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October 13, 2017

Via ECF

Gino J. Agnello
Clerk of Court
United States Court of Appeals for the Seventh Circuit
Everett McKinley Dirksen United States Courthouse
219 S. Dearborn Street
Room 2722
Chicago, IL 60604

Re: *Roberts v. Federal Housing Finance Agency*, No. 17-1880

Dear Mr. Agnello:

FHFA recently released a strategic plan that describes 12 U.S.C. § 4617(b)(2)(D) as a "statutory mandate[ ]" and says that "FHFA, acting as conservator . . . , must follow the mandates assigned to it by statute." FHFA Strategic Plan: Fiscal Years 2018-2022 at 4 (Sept. 27, 2017) (Exhibit A). In written remarks submitted to Congress, FHFA's Director recognized what the Net Worth Sweep means for his agency's pursuit of this mandate, describing the Companies' lack of capital as "especially irresponsible." Statement of Melvin L. Watt, Director, FHFA, at 7 (Oct. 3, 2017) (Exhibit B). These acknowledgements that as conservator FHFA is required to seek to preserve and conserve the Companies' assets and that the Companies' lack of capital is "especially irresponsible" directly contradict FHFA's litigating position. *See* FHFA Br. at 23-27 (Aug. 7, 2017).

FHFA's recent statements give content to the "best interests of . . . the Agency," which 12 U.S.C. § 4617(b)(2)(J) permits FHFA to consider. If FHFA's statutory mission is to restore the Companies to soundness and solvency, FHFA cannot advance its "best interests" by requiring the Companies to operate forever in

an inherently unsound manner. Action that is "irresponsible" for FHFA cannot be in its "best interests." The more expansive interpretation of Section 4617(b)(2)(J) advanced by FHFA in this case would render Section 4617(b)(2)(D) surplusage and contradict the "commonplace of statutory construction that the specific governs the general." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2071 (2012). As Judge Brown explained, the only way to give meaning to all of the statutory text is to recognize that Section 4617(b)(2)(D) "mark[s] the bounds of FHFA's conservator . . . powers." *Perry Capital LLC v. Mnuchin*, 864 F.3d 591, 638 (D.C. Cir. 2017) (Brown, J., dissenting). It is extremely significant that, even in the wake of the D.C. Circuit's decision, FHFA continues to make statements that recognize that Section 4617(b)(2)(D) is a "mandate[ ]" that "as conservator" the agency "must follow."

Respectfully submitted,

/s/ David H. Thompson
David H. Thompson

Counsel for Appellants

cc: Counsel of Record (by ECF)

CERTIFICATE OF SERVICE

I hereby certify that on October 13, 2017, an electronic PDF of this Rule 28(j) letter was uploaded to the Court's CM/ECF system, which will automatically generate and send by electronic mail a Notice of Docket Activity to all registered attorneys participating in the case. Such notice constitutes service on those registered attorneys.

/s/ David H. Thompson
David H. Thompson

EXHIBIT A

FHFA STRATEGIC PLAN: FISCAL YEARS 2018-2022

As released for public input on September 27, 2017

Office of Budget and Financial Management

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Mission

Ensure the regulated entities operate in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment.

Vision

A reliable, stable, and liquid housing finance system.

FHFA's Values

Respect We strive to act with respect for each other, share information and resources, work together in teams, and collaborate to solve problems.

Excellence We aspire to excel in every aspect of our work and to seek better ways to accomplish our mission and goals.

Integrity We are committed to the highest ethical and professional standards to inspire trust and confidence in our work.

Diversity We seek to promote diversity in our employment and business practices and those of our regulated entities.

About the Federal Housing Finance Agency

The Federal Housing Finance Agency (FHFA) was established by the Housing and Economic Recovery Act of 2008 (HERA) and is responsible for the effective supervision, regulation, and housing mission oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank System, which includes 11 Federal Home Loan Banks (Banks or FHLBanks) and the Office of Finance. The Agency's mission is to ensure that the regulated entities operate in a safe and sound manner so that they serve as a reliable source of liquidity and funding for housing finance and community investment. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac (together, the Enterprises).

FHFA's Regulatory Oversight of the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. As part of the Agency's statutory authority in overseeing the Federal Home Loan Bank System and the Enterprises, the Federal Housing Enterprises Financial Safety and Soundness Act (the Safety and Soundness Act), as amended by HERA, requires FHFA to fulfill the following duties:

"(A) to oversee the prudential operations of each regulated entity; and

"(B) to ensure that--

(i) each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls;

(ii) the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities);

(iii) each regulated entity complies with this chapter and the rules, regulations, guidelines, and orders issued under this chapter and the authorizing statutes;

(iv) each regulated entity carries out its statutory mission only through activities that are authorized under and consistent with this chapter and the authorizing statutes; and

(v) the activities of each regulated entity and the manner in which such regulated entity is operated are consistent with the public interest."

12 U.S.C. § 4513(a)(1).

FHFA's Role as Conservator of Fannie Mae and Freddie Mac. As part of HERA, Congress granted the Director of FHFA the discretionary authority to appoint FHFA as conservator or receiver of Fannie Mae, Freddie Mac, or any of the Federal Home Loan Banks, upon determining that specified criteria had been met. On September 6, 2008, FHFA exercised this authority and placed Fannie Mae and Freddie Mac into conservatorships. Since the Enterprises were placed into conservatorships, the U.S. Department of the Treasury (Treasury Department) has provided essential financial commitments of taxpayer funding under the Senior Preferred Stock Purchase Agreement (PSPAs). Fannie Mae and Freddie Mac have drawn a combined total of $187.5 billion in taxpayer support under the PSPAs to date. As of June 30, 2017, the Enterprises have paid the Treasury Department a total of $270.9 billion in dividends on senior preferred stock. Under the terms of the PSPAs, the Enterprises' dividend payments do not offset the amounts drawn from the Treasury Department. FHFA continues to oversee these conservatorships.

FHFA's authority as both conservator and regulator of the Enterprises is based upon statutory mandates, which include the following conservatorship authorities granted by HERA:

"(D) …take such action as may be--

(i) necessary to put the regulated entity in a sound and solvent condition; and

(ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."

12 U.S.C. § 4617(b)(2)(D).

Carrying on the business of the Enterprises in conservatorships also incorporates the above-referenced responsibilities that are enumerated in 12 U.S.C. § 4513(a)(1). Additionally, under the Emergency Economic Stabilization Act of 2008 (EESA), FHFA has a statutory responsibility in its capacity as conservator to "implement a plan that seeks to maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer, to take advantage of…available programs to minimize foreclosures." 12 U.S.C. § 5220(b)(1).

FHFA, acting as conservator and regulator, must follow the mandates assigned to it by statute and oversee the missions assigned to the Enterprises by their charters until such time as Congress revises those mandates and missions.

Strategic Goal 1: Ensure Safe and Sound Regulated Entities

I. Performance Goal 1.1: Assess the Safety and Soundness of Regulated Entity Operations

As regulator of the FHLBank System and as regulator and conservator of the Enterprises, FHFA promotes safe and sound operations at the regulated entities through the Agency's supervisory program. FHFA uses a risk-based approach to conducting supervisory examinations, which prioritizes examination activities based on the risk a given practice poses to a regulated entity's safe and sound operation or its compliance with applicable laws and regulations. FHFA will assess the safe and sound operations of the regulated entities through annual examinations, targeted examinations, ongoing monitoring, and off-site reviews, as appropriate. FHFA uses a uniform examination rating system to assign ratings for the FHLBanks, the Office of Finance, and the Enterprises. FHFA assigns two ratings:

1) Composite rating for the overall condition of each regulated entity; and
2) Individual component ratings for Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to Market Risk, and Operational Risk (CAMELSO).[1]

FHFA assigns these ratings for each regulated entity on an annual basis.

II. Performance Goal 1.2: Identify Risks to the Regulated Entities and Set Expectations for Strong Risk Management

FHFA's supervisory activities will identify existing and emerging risks to the regulated entities. FHFA develops risk assessments by collecting and analyzing information from various sources, including the regulated entities. FHFA coordinates with other supervisory agencies as needed.

[1] FHFA assigns only individual component ratings for Management and Operational Risk for the Office of Finance.

In order to articulate supervisory expectations for risk management across all risk types, FHFA publishes guidance for examiners and management at the regulated entities. This includes issuing advisory bulletins on specified topics. Additionally, FHFA includes supervisory guidelines in the Agency's Examination Manual, which FHFA revises as necessary. FHFA also issues additional examination instructions to address emerging issues and provide procedural updates.

