

**OVERSIGHT OF THE FEDERAL HOUSING  
FINANCE AGENCY'S ROLE AS  
CONSERVATOR AND REGULATOR OF THE  
GOVERNMENT SPONSORED ENTERPRISES**

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**HEARING**  
BEFORE THE  
COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED FIFTEENTH CONGRESS  
SECOND SESSION

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## **OVERSIGHT OF THE FEDERAL HOUSING FINANCE AGENCY'S ROLE AS CONSERVATOR AND REGULATOR OF THE GOVERNMENT SPONSORED ENTERPRISES**

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**Thursday, September 27, 2018**

**U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON FINANCIAL SERVICES,  
Washington, D.C.**

The Committee met, pursuant to notice, at 10:34 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Present: Representatives Hensarling, Royce, Lucas, Posey, Luetkemeyer, Huizenga, Duffy, Hultgren, Ross, Pittenger, Wagner, Rothfus, Tipton, Williams, Poliquin, Hill, Emmer, Zeldin, Trott, Loudermilk, Mooney, Davidson, Budd, Kustoff, Tenney, Hollingsworth, Waters, Maloney, Velazquez, Sherman, Meeks, Clay, Green, Cleaver, Perlmutter, Foster, Kildee, Delaney, Sinema, Beatty, Heck, Vargas, Gottheimer, Crist, and Kihuen.

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, "Oversight of the Federal Housing Finance Agency's Role as Conservator and Regulator of the Government Sponsored Enterprises." I now recognize myself for 3-1/2 minutes to give an opening statement, although I warn others, I may go over.

Ten years ago, at the time of the financial crisis, Fannie and Freddie were thinly capitalized. They bought loans for as little as 3 percent down. They issued mortgage-backed securities encompassing roughly half of all first lien mortgages, and they were embroiled in multiple scandals.

Fast forward to today. The GSEs remain thinly capitalized. They still securitize half of new mortgages. They are buying, once again, high-risk, 3 percent down loans, and surprise, they are once again embroiled in scandal.

Recent headlines from a newspaper, "Housing Finance System Roiled by Maze of Investigations." Let me read the first two paragraphs. "The U.S. Housing Finance Administration has been rocked by a series of investigations that have raised fresh doubts about the Federal Government's management of the vast system

that supports most of the Nation's mortgages. The country's top housing regulator is under investigation for alleged sexual harassment."

"The watchdog looking into his behavior is herself under a probe, partly over claims that her office is too cozy with his. And the outgoing CEO of the largest mortgage financier was faulted in a report for failing to disclose potential conflicts stemming from a romantic relationship."

These headlines are not fake news. And so what we know is after 10 years, our housing finance is in dire need of reform, and FHFA is in dire need of oversight. Should anybody need a refresher course, the Housing and Economic Recovery Act of 2008, known as HERA, directs the Director of FHFA to oversee the GSEs, and to ensure they are operated in a safe and sound manner to ensure that the housing finance market is resilient and competitive; that they are operated in the public interest. But we have already heard testimony within this hearing room that gives strong evidence that they are not.

So for the past 7 months, this Committee has been investigating FHFA's conduct as the supervisor and regulator of the GSEs, and this has been strongly influenced by a series of reports by their inspector general, who we will hear from shortly. Those reports would give very strong evidence that Fannie Mae has engaged in excessive spending inconsistent with its conservator status, and that FHFA failed to control that spending. There is reason to believe that Fannie Mae avoided the FHFA lobbying regulations, and FHFA failed to properly enforce these regulations. There is evidence that the GSEs have attempted to evade restrictions on CEO salaries with the FHFA's consent. There is strong evidence supporting that Fannie Mae failed to appropriately address senior officer conflicts in FHFA's failure to exercise adequate oversight in this area, and the list goes on and on.

It is somewhere between folly and peril in legislative malpractice to continue to entrust almost all of housing finance to two GSEs and one unelected, unaccountable individual with omnipotent powers, a position that the Fifth Circuit has found unconstitutional.

Now, we have three panels today. Our third panel, we will hear from Director Watt, as well as the CEO of Fannie, and the CEO of Freddie, as well.

Our second panel will contain the Inspector General for the Federal Housing Finance Agency, and our first panel consists of one witness, Miss Simone Grimes. Welcome, Ms. Grimes.

Ms. Grimes is a Senior Staffer, and she is a special advisor at FHFA. She has made a serious allegation of sexual harassment against Director Watt. She has filed an EEOC claim and a civil suit under the Equal Pay Act.

We all know that accusations are a daily occurrence in this town, but Ms. Grimes did not just bring an accusation; she brought evidence, as to substantiate her claim. As requested, she has submitted to an interview of the Financial Services Committee staff, and she brought evidence as well. She deserves to be heard and she needs to be heard, and she has been invited as a witness.

Now, given what is happening at the other end of the Capitol as I speak, I am not sure this hearing will be heard, but it should.

And importantly, Director Watt deserves to be heard and he will be.

There has been one investigation by the Postal Inspector General of Ms. Grimes' claims, and another is currently ongoing at the office of the FHFA Inspector General, who we will hear from shortly.

This investigation must be independent, must be impartial, must be fair, and must be thorough. And we expect Director Watt to cooperate.

I believe the record will show that Director Watt did not participate or cooperate in the first investigation, asserting a legal privilege which many do not recognize.

As Chairman of the Committee, I will not hesitate to use my full subpoena power to compel cooperation where necessary. I am also aware that our Committee is not a court of law.

We are not best-equipped to be the finder of fact nor the dispenser of justice. That is best left to a forum with formal rules of evidence, due process, and the rules of civil procedure.

So after both parties are heard, we will follow closely the FHFA investigation and Ms. Grimes' civil suit as we continue to conduct our oversight and continue to conduct our investigation.

But today, I expect both parties to be heard and fully heard and treated fairly. Federal employees must be able to work in a hostile-free environment, free of harassment, free of discrimination and no one is above the law. And it is the business of this Committee to ensure that takes place.

Now I know that this charge does not exist in a vacuum, so I want to make a few comments about it. One, again, I am disturbed that anyone would hold themselves above the law or believe that standards apply to their employees that do not apply to them.

I am also disturbed that the seriousness of a charge can somehow shift the burden of persuasion or the burden of proof to the accused. A presumption of innocence is foundational to our society, as is due process.

I am the father of two teenagers. I want them to dream big dreams. I want them to live purpose-driven lives. I want them to achieve the happiness that comes with earned success, using their hard work and talents.

It is horrific to me, to think that, one day, when my daughter enters the workforce, that she might be harassed, that she might be discriminated against. That somebody might force themselves upon her or hold out a career advancement on some type of quid pro quo.

That is intolerable to me, and I would want her to have the courage to bring those charges forward. And I would want society to support her and to take her charges seriously and I would want justice. Too long these charges were not taken seriously in American society.

But I am also the father of a teenage son. And when he enters the workforce, it is intolerable to me to think that a mere accusation of impropriety would somehow deny him the presumption of innocence, somehow deny him his due process. That, too, is intolerable to me. And in our society, as has been stated before, where do you go to get your reputation back?

These are, indeed, troubling issues, and so whatever happened between Ms. Grimes and Director Watt should not be about sym-

bolism, it ought to be about facts, it ought to be about equality before the law, it ought to be about fairness, and ought to be about justice.

I do believe there is at least one inescapable conclusion, and that is, there is something amiss at FHFA and this Committee has to get to the bottom of it.

And I will yield 5 minutes to the Ranking Member for an opening statement.

Ms. WATERS. Thank you very much, Mr. Chairman. We are here today for a hearing on "Oversight of the Federal Housing Finance Agency's Role as Conservator and Regulator of the Government Sponsored Enterprises."

FHFA plays a critical role in our housing system, and this Committee has a responsibility to conduct rigorous oversight of the agency and that includes all aspects of this agency. I want to say up front that I have been friends with Director Watt for years. Of course, he was a Member of this Committee and a colleague.

In addition to that, I have dined at his home with him and his wife and mother, and of course, I have visited with his son in California and presented his grandchildren with gifts. We are indeed friends and colleagues.

If this were a jury in a court of law I would need to recuse myself, but this is not a jury or a trial. This is a Congressional oversight matter and no matter our friendship, no matter I have visited his home, that I have dined with him, that I know his grandchildren and have presented them with gifts, I have a responsibility to ensure that Simone Grimes, who has raised deeply troubling allegations against Director Watt, is heard before this Committee.

Today, Ms. Grimes will testify. While there are several ongoing investigations into this matter, in addition to Ms. Grimes' litigation against FHFA, I do not believe, given the seriousness of this issue, that the existence of these investigations and pending lawsuit should prevent Ms. Grimes from testifying today.

As I have stated, we must face the reality that women throughout all sectors feel that existing policies and procedures have worked against them and left them silenced when they have complaints about discrimination and harassment.

Sexual harassment, discrimination are wrong and against the law. I and others on this Committee, including some of the women who have been anxious to deal with this whole issue of sexual harassment, have responded.

We have said yes, Ms. Grimes should be able to testify here today. And when she requested that, we did respond.

We have been witnessing a confirmation process in the Senate, in which several women have come forth with grave accusations against Judge Kavanaugh, who has been nominated for a seat on the Supreme Court.

That hearing is in process and that hearing is a travesty. And questions remain about whether all of the women who have made allegations will be allowed to testify before the Senate Judiciary Committee.

I believe that we must listen to the claims of women who come forth with allegations of harassment, abuse, or misconduct. With

this Committee, my staff, and Chairman Hensarling's staff have worked together earlier this week to interview Ms. Grimes so that she may testify today regarding her allegations.

