac can responsibly serve these three markets, and we will continue that approach. Next year FHFA will have its first opportunity to complete an evaluation of the Enterprises' duty to serve performance, and we have continued to establish the processes necessary to complete that statutory responsibility.

We have also laid the groundwork for greater outreach to borrowers with Limited English Proficiency (LEP), a growing segment of the market, to reduce the language barrier to access to credit for homeownership. Over the past year, FHFA, Fannie Mae, and Freddie Mac have engaged in a collaborative process with lenders, servicers, housing counselors, other mortgage market participants, and other government agencies to develop a Mortgage Translations Clearinghouse that FHFA will launch next month. In its first year, we expect that the Clearinghouse will include a Spanish-English glossary developed by the Consumer Financial

Protection Bureau in collaboration with FHFA and the Enterprises of more than 1,500 mortgage-related terms, as well as a library of documents and educational materials in Spanish that are intended to serve as a resource for the industry and others who work with LEP mortgage applicants and homeowners. In subsequent years, materials in additional languages will be added.

We expect this effort to lay the groundwork for improving assistance to LEP borrowers to enable them to better understand their housing finance transactions and documents and to lower the language barrier to access to credit.

Our work to maintain liquidity in the housing market has also included refining the Enterprises' loss mitigation programs and neighborhood stabilization initiatives. While loss mitigation, fortunately, is no longer as widespread a need as it was ten years ago during the financial crisis, we remain focused on how to improve these efforts going forward. Lenders as well as the Enterprises learned valuable lessons about the benefits of loss mitigation programs during the crisis and all housing market participants have worked together to take advantage of those lessons. Over the last several years, FHFA and the Enterprises have comprehensively assessed the lessons learned and applied those lessons in close consultation with lenders and other housing market participants to improve the Enterprises' loss mitigation toolkit. These enhancements have included the introduction of foreclosure alternatives such as the Flex Modification, updating short-term hardship standards, and releasing a new Mortgage Assistance Application. This work has positioned the Enterprises and the industry to be better able to anticipate and try to deal with the prospect that borrowers will default before the default occurs as a means of mitigating losses and helping more borrowers deal with adversities that can result in default.

We have also implemented lessons learned on how best to help borrowers impacted by natural disasters through strategies that also help mitigate losses to the Enterprises, and therefore to taxpayers. Following Hurricane Sandy in 2012, FHFA and the Enterprises developed a toolkit of strategies to help homeowners who live or work in areas declared a major disaster area. This includes forbearance options, targeted modifications, moratoriums on foreclosure sales and evictions, and a suspension on late fees and negative credit bureau reporting for designated periods of time. Following Hurricanes Harvey, Irma, and Maria last year, FHFA and the Enterprises put in place temporary measures that continue to be available to eligible individuals impacted during the 2018 hurricane season, including Hurricane Florence. These include an additional modification option called the Extend Modification for Disaster Relief and streamlined policies for servicers to disburse insurance proceeds to certain borrowers impacted by a natural disaster. Following last year's hurricanes the Enterprises also permanently put in place representation and warranty relief standards for impacted loans when borrowers re-perform on their loan following a natural disaster. FHFA and the Enterprises will begin evaluating the

temporary measures later this year to determine whether they should be made part of the Enterprises' standard toolkit or whether they should sunset.

In addition to evaluating and establishing the policies behind our disaster-relief strategies, FHFA and the Enterprises have also worked to standardize the practices and procedures of communicating with other government agencies, lenders, servicers, and other stakeholders in such situations. We are continuing to refine these protocols in coordination with Fannie Mae and Freddie Mac.

On the multifamily side, we continue to grapple with the persistent gap between household incomes and the cost of rental housing. As the Joint Center on Housing Studies at Harvard University has documented, millions of low- and moderate-income households continue to pay over 30 percent or even 50 percent of their incomes toward rent. These disproportionate rent payments have a significant impact on households, including their ability to build wealth. Households are not able to build savings or equity with rent payments, as is the case with homeownership. Like the rise in student loan debt, high rent payments also diminish the ability of families to save toward a down payment.

Our approach to managing Enterprise multifamily loan purchases has been twofold. First, we set an annual volume cap so the Enterprises can play their historical roles in the overall multifamily market without crowding out private sector market participants. We then exempt certain categories of multifamily loan purchases that support affordable rental housing, underserved markets, or both because private sector market participants have shown limited interest in being robust participants in this part of the market without Enterprise participation. The exempted categories include loans on affordable units in expensive housing markets, manufactured housing community rental blanket loans, and loans that finance energy or water efficiency improvements. In these exempted categories, the volume of Enterprise loan purchases are unrestricted, and FHFA continues to refine the definitions for these excluded categories each year.

