SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

OCTOBER 3, 2017

Printed for the use of the Committee on Financial Services

Serial No. 115–44

U.S. GOVERNMENT PUBLISHING OFFICE

30–240 PDF WASHINGTON : 2018

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. McHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
STEVE STIVERS, Ohio
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
LEE M. ZELDIN, New York
DAVID A. TROTT, Michigan
BARRY LOUDERMILK, Georgia
ALEXANDER X. MOONEY, West Virginia
THOMAS MacARTHUR, New Jersey
WARREN DAVIDSON, Ohio
TED BUDD, North Carolina
DAVID KUSTOFF, Tennessee
CLAUDIA TENNEY, New York
TREY HOLLINGSWORTH, Indiana

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
CHARLIE CRIST, Florida
RUBEN KIHUEN, Nevada

KIRSTEN SUTTON MORK, *Staff Director*

CONTENTS

SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY

Tuesday, October 3, 2017

U.S. House of Representatives,
Committee on Financial Services,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Present: Representatives Hensarling, Royce, Pearce, Posey, Luetkemeyer, Huizenga, Duffy, Stivers, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Williams, Poliquin, Love, Hill, Emmer, Zeldin, Trott, Mooney, MacArthur, Davidson, Budd, Kustoff, Tenney, Hollingsworth, Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Clay, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Foster, Kildee, Sinema, Beatty, Heck, Vargas, Gottheimer, Gonzalez, and Crist.

Chairman Hensarling. The committee will come to order.

Without objection, the chair is authorized to declare a recess of the committee at any time, and all members will have 5 legislative days within which to submit extraneous materials to the chair for inclusion in the record.

This hearing is entitled "Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency."

I now recognize myself for 3–1/2 minutes to give an opening statement.

Today, we welcome back our former colleague and committee member, Mel Watt, the Director of the Federal Housing Finance Agency. Director Watt served with distinction on this committee for many, many years and was respected on both sides of the aisle.

Sir, it is good to have you back in our hearing room.

As we know, the Federal Housing Finance Agency (FHFA) oversees the two enormous government-sponsored mortgage buying corporations, Fannie Mae and Freddie Mac, as well as the eleven Federal Home Loan Banks. As all Americans painfully remember, in 2008, taxpayers were forced to bail out these $5 trillion behemoths that imperiled not only the U.S. housing market, but also the entire global financial system. It was the largest taxpayer-funded bailout in history, and the government-sponsored enterprises (GSEs) have been wards of the state ever since. Taxpayers should never be put in that position again, yet Fannie and Freddie's 9-year conservatorship, little has fundamentally changed.

The GSEs are today as big as they were before the financial crisis. They represent a virtual government monopoly in housing finance that lacks meaningful competition or innovation. Taxpayers remain on the hook for $5.3 trillion. Underwriting standards are being eroded. I fear a number of mistakes that led to the 2008 crisis are being repeated today.

Clearly, it is time, in fact, it is well past time for Congress to enact sustainable housing finance reform with private capital at its center. It is time to get off the boom-bust-bailout cycle. In order to move forward, we need to first critically assess the state of the GSEs' 9-year conservatorship. This hearing provides an opportunity to do just that.

The two most significant developments in the conservatorship clearly have been the credit risk transfer programs and the common securitization platform. Virtually everyone believes that these two developments are key points in the transition to a housing finance system in which private capital plays the predominant role. Yet despite these positive developments, there have been other changes under the conservatorship that are cause for concern.

Those of us who worry about another taxpayer bailout should be worried about efforts to lower downpayment requirements, raise the debt-to-income ratio, and divert funds to a Housing Trust Fund that lacks accountability, all the while taxpayers who paid to bail out the GSEs in 2008 remain in harm's way.

This Congress, in this moment, represents our best chance to move forward toward building a long-term sustainable housing finance system that allows Americans to buy homes they can actually afford to keep.

Director Watt, I peeked at your testimony and I wish to quote it and save you a little effort later on. Quote: "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. I reaffirm my 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."

I agree completely with that portion of the director's testimony, and I look forward to working with him, and I look forward to working with my colleagues on both sides of the aisle to tear down the vestiges of the failed GSE experiment and build in its place a new housing finance system that provides opportunity, affordability, and sustainability for homeowners, for taxpayers, and for the broader economy.

I now recognize the ranking member for 3 minutes for an opening statement.

Ms. WATERS. Thank you very much, Mr. Chairman.

Today, we welcome back our former colleague and my good friend, Federal Housing Finance Agency Director Mel Watt. It has been more than 2 years since Director Watt last testified before us. I must note that, while he has been hard at work righting the path of Fannie Mae and Freddie Mac, this committee has been at a standstill on housing finance reform.

Under Director Watt's leadership, the Federal Housing Finance Agency has systematically addressed many of the technical weaknesses in the housing system to better protect homeowners, taxpayers, and our economy. The GSEs have now transferred to the private sector an amount of credit risk comparable to that lost by the GSEs during the crisis, thereby protecting taxpayers in the future.

Director Watt has also sought to improve affordability, by, for example, enabling qualified, creditworthy families to purchase homes with as little as 3 percent down, proving that such borrowers are just as responsible as those with more means. Unfortunately, for the last 7 years, under Republican control, the House has entirely failed to advance broader legislation reforms to end the GSEs' conservatorship. In fact, this committee has not convened a single hearing since Director Watt's last appearance before us more than 2–1/2 years ago on any topic related to reforming the GSEs. Even the Senate, known for its slow deliberation, has already convened two hearings on the topic this year.

Unfortunately, our chairman refuses to abandon the failed ideas in the PATH Act, which is still opposed by industry, consumer groups, civil rights groups, all Democrats, and even a few Republicans. Those who oppose understand that the PATH Act hurts middle class families and is bad for America. Democrats and the American people know what is important in the housing finance reform debate: an explicit paid-for government backstop, a mission to promote affordability, the 30-year fixed rate mortgage, a robust Housing Trust Fund, strong Federal oversight, support for the multifamily housing market, and equal market access for our community banks and credit unions. Any proposal that fully embraces those principles should be taken seriously.

I thank you, Mr. Chairman. I welcome you, Mr. Watt. And I yield back the balance of my time.

Chairman HENSARLING. The chair now recognizes the gentleman from Wisconsin, Mr. Duffy, the chairman of the Housing and Insurance Subcommittee, for 1–1/2 minutes.

Mr. DUFFY. Thank you, Mr. Chairman. And, Mr. Watt, welcome back to the committee.

While the pivotal role that the housing crash played in the financial crisis is well-documented, we still haven't passed significant reforms to housing finance in over a decade. Since the 2008 crisis, significant reforms in this space haven't been addressed. We passed a big bill, Dodd-Frank, but as you are well aware, and so is this committee, this space for the most part was left alone.

So this hearing kicks off what will be several hearings held by Chairman Hensarling and myself this fall as we look to finally address the root causes of the 2008 financial crisis.

Mr. Watt has been at the helm of the FHFA for over 3 years now, and I want to hear exactly what he has done at the FHFA to reduce GSEs' risk to American taxpayers. In particular, I am interested in hearing updates in the area, as the chairman mentioned, on credit risk transfers, the common securitization platform, and how private sector capital can play a larger role in housing finance reform.

I think the main question here is, are we better off today than we were in the lead-up to the 2008 crisis? What reforms have been undertaken to have learned the lessons from the 2008 crisis? Or are we in a space where we believe that time heals all wounds? This was almost 10 years ago. We have forgotten the lessons learned and we are going back to the ways of old, which we understand is horrible for the American homeowner and devastating to the American economy.

With that, I yield back, Mr. Chairman.

Chairman HENSARLING. The gentleman yields back.

The chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of the Housing and Insurance Subcommittee, for 1 minute.

Mr. CLEAVER. Thank you, Mr. Chairman, Ranking Member Waters. Thank you for being here, Mr. Watt.

Let me just say that, whether there has been significant reform over the 2 years since you have been there, I think it is also important to know that, legislatively, we have not done anything in terms of reform. And so I am not sure whether the suggestion is we should turn all reform over to the FHFA. I am willing to do that, at least for the next year and a half.

But it has now been over 9 years since Fannie Mae and Freddie Mac have been placed in the conservatorship. And as we all know, at that time, the U.S. Treasury also entered into a preferred stock arrangement with Fannie and Freddie, and under that arrangement, $270.8 billion in dividends has been paid to the Treasury. And that far exceeds the amount that either enterprise has needed in assistance from the U.S. Treasury. Fannie has not needed to draw down assistance from the Treasury in the last 6 years, and Freddie has not needed it since 2020.

Today's hearing, I hope, will give all of us an opportunity to hear more about the steps that have been undertaken by FHFA, and I hope that from your presence before our committee we will take the responsibility of legislating.

I yield back. No time left.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Michigan, the vice ranking member, Mr. Kildee, for 1 minute.

Mr. KILDEE. Thank you, Mr. Chairman. And thank you, Madam Ranking Member.

Welcome back, Mel. I was fortunate to serve with you, as most of us have. We miss you here, but the country's better off for having you working in the position you are in right now.

Since the 2008 crisis, a lot of communities have realized restoration of housing values, which is obviously good news. But in a lot of places, including many of the places I represent in Michigan, they have not shared in that rebound. And so I am particularly concerned about policies that might impact that.

And I will share that I am concerned about bulk sales of bank-owned houses and how these might contribute to an uneven recovery. I know Mr. Capuano and I both have voiced concerns over these sales, especially the recent $1 billion deal with the Blackstone Group. So I am anxious to hear how these bulk property sales to hedge funds and private equity groups fit within the responsibilities of FHFA.

The bulk sale of foreclosed homes to people who don't live in these communities and are not really invested in these communities can actually stunt revitalization. So I am anxious to hear how we might work together and how Congress might act to support efforts to ensure that local development organizations, community-based organizations, focusing on affordable housing, public land bank authorities, there are 140 of them that I helped create across the country, how they might be able to work to ensure that the disposition of the properties has a positive impact on the other investors who live in the houses that surround the subject property. I am anxious to hear how we might work together on that subject.

Thank you, and I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

Before proceeding, I just wish to acknowledge how, as important as this topic is, it pales in comparison, of course, to the tragedy that took place in Las Vegas. And on behalf of the committee, our hearts remain heavy, our prayers remain earnest, and in the days and weeks to come, that simply will not change.

Today, we welcome the testimony of the Honorable Mel Watt, Director of the Federal Housing Finance Agency. Director Watt, again, served with distinction with many of us on this committee, so it is good to welcome him back, and I believe he needs no further introduction.

Without objection, the witness' written statement will be made part of the record.

Director Watt, you are now recognized to give an oral presentation of your testimony. Thank you.

STATEMENT OF THE HONORABLE MELVIN L. WATT, DIRECTOR, FEDERAL HOUSING FINANCE AGENCY

Mr. WATT. Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for inviting me back to testify. I always look forward to being in this committee room where I spent so many years. And after more than 3–1/2 years at the Federal Housing Finance Agency, I look forward to talking about our work to support the Nation's housing finance system.

In addition to FHFA's role as regulator of the Federal Home Loan Bank system, Fannie Mae and Freddie Mac, we also are responsible for Fannie Mae and Freddie Mac in conservatorship. These conservatorships are unprecedented in scope in that the enterprises back over $5 trillion of mortgages, and they are unprecedented in duration in that they have now continued for over 9 years.

My commitment during my tenure as director of FHFA has been to uphold the statutory responsibilities assigned to FHFA as regulator and to operate Fannie Mae and Freddie Mac in conservatorship in what I often refer to as "the here and the now." This is in line with my consistently repeated belief that it is the role of Congress, not FHFA, to decide on housing finance reform.

We will continue to ensure that our regulated entities operate in a safe and sound manner and support liquidity in the housing finance market. As conservator, we will also work to preserve and conserve enterprise assets. Balancing all these responsibilities is woven into everything we do.

Over the 9-plus years that the enterprises have been in conservatorship, FHFA has taken significant steps to reduce the risk of their operations. After an extensive review of the guarantee fees they charge, we determined that these fees have been raised to appropriate levels. We have continued to oversee reductions to the enterprises' retained portfolios, which are now over 60 percent smaller than in 2009.

Another ongoing priority has been expanding and improving the enterprises' credit risk transfer programs in ways that attract private capital, reduce taxpayer risk, make economic sense, and broaden the private sector investor base. The enterprises now transfer a meaningful amount of credit risk to private investors on at least 90 percent of their targeted single-family loans. Since 2013, they have transferred a portion of credit risk on $1.6 trillion of mortgages, totaling $54 billion risk in force.

We continue to make steady progress on developing a new securitization infrastructure that will be adaptable for other market participants to use in the future. Since late 2016, the common securitization platform is now processing the majority of Freddie Mac's existing securities. The next project milestone will be launching the Single Security Initiative in 2019, after which the securities of both Fannie Mae and Freddie Mac will be processed on the common securitization platform (CSP).

Responsibly broadening access to credit for creditworthy borrowers is another consistent effort. An example is our statutory mandate to oversee the enterprises' duty to serve three markets: manufactured housing, affordable housing preservation, and rural housing. The enterprises are on track to start implementing their duty-to-serve plans starting in January 2018.

In my most recent testimony before the Senate Banking Committee and in my written testimony for this hearing, at pages 3 through 5, I provided details on the above steps and on numerous other steps we have taken to reform the enterprises over the 9 years the enterprises have been in conservatorship.

While I like to think of the steps we have taken as GSE reform, I want to reiterate my strong belief that it is the role of Congress to make the tough decisions that I think of as housing finance reform. This will involve deciding how much backing, if any, the Federal Government should 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, the enterprises should 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; and what regulatory and supervisory structure and authorities will be needed in a reformed system and who will have responsibility to exercise those authorities.

It is important that these decisions get made expeditiously. Just as the conservatorships are unprecedented, I also firmly believe that the conservatorships are unsustainable.

Before I close, let me take a moment to say a few words about the recent hurricanes that have affected so many people. FHFA and our regulated entities are working to assess the impact on the housing market and to assist those affected. The enterprises have implemented their disaster relief policies for affected homeowners, and we will continue to monitor the impact of these hurricanes closely.

I thank you again for inviting me to be here today. I have provided much more detail about FHFA's activities in my written statement, and I look forward to answering your questions.

[The prepared statement of Mr. Watt can be found on page 62 of the Appendix.]

Chairman HENSARLING. The chair now yields himself 5 minutes for questions.

Before proceeding with my questions, though, I do wish to take sad note that I believe since last we gathered, the national debt clock has now turned from $19 trillion to $20 trillion, perhaps the greatest existential threat to our Nation that practically no one in the Nation's capital is paying attention to, but we will at least pay attention to it here since, if we do not correct this trajectory, we will wake up one day and find ourselves a second-rate military power, a second-rate economic power, and lose our moral authority.

Mr. Watt, in June 2017—you are probably familiar with the Treasury Department report—in it, they spoke about the exemption the GSEs have been granted from the Consumer Financial Protection Bureau's (CFPB's) qualified mortgage rule and said that has resulted in a concentration of the mortgage market in the government-sponsored programs because the exemption allows the GSEs to securitize loans that obviously private institutions cannot. Treasury said this creates an asymmetry and regulatory burden for privately originated loans.

Is there anything FHFA can do to help level this playing field or is this a matter for CFPB or perhaps Congress?

Mr. WATT. Well, the qualified mortgage (QM) standards, which were adopted pursuant to legislation passed by this committee and the House and Senate and signed by the President, are important. And you know how important they are to me, because I was the originator of the idea of having a requirement that borrowers be able to document their ability to repay their loans.

Chairman HENSARLING. Well, should it apply to the GSEs, because today it doesn't?

Mr. WATT. Well, the way the mechanism was set up with CFPB was to look at it. We were to responsibly, as conservator and regulator, look at alternatives to it, alternatives to QM. And then after a period of time, CFPB was to go back and reevaluate that. And that reevaluation process has now started and will culminate in perhaps a new QM standard that recognizes a merger of what we have been doing and testing as safe and sound.

Chairman HENSARLING. OK. But besides the asymmetry, the fact that GSEs do not adhere to the QM rule, doesn't this mean that they are underwriting riskier loans?

Mr. WATT. No, I don't think so. What it—

Chairman HENSARLING. Then why should QM apply to private institutions?

Mr. WATT. What it recognizes is that there are probably loans outside the QM standard that are safe and sound that will allow qualified borrowers who are able to pay their mortgages to have access to credit. And so if we responsibly oversee that, which we have, then we can develop, on a parallel track with QM, to test what will work in the marketplace without getting back into a—

Chairman HENSARLING. There still remains an asymmetry.

Let's talk a little bit about underwriting standards. Former Chairman Barney Frank of this committee once said, quote: "It was a great mistake to push lower income people into housing they couldn't afford and couldn't really handle once they had it," unquote. That was Chairman Frank.

I am really wanting to know, again, focusing on underwriting standards, how do we ensure that we don't end up hurting the very people that we are trying to help and ensure they have homes they can afford to keep? And in that regard, you have lowered, at least on some of the loans, the downpayment to as low as 3 percent. So I am trying to figure out, what is it the FHA is doing to ensure these loans are sustainable and that taxpayers are not left holding the bag, particularly as you lower standards with 3 percent downpayment?

Mr. WATT. This is exactly one of the things that we are doing on a parallel track with QM, testing to see whether that is safe and sound and sustainable. And you may be surprised to know that those loans, which represent about 3 percent of the enterprises' portfolio, the new loans that are being made, their default rates are equivalent to QM default rates, which is close to nothing, really, less than 1 percent.

Chairman HENSARLING. Well, Director Watt, I hope that proves true on a go-forward basis, because I fear similar words were uttered in this committee room a number of years ago, and we know where it led us.

My time has expired. I now recognize the ranking member for 5 minutes.

Ms. WATERS. Thank you very much.

Since the chairman took a moment when it was time for him to speak about the national debt, I would like to include this in the record. Estimates say the proposed tax reform measures of the President and the Republicans could add more than $2 trillion to the national debt over the next decade. The national debt, of course, is currently over $20 trillion, more than 100 percent of U.S. gross domestic product, a level that worries many economists and policy analysts.

And I would just add, if the chairman is concerned about that, perhaps a second look should be taken at the tax reform measure that I think he now supports.

Having said that, let me talk to Mr. Watt about the Housing Trust Fund. FHFA plays an important role in expanding affordable housing. And under your leadership, the Housing Trust Fund and Capital Magnet Fund have started to receive funding to do just that. In particular, the Housing Trust Fund is the only Federal housing program that is targeted for the creation and preservation of rental housing that is affordable for extremely low-income (ELI) households.

Los Angeles is among the top three metro areas with the lowest availability of rental units affordable to extremely low-income households, with just 17 units affordable and available to ELI households for every 100 renter households. The Los Angeles metro area has a deficit of 382,106 units that are both affordable and available to ELI households.

In the midst of the current rental housing crisis, the need for a Housing Trust Fund is abundantly clear, and I believe that preservation of the Housing Trust Fund should be retained in any GSE reform package that Congress passes.

Can you discuss FHFA's broader strategy on expanding affordable housing and the progress you have seen since Fannie and Freddie have begun to fund this important program?

Mr. WATT. So let me start with the funding of the Housing Trust Fund. You know it was suspended for a period of time, and I reinstated the contributions to the Housing Trust Fund. But you will recall, in my confirmation hearing in the Senate, I said, look, my role is to apply the statutes that you all have adopted. I come from the legislative branch, so I have the highest respect for laws that get passed. I practiced law for a long time.

And the statute said what the funding formula would be. And the statute said, unless we could demonstrate that funding them contributed to the financial instability of the enterprises, that we were required to fund them. And for a period of time they were not funded, because they would have contributed to the financial instability. But Fannie and Freddie are back on stable financial ground, and that was no longer true. So all I was doing was applying the statute as it was written, and I will continue to do that.