Director Watt will also have the opportunity to address these questions, with regard to the ongoing investigations and to Ms. Grimes' allegations. I would encourage both Director Watt and Ms. Grimes to cooperate fully. And with that, I will give back the balance of my time so that we can get on with this very, very important hearing.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, the Chairman of our Oversight and Investigations Subcommittee for minute and a half.

Mrs. WAGNER. Thank you Chairman Hensarling. And I would like to associate myself, in its entirety with your opening statements, sir. My opening statement encompasses all three panels and our entire work that we have been doing on the Oversight and Investigations Committee.

Following the 2007 housing crisis, Congress passed a series of laws in an attempt to protect our financial markets from unnecessary exposures and liabilities. Unfortunately, 10 years later, Fannie Mae and Freddie Mac retain their stranglehold on the U.S. housing finance market with no end in sight.

In fact, a recent CBO report confirms that, by 2028 those liabilities will almost quadruple. Earlier this year, the Oversight and Investigations Subcommittee, which I have the privilege of chairing, began an investigation into that complicated relationship that exists between the Federal Housing Finance Agency, FHFA, and government-sponsored enterprises, Fannie and Freddie.

At our April hearing, the subcommittee heard testimony from FHFA's Office of Inspector General, who highlighted concerns on extravagant buildings, a lack of oversight on the GSE cyber security programs, and whether or not FHFA had established themselves as an effective regulator.

Unfortunately, today you will hear more of the same. Specifically, you will hear how Fannie Mae's decision to consolidate and relocate its Northern Virginia workforce will cost taxpayers, are you ready for this, \$727 million.

You will also hear how FHFA spent \$7.7 million to produce additional qualified commissioned examiners. Yet, after nearly 7 years, FHFA, in fact, has one less qualified commissioned examiner than they had back in 2011 when the program started.

Mr. Chairman, I look forward to shining a light on this waste, fraud, and abuse and other very serious and troubling allegations that we are going to hear about today. I look forward to hearing from Ms. Grimes and from all of our witnesses. And I yield back the balance of my time.

Chairman HENSARLING. Time of the gentlelady has expired. Our first witness today, again, is Ms. Simone Grimes, who is a Special Advisor at the Federal Housing Finance Agency in the Division of Conservatorship and the Head of the FHFA Program Management Office.

She attended George Washington University and received an MBA from Cornell. Ms. Grimes previously worked at PricewaterhouseCoopers and Grant Thornton.

Ms. Grimes, you will be recognized for 5 minutes to give an oral presentation of your testimony and without objection; your written statement will be made part of the record. Since, Ms. Grimes, you have not testified before us before, please, when you testify, pull the microphone close to you so all can hear and ensure that you press the button as well. You are now recognized for your testimony, and welcome.

#### **STATEMENT OF SIMONE GRIMES**

Ms. GRIMES. Thank you. Thank you Chairman Hensarling, Ranking Member Waters, and Members of the House Financial Services Committee. I want to especially thank you for your opening comments today which were poignant, and which I agree with wholeheartedly.

Thank you for the opportunity to testify today regarding my complaints of sexual harassment, retaliation, and violations of the equal pay act that I experienced at the Federal Housing Finance Agency.

I appreciate the Committee taking these matters seriously and working expeditiously to get through the tremendous volume of evidence presented to you. I began my career with the agency in September 2010, I enjoyed my early years at FHFA, was and continue to be committed to its mission.

I quickly moved up the ranks with the highest level of performance review for my accomplishments for 7 consecutive years. I found the agency to be mostly populated with bright, talented, and enthusiastic employees who are mission-driven and dedicated. I would like to provide a little background on my particular circumstance, and then cover three points which I believe have consequences beyond my individual matter.

As background, in early 2015 I was asked to temporarily take on the role of Executive Special Advisor in the Division of Conservatorship, but I was not given the benefits commensurate with the position as had been paid to my predecessor.

As time passed and I continued to serve in this temporary role, I raised the issue of equal pay within my supervisory chain. I was advised that the decision would need to be approved by former Congressman and FHFA Director, Melvin Watt.

Beginning in September 2015, Director Watt made multiple unwanted advances toward me and insisted that we meet in several unusual locations in order to discuss my professional issues, to include my equal pay complaints. The frequency of the advances, coupled with the advice from friends in the security industry, led me to begin recording many of our interactions.

I felt vulnerable and unsafe. Director Watt more than once implied that his advances were linked to my ability to receive promotions and pay increases. When I attempted to pursue other career advancement opportunities outside of his direct chain, within the agency, they were blocked through the use of the Office of Inspector General Hotline Complaint Process, which I believe were initiated at the direction of Director Watt.

My three points are as follows—lack of communication or corrective action after investigation concludes. When an employee musters the courage to formally file a complaint, they are looking for answers and resolution. The United States Postal Service investigation into my complaints concluded on August 13, 2018 and the agency was given a 600 page report, plus a 73 page summary. I was not made aware by the agency that the report was completed, or that the investigation was over.

When I finally obtained a copy of the report 2 weeks ago, I was alarmed to learn that the agency had been sitting on the report for more than 30 days and had not reached out to me or taken any action. I reached out the Human Resources Director and my counsel reached out to the agency's outside counsel to question what was the status of the report and any next steps.

To this day we have not received any response. The act of not providing a timely response to an aggrieved party of a harassment complaint serves the same effect as the harassment itself, it is dismissive, demeaning, and serves to delegitimize the complainant and the complaint.

Number two, the refusal of a government official to participate in an independent investigation into their own misconduct; as was stated, in an e-mail to the USPS Investigator, Director Watt indicated that he does not see himself as an employee of the agency and therefore is not subject to its policies.

My fellow employees have shared with me the atmospheric shift they have felt inside the agency, having a leader who refuses to be accountable to the very policies he signs, has had a chilling effect.

I have been further disappointed that none of the agency officials who own these policies have issued a statement to FHFA staff to directly address what has become a very public matter, or to offer any assurance whatsoever that the agency takes its own standards seriously. The actions of Director Watt, and by extension the lack of actions by his senior staff, have served to chip away at the culture of pride, ethics, and integrity that had existed at FHFA.

My third and final point is the culture of fear that is established when an agency and its inspector general retaliate against victims for filing complaints. It is never easy to file a complaint against your current employer. It is even harder to codify in writing, your concerns about your inspector general.

To be clear, my complaints have, from the very beginning, always included the lack of independence between the FHFA senior officials and the FHFA Office of Inspector General. And that the OIG's processes were used to further harass and discriminate against me.

My interactions with Inspector General Wertheimer and her staff surrounding my complaints have been, from the beginning, that of hostility, intimidation, bullying, laden with gossip, and public shaming.

In early July, after learning that the Inspector General was doing a parallel investigation into my allegations, I raised the very specific question to Leonard DePasquale, the Chief Counsel for Ms. Wertheimer, regarding the ability of the Inspector General to investigate a matter to which it was a named party.

To my understanding, this is a direct violation of the CIGIE (Council of Inspectors General on Integrity and Efficiency) quality

standards. The OIG denied my request for more information, refused to acknowledge the inherent conflicts of interest, and instead engaged in the following retaliatory tactics.

Number one, the Inspector General made my identity as the victim of sexual harassment a matter of public record by suing me in court under my full name, this could have been done in a series of other ways that did not reveal my identity.

On August 1, I was advised in writing that the agency would delay any alternate dispute resolution or mediation settlements related to my claim until I cooperated more fully with the OIG.

And third, would decline to put me in the executive level promotion that I was selected for until the agency had time to review my allegations of Director Watt, and had an opportunity to review them and decide what to do next with regards to my promotion.

These retaliatory and aggressive actions pursued by Ms. Wertheimer, coupled with Director Watt's public statement that he believed the investigation would clear him, while simultaneously refusing to participate in said investigation, lead me to the conclusion that the OIG's participation in this matter was solely to provide Director Watt with a "clean report".

Thank you for your time, I believe hearing these issues is an important step forward in reestablishing the trust and faith that all public servants need to place in the systems that are designed to protect us and hold our leaders accountable. Thank you.

[The prepared statement of Ms. Grimes can be found on page 96 of the appendix.]

Chairman HENSARLING. Thank you, Ms. Grimes, for your testimony. We know it is not always easy to be in this chair and discuss these types of charges. The Chair now yields himself 5 minutes for questions. I guess my first question, Ms. Grimes, is for the first internal investigation that was conducted by the Postal Service IG. When you did you learn that Director Watt—or what were the circumstances whereby you learned that Director Watt would not cooperate?

Ms. GRIMES. During periodic updates with the investigator. I was given an update on the status of the investigation, and it was in the second week of July that I learned that Director Watt had declined to participate.

I wasn't given the specific reasons why he declined, and I didn't learn his specific reasoning until I saw the report 2 weeks ago.

Chairman HENSARLING. And that reasoning was as presented to you?

Ms. GRIMES. That he, according to a provision as a section—as a political appointee, the laws of the agency were not intended to apply to him.

Chairman HENSARLING. And the non-harassment policies that are distributed to the FHFA employees, are those signed by Director Watt, to the best of your knowledge?

Ms. GRIMES. They are signed by Director Watt, as is an anti-harassment statement, stating that the agency will not tolerate actions of harassment and it will hold all employees, regardless of rank, accountable to that policy.

Chairman HENSARLING. Is it now well known within FHFA that Director Watt asserted, for lack of a better term, a legal privilege

that imposed a standard of conduct on everyone else at FHFA but him?

Ms. GRIMES. Yes, it is well known.