III. Performance Goal 1.3: Require Timely Remediation of Risk Management Weaknesses

In order to assess both timeliness and effectiveness, FHFA evaluates the regulated entities' efforts to remediate identified weaknesses. Adverse examination findings and conclusions are carefully documented and communicated to the regulated entities. Where examination staff identify issues that should be addressed, FHFA uses three categories of examination findings: 1) Recommendations, 2) Matters Requiring Attention (MRAs), and 3) Violations.

Recommendations identify policies, procedures, or practices that could be improved. MRAs and Violations require the regulated entity to take remedial action. FHFA subsequently evaluates the actions taken in response to these supervisory communications through its ongoing supervisory work.

Strategic Goal 1—Means and Strategies

- **Conduct risk-based examination work in accordance with examination plans for each regulated entity, including ongoing monitoring, targeted examinations, periodic special and horizontal reviews, and annual examinations.** FHFA examiners use a risk-based approach designed to: 1) identify existing and potential risks that could adversely affect the regulated entity; 2) evaluate the effectiveness of each entity's risk management and internal controls; and 3) assess compliance with laws and regulations.

  FHFA develops examination plans for each regulated entity that provide risk-based on-site examinations. In addition to annual examinations, FHFA's supervisory engagement with the regulated entities may include ongoing monitoring and targeted examinations, as well as communication in various formats. FHFA examines risk management practices and the regulated entity's financial condition and safety and soundness relative to applicable laws, regulations, supervisory guidance, and prudent business practice.

  On-site examinations are a critical means of evaluating the effectiveness of risk management by the regulated entities.

- **Identify MRAs of the regulated entities and monitor remediation for both timeliness and efficacy.** FHFA will identify risk management deficiencies, control weaknesses, or other issues that could compromise safe and sound operations or affect compliance with laws, regulations, or Agency directives. Such deficiencies and weaknesses may result in FHFA issuing an adverse examination finding(s) in the form of a recommendation, violation, or MRA.

  FHFA communicates examination results to the regulated entities through the examination process. FHFA requires timely corrective action articulated in written remediation plans with timeframes that reflect the significance of an adverse finding(s).

  FHFA may pursue an enforcement action, in accordance with published policy on supervisory enforcement, when deficiencies are severe or the regulated entity does not remediate them.

- **Perform off-site analyses of key risk areas to strengthen supervision.** Off-site analyses of key risk areas complement on-site examinations by bringing cross-disciplinary resources that support FHFA's risk-based approach to supervision. Off-site analyses are based upon reviews of data reported by the regulated entities, published financial statements and reports, other available sources of data on housing finance trends, and market drivers of financial results, such as interest rates, rate spreads, and house prices.

  Off-site analyses address issues such as financial market conditions, the effect of changes in interest rates and house prices on the financial condition and risk exposure of the regulated entities, management of troubled real estate assets, and executive compensation. FHFA will continue ongoing off-site monitoring of financial trends and emerging risks of the regulated entities.

- **Monitor emerging risks, industry trends, supervisory standards, and macro-economic market conditions in order to inform risk assessments and adjust supervisory approaches when appropriate.** The regulated entities operate in markets that are subject to uncertainty, volatility, and changing processes and practices. In order to inform the Agency's assessment of risk, FHFA will review and analyze relevant data, monitor changing market conditions and developments, and continue to collaborate with other financial regulators, where appropriate.

- **Issue supervisory guidance, supervisory policies, and regulations in order to set standards and expectations for safe and sound operation of the regulated entities.** Taking into account examination findings and analysis of existing and emerging risks, FHFA will issue internal guidance to examiners in the form of Examination Manual modules and supplemental guidance. FHFA will issue external guidance to the regulated

entities in the form of advisory bulletins that set forth supervisory expectations in particular areas of risk management, internal controls, or compliance. FHFA will issue and revise guidance and regulations as necessary to ensure the regulated entities' policies and practices abide by safe and sound principles.

- **Continue to enhance training and development of examination staff.** FHFA will enhance examiner capability through the ongoing development and administration of examiner education and accreditation programs. FHFA will also continue to develop technical training on market developments, emerging risks, FHFA guidance, and sound industry practices and standards.

Strategic Goal 2: Ensure Liquidity, Stability, and Access in Housing Finance

I. Performance Goal 2.1: Ensure Liquidity in Mortgage Markets

For both the FHLBank System and the Enterprises, FHFA has the statutory obligation to "foster liquid, efficient, competitive, and resilient national housing finance markets" while ensuring that the regulated entities meet their fundamental safety and soundness obligations. FHFA's responsibilities for housing finance market liquidity and safety and soundness are inherently intertwined. FHFA will evaluate policies and take appropriate action to promote both goals.

Federal Home Loan Banks: The FHLBanks' core mission is to serve as a reliable source of liquidity for their member institutions in support of housing finance and community lending. As regulator of the FHLBank System under the Safety and Soundness Act and the Federal Home Loan Bank Act, FHFA will work to ensure that the FHLBanks continue to fulfill their statutory mission of providing liquidity to their members.

The Enterprises: As both regulator and conservator of the Enterprises, FHFA will require the Enterprises, where feasible, to: 1) take actions to improve liquidity in the single-family housing finance market; 2) continue to improve servicing standards and foreclosure prevention actions; and 3) maintain a critical ongoing role in the multifamily sector, particularly for affordable multifamily properties and underserved market segments.

II. Performance Goal 2.2: Promote Stability in the Nation's Housing Finance Markets

FHFA will focus on promoting stability in the housing finance market, both as regulator of the FHLBank System and regulator and conservator of the Enterprises. In support of this objective, FHFA will seek to provide clarity and certainty about the Agency's supervision and conservatorship expectations of the regulated entities. In addition to seeking feedback from the regulated entities, FHFA will seek public input from market participants and stakeholders on priority issues. FHFA will also provide notice, as appropriate, when significant policy decisions require market implementation. Additionally, FHFA expects the regulated entities to promote stability in the nation's housing finance markets by establishing transparent and well-reasoned policies and procedures.

As conservator of the Enterprises, FHFA will also promote stability by working to preserve and conserve the Enterprises' assets and business operations. Additionally, FHFA will encourage the Enterprises and the housing industry to adopt standards and practices that promote market and stakeholder confidence.

III. Performance Goal 2.3: Expand Access to Housing Finance for Qualified Financial Institutions of All Sizes, in All Geographic Locations, and for Qualified Borrowers

Having a liquid housing finance market throughout the country requires active participation by a wide range of lenders, including small lenders, lenders serving rural areas, and state and local Housing Finance Agencies. Additionally, a healthy housing market requires liquidity and access across different borrower market segments to provide homeownership opportunities to creditworthy borrowers, sensible and appropriate loss mitigation options when borrowers fall into economic distress, and affordable rental housing options. Even in liquid markets, and especially during times of market uncertainty, some qualified borrowers and financial institutions may face barriers and disruption in their access to financing. FHFA is committed to fair and equitable access to the regulated entities' financial services by qualified financial institutions and creditworthy eligible borrowers.

Strategic Goal 2—Means and Strategies

- **Promote actions by the Enterprises to maintain liquidity in the single-family secondary market for purchase money and refinance mortgages.** FHFA will continue to focus on meeting the goals of the conservatorships by maintaining Enterprise support for the housing finance market and mitigating losses to taxpayers. FHFA will promote ongoing liquidity in the marketplace for new mortgages and mortgage refinance activities and will continue the critical tasks of foreclosure prevention and loss mitigation.
- **Ensure the FHLBanks continue to provide advances in a safe and sound manner in support of member liquidity.** FHFA will examine FHLBanks' credit and collateral risk management practices and advance terms to ensure consistency with regulation and supervisory expectations.
- **Monitor access to mortgage credit.** FHFA analyzes trends in the availability of mortgage credit to both single-family and multifamily borrowers. FHFA will monitor access to mortgage credit using data reported by the regulated entities, data from third-party sources, and discussions with industry sources. FHFA's assessment of access to mortgage credit will inform potential policy initiatives.
- **Support multifamily housing needs with a focus on the affordable and underserved segments of the market.** The Enterprises play a significant role in supporting liquidity in the multifamily housing market. FHFA expects the Enterprises to maintain a multifamily liquidity presence in all geographic areas and through all market cycles, and to focus on the affordable segment of the market. FHFA may impose a production cap on the Enterprises' multifamily business as part of the annual conservatorship scorecard. To encourage purchases in underserved market segments, certain mission-related activities will not count toward the production cap. These mission-related activities include affordable rental housing, rural housing, buildings with between 5 and 50 units, seniors' housing, and property improvements that help realize energy and water savings.
- **Collaborate with other federal regulators to identify and address risk and other emerging issues.** FHFA works with other federal regulators through its participation on the Financial Stability Oversight Council, the Financial Stability Oversight Board, the Federal Housing Finance Oversight Board, and other interagency initiatives. FHFA will continue to collaborate with other regulators to: 1) identify and address foreign and domestic risks; 2) coordinate supervision efforts consistent with each agency's respective examination and supervision responsibilities; 3) complete interagency rulemaking; and, 4) pursue efforts that streamline and increase efficiency of regulatory activities.