Now, we have made additional steps outside the Housing Trust Fund. Of course, FHFA does not control the disposition of the funds that go into the Housing Trust Fund. The Treasury Department controls part of them and the U.S. Department of Housing and Urban Development (HUD) controls the other part. We have nothing to do with the actual application of the funds. Those funds go into the Trust Fund. They get distributed by other agencies.

We have taken steps outside of that to increase access to credit in a responsible, safe, and sound manner, as one of the programs that I just described to Chairman Hensarling, but we always do it conscious of—we always do it in a very narrow way, and we do it monitoring it consistently and making sure that we are not doing anything that is unsafe and unsound to the system. And we do it in a way where we try to make sure that every borrower has the ability to repay his or her loan. Because if payment is not sustainable, it gets the enterprises into trouble, it causes taxpayers problems, and as importantly, it causes borrowers problems, and we have no interest in doing either one of those things.

Ms. WATERS. Thank you very much. I yield back.

Chairman HENSARLING. The chair now recognizes the gentleman from Wisconsin, Mr. Duffy, Chairman of our Housing and Insurance Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman.

And, again, welcome, Mr. Watt. I am going to drill into this issue on the QM rule. Do you think the GSEs should adopt the QM rule as written?

Mr. WATT. No. And for the same reason that I just explained to Chairman Hensarling. The process was set up to have a QM rule; and parallel to that, with somebody intensively supervising what was happening in the space, a process was set up to determine whether other non-QM loans could be sustainable. And over time, those two things will be merged and the information will be collected and a determination will be made.

Mr. DUFFY. I will accept your answer. Let me take a step back, because you have indicated I am concerned about borrowers and are borrowers getting loans that they can't repay? And shouldn't we as policymakers—you were one of them on this committee—say, let's look at the debt-to-income of the borrower to make sure they can pay their loan? Right? That was the concept that you had.

So if you look at the QM rule, and you can have a debt-to-income ratio of 43 percent as a non-GSE borrower, but if I go to the GSEs, I can have a debt-to-income ratio of 50 percent, me as the borrower, how is it different for me if I have my debt held by the GSEs or securitized by the GSEs or a private entity? For me, the debt is the same. Why do we let you have debt-to-income ratios that are much higher if you care about the people who are getting the loans? Do you understand the question?

Mr. WATT. Yes, I understand your question. Let me respond to it. What you find out very quickly if you are in the mortgage lending or any lending space is that one size does not fit all. There is nothing magic about a 43—

Mr. DUFFY. Mr. Watt—

Mr. WATT —debt-to-income ratio.

Mr. DUFFY. Mr. Watt, hold on a second, because I don't have much time. I don't mean to interrupt you and I know I am. But you supported a QM rule that was a one-size-fits-all. That was the idea in this. One-size-fits-all, 43 percent, but we are going to exclude the GSEs and get us to 50 percent. So this rule is one-size-fits-all.

Mr. WATT. Let me ask this question: Do you think there are people between the 43 percent debt-to-income ratio and the 50 percent debt-to-income ratio that can afford to pay a loan? All of the research that we have suggests that there are multiple people, if you are careful about making loans to them, if you give them credit counseling, if you are very careful in the selection of them. And to do otherwise would be to deprive those people who deserve to have home ownership, just like you and I do, of the ability to do that. And that is not the concept that this country has ever followed.

Mr. DUFFY. We are dancing together now, because then we are going to both agree that maybe the concept of a hard-and-fast qualified mortgage rule might have been flawed, or the—

Mr. WATT. Well, we both agree on that because, over time, we are going back to look at whether it should be 43 percent or whether it should be higher. We don't disagree on that. You and I are—you are right, we are in—

Mr. DUFFY. We are talking—maybe we are going to join and say Richard Cordray at the CFPB got this wrong. Maybe he made a hard-and-fast rule. Maybe we have to look at other factors in how we look at what a qualified mortgagee looks like. And so I will join you in saying Richard, Director Cordray, he missed the boat on this.

And I am going to pivot. Isn't it fair to say too that we have given a benefit now to the GSEs far over the private sector? And no doubt you have expanded your role in housing finance, because the rule—

Mr. WATT. It is fair to say that, yes.

Mr. DUFFY —the rules play in your favor. And if we wanted to really adopt the concept that you take credit for, I would hope that you go, yes, Director Cordray might have got this wrong.

Mr. WATT. Well, I don't think Director Cordray made the decision. A whole intersection of his various agencies contributed to that decision. And when the decision is made the next time, Director Cordray won't be there—

Mr. DUFFY. I hope not.

Mr. WATT —so somebody else will make that decision, because it is about 2 or 3 years out beyond—

Mr. DUFFY. We are on the same page. Hard-and-fast rules I don't think work. They don't take into account many factors that we—

Mr. WATT. Which is exactly why FHFA and the enterprises—

Mr. DUFFY. But I would also say, if you support this rule and you are the one who takes credit for it, I think you should live by it. And you should say, if it is good for the private sector, it should be good for the GSEs. If you live by the sword, you die by the sword. And to say I get a benefit of the GSEs for a rule that I promoted to the exclusion of private capital I think is unacceptable.

I yield back, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Welcome, Mr. Watt.

Mr. WATT. Thank you.

Ms. VELAZQUEZ. As you know, Hurricane Maria slammed into Puerto Rico and the Virgin Islands almost 2 weeks ago, causing unimaginable destruction, the likes of which the island has never seen before. I am not saying this. General Buchanan, three-star general appointed to oversee the relief effort, stated that this morning in an interview.

Thousands of American citizens and families remain homeless. This season, hurricanes have also ravished parts of Texas, Louisiana, Florida.

What steps is the FHFA taking to help homeowners in Puerto Rico and the Virgin Islands and other parts of the country that are suffering as a result of this storm?

Mr. WATT. Congresswoman, we learned a lesson from Hurricane Katrina. The enterprises established standard programs to help homeowners in areas declared a major disaster with individual assistance trying to help people.

The enterprises have a standard 90-day forbearance option that can be extended to up to 12 months. At the end of this temporary payment break, you won't have late fees. You won't have delinquencies reported to credit bureaus. You won't have to catch up on all your payments at once. You can work with your servicer to resume making a mortgage payment that is smaller or similar to what you paid before the disaster. Or if you need additional modification help, you can work with the servicer to modify the loan under existing modification programs.

Foreclosure, sale, and eviction moratoria are in effect. Fliers have been sent to every Member of Congress advising them of this so that they can advise their constituents.

Ms. VELAZQUEZ. The issue that they are facing today is, in Puerto Rico, 95 percent of the households do not have electricity, as well as in the Virgin Islands. Out of 1,600 telecommunication towers, 1,300 are down.

So how is the FHFA trying to reach homeowners in Puerto Rico and other parts of the country?

Mr. WATT. Well, we don't have the capacity or authority or—I mean, we don't control electricity.

Ms. VELAZQUEZ. I understand.

Mr. WATT. We just control the mortgage part of it. And what we try to do is take that burden off of these homeowners so that they don't worry about that as an additional thing that they have got to worry about for a protracted period of time. So—

Ms. VELAZQUEZ. If there is a timeline, how long will people have? Because if they don't have a way to learn about this, it doesn't do any good.

Mr. WATT. We have been very open about making that public announcement. We have given the information to Members of Congress so that they can distribute it. We have publicized it. And in addition, the Federal Home Loan Banks have stepped up. The New York Federal Home Loan Bank placed $1 billion to try to help Puerto Rico and the Virgin Islands and Florida.

But we also have to acknowledge that we don't have control over all of the things that are adversely impacting hurricane victims, and I don't know how to address that.

Ms. VELAZQUEZ. OK. Mr. Watt, as you know, Congress recently passed legislation that reauthorizes the National Flood Insurance Program (NFIP), but that reauthorization only lasts until December 8.

First, can you please speak to the critical role the NFIP plays on the national housing market? And then can you please speak to the importance of passing legislation that not only reforms the program, but also reauthorizes it for the longterm?

Mr. WATT. I think it is critical to have a flood insurance program. I think it is critical for the government to be backing it and for private participants to be participating in it. And as long as the private participants and the government participants are playing by the same rules and required to meet the same standards, we contract with them equally at the enterprises.

But the flood insurance is critical, and we have found it now in these hurricane seasons that it is even more critical than most people had assumed it was.

Ms. VELAZQUEZ. Thank you.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentlelady has expired.

The chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, Chairman of our Financial Institutions Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. And welcome, Director Watt.

One of the things that I have been concerned about and expressed a lot of support for over the last several years here is I would like to see a greater number of front-end credit risk transfers, a move that I believe would drive more business to the private companies, private sector, but it, in my judgment, has been sidelined and not being very effective right now.

In your testimony, Director Watt, you asked the rhetorical question, what do the role—what role does the GSEs have to transfer more of these transactions to the private sector? I think it is one of your stated goals is to reduce risk by increasing the amount of these transfer deals. But to date, most of these transactions have involved the GSEs like yourself onboarding the risk, holding it on your balance sheet up to 15 months, and then laying off the second loss risk using capital markets executions.

So my question is, when can we expect an actual up-front risk share of these transactions? And how can we ramp it up and minimize what the GSEs are doing?

Mr. WATT. We definitely started the process of risk transfer with back-end risk transfers. And we have been working vigorously to try out various mechanisms, both on the back end and on the front end.

In the first quarter of 2017, the portion of risk transferred through back-end transfers was 77 percent. Through transactions with insurers and reinsurers, it was 19 percent. And it was 4 percent on the front-end transaction. So we are tracking this and trying to turn more to front-end if it meets the criteria, if it is viable and it is sustainable.

Mr. LUETKEMEYER. It is hard to wind the GSEs down, though, when you take in more on the front end than you go out the back end, is it not?

Mr. WATT. I don't think that has anything to do with winding down or not winding down. And I don't see anything in my statute that requires me to wind down. If Congress wants to wind down, Congress should wind down the enterprises.

Mr. LUETKEMEYER. Well, I think you made the statement a while ago you got $1.6 trillion that you have transferred off the books. Is that not correct?

Mr. WATT. That is correct. That is reducing risk to taxpayers. That is not winding down the enterprises. We still have to provide liquidity in the market, and we are doing that and then transferring that risk to the private sector to get it off the enterprises' books and potentially off the taxpayers' backs.

Mr. LUETKEMEYER. OK. Before my time runs out here, I have one more question for you. I chair the Subcommittee on Financial Institutions, and one of the things that we are looking at is data security, cybersecurity. In this next 2 days—

Mr. WATT. I am sorry, you are looking at what?

Mr. LUETKEMEYER. We are looking at data security and cybersecurity as the top topics of the day here. And this week, in fact, we are having Secretary Clayton, the SEC, in tomorrow to testify in front of this committee. I think on Thursday we have got another hearing with regards to data security that deals with Equifax.

So these are top of mind. And I know you made a comment here in your 2016 annual report to Congress that operational risks associated with information security and cyber risks are significant for the enterprises, as they are for all financial institutions. So if you believe they are significant, Director Watt, what are you doing to protect that data, because we just had a breach with SEC? And what kind of liability do you have? Have you assessed that liability risk?

Mr. WATT. We are doing the same things that everybody is doing in the private sector and in government—to try to protect against cybersecurity risk. I think everybody is behind the curve, because the people who are trying to hack are generally one step ahead of us. But we are doing exactly the same things, and we are vigorously pushing it.

Mr. LUETKEMEYER. Forgive me for interrupting, but I have 30 seconds left here. One of the problems, though, with the SEC was they knew this breach many, many months ago and we just now found out about it. Do you have in place in your agency any protocols that say, when we know that a breach has occurred, we will notify everybody within a certain period of time, or is there nothing in your protocols that—

Mr. WATT. If there is a breach at the enterprises, we know about it instantaneously. There are protocols in place that they have to notify FHFA immediately. And if it were a breach that impacted the public, we would notify the public immediately.

Mr. LUETKEMEYER. OK. My time has expired.

Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Watt, I know it has been 3-plus years, but I can't get used to you down there as opposed to sitting up here, but it is good to see you.

Mr. WATT. Today I would rather be sitting beside you, I think.

Mr. MEEKS. Let me ask you, section 113 of Dodd-Frank provides the Financial Stability Oversight Council (FSOC) with the authority to subject nonbanks to enhanced supervision and prudential standards. And the designation process requires a two-thirds vote, as mandated in Dodd-Frank. And then I noticed last week that FSOC voted to relieve the American International Group (AIG) of its designation. However, there are legitimate questions about whether the vote was conducted properly and if the two-thirds vote was achieved, considering the recusal of the SEC chair, Clayton, and the opposition of three members, including yourself.

So I have two questions on that matter. One, do you think the vote in favor of de-designating AIG was properly conducted, and if not, what is your reasoning? And two, could you discuss your no vote and your perspective on the risk you believe AIG may still pose to our financial system?

Mr. WATT. So I dissented from the FSOC decision both on substance grounds and on process grounds. There are 10 members, voting members of FSOC. A designation or de-designation requires a two-thirds vote. And the question was whether the denominator was going to be 10 or whether it was going to be 9, because SEC was recused from the vote.

I thought the statute required 7 out of 10 rather than 6 out of 9. So that would have been a two-thirds vote. And I understand the reasoning that went into it, but that is where I—after looking carefully at the law and having our general counsel's office research it, we landed there, that 10 should be the denominator, not 9.

On the substance, there are two standards under FSOC for determining whether somebody should be designated for a higher standard of supervision. And the designation of AIG was made on one of those standards, never looked at the second standard. And when it came time to de-designate or consider de-designation, they again looked at only the one standard as opposed to looking at the other standard.

I actually agreed with them in their assessment on the one standard. My dissent was based on the fact that they had never looked at the second standard and that I thought it was improper to de-designate without making an independent evaluation under the second standard. It was a legal—and, actually, I was the only member of FSOC that—one other member joined me in the dissent, but I was the only member that raised this.

Congress set two standards, and I think we are obligated to do what Congress tells us to do under the statute. And I don't believe FSOC did what we were obligated legally to do, because we looked at only one of the standards and ignored the second standard.

Mr. MEEKS. So do you see any prospective risk still as far as the de-designating as far as AIG is concerned, any dangers?

Mr. WATT. Well, it is clear that AIG is somewhat smaller in some respects than they were. They have gotten out of some of the businesses that led—particularly in the mortgage market, they were just insuring mortgages with no basis for insuring them. They are out of that business now.

So I think if we looked at the second standard, we may find that they still should be de-designated, but I don't think we can ignore the statutory requirements and just ignore one of the two standards. And that was the basis on which I dissented substantively from the decision.

Mr. MEEKS. I am out of time. I yield back.

Chairman HENSARLING. The gentleman's time has expired.

The chair now recognizes the gentleman from Michigan, Mr. Huizenga, Chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. And welcome back, Director Watt.

Mr. WATT. Thank you.

Mr. HUIZENGA. Real quickly, I am going to try and move through a couple of issues here. One on Puerto Rico, as my colleague from New York was asking. You had said—and I wrote this down. I think you said that you anticipated that taking the burden off of homeowners would be for a, quote, "protracted time period."

Mr. WATT. Ninety days up to a year. I don't want you to read protracted beyond a year.

Mr. HUIZENGA. OK. That is why I wanted clarification, because we know that the banking system is not up, and we have been asking a number of those questions. Payment systems are not up. So does that mean that there is going to be a suspension of any of their payments or is it going to be accrued that they will have to pick up those payments later? How is that going to work?

Mr. WATT. They would pick them up, but they would pick them up on the back end, unless they modified the loan.

Mr. HUIZENGA. Basically—

Mr. WATT. Now, there are modification programs that they could get, but they wouldn't be penalized. They wouldn't be doubled up immediately. They would be just put on the back end.

Mr. HUIZENGA. And that is not just Puerto Rico. The same thing is happening for Harvey and for Irma, correct?

Mr. WATT. Yes.

Mr. HUIZENGA. Yes, OK. All right. I just wanted to make sure that that was the case. It is vital that we get help to those folks.

Secondarily, I want to touch on a couple of IG reports that have come to light. One, I am assuming that you are familiar, the report December 6 of 2016, regarding vehicle usage and FHFA employees' use for personal travel. I am not going to beat you up too badly on it. What I am confused about—

Mr. WATT. I hope you will, because—

Mr. HUIZENGA. But I am confused on it because why it was redacted as extensively as it was, and then last night there was a leaked nonredacted copy of that. And it seems vehicle usage with security and all those kinds of things.

What my question is is, there was, I believe, seven very specific items that the IG had recommended. Are you implementing those recommendations?

Mr. WATT. We have already implemented all of them. And the newspaper coverage made it sound like I somehow demanded this. I was told that this was the policy.

Mr. HUIZENGA. And I read the report, and the acting director prior to you had death threats and they were extending some of those things, I think.

Mr. WATT. And it is exactly what Members of Congress—I had been used to it for 21 years as a Member of Congress, having my personal travel done by my office here. It is just a coordination issue, from my perspective.

Mr. HUIZENGA. And that was my question. I just wanted to make sure that you were familiar with it and you were doing it.

What I think is more troubling, though, is the second report, June 2016, and then, last week, there was an updated issue and report of Fannie Mae's new building in downtown D.C. It said, quote: "We believe there are"—this is from 2016—"that there are significant financial and reputational risks from the projected costs associated with Fannie Mae's relocation of its headquarters that warrant immediate and sustainable comprehensive oversight from FHFA."

Last week, the FHFA IG issued a followup report, just last week, noting, quote: "We learned that the project's build-out costs had risen dramatically, from $115 million when the agency approved the project in January 2015, to $171 million in March 2016, and that the plans for it included high-end features, such as multi-million dollar glass walkways between the towers Fannie Mae would occupy," end quote.

It has also been reported that the budget for the headquarters includes bars, quartz and glass countertops in the wellness room, town center cafe, freestanding decorative wood, quote, "lunch huts," whatever in the world that is, custom wood menus.

Mr. Watt, we are talking about spending hundreds of millions of dollars, tens of millions of dollars certainly of hardworking taxpayers' dollars on walkways, decorative walkways, and decorative wood lunch huts. I do want to see a picture of one of those.

Is that consistent with how we need to treat those taxpayer dollars? And are you concerned by this? And what are you doing to address these, what I would view as, outrageous overruns?

Mr. WATT. Well, first of all, I don't agree with you that they are outrageous overruns.

Mr. HUIZENGA. OK. Please then—here's my formal request—provide me with a photo of a wooden lunch hut. I want to see what this is. I am in developing. I am a builder.

Mr. WATT. You know, I—

Mr. HUIZENGA. I know what overruns are.

Mr. WATT. But you also know what projections are. And the original IG report was based on projections, and this IG report is also based on projections.

Mr. HUIZENGA. So it could be higher?

Mr. WATT. No. They are coming down every time we get a report, which is exactly what I told the IG.

Mr. HUIZENGA. What decisions have you—

Mr. WATT. Look, I did this when I was in the private practice of law. You set up a tenant improvement allowance and you work toward trying to bring this in under the tenant improvement allowance if you are in the real estate business. And that is what we have been doing.

Mr. HUIZENGA. Mr. Chairman, I will followup with some written questions, and hopefully I will get—

Chairman HENSARLING. The time of the gentleman—

Mr. HUIZENGA. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

Before I get to Mr. Watt, I also want to talk about the debt clock. I will be very clear: Democrats have some blame for the debt clock. I voted for the stimulus. I am glad I did. I thought it was a good thing. I voted for the bailouts. I thought they were a good thing. And by the way, all those bailouts, almost all of them have been repaid. But I will take my share of the blame. But also, the Republicans on the other side voted for tax cuts under George Bush that were unnecessary and for two wars that are still going on that have been unfunded. So we all have something to share in the number that is there. But be warned, the minute you vote to increase it $2 trillion to $5 trillion additional dollars, it belongs entirely to you.