Chairman HENSARLING. What is your opinion of that and do you have an opinion of how other Federal employees at FHFA feel about that assertion?

Ms. GRIMES. Yes, other employees have shared with me that it has made the work environment one of hypocrisy. Just a few days ago, an ethics statement was issued, and I think it was viewed as a big joke, that the agency would issue an ethics statement when its leader, itself, was not conducting himself ethically.

My personal view on his recusal to participate is just to further enforce the unbalanced power dynamics that exist here. By his refusing to participate, he has had full advantage of seeing a full investigative file, has had 40 days to sit with it, and can now decide what he will and will not say.

The process was intended to be fair, and it was affirmed that we would all be required to provide written testimonies and disclosures that we would be held accountable under oath of Federal Government.

Chairman HENSARLING. So I can safely assume you do not believe the first investigation is complete, since Director Watt refused to cooperate. Is that correct?

Ms. GRIMES. One could say that his refusal to participate makes it complete, or you could say it does not.

Chairman HENSARLING. The current investigation by the FHFA IG, you have stated, in your opening statement, some concerns. Could you go into greater detail why you seemingly have concerns? Again, it is an ongoing investigation, but you seem to have concerns that it will not be thorough, fair, and complete. Why is that?

Ms. GRIMES. Number one, there is an inherent conflict in my allegations and the role of the Inspector General. My allegations have consistently named the Office of the Inspector General as having participated in the harassment and discrimination, as well as having contributed to the agency's ability to discriminate against me.

I believe that it is very hard for an inspector general to investigate a matter to which it is a named party, and it is, in fact, prohibited under CIGIE's quality standards. A matter of independence is supposed to be, in fact, present, as well as perceived as being present.

Chairman HENSARLING. Ms. Grimes, in the interview you had with committee staff, you indicated concerns about the hiring process or Director Watt's approach to the hiring process. Can you please elaborate upon those concerns in this area?

Ms. GRIMES. Yes, absolutely. On several occasions, Director Watt made it clear to me that while we could go through an actual employment process that appeared to be fair, that he had the ability and would exercise the ability to make that process a charade and to get to the end result that he intended to get to.

He also mentioned that, often, employees need to go through a charade of process in order to feel as though the process was fair, even though it would not be.

Chairman HENSARLING. My time has expired. The Chair now recognizes the Ranking Member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. In at least 1 or 2 minutes of the 5 minutes, I would like to know, Ms. Grimes, is there something you would like to add or expand on that you have not had the opportunity to do at this point?

Ms. GRIMES. No, I am fine. Thank you.

Ms. WATERS. Also, I would like to know, as you were pursuing your ability to apply for promotion or other jobs, was Mr. Watt, at the same time, implying, in some way, that perhaps that was possible if you cooperated with him?

Ms. GRIMES. Absolutely.

Ms. WATERS. Can you describe that?

Ms. GRIMES. Yes. Every—the fact pattern was that every time I raised a concern in my supervisory chain, I would be referred to Director Watt. I didn't reach out to Director Watt, but then he would reach out to me and suggest we needed to discuss my professional advancement. He suggested that we needed to meet again, in unusual locations, to discuss my professional advancement. He certainly offered me a number of positions, but he always tied it to the fact that he had an attraction to me.

In a November 11 meeting, in which I clearly established that I would not do anything in return for these professional advances, he said he agreed, but then continued to discuss how attractive I was and his feelings for me. There was a clear correlation between the two.

Ms. WATERS. How did this make you feel?

Ms. GRIMES. Extraordinarily uncomfortable and again, unsafe. And I have never, in my professional career, been diminished to just an object.

Ms. WATERS. And I understand that, in addition to your request to the IG to investigate, you also have a lawsuit?

Ms. GRIMES. That is right.

Ms. WATERS. Is that proceeding at this time?

Ms. GRIMES. Yes, it is.

Ms. WATERS. What would you like this Committee to do to help you pursue justice with your case? We are glad that you are here today. We are pleased that we are acting responsibly and that we are not, in any way, duplicating what is going on on the Senate side.

And we want you to take full advantage of being here today to express yourself, to share with us any information that you have that will help us to understand exactly what is taking place. Feel free to do that.

Ms. GRIMES. Thank you very much. The things that I would like to see, as stated in my civil lawsuit, is that the agency be compelled to consistently pay its female employees equally to their male counterparts.

I may be the only one sitting here, but I am not the only one who has experienced this disparity in pay. Number two, I don't believe that an inspector general who is not independent should be permitted to investigate themselves. Number three, I think that people who enter this situation would like quick resolution.

The act of agencies creating protracted processes for victims to receive resolution is costly, it is punitive, it is designed to wear down the victim and to bleed them out financially. I believe that this Committee should reinforce that matters like this should receive quick and efficient resolution.

Ms. WATERS. Thank you very much. I appreciate your ability to come and not be intimidated by this process and to speak freely and to share with us what you have experienced. And again, even though I only have about 1 minute left, if there's anything that you would like to share with us, please feel free to do so.

Ms. GRIMES. Since I am not infringing on your time, obviously I am a huge fan of yours as of the Committee and I just truly appreciate you taking the opportunity to hear me today. I found this to be a very warm and receptive process and I appreciate that.

Coming forward with these matters is very difficult and challenging. I did not appreciate being named publicly, but now that I have been, I have heard from so many other women that are in similar situations that have encouraged me to go forward and speak about these matters.

So I appreciate the opportunity to do so.

Ms. WATERS. Thank you very much and I yield back the balance of my time.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, Chair of our Oversight and Investigations Subcommittee.

Mrs. WAGNER. Thank you, Mr. Chairman. Ms. Grimes, thank you for your testimony and your willingness to come before this Committee. I admire your courage and your fortitude. I wanted to start this morning by talking about workplace culture. Briefly, because of our limited time, can you help the Committee understand the workplace environment at FHFA?

Ms. GRIMES. So I would say that prior to 2015, I found the workplace environment to be dynamic, full of bright people who are very mission driven and who are excited and dedicated to make the right decision for homeowners, taxpayers, and the housing system. I found it to be a culture that is very professional. This only changed after 2014, in my experience. I believe that the notion that some people were exempt from the rules of the road has been percolating for several years and that this is obviously a more blatant explanation of that belief, but it has been unfortunate.

Morale at the agency—it is hard to work somewhere where you are in fear. And from what I have heard from several others who have come forward with other similar complaints, using fear as a tactic has been prevalent for some time.

Mrs. WAGNER. And has worked through the entire environment of the FHFA.

Ms. GRIMES. That is right.

Mrs. WAGNER. In your opinion, has this culture impacted your perception about upward mobility at FHFA?

Ms. GRIMES. Absolutely. 100 percent.

Mrs. WAGNER. Not just for you, but for others.

Ms. GRIMES. Not just for me, for many bright and talented women and others who were not given the opportunity. I fear that the agency is setting itself up for a brain drain, where talented peo-

ple leave because they have nowhere to move up. Additionally, I can't overstate how challenging it is to be in an environment where none of the rules of ethics or conduct are upheld.

Mrs. WAGNER. And I am going to get to that. Has Director Watt personally affected his workplace culture?

Ms. GRIMES. My opinion is yes.

Mrs. WAGNER. Based on your understanding, what is the harassment policy at FHFA?

Ms. GRIMES. The anti-harassment policy is pretty explicit and it states that the agency does not tolerate any type of harassment and that all levels of agency officials are held accountable to that standard.

Mrs. WAGNER. And all agency officials and employees are briefed on these policies, is that correct?

Ms. GRIMES. That is correct.

Mrs. WAGNER. And signed by the Director.

Ms. GRIMES. Right.

Mrs. WAGNER. As an employee, how did it make you feel that Director Watt declined to participate in the internal investigation based on EEOC allegations that you have put forward?

Ms. GRIMES. I personally found it appalling and I think it was a disappointment to Americans everywhere to hear that there are leaders that believe that they are above the laws that have been put in place to protect their employees.

Mrs. WAGNER. How did that affect the environment overall of other employees and public servants at FHFA?

Ms. GRIMES. The response and feedback that I have heard is that it has had a chilling effect and has served to chip away at the morale of the employees at FHFA.

Mrs. WAGNER. And as our Ranking Member has also generously done with some of her time, I also have, in my limited time remaining, I will offer you an opportunity. If there is anything else, Ms. Grimes, that you would like to offer based on my line of questioning or anything else to offer for this Committee.

Ms. GRIMES. Well thank you very much. Again, I do believe it is important to have this type of hearing today. We will soon have a new Director and a new set of appointees and I believe it is important that we set a precedent for what is and is not acceptable. I also agree with the Chairman's initial comments. I too have a teenage daughter and a teenage son and I would want them both to feel comfortable that their rights are protected, whether they are the accused or the accuser.

Mrs. WAGNER. We all feel that way, Ms. Grimes. And again, let me say again, I appreciate your coming forward, I appreciate you meeting with my staff and that of the minority. I think we have worked well together in this process, and I appreciate your courage and your fortitude. I yield back, Mr. Chairman.

Ms. GRIMES. Thank you.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Ms. Grimes, thank you for coming forward this morning and sharing your story. I admire your courage and bravery for stepping forward. My question to you, if it is not that difficult and you wouldn't mind sharing, how

did each of Director Watt's unwanted sexual advances make you feel?

Ms. GRIMES. So I would say that they grew more and more uncomfortable. I was hopeful with each encounter, as I was explicit in having no interest in that type of conversation, that in the next encounter we would move on. However, that was not the case. I did feel trapped and as if my back was against the wall because I was being ushered to him as the decision maker, no matter what other channels I chose to pursue.