- **Monitor housing markets and conduct independent studies and reports.** FHFA will continue to develop studies and reports that analyze various factors affecting access to housing finance for qualified borrowers and financial institutions. The information resulting from these reports and analyses will contribute to FHFA's ability to ensure liquidity, stability, and access in the housing finance markets. Additionally, FHFA will continue to develop monthly and quarterly house price indexes reflecting changes in house prices in each of the states and nine Census divisions.

- **Continue to promote home retention and loss mitigation programs.** Home retention initiatives, such as loan modification and refinancing programs, help reduce the number of defaults and foreclosures by allowing eligible borrowers to obtain more favorable rates or terms on their mortgages. Such initiatives reduce losses to the Enterprises and contribute to greater stability and liquidity in housing markets and neighborhoods. FHFA expects the Enterprises to continue their support for the Flex Modification (Flex Mod) program, the successor to the Home Affordable Modification Program (HAMP) and Standard and Streamlined Modifications. FHFA expects the Enterprises to also support related initiatives to review and update loss mitigation standards where appropriate.

- **Responsibly reduce the number of severely-aged delinquent loans and real estate owned (REO) properties with a priority on neighborhood stabilization.** FHFA will work with the Enterprises to continue their non-performing loan (NPL) sales of severely-aged delinquent loans, including through geographically targeted pools that are designed to enhance participation by non-profit entities. FHFA will also continue to work with the Enterprises to support the responsible disposition of REO properties in the most distressed communities through the Neighborhood Stabilization Initiative.

- **Promote policies and practices at the regulated entities to provide fair access to finance and financial services for all eligible financial institutions and qualified borrowers.** FHFA will work with the FHLBank System to ensure that FHLBank membership and advance policies enable fair access by eligible institutions. FHFA will also work with the Enterprises to address barriers for small lenders, lenders serving rural areas, and state and local Housing Finance Agencies.

  Consistent with the safety and soundness of the Enterprises, FHFA is committed to reducing barriers that restrict creditworthy borrowers' access to responsible lending. FHFA will continue to work with the Enterprises, lenders, and other stakeholders to provide greater clarity regarding both origination and servicing obligations. FHFA also expects the Enterprises to assess whether there are additional opportunities, including pilots and initiatives, to reach underserved creditworthy borrowers.

FHFA will work to promote and ensure diversity and inclusion of minorities and women in the business and activities of the Agency and the regulated entities. The Safety and Soundness Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act require FHFA, Fannie Mae, Freddie Mac, and the FHLBanks to promote diversity and inclusion of women and minorities in all business and activities. FHFA will continue to provide technical assistance to, and supervise and examine, the regulated entities' diversity and inclusion programs in the areas of supplier diversity, workforce and board diversity, and capital markets and financial transactions. FHFA's examination work will look at how the regulated entities are implementing programs to advance access and participation in their business and activities. FHFA will also continue to advance the Agency's own diversity and inclusion program in its business and activities.

- **Oversee the regulated entities' additional statutory requirements.** FHFA will meet its statutory responsibilities to issue regulations as needed defining the regulated entities' Housing Goals and Duty to Serve obligations for the Enterprises, and FHFA will annually monitor the Enterprises' Housing Goals and Duty to Serve performance. FHFA will also continue to monitor and examine the FHLBanks' activities annually under the Affordable Housing Program (AHP), Community Investment Program (CIP), Community Investment Cash Advance program (CICA), and FHLBank Housing Goals.

Strategic Goal 3: Manage the Enterprises' Ongoing Conservatorships

I. Performance Goal 3.1: Preserve and Conserve Assets

FHFA's authority as both conservator and regulator of the Enterprises is based upon statutory mandates to foster a liquid, efficient, competitive, and resilient national housing finance market; ensure safe and sound Enterprise operations; and preserve and conserve Enterprise assets. FHFA will oversee the conservatorships of the Enterprises in their current state and seek to ensure that the Enterprises' infrastructures meet the needs of their current credit guarantee businesses and other operations. FHFA will also maintain programs and strategies to support ongoing mortgage credit availability, assist homeowners facing hardships, and minimize taxpayer losses. While the Enterprises are in conservatorships, FHFA will strive to maintain core business operations, maintain executive management and board oversight, ensure timely replacement of departing executive officers and board members, and provide clear expectations to Enterprise boards and management.

FHFA will develop an annual Conservatorship Scorecard to guide Enterprise management in fulfilling FHFA's *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* and will establish performance metrics to measure how well the Enterprises are meeting their Scorecard goals.

II. Performance Goal 3.2: Reduce Taxpayer Risk from Enterprise Operations

FHFA is focused on introducing additional private capital into the housing finance system to lessen taxpayer risk by reducing Fannie Mae and Freddie Mac's overall risk exposure. FHFA's objective is to shift risk to private market participants and away from the Enterprises in a responsible way that does not reduce liquidity or adversely impact the availability of mortgage credit.

This priority includes having the Enterprises conduct credit risk transfers for their single-family credit guarantee business. These programs have become core parts of the Enterprises' business model. The transactions to date have attracted private capital to share in credit losses, and FHFA will work with the Enterprises to continue and enhance these programs.

FHFA is also overseeing ongoing and required reductions in the Enterprises' retained portfolios. The Senior Preferred Stock Purchase Agreements (PSPAs) with the Treasury Department require the Enterprises to reduce each of their portfolios to no more than $250 billion by 2018. FHFA is requiring that the Enterprises continue to prioritize selling their less liquid portfolio assets, implement plans to meet the PSPA 2018 portfolio reduction goals even under adverse market conditions and in a way that is consistent with neighborhood stabilization, and develop retained portfolio plans for post-2018.

Another risk-reduction priority involves overseeing appropriate Enterprise counterparty requirements. FHFA will continue to monitor these standards and make improvements where appropriate in a manner that is consistent with safety and soundness and access to credit considerations.

III. Performance Goal 3.3: Build, Implement, and Operate a New Single-Family Securitization Infrastructure and Implement the Single Security Initiative

Building a new infrastructure for the securitization functions of the Enterprises remains an important priority for FHFA. This includes ongoing work to develop the Common Securitization

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Platform (CSP) and to improve the liquidity of Enterprise securities. Additionally, FHFA continues work to build more accurate and uniform mortgage data standards used by both the Enterprises and other market participants.

Development and implementation of the CSP will focus on making the new shared system operational for existing Enterprise single-family securitization activities. Developing this shared infrastructure will require modifying the Enterprises' current securitization systems, software, and processes so that they can effectively integrate with the CSP. Targeting the CSP development to the Enterprises' current functions will allow FHFA and the Enterprises to manage the risk of this project appropriately. While FHFA will require the Enterprises to build the new infrastructure for use by both companies, FHFA will also require that the CSP be adaptable for use by additional market participants in the future. As a result, the Enterprises and CSP team will continue to focus on leveraging industry-standard interfaces, industry software, and industry data standards where possible.

In order to leverage CSP advantages fully, FHFA is also prioritizing ways to improve the overall liquidity of the Enterprises' securities. This includes implementing the Single Security Initiative, which entails the development of a common security known as the Uniform Mortgage-Backed Security (UMBS). This initiative should increase the overall liquidity of the secondary mortgage market. In addition, this initiative should reduce the trading value disparities between Fannie Mae and Freddie Mac securities. The different mortgage securities currently issued by the Enterprises are not fungible with one another, and Freddie Mac's security has historically traded less favorably compared with Fannie Mae's security. As part of the effort to implement the Single Security Initiative, FHFA and the Enterprises have defined the security characteristics, disclosure requirements, and timeline for implementation.

Strategic Goal 3—Means and Strategies

- **Provide clear conservatorship expectations to Enterprise boards and management.** FHFA will continue to use four key approaches to provide clear expectations to the Enterprises' boards and management. First, FHFA establishes the overall strategic direction for the Enterprises in the Agency's *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* and in annual scorecards. Second, FHFA authorizes the boards of directors to oversee and senior management to 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 oversees and monitors Enterprise activities.