So with that being said—and by the way, I want to be real clear. If you want to cut spending by $2 trillion to $5 trillion, I will disagree, but at least I will think it is internally consistent. The only thing I will say to that is I have no doubt whatsoever that the chairman would do so; and that being the case, that is one of the reasons I respect him, though deeply disagree.

So with that being said, Mr. Watt, I would like to talk about—the one thing normally we talk about is bulk sales, but we have had that conversation repeatedly. I think you have taken some steps in the direction I think is right. Obviously, you know I would like you to do more and quicker, but a discussion for another day.

I would like to talk a little bit about capital reserve. As I understand it, in the last 5 to 6 years, Fannie Mae and Freddie Mac have pretty much both made a profit, for the lack of a better word. Their revenues exceed their expenses. Is that right?

Mr. WATT. If you define profit that way, yes.

Mr. CAPUANO. Well, I am using the term loosely, mostly so average people, including my colleagues here, can understand. I will speak slower for some of them.

And so if they have what normal people would call a profit, that means their cash-flow has been positive over the years. That means your capital reserve must be incredibly good. You must have a lot of money there. So God forbid there is another bump in the economy, you will be able to cover it without a taxpayer bailout. Is that a fair assessment?

Mr. WATT. Well, not without drawing on taxpayer funding. We have taxpayer backing, but we have no capital buffer.

Mr. CAPUANO. No capital reserve? What has happened with all the money you made?

Mr. WATT. We have $600,000 until—$600 million until the end of the year, but then it goes to zero.

Mr. CAPUANO. And so what happened has with all the money you made?

Mr. WATT. It has gone to the Treasury under the—

Mr. CAPUANO. To the Treasury? To the general fund?

Mr. WATT —under the preferred stock purchase agreement (PSPA).

Mr. CAPUANO. Who pays all the revenue that you get? Am I wrong to think that the vast majority of your money comes out of fees that are charged to middle-income homeowners on top of their mortgage? Is that where most of the money comes from—almost all of it?

Mr. WATT. Yes. Disproportionately more and more of it is coming from that as opposed to portfolio income.

Mr. CAPUANO. So middle-income homeowners are paying extra on their mortgage so the United States Government's books look better than they should. By the way, those people are still paying income taxes and corporate taxes and all the other taxes that everybody else pays.

So they are paying extra for the ability to own a home? Do they know this? Have they been told this?

Mr. WATT. Well, I don't get into that part of it. What I have been very transparent and open about is that it is really irresponsible to try to run any business without some kind of capital cushion.

Mr. CAPUANO. So would you, if you have your druthers, would you like to increase that reserve?

Mr. WATT. Yes. And we are working with the Secretary of the Treasury to try to resolve that issue.

Mr. CAPUANO. It is my understanding that he doesn't think you should.

Mr. WATT. Well, I wouldn't say that. We are working with him now to try to resolve the issue.

Mr. CAPUANO. As I understand it, you need the permission and the agreement of the administration in order to do that. But you don't need—

Mr. WATT. No, I don't absolutely need it. I could do it by myself.

Mr. CAPUANO. Oh, good.

Mr. WATT. But I don't think that would be the best way to do it.

Mr. CAPUANO. I would agree with your interpretation, but some people might disagree with that. And I know there will be a family fight about who has the authority to do what. But it is unequivocal that you have the authority to lower fees on your own. No one has to approve those.

Mr. WATT. Well, I wouldn't lower fees to solve this problem.

Mr. CAPUANO. No, no, it won't solve the problem. But if the money is—if I am paying a mortgage and I know you are taking money and not building up a reserve and not using it to help me, and I am just adding, it is like an extra tax on me.

Why would you want to do that? If you can't buildup a reserve and therefore help provide housing to America, why don't you just cut the fees and that will solve all the problems. They are not going to let you keep it or give it back to your investors or reduce mortgages. Just cut the fees, that way you would effectively be reducing mortgages.

Mr. WATT. I don't think I could statutorily, consistent with the statutes, cut the fees to take that into account because I have an independent statutory responsibility in setting guarantee fees that are reasonable.

Mr. CAPUANO. I think you could, but we will talk about that later.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Kentucky, Mr. Barr, Chairman of our Monetary Policy and Trade Subcommittee.

Mr. BARR. Director Watt, welcome back to the committee. Good to see you.

I know you share the general concern that the government has a near monopoly in the mortgage market. I think the most recent statistic, from 2017, is that 97 percent of all mortgaged-backed securities issued this year are explicitly backed by the Federal Government.

Given some of the changes that you started to make at FHFA, do you agree that additional steps should be taken to encourage greater private sector participation in the housing finance market?

Mr. WATT. Yes, and we are in the process of doing that through the risk transfer program.

Mr. BARR. Right. And I have read your report on risk transfer, and I want to get to that in a minute, and I applaud you for that, and I think more can be done.

But let me just revisit a little bit of the discussion from Chairman Hensarling and Chairman Duffy, a little bit more about the asymmetry with the qualified mortgage rule.

I agree with you that one size does not fit all. I also agree with your comment that there is nothing magic about the 43 percent debt-to-income ratio. And that is exactly why I have introduced legislation called the Portfolio Lending and Mortgage Access Act. And that bill would allow a credit union or a community bank to portfolio a mortgage that doesn't fit within the CFPB's credit box, but where there is a personal relationship between that community banker and that farmer in rural Kentucky. And that farmer has never missed a payment in 30 years, but may not fit within the rigid, one-size-fits-all CFPB QM rule.

My question to you is, given our agreement on this point, would you support that legislation? And don't you agree that this one-size-fits-all CFPB QM rule is a regulation that is keeping private capital from coming back into this market? And given your goal of bringing private capital back in the market, wouldn't you support that legislation?

Mr. WATT. Well, we don't support legislation one way or another. That is just not in my portfolio to either support. We apply legislation after it is passed and signed into law, but I just don't have the—

Mr. BARR. Let me ask the question this way. Under the CFPB QM rule, if a bank or credit union originates a loan with a DTI greater than 43 percent, that lender is liable, is subject to legal liability to a defaulting borrower. Is that correct?

Mr. WATT. They would be subject to legal liability to a defaulting borrower whether they were within QM or outside QM.

Mr. BARR. Right.

Mr. WATT. So that is not the difference between QM and—

Mr. BARR. Under the GSE exemption, the GSEs are not—are not subject to that same liability.

Mr. WATT. We would be subject to the same. If somebody fails to pay a mortgage, there is no free lunch in this space.

Mr. BARR. The point is, why would we want to limit affordable housing options, but instead of putting the risk of a riskier loan on the taxpayer, why wouldn't we want that risk to go on the shareholders of a private community bank, especially one that is not systemically risky?

Mr. WATT. That risk is still there if credit unions and other lenders can make loans outside QM, they just don't have a safe harbor presumption. So there is nothing legally to restrict them from doing that.

Mr. BARR. So I think, just to conclude the conversation here, I think a portfolio lending solution for community banks and credit unions is a lot better way to bring private—No. 1, to provide that affordable housing flexibility, but do so in a way that doesn't put the taxpayers at risk and brings back private capital into housing finance.

So I think we are on the same page here, I just don't think the GSEs should be doing it. I think community banks and credit unions should be doing it, particularly those that are not systemically risky.

Let me move on to the credit risk transfer issue. And one question I have for you is, how have the high capital requirements affected dealers' ability to make markets in credit risk transfers? So the high capital requirements, are they precluding the credit risk transfer progress that you are trying to make?

Mr. WATT. I am not sure exactly that I understand your question.

Mr. BARR. Do they—do the high capital standards prevent—

Mr. WATT. What I found out pretty quickly is in this area you have to have capital to do about anything. And there are capital requirements associated with virtually everything that we do, which is one of the concerns that I have expressed to Mr. Capuano.

Mr. BARR. Well, of the total 5 trillion in GSE credit guarantees, how much of that risk has been transferred away from the GSEs through these transfer programs?

Mr. WATT. I am sorry, repeat the question.

Mr. BARR. Of the 5 trillion in credit guarantees, how much have you transferred away to the private sector?

Mr. WATT. We have transferred part of the credit risk on $1.3 trillion over the last 3 years. Now, those are new loans, and we have other programs to transfer older loan credits, and we are doing that.

Mr. BARR. My time has expired. I think more can be done. Thank you for your testimony.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Yes. Thank you, Mr. Chairman.

Welcome home, Mel. Good to see you.

Listen, I want to take my 5 minutes so that you can have time to share with the American people what you have been doing over there that is very beneficial.

Now, I have followed your career over there since you left. Worked with you. And there are three pillars that I would like for you to address that go right to the heart of some of the comments from my Republican friends.

First of all, HARP, the Housing Affordable Refinance Program. Is it not true that because of your efforts with HARP, over 3 million underwater or near underwater American families have benefited?

Mr. WATT. You know, Congressman Scott, one of the untold stories of this meltdown will be the people whose homes went underwater and they continued to pay their mortgages. And the HARP program was designed to help that category of people, people who, against all odds, they may have had a debt-to-income ratio of 80 percent, not 50 percent, but they continued to pay their mortgage because they knew they needed that home.

Mr. SCOTT. Right.

Mr. WATT. And the HARP program has been very successful in helping those people.

Mr. SCOTT. Exactly. I only have 5 minutes, but I want to get to another point, because a lot has been made here about the common securitization platform. And I want to make sure that folks understand. C-SPAN has a big audience, this gives you an opportunity.

But let's talk about that credit risk transfer that my colleague on the other side just talked about. Isn't it true that you used the credit risk sharing with the private sector, which has greatly reduced taxpayer exposure to Fannie and Freddie? Is that not true?

Mr. WATT. Yes, that is true.

Mr. SCOTT. Absolutely.

Now, let's go to the common securitization platform. Under your leadership at the FHFA, you have made moves to develop what is known as single security. Please explain how that is beneficial.

Mr. WATT. So in the marketplace, Fannie Mae and Freddie Mac securities were trading at different values, and Freddie Mac has been subsidizing for years its security to try to equalize it. So the single security will make both Fannie Mae and Freddie Mac securities fungible, so to speak, and eliminate that trading differential. We project that it will save the taxpayers well over a billion dollars a year or close to a billion dollars a year when that is implemented. And it will be implemented in 2019.

Mr. SCOTT. Absolutely.

The other thing is this. As we look at your position—and I am so delighted that your position will go on until 2019. I hope it could go further. But we are, as a Nation, at a very critical point as far as affordable housing. All we have to do is turn on the television, and we look at what Maria, the hurricane, has devastated, almost utterly destroyed, homes of American families, American citizens, and Puerto Rico. And there is a huge cry for this Federal Government to do much, much more, and it is very critical that we have you in this position to do that.

But not only that. When we look at Texas, we look at Florida, I don't think there has ever been a time in American history where we had this convulsion of hurricanes that have utterly destroyed homes that put you in the position of needing to provide the help of restructuring it and making sure it is affordable.

And that, my friend, is what I think, and why I think you have done an extraordinary job, and we look forward to you continuing to do more.

Mr. WATT. I thank you for the compliment.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Ohio, Mr. Stivers.

Mr. STIVERS. Thank you, Mr. Chairman.

Thank you, Mr. Watt, for being here. I appreciate your service and what you do.

I want to ask a few questions. The first, as you know, the GSEs are enormous and they are concentrated in one asset class, and that is housing. Fannie and Freddie are the very definition of systemically important financial institutions, without actually having that designation.

So if the GSEs were to one day come out of conservatorship, can you give us your thoughts on what the capital requirements should be of Fannie and Freddie post-conservatorship, and do you think they should have systemically important financial institution (SIFI)-level capital requirements?

Mr. WATT. Well, the last part of the question is easy. I think they would certainly qualify as SIFIs if they were not in conservatorship. And, in effect, being in conservatorship gives them the enhanced supervision that being a SIFI would provide to them, just that FHFA is providing it rather than the Federal Reserve providing it. So that is the easy part.

The capital question is more complicated. And if you ran it on bank standards, you would be talking, what, 4, 5 percent of $5 trillion. That is a lot of money.

Now, we wouldn't do it, I don't think, on bank standards, because if you take the risk transfers that we are doing, that would reduce it some. But I would say probably in the range of 2, 3 percent of 5 trillion would be the capital requirements.

Mr. STIVERS. So I want to followup on something that Congressman Duffy talked about earlier. He talked about it in terms of the new Fannie Mae headquarters. But from an expense perspective, because any money the GSEs don't currently spend is swept to the Treasury, doesn't that create a rather perverse incentive for the GSEs today to spend money?

Mr. WATT. No, because you would think—if you think about the GSEs, Fannie Mae and Freddie Mac, they are the most regulated enterprises in America. They are in conservatorship under the Federal Government's control. And there is no incentive for them to go out and do anything other than try to be efficient. We have replaced their boards in conservatorship. We have replaced substantial parts of their top management in conservatorship.

The notion that there is some irresponsibility going on out there that is running rampant is just—it is fiction. And even in the space context that I was asked about, if you look at the whole dynamic, we are going to save the taxpayers millions of dollars by making the move from Fannie's current location to the new location.

Mr. STIVERS. So you see the headquarters in your conservator role as a cost-saving measure?

Mr. WATT. Absolutely. And if you haven't read the reports on it, you should read it. We have run the numbers. And it is in somebody's interest, sometimes it is in the IG's interest to make it sound like there is irresponsibility going on, but that is, you know—don't get me started talking about my ideas.

Mr. STIVERS. OK. So last question. You talked a little bit about, in your testimony, how you review the gaurantee fees (Gfees), try to make sure they are at an appropriate level. Can you help us understand what criteria you use when you review the Gfees?

Mr. WATT. Well, Gfees are designed to cover administrative costs, the risks that are associated with loans, operating costs. And we have factored all of those things into a determination of what the Gfees are, and we are constantly reviewing them and reporting to Congress annually.

Mr. STIVERS. One quick followup. Do you think there is any way some private sector evaluations could be used in evaluating that risk?

Mr. WATT. We use private sector evaluations. We use the same standards that anybody else would. And if you look at what the private sector is paying in the risk transfer space, it has actually verified the reliability of the Gfees that we set.

Mr. STIVERS. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Missouri, Mr. Cleaver, Ranking Member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Watt, you were here, as well as I, and Ranking Member Mrs. Maloney and the chair, in 2008 when Ed DeMarco suspended payments to the two funds, the Housing Trust Fund and Capital Magnet. And I think it was last year, I can't remember exactly when, you—

Mr. WATT. Year before last.

Mr. CLEAVER. Year before last. You actually ordered the payments being made to those two trust funds.

I live here in D.C., not far from the Capitol. My rental payment is significantly higher than my mortgage payment in Kansas City. And every time I make the payment at the beginning of each month, I think about the fact that for the extremely low income, they are paying more than half of their income on rent. And I think we are about 7 million units short of affordable rental units. So your decision is something that I applaud.

Do you think this rebalancing is enough? And if not, what other steps should be taken, at least either administratively or legislatively?

Mr. WATT. First, let me go back to the beginning of your question and make it clear that when I reversed the decision not to fund the Housing Trust Fund, I made it clear that that decision, when it was made, I thought was the appropriate decision, because Fannie and Freddie at that time were bleeding blood, so to speak.

So my decision was made on a different standard—on the same standard at a different time, let me put it that way. So I have been clear on the record, my reversal was not a criticism of the decision that Ed DeMarco made as director of this agency.

Now, the funds go into—half the funds go to Treasury and half the funds go to HUD. What they do with the Housing Trust Fund funds, we don't have any control over.

What we try to do outside that space, outside the Housing Trust Fund, is to come up with criteria that are reliable criteria of when and how and whether a borrower will make loan payments.

You never want to make a loan to somebody who can't pay it back. But the ability to pay back a loan is an individual person-by-person-by-person decision. And at some point the system got out of whack and loans were being made to people who had no ability to pay them back.

I recognize that on this committee, three terms of Congress before we passed Dodd-Frank. And we introduced bills, if you will recall, that would have set up an ability-to-repay standard before Dodd-Frank, but nobody took it seriously because everything was going great.

So there is not a person in America who will be more forward-leaning about not making a loan to somebody who cannot afford to pay it, because it devastates them if they can't afford to pay it, it devastates the lender if they can't afford to pay it, and in this case, because Fannie and Freddie are in conservatorship, it increases risk to taxpayers.

So every decision we make, the 3 percent downpayment decision, every decision we make is calculated with the notion that we are trying to find out what are the triggering factors that make it possible, likely, that a borrower will pay a loan. And that is the space in which we have been operating, and we have been doing it with the utmost care and responsibility, I can assure you.

Mr. CLEAVER. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from New Mexico, Mr. Pearce, the Chairman of our Terrorism and Illicit Finance Subcommittee.

Mr. PEARCE. Good to see you, Director. It has been many years since we served together on this committee, and I appreciate your service currently.

Mr. WATT. Thank you.

Mr. PEARCE. The last two questions, Mr. Stivers and the last question, really started digging into the heart, I think, of the challenge that we are faced, and that is this assessment of risk.

Now, I was in business and we were in a high capital business, the oil and gas. We did down hole repairs, a lot of equipment and a lot of expensive equipment. And the real challenge was figuring out if we could replace that equipment downstream. We could borrow for the equipment now, but are we going to have enough money to replace it 15 years down the road?

Pricing and assessing risk are so, so difficult, and they can't be done by numbers. I had good friends in the same business. Somewhere along our 14 years in business, they went out and we were able to stay in, and it was a constant juggling act.

So I am sympathetic when I hear you say that you are using the same standards, but that really doesn't—is not going to get us there, because you have got one advantage that businesses don't have. And that disadvantage businesses face is, at the end of the day, they have to pay the bills and, frankly, you all don't. You can simply go to the taxpayer, and say, "Well, we are underwater a couple billion dollars and things."

And that is a great—it is a great flaw in the idea that somehow we can let government run business-type operations, because there is always that safety net and always that ability to go straight to the taxpayer.

Even this idea of the downpayment amount, the 3 percent versus 10 or 20 or whatever, that is a huge question. And the assessment of people who are going to pay or not is basically how much skin they have got in the game. If they have got enough left on the table, they are going to figure it out. If they didn't have to put anything on the table, then they are not going to figure it out.

So I probably would come to different conclusions, but I appreciate the fact that you are there trying to work your way through very difficult stuff.

Now, the Second District of New Mexico has more dirt in it than most districts, it is 70,000 square miles, and it is mostly rural. A lot of dirt and not much water, so people just struggle for a living. It is one of the poorest districts in the country. Fifty percent of our housing is manufactured housing. They call them row houses up here, but we don't get the wheels with them.

So we have been discussing with Director Cordray over the past several years what CFPB is doing to hurt rural housing. Last time he was here he had explained how he had taken care of all of it, and I disagreed with him here in this format. And I wonder, my question for you is, are you watching what they are doing over there as it affects rural housing?

Mr. WATT. Well, I have enough responsibility watching what I am doing at FHFA. I am sure you all are providing oversight to CFPB.

Mr. PEARCE. But surely you have conversations.

Mr. WATT. Yes, we are in regular conversations with each other. But they have a set of responsibilities and we have a set of responsibilities. I can tell you what we are doing to try to help with rural housing and—

Mr. PEARCE. What did you do on qualified mortgages?

Mr. WATT. If you look at the Duty to Serve requirements, which is a statutory requirement, we are aggressively moving into trying to level the playing field for the rural communities.

Mr. PEARCE. The qualified mortgages was very difficult, and then that brought along the balloon note, which the CFPB said all balloon notes are prejudicial. I can't find anybody in any of these Eastern States that are willing to come out and loan money for 30 years on a trailer house, frankly.