Ms. VELAZQUEZ. How do you feel right now in this moment?

Ms. GRIMES. I think it is unfortunate. It is an unfortunate misuse of a process that is designed to bring some type of resolution and justice to all parties in this matter, but it has been misused to exempt certain individuals from allowing the Committee and the agency to reach a firm conclusion.

Ms. VELAZQUEZ. Thank you. Do have any message for the other women out there who have gone through similar experiences and are viewing your testimony here this morning. Is there anything you would like to say to them?

Ms. GRIMES. Thank you very much. I would like to say, it is difficult to come forward. I will not underestimate the challenges and the obstacles that you face, from the time you come forward until you have reached resolution.

But I lean toward the statement of Martin Luther King. That the arc of the moral universe is long, but it bends toward justice. And that if we all continue to take a stand that eventually things will, and have already begun to get better.

Ms. VELAZQUEZ. Thank you. And last, again, if you would like to share, how has Director Watt's unwanted sexual advances, and this experience, changed your relationships with your coworkers? How has this made you feel at work?

Ms. GRIMES. Yes. Actually, going into the work office started to become a very traumatic experience. There were at least 2 weekly meetings that I would have with Director Watt. And I knew that in those two meetings, either before or after, he would take advantage of an opportunity to make an inappropriate comment to me. It made me feel very uncomfortable.

And my attendance at those meetings began to drop. I think it is very hard to lead a team, and try to instill in them morale, and energy, and enthusiasm when you, yourself, are feeling defeated.

I think the act of harassing someone makes them feel demeaned, disempowered, and of very little value. It has been a constant contradiction to show my staff a positive and encouraging view of the agency when I, myself, did not have that same perception.

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

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, Chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Ms. Grimes, I appreciate you being here, and having your story be told. And, certainly, it took a lot of forethought and planning to go through and gather information, and do the recordings. And this must have been an extended period of time that you were going through this.

And I think on behalf of all of us, one, we are proud of you coming here and being a part of this even though it, maybe, didn't start out voluntarily. Having your name exposed that way. But the seriousness that, hopefully you are seeing us approach this with, is sincere. And it is one that we are hoping to change culture over. I want to try to touch on, very quickly, maybe some specifics from your experience. What we can do to improve that process to allow employees, like you, that have serious allegations to come forward? But as you had pointed out, there's going to be a new Director and new political appointees.

And I am curious, did you find other political appointees, who were there at FHFA, were somehow protective of the Director, or maybe covered up some of those actions, or, in any way, hindered that inspection from the IG?

Ms. GRIMES. So, in terms of the appointed senior advisors that the Director brought in, number one, outside of this specific instance, I have the utmost respect for them, their professionalism, the knowledge that they bring to the agency, and have continued to offer to homeowners, taxpayers, and the market systems. I would like to start with that.

I believe that whenever I tried to approach any of them with an issue or concern, they always deferred back to Director Watt with the assumption that he had my best interest at heart. It became very hard.

Mr. HUIZENGA. I was just going to ask, were you specific about what was going on with them, and then they still said, hey, we can't help you. You need to go talk to the Director? Or how did that—

Ms. GRIMES. So, two separate issues. I first began complaining of prohibited personnel practices that had led to my equal pay violation in 2015. From 2015 to 2018, no action was ever taken to investigate that, or bring it forward. That was my first indication that, despite reporting openly, what had happened, which is a violation of Federal law, the agency was reluctant to take action against its senior leaders.

When I began to disclose more fully what had happened, what I received was just silence. As I spoke to what I had believed to be colleagues, people who I had a tremendous respect for, and had expressed a respect for me, I was just met with silence.

Mr. HUIZENGA. That must not feel very good.

Ms. GRIMES. It does not.

Mr. HUIZENGA. Because these are serious allegations. So it certainly at least implies that there were others who knew and who remained silent, and for whatever their reasons may be, whether it would be to protect the Director, or protect themselves, but certainly not helping you.

Ms. GRIMES. That is correct.

Mr. HUIZENGA. How can we, as an oversight committee, specifically, reform the Inspector General process, internally, to make sure that employees, like yourself, have a better path, moving forward, to bring these types of accusations to the authorities when they have a complaint like this?

Ms. GRIMES. I think that is a very good question. I do not have all of the answers. I believe some of the recent ruling that has

begun to question the autonomy of the agency, its Director, and its inspector general, are steps in the right direction.

I hope that we continue to understand that these agencies need more oversight. And that, while HERA, as intended, was designed to create a process for these enterprises to do the best they could for the taxpayers with little interference. Unfortunately, when you have individuals who abuse that power, more oversight is needed.

Mr. HUIZENGA. I look forward to working with you, and I know this Committee does as well, as you are able to relay those experiences, and how we can improve that to make sure that doesn't happen again in the future. And, certainly, again, I just appreciate your willingness to come and, publicly share this, with the evidence, and the background that you have brought.

It's certainly a compelling story of what is going on, and the culture that has been created at FHFA. And I, for one, and I believe all my colleagues on both sides of the aisle, want to change that culture. I appreciate your willingness to be in front of the Committee. I yield back.

Ms. GRIMES. Thank you very much.

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. Thank you, Ms. Grimes. Let me, first, absolutely associate myself to the opening remarks of, both, Chairman Hensarling and Ranking Member Waters. And full disclosure, as Ranking Member Waters has done, I need to just say that I have been a friend and a colleague of Director Watt for my entire being here at the U.S. Congress.

But also, I have three daughters. And I am deeply concerned about the allegations. And I appreciate you coming here, and having the courage to come here, and to testify, and to speak on your scenario, and what has taken place to you.

And I do believe that Congress has an oversight role to play when it comes to diversity and inclusion in our workforce, encouraging diversity, and inclusion demands stamping out a culture of sexual harassment that oftentimes limits women's and minorities' career advancement limits. It limits their success. It limits their well-being and we must make sure that does not happen. It is just not the right thing to occur.

I don't know how I would feel if my daughter—well I know how I would feel—so it is I think courageous upon you but it is important that you are here testifying today. In listening to your testimony and in reading the letter that your attorney talked about, the cozy relationship between the FHFA's Director and the IG's perpetuated harassment, discrimination, and retaliation against you.

In addition to this, I know I was listening to some of the questions that others have asked and I was wondering if there were other things that you might be able to tell us as far as the structural or cultural issues at the agency that continue or may foster a culture of harassment and discrimination that we on this Committee and Congress in general, should be aware of.

For example, do you feel like there were adequate human resources at FHFA for potential victims of sexual harassment and is there something that we should be looking at as Congress to make

sure that those resources were there so that this would not happen to someone ever again?

Ms. GRIMES. Thank you very much. Thank you for the question Congressman, and I have followed your career and I am also a fan of yours, thank you and I do appreciate that it is challenging to enter into this hearing with friendships and I appreciate that you have put that to the side for today's purposes.

In terms of factors at play at the agency that make it challenging for people to come forward, I believe that the way that the agency has currently structured those entities that may be designed to protect the interests of employees certainly have taken the posture that they are there to defend the agency and its senior staff, regardless of what they have done.

I found H.R. to be particularly unhelpful in this matter. I found that our Office of Minority and Women Inclusion, which reports directly to Director Watt at a lower level, made some attempts to bring independence into this issue by engaging the United States Postal Service.

I think that their level of ability to exercise anything beyond that is limited since the decisionmaking ultimately goes to the head of human resources and I have found that our Office of General Counsel, and as regards to this matter, has been not only hostile, but has been very threatening toward me throughout this process.

So, in approaching a situation like this, not only are you hurt by what has happened, but you quickly learn that all of the agency mechanisms that you hope would have a sympathetic ear are slightly hostile and make clear that their position is not to support you, but to defend their client, regardless of what their client has done.

Mr. MEEKS. I thank you and I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentlelady from New York, Ms. Tenney.

Ms. TENNEY. Thank you Mr. Chairman. I too would like to echo the comments and the introductory remarks by the leadership as well.

I thank you Ms. Grimes for being here. I know it is a difficult thing to do. As an attorney, I represent a number of people who have been in this situation and I think it is really important and really credible that you were not the one that brought this forward, that it was brought out through a public lawsuit and, unfortunately, now you are dealing with the consequences and I think doing it in a very credible and very honest way.

I first just want ask you what is the current status of your work right now?

Ms. GRIMES. That is a very good question, thank you for that question Ms. Congresswoman.

So currently I am still in the supervisory chain of command of Director Watt and the COO, both of whom are named in my allegation. We have requested on four separate occasions, for the sake of this process until concluded, to allow me to report to someone who is independent and outside of my chain of harassers and through communication from the agency's outside counsel, I have been advised four times that in no way would my supervisory chain be changed.

Ms. TENNEY. So you are still reporting to Director Watt?

Ms. GRIMES. That is correct.

Ms. TENNEY. And there is no one that is in any intermediary position on a human resources team or anyone that is in the middle.

Ms. GRIMES. We have not been made aware of any protective or corrective actions that are being put in place to ensure that I am not retaliated against. I have already filed one retaliation complaint and never received a response.

Ms. TENNEY. And so on your four separate times, have you been advised of anything in a handbook or in any human resources ethics complaint about how these are to be dealt with officially by the agency?

Ms. GRIMES. The official response has been that I should stop complaining about it and until otherwise notified that I will maintain that supervisory chain.

Ms. TENNEY. So the only official aspect of this for you has been that you have been involved in a lawsuit and then you had one filed against you as well.

Ms. GRIMES. That is correct.