- **Oversee Enterprise staffing.** Successful accomplishment of FHFA's conservatorship objectives requires qualified boards of directors, Chief Executive Officers (CEOs), management, and staff at each Enterprise. FHFA will continue to oversee the hiring and retention of board members and CEOs.
- **Address outstanding claims involving FHFA, Fannie Mae, and Freddie Mac.** FHFA is nearing the conclusion of its litigation concerning pre-conservatorship violations of federal securities laws in mortgage-backed securities (MBS) sales to Fannie Mae and Freddie Mac. FHFA has settled the majority of this litigation and one litigated case remains on appeal as of this publication. FHFA will also continue monitoring legal developments that might affect FHFA's role as conservator of the Enterprises.
- **Promote credit risk transfers that reduce taxpayer risk by attracting private capital.** FHFA will continue to oversee the Enterprises' activities to increase and deepen credit risk-sharing transactions by setting targets for multiple types of single-family mortgage credit risk-sharing transactions, and holding Enterprise management accountable for meeting those targets. FHFA also requires the Enterprises to assess the economics and feasibility of additional types of risk transfer structures. FHFA also expects the Enterprises to explore opportunities to share additional credit risk with private capital on multifamily mortgages, while also maintaining the Enterprises' multifamily business models and evaluating the cost of such risk sharing.
- **Oversee Enterprise counterparty eligibility requirements.** FHFA will work with the Enterprises to oversee their counterparty requirements – including the recent requirements for private mortgage insurers and Enterprise seller/servicers – and will make improvements where appropriate.
- **Reduce the Enterprises' legacy retained portfolios.** FHFA will continue to oversee the Enterprises' activities to reduce their retained portfolios to $250 billion by December 31, 2018 in accordance with the PSPAs, even under adverse market conditions and in a manner consistent with neighborhood stabilization, by: 1) reducing the volume of less liquid assets within the retained portfolios; 2) evaluating sales for their economic advantages to the Enterprises; and 3) ensuring that sales consider impacts on the market, borrowers, and neighborhood stability.
- **Support the development, implementation, and operation of the Common Securitization Platform.** FHFA will continue to work with the Enterprises to develop, test, and implement the CSP to replace the current separate proprietary systems at each Enterprise. When the CSP is completed, the platform will support the Enterprises' issuance, settlement, and monthly bond administration of mortgage-backed securities, including the related disclosures and tax reporting activities.

- **Implementation of the Single Security Initiative for Fannie Mae and Freddie Mac.** FHFA is working with Fannie Mae and Freddie Mac to implement the Single Security Initiative, which focuses on both Enterprises issuing a common security. The new UMBS should improve the overall liquidity of the Enterprises' securities. FHFA and the Enterprises have established the common security's characteristics and disclosure standards, have announced the timeline for implementation, and have set expectations for the UMBS within the market. Throughout this process, FHFA will solicit feedback from stakeholder groups.
- **Oversee the Enterprises' implementation of the Uniform Mortgage Data Program.** FHFA will continue to guide Enterprise work on developing uniform standards for mortgage-related data reporting. The Uniform Mortgage Data Program is currently focused on improving the reporting consistency, quality, and uniformity of data collected during the mortgage process.

Critical Factors that Affect Achievement of Strategic Goals

While the housing finance market has stabilized considerably since Fannie Mae and Freddie Mac entered conservatorship in 2008, the economic and housing market landscape is fundamentally different than it was in 2008. Over the five years covered by this plan, FHFA understands that legislative and market uncertainties may ultimately affect the goals and objectives laid out in this Strategic Plan. Significant labor and housing market uncertainties remain. Market developments and legislative reform initiatives may affect the financial condition, performance, and future of the regulated entities.

The Domestic Housing Market

Although house prices have enjoyed steady and sizeable price gains over the last five years, the domestic housing market is still likely to be challenging over the next five years. Against a backdrop of legislative and policy initiatives that could change regulatory and credit conditions, interest rate volatility could affect markets. Affordability in the housing market for first-time buyers is another ongoing concern, particularly in larger cities where first-time homebuyers are more likely to seek home ownership. Home construction, a factor that has historically played a role in improving affordability, has been relatively modest for a number of years and, given labor shortages for certain key trade groups, and other factors, many observers do not anticipate a rapid expansion in construction activity.

While not without challenges and uncertainties, multifamily housing markets are generally expected to remain relatively strong. For instance, it is expected that growing demand for multifamily units will continue, particularly in those metropolitan areas with the best prospects for job growth. Much of the growth in the multifamily market has taken place with more expensive units, and rental affordability continues to be a challenge for many households.

Economic Conditions and the Regulated Entities

The financial condition and performance of the Enterprises and the FHLBanks are dependent on the performance of the U.S. housing and mortgage markets, agency debt markets, and general business and economic conditions. The Enterprises and the FHLBanks are exposed to credit risk on mortgage loans and mortgage securities held in their investment portfolios. In addition, the Enterprises are exposed to credit risk on mortgage loans that back MBS guaranteed by the Enterprises that is outside the coverage provided through credit risk transfer transactions. The FHLBanks are exposed to credit risk on mortgage loans and securities held as collateral for their advances to members. Both the Enterprises and the FHLBanks have exposure to interest rate risk from the capital markets, especially in the agency debt markets. The debt markets affect the regulated entities funding cost, mortgage rates, and mortgage prepayment behaviors.

The Enterprises have two primary sources of revenue: 1) guarantee fees on mortgages held by consolidated trusts holding Enterprise mortgage-backed securities; and 2) the difference between the interest income earned on the assets in the Enterprises' retained mortgage portfolios and the interest expense paid on the debt that funds those assets. In recent years, the Enterprises have earned a greater proportion of net income from guarantee fees than from interest income. The shift has been primarily driven by guarantee fee increases put in place during conservatorship and the reduction of the retained portfolios in accordance with the requirements of the PSPAs between the Treasury Department and the Enterprises. Market conditions or actions that significantly reduce guarantee fee revenue or increase credit costs could affect the financial condition of the Enterprises.

Advances, the primary business of the FHLBanks, have increased in recent years with an improving economy and with regulatory changes that made advances a more attractive source of funds for some members. Advances spiked to $1.01 trillion in the third quarter of 2008 as many members used the FHLBanks as sources of liquidity during the financial crisis. After October 2008, the FHLBanks experienced a sharp decline in the demand for advances driven by a weak economy, decreased loan demand, and by members' access to alternative funding sources, including an increase in deposits from members' customers. Advance demand has since increased due to new liquidity guidelines for some members and other factors. Changes to

money market rules have also increased demand for agency debt, allowing the FHLBanks to borrow more cheaply.

Although they have a positive effect on funding costs, low interest rates have dampened revenues from interest-earning assets held by the regulated entities. Meanwhile, the regulated entities' continued access to debt markets at attractive rates remains critical to their effectiveness and ability to support housing finance.

The Conservatorships of Fannie Mae and Freddie Mac

The Enterprises were placed into conservatorships in September 2008 in the midst of a severe financial crisis. Their ongoing participation in the housing finance market has been an important factor in maintaining market liquidity and stability. Conservatorship permitted the U.S. Government to take greater control over management of the Enterprises and gave investors in the Enterprises' debt and MBS confidence that the Enterprises would have the capacity to honor their financial obligations. As conservator, FHFA establishes restrictions and expectations for the Enterprises' boards and for their managements while authorizing them to conduct the Enterprises' day-to-day operations.

As detailed earlier, FHFA's authority as both regulator and conservator of the Enterprises is based upon statutory mandates. FHFA, acting as regulator and conservator, must follow the mandates assigned to it by statute and the missions assigned to the Enterprises by their charters. Congress may choose to revise the statutory mandates governing the Enterprises at any time.

The priorities outlined here in *FHFA's Strategic Plan: Fiscal Years 2018 – 2022* continue to reflect and refine the strategic goals established in the *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac*.

While operating in conservatorship, progress has been made with respect to the development of the CSP, a joint venture formed by the Enterprises under FHFA's direction, as well as the Enterprises' single-family credit risk transfer programs. These and other reforms represent multiyear changes to the Enterprises and their operations, practices, and protocols that will provide benefits to the housing finance markets and reduce exposure and risks to taxpayers.

The Enterprises are also parties to PSPAs with the Treasury Department. Under the PSPAs, the Enterprises are provided U.S. taxpayer backing with explicit dollar limits. The PSPA commitment still available to Fannie Mae is $117.6 billion and the commitment still available to Freddie Mac is $140.5 billion. Additional draws would reduce these commitments, and dividend payments do not replenish or increase the commitments under the terms of the PSPAs. Starting

in 2013, the PSPAs provided each Enterprise with a capital buffer of $3 billion to protect each Enterprise against making additional draws of taxpayer support in the event of an operating loss in any quarter, and the PSPAs provide mandated declines of $600 million each year to these capital buffers. On January 1, 2017, each Enterprise's capital buffer declined to $600 million and the capital buffer is scheduled to decline to zero on January 1, 2018.