Mr. WATT. Nor will we, unless you put the land under it, at this moment. Now, we are looking at the—

Mr. PEARCE. My point is that the prejudicial nature of the qualified mortgages and the balloon notes and the rural definitions they started with over there made it very difficult. And, frankly, I don't know that I see it changing much, even with your agency, that people in rural areas are still 52 percent less likely to be able to buy houses because of the impediments that are brought up by the system. And I know you don't technically run that, but you have to be over there sitting, saying, what about those people out in the rural areas?

Mr. WATT. That is exactly what we are doing.

Mr. PEARCE. There are more rural areas than there are urban areas and we are limiting their ability to own houses.

Mr. WATT. That is exactly what we are doing under Duty to Serve. I hope you will look carefully at what we are doing there.

Mr. PEARCE. I trust you will get to it. Thank you, sir. I appreciate it.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentlelady from New York, Mrs. Maloney, Ranking Member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you.

And welcome back to Congress. Good to see you. We miss you.

Mr. WATT. Thank you.

Mrs. MALONEY. In December 2014, you made the decision to restart the annual funding that Fannie and Freddie provide to the Housing Trust Fund and the Capital Magnet Fund, which had been suspended during the financial crisis. These two funds are critically important because they provide hundreds of millions of dollars for affordable housing every year. So I want to thank you for that again.

And when you made this decision to restart the funding for these two funds, you stated that if Fannie or Freddie took a draw from Treasury, then the company that took a draw would not make its required annual payment to the Housing Trust Fund or Capital Magnet Fund.

My question is, is this still your position? And is that one of the reasons why you believe Fannie and Freddie should be allowed to hold a modest capital buffer?

Mr. WATT. It is still my position, but it has nothing to do with the buffer from my perspective. We need a buffer because any business to operate effectively needs to have some capital cushion for things that could go wrong or things that really, in our case, not even things that go wrong, there are just fluctuations that take place.

So my discussions about the buffer have nothing to do with the Housing Trust Fund, from my perspective. The Housing Trust Fund would become relevant because if one would presume if we were in a position where we were making a draw, we may not be meeting the statutory standards, because the standard to contribute or suspend payments to the Housing Trust Fund, the standards are statutory. And if we found that it was going to increase the instability of the enterprises, that is where the intersection takes place.

But that is a different discussion than the buffer discussion, in my mind. I haven't connected the two. Now, I know that publicly some people have tried to connect those things, and I understand what they are saying. But from my reasoning, the two are totally separate issues.

Mrs. MALONEY. And as you well know, Fannie and Freddie's multifamily housing divisions performed extremely well even during the crisis. And the multifamily businesses already do a lot of risk sharing with the private sector, and they share upwards of 15 percent of the risk with the private sector on each and every deal.

So in your view do any changes need to be made to Fannie and Freddie's multifamily housing divisions in order to adequately protect taxpayers, or should we just try to spin their current multifamily businesses out in a housing finance reform bill?

Mr. WATT. Well, I don't think I should address the question of whether they should or should not be spun out in a housing reform bill, that would be a decision for you all to make. But we are constantly looking at improving and solidifying the multifamily part of Fannie Mae and Freddie Mac, just like we are the single family part of Fannie Mae and Freddie Mac.

They did do well during the crisis. There is risk sharing. Fannie Mae generally is in partnership with the private sector, and so there is generally 15, 20, 25 percent risk sharing there. And we are trying to figure out ways to risk share beyond that.

On the Freddie Mac side, they make the loans or they take the loans in and they immediately securitize them as soon as they can do that. So they have the risk only for a very short period of time until they resecuritize.

So in a sense they are risk sharing all of their risk off of their books in the multifamily space.

Mrs. MALONEY. My time has expired. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you, Director.

I am going to start my questions actually by yielding to my good friend and colleague, the Chairman of the Capital Markets Committee, for a very brief time, Chairman Huizenga.

Mr. HUIZENGA. I appreciate it.

And good news, Director Watt. I have saved you a couple of million dollars on the $56 million overrun. This is a photo of the bridges, plural, that are connecting the buildings. There is one on floor 11, one on floor 13. The $2 million additional cost for one on floor 9, you could cancel that bridge and save a couple of million bucks.

Mr. WATT. You could cancel the bridge under the thing to the Capitol.

Mr. HUIZENGA. If we can go to the next—

Mr. WATT. But you would become a lot less efficient.

Mr. HUIZENGA. I am sorry. My time. It is my time. I will be following up with questions.

Chairman HENSARLING. The time belongs to the gentleman from Michigan.

Mr. HUIZENGA. If we can go to the next photo. Good news, I discovered what a wooden lunch hut is. Keep the wooden lunch hut. Cancel the damn spiral staircase. All right? I have built those and paid for people to build those. It is outrageous that you would have that kind of—you are making K Street law firms and lobby shops jealous. They want to move to 15th and L. They want to move off K Street if this is your headquarters.

So with that, I yield back to the gentleman from Illinois. I appreciate it.

Mr. HULTGREN. Thank you. Reclaiming my time.

Thanks, Director Watt. Good to have you here.

Mr. WATT. Thank you for reclaiming your time.

Mr. HULTGREN. In previous hearings with the FHFA the committee has raised questions about the policy rationale behind the current level of conforming loan limits and why taxpayers should be subsidizing homes that approach and in many cases exceed half a million dollars or more.

While previous responses to our questions were based on the lack of private capital and capacity in the private label securities market, it is certainly clear to me today and others that the appetite in prime jumbo markets would comfortably support additional capacity.

Wouldn't lowering conforming loan limits serve the dual purpose of reducing taxpayer exposure and also help to reinvigorate the private market?

Mr. WATT. Again, loan limits are statutory. We apply the statute as it is written, and we do it annually. If you all wanted to change the statute, we would apply it as rewritten. But as long as the statute is on the books, we are going to apply it the way it is written.

Mr. HULTGREN. I think the concern is providing funding for these half-million-dollar-plus mortgages.

Let me move on. Recognizing that the QM patch has allowed creditworthy borrowers to obtain access to credit at competitive rates with the GSEs but not with other commercial lenders, and given that the QM patch will expire in 2021, what specific steps is the FHFA undertaking to cede market share in order to facilitate smooth transition from a GSE-dominated market to a market where private lenders can also provide access to credit at competitive terms?

Mr. WATT. Just about everything we do is calculated to move in that direction.

Mr. HULTGREN. How is it coming?

Mr. WATT. We are waiting on housing finance reform to really be able to move more aggressively. But we have taken about every step that we can take and continue to take additional steps to try to reinvigorate the private market. I am a very strong supporter of private market involvement in every aspect of business in this country.

Mr. HULTGREN. In your testimony you point out that FHFA and the GSEs are working on initiatives to help individuals achieve home ownership that may be creditworthy, but are unable to make a substantial downpayment.

I agree that it can be difficult in many places across the country for individuals or families to be able to save a 20 percent downpayment. But we also know a downpayment or actuarially equivalent offset, such as mortgage insurance, is essential to limiting moral hazard and minimizing risk in the financial system.

Over the last couple of years the GSEs have allowed some lenders to use very low down payment programs, such as 1 percent. You mentioned that the GSEs price their guarantee fees as if they are held to risk-based capital standards.

Recognizing that this is only a theoretical exercise, why hasn't the capital model been made public? Is it possible for any of us to understand GSE pricing unless we have access to the capital model? Will you commit to releasing the capital model for each of the GSEs?

Mr. WATT. Let me send you a response that we are sending to Senator Elizabeth Warren. You all seem to be in the same position on that. You will be surprised to find that, I am sure. But we are developing a response to her question, which was almost identical to yours.

Mr. HULTGREN. Well, yes, anything that would be responsive to my concerns and I think others' concerns of what we see as some potential overreach.

I would also argue that this is a dangerous road where you look at the name of affordability and not only increase risk of the loans being backed by the GSEs but also really reducing taxpayer protection on those very same loans by not requiring mortgage insurance.

My time has expired. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Connecticut, Mr. Himes.

Mr. HIMES. Thank you, Mr. Chairman.

And welcome, Mr. Director. It is good to see you back.

Mr. WATT. Thank you.

Mr. HIMES. In the spirit of my friend from Michigan, I have a long list of interior decorating tips, too, but I am going to run those by my staff, or at least my wife, before I submit them to you.

Instead, I want to talk with you a little bit about something that we have gone back and forth on a little bit, which is alternative credit scoring models. You will recall that about 4 years ago Representatives Maloney, Royce, Bachus, and I urged you to take action, I will quote the letter, "to ensure that Fannie Mae and Freddie Mac revise their seller servicer guidelines to foster competition among credit score providers."

As you know, competitive markets are important because they help ensure innovation and guarantee that the providers will provide the best product. Today lenders are still required to use certain credit scoring models despite the fact that more inclusive and predictive models exist.

Now, I know in the last 3 years the scorecards for the GSEs have instructed Fannie and Freddie to, quote, "assess the feasibility of alternative credit score models." On August 1, you announced that any credit score model change would not go into effect before 2019.

It seems like a long time. My worry is, of course, that millions of creditworthy potential mortgage applicants could be denied an opportunity for home ownership because of the sticking to one model.

So my question, Mr. Director, is would FHFA under your leadership be willing to authorize a pilot program utilizing competing credit score models that claim to be more predictive and more inclusive than currently used models? And I wonder whether you might be willing to initiate such a pilot program on a schedule a little faster than your projection of 2019?

Mr. WATT. I think in this space it would be very difficult to do a pilot. We rely a lot on pilots to move carefully and study issues. But in this space, it would be very difficult because anything we put in that pilot would have to be held out of the risk transfer program.

And I think we are moving in the direction that—this is not an access question. Once we started delving into it, we ran into a host of other concerns that we had about competition in this space. How do you provide—how do you ensure that the competition is just not scoring more people as opposed to having competition to assess the ability of people to pay? How do you ensure in the long run that one of the credit scoring companies which is owned by the credit repositories doesn't have an advantage over the credit scoring company that is not owned by the credit repositories?

This got to be a much, much more complex analysis than we ever thought it would be. I started at the same place you started, saying, how could anybody question competition? Competition is always good. I think we always assume that. But once we got into trying to analyze the benefits and how to assure real competition in this space, it got to be more and more and more complex.

So what we are doing now is we are getting ready to go back out and ask a series of questions in a request for input to get additional information about some of the concerns that have come up as a result of this initial assessment.

I don't think it is going to adversely impact access to credit because both Fannie and Freddie are using a lot of information other than credit scores to increase access to credit anyway. They have probably as much information about people's ability to pay as the two credit scoring companies' competitors have. And we just didn't find that there was significant difference in these credit scores from an access perspective.

I am not trying to take your time, I am just telling you, this turned out to be a much, much more complex issue than any issue that I have dealt with since I have been over there.

Mr. HIMES. Thank you. I yield back.

Chairman HENSARLING. The time of the gentlemen has expired.

The chair wishes to alert members that in approximately 10 minutes the committee will recess for 10 minutes.

The chair now recognizes the gentleman from California, Mr. Royce, chairman of the Foreign Affairs Committee.

Mr. ROYCE. Thank you very much, Mr. Chairman.

Director Watt, nice to have you back. It must feel like a homecoming of sorts.

Mr. WATT. An adversarial homecoming.

Mr. ROYCE. Oh, no, I am trying to reach common ground here on something.

Mr. WATT. I am not the prodigal son coming home, unfortunately.

Mr. ROYCE. Well, I appreciated the comments in your testimony that the FHFA is working with the GSEs to, in your words, further refine and improve the risk-sharing programs in ways that reduce taxpayer risk, make economic sense, and help attract a diversified and broad investor base. Now, this is something we have talked about in the past.

But here is the conundrum. It has been noted that the GSEs have included more than 1.6 trillion in mortgage loans in expanded risk sharing since 2013, but that means only 54.2 billion of risk has actually been transferred.

Now, that is 1.3 percent on the more than 4 trillion in mortgages purchased by the GSE. So, clearly, more could be done, and that is where I want to take the conversation.

The long-term goal here should not be to preserve the GSEs' business model by simply allowing them to develop a new business activity. The objective for us should be the transfer of credit risk in the most effective, efficient, transparent, and reliable means.

Mr. WATT. And cost-effective, I hope.

Mr. ROYCE. And cost-effective means.

And we are setting the stage for future comprehensive reform here. And, as you know, Congresswoman Gwen Moore and I introduced H.R. 3556, this is the Taxpayer Protections and Market Access for Mortgage Finance Act of 2017. This is a bipartisan bill that directs the FHFA director to establish guidelines requiring that Fannie Mae and Freddie Mac engage in significant increasing and varied credit risk transfer.

I wanted to ask you a few questions about your comments in support of expanding the diverse investor base that will increase the likelihood of having a stable CRT market through different housing and economic cycles, something our legislation would support.

So we have heard, as you have explained these points, including we have heard from the GSEs, that they have commented that back-end transactions decrease counterparty risk exposure, but they are also—you add this caveat—volatile, they can be volatile and not available in all market cycles.

You mentioned in response to Mr. Luetkemeyer that you were doing more to encourage front-end transfer structures, but, clearly, if you have only got 4 or 5 percent at the end of the day, that is not enough if the goal here is balance through all cycles. If that is where we are headed, I think we need to look at both ends of the equation.

Do you have a target in terms of where we should end up and how quickly? And shouldn't this be a priority, given the mere 1.3 percent?

Mr. WATT. My target is as much as we can do meeting the criteria that we have been very transparent about setting. And one of the concerns that I have is, if you require a specific number, we will not necessarily be able to meet that cost-effective criteria, which is why—

Mr. ROYCE. Let me followup with one other question. In terms of back-end, you also reference the work FHFA is doing to improve CAS and STACR, including a proposal for future offerings to be issued as notes that qualify as real estate mortgage investment conduits. And you said, "We expect that the proposed structure would satisfy asset and income tests for real estate investment trust investments."

Now, I am hearing reports that this is well past the point of the proposal stage. The rollout now is planned, I guess, January 1, and that is not that far off.

I think we need to get past expectations and ascertain whether the structure will or will not qualify for real estate investment trust (REIT) investors. Could you share details about the rollout of the technical aspects of this proposal to the REIT community and how documents and—maybe you can just lay that out for us, the details on some of that.

Mr. WATT. Well, I can tell you that we have been transparently meeting with people to try to make this work. And some of the concerns are legal concerns and may require statutory changes. We think we have been able to work around some of those, but I don't think we have indicated that we are planning to implement this January 1 of 2018. We are trying to get there as quickly as we possibly can, though.

Mr. ROYCE. Thank you, Director Watt.

Thank you, Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Before I start, Mr. Chairman, I do have a parliamentary inquiry for you.

Chairman HENSARLING. The gentleman will state his inquiry.

Mr. ELLISON. My inquiry is simply this, Mr. Chairman. Several weeks ago, back on September 14, 11 members of this committee sent you a letter asking for a hearing to explore what financial institutions can do to help customers avoid financial devastation when there is a disaster. Director Watt already mentioned that there is a 90-day period, to be extended up to a year, but we still think that there should be more focus given the disasters our country has seen in the last several days.

So my inquiry is, can we have a hearing on how financial institutions, insurance and realty firms, can best respond to disasters?

Chairman HENSARLING. The gentleman has not stated a proper parliamentary inquiry, but I would be glad to continue to work with the gentleman on his request.

Mr. ELLISON. Thank you, sir.

Mr. Watt, thank you. Welcome back to the committee. I want to join my colleagues in remembering fondly the tremendous contributions you made on this committee, and thank you for your service as director.

My first question is, if nondepository community development financial institutions (CDFIs) could pledge their loans to a Federal Home Loan Bank, could they make more loans and create more jobs and expand more businesses?

In other words, if we expanded the loans that they could make, could that make a difference in terms of economic development in, particularly, underserved communities?

Mr. WATT. Yes.

Mr. ELLISON. Could you talk a little bit about what possibilities that might include?

Mr. WATT. Well, CDFIs, obviously, first have to go through qualification with Treasury to get designation to even qualify to join the Federal Home Loan Banks. And then CDFIs, after they join a Federal Home Loan Bank, have to meet collateral criteria that are consistent with other members. And that has been the biggest impediment, because a lot of the CDFIs don't have the robust collateral.

So we have been trying to work with them and expand their collateral base, work with some of them to try to get them to have investors so that they have more capital.

But our responsibility is to protect the Federal Home Loan Banks, and we have a statutory responsibility to do that. So whatever we do in this space, we have to do it very carefully and with that in mind.

Mr. ELLISON. I wonder what your thoughts are about the findings of the 2015 Government Accountability Office (GAO) report that collateral requirements discourage some community development financial institutions from seeking membership, that the inability of CDFIs to pledge small business and community development collateral has limited the ability of CDFIs to join the Federal Home Loan Bank and invest in economic development projects like healthcare facilities, community boathouses, shopping centers.

Do you have any thoughts on the GAO report and its findings?

Mr. WATT. I am not familiar with the GAO report, but that certainly is consistent with one of the impediments that is holding them back, because we normally look more to housing collateral than to other kinds of collateral. The GAO finding does not surprise me.

Mr. ELLISON. I would like to just mention that I have a bill, which is bipartisan in scope, Mr. Stivers, Mr. Pittenger, other Members on both sides of the aisle, we have come together for a bill we call the Small Business and Community Investment Expansion Act. It would allow nondepository CFDIs to pledge nonhousing loans to a Federal Home Loan Bank. I would encourage Members to join the bill. I think it would be a great bipartisan way to get more loans out there to improve community and strengthen the community economic activity.

We know that positive economic activity is not just because of private sector activity. Local, state, and Federal Governments also have important roles to play. So I think we should use resources we have, like the Federal Home Loan Bank and community development financial institutions to help businesses succeed and thrive in their communities.

So, Mr. Watt, again, thanks for the great work you are doing, and we look forward to working with you in the future.

Mr. WATT. I will tell you the same thing I have told other Members. If you all get the bill passed, we will apply it.

Mr. ELLISON. I hear you, sir.

I yield back.

Chairman HENSARLING. The gentleman yields back.

The committee stands in recess for approximately 10 minutes.

[Recess.]

Mr. HUIZENGA [presiding]. The committee will come to order.

And with that, the chair will recognize the gentleman from Pennsylvania for 5 minutes, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Good afternoon, Director Watt. I want to followup a little bit on some of the issues we have been talking about this morning. As of August of this year, the GSEs either owned or guaranteed 53.2 percent of all new residential mortgage loans. I would also point out that the private label securitization market for residential mortgages comprises only one one-hundredth percent of the overall U.S. market.

Can you give some insights as to why you think the private sector participation in these markets has been so limited?

Mr. WATT. Well, I think there are a number of factors. Capital standards is a factor. The fact that a number of them got burned during the meltdown was a factor. There was litigation that resulted after the meltdown.

Mr. ROTHFUS. My colleague Congressman Duffy, who is not here right now, had a conversation with you about the exceptions with respect to QM as being an example. Are there other regulatory examples that would limit the participation in the private—

Mr. WATT. Can I say a word about the QM first, just to be clear?

Mr. ROTHFUS. Yes.

Mr. WATT. The enterprises comply with most of the QM standards. They require all loans that they back to be fully amortizing.

Mr. ROTHFUS. If we talk about the debt-to-income ratio, they don't have to comply with that.

Mr. WATT. The debt-to-income ratio is the only one that we are not required—that we don't comply with, and that is because of the reasons that I explained earlier. Additionally—

Mr. ROTHFUS. You made the point during your conversation with Congressman Duffy about the default rates being comparable between QM and the GSE non-QM loans, but really, I might suggest that is given the relatively stable market that we have had over the last several years. And also, you take a look at Fed policy, low interest rates, and what has been happening there. But should we expect the same to be true if interest rates start to go up?