Ms. TENNEY. OK. Let me just ask you about the—so now we are—it appears that the nature of the agency seems somewhat accountable at this point. Has Director Watt ever specifically spoken to you about the complaint that it could affect your career or it could affect your reputation in an attempt to either discourage you from pursuing it or an attempt to discourage you from trying to bring this forth?

Ms. GRIMES. Yes, in a recording that I provided to the Committee which you may or may not have had an opportunity to listen to, Director Watt warned me of the failings of the MeToo Movement stating that anyone could say anything and he, in fact, could lodge a complaint against me tomorrow and it would have to be taken credibly.

He also warned that the victims who file complaints are usually further persecuted by the laws that are intended to protect them. I thought and found this to be a threat and have found that since I lodged the complaint that has in fact been the case.

Ms. TENNEY. So do you think the purpose of him making these statements to you was in retaliation?

Ms. GRIMES. It was a warning, yes.

Ms. TENNEY. A warning. Do you think that his attempts to do this retaliation also may have been in effect an admission by Mr. Watt that the process isn't going to help you and just saying, by the way you are going nowhere with this?

Ms. GRIMES. Absolutely.

Ms. TENNEY. OK, so you would say that the process is flawed in terms of the accountability?

Ms. GRIMES. It's flawed, it has been manipulated, and it doesn't hold any water.

Ms. TENNEY. And you haven't had any assistance from human resources or anyone in that vein.

Ms. GRIMES. I have had the exact opposite.

Ms. TENNEY. OK. Do you think that, again, let me just put this a different way. Do you think that Mr. Watt was trying to take ad-

vantage of the fact that there is a void in procedure, in policy, and a void in the accountability of the office itself?

Ms. GRIMES. I believe he made sure that I was aware that he knew that there was a void and that the buck stops with him.

Ms. TENNEY. OK. So you mentioned earlier that there was like a charade, maybe, I don't know if sketchy is the right word, I am not trying to take your words, in hiring procedures at the FHFA.

Do you think those were used and you indicated this and I just want to clarify it, that these were used to empower the Director versus someone like you or anyone else in this situation?

Ms. GRIMES. Yes, so the term charade was actually a term used by Director Watt to describe the employment process, and he specifically stated that while he could go through what appears to be a fair and open process, he would know that it was a charade.

Ms. TENNEY. So do you think sketchy is a good word to use in this situation?

Ms. GRIMES. It seems appropriate.

Ms. TENNEY. Thank you. I think I am out of time. But thank you for your courage and for coming out on this. I know it is not easy and I know you are doing this in an involuntary basis and we are grateful for your testimony.

Ms. GRIMES. Thank you.

Ms. TENNEY. Thank you.

Chairman HENSARLING. Time of the gentlelady has expired. The Chair now recognizes the gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman, and thank Ranking Member Waters, both of you for conducting this hearing today. And thank you, Ms. Grimes, for your bravery and courage in coming forward and sharing your story with this Committee.

Let me preface my remarks by saying that I have a 24-year-old daughter who's starting her professional career and I would dread her having to experience what you have been through.

I have one line of questioning, wanted to know when the inappropriate advances initially began, did you have coworkers that were witness to this inappropriate behavior?

Ms. GRIMES. I think Director Watt did a very good job of making sure that his comments and interactions with me were not in the public domain of employees. That being said, I reported what was happening to several employees along the way and provided an extensive witness list to the investigator.

Mr. CLAY. And I haven't read your complaint or EEOC complaint. But is that all part of the record and you gave them names and follow up people?

Ms. GRIMES. Yes.

Mr. CLAY. OK. All right. That was pretty much what I was curious about, and at this point I have no other questions. If you wanted to add something to it, feel free.

Ms. GRIMES. So the only other comment that I would add is that in this process where someone is coming forward to bring an Equal Pay Act complaint, they are already underpaid and the process to do this is extraordinarily expensive.

I think the agency knows that and protracts it as a way to get victims to fold much more easily. I have already spent tens of thousands of dollars on this process, and just in speaking with other fe-

males who lodged similar complaints against the agency, they admitted that they folded early because they simply couldn't afford it.

And so I think this process of dragging things out and adding new layers is designed to overburden the victim and in fact cause them to cave. I would also like to say, it has already been said, but I want to reiterate that the action of publicly naming me as a victim of sexual harassment, in fact, publicly shaming me also serves to prevent other women from coming forward.

I did not ask to be named, and as a matter of fact, I requested anonymity and my attorney communicated with all Members of the media that we wanted to keep my identity private. I think it was a shameful tactic by the Inspector General to name me publicly and force me to speak publicly.

Now that I am here I will speak publicly, but it is costly.

Mr. CLAY. And what you have just described is a toxic culture of the FHFA and the process itself. And we as a Committee ought to address that. So let me say thank you again for your bravery in coming forward, sharing your story.

And Mr. Chairman, I yield back.

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

Mr. DUFFY. Thank you, Mr. Chairman. Ms. Grimes, I spent 10 years as a State prosecutor and dealt with many, many sexual crimes.

All the victims of the crimes I dealt with were women, some of them children, and if you deal in that environment with someone who has been a victim of those unwanted advances to the far extent of rape, it is incredibly hard to talk about, and I know firsthand how difficult it is and I want to thank you again for being here and being willing to tell your story.

Though I do note that you didn't want to be public, I think we have all heard that loud and clear. But now that you have and you are willing to communicate with us, we are grateful. What time-frame was this taking place?

When did it start? When did it end?

Ms. GRIMES. So the equal pay violation began in January, February 2015. The sexual harassment began in September 2015 and concluded in March when I filed my first set of complaints.

Mr. DUFFY. So this began with Director Watt roughly 3 years ago.

Ms. GRIMES. That is correct.

Mr. DUFFY. OK. And it is unique for us, and as a former prosecutor I would hear allegations and sometimes you would have someone say listen, this is what happened to me and we want to verify and confirm with whatever evidence we can, did it happen or not.

And to maybe go into your opening statement, this is more than your word versus Mr. Watt's word, isn't it?

Ms. GRIMES. It is in fact also his words against himself.

Mr. DUFFY. And by way of a recording.

Ms. GRIMES. That is correct.

Mr. DUFFY. Those who have heard it would say it is pretty damning for Mr. Watt. So in his words, we have him saying things in-

credibly—if we want to—I will use a soft word of inappropriate, I will—which maybe we would all disagree with that characterization is beyond inappropriate.

Fair enough?

Ms. GRIMES. I believe they were inappropriate.

Mr. DUFFY. So in regard to your allegation, it is pretty clear cut what he was doing, because he is on tape doing it.

Ms. GRIMES. I believe so.

Mr. DUFFY. OK. Has Mr. Watt recused himself from decisions that affect you and your employment?

Ms. GRIMES. Not to my knowledge.

Mr. DUFFY. OK, so he actually might still be making decisions that affect your professional career?

Ms. GRIMES. I have not been advised that he is not.

Mr. DUFFY. That he has been recused, OK. We have consolidated great power at the head of the FHFA. Do you see a problem with the way that structure works?

Ms. GRIMES. Absolutely.

Mr. DUFFY. Do you have any recommendations on how that structure should be changed to us who could change it in this Committee?

Ms. GRIMES. Yes, again referring back to the Fifth Circuit Court's decision, I think those are the right steps to begin to question the constitutionality of the makeup as well as the limited ability for lawmakers to question the head of, not only the FHFA, but other similarly structured agencies.

I believe there needs to be a lot more accountability, visibility, and another way for individuals, like myself, to reach out beyond just our own inspector general to air concerns that we have.

Mr. DUFFY. I am going to just note that if we are doing the daughter game, I have five. I have five sisters. I have one mother, one wife. And this is unacceptable in America today. I would just note that today, I have never met you before until this interaction, and today you are here as a victim.

But I would just note that you are far from a victim. You are a very accomplished woman. Well-educated who has risen through the ranks. Beyond this, tell us who you are, because you are more than what you are saying today. And I think sometimes it is important to recognize the whole of the person.

Ms. GRIMES. Thank you. I feel like you are giving me 20 seconds to brag about myself.

Mr. DUFFY. Only if the Chairman gavels us down. Go ahead.

Ms. GRIMES. So just other forms of context, I am absolutely a devoted parent to two teenagers, a daughter and a son who support me fully in this endeavor. I am an active member of my community; I participate in my children's sports teams, as well as my daughter's Girl Scout troop.

I am a very faith-oriented person. I am an active member in my faith-based community. And I strive always to be a good neighbor and a responsible person.

Mr. DUFFY. Thank you for being here. Thank you, Mr. Chairman.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green, the

Ranking Member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witness for appearing today. And while I do not have children, and I have no siblings, like all of us, I had a mother. And I had a father. And I saw my mother discriminated against. I saw my father discriminated against.

So, I have grown up with this belief that invidious discrimination has to be challenged. I also believe that we talk a lot about no one being above the law. I do it myself quite often. And I also believe that no one should be beneath the law. Law has to reach down as well as up.

So, when you made your statements about being exposed by the IG, it caused me a good deal of consternation. And I would start by asking you what was the response from the IG after having been told that you did not desire to be exposed? What was the response?

Ms. GRIMES. The response was to file a suit in court naming me publicly.

Mr. GREEN. Literally those words were stated.

Ms. GRIMES. No. My attempts to question why IG Chief Counsel, Leonard DePasquale, about just the specifics about what exactly they were investigating, how they were able to investigate a matter in which they were a named party.

And how would provisions be put in place to isolate those matters in which they were implicated. I never received a response; instead, I received a lawsuit.