FHFA continues to encourage Congress to complete the important work of housing finance reform. FHFA has reiterated the urgency of reform and that it is up to Congress to determine what future, if any, the Enterprises will have in the future housing finance system.

FHFA Resources

Managing FHFA's resources successfully is critical to goal and mission achievement. Strategic goals and expected outcomes cannot be achieved without prudent and effective management of resources to ensure that the right people, funds, supplies, physical space, and technology are in place. In addition, achievement of FHFA's goals requires communication, collaboration, and coordination by staff and across all offices and divisions within FHFA.

FHFA will continue to recruit, develop, and retain a talented, diverse, and adaptive workforce that promotes organizational excellence and ensures prudential operations of each regulated entity. In order to foster increased staff capabilities, FHFA will also continue to promote accountability and continuous learning. FHFA managers and executives will assess key work requirements and monitor activities in support of FHFA's goals.

Responsive, secure, and efficient information technology capabilities are essential to FHFA's ability to accomplish its mission. To meet the information technology demands, FHFA will continue to provide and update expertise, capabilities, and services in systems development and support. The Agency will also continue to meet the needs for data, information, and knowledge management; information sharing; telecommunications and network support; and technical support and security.

Careful and collaborative planning will be necessary to ensure that *FHFA Strategic Plan: Fiscal Years 2018- 2022* is supported and that Agency resources are available and employed efficiently to support planned activities. FHFA management, technical and program support personnel, and administrative staff will work together on workforce, acquisition, and technology plans, as well as logistical plans for space, supplies, and transportation that align with strategic and annual plans.

Appendix A: Strategic Planning Process

FHFA developed the *FHFA Strategic Plan: Fiscal Years 2018-2022* through a collaborative process within the Agency. With guidance from the Director, FHFA managers and other subject matter experts were involved with the development of the strategic and performance goals in this Strategic Plan.

To monitor FHFA's progress toward goal achievement, FHFA senior managers meet quarterly to evaluate performance and identify obstacles that could prevent the Agency from achieving its goals. FHFA also uses regular management meetings, reports, and performance review meetings to communicate and discuss organizational goals and objectives. FHFA employees align their job performance plans and individual development plans to support FHFA's strategic goals.

Appendix B: Consultation and Outreach

FHFA is inviting input from Congress, stakeholders, and the public on the *FHFA Strategic Plan: Fiscal Years 2018-2022* through a 30-day request for input period ending on October 27, 2017.

Appendix C: Program Evaluations

Program evaluation is an important feedback tool that can provide managers with information to ensure that FHFA's goals are meaningful and the strategies for achieving them effective. The results from FHFA's program evaluations enable staff and senior management to assess goal achievement and plan future programs. FHFA considers the findings from these evaluations and audits in order to improve Agency operations. The primary internal and external evaluations are listed below.

Internal

Executive Committee on Internal Controls. FHFA's Executive Committee on Internal Controls meets quarterly to review the results of internal and external program evaluations. The committee evaluates the findings and remediation activities for FHFA. Committee activities support FHFA's determinations of the adequacy of internal controls under Office of Management and Budget Circular A-123.

Office of Quality Assurance. FHFA established an Office of Quality Assurance (OQA) as part of the Agency's overall internal control structure. OQA's primary function is to assist

management in strengthening risk oversight and improving effectiveness and efficiency of operations by providing objective assessments of FHFA processes and work products, based on an annual risk assessment and as specific needs are identified.

External

Office of Inspector General.

FHFA's Office of Inspector General conducts independent audits, evaluations, and investigations to help FHFA achieve its mission and goals and guard against waste, fraud, and abuse.

For example, the Office of Inspector General reviews the Agency's information security program annually and reports the results to the Office of Management and Budget, as required by the Federal Information Security Management Act. FHFA uses recommendations from this audit to implement improvements in its information security program.

Government Accountability Office. The Government Accountability Office, an investigative arm of Congress, audits FHFA's financial statements, periodically conducts targeted reviews of FHFA's programs and initiatives, and testifies before Congress on its observations and recommendations.

Congressional Budget Office. The Congressional Budget Office, also an arm of Congress, periodically issues reports and analytical studies of issues related to the costs, benefits, and risks of the regulated entities and their oversight and testifies before Congress on its findings.

Office of Personnel Management. The Office of Personnel Management periodically conducts reviews of FHFA human capital operations to ensure they support the Agency's human capital management and are in compliance with merit system principles.

Office of Government Ethics. The Office of Government Ethics periodically conducts reviews of the FHFA ethics program to ensure that it meets the requirements set forth by law, regulation, and OGE guidance.

National Archives and Records Administration. The National Archives and Records Administration reviews the annual agency self-assessment submitted by FHFA to ensure that FHFA is in compliance with statutory and regulatory recordkeeping requirements.

Federal Emergency Management Agency. The Federal Emergency Management Agency conducts a biennial assessment of FHFA's continuity capability and reports the results to the President through the National Continuity Coordinator.

EXHIBIT B

EMBARGOED UNTIL DELIVERY

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

"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency"

Before the U.S. House of Representatives Committee on Financial Services

October 3, 2017

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for inviting me to testify this morning. It's a pleasure to be back in this Committee room, and I look forward to sharing information about the Federal Housing Finance Agency's work to support the nation's housing finance system.

My commitment during and since my confirmation hearing has been to uphold the statutory responsibilities assigned to FHFA. This includes our supervisory oversight of the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. It also includes our statutory responsibilities as conservator of Fannie Mae and Freddie Mac (the Enterprises). As conservator, we operate the Enterprises in the present – or what I often refer to as "the here and now." This is in line with my belief, that I have consistently repeated, that it is the role of Congress, not FHFA, to decide on housing finance reform. We will continue to work to ensure that the Federal Home Loan Banks and Enterprises operate in a safe and sound manner and that they support liquidity in the housing finance market. As conservator, we also work to preserve and conserve Enterprise assets. Balancing these responsibilities is woven into everything we do.

My testimony discusses the conservatorships of Fannie Mae and Freddie Mac, followed by a discussion of FHFA's oversight of the Federal Home Loan Bank System.

Oversight of Fannie Mae and Freddie Mac

Since September 6, 2008, Fannie Mae and Freddie Mac have been operating in conservatorships under the direction and control of FHFA and with backing of the U.S. taxpayers with explicit dollar limits as set out in the Senior Preferred Stock Purchase Agreements (the PSPAs) with the U.S. Department of the Treasury (Treasury Department). As a result of prior Enterprise draws totaling $187.5 billion against the PSPA commitments, the PSPA commitment still available to

Fannie Mae is now limited to $117.6 billion and the commitment still available to Freddie Mac is $140.5 billion. Additional draws would reduce these commitments further; however, dividend payments do not replenish or increase the commitments under the terms of the PSPAs.

Last month marked the beginning of the tenth year that the Enterprises have been in conservatorships. These conservatorships have been unprecedented in scope, complexity, and duration, especially when you consider that the Enterprises support over $5 trillion in mortgage loans and guarantees.

As I last testified before this Committee, the Enterprises' operations have stabilized and their financial performance has improved significantly since the beginning of conservatorship. For 2016, Fannie Mae reported net income of $12.3 billion, and Freddie Mac reported net income of $7.8 billion. In 2016, the Enterprises earned a greater proportion of net income from guarantee fees than from interest income from the retained portfolios. This shift is primarily driven by the impact of guarantee fee increases and the reduction of the retained portfolios in accordance with the requirements of the PSPAs with the Treasury Department.

The Enterprises continue to provide liquidity to the housing finance market. In 2016, Fannie Mae purchased $581 billion of single-family mortgages, and Freddie Mac purchased $393 billion. In the multifamily sector, Fannie Mae purchased $55 billion in 2016, and Freddie Mac purchased almost $57 billion.

The Enterprises' serious delinquency rates have substantially declined during conservatorship. Delinquency rates peaked at 5 percent during the height of the crisis. The percentage of Enterprise loans that were at least 90 days delinquent as of the second quarter of this year stood at a combined 0.95 percent.

I have said repeatedly, and I want to reiterate, that these conservatorships are not sustainable and they need to end as soon as Congress can chart the way forward on housing finance reform. However, it is important for all to acknowledge that the conservatorships have led to numerous reforms of the Enterprises and their operations, practices, and protocols that have been extremely beneficial to the housing finance market and have reduced exposure and risks to taxpayers.

It is critically important for the members of this Committee to be well aware of these reforms because you will have the responsibility to ensure that the reforms are not disregarded or discarded because of assertions some will make that the Enterprises now are the same or mirror images of the Enterprises that FHFA placed into conservatorship over nine years ago. I can assure you that such assertions would be unfounded.