The multifamily market has been robust in recent years with a significant increase in the production of rental units, but much of this has been at the high end of the market. Making new construction units affordable to moderate or low-income families very often requires a patchwork of subsidies, but this funding has not kept pace with the demand and need in many markets. To address this market reality, FHFA and the Enterprises have taken several steps to make a difference in the market where possible, although significant challenges remain in the affordable rental market. Enterprise efforts include developing approaches to maintain and preserve naturally occurring affordable housing, which involves buildings affordable to lower-income households without the use of subsidies and are often found in smaller or older rental buildings.

Another strategy has been the Enterprises' modest re-entry into the low-income housing tax credits (LIHTC) market as equity investors. FHFA announced this decision in November 2017 and limited each Enterprise to an annual investment limit of $500 million. Any investments above $300 million in a given year and up to the full cap of $500 million must be in areas that FHFA has defined as having difficulty in attracting investors. This strikes an appropriate balance that enables the Enterprises to effectively re-enter this market while targeting their efforts in areas with greater need for LIHTC investors. In addition to these and other efforts, FHFA will continue to assess opportunities to work with the Enterprises and with the private sector to responsibly address the limited availability of affordable rental housing and the need to preserve housing units that are already affordable to low- and moderate-income households.

One strategy we recently decided not to continue to allow the Enterprises to continue to pursue after we evaluated several test-and-learn pilots is providing financing to institutional single-family rental investors. After careful analysis, FHFA concluded that sufficient liquidity existed in the single-family rental market for these larger investors without Enterprise participation. The Enterprises will, however, continue to participate in the single-family rental market through their longstanding investor programs that are limited to six properties per investor for Freddie Mac and ten properties for Fannie Mae.

In making this decision, FHFA recognized the potential need for long-term financing for mid-size investors that own affordable single-family rental assets, but FHFA also believes it is premature to allow the Enterprises to provide financing for this portion of the single-family rental market without additional research and evaluation.

Across all of our efforts to support access to credit, loss mitigation, and affordable rental housing, FHFA continues to balance its statutory responsibilities to ensure that the Enterprises operate in a safe and sound manner while also ensuring that the Enterprises support liquid, efficient, competitive, and resilient national housing finance markets. Our statutory mandates require us to balance those responsibilities on an ongoing basis.

Building New Infrastructure for Single-Family Securitizations

The last strategic objective FHFA has pursued is the BUILD objective, under which the Enterprises are building a new securitization infrastructure for the Enterprises that will be usable for private market participants in the future. The projects included as part of this objective have garnered widespread support across the industry: (1) build a common securitization platform (CSP); (2) launch a single security now referred to as the Uniform Mortgage Backed Security or UMBS; and (3) update and standardize mortgage data across the industry. Each of these objectives require meticulous attention to detail and preparation in order to ensure successful

implementation. FHFA and the Enterprises have been engaged in a methodical, multi-year plan to bring each of these complex efforts to fruition.

We have built the CSP and Freddie Mac has been processing all of its single-family, fixed-rate securitizations on the CSP since November 2016. We continue to refine the CSP as both Freddie Mac and Fannie Mae do rigorous and methodical testing of the securitization architecture in preparation to fully launch the UMBS on our announced launch date of June 3, 2019. We are on track, and I am confident that this launch date will be met. We have developed new disclosures for the UMBS to ensure a smooth transition to the UMBS and our steps to update and standardize mortgage data across the industry will continue before and after the UMBS launch date.

To further ensure liquidity in the housing finance market, FHFA issued a proposed rule earlier this month to require the Enterprises to maintain policies that promote aligned investor cash flows on the UMBS. The comment period on this proposed rule ends on November 16, 2018, and we are encouraging the public to review the proposed rule and submit their comments. Prior to issuing the proposed rule, FHFA released its first prepayment monitoring report in May of this year, and the Agency will continue to produce these reports on a quarterly basis.

Throughout this entire process, the Enterprises have worked with the industry to provide transparency about the initiatives, gather feedback, and help market participants prepare for implementation of the UMBS. FHFA and the Enterprises will continue to assist market participants to prepare for the June 3, 2019 UMBS launch.

FHFA has also continued its efforts to update and standardize mortgage data through the Uniform Mortgage Data Program (UMDP) to improve lender efficiency, loan quality, and mortgage credit risk management. The Enterprises have continued to work on implementing the Uniform Closing Disclosure Dataset and the Uniform Residential Loan Application and related data fields. In addition, FHFA has worked with the Enterprises to assess and implement strategies to improve the mortgage industry's ability to originate and deliver eMortgages.