Mr. GREEN. And you indicated that you made a request that you have your anonymity protected, and by and through your lawyers. If you don't have it, I will understand. But I do intend to ask questions about this when the IG is before us.

Ms. GRIMES. Absolutely.

Mr. GREEN. So, if you don't have the request, I understand. But do you happen to have that request?

Ms. GRIMES. Yes. On March 27th, prior to filing the EEO complaint, but when I had filed the complaint with the OIG, they asked if I would waive my right to anonymity, I declined to waive my right to anonymity.

Additionally, when the press began asking about my involvement in this matter, and I am not sure how they knew that, but they contacted my attorney. My attorney made several public statements, stating that I did not wish to reveal my identity publicly.

So, in two separate instances we did communicate a lack of willingness to be named publicly.

Mr. GREEN. I saw you turn to your lawyers. If you desire to confer, you may. That is always available to you; would you like to confer for a moment?

Ms. GRIMES. I think that sums it up.

Mr. GREEN. Thank you. And as a result of your anonymity being violated, have you suffered some consequences that you would like to call to my attention?

Ms. GRIMES. I don't believe I ever intended to Google my name and see sexual harassment over and over and over again. That wasn't the legacy I was hoping to leave.

I think once I was put in the position of having to defend myself publicly, it has taken a lot of energy and effort. I am not used to dealing with the press. They have been very courteous; I do want to say that.

But it has just added a new layer of burden that I didn't anticipate. Additionally, just for the record, we did not file the civil lawsuit before being named publicly. We had no intention of going forward with a public lawsuit.

Our hope was all along to settle this through an ADR process as advised by the Equal Employment Opportunity Commission. Those actions were taken subsequent to being denied any right to due process, internal to the agency and after being named publicly.

Mr. GREEN. I thank you for your testimony. And I assure you that I plan to pursue this with the IG. Thank you very much.

Ms. GRIMES. Thank you.

Mr. GREEN. I yield back the balance of my time.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTINGER. Thank you, Mr. Chairman. Good morning, Ms. Grimes.

Ms. GRIMES. Good morning.

Mr. PITTINGER. Thank you again for being here with us. Ms. Grimes, I am a father of three girls, and five granddaughters. They are special to me. And it would be a grievance thing for me to know that they had gone through what you have gone through.

So, I want to share with you my respect for you, for the judicious manner that you have processed this through. You have filed in your grievance. You provided corroborating evidence.

You did everything that you know would be the appropriate thing to do. And at the same time, you weren't even treated with full respect during your process. The fact that all women should be treated with respect in private life, public life, the workplace—in all regards. I am from Charlotte, I have known Director Watt for some time. We are not close friends, we knew each other before I got to Congress—he got here before I did; shared some in this body together.

The people of Charlotte have known him as a man of high regard, highly educated, very professional, skilled at what he did. This is a big shock to Charlotte, they are watching this very closely.

And I would like for you to take an opportunity, if you would, from my perspective as a Charlottean, for what you would like for them to know about their person, Director Watt, and the manner in which the FHFA has been lead during this time.

Ms. GRIMES. Thank you very much, Congressman. I do not have a personal vendetta against Director Watt, I simply wanted justice to be served. As a personal belief, I believe someone can do good things, and do bad things as well. Many of the policy decisions that he has made for the benefit of homeowners, I believe have been sound.

And I believe that in carrying out his duties as it pertains to the mission of the agency, I don't have any reason to doubt his good intentions there. The circumstances that occurred with me are unfortunate, and I do not have any reason to believe that I am the

first, hopefully the last person who has experienced this with Director Watt.

Mr. PITTINGER. Thank you very much, I yield back my time.

Chairman HENSARLING. The gentleman yields back, the Chair now recognizes the gentleman from Missouri, Mr. Cleaver, Ranking Member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Ms. Grimes. Thank you, Mr. Chairman and Ranking Member. Because I know Mr. Watt, I am, stunned is another word, but I am wondering what was the response when you verbalized your feelings about the advances, the sexual advances? Did you verbalize that—in that I am interested in—was that like, "OK, I will back off," I mean, what?

Ms. GRIMES. Right, so verbally Director Watt acknowledged my rejection of his advances and would state that it would not be an issue, however the topic came up over and over again. And as a result of me denying to engage in any type of relationship, none of my pay issues were remediated and I have, to this day, been denied a promotion to which I was selected because of the complaints that I lodged, they have been directly tied through a letter from the agency's outside counsel.

So while Director Watt would put me at ease by saying that my rejection of his advances were not being taken personally or would not get in the way, in fact they did.

Mr. CLEAVER. Did any of your co-workers, or individuals in the high levels of leadership begin to treat you differently once you rejected?

Ms. GRIMES. Once the matter became public, obviously yes. So I have had individuals, a large number of individuals, who have contacted me on the side, to vocalize their support but, those people who I worked most closely with who were in the more senior levels of the agency, I have just been met with silence.

Mr. CLEAVER. I am concerned also about FHFA and the atmosphere there at this time. Are there some words that you could use to allow us to know—I mean, this is obviously public now and they know, they knew before we did so—what is the atmosphere? Is it like, uh-oh, or is it, this might fix things, or—

Ms. GRIMES. In terms of this hearing?

Mr. CLEAVER. No, in terms of the fact that your situation, or Mr. Watt's situation has become public. I mean is there anticipation that this may create something good? That something good could come out of this, or are people walking around with their heads down?

Ms. GRIMES. I believe people are waiting and seeing. Waiting, watching, and waiting to see what happens next. The failure of the agency to publicly issue a reinforcement of its policies, especially those around anti-harassment and equal employment opportunity, I think was a grave misstep on their part.

I believe that the only policy that they have reinforced publicly with agency staff is the policy that states that staff cannot speak to the media. So I think that they enforced the wrong policy and have ignored the more important policy, the elephant in the room.

Mr. CLEAVER. Not—policies you cannot speak to the media about a complaint?

Ms. GRIMES. There is a policy that states that all media inquiries have to go through the Office of Communications and Congressional Affairs, and right after this issue was made a matter of public record, staff were reminded during their staff meetings that violating that policy could be a terminable offense.

Mr. CLEAVER. My final question, did you ever say to Mr. Watt, look, I have a recording here and I—

Ms. GRIMES. Yes.

Mr. CLEAVER. What was the—

Ms. GRIMES. I don't think he believed me.

Mr. CLEAVER. Thank you. Thank you for being here.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Michigan, Mr. Trott.

Mr. TROTT. Thank you Chairman, thank you Ms. Grimes for being here today and for having the courage to discuss these matters with us. I apologize if I ask some questions you have already answered but I had to step out, so you may have already discussed some of this, but you said in your statement that the Inspector General at FHFA has impeded, and in some respects perpetuated, the problem. Can you give me a little more detail around how that exactly has happened?

Ms. GRIMES. For my specific instance, I first became aware of some targeted allegations that had been made about me for a job that had not yet even been posted, and for which I had not yet interviewed.

After my interviewing for that position and being selected, I learned that a series of questions were made of coworkers and other staff that alluded to whether or not I was being given preference based on my race and gender, making the insinuation that I was potentially a diversity hire. That is very disparaging to hear.

Once I was interviewed myself and heard the line of questions that I was asked, my then attorney and I became very suspicious that the allegations in part may have been planted by Director Watt, so we filed a complaint with the OIG, asking them to investigate their own process. On two separate occasions, they refused to investigate their own process as it related to my matter.

Mr. TROTT. And what was basis for that refusal?

Ms. GRIMES. They simply said that matters regarding discrimination should go to the EEO.

Mr. TROTT. OK. And what was the timeframe when this was occurring?

Ms. GRIMES. March. March of this year.

Mr. TROTT. OK, so after the September 15—well after the harassment.

Ms. GRIMES. Absolutely.

Mr. TROTT. OK. And you mentioned, you mentioned a few times, there have been discussion of tapes. How many tapes are there?

Ms. GRIMES. I believe I provided the Committee with 15. But I can double check.

Mr. TROTT. That is plenty. And I don't want to get into specifics, but is it fair to say if someone listened to the tapes they would find it clearly to be harassment in your opinion?

Ms. GRIMES. That is my opinion.

Mr. TROTT. OK. You mentioned a lawsuit. You were sued, you are suing. Can you give me the status of any lawsuits?

Ms. GRIMES. So the Inspector General sued me to force compliance with their administrative subpoena, which was for the recordings that I have subsequently given the Committee and they are still suing me for those.

Mr. TROTT. OK. And you have no lawsuit otherwise in the civil court?

Ms. GRIMES. So we filed a civil lawsuit to enforce the Equal Pay Act violation. Again, this was only because we couldn't get to resolution inside the agency.

Mr. TROTT. Right. OK. So that is the tens of thousands of dollars you have spent on lawyers for those lawsuits?

Ms. GRIMES. Yes, the actions by the Inspector General more than doubled my legal expenses.

Mr. TROTT. Got you. What is your current job situation? How would you describe your position and atmosphere?

Ms. GRIMES. I currently have been told in writing that I will not be given the promotion that I was selected for until the agency has had an opportunity to review the results of the investigation. Those results have been completed for over 40 days and we have heard nothing. I continue to remain at the diminished position and I continue to report to my harassers.

Mr. TROTT. OK. Great, well I appreciate your candor and I have no other questions and am happy to yield back any time to you if you want to add anything that the Committee should know.

Ms. GRIMES. Thank you very much. I think I have covered—

Mr. TROTT. I yield back, Chairman.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Maryland, Mr. Delaney.