Let me highlight some of the most important changes and reforms that have taken place during the conservatorships.

1. **Board leadership and management:** When the Enterprises were placed into conservatorship, FHFA replaced most members of their boards of directors and many senior managers. Both through conservatorship and through our on-site regulatory oversight of the Enterprises, FHFA has required Fannie Mae and Freddie Mac to make a number of changes to improve risk management, update many of their legacy systems, prioritize information security and data management, and better address other areas of operational risk. FHFA has also taken steps to prohibit certain activities, such as lobbying, by either Enterprise. The Enterprises' boards of directors and senior management have taken great strides to implement these improvements in coordination with FHFA.

2. **Alignment of certain Enterprise activities:** While some aspects of their pre-conservatorship competition resulted in negative consequences or in a race to the bottom, FHFA has aligned many practices and policies on which the Enterprises are no longer allowed to compete, such as loss mitigation standards and counterparty eligibility standards. However, based on expectations established in conservatorship and regularly emphasized by FHFA to the Enterprises' boards and managements, we expect them to compete to find and implement innovative ways to make the housing finance markets more efficient and liquid, on customer service provided to Enterprise seller/servicers, and on the quality of their business practices.

3. **Sound underwriting practices:** The Enterprises are required to emphasize sound underwriting practices in their purchase guidelines, and these practices facilitate responsible access to credit and sustainable homeownership for creditworthy borrowers. The Enterprises' serious delinquency rate on single-family loans is at its lowest level since January 2008.

4. **Appropriate guarantee fees:** Guarantee fees have been increased by two and a half times since 2009. The guarantee fees are set to reflect the cost of covering credit losses in the event of economic stress or a housing downturn and the administrative expenses of running the companies. While the Enterprises cannot retain capital under the PSPAs, we also set their guarantee fees under the assumption that they are earning an appropriate return on capital. FHFA regularly reviews the Enterprises' guarantee fees to ensure that they remain at appropriate levels.

5. **Smaller portfolios for core business purposes:** The retained portfolios of the Enterprises have been reduced over sixty percent since 2009 and both Enterprises are ahead of schedule to meet the 2018 maximum portfolio limits established in the PSPAs.

The Enterprises' multiyear retained portfolio plans to achieve these reductions have focused on selling less liquid assets and investment assets, in addition to prepayments that have occurred over time. Their retained portfolios are now focused on supporting the core business operations of the Enterprises, including aggregation of loans from small lenders to facilitate securitizations and holding delinquent loans in portfolio so investors can be made whole, servicers can facilitate loan modifications that also minimize losses to the Enterprises, and borrowers can stay in their homes whenever possible.

6. **Single-family credit risk transfer programs transfer credit risk to private investors:** The Enterprises have developed and continue to refine credit risk transfer (CRT) programs that transfer a meaningful amount of credit risk to private investors on at least 90 percent of their targeted, fixed-rate, single-family mortgage acquisitions. The Enterprises are also developing their single-family CRT programs with the objective of cultivating a mature and robust credit risk transfer market, including by building and expanding a diverse investor base that will increase the likelihood of having a stable CRT market through different housing and economic cycles.

7. **New securitization infrastructure:** Through a joint venture formed by the Enterprises under FHFA's direction, the Common Securitization Platform (CSP) is now operating and all of Freddie Mac's existing single-family, fixed-rate securitizations are being processed using the CSP. All parties are now well down the multiyear path toward the CSP becoming the infrastructure used by both Enterprises to issue a common single mortgage backed security. When fully implemented, we believe these changes will facilitate deeper liquidity in the housing finance market, support the to-be-announced market, and eliminate costly trading differences between the Enterprises' securities. The Enterprises are developing the CSP with an open architecture such that it will be usable by other market participants.

8. **Responsible access to credit supporting sustainable homeownership:** The Enterprises have worked closely with FHFA on a number of initiatives designed to support responsible access to credit and sustainable homeownership. For example, they undertook a multiyear process to revamp their Representation and Warranties Framework to reduce uncertainty and support access to credit throughout the Enterprises' existing credit boxes. We are also asking the Enterprises to identify additional opportunities to improve access to credit in a safe and sound manner, including a focus on the needs of future borrowers – millennials, seniors, minorities, the self-employed, and multi-generational households. Another recent area of focus has been implementing the Enterprises' statutory duty to serve three underserved markets – manufactured housing, affordable housing preservation, and rural housing. The Enterprises' Duty to Serve Plans will start to be implemented in 2018.

9. **Multifamily market liquidity and affordable rental housing:** The Enterprises' multifamily programs, which performed well during the crisis while other parts of the housing market struggled, continue to share a substantial amount of credit risk with private investors and continue to provide needed liquidity for the multifamily market, with major emphasis on affordable rental housing and underserved markets.

10. **Loss mitigation, foreclosure prevention, and neighborhood stabilization:** The Enterprises have worked with FHFA to develop effective loss mitigation programs that minimize losses to the Enterprises and allow borrowers to avoid foreclosure whenever possible. This has included aligning the Enterprises' loss mitigation standards and developing updated loan modification and streamlined refinance products to follow the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP). The Enterprises have developed a new standard modification program to be effective October 1. The Enterprises are also effectively pursuing efforts to stabilize neighborhoods, including through the Neighborhood Stabilization Initiative.

11. **Level playing field for lenders of all sizes:** The Enterprises have eliminated volume-based discounts for larger lenders, which has leveled the playing field for lenders of all sizes – small, medium and large. This new approach, along with supporting the ability of small lenders to purchase loans through the cash window, has significantly increased the percentage of Enterprise acquisitions from smaller lenders during conservatorship.

Congress Urgently Needs to Act on Housing Finance Reform

While many reforms of the Enterprises' business models and their operations have been accomplished through conservatorship, FHFA knows probably better than anyone that these conservatorships are not sustainable and we also know that housing finance reform will involve many tough decisions and steps that go well beyond the reforms made in conservatorship. So I want to reaffirm my strong belief that it is the role of Congress, not FHFA, to make these tough decisions that chart the path out of conservatorship and to the future housing finance system.

Among the important decisions Congress will need to make as part of housing finance reform are the following:

- How much backing, if any, should the federal government provide and in what form?
- What process should be followed to transition to the new housing finance system and avoid disruption to the housing finance market, and who should lead or implement that process?

- What roles, if any, should the Enterprises play in the reformed housing finance system and what statutory changes to their organizational structures, purposes, ownership and operations will be needed to ensure that they play their assigned roles effectively?
- What regulatory and supervisory structure and authorities will be needed in a reformed system and who will have responsibility to exercise those authorities?

I reaffirm my belief that it is the role of Congress, not FHFA, to make those housing reform decisions and I encourage Congress to do so expeditiously.

FHFA Must Continue to Meet Its Obligations While Housing Finance Reform Takes Place

A significant challenge FHFA faces as conservator while Congress continues to move ahead on housing finance reform is one I first discussed publicly in a speech I delivered at the Bipartisan Policy Center on February 18, 2016, and one in which I reiterated my views in testimony before the Senate Committee on Banking, Housing, and Urban Affairs earlier this year.

The challenge is that additional draws of taxpayer support would reduce the amount of taxpayer backing available to the Enterprises under the PSPAs and the foreseeable risk that the uncertainty associated with such draws or from the reduction in committed taxpayer backing could adversely impact the housing finance market. This challenge is significantly greater today than it was last year and will continue to increase unless it is addressed. Let me explain why that is so.

At the time I delivered my speech at the Bipartisan Policy Center in 2016, each Enterprise had a $1.2 billion buffer under the terms of the PSPAs to protect the Enterprise against having to make additional draws of taxpayer support in the event of an operating loss in any quarter. Under the provisions of the PSPAs, on January 1, 2017 the amount of that buffer reduced to $600 million and on January 1, 2018 the buffer will reduce to zero. At that point, neither Enterprise will have the ability to weather any loss it experiences in any quarter without drawing further on taxpayer support.

This is not a theoretical concern. GAAP accounting regularly results in large fluctuations in Enterprise gains or losses in the ordinary course of business. The factors causing the fluctuations are not related to the credit quality of the Enterprises portfolios. Some of these non-credit related factors include interest rate volatility and the accounting treatment of derivatives used to hedge risks. In addition, the Enterprises continue to report reduced income from declining retained portfolios and reduced revenue from the increasing volume of credit risk transfers which, while supporting our objective of transferring risk and opportunity to the private sector, also transfer current revenues away from the Enterprises. We also know that a short-term consequence of corporate tax reform would be a reduction in the value of the Enterprises' deferred tax assets, which would result in short-term, non-credit related losses to the Enterprises. The greater the

reduction in the corporate tax rate, the greater the short-term losses to the Enterprises would be. Regulatory changes, such as the Current Expected Credit Loss (CECL) accounting change, have one-time and ongoing impacts on reported net income. In addition to the regular and on-going prospect of non-credit related losses, even minor housing market disruptions, natural disasters like hurricanes, or short periods of distress in the economy could also cause credit-related losses to the Enterprises in a given quarter.