Mr. WATT. Well, as far as their mortgage payments are concerned, since we don't back loans that have adjustable rates to them, the mortgage part of the obligations would remain the same in adverse times and in good times. So now we might start looking at new loans in a different fashion as a result.

Mr. ROTHFUS. Is that necessarily the case? Because if interest rates go up and there is a slowdown in the economy, if people are struggling with a job they have a mortgage, maybe they got their mortgage with a 3 percent downpayment, and these are—

Mr. WATT. I have tried to explain we don't control every aspect of life. We just try to control what we can control in the mortgage space. And while we couldn't solve all the electrical problems associated with the hurricanes, we did our part in the mortgage space. In the same way, the parallel to what you are asking is, we can only do what we do in the mortgage space. We can't control every other aspect of life. We can't control—

Mr. ROTHFUS. But that is true with the private sector. That is true with the GSEs.

Mr. WATT. Well, the private sector didn't do very well in this space during the meltdown either.

Mr. ROTHFUS. Well, we have been talking about the unlevel playing field between what the GSEs have been doing and the private sector and how that has tilted the playing field toward the GSEs.

In your speech earlier this year, you said, between 2015 and June 2017, the Enterprises have purchased over 130,000 mortgages with a 3 percent downpayment, and the program has continued to grow.

Now, that would amount to over $23 billion in new loans with a very low downpayment. Earlier, you had said that only 3 percent of your portfolio are with these 3 percent downpayment mortgages. Would that apply—

Mr. WATT. That is the current figure.

Mr. ROTHFUS. So would that apply—looking at that period between 2015 and June 2017, when you purchased over 130,000 mortgages, what percentage of those 130,000 mortgages might only have a 3 percent downpayment? You talked—

Mr. WATT. I thought you were talking about the—the question was about the 130,000 mortgages.

Mr. ROTHFUS. Well, I am talking about—yes. You testified earlier that 3 percent of your portfolio has those 3 percent downpayment mortgages in them. My question is, of the 130,000 mortgages that were purchased between 2015 and June 2017, what percentage of those have a 3 percent? It would be a subset of your entire portfolio.

Mr. WATT. I think we are like ships passing in the night here. The 130,000—

Mr. ROTHFUS. My time has expired, but we will followup with you.

Mr. HUIZENGA. The gentleman's time has expired.

Mr. ROTHFUS. I am going to followup with you on some questions on that and looking for some more detail on that.

Mr. HUIZENGA. The gentleman's time has expired.

Mr. ROTHFUS. Thank you.

Mr. HUIZENGA. With that, the chair recognizes the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you, Mr. Chairman. Thank you to our ranking member. But more importantly today, thank you to our witness, Director Mel Watt, for being here.

To save my time, let me just echo what all my other colleagues have said positively about Director Watt and his work. I am, in part, here on this committee because of his mentoring and his encouragement. And, Mel, I still rise.

So, with that, I have two questions I will try to quickly get through. The first question, because we have had a lot of questions about housing and finance, quite appropriately, but we have not had a lot of questions about people. And when I think about your work, it can't be absent of the people, and especially what we are witnessing now, whether it is in the Virgin Islands, whether it is in Puerto Rico, which I just returned from a couple of weeks ago. The devastation is beyond the bricks and mortar.

So, with that, I think it is so important, as we look at diversity and inclusion, to state more for the record, but to commend you on your people services. Unlike many of the other Federal directors who are only held to section 342 of the Dodd-Frank on the Office of Minority and Women Inclusion (OMWI), you also have, under the Housing and Economic Recovery Act, 1116, diversity issues, and you have exceeded them. So, for the record, I want to applaud you and thank you for your leadership and your commitment.

And the point I am trying to make is beyond just saying thank you to you. When you put people in the room who look like you and I, I believe, like the Rooney rule, like the Beatty rule, it makes a difference. And maybe we would have had quicker reactions in the Virgin Islands and in Puerto Rico if there were more people who were women and minorities to understand it.

So I wanted to enter that in the record, and take this time to say thank you for doing what every director should do.

Now, Ranking Member and Mr. Chairman, and to you, Mr. Watt, I have a question on the other side. As we look at your work, I want to ask you, as we know it, the mission of the FHFA is to ensure that Freddie and Fannie operate in a safe and sound manner, to serve as a reliable source of liquidity and funding for the housing finance and community investment. Through that Housing and Economic Recovery Act of 2008, it grants you, the director, broad authority to assure that this mission is carried out.

There has been a lot of discussion about whether you allow Fannie and Freddie to keep some of the capital as a buffer to shield against the future draw on the U.S. Treasury, with their capital reserves set to be depleted by the end of the year. So I guess my question is, do you believe you have the authority to make this change?

Mr. WATT. Yes, I believe we have the authority to make it. But at the same time, we are under a contractual arrangement with the Department of Treasury, and my preference, strong preference would be to work through this in coordination with the Secretary of Treasury. And we have been having some constructive discussions recently that hopefully will lead us to that conclusion.

Mrs. BEATTY. OK. And for the remainder of my time, Director Watt, if there is anything else you would like to say, I will allow my time to do that. And before I do that, let me just say again, thank you for your work and also for your team that is behind you. So often we don't thank people for bringing people with them who also do a good job. And I want to say to them that I am making a commitment that we talk about more than the staircases of bricks and mortar, but the staircases of saving lives and spending more time on the staircases of getting people out of poverty, flood insurance, and bringing relief to those in the territories.

Mr. WATT. Well, of course, you mentioned staircases, so this gives me an opportunity to talk about the staircases. That has to do with the efficiency of operation. Just like the tunnel underground makes you all more efficient in going to and from, imagine how many times during the course of the day Fannie and Freddie employees have to go and interact with each other. If they had to go all the way down to the lobby and then go across and take an elevator all the way back up, imagine how inefficient that would be.

You know, we don't make any decisions that don't have thoughtful impacts, and so I just—I am glad you gave me the opportunity to get that in the record, because the chair now—

Mr. HUIZENGA. The gentlelady's time has expired.

Mrs. BEATTY. I yield back.

Mr. HUIZENGA. With that, the chair recognizes the gentlelady from Utah, Mrs. Love, for 5 minutes.

Mrs. LOVE. Hello, Director Watt. How are you doing?

Mr. WATT. Hello.

Mrs. LOVE. It is nice to see you again. The last time you and I were here at the committee about 2–1/2 years ago, you and I talked a little bit about the negative consequences of putting people in homes that they could not afford. As a former mayor and a city council member, I have witnessed the downturn, the housing downturn on a municipal level. I know that firsthand—I know firsthand that the last thing that vulnerable Americans need is access to credit so that they can buy homes that they can't afford.

It is something that I have actually seen firsthand when you see a family that has really worked hard to get into a home, and then all of a sudden they are having to pack up all of their things. You can't imagine how devastating it is. Their children are leaving a school that they know. They are leaving their friends. They are leaving a neighborhood. The communities are hurting.

I think it is incredibly important that we help people be able to have access to the American dream, but what do we do? What happens when that family isn't able to keep that home that they afford? I think that that is incredibly devastating.

Specifically, we talked about, at your last appearance here, the issue of ultra low 3 percent downpayments. This summer, I am going to note that speech, the National Association of Real Estate Brokers, where you said, quote: "Between 2015 and 2017, the enterprises have purchased over 130,000 in mortgages with 3 percent downpayment, and that program is continuing to grow."

Given the amount, given the thought that the average amount of these loans are about $180,000, this represents $23.4 billion in new loans, with a 3 percent downpayment. So I just wanted to get your thoughts on some concerns that I have and wanted to get some of your ideas. First of all is the risk to individual families that may get in over their head when they get into a home, and what are your thoughts about that?

Mr. WATT. Well, if you look statistically, and this is historically going back, there is not a direct correlation between downpayment and people's payment of mortgages. And, in fact, disproportionately, people paid their mortgages with no equity in their homes during the meltdown. So that correlation that we—

Mrs. LOVE. Well, that was just one of the things that we talked about, but you would think that the debt-to-income ratio would actually affect that.

Mr. WATT. It would, you would think, but it has not up to this point, and we are monitoring it carefully. Now, the question was asked could that change during adverse economic times. It could change during adverse economic times—

Mrs. LOVE. So what do you think—

Mr. WATT —and we would be monitoring that to make sure that—and that is why we put into place modification programs that would allow those people to modify those loans in that space.

Mrs. LOVE. Let me ask you a question, because I am truly trying to figure this out. I have seen a lot of these families. I am a mayor. I was there when the housing market went under. It was devastating, not just for those families, but for communities all around. If you understood the Utah culture, your neighborhood, those are the people that you go to church with, those are the people that—you are ripping families—families are being ripped away from that. And also, you are left with a home that lowers the values of so many other homes.

So something is happening. Something is happening there, and so I am trying to figure out what has happened. What happens with—because there are families that have gotten into homes that they could not truly afford.

Mr. WATT. You are absolutely right. And you weren't on the committee at that time, but me and one other member from North Carolina recognized that three terms of Congress before the meltdown, which is how we got to a qualified mortgage standard, an ability to repay rule in the first place. We wrote it into the statute for that reason. Now—

Mrs. LOVE. There is—I have 20 seconds. I have 20 seconds. There was one more thing I wanted to get into. You can roll it into your answer.

The second is, the policies that we have right now would indicate that we have learned nothing from the last housing crisis, especially if we are sticking with our standards. Are we setting up the Nation for the next housing bubble that I think is foreseeable?

Mr. WATT. We are constantly monitoring to try to figure out and to make sure that that does not happen also. And I think the way to do that is to make responsible loans when you make them, not irresponsible loans. You can't make an irresponsible loan at the time that it is made and expect that it is going to—

Mrs. LOVE. My time has expired. Thank you so much for your—

Mr. HUIZENGA. The gentlelady's time has expired.

Mrs. LOVE. Thank you.

Mr. HUIZENGA. With that, the chair recognizes the gentlelady from Wisconsin, Monetary Policy and Trade Subcommittee Ranking Member Ms. Moore, for 5 minutes.

Ms. MOORE. And thank you so much, Mr. Chairman.

And I do want to thank our witness, Director Watt, for appearing and really enduring a lot of our heartfelt questions.

Director Watt, I do recall your service on this committee, and I can tell you that the IQ of this committee has gone down dramatically since you left. I often told you nobody would be bothered with you if you weren't so brilliant, and we are seeing that here today.

I do remember you being here and, really, when we were not in the majority trying to curb predatory lending. So that the case that Mrs. Love really raises, which is really important, when people didn't have skin in the game, the credit rating agencies, that you raised this before the crisis. And so when we finally got into the majority and did Dodd-Frank, you led this committee on the issue of putting skin in the game, improving mortgage writing standards. And the FHFA, which you weren't leading then, requiring increased counterparty capital requirements. So I just want to join in with my colleagues in thanking you for all your hard work on that.

Speaking of increasing counterparty capital requirements, I think Mr. Royce indicated earlier that I was a cosponsor of his legislation, which would provide more front-end risk sharing to take the risks off the books of the GSEs. And I heard you very clearly in that exchange say that you are working on this, that if we give you some exact number, you may not be able to meet those requirements. But then I just want to share with you that I trust your judgment and, like you said, you are a very precise dude, and we appreciate that. So I look forward to diversifying the risk sharing, and I do want to look at that more front-end piece.

I also want to thank you—and this is my time, so I don't have to let you talk, because I don't want my behind whipped up here with your brilliance. I want to thank you for supporting me and putting up with all the questions that I raised with you about grandfathering the captive insurance companies into the Federal Home Loan Banking system. I have a crisis in my district. We have the Chicago Federal Home Loan Bank and, of course, Milwaukee belongs to that. And we appreciate the fact that you are—this is a tiny nexus. It does have a housing nexus, and I appreciate you for recognizing that.

In all of the discussions about winding down the GSEs and proposals that are being brought forward, Director Watt, I am concerned about multifamily. There doesn't seem to be a really vigorous effort to make sure that the supply of multifamily stays in the process. Can you talk about the different models that are for multifamily and the differences in how you ensure that both models are meeting FHFA's expectations of safety and soundness, as well as expanding the access to affordable housing?

Mr. WATT. Happy to do that. Most people lead their discussions about the enterprises talking about single family and home ownership. Actually, Fannie and Freddie are agnostic in their statutory responsibilities about home ownership versus rental. Our objective is to provide liquidity for the market, to provide housing, both ownership and rental.

And so we pay a lot of attention to the multifamily side. And since the meltdown, more and more people have moved to the multifamily side, which has increased the demand. And the supply is not there to meet that demand, so rental prices have gone up immensely, and that is especially true in metropolitan areas.

So we have done a lot of work to try to figure out how to ensure that affordable multifamily rental is there, and we will continue to do that, and I will be happy to explore that with you more outside the hearing.

Ms. MOORE. Thank you. Thank you.

Chairman HENSARLING [presiding]. The time of the gentlelady has expired.

The chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman, for putting on this important hearing. And reforming our housing finance system is a major priority for all of us. I look forward to helping our committee achieve this goal, and I would like to thank my fellow North Carolinian, Director Watt, as he testifies today.

Mr. WATT. You can really welcome me home.

Mr. PITTENGER. Yes, sir. Director Watt, the time for housing reform truly is now. All together, the GSEs own or guarantee more than half of the $10 trillion U.S. mortgage market. These conservatorships continue to put U.S. taxpayers at risk. It is important that Congress develop a plan for shrinking the GSEs' oversize role in the housing market at this time. Without a reduction in the role of the GSEs, private enterprise will continue to have difficulty competing to fill the needs of the market, and the threat of future crisis and taxpayer-funded bailouts will remain.

Director Watt, what can you tell me today of the committee and this Agency's—and tell the committee of the Agency's progress on scaling back the GSEs' role in the marketplace, as well as what actions do you recommend that Congress could take to encourage more private investment back in the flow of our market?

Mr. WATT. Well, I can tell you that, as I have said before, there is nothing in our statute that gives us the authority or responsibility to do anything other than provide liquidity in the market. So

I am hopeful that housing reform will provide more opportunities for that to be done in the private sector. I support that fully.

But in the meantime, I have to operate Fannie and Freddie in the here and now, in compliance with their existing statutory requirements. And there is nothing there that says that I am supposed to go and wind them down. In fact, it says I am supposed to provide liquidity and ensure liquidity, and I don't know how you could do that by winding them down unless the private sector stepped into that space.

Mr. PITTENGER. But you would agree, Director Watt, that the private sector is being crowded out of the GSE market today?

Mr. WATT. I am not sure that I would characterize it as crowding out. There are reasons that the private sector has not been involved, but I am not sure that—

Mr. PITTENGER. Then how would you generate a greater engagement by the private sector?

Mr. WATT. Well, I think that is—

Mr. PITTENGER. If you are—

Mr. WATT —what housing finance reform should be all about. And I keep waiting on—

Mr. PITTENGER. What are the impediments then? It seems to me that we have established impediments with the GSEs that don't allow the private market to enter there or else they would be there today.

Mr. WATT. Some of the things that have served important positive purposes also reduced the involvement of the private sector in housing. Capital standards that are associated with keeping mortgages on lenders' books. Skin in the game. And all of those things are good, but they were put in place to solve a problem, and they are having some unintended consequences.

Mr. PITTENGER. Let me go to the home front, if I could, please. In Fayetteville, North Carolina, that is in my district, the percentage of our families—

Mr. WATT. Is it?

Mr. PITTENGER. Yes, it is. The percentage of our families earning enough income to qualify for a mortgage loan has been decreasing annually, most recently down now to 5.5 percent in 2016. This means that an increasing number of hardworking North Carolina families are not able to afford these mortgages.

In your opinion, what could be done at this time to accomplish building a better housing finance model so that more Americans, including North Carolinians in my district, could fulfill their dream of owning a home?

Mr. WATT. Again, that is about housing finance reform. And, despite the various ways that members of this committee and members of the Senate Banking Committee have asked me what my ideas on housing finance reform, my response has always been I left that responsibility behind when I left this body.

Mr. PITTENGER. But, sir, you are in an important responsibility. You can't abdicate the job and say that you don't have a response to that. Each of us in a position that you are in needs to be accountable to that.

Mr. WATT. I have a responsibility as FHFA, and my personal views about how to do that I had to leave behind when I took on a—

Mr. PITTENGER. My time has expired.

Mr. WATT —different responsibility is the point I am making.

Chairman HENSARLING. The time of the gentleman has expired. The chair now recognizes the gentleman from Washington, Mr. Heck.

Mr. HECK. Thank you, Mr. Chairman.

Director, thank you for being here. As you well know, there is an ongoing debate about who should be allowed to join the Federal Home Loan Banks. My view is that we ought to be agnostic on that point. As long as the new members are required to have a strong, demonstrably strong housing mission and as long as the Home Loan Banks can take the appropriate steps to secure their safety and soundness, we should allow any institution that contributes to housing finance liquidity to join the FHLB system. What is your perspective?

Mr. WATT. Unfortunately, Congressman, that is not the statutory requirement.

Mr. HECK. Right. I was asking your perspective on the question I asserted.

Mr. WATT. Well, I think the point you make is a good point. And if the statute were revised to make that the nexus that was required, we obviously would enforce it that way, but that is not the way—

Mr. HECK. Is that the same thing as you would support legislation that would do that, especially in light of the fact that in your opening testimony you indicated that your purpose was to ensure that the Federal Home Loan Banks operate in a safe and sound manner and that they support liquidity in the housing finance market? Would you support that legislation, of course, depending on its wording?

Mr. WATT. Well, I have tried to stay out of supporting or not supporting legislation.

Mr. HECK. OK.

Mr. WATT. I support the concept of expanding access to affordable housing for both rental and ownership for the American people.

Mr. HECK. OK. Moving on.

Mr. WATT. All right.

Mr. HECK. You also indicate in your opening testimony that, and I quote: "Conservatorships are not sustainable and they need to end as soon as Congress can chart the way forward." Why?

Mr. WATT. Yes.

Mr. HECK. Why?

Mr. WATT. Why?

Mr. HECK. Why aren't they sustainable? The definition of that is they cannot continue. What do we see that will cause them to implode or stop? It is not my preference that they continue, but what you assert here is they are not sustainable. Why aren't they sustainable?

Mr. WATT. They are not sustainable, and I can probably give you a million reasons, but I can tell you that the biggest frustration I have is that everything we do as conservator is subject to second-guessing from multiple sources. You know, I got the IG telling me how to build staircases or not build staircases. I got Congress telling me what to do and not to do.

So from an operational perspective, this gets more and more complicated every single day for the conservator to be operating in this space. Regular corporations that are not in conservatorship don't get nitpicked to death. Now you call them up here when they do something that is egregious, but they don't have the kind of scrutiny that is associated with what we do as conservator. They don't get—

Mr. HECK. So we have been at this—as you acknowledge, we have been at this 10 years. And I am still trying to sort out, even based on your answers, sir, what is not sustainable. Why is it that we can't be sitting here 10 years from now, and I would acknowledge, unfortunately, having this same conversation? But that is not what unsustainable means. What I hear you saying, what I am interpreting is it is not desirable.

Mr. WATT. It is not desirable. Maybe unsustainable is the wrong word. I don't know. But I don't think you would want either Republicans or Democrats, I don't think either one would want 15, 20 percent of their economy in conservatorship for years and years. I just don't think that is a sustainable or desirable place to be in a capitalistic democratic society. And, now, you have made me come out with some other views there, but I am just telling you I don't think you want to keep this much of the economy in conservatorship for a prolonged, extended period of time.

Mr. HECK. So I agree with that. I think there are a lot of reasons to end conservatorship, including creating a system that perhaps has more potential for innovation.