FHFA Approach to Oversight and Monitoring of the Enterprises

As conservator, FHFA uses four key approaches to managing the Enterprises. First, FHFA establishes the overall strategic direction for the Enterprises. Second, FHFA authorizes the Enterprises' boards of directors and senior management to oversee and carry out the day-to-day operations of the companies. Third, FHFA has carved out actions of the Enterprises that require advance approval by FHFA. Fourth, FHFA regularly oversees and monitors Enterprise activities.

Using the objectives set out in our 2014 Conservatorship Strategic Plan described above as guideposts, we set the Enterprises' strategic direction annually by issuing a public Scorecard against which the Enterprises will be measured. We track Enterprise progress against our scorecard objectives on a quarterly basis, rate their performance, and provide feedback. We meet with and have regular dialogue with Enterprise staff about specific projects, and the Enterprises prepare and send regular reports on specified topics.

Under the second and third approaches, the delineation of what items FHFA authorizes the boards and senior management of the Enterprises to oversee and what items are reserved for FHFA decision making is governed by extensive letters of instruction (LOIs), which have evolved over the ten year duration of conservatorship and were most recently updated in December 2017. Unless we were to exponentially increase the number of staff at FHFA, it would be impossible for FHFA to carry out all of the Enterprises' day-to-day operations. As a result, our approach to conservatorship has allowed for the efficient operations of the companies while also reserving FHFA's ability to make important policy decisions on behalf of the Enterprises.

FHFA approaches our monitoring of the Enterprises in conservatorship, the fourth approach described above, in a number of ways. As conservator, I personally attend executive sessions of Enterprise board meetings and engage regularly (by telephone and regular in-person meetings) with the CEO at each company. FHFA reviews and approves each Enterprises' budget on an annual basis, and FHFA staff attends and reports on senior management meetings at each Enterprise. This is all in addition to almost constant dialogue and meetings with Enterprise staff about projects, policies, and Enterprise operations.

As I explained in remarks at the Bipartisan Policy Center in 2016, during the last ten years FHFA has had to fulfill the "dual responsibilities" of serving as both supervisor and conservator of the Enterprises. On the supervision side, we have enhanced our supervisory program under the expanded authorities granted to the Agency in the Housing and Economic Recovery Act of 2008. We have supervision staff both at FHFA headquarters and onsite at each Enterprise. We conduct examinations based on risk assessments with the objective of focusing on areas of highest risk to the Enterprises. We issue "matters requiring attention" on areas of supervisory concern, review remediation plans, and oversee Enterprise efforts to implement these improvements. Our supervisory work culminates in an annual report of examination in which we assess each Enterprise on capital, asset quality, management, earnings, liquidity, sensitivity to market risk, and operational risk (the CAMELSO rating system).

To carry out our statutory mandate to further diversity and inclusion in all aspects of the Enterprises business, FHFA has also established a diversity and inclusion supervisory program.

These examinations assess the progress Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBanks) are making to implement their diversity and inclusion strategic plans. To conduct these diversity and inclusion examinations, we built a team of examiners with experience in examining financial institutions, developed a diversity and inclusion examination module (the first of its kind), and completed a baseline review of each regulated entity's diversity and inclusion plans and the infrastructure for implementing the plans. Our OMWI examination teams completed examinations in 2017 at Fannie Mae and Freddie Mac as well as at all eleven FHLBanks and the Office of Finance, and are about to start the fourth quarter of our 2018 examinations for the regulated entities.

The dual responsibilities of supervision and conservatorship provide FHFA with an unprecedented level of control over and insight into the Enterprises' policies and day-to-day operations. FHFA staff have expertly carried out our responsibilities over a period of significant change. I want to recognize and thank FHFA staff for their significant work to blunt the effects of the financial crisis and to carry out the conservatorships of Fannie Mae and Freddie Mac.

Although the invitation letter for this hearing focused solely on the Enterprises, I must also take this opportunity to mention and recognize the work of FHFA staff who oversee the safety and soundness and mission advancement of the Federal Home Loan Banks. The FHLBanks, which are not in conservatorship, also play an important role in the housing finance system, and our staff have expertly carried out our supervisory responsibilities to oversee these companies

Ongoing Challenges in Overseeing Fannie Mae and Freddie Mac

As I did in my last testimony before the Senate Banking Committee, I believe I would remiss if I did not close my comments by also discussing some of the challenges that I believe lie ahead.

As I discussed above, a central challenge that is inherent to the state of conservatorship is uncertainty about the future. I have had to grapple with this uncertainty during my tenure as Director, and I am sure that the next Director of FHFA will have to do so for as long as the Enterprises remain in conservatorship. FHFA's experience as conservator confirms that it is extremely difficult to manage the Enterprises in the present without establishing some kind of plans for the future. I doubt that I can express this concern any more coherently than I did in my speech at the Bipartisan Policy Center back in 2016, where I expressed it this way:

> Here, I'm not talking about plans for housing finance reform, but plans for everyday operations, including strategic planning that every well-run business does, and project planning that's necessary to continue key initiatives. Without looking somewhat down the road, FHFA and the

> Enterprises would both lose their momentum and jeopardize day-to-day success. The key dilemma when you have an uncertain future, however, is how far down the road to look and how to retain the necessary talent to implement either short-term or longer-term plans.