Like any business, the Enterprises need some kind of buffer to shield against short-term operating losses. In fact, it is especially irresponsible for the Enterprises not to have such a limited buffer because a loss in any quarter would result in an additional draw of taxpayer support and reduce the fixed dollar commitment the Treasury Department has made to support the Enterprises. We reasonably foresee that this could erode investor confidence. This could stifle liquidity in the mortgage-backed securities market and could increase the cost of mortgage credit for borrowers.

As I mentioned at the outset, FHFA has explicit statutory obligations to ensure that each Enterprise "operates in a safe and sound manner" and fosters "liquid, efficient, competitive, and resilient national housing finance markets." To ensure that we meet these obligations, we cannot risk the loss of investor confidence. It would, therefore, be a serious misconception for members of this Committee, or for anyone else, to consider any actions FHFA may take as conservator to avoid additional draws of taxpayer support either as interference with the prerogatives of Congress, as an effort to influence the outcome of housing finance reform, or as a step toward recap and release. FHFA's actions would be taken solely to avoid a draw during conservatorship.

Other FHFA Activities During Conservatorship

FHFA and the Enterprises have been pursuing a number of other conservatorship priorities, and individual topics are discussed below. In addition, FHFA has reported extensively on some of the important reforms we have made and on our conservatorship priorities in our *2014 Conservatorship Strategic Plan;* in our annual scorecards, including the *2017 Scorecard;* and in our regular status updates, including three reports released earlier this year – *2016 Scorecard Progress Report*, *Credit Risk Transfer Progress Report*, and *An Update on the Implementation of the Single Security and the Common Securitization Platform*. FHFA's annual Report to Congress also includes information about FHFA's supervision and conservatorship oversight of the Enterprises.

Disaster Relief: Following the recent hurricanes that have affected so many, FHFA staff and our regulated entities are working to assess the impact on the housing market and to assist those impacted. FHFA staff are also in regular contact with staff from other federal agencies about the

response to these natural disasters. Our most immediate goal is to make sure homeowners focus on their safety and that we get the word out about mortgage relief options for those affected by the hurricanes. In coordination with FHFA, the Enterprises have implemented their disaster relief policies for affected homeowners, which were updated following Hurricane Sandy. The Enterprises have a standard 90-day forbearance option that can be extended up to a year for homeowners who live or work in areas declared a major disaster. The Enterprises also have a standard modification for disaster situations if homeowners need more permanent help. Moratoriums on foreclosure sales and evictions in these areas are in place through year-end. In addition, there will be no late fees or delinquencies reported to the credit bureaus for these households during this time. A resource document about the Enterprises' disaster relief policies is available on FHFA's website.

Potential losses to the Enterprises are difficult to estimate at this point. The Enterprises are working with servicers to understand the damage to affected homes and where there may be gaps in flood insurance coverage. In addition, FHFA staff are also working with the Federal Home Loan Banks to determine the impact on member institutions and on collateral for advances or their acquired member asset (AMA) programs.

We will continue to monitor the impact of these hurricanes closely.

With work continuing on reauthorizing the National Flood Insurance Program (NFIP), I should also add that flood insurance is an important and necessary component to the Enterprises' risk management. Flood insurance policies that are deemed by the Enterprises adequate to provide protection are NFIP policies, policies that meet NFIP requirements (such as "Write Your Own" policies), and policies issued through a private insurer when the terms and coverage of the policy are "at least equal" to that provided through the NFIP. As Congress continues its efforts to reauthorize the NFIP, including possible amendments to the definition of private flood insurance, it is important to preserve Enterprise contractual requirements that protect against collateral risk and help protect neighborhoods.

Potential Credit Risk Transfer Enhancements: The Enterprises' credit risk transfer programs have made a substantial amount of progress in a short period of time. FHFA continues to work with the Enterprises to further refine and improve their programs in ways that reduce taxpayer risk, make economic sense, and help attract a diversified and broad investor base. Earlier this year, the Enterprises announced that they are exploring changes to the structure of the Connecticut Avenue Series (CAS) transactions for Fannie Mae and the Structured Agency Credit Risk (STACR) transactions for Freddie Mac. Under the proposed changes, CAS and STACR transactions would be issued as notes that qualify as Real Estate Mortgage Investment Conduits (REMICs). This would have several benefits. First, the proposed structure would be accounted for as an insurance transaction, which better aligns the credit risk sharing benefits with the recognition of credit expenses. Second, the notes would be issued by a Bankruptcy Remote

Trust, which would insulate investors from Enterprise counterparty risk. Third, we expect that the proposed structure would satisfy asset and income tests for Real Estate Investment Trust (REIT) investments, which would help broaden the investor base. Fourth, for the CRT bonds with the most risk, the proposed structure would potentially broaden the appeal of these transactions to non-U.S. investors.

The Enterprises are getting market feedback about these potential changes, and FHFA will be working toward a decision of whether to move forward with these transaction changes.

CSP and Single Security Initiative Progress: Beginning with the 2016 Scorecard, FHFA developed a two-stage schedule for the CSP and the Single Security Initiative. Under Release 1, the CSP would begin issuing Freddie Mac's existing single-class securities. Under Release 2, the Single Security would be issued on the CSP for both Fannie Mae and Freddie Mac.

CSS and Freddie Mac successfully implemented Release 1 in November 2016. This implementation involved moving certain back-office operations of Freddie Mac to CSS and the CSP. With the implementation of Release 1, Freddie Mac is now using the CSS modules for Data Acceptance, Issuance Support, and Bond Administration activities related to Freddie Mac's current single-class, fixed-rate securities – PCs and Giants – and for certain activities related to the underlying mortgage loans, such as tracking unpaid principal balances.

At the end of last year, FHFA announced that Release 2 would be implemented in the second quarter of 2019. This announcement provided stakeholders more than 24 months' advance notice and is intended to facilitate further engagement on the part of market participants in this transition.

Alternative Credit Score Project: FHFA is continuing to make progress on this project, which is evaluating the impact on safety and soundness (including the ability to appropriately predict future mortgage default rates), access to credit, competition in the credit score market, and operational impacts of any changes on the Enterprises and the broader mortgage industry.

FHFA is preparing a request for input to be released this fall to gain stakeholder feedback on questions about competition and operational impact. We have looked deeply at these issues, and this process has raised additional concerns. For example, how would we ensure that competing credit scores lead to improvements in accuracy and not to a race to the bottom with competitors competing for more and more customers? Also, could the organizational and ownership structure of companies in the credit score market impact competition? We look forward to getting reliable feedback on these and other issues. It is FHFA's obligation to get this right, and we need more information to be able to do so.

FHFA has received overwhelming feedback from the industry that it would be a serious mistake to change credit scoring models before the Enterprises implement the Single Security in mid-2019. Consequently, even if FHFA announced a decision immediately about alternative credit

score models, the changes would not go into effect before 2019. This is a realistic implementation timeline that takes into account operational challenges and the timing of other system changes being made by the mortgage industry.

The Enterprises and FHFA continue to take other steps around credit scores independent of the model used by the Enterprises. For example, the Enterprises have taken recent steps to allow borrowers without a credit score to be evaluated for a mortgage through their automated underwriting systems, rather than rely solely on manual underwriting.

Duty to Serve: Pursuant to the Housing and Economic Recovery Act, FHFA continues to move forward on implementing the Enterprises' Duty to Serve three underserved markets – manufactured housing, affordable housing preservation, and rural housing. We published our final rule in December of last year, and the Enterprises posted their initial Duty to Serve Plans earlier this year. Receiving and reviewing public input on these draft plans has been an essential part of FHFA's review process. The Enterprises are on track to finalize their Duty to Serve Plans later this year and begin implementation of the Plans starting in 2018.