Mr. DELANEY. Thank you, Ms. Grimes. First, I want to start by telling you how sorry I am that you have endured what you have endured in your service to our country and working for the Federal Government. As a Member of the Congress of the United States, we all should take some responsibility when we allow conditions to exist in any agency of the Government where a situation like yours occurred. So on behalf of the Congress, I apologize to you.

I want to thank you for being here. You have learned today that many of the Members of this Committee have daughters. I have four of them myself and I obviously am grateful that you are stepping forward today on behalf of all young girls and all women because what you are doing here today will lead to a world where women and girls are in an environment where they are not discriminated against or subject to harassment. So I am grateful for that and I think you are very brave and courageous to do it.

People should care about this whether they have daughters or not. And I think that is also an important point to make. We shouldn't just care about this because we happen to have a situation in our own family and we think about it in the context of how terrible we would feel if it were to happen to someone in our own family, which I obviously do. The thought of this happening to one of my daughters is very disturbing, as my colleagues have said about their own family situations.

But of course we should care about this whether we have daughters or not. I did have one question for you. In your opening statement you talked about how you would meet with your supervisor and you would discuss this pay inequity that you were subject to. And your supervisor would say that it was up to Director Watt. And then you said that you would never reach out to Director Watt about it. And it is obvious why you didn't do that, based on what you were enduring.

But it seemed like Director Watt would then reach out to you. So you obviously believe your supervisor was communicating with Director Watt these discussions they would have with you, because otherwise how would Director Watt know to reach out to you about those discussions. Is that an accurate assessment?

Ms. GRIMES. That is correct. And I would also just like to add that my supervisor, I believe, was fully supportive of making an adjustment but felt as though his hands were tied.

Mr. DELANEY. So do you think your supervisor, who—I am happy to hear that your supervisor was fully supportive of the adjustment. That speaks well to your supervisor because I am sure you are imminently qualified for this salary and pay adjustment. Do you think your supervisor was aware of the situation you were facing with Director Watt?

Ms. GRIMES. No, he was not.

Mr. DELANEY. Got it. OK. Well that was the only question I had. Again, I am grateful that you are here. I am sorry that you have had to endure what you have endured. I will also offer you time, although based on what my colleague Mr. Trott said, it doesn't seem like you have any more comments. But absent that, then I will yield back to the Chair.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you to the Chairman and to the Ranking Member and to you, Ms. Grimes. Thank you for being here. I proudly associate myself and echo the words of our leadership. Being last gives you an opportunity to add something new, which was not asked a lot at all. So I am going to take part of my time to say to you how sorry I am that at this time, you have to be here. As a female myself, before I talk about granddaughter and grandson, being a woman of color, someone who took great pride in growing up to be a first generation college graduate and to work hard and pull my way up to some of the top ranks, I sit here appalled, angry, and frustrated for what you have had to go through. So let me just say how proud I am of this Congress that you are in the right place for us to hear you.

Thank you also for coming in, not just putting blame and complaining but to have resolve. I was always taught when you have a complaint, come with an answer. I appreciate that in your statement. I have grandchildren, a granddaughter who I think is gifted, talented, beautiful, and bright. I have a grandson, who I think is sweet and naive and loves his Grammy to death.

So my statements are for all the children out there, that today many eyes are watching you and I want you to know that as you quoted Martin Luther King, I too often quote him. But my favorite quote is when he says, "it is not where we stand in the time of com-

fort and convenience, it is the actions that we take in the times of challenges and controversy."

So I say to you I believe in that moral arc of justice. I think that what hopefully you will leave here and feel with your children, when you go home, you embrace them and you tell them that mother was not a victim today, mother stood up for people, mother made a statement so your children could have a brighter future.

As it relates to some of the departments, let me just say how proud I am of my Ranking Member, Congresswoman Maxine Waters, who had stood with us whether we are with her or against her. I can honestly say that I have not always voted the same, but she has always been fair with me.

I can also say that she entrusted me to work with OMWI, so you gave me great pleasure today, when you said you thought they had listened and been fair. For the public, that is the Office of Minority and Women Inclusion. So I thank you for reaching out to those departments.

I think we put a lot of trust in the inspector general. So my one question, and I think my colleague who is no longer here, Mr. Delaney, might have hit on it. But for clarity, Ms. Grimes, you stated on May 8, 2018 that Director Watt called you and questioned you about an anonymous complaint you had submitted to the FHFA Office of Inspector General on or about March 19 or April the 4th. Is that correct?

Ms. GRIMES. That is correct.

Mrs. BEATTY. Why do you think that Director Watt called you about this anonymous complaint? Do you think he assumed that the complaint came from you? Maybe, at that time, you had told him about the tapes? And do you believe that he was told by somebody in the Inspector General's office about this?

Ms. GRIMES. I do not know for sure what happened. My assumption is the latter of your comments, that he was made aware of my complaint, and I was very surprised that he restated it to me, given that I had refused to waive my right to anonymity.

Mrs. BEATTY. And let me be clear. You have actually worked for him, and I have read most of the testimony, and I have listened to the tapes. So you actually, really work two jobs and weren't even paid the highest salary for the highest job you did. Is that correct?

Ms. GRIMES. That is correct.

Mrs. BEATTY. Let me tell you. I am so appalled, and I am a big fighter, and every day I come to this Committee and I talk about women in every platform and equal pay for equal work. That, alone, is appalling to me, and then to have to couple it with you being considered an object and degraded and put in any hostility.

Let me just say the two most powerful words I can say to you, thank you for being strong, thank you for continuing to work, and thank you. I yield back my time.

Ms. GRIMES. Thank you for your leadership.

Chairman HENSARLING. The gentlelady yields back. We have no other Members in the queue who have not previously asked questions. Ms. Grimes, thank you very much for your testimony today.

To repeat, we are not a trier of fact or a court of law, but we are committed, as a Committee, to the proposition that every Federal

employee should be treated fairly and in a work environment that does not tolerate hostility, harassment, or discrimination.

Please know that we will continue to monitor this investigation very, very closely. You have brought serious charges. This Committee takes them seriously. And we know that it takes courage to stand up and be heard. And we, again, appreciate you coming forward.

I now wish to alert Members. We will take a short recess, in order to seat the next panel. Ms. Grimes, you are now excused. And the Committee will recess for approximately 10 minutes.

[Recess.]

Chairman HENSARLING. Committee will come to order. Our second witness today is Ms. Laura Wertheimer. She is the Inspector General of the Federal Housing Finance Agency. Ms. Wertheimer earned a B.A. from Yale and a J.D. from Columbia. Previously, Ms. Wertheimer was a partner at Wilmer Cutler Pickering Hale and Dorr LLP.

Ms. Wertheimer, you will be recognized for 5 minutes to give an oral presentation of your testimony, and then without objection your written statement will be made part of the record. You are now recognized for your testimony.

#### **STATEMENT OF THE HON. LAURA WERTHEIMER**

Ms. WERTHEIMER. Chairman Hensarling, Ranking Member Waters, Members of the Committee, thank you for inviting me to testify regarding the work of the Office of Inspector General for the Federal Housing Finance Agency.

Created by statute in 2008, FHFA has dual responsibilities as conservator and supervisor of Fannie Mae and Freddie Mac, and as supervisor of the Federal Home Loan Banks. These financial institutions together comprise about \$6.5 trillion in assets.

As conservator of Fannie and Freddie, FHFA has the ultimate authority and control to make business, policy, and risk decisions for both of those enterprises. These business and policy decisions influence and affect the entire mortgage industry. In the words of Director Watt, it is extraordinary for a regulatory agency to fulfill both the role of conservator and supervisor at the same time, which FHFA has done for the last 10 years.

FHFA also acts as supervisor for the Federal Home Loan Banks and for Fannie Mae and Freddie Mac, and as supervisor, FHFA conducts safety and soundness examinations of those entities similar to the exams conducted by other Prudential Federal Financial Regulators. Like inspectors general for other Prudential Federal Financial Regulators, we assess the effectiveness of FHFA's supervision program for its regulated entities.

During my tenure, FHFA OIG has issued 46 reports involving FHFA's supervision of its regulated entities, where we have identified deficiencies in those programs or operations or shortcomings. In FHFA's implementation of its policies and guidance, we have reported those and we have proposed 63 recommendations to address identified weaknesses.

FHFA fully accepted 45 of those recommendations, or 71 percent. Of those 45 recommendations, we have closed 30, or 67 percent, based on materials and representations from the agency.

Unlike inspectors general for other Prudential Federal Financial Regulators, FHFA OIG's responsibilities include oversight of FHFA's actions as conservator of Fannie and Freddie. That work has looked at decisions made and actions taken by the enterprises; because FHFA as conservator bears responsibility for them.

During my tenure, FHFA OIG has issued 37 reports that address FHFA's conservatorship of the enterprises.

Again, where we have identified shortcomings and weaknesses at FHFA's conservatorship operations, we have reported them and we have proposed 39 recommendations to address identified shortcomings and weaknesses. FHFA fully accepted 33, or 85 percent, of those recommendations, and of those 33 we have closed 18 of them, or 55 percent.

Another aspect of our work is to assess the effectiveness of FHFA's internal controls for its own operations; travel and purchase cards, technology, privacy. We have issued 20 reports that address the sufficiency of FHFA's internal controls, and again, where we have identified weaknesses and shortcomings, we report them and we have proposed 28 corrective actions of which FHFA fully accepted 27, or 96 percent, of them. Of those 27 recommendations, we have closed 17, or 63 percent.

Recommendations accepted and fully implemented by FHFA require meaningful follow up and oversight and we conduct validation testing of those closed implemented recommendations. Since January 2015, we have conducted validation testing of 15 closed recommendations. We found that FHFA fully implemented 8, or 53 percent.

