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.