Other Access to Credit Initiatives: FHFA continues to work with the Enterprises on other access to credit initiatives, including low-down payment programs. FHFA and the Enterprises' analysis showed that many borrowers were creditworthy and could sustain paying a mortgage, but did not have the money or wealth to cover a large down payment and closing costs. In 2014 FHFA approved a limited program that allowed the Enterprises to purchase mortgages with a three percent down payment. Between 2015 and June 2017, the Enterprises have purchased over 130,000 mortgages with a three percent down payment and the program is continuing to grow. The average loan amount has been about $180,000, and over 95% of these borrowers were first-time homebuyers. The Enterprises also allow reduced fees when the borrower's income is at or below the area median income. When evaluating a borrower's eligibility for these loans, both Enterprises establish purchase guidelines and underwriting standards that include appropriate compensating factor requirements and risk mitigants. The Enterprises are continuing to evaluate and address other access to credit challenges, including the growing challenge that student loan debt poses for many young people.

Private-Label Mortgage-Backed Securities Litigation: FHFA filed a total of 18 lawsuits in 2011 as conservator of Fannie Mae and Freddie Mac alleging violations of various statutory provisions by participants in the mortgage finance sector. In July 2017, FHFA announced a 17th settlement of these cases, with the most recent settlement being with the Royal Bank of Scotland Group relating to sales of private-label residential mortgage-backed securities to Fannie Mae and Freddie Mac between 2005 and 2007. FHFA received a favorable verdict after trial in the 18th case and that verdict has been affirmed on appeal. In total, there have been settlements and a verdict totaling more than $25 billion from these cases.

Oversight of the Federal Home Loan Bank System

The FHLBanks continue to play an important role in housing finance by providing a reliable funding source and other services to member institutions, including smaller institutions that would otherwise have limited access to these services. In addition, the FHLBanks have specific statutory requirements related to affordable housing and, as a result, the FHLBanks annually contribute substantially toward the development of affordable housing.

The FHLBank System had its most profitable year in history in 2016, with net earnings of $3.4 billion. Earnings in 2016 were increased by private-label securities litigation settlements by some FHLBanks, which contributed $952 million of the total. While settlement income is non-recurring, the System's strong net interest income has allowed the FHLBanks to continue a trend of strong net income from recurring activities.

In 2016, FHLBank advances grew by $71.2 billion to $705.2 billion. The increase in advances pushed System assets past the $1 trillion mark for the first time since 2009. System-wide retained earnings now constitute more than 1.59 percent of aggregate FHLBank assets and more than 31 percent of regulatory capital, up from 1.25 percent and 19 percent, respectively, from five years ago. The FHLBanks' 2016 net income generated $392 million in Affordable Housing Program (AHP) funding, pushing the average contribution for the last five years to over $300 million per year.

FHFA conducts annual safety and soundness and affordable housing program examinations of all 11 FHLBanks and the Office of Finance based on well-defined supervisory strategies using a risk-based approach. Starting in 2017, FHFA safety and soundness examinations started to include assessments of progress on diversity and inclusion in accordance with standards developed by FHFA and in compliance with the provisions of Section 1116 of the Housing and Economic Recovery Act. As the first federal regulator to establish examination protocols in this area, FHFA is carefully monitoring its implementation. Information from the Reports of Examination is included in FHFA's annual Report to Congress. FHFA's recent supervisory work has assessed advance pricing to ensure compliance with applicable regulations, advance limits to large members, debt issuance practices for both short-term and long-term funding, cyber/information security management, mortgage asset pricing, distressed asset disposition management, and vendor management.

FHFA has taken recent steps to implement and update several regulatory requirements for the FHLBanks. In June, FHFA issued a final rule implementing Section 82001 of the Fixing America's Surface Transportation Act (FAST Act), which amended the Federal Home Loan Bank Act to authorize certain credit unions without Federal share insurance to become FHLBank members.

Earlier this year, FHFA also issued a proposed rule on the FHLBanks' risk-based capital requirements, primarily addressing the risk-based capital requirements for credit risk. We believe there is an opportunity to take advantage of new data and modeling improvements that have become available since 2001 when one of FHFA's predecessor agencies, the Federal Housing Finance Board, issued the current rule. This proposed rule would also bring FHFA into compliance with Section 939A of the Dodd-Frank Act's requirement to remove references to, and prohibit any FHLBank from relying solely on, ratings from Nationally Recognized Statistical Rating Organizations (NRSROs). The proposed rule replaces references to NRSRO ratings with requirements that each FHLBank develop an internal credit rating for each asset or unsecured credit exposure for which the current rule requires an NRSRO rating. The proposed rule would also modestly increase the capital charges for advances and certain other rated assets, but would carry over the same capital charges currently in place for all mortgage-related assets. The comment period for this proposed rule ended on September 1, 2017, and FHFA is working toward developing a final rule.

FHFA also issued a final rule in December 2016 that addresses the NRSRO requirement in the Dodd-Frank Act relating to acquired member asset programs, under which the Banks provide financing for members' housing finance activities by purchasing eligible mortgage loans. In addition to removing or replacing references to NRSROs, the final rule provided the FHLBanks greater flexibility in choosing the model they use to estimate the required credit enhancements, authorized the transfer of mortgage servicing rights on acquired member asset loans to any institution, and allowed FHLBanks to acquire mortgage loans that exceed the conforming loan limit if they are guaranteed or insured by a department or agency of the U.S. government.

FHFA is working on updating our regulatory expectations for FHLBank liquidity risk management that reflect the System's access to global capital markets and wholesale funding model. We are working to incorporate lessons learned from the financial crisis and best practices for liquidity risk management, and we anticipate having an update on these standards in early 2018.

FHFA is also monitoring the impact of recent natural disasters on the Federal Home Loan Bank System. For those loans held in portfolio by one of the FHLBanks, they have implemented a standard 90-day forbearance option for homeowners. The FHLBanks have also implemented moratoriums on foreclosures and evictions in these areas for 90 days. In addition, there will be no late fees or delinquencies reported to the credit bureaus for affected households during this time.

In my last appearance before this Committee, I discussed three issues that were in process at that time and have resulted in subsequent activity by FHFA. The first of these items was the merger

of the FHLBanks of Des Moines and Seattle into a single, combined entity as of May 31, 2015. The merger was the first voluntary merger for the FHLBank System and was executed under the terms of FHFA's voluntary merger guidelines adopted in 2011. FHFA approved the FHLBanks' merger application in December 2014, and members of both FHLBanks later voted overwhelmingly to ratify the merger agreement. The FHLBank of Des Moines is the continuing institution and, as of June 30, 2017, serves 1,417 member financial institutions across 13 states and the U.S Pacific territories with outstanding advances of nearly $119 billion. As of the same date, the combined Des Moines FHLBank had assets totaling slightly more than $165 billion, making it the largest FHLBank by asset size. FHFA views the merger as consistent with the FHLBank System's mission and with the safe and sound operation of each FHLBank.

The second item was FHFA's work with the FHLBanks to develop standards around "core mission assets," which relates to the way FHLBanks support their housing finance and community investment mission. Following the formation of a Joint Core Mission Working Group in 2014, FHFA issued an Advisory Bulletin in July 2015 that provides guidance on FHLBank core mission achievement. It establishes two categories – preferred and evolving – that measure a Bank's core mission achievement using ratios of primary mission assets (advances and acquired member assets) compared to consolidated obligations, which is the debt issued on behalf of each FHLBank to fund its operations. Pursuant to the standards set out in our advisory bulletin, FHFA regularly monitors the core mission achievement of each FHLBank. Through the first half of 2017, nine FHLBanks had a core mission ratio at or above 70 percent (preferred) while two FHLBanks had a ratio below 70 percent but above 55 percent (evolving).

Lastly, I want to also provide a status update on FHFA's recent membership rule, which the Agency proposed in September 2014 and finalized in January 2016. Under this final rule, FHFA sought to ensure that only institutions legally eligible under the Federal Home Loan Bank Act to obtain membership in the FHLBank System were able to obtain the benefits of membership. In defining "insurance company" to exclude captive insurers, FHFA sought to prevent entities that do not otherwise meet the statutory membership requirements from becoming FHLBank members by establishing and using captives as conduits to circumvent the membership eligibility requirements and gain access to low-cost FHLBank funding and other benefits of FHLBank membership.

Under FHFA's final rule, captive insurers that joined a Bank after the proposed rule was issued in 2014 had one year to leave the FHLBank System. Captive insurers that joined a Bank before issuance of the proposed rule have five years to leave the FHLBank System. As of March 31, 2017, all captive insurers required to leave the System in 2017 had repaid their advances and had their memberships terminated. Those entities required to leave the System by 2021 have $25.9 billion in advances remaining through the second quarter of 2017.

Conclusion

Thank you again for the opportunity to be here this morning. All the work I have discussed here has been made possible by the incredibly dedicated and talented staff at the Federal Housing Finance Agency. It is a pleasure to work with colleagues who have such a deep expertise in housing finance issues and a commitment to excellence.

I look forward to answering your questions about our work and the ways the Federal Housing Finance Agency supports the housing finance market.