I will point out, however, that I find it inconsistent that you have implied a policy, desirable goal in the latter instance, but when I ask you about the Federal Home Loan Bank, you have refused to say whether or not it would be desirable to having additional institutions who contribute to—

Mr. WATT. No, I didn't equivocate about the desirability of providing more liquidity in the market. That I have no equivocation about, but it has to be responsible liquidity, and I am committed to that.

Mr. HECK. Thank you, sir.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. I thank the chairman.

I thank the director for being here today. I appreciate your forbearance and patience.

I am concerned, and I think a lot of people in the real estate industry are concerned, about anything that would delay this issue of reforming our secondary market operation and reforming the GSEs. And yet you say you have had some constructive conversations about rebuilding capital. Wouldn't that slow down our effort to have wholesale reform and fix this broken problem that Mr. Heck just talked about?

Mr. WATT. You have misstated what I said. I said I had constructive conversations about a capital buffer. That is all I have ever talked about. I have never talked about rebuilding capital, recap and release, all of the things—

Mr. HILL. What is the difference between those two things, rebuilding capital or a capital buffer?

Mr. WATT. If you have been in business, you will have—

Mr. HILL. I have for 35 years, so that is why I am curious.

Mr. WATT. Well, then you know that you cannot operate on a day-to-day basis without—

Mr. HILL. We have been operating that way for 10 years, because we have the full faith and credit of the United States and over $200 billion standing behind Fannie Mae and Freddie Mac right now. Isn't that correct?

Mr. WATT. I do not deem that as operating capital, and I never want to draw on it again.

Mr. HILL. But under the conservatorship, that is the state of affairs, right?

Mr. WATT. It is. We do have the Federal Government backing, to the extent that they have contractually agreed to do that.

Mr. HILL. And so because of that—

Mr. WATT. But it is my responsibility not to draw on that if I can avoid it. And if I had a capital buffer, I could avoid it, I think. That is all I have said.

Mr. HILL. Right.

Mr. WATT. It is not about building capital, be clear on that.

Mr. HILL. In 2011, the Obama Administration put forth a plan to reform the GSEs. I know you weren't in your position; you were in Congress then. Do you know of any attempt after 2011 by the Obama Administration to propose a reform plan to create a new secondary market utility and essentially deal with, resolve permanently our current GSE losses? Were you involved in any conversations on that?

Mr. WATT. Well, actually, that was not a plan. It was just an outline.

Mr. HILL. Well, the beginning of a plan is an outline for a plan, right?

Mr. WATT. I won't get into semantics.

Mr. HILL. Well, you said you were waiting on Congress, but in Congress, we have had Johnson-Crapo in the Senate. We have had Mr. Himes, Mr. Delaney, former Member Carney all submit ideas. We have had our chairman outline a plan.

So my question is, did you see a plan or a reaction from the Obama Administration, since you have been director, on how to deal with this decade-long no man's land, as the situation as it has been for a decade now, to permanently reform the GSEs?

Mr. WATT. Congressman, I served over here a long time, and I have never known the White House to initiate legislation. It always—

Mr. HILL. I don't think that it is correct. In 1992, the legislation to create the oversight of the GSEs came from the Treasury Department in 1992 as a bill sent to Congress.

Mr. WATT. You all wrote it. Somebody over here dropped it. I am not trying to be obtuse with you, but for you to make it sound like I am trying to defend either the last administration or this administration, nobody has acted on this. We have been in conservatorship now approaching 10 years.

Mr. HILL. Right.

Mr. WATT. Nobody has acted on it.

Mr. HILL. I find that unacceptable, but I also find it very unusual that the top government official overseeing the two institutions in question after question simply abdicates having a point of view about how to resolve the GSEs and just dealing with the facts as they are.

We need leadership in your position and with either the Jack Lew Treasury or the Mnuchin Treasury to submit concrete views, react to proposals in Congress, and move on with this. And I would argue, in the 2–1/2 years I have been here, I have not seen that.

Mr. WATT. We do regular consultation with all the committee staff. On Johnson-Crapo, on Corker-Warner, we were—

Mr. HILL. Which preferred bill do you prefer then? Which of the Senate approach or the PATH Act or Mr. Delaney and Mr. Himes' proposal? Since you have studied them and consulted with the staff, do you have a preference of what we should talk to the Trump Administration's Treasury about?

Mr. WATT. Congressman Hill, I am the director of FHFA. My personal views about what I prefer I left behind when I became the director of FHFA. FHFA has no view about which one of these bills is more desirable than the other, and it is not in our statutory mandate to develop a view about what is desirable or not desirable.

Mr. HILL. My time has expired, but I find that distinctly disappointing.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Missouri, Mr. Clay, Ranking Member of our Financial Institutions Subcommittee.

Mr. CLAY. Thank you, Mr. Chairman.

And good to see you again, Mr. Director.

Mr. WATT. Thank you.

Mr. CLAY. I want to go back and follow the line of questioning that my good friend and colleague from North Carolina was on about increasing home ownership. According to a recent study by Fannie Mae and the University of Southern California, home ownership rates are resting near 50-year lows, and home ownership among young adults experienced large declines over the past decade. Specifically, the home ownership rate of young adults age 25 to 44, the prime ages for first-time home buying, plummeted by 10 percent in the past decade. And I am concerned that one of the barriers to home ownership for millennials is the high levels of student debt that they hold. And you and I know that in the 2016 election, both sides, both sides of the aisle, all candidates talked about how do we attack the student loan debt?

And that is the reason why I bring this issue up, because, along with Marcy Kaptur and I, we have cosponsored legislation which directs the secretary of HUD and the director of the FHFA, you, to jointly implement a pilot program or to look at the market and tell us what is possible to assist borrowers with federally insured student loans. The bill provides the HUD and FHFA with broad discretion in terms of the types of assistance, which may include the development of new market products or flexibility in underwriting standards.

And tell me what you think about this approach, and what is the FHFA already doing to expand home ownership among millennials?

Mr. WATT. We actually may be one step ahead of you, because we have a pilot with a lender, which is actually trying to take student loan debt, which is at a very high interest rate typically, and, where practicable, roll it into mortgages. And it is picking up some degree of steam.

I can't comment on the legislation that you proposed because I am not familiar with it, but I think student debt is one of the impediments to home ownership. There is no question about that.

Mr. CLAY. And thank you for that response.

Mr. Chairman, you know my colleague from Arkansas talked about winding down GSEs. And perhaps a program like that could be a repurpose or add to the responsibilities of Freddie and Fannie, while we also attack the real problem that millennials have about student loan debt. And it may be a venture that this committee could benefit from and the American people could benefit from. And I am just suggesting that we may want to look at that and would love to hear what your thoughts on it are.

Chairman HENSARLING. I would be happy to entertain the gentleman's suggestion at the appropriate time.

Mr. CLAY. And I will yield back the balance of my time, and thank the director for his response.

Chairman HENSARLING. The gentleman yields back.

The chair now recognizes the gentleman from Florida, Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman.

And Director Watt, thank you for being here. It has been over a month since Hurricane Harvey devastated the Gulf Coast of Texas and parts of Louisiana. Under current projections, Hurricane Harvey has caused between $70 and $90 billion in economic damages. It has also been reported that more than 60 percent of the property damages caused by Harvey are uninsured, because a majority of these losses are related to flooding, which is not covered under a standard homeowner's policy. Data from FEMA suggests that only a little more than 10 percent of these flood losses will be covered by the National Flood Insurance Program, which has probably already expended its borrowing authority now.

As you know, this committee has been working through a long-term reauthorization of the NFIP. And as we consider how we should manage this reauthorization and the flood risk in our Nation, I think it would be helpful if you could provide some insight into the risk taxpayers bear through the housing finance system as a result of the number of homes with federally backed mortgages that do not have flood insurance.

Mr. WATT. We are in the process of making that assessment. What we do know is that a number of these homes were not in flood zones.

Mr. ROSS. Right.

Mr. WATT. So we don't require—Fannie and Freddie do not require flood insurance for home mortgages—

Mr. ROSS. Correct, who aren't in the flood zone.

Mr. WATT —that are not in flood zones.

Mr. ROSS. Is there any backstop that would say that if you are in a flood zone and you have purchased flood insurance, we are going to enforce every—

Mr. WATT. Yes.

Mr. ROSS. And how is that working? Because one of the problems we have found is, is that once a policy is issued, in order to effectuate a closing, the mortgage is secured, everybody goes on. Its renewal is next year. There is no enforcement mechanism to make sure that they are there.

Mr. WATT. We do have an enforcement mechanism. We have contractual arrangements between Fannie and Freddie and the servicers of the loans that obligate them to make sure that borrowers in flood zones have flood insurance, just like they have insurance—regular homeowner's insurance. And if the servicers do not do that, then they become responsible to Fannie and Freddie—

Mr. ROSS. And that is what I want to hit on.

Mr. WATT —so there is a built-in incentive for them to be aggressive in that.

Mr. ROSS. And I don't expect you to be able to answer this question now, but I would like to find out how that enforcement mechanism is working. In other words, whatever was written this year under federally backed mortgages, how many have not renewed? That is something I am very interested in.

Mr. WATT. We are gathering that information. Be happy to provide it to you. But from anecdotal information, up to this point, it appears that few of the Fannie and Freddie loans in flood zones that required flood insurance, few of them did not. The overwhelming majority of them did.

Mr. ROSS. And I guess that is my next point. If we are going to have 78 percent of the market mortgages backed by GSEs, we need to take into consideration this flood risk. And if there is any actuarial assessment of this flood risk, no matter how low it is, would it not be in everybody's best interests to have a flood policy?

Have you been able to quantify the 1 in 100 risk, 1 in 100 year risk of those homes that are backed by the Federal Government in a flood plain?

Mr. WATT. In a flood plain, yes. But outside the flood plain, I mean, is where—

Mr. ROSS. Which is a moving—which, to me, is a moving target, and I think we have seen that because of this storm season, as you have seen areas flood that were not expected to flood.

Mr. WATT. I hope you are not suggesting that we should go out in front of the legislative process—

Mr. ROSS. No.

Mr. WATT —and require flood insurance outside the flood plain.

Mr. ROSS. No, I think that is something—I am not suggesting that at all. I am just suggesting to you, though, is would it not make it a little bit easier to assess the risk if everybody, based on their actuarial risk, carried a flood insurance policy? If you are 10,000 feet, your risk is probably nothing, so you are paying a dollar. But we have seen—like I said, FEMA says 10 percent is all that is covered under the National Flood Insurance Program.

My next question to you is, and I don't have enough time, but I appreciate your earlier comments that you strongly support a private market, both in terms of being able to ease the burden of the GSEs, but also would you not support a private market for flood insurance so that you are able to take that risk, which right now I think is going to be assessed at a very, very expensive risk because of these three storms that came through? Why centralize it all on the taxpayers? Would it not be better to pool that risk and encourage a private market to come in for flood insurance?

Mr. WATT. Fannie and Freddie don't distinguish between the Federal Flood Insurance Program and private insurers, as long as they meet the same standards that—

Mr. ROSS. Right. But there is only one game in town right now, and that is NFIP.

Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Mr. Chairman, I want to commend you for having the debt clock up behind the witnesses. I know that is only up there when you have Republican time, but I would like it up there. I do point out that there are proposals to have that clock go $150 billion a year to $200 billion a year faster through massive tax cuts.

What is much less known is that sitting where our friend Mel Watt is sitting, we have had the chair of the Federal Reserve Board, and she has heard tremendous pressure and appears to have been responding to that and other things in shrinking the balance sheet of the Fed. That will cause that clock to turn another $100 billion a year faster. So we are taking actions here in Congress that are $250 to $300 billion a year faster on that clock. It seems to be moving faster now as I speak.

As to the GSEs, we had a terrible system up until the conservatorship. We had what is basically called crony capitalism. That is to say we privatized the profits and socialized or put on the shoulders of the taxpayer the risk. We cannot go back to that situation.

It is absurd that there are any listed private shareholders. They were wiped out. The government should not be sharing any future profits with them. And the ownership should increase from 79.9 to 80 percent, at least, so that we totally wipe out any net operating loss carry-forwards. The idea that the government would structure a deal designed to reduce taxes strikes me as absurd. I guess there are other reasons to stay right below 80 percent.

The system is working now. Mr. Watt, you do point out that you are subject to tremendous second-guessing and perhaps that can be adjusted, but as to it being unsustainable, I remember when you were sitting here and you had 700,000 people second-guessing everything you did every day. So you may forget that, but we up here still remember it.

Mr. WATT. I have exponentially more now, I can tell you.

Mr. SHERMAN. In any case, there could very well be an adjustment in the number of agencies second-guessing you. But the fact is you produced $270 billion in profits for the Federal Government. We have got 30-year fixed rate, low-interest rate mortgages.

When else in the history of the world, where else in the world can ordinary working people borrow hundreds of thousands of dollars at low interest rates and at fixed terms for 30 years? So obviously, it is not broke, we have got to fix it.

I want to talk a little bit about conforming loan limit. It is my understanding that on the mortgages between what, 417 and 625, you actually make a bit better profit for the Federal Government, but, more importantly for me, working families in Los Angeles, the average home sells for more than $633,000, and that is if you can get the Zillow price. So I hope that you will not lower the conforming loan limit, except perhaps in those districts of Members of Congress who are urging you to lower the conforming loan limit.

I want to talk a little bit about the FICO score. We have got millions of people with modest incomes or who have avoided debt, which is commendable in their life. They may not have much of a credit history. Minorities, immigrants are going to be the drivers of a big part of our economic growth in the future. With new credit scoring models that incorporate additional predictive metrics and payment history helps you rate those with a thin file. Those models seem to have support in the industry.

But what are your thoughts about using alternative credit scoring models for those who cannot be adequately rated? And I would also point out that FICO has at least modified their scoring with regard to medical bill collection accounts. And I wonder what is your thinking for how we rate home buyers?

Mr. WATT. Well, I think the notion that there would be substantially more people credit scored and that would increase access if we had competition is probably exaggerated, but we continue to study it and study the pros and cons of competition in this area. So—

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Minnesota, Mr. Emmer.

Mr. EMMER. Thank you, Mr. Chair. And thanks to Director Watt for all his time today.

A couple questioners ago, Representative Heck quoted your testimony about—and I am not going to read the whole thing—these conservatorships are not sustainable. But the important thing for me is, you said, and they need to end as soon as Congress can chart the way forward on housing finance reform.

My question, Director, is: You have said this repeatedly and people have been playing games with the word "sustainable" or have been questioning why you use that term. I would like to go a different direction. When you left Congress to take this job—and by the way, thank you for your years of service—you said you left things behind and you went to run this agency.

Knowing that it has got to change, what have you done under your leadership to prepare the FHFA, and specifically to prepare Fannie and Freddie for that day when they come out of conservatorship, and how do we build on what you have done?

Mr. WATT. If you would take a look at pages 3 through 5 of my written testimony, we have made a laundry list of things that we have done that, in my mind, I think of as GSE reform, reforming the enterprises. And then in my oral testimony, I made the distinction between GSE reform and housing finance reform and the questions that Congress needs to answer in the housing finance reform space.

So, I mean—

Mr. EMMER. I see them, 1 through 10.

Mr. WATT. Yes, 1 through 10. Those things are things that we have done to reform Fannie and Freddie during the period that they have been in conservatorship. They are not the same Fannie and Freddie that went into conservatorship, I can assure you of that.

Mr. EMMER. So contrary to all the questions and answers before now, you have taken a position on what should happen with the GSEs. You are sensitive about saying you folks should draft your bill to look like this. These are the steps that you have taken, and you expect Congress to build on this?

Mr. WATT. Right. I think it would be a serious mistake for Congress to disregard all these 10 things and other things that are not listed here that we have done to—if they are going to retain Fannie and Freddie as part of the housing finance system of the future, it would not be a good idea to throw those things out the window.

Mr. EMMER. OK. But you aren't going to take a position on whether the GSEs should remain?

Mr. WATT. I think that is a decision that is for Congress to make.

Mr. EMMER. In its June 2017 report on banks and credit unions, the Treasury Department found that when reviewing residential mortgage lending, quote: "The revised regulatory regime disproportionately discourages private capital from taking mortgage credit risk, instead encouraging lenders to channel loans through Federal insurance or guarantee programs or Fannie Mae or Freddie Mac."

Do you agree with this assessment by the Treasury?

Mr. WATT. I think in response to, I think it was Representative Royce's questions, I said that there are some things that were done statutorily and through regulation that provide some disincentives. Even though those things may serve important positive purposes, they provide some disincentives for the private sector to do mortgage financing.

Mr. EMMER. Can you give us an example of how this is taking place?

Mr. WATT. Well, to keep a mortgage on a bank's books, there are high capital requirements associated with that. Now, are high capital requirements important? Yes. But does it have an adverse impact on mortgage lending for a lender? If we were not there and able to take those mortgages off the books, if Fannie and Freddie were not there to take them off the books, there would be a tremendous disincentive for them to do it.

Mr. EMMER. But I think this gets back to the chairman's opening questions when he was asking you, it is not intellectually consistent to say if it is not OK for private banks, private lenders, how could it be OK for the Fannie and Freddie.

Mr. WATT. I am not sure I hear a question there.

Mr. EMMER. Exactly. The capital requirements for the private lenders, you are taking—because of the policy—I see my time has run out. I will address it in writing to you. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Ohio, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

Thank you, Mr. Watt. Nice to talk with you. And I have enjoyed your testimony. I am particularly interested in credit risk transfers. And if I have got it right, of the more than $5 trillion of securities, $1.6 trillion has been put into credit risk transfer programs.

Mr. WATT. Those are the new loans, yes. Primarily, we are doing 90 percent of the new loans, running them over into risk—

Mr. DAVIDSON. On the back end.

Mr. WATT. Yes.

Mr. DAVIDSON. Primarily.

Mr. WATT. So you have got a dichotomy between the legacy book and the new book, yes.

Mr. DAVIDSON. OK. So is it a priority of yours to grow that percentage?

Mr. WATT. Yes.

Mr. DAVIDSON. So what needs to happen in order for you to grow the amount of risk that the market is taking and decrease the amount of risk that the taxpayers are taking?

Mr. WATT. To make sure that we do it in a thoughtful, methodical way that meets the criteria that I outlined in my opening statement.

Mr. DAVIDSON. OK. And so when you look at those securities, when they are traded, are they traded by geography or are they bundled based on risk or categories of risk, or is it diluted and distributed so you got some like sausage, some bad stuff in there with some good stuff?

Mr. WATT. We have tried various iterations, but generally, we try to stay away from geographical allocations, because if something goes wrong, for example, if we did all of Florida and you had a hurricane in Florida, then that would—there is some kind of protection by—

Mr. DAVIDSON. Right.

Mr. WATT —by the geographic—

Mr. DAVIDSON. What works in the market? Because this is subject to market forces.

Mr. WATT. Yes.

Mr. DAVIDSON. What works in the market? What is driving the most demand in the market?

Mr. WATT. Well, I think the demand has been there, and we are trying to methodically increase the level of demand. There are some constraints on some things, credit linked notes, for example. We are working through to try to get to a point where those can be done consistent with the tax law and consistent with existing legislation.

But we have been very aggressive on this front. Remember, the $1.6 trillion is between 2013 and now. This is a new—risk transfer is a new concept, so you can't gear it up and do it all at one time. I think that would be very impossible, really.

Mr. DAVIDSON. OK. So when you look at growing that market, how are the Fed's actions, if the Fed unwinds their balance sheet of mortgage-backed securities, granted these are different types of securities, how does that look to affect the market for the securities you are trying to sell, which are very similar securities in that—

Mr. WATT. You know, I haven't really tried to analyze that. If you say that there is—if you start with the notion that there is a limit on the amount that the private sector can take up, which some people don't believe—if there is no limit, then it would have no impact. If there is a limit on what the private sector can take up and do, it might have some marginal impact when the Fed starts to—

Mr. DAVIDSON. I guess my question is, based on the demand for the products you already have, do you see that the market is bigger and that the private sector is anxious for you to make more of these securities available?