This uncertainty about the future manifests itself in different ways. It will certainly be an important factor as each Enterprise searches for a new CEO and replaces a number of board members who joined the boards at or shortly after conservatorship started and have 10-year terms that will expire in the near future. The tension between managing the present and needing to plan for the future also makes certain decisions ideal for second guessing. Examples of this are FHFA's decisions to approve Fannie Mae's sale of office buildings and to relocate their staff to consolidated rental space. Without going into detail about the many factors considered over the last several years in the process of making these decisions, I'm certain that it will be obvious to everyone that these decisions would have been much easier to make had we been sure about Fannie Mae's future and had Fannie Mae not been in conservatorship. I should also note that while I have disagreed with our Inspector General about some issues, including decisions around Fannie Mae's workplace consolidations, we have agreed to and have either implemented or are working to implement in excess of 80 percent of the Inspector General's recommendations. Whether we agree or disagree, we do so respectfully and with a keen appreciation for the oversight that the FHFA Inspector General and her staff provide.

A second challenge that I have discussed at several points is how to ensure market discipline as the Enterprises remain operating in conservatorship. Because the Enterprises have been insulated while operating in conservatorship from normal market forces that would otherwise inform their operations and business decisions, FHFA has had the responsibility for creating its own regime for market discipline. One of the most important steps has been to require the Enterprises to use an aligned capital framework when evaluating business decisions even though they are not able to build capital beyond the limited buffer agreed to in the PSPAs.

Incorporating capital requirements into the analytics of day-to-day business is essential to making rational business decisions about when to conduct different transactions or pursue certain ideas. FHFA has worked with the Enterprises to develop a Conservatorship Capital Framework that establishes aligned capital guidelines for both Enterprises across different mortgage loan and asset categories. Both Enterprises now use this aligned framework to make their regular business decisions. FHFA also uses this framework in its role as conservator to assess Enterprise guarantee fees, activities, and operations and to ensure that the Enterprises do not make competitive decisions that could adversely impact safety and soundness.

To build on the work developing the Conservatorship Capital Framework, FHFA released a proposed regulation on capital requirements for Fannie Mae and Freddie Mac in June of this

year. This proposed rule has two components: a new framework for risk-based capital requirements and a revised minimum leverage capital requirement for the Enterprises. The proposed rule would replace the Office of Federal Housing Enterprise Oversight capital standards that were in place prior to conservatorship and that are now suspended while the Enterprises are in conservatorship. While FHFA would immediately suspend any final regulation on Enterprise capital requirements for as long as the Enterprises remain in conservatorship, we believe it is important for our Agency, as the prudential regulator for Fannie Mae and Freddie Mac, to start a healthy, robust and much-needed discussion about the amount of capital the Enterprises should have given the risks inherent in their businesses.

We also believe our proposed rule provides valuable transparency to the public about capital, and we look forward to receiving public input on our proposals. In response to requests for additional time, FHFA has extended the comment period from September 17, 2018 to November 16, 2018 to provide the public additional time to provide their feedback and input on this important rule. Public input on our proposed rule will also provide valuable feedback to FHFA about refinements that may be appropriate to our Conservatorship Capital Framework, which FHFA will continue to apply while the Enterprises remain in conservatorship.

As I have repeatedly emphasized, this rulemaking is not connected in any way to any efforts or ideas others may have about recapitalizing and releasing the Enterprises from conservatorship. Nor is it connected in any way to any ideas or proposals about housing finance reform.

A final challenge I want to mention is the limited supply of affordable single-family homes and affordable rental units that is simply not keeping up with demand in many areas and is exacerbating house prices and rental costs. There are a number of factors leading to this lack of supply. A significant part of this problem relates to the many challenges around preserving existing affordable housing. In addition, following the foreclosure crisis, single-family new construction has lagged behind historical norms. Subsidies for affordable rental housing have not matched the dramatic increase in the number of renters. New household formation is showing signs of increasing after many young people lived at home following the financial crisis, which will likely add to demand for affordable rental housing. Lower-density zoning is often at odds with high demand for housing in certain metropolitan areas. I mention this not because FHFA or I have all, or even most, solutions to address the complex problem, but to let you know that this is perhaps the most serious challenge that the industry and others must face in the housing arena.

Thank you for the opportunity to provide this written testimony.