Mr. WATT. Yes, we think it is bigger. Whether it will be bigger in adverse times, in adverse economic times, we are not as confident about. But it is certainly big now because the market has been going very well.

Mr. DAVIDSON. Well, it may be much bigger in adverse times because the market going well, they can find better returns quite easily. And right now the returns on the mortgage-backed securities are lower. So in adverse times it may be a safe haven if they aren't loaded with too many bad mortgages.

So I guess the quality of those mortgages goes to the heart of the quality of what you are putting on the front end is ultimately what will be available on the back end.

My time has expired.

Mr. WATT. Understand we are transferring risk now, we are not just transferring loans. We are transferring risk.

Mr. DAVIDSON. Mr. Chairman, my time has expired. I yield.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Tennessee, Mr. Kustoff.

Mr. KUSTOFF. Thank you, Mr. Chairman.

Thank you, Director Watt, for being here this afternoon.

If I could followup a little bit on the avenue that Mr. Emmer was going as it relates to the ratios, prior to the financial crisis we know Fannie Mae's core capital ratio was around 1.5 percent and that Freddie Mac's was around 1.7, 1.8 percent, which made them, I think we can all agree, extremely vulnerable to the real estate and financial crises.

Now, here we are almost 9 years later following the crisis. The largest U.S. banks, or some of the largest U.S. banks, now have a core capital ratio of around 10 percent, some a little bit less, some a little bit greater, but around 10 percent, while these GSEs continue to operate at seemingly low levels, the same pre-crash ratios.

Two questions. First of all, wouldn't you agree that the ratios with the GSEs are low? And if the answer is yes, what do you think that those ratios should be or what is the appropriate level of capital that Fannie and Freddie should have to protect the taxpayers from another bailout?

Mr. WATT. You mean outside of conservatorship what do I think? I have already indicated somewhere between 3 and 5 percent would be sufficient, but that assumes we are doing risk transfer. I don't think you would apply the same capital requirements to these entities that you would to banks necessarily.

Mr. KUSTOFF. Director Watt, is the FHFA currently studying at any level or capacity the appropriate level of core capital for any entity engaged in the business of purchasing, securitizing, and ensuring residential mortgages?

Mr. WATT. You mean on the parties to which we transfer risk?

Mr. KUSTOFF. Yes.

Mr. WATT. Yes. I think we want to ensure that they are adequately capitalized to take the risk that is being transferred to them, yes.

Mr. KUSTOFF. Is anybody studying that issue or what those ratios should be?

Mr. WATT. We are constantly studying it, yes.

Mr. KUSTOFF. Your Agency is?

Mr. WATT. Yes.

Mr. KUSTOFF. Earlier today we heard in your testimony, I think in relation to questions that Mr. Pearce asked, regarding the rural housing market. A lot of my district in west Tennessee, which is where I am from, is similar in that regard. As we continue to explore further options for housing reform, it appears that much of the work needs to be done as to who is considered a qualified mortgage buyer and who is not.

In my district, we have a strong community financial institution. We have strong community banks. More often than not, the determination being made as to who is qualified to obtain a mortgage remains at the Federal level through the FHFA.

Many times these determinations could preclude good, hard-working people from achieving their American dream of owning a home. And I wonder whether these decisions are best left to the financial institutions who serve their communities.

Let me ask you if you believe that there is a strong benefit to having a robust private industry, as I do, and if you believe that those people deserving a home are not deprived from doing so. So what can the FHFA do to ensure that our community financial institutions play a role in the Federal home loan approval process?

Mr. WATT. Well, lenders are the primary gateway to the mortgage market. Fannie and Freddie don't make loans. We buy loans, take them off of lenders' books. So if lenders are not robustly engaged or are constrained, it is going to adversely impact. So private small lenders are absolutely critical.

I neglected to say in response to questions earlier that many small lenders—and I don't know about the specific bank that you are referring to—but many of them are exempt from QM, the qualified mortgage standards. So you and I seem to be in the same position on this.

Mr. KUSTOFF. Thank you.

My time has expired. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Indiana, Mr. Hollingsworth.

Mr. HOLLINGSWORTH. Good afternoon. Thank you so much for being here.

My colleague, French Hill, had gone into this a little bit and skirted around the edges, but I really wanted to dig much deeper into better understanding the reason for the limited buffer. I have seen in your testimony you talked about some concern around erosion of investor confidence. But I want to come back to what Representative Hill said and better understand it.

So the full faith and credit, up to $258 billion the U.S. Treasury stands behind Fannie and Freddie right now, what is the reason why you would need a limited buffer in addition to that?

Mr. WATT. The same reason—do you have children?

Mr. HOLLINGSWORTH. I just had my first 63 days ago.

Mr. WATT. Well, this may not apply to you yet, but you will get it soon. Your son or daughter has the full faith and credit of you standing behind them. But at some point your son or daughter will want to have some money in their pocket to deal with emergencies that come up. And that is the way I think of a capital buffer. It is different than having the full faith and credit of a parent or the government standing behind.

What you want them to not have to do is in the middle of the night call you and draw on that full faith and credit. And that is what I have assiduously tried to avoid in this space.

Mr. HOLLINGSWORTH. And I can certainly appreciate the lack of desire to do that and doing it through lowering the risk profile of Fannie and Freddie. But retaining and not paying out to the Treasury is effectively like bailing out earlier rather than bailing out later. Because there is no difference, right? The capital inside the firm is still technically the Treasury's capital, it is just not at Treasury.

I feel like the difference you are telling me is you just don't want everybody to know and it to be a widely publicized event that you had asked the Treasury for dollars. You would rather just draw down this limited capital buffer within the firm.

And I feel like if the U.S. taxpayer—and it is the U.S.taxpayer's money—that they should have a say and they should be made aware when their dollars are being mobilized to cover losses that are being incurred at Fannie and Freddie.

Isn't that true? Don't we owe it to them to ensure that they are aware of the fact that their dollars are being used, their hard-earned tax dollars?

Mr. WATT. I think you might be right if I were continuously building up capital and desiring to do that. All I am trying to do is have a modest daily reserve so I don't have to run to my parent every day to ask for—

Mr. HOLLINGSWORTH. And I want to come back to what the modest amount is, but a couple of more things. Would you propose then that if somebody said, yes, buildup this modest capital buffer, that it would be subtracted from the Treasury's obligation of $258 billion?

Mr. WATT. Well, it actually would be added.

Mr. HOLLINGSWORTH. No, I understand that if you don't pay it out. If we said to you, buildup $10 billion inside the firm, but the Federal Government is only going to come now to the tune of $248 billion rather than $258 billion, is that something that you would be supportive of?

Mr. WATT. I think that is the way the thing is set up right now, the PSPA set up that way, because if I don't pay it, then I owe it later. So you get to the same—

Mr. HOLLINGSWORTH. Do you believe you have to unilateral right to do that?

Mr. WATT. Yes.

Mr. HOLLINGSWORTH. You do. And do you believe that the Treasury—that if you are going to make a unilateral decision and you are concerned about erosion of investor confidence, that that wouldn't serve to erode investor confidence that other actors can make unilateral decisions and change this agreement?

Mr. WATT. Well, I am not making a unilateral decision. I am making a decision that is based on the contract that was written. I am not reneging on the contract, I am just enforcing the contract as it is written. It gives me that authority.

Mr. HOLLINGSWORTH. But I thought the concern was investor confidence. You don't think investors are going to—some of their confidence is going to be eroded at the fact that you are suddenly changing the way the game is played?

Mr. WATT. The point is, I don't know what will impact investor confidence.

Mr. HOLLINGSWORTH. OK. So we don't know—

Mr. WATT. We don't know that. And one of the things that I think could—and could very well impact investor confidence would be an additional draw, and I don't want to run that risk.

Mr. HOLLINGSWORTH. OK. But failing to pay taxpayer dollars to a taxpayer institution—

Mr. WATT. I have been talking about this for 2 years, it hadn't had any impact on investors so far.

Mr. HOLLINGSWORTH. OK. So we are unclear what an erosion of investor confidence looks like, but you are absolutely certain you have the unilateral right to make a decision that could impact investor confidence without consulting the American people or their Representatives.

Mr. WATT. Unfortunately, I make those decisions every single day.

Mr. HOLLINGSWORTH. This is a quarter of a trillion dollars of U.S. taxpayer money that we are talking about here. I think they are owed some public service and announcement when their dollars are being utilized, whether inside the firm or outside the firm.

And with that, Mr. Chairman, I will yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The chair now recognizes the gentleman from Michigan, Mr. Trott.

Mr. TROTT. Thank you, Mr. Chairman.

Thank you, Director Watt, for your time and service.

And I want to just pause and caution my good friend, Mr. Hollingsworth, even if your son has a few dollars in his pocket down the road, he may still call you in the middle of the night.

Mr. WATT. That is true. That is true.

Mr. TROTT. So, Director Watt, I think you and I would probably agree that the Federal Government should be involved in helping some Americans realize the dream of home ownership. My question to you is, do you believe the Federal Government has a role in helping people realize the dream of owning a second home?

Mr. WATT. You know, I don't know that I have an opinion on that, and certainly FHFA does not have an opinion on that.

Mr. TROTT. Fannie and Freddie are involved in that, right?

Mr. WATT. Well, they are doing what they are statutorily allowed to do, yes.

Mr. TROTT. Do you think they should be involved in providing liquidity for people to obtain mortgages for second homes?

Mr. WATT. I don't know that I can answer that question.

Mr. TROTT. Let's talk about, along the same lines, do you think Fannie and Freddie should be involved in helping people realize the dream of refi'ing their loans so they can get a better interest rate? Is that a proper role of the Federal Government in terms of the dream of home ownership?

Mr. WATT. Well, it is certainly something that is possible now, and it is sanctioned statutorily. If you wish to change that, I don't think FHFA ought to change it. I think the legislative branch—

Mr. TROTT. OK. You have said that a few times today, that you are waiting for Congress to do something. And as you know, it is sometimes difficult for things to get done here in Congress.

So let's assume that we struggle with GSE reform. One simple approach would be just to change the sandbox that Fannie and Freddie can play in and take them out of the refi business, which is about two-thirds of their portfolio.

What would you think of that solution in terms of the housing market, both in terms of the impact it would have and also limiting the role of the Federal Government? How about we get Fannie and Freddie out of the refi business as our GSE reform solution?

Mr. WATT. If you decided to do that legislatively, I wouldn't do it through FHFA.

Mr. TROTT. You have no opinion on that solution, though, as one option?

Mr. WATT. I don't have any opinions. I keep telling you. I left my opinions behind and FHFA—unless FHFA has a position on something.

Mr. TROTT. I understand. Reclaiming my time. Let's go to some opinions you expressed here today.

You said earlier today that there are untold stories about people that paid their mortgage even though they had negative equity during the mortgage crisis.

So would you agree with the proposition that if property values stop appreciating as they have been over the last several years and suddenly dip, as they inevitably will, that there will be an increase in defaults?

Mr. WATT. Probably to some extent, yes.

Mr. TROTT. So the $24 billion worth of loans that Fannie and Freddie bought over the past couple of years with 3 percent downpayment, some of those folks are going to go into a negative equity situation. Do you agree with that?

Mr. WATT. And some of the ones where there was a 20 percent downpayment, and some of the loans where there was a 50 percent downpayment.

Mr. TROTT. Would you agree that a 3 percent downpayment is a lot riskier than a 20 percent?

Mr. WATT. No, I don't necessarily agree with that.

Mr. TROTT. So let's go to the QM rule. There are a lot questions today about why Fannie and Freddie don't have to deal with the QM rule. So I want to followup on a line of questioning that Chairman Barr started.

Just generally as a proposition, who is better to decide when to loan outside of the QM box, a community bank in rural Kentucky who has known the mortgagor for 30 years or Fannie and Freddie? Who is going to make a better decision about the ability about that mortgagor to repay, in your opinion?

Mr. WATT. I don't know who would make a better decision, but most community banks, a number of them are exempt from the QM standards, and they would be able to make that determination without worrying about the QM standards.

Mr. TROTT. So one of the reasons why you have defended not subjecting Fannie and Freddie to QM is that to put the QM Rule into place would deny people who deserve a home the opportunity to own a home. You fundamentally believe the Federal Government should be deciding who deserves to be able to own a home?

Mr. WATT. I don't think that is my decision to make. That is a legislative decision.

Mr. TROTT. It is one of your reasons for saying the QM rule shouldn't apply. That was your reasoning. So do you think that is a sound reason, we should decide who deserves a home? Maybe we should decide who deserves a car and who has the money to take a family vacation.

Mr. WATT. I apply the law as it is written now, and if you all want to change it—

Mr. TROTT. I am out of time. But Mr. Huizenga raised a question about your building. I never heard of any entity that is in conservatorship buying or renovating a building. That is ludicrous.

Chairman HENSARLING. The time of the gentleman has expired.

The chair wishes to inform members there is currently a vote taking place on the floor, approximately 12 minutes to go. The gentleman from Maine will be the last member recognized.

Mr. Poliquin is now recognized for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman.

Mr. Watt, thank you very much for being here, since I am the last and you have been sitting here, along with myself, for 3–1/2 hours. The chairman did promise me that after votes we are coming back and do this all over again with everybody else in the committee. So you better tell your wife you won't be home.

Mr. WATT. I was tempted to ask for a recess, but I know you are the last one.

Mr. POLIQUIN. Mr. Director, we are very proud of our home ownership in Maine. About 70 percent of my fellow Mainers own a home. It is one of their largest assets and they are very proud of that. And so access to a mortgage is absolutely critical, including 30-year fixed.

Now, you folks are the regulators for Fannie and Freddie, and in 2016, or it might have been this year, I can't recall, but in any event, 52 percent, roughly, of the mortgages that were originated this year are held by Fannie and Freddie. That is a very big number. You folks regulate that part of our economy. And so your role in the housing finance system and therefore the people that I represent, very important.

Fannie and Freddie, as we all know, operate with a taxpayer guarantee for the mortgages that they are responsible for. That backstop by the taxpayers, sir, is about $5.3 trillion.

Now, you and I agree, because you have said it several times already today, that it is to the benefit of the U.S. taxpayer. You want to take care of the folks that want to buy a home. I understand that, access to a mortgage. We now have to look at the U.S. taxpayer, they are on the hook for $5.3 trillion in liabilities, dealing with the folks that you regulate.

I think we both agree that it is a good idea to try to transfer some of that credit risk to the private market. And as a result you have the credit risk transfer program. And I am sure that if you are able to do that—and thank you for doing that, sir—that it gives us a more stable housing finance market and therefore helps our families in Maine and throughout the country.

Now, my question to you, Mr. Watt, is what percent of the total credit risk assumed by the GSEs is now in the hands of the private market? Not new loans on the books. I know you are doing a better job in the last 3 or 4 years, about 90 percent, I think is what you said, of that credit risk is transferred or being transferred to the private sector. Your total book of business, including your legacy book.

Mr. WATT. It is small.

Mr. POLIQUIN. Yes, it is very small, about 1 percent.

Mr. WATT. I don't have a specific number.

Mr. POLIQUIN. It is about 1 percent.

Mr. WATT. Yes.

Mr. POLIQUIN. About 1 percent.

OK. So here we have the taxpayers on the hook for $5.3 trillion—

Mr. WATT. Well, let me correct you there. You are not really on the hook for all of that. There is a specific contract amount that the Federal Government—

Mr. POLIQUIN. So you think if you folks got in trouble beyond that specific amount—yes, come on. I was the State treasurer in Maine, we know how this works when you have a moral obligation.

But in any event, my point is the following. What is your goal and when can you get there? You must have an idea, and all of these wonderful staffers sitting behind you must have an idea, what is the optimal level, Mr. Director, that you want to—I am not done yet—that you transfer not only from your new book of business, but from your legacy book of business, onto the private sector to make it a more stable market, help our families? What is that number, sir?

Mr. WATT. I can't give you a number, but I can tell you it is the absolute maximum that we could get to applying the criteria that I outlined in my opening statement.

Mr. POLIQUIN. So you don't have an idea what that number is?

Mr. WATT. I don't know.

Mr. POLIQUIN. OK. So you have been over 5 years, about 1 percent of the total risk on the taxpayer has been transferred to the private sector over a 5-year period of time—

Mr. WATT. We started the risk transfer program in 2013.

Mr. POLIQUIN. Oh, I am sorry, 4 years.

Mr. WATT. All of this has been done in—

Mr. POLIQUIN. Can you address your legacy book of business, Mr. Watt? Are you able to do that?

Mr. WATT. Yes.

Mr. POLIQUIN. Oh, you can. OK, so it is not just the new loans, but it is the folks, the loans that you have on the books. But you haven't made much of a dent if you have 1 percent of the risk, the credit risk transferred to the private sector, the rest is on the backs of the taxpayers to the tune of roughly $5.3 trillion, and it has taken you 4 years to do this. So how would you rate your performance?

Mr. WATT. I don't lay awake at night trying to rate my performance. I try to go to work every day, do what I am supposed to do. I think the market—

Mr. POLIQUIN. OK, I get it.

Mr. WATT. If you ask people in the market to rate it, they would probably say that I far exceeded any expectations that they had, including the chairman and the people who, you know—so I don't—but I don't—I'm not in the rating—

Mr. POLIQUIN. You transfer about 1 percent of your credit risk that the taxpayers assume on the private sector, you have done a good job. OK. That is what you feel. I happen to feel a little bit differently, Mr. Watt. But I am not picking on you, I just want to understand this.

Mr. WATT. I understand.

Mr. POLIQUIN. How do you evaluate the effectiveness of your program? For example, when you talk about—explain to us how using the reinsurance strategy transfers risk from the taxpayers to the private sector. Explain that us to.

Mr. WATT. Well, reinsurers are privately backed. They have capital. So that is in the private sector.

Mr. POLIQUIN. And what happens if something goes wrong? How can you assure the taxpayer that that risk that has been transferred from their backs to the private sector will in fact be paid?

Mr. WATT. There is collateral to back it.

Chairman HENSARLING. The time of the gentleman has expired.

Mr. POLIQUIN. Thank you, Mr. Chairman. I yield back my time.

Chairman HENSARLING. I thank our witness for his testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

I would ask Director Watt that you would please respond as promptly as you are able.

This hearing stands adjourned.

[Whereupon, at 1:40 p.m., the committee was adjourned.]

A P P E N D I X

October 3, 2017

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.

NMHC NATIONAL MULTIFAMILY HOUSING COUNCIL NAA NATIONAL APARTMENT ASSOCIATION

October 2, 2017

The Honorable Jeb Hensarling
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

Thank you for your leadership on housing finance reform and for holding this hearing entitled, "Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency."

For more than 20 years, the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of more than 160 state and local affiliates, NAA encompasses over 73,000 members representing nearly 9 million apartment homes globally.

We are experiencing fundamental shifts in our housing dynamics, as more people are moving away from buying houses and choosing apartments. One in three Americans rent, and 19 million of those households are building their lives in apartments. In the past five years, an average of one million new renter households were formed every year, which is a record amount. This increased apartment demand means a critical need for 4.6 million new apartments at all price points by 2030. Access to capital to meet this demand is a crucial need of the apartment industry.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. Yet, those shortcomings were confined to the single-family residential home mortgage sector. The Government-Sponsored Enterprises' (the Enterprises) multifamily programs were not part of the meltdown, and have generated over $29 billion in net profits since the two firms were placed into conservatorship.

More than just performing well, the Enterprises' multifamily programs serve a critical public policy role. Even during normal economic times, private capital alone cannot fully meet the industry's financing demands. Many factors influence the apartment industry's health and its ability to meet the nation's growing demand for rental housing, but the availability of consistently reliable and competitively priced capital is absolutely essential.

The Enterprises ensure that multifamily capital is available in all markets at all times, so the apartment industry can address the broad range of America's housing needs from coast to coast and everywhere in between. Further, their business models weathered the recession, producing a strong credit performance with low delinquencies and losses. In fact, the multifamily model can provide valuable components that lawmakers and stakeholders can use as a basis for crafting a long-term solution for housing finance reform.

NMHC/NAA urge the Committee to recognize the unique needs of the multifamily industry. We believe the goals of a reformed housing finance system should be to:

1. Maintain an explicit, paid-for federal guarantee for multifamily-backed mortgage securities available in all markets at all times;
2. Recognize the inherent differences of the multifamily business from the single-family business;
3. Promote private market competition;
4. Protect taxpayers by keeping the concept of the Enterprises' multifamily first-loss risk sharing model;
5. Retain the successful components of the existing multifamily programs in whatever succeeds them;
6. Avoid market disruptions during the transition to a new finance system.

We look forward to working with the Committee as you undertake this important work.

Sincerely,

Doug Bibby
President
National Multifamily Housing Council

Robert Pinnegar, CAE
President & CEO
National Apartment Association

U.S. House of Representatives
Committee on Financial Services
"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency"
October 3, 2017

Questions for the Honorable Mel Watt, Director, Federal Housing Finance Agency, from Representative Joyce Beatty:

The mission of the Federal Housing Finance Agency is to ensure the enterprises operate in a safe and sound manner to serve as a reliable source of liquidity and funding for housing finance and community investment. The Housing and Economic Recovery Act of 2008 grants the Director broad authority to ensure this mission is carried out.

Due to provisions in the Preferred Stock Purchase Agreements, the capital reserves of Fannie Mae and Freddie Mac are expected to be decreased to zero by January 1, 2018. In your testimony before the Committee, you have stated, unequivocally, that you believe you have the authority to take action to remedy this situation. You have also stated it is your preference to work with U.S. Department of Treasury Secretary Steven Mnuchin, to make this happen. However, if you find that Secretary Mnuchin does not agree with your assessment that it is critical for Fannie Mae and Freddie Mac to retain at least some capital, are you prepared to act unilaterally, and allow the government-sponsored enterprises to retain capital as a reserve from their Q4 net worth sweep?

Additionally, have there been discussions at FHFA of taking the intermediate step and requiring the government-sponsored enterprises to sweep their profits on an annual basis, as opposed to a quarterly basis?

On December 21, 2017, FHFA entered into a letter agreement with the Department of the Treasury on behalf of Fannie Mae and Freddie Mac (the Enterprises) to reinstate a $3 billion capital reserve amount for each Enterprise under the Senior Preferred Stock Purchase Agreements.[1] As a result of these agreements, an Enterprise will only pay a dividend to Treasury if the net worth at the end of the quarter is more than $3 billion. These terms apply to any quarterly dividend paid for the fourth quarter of 2017 and each quarter thereafter. FHFA considers the $3 billion capital reserve sufficient to cover other fluctuations in income in the normal course of each Enterprise's business. In light of the letter agreement, it was not necessary for FHFA to consider whether "to act unilaterally", or to consider "taking the intermediate step and requiring the government-sponsored enterprises to sweep their profits on an annual basis, as opposed to a quarterly basis."

On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) was enacted into law reducing the statutory corporate tax rate from 35 percent to 21 percent. While the TCJA was not effective until January 1, 2018, generally accepted accounting principles require companies to re-measure their deferred tax assets (DTA) at the reduced rate in the period in which legislation is

[1] https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-from-FHFA-Director-Melvin-L-Watt-on-Capital-Reserve-for-Fannie-Mae-and-Freddie-Mac.aspx.

enacted. As a result, Fannie Mae and Freddie Mac recorded one-time federal income tax provision expenses of approximately $9.9 billion and $5.4 billion, respectively, in the fourth quarter of 2017. Consequently, in the first quarter of 2018, FHFA submitted a request to Treasury on behalf of Fannie Mae for $3.7 billion and on behalf of Freddie Mac for $0.3 billion to eliminate their net worth deficit. Although the tax provision expense resulted in a large reduction of net income in 2017, the Enterprises expect to benefit from the reduction in the corporate tax rate going forward. The Enterprises will continue to make dividend payments on a quarterly basis per the terms of the existing agreements.

U.S. House of Representatives
Committee on Financial Services
"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency"
October 3, 2017

Questions for the Honorable Mel Watt, Director, Federal Housing Finance Agency, from Representative Randy Hultgren:

In February, The Hill published an Op-Ed by Ian Adams with the R Street Institute, where he wrote: "Insurance broker Aon Benfield estimated in an August 2011 report to the Federal Reserve Bank of Atlanta that U.S. taxpayers currently are providing a $100 billion subsidy to the GSEs for the cost of their earthquake risk, about half of which can be attributed to California." In 2015, the US Geological Survey stated that 10 states – including Illinois – have the highest number of people exposed to potential major damage from an earthquake.

What assessments and/or studies have been conducted by FHFA to assess and manage those risks? Will FHFA please consider conducting a study if they have not already done so?

FHFA has participated in meetings over the past several years to better acquaint itself with mortgage risk issues posed in earthquake zones. FHFA has met with the Federal Emergency Management Agency (FEMA) to understand their perspective and role in designating earthquake areas. FHFA and FEMA are also involved in regular intra-agency dialogue to share information and take appropriate steps to mitigate risks. FHFA has also met with the California Earthquake Authority, which has proposed a number of steps to be taken ranging from retrofitting homes to making earthquake insurance more affordable and with greater coverage. Some of these actions have already occurred. FHFA, for example, has not discouraged Fannie Mae and Freddie Mac from permitting mortgage loans or re-financings to include home retrofits related to earthquake risk mitigation. While FHFA does not conduct studies on these matters, the Agency looks to the work of other federal and state agencies for their perspectives on appropriate actions by government in relation to these risks.

Have the GSEs taken any action, or has the FHFA required any action of the GSEs, to reduce their earthquake exposure?

FHFA does not prohibit the Enterprises from purchasing loans without earthquake insurance. FHFA does, however, require the Enterprises to consider and mitigate earthquake, flood, hurricane, tornado, and other disaster risk through risk-based pricing models. The Enterprises support the purchase of residential earthquake insurance during the loan application process. Through these efforts, FHFA ensures that the Enterprises maintain appropriate prudential risk standards to address earthquakes and the myriad of natural disasters that occur across the country.

Will you please provide the Committee with copies of all of your studies on GSE earthquake exposure and also your recommendations on how to reduce or eliminate it?

FHFA does not conduct earthquake exposure studies. Instead, the Enterprises conduct their own assessments of risk to various disaster types and apply appropriate pricing models and risk sharing tools in order to protect their mortgage portfolios. The Enterprises encourage borrowers to obtain additional insurance coverage when warranted. However, because states do not generally require, and some states may bar, mandatory purchase of earthquake coverage, mitigation efforts through retrofitting or stronger building codes appear to be a more workable option.

U.S. House of Representatives
Committee on Financial Services
"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency"
October 3, 2017

Questions for the Honorable Mel Watt, Director, Federal Housing Finance Agency, from Representative Barry Loudermilk:

As you know, the GSEs have transferred a portion of the credit risk on mortgages with total unpaid principal balance of $1.6 trillion since 2013, but, as of 2017 Q1, only 4% of that credit risk transfer is taking place on the front end.

Why are the GSEs and the FHFA choosing to focus on back-end credit risk transfer investors that are only willing to participate in transactions that leave the GSEs– and therefore the federal government and taxpayers– on the hook in the first-loss position?

FHFA distinguishes between "front-end" and "back-end" credit risk transfer (CRT) transactions based on when the arrangement of the credit risk transfer occurs. "Front-end" credit risk transfer transactions are those in which the arrangement of the risk transfer occurs prior to, or simultaneous with, the acquisition of residential mortgage loans by an Enterprise. Conversely, back-end credit risk transfer applies to transactions in which the arrangement of the credit risk transfer occurs after the acquisition of residential mortgages by the Enterprises. It is important to note that regardless of when the credit risk transfer occurs, the Enterprises' exposure to counter parties providing credit risk protection remains unchanged. The Enterprises will transfer first-loss risk when it is economically sensible and do so with either front-end or back-end transactions.

The Enterprises have taken a balanced approach to transferring credit risk with front-end and back-end transactions. From 2013 through the end of 2017, the Enterprises transferred a portion of credit risk on approximately $2.1 trillion in single-family loans through CRTs. During the same period, an additional $972 billion of credit risk has been transferred to primary mortgage insurers. The cumulative value of this primary mortgage insurance (PMI) is $246 billion of risk-in-force. In addition, PMI on loans with loan-to-value ratios greater than 80 provides the largest share of front-end credit protection to the Enterprises.

It should be noted that the Enterprise, not the CRT investor, is typically responsible for the risk of mortgage insurers not fully paying claims. The Enterprises have assumed this risk because CRT investors do not assign sufficient value to mortgage insurance to make it economic for the Enterprises to transfer the counter party risk. As a result, in order to reduce counter party risk, FHFA in its role as Conservator of the Enterprises, directed Fannie Mae and Freddie Mac to revise and align their private mortgage insurer eligibility requirements (PMIERs) to ensure that approved mortgage insurers possess greater financial and operational capacity to better withstand a financial crisis or severe downturn. The PMIERs undergo regular review by FHFA.

FHFA has encountered several challenges to expanding direct front-end credit risk transfer opportunities with lenders. Foremost among these challenges are a regulated financial institution's inability to receive capital relief for credit risk transfers. Currently, financial institutions may only receive relief when selling the entire loan. In addition, when banks retain some portion of credit risk, they may not be able to achieve a true loan sale for GAAP accounting purposes.

Would it not be beneficial for the GSEs to increase the number and types of front-end credit risk transfer transactions to immediately transfer mortgage credit risk upon the beginning of a loan and before the risk ever hits the GSEs' balance sheets?

FHFA believes that pursuing a broad portfolio of credit risk transfer transaction structures best furthers FHFA's objectives of having the Enterprises diversify their investor base for credit risk transfers and being able to compare execution across different structures and market environments. To achieve this, both Enterprises are making significant progress to expand the front-end risk transfer approach to the private mortgage insurance and reinsurance industries. In 2017, the Enterprises continued to evaluate and implement new ways to transfer credit risk on newly acquired single-family mortgages. This includes the Enterprises expanding on front-end collateralized lender recourse transactions executed in 2016. It also includes front-end credit risk transfer transactions with mortgage insurance affiliates beyond the previous year's pilot programs. One such transaction utilizes a forward commitment, CIRT and ACIS forward commitments, with a panel of diversified reinsurers as a counterparty. Lastly, Freddie Mac's IMAGIN pilot is a prime example of a front-end credit risk transfer that uses a lender-paid mortgage insurance structure with the mortgage insurance provided by reinsurers who meet strong counterparty requirements and put up collateral to minimize counterparty risk.

Debt issuances (CAS and STACR) and reinsurance transactions (ACIS and CIRT) have dominated the GSEs' credit risk transfer program. However, the demand and investor base for these back-end structures could disappear overnight due to market volatility, reduced yield, and reduced appetite for mortgage credit risk.

When does the FHFA plan to implement policies to bring greater balance between front-end and back-end credit risk transfer structures, including through the use of front-end mortgage insurance deeper cover?

The Enterprises must establish a variety of credit risk transfer channels on economically reasonable terms across all economic cycles. As noted above, the Enterprises have continued to increase their use of front-end credit risk transfer structures. The FHFA 2017 Scorecard asked the Enterprises to consider front-end credit risk transfer to further advance their programs.

You rightfully stated in the hearing that credit risk transfer is important for protecting taxpayers. You also stated that the FHFA is trying to use more front-end credit risk transfers when it is "viable and sustainable", and is trying to do as much credit risk transfer as possible while meeting certain criteria. It seems there could be more concern about "sustainability" on credit risk transfers with back-end transactions given the volatility and availability of this capital.

Can you please define what is "viable and sustainable?"

By "viable and sustainable," FHFA means that credit risk transfer transactions employed by the Enterprises must be economically sensible, i.e. the credit risk transfer program should consist of transactions in which the cost to the Enterprise for transferring the credit risk does not meaningfully exceed the cost to the Enterprise of self-insuring the credit risk being transferred. [2]

At a speech before the North Carolina Bankers Association earlier this year, you stated that the "FHFA and the Enterprises have determined that it is better if Fannie Mae and Freddie Mac retain the first 50 basis points of expected losses in most transactions." In the speech, you cite that it may not make "economic" sense to transfer this risk. Given that first loss risk is in fact the most "at risk," having the GSEs retain the first 50 basis points of credit risk seems to run counter to the FHFA's conservatorship goal of reducing taxpayer risk by reducing the GSEs' overall risk exposure. There are private sector credit enhancers currently in the market with extensive experience with first-loss risk who are willing to take the first-loss position.

Can you commit to providing transparency on what the FHFA and the GSEs determine to be "economic" for the GSEs to transfer first loss risk?

The credit risk transfer program should consist of transactions in which the cost to the Enterprise for transferring the credit risk does not meaningfully exceed the cost to the Enterprise of self-insuring the credit risk being transferred. The cost of these transactions should not exceed their CRT benefits. The Enterprises experimented with selling the first 100 basis points of credit losses to investors. As a result, we learned that selling the first 50 basis points of these expected loss is expensive. Investors, like the Enterprises, know that there will be some degree of expected credit losses for any portfolio of mortgages no matter the economic conditions. We determined it was better for the Enterprises to retain the first 50 basis points of expected losses in most transactions. This means that the Enterprises have begun selling credit losses between 50 to 100 basis points, and early indicators reflect better pricing and greater competition for credit losses beginning at 50 basis points rather than zero basis points. FHFA and the Enterprises continuously assess the economics of selling or retaining expected or first loss risk and will transfer such risk when economic.

It is critical for the GSEs' credit risk transfer programs to have a broad investor base made up of reliable counterparties that are available across market cycles and that are willing to assume mortgage credit risk even during financial downturns.

To safely minimize taxpayer exposure to losses, it is important that there be a level playing field for credit enhancers and credit risk transfer partners. Does the FHFA believe that there should be comparable standards for all forms of credit enhancement, including in the areas of oversight, regulatory capital, reserves, and leverage and liquidity requirements?
FHFA does believe that there should be comparable standards for all forms of credit enhancement, including in the areas referenced in the question. Ensuring the Enterprises

[2] FHFA 2017 CRT Progress Report.

engage in transactions with strong counterparties is important to the housing finance market and taxpayers. Maximizing the likelihood the providers of credit protection are able to meet their obligations is one of the reasons FHFA and the Enterprises have relied so heavily on STACR and CAS CRTs. These CRT transactions are fully funded up front through a bankruptcy remote trust, leaving Enterprises with no counter party exposure.

In transactions in which the credit risk being transferred is not fully collateralized, credit risk transfer counterparties to the Enterprises should be financially strong companies that are able to fulfill their financial commitments even in adverse markets. The Enterprises complete due diligence on their counterparties, whether they be mortgage insurance companies subject to PMIERs, or reinsurers subject to other counterparty standards, and where necessary, the Enterprises may also require collateral to ensure that counterparty risk is mitigated.

"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency"
October 3, 2017

Questions for the Honorable Mel Watt, Director, Federal Housing Finance Agency, from Representative Steve Stivers:

As you know, in July, a dozen members of this Committee wrote to you regarding potential plans to add a question on borrower language preference to the Uniform Residential Loan Application. In that letter, we recommended that FHFA work with other regulators to provide greater clarity and certainty to those impacted before proceeding with any potential changes. We also asked FHFA to share any and all data from consumer testing to ensure that applicants are not unintentionally misled to think the entire transaction can be conducted in their language, or fearful that the information will be used against them in reviewing the loan. Can you tell me what your agency has done to fulfill these requests?

FHFA, Fannie Mae, and Freddie Mac have taken a number of steps to gather information about issues facing limited English proficiency (LEP) borrowers and options for improving access for LEP borrowers. As I mentioned in my July 28th response to your letter, in 2017 FHFA and the Enterprises conducted industry and stakeholder outreach on the experiences of mortgage industry participants in serving LEP borrowers. The Agency also issued a Request for Input (RFI) in May 2017 and received over 200 responses to the RFI, which were made public on FHFA's website. FHFA also collected data on the experience of LEP borrowers by adding language-related questions to the National Survey of Mortgage Originations and the American Survey of Mortgage Borrowers and FHFA has publicly shared that data.

In coordination with FHFA, Fannie Mae and Freddie Mac also conducted individual borrower and lender focus group and testing sessions to learn more about the experiences of LEP borrowers in navigating the mortgage process and of mortgage industry participants in serving LEP borrowers. Two of these sessions tested reactions to various forms of a borrower language preference question on the Uniform Residential Loan Application (URLA) and a separate disclosure. FHFA made results from all consumer testing related to LEP issues available on its website[3], and used the information in formulating the question for the URLA.

Consumer testing revealed important insights on how to ask about preferred language in a way that appropriately manages borrower expectations for in-language services. Initial feedback showed increased borrower expectations for in-language resources upon viewing an early version of the question. This contrasted sharply with borrower expectations after reviewing a disclosure that explained that mortgage transactions are likely to be conducted in English, and that identification of a preferred language by the consumer does not mean that lenders or servicers are able to provide, or agree to provide, communications in the preferred language. As a result, in the second round FHFA tested a revised version of the question that incorporated key language from the disclosure. Borrowers and lenders felt the revised question more accurately set borrower expectations. All versions of the question in the second round of testing

[3] See https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Language-Access.aspx.

also contained clear language stating that a borrower's answer will not negatively impact their mortgage application.

The results from all outreach, research, and testing were used by FHFA in deciding whether and how to include the language preference question on the URLA. On October 20, 2017 FHFA announced that the language preference question would be included on the redesigned URLA. The Consumer Financial Protection Bureau issued a notice approving use of the redesigned URLA under the Equal Credit Opportunity Act (ECOA) on November 24, 2017. The Enterprises published the redesigned URLA and supporting documents on December 19, 2017. Lenders may begin using the redesigned URLA in July 2019, and mandatory use for Enterprise loans will not begin until February of 2020.

In 2018, the Enterprises have finalized and are starting to implement the Language Access Multiyear Plan, which is accessible on FHFA's website. Three key components of that plan involve:

1) *<u>An external Language Access Working Group consisting of industry trade associations, consumer advocacy groups, technology providers, and others</u>. The group serves as a consultative body for FHFA and the Enterprises to discuss and gather feedback on elements of the Multiyear Plan. The Working Group had its kickoff meeting on April 11, 2018, and the next meeting is scheduled for June.*

2) *<u>Creation of an online clearinghouse that provides a centralized collection of resources to assist lenders, servicers, and housing counselors in serving LEP borrowers.</u> Phase 1 (2018 implementation) will allow these parties to access existing Enterprise materials, as well as materials from other government agencies. Additional stages, such as functionality in additional languages, will be implemented in subsequent phases.*

3) *<u>The release of the language disclosure described above.</u> The disclosure will be translated in Spanish, Vietnamese, Chinese, Korean and Tagalog and will be available for use alongside the preferred language question, or at any other point in the mortgage process. As discussed, the disclosure will help accurately manage borrower expectations for in-language services.*

FHFA and the Enterprises continue to work with other government agencies to discuss feedback that FHFA has received from outside parties, collaborate on the initiatives described in the Multiyear Plan, and, when possible, provide greater clarity and certainty to those in the mortgage industry that work with LEP borrowers.