The 103 reports issued during my tenure reflect the independence of mind, objectivity, and professional skepticism of our professionals.

Through our work, we challenge FHFA to improve its oversight over its conserved entities; enhance its supervision; put more rigorous internal controls into place; and look for and eliminate fraud, waste, and abuse.

I have listened to Ms. Grimes today. I read her EEO complaint in July, when I first became aware of it. And there appear to be some significant misunderstandings about our work, which I am fully prepared to answer today, as well as any other questions you may have.

All the work I will discuss and have discussed in my written testimony is made possible by the dedicated career staff of this agency, the senior staff of which are seated behind me. So I look forward to answering all of your questions. Thank you.

[The prepared statement of Ms. Wertheimer can be found on page 154 of the appendix.]

Chairman HENSARLING. Thank you for your testimony, Ms. Wertheimer. The Chair now yields himself 5 minutes for questions.

I am glad that you heard Ms. Grimes' testimony. I know that she is still in the hearing room. Hopefully I am not mischaracterizing what I thought I heard her say. I am not sure she questioned the competence of your office, but perhaps the ability of your office to conduct a thorough, unbiased investigation of her claims.

So I do wish to pursue, and I think you used the term misunderstanding. First, has your investigation of Director Watt on her

claims, has that deviated, in any way, from any other normal harassment or discrimination investigation conducted by your office?

Ms. WERTHEIMER. Chairman Hensarling, we are not investigating Ms. Grimes' claims. Those sound in EEO for which the agency has jurisdiction. And they sound in the Equal Pay Act. And Ms. Grimes, as she indicated, has filed suit in Federal court to pursue those.

We are looking at issues that are squarely within our mandate under the Inspector General Act, whether there has been abuse of position by Director Watt, and whether there has been any waste associated with the actions taken by Director Watt.

Chairman HENSARLING. Can Director Watt fire you?

Ms. WERTHEIMER. I don't believe he can, sir. I think only the President of the United States can fire me.

Chairman HENSARLING. Can he demote you?

Ms. WERTHEIMER. I don't believe so, sir.

Chairman HENSARLING. Can he cut your office's budget?

Ms. WERTHEIMER. No, nor has he ever tried.

Chairman HENSARLING. Do you socialize with Director Watt?

Ms. WERTHEIMER. No, sir.

Chairman HENSARLING. Do you consider him a personal friend?

Ms. WERTHEIMER. I meet him on a scheduled basis with the Associate Inspector General. And Director Watt attends those meetings with two members of his senior staff. And that is the only time I meet with Director Watt.

I have never, not only, socialized with him, I haven't had lunch with him. I don't eat in the cafeteria with him. If I see him on the elevator we exchange pleasantries about the weather.

Chairman HENSARLING. So, does this mean you believe that any investigation you have of Director Watt, on any matter, you believe to be unbiased, is that correct?

Ms. WERTHEIMER. I do. And I think the hallmark of the 103 reports issued during my tenure demonstrate our independence, our objectivity, our professional skepticism, and our willingness to make hard decisions and call out what we find.

Chairman HENSARLING. Did your office leak information regarding Ms. Grimes to the Director?

Ms. WERTHEIMER. I am not aware that it did.

Chairman HENSARLING. You are aware that accusation is out there?

Ms. WERTHEIMER. I am. And I am fully prepared to answer those allegations.

Chairman HENSARLING. So, have you investigated to ensure that there was not an internal leak?

Ms. WERTHEIMER. Yes. I didn't investigate my own people. I certainly questioned those people who had dealings with the agency. And I believe I understand the basis for Ms. Grimes' concern which I am fully able to answer.

Chairman HENSARLING. Do I understand correctly, that your office found, previously, that Director Watt violated policies regarding the personal use of official vehicles? Is that correct?

Ms. WERTHEIMER. As well as use of his personal assistant for—

Chairman HENSARLING. And what happened to that report? Where was that report transmitted?

Ms. WERTHEIMER. We wrote the report as a management alert. I signed it. It was given to Director Watt in unredacted form. It was given to our oversight Committees in unredacted form. It was sent to the White House and the Office of Government Ethics the day it was issued, in unredacted form. It was on our website, in redacted form because of the Privacy Act, and advice from the Office of Counsel, the most prudent force would be to redact it on our website.

Chairman HENSARLING. If, in any of your reviews or investigations, your office concluded that Director Watt acted improperly, with regards to Ms. Grimes, what will happen to that report?

Ms. WERTHEIMER. I believe when that inquiry is finished, it will result in the same written report that we have issued 103 times, previously. It will be given, in unredacted form, to our oversight Committees, to the White House, to the Office of Government Ethics. And, depending on advice from our Office of Counsel, it will either be redacted on our website, or not. I can't answer that yet.

Chairman HENSARLING. So much more ground to cover in your previous reports. That will have to be left to other Members of the Committee. The time of the Chairman has expired. The Chair now recognizes the Ranking Member.

Ms. WATERS. Thank you very much, Mr. Chairman. I would like to cut to the chase. There has been an accusation that you appear to have some kind of relationship with Mr. Watt that is rather outsized on your decisionmaking, or on the operation of the OIG.

Now, I don't want to talk about whether or not you had lunch with him, or whether or not you had some other activity outside of the agency. I want to really understand your relationship inside the agency. You talk often on the telephone—

Ms. WERTHEIMER. Never.

Ms. WATERS. As we understand it.

Ms. WERTHEIMER. I don't have any e-mails with Director Watt.

Ms. WATERS. I can't hear you. What did you say?

Ms. WERTHEIMER. I have searched my e-mails. I have no e-mail exchanges with Director Watt save for two. One that he sent in November 2014 thanking my predecessor for efforts on the technology audit, and one after a holiday party where OIG personnel participated in a choir Director Watt had assembled. And he sent an e-mail to me, every member of the choir, thanking them for their participation.

Ms. WATERS. Describe to me the hotline. What is your relationship to the hotline? Is this a hotline where people can make complaints that you then take a look at and determine whether or not that is within your power to deal with?

Ms. WERTHEIMER. We use a vendor for the hotline because we want to make sure that individuals calling feel that they can speak freely to someone who, if you will, is going to have no role in deciding whether or not an inquiry should or should not be investigated.

Those hotline complaints are taken in by the independent vendor. They are then provided to the Deputy Inspector General for the Office of Investigations and his Assistant Inspector General. And a career professional—

Ms. WATERS. Do you have access to that information once the complaints are taken off the hotline?

Ms. WERTHEIMER. I suppose, theoretically, I do, but.

Ms. WATERS. No, not theoretically. Just do you have access? Do you know? Do you listen to? Does someone share the information with you? Do you get the information in any shape, form, or fashion?

Ms. WERTHEIMER. It depends on the allegation.

Ms. WATERS. So, sometimes you do?

Ms. WERTHEIMER. Sometimes I do. That is right.

Ms. WATERS. OK. Evidently, Ms. Grimes used the hotline.

Ms. WERTHEIMER. Yes.

Ms. WATERS. And evidently, somehow, the fact that she had used the hotline was shared with Mr. Watt, is that right?

Ms. WERTHEIMER. That is correct.

Ms. WATERS. Did you do that?

Ms. WERTHEIMER. I did.

Ms. WATERS. So that is how he knew that she had used a hotline, is that right? And in a conversation with her, he referred to the hotline which caused her to suspect that you had shared this information. Why did you do that?

Ms. WERTHEIMER. Thank you. There had been an investigation previously. Not into Ms. Grimes but there were multiple hotline complaints alleging prohibited personnel practice in preselecting Ms. Grimes for a position. These were not about Ms. Grimes, she was the person allegedly preselected.

Our Deputy Inspector General put together a team of seasoned law enforcement professionals, career professionals, long history in the Office of Inspector General, as well as a senior investigative counsel and the head of our human relations function is a subject-matter expert.

They collected documents, they interviewed 12 FHFA individuals, and their fact-finding led them to believe there was no prohibited personnel practice, but because the Office of Special Counsel is the office that is, if you will, the personnel police, we had contacted them early in the process to say we wanted to send our fact-finding to them so that they could opine on whether or not this was prohibited personnel practice. We did that on March 22 and we sent the file to them in early April. Ms. Grimes was interviewed by these investigators on March 16.

On March 19, she filed, as she said, a whistleblower complaint that had several aspects to it. One, as she said, she suspected that the whistleblower complaints, all of which were anonymous, were—I think she testified to it—at Director Watt's instigation.

And the other was that there was a serious disparity in the promotion or hiring of executives, that there were something like 47 white males promoted into executive positions and there were only five African-American females.

I found that—I don't believe that those statistics were originally in the whistleblower complaint but the complaint of racial disparity. It is true that we asked her to approach the EEO office because of course that is—

Ms. WATERS. OK, let me stop you here. Thank you for all of that information. Thank you for giving me all of that information where it appears what you are doing is you are telling me that you happened to disclose the fact that she had contacted the hotline be-

cause of all of the other things that were going on and the interactions you were having but you did not mean to do that and you had not started out to do that but that is what happened, is that what you are trying to tell me?

Ms. WERTHEIMER. No, Representative Waters, what I am trying to tell you is this. We got a letter from her then counsel on April 4 saying the EEO office, FHFA, had rejected her claim. I was quite concerned about that because these are EEO issues, they facially sounded quite intensely serious to me. EEO has a pretty short timeline. I felt that appropriate for the EEO office to deal with it. Ms. Grimes had already identified herself and her complaint to the EEO office.

What I said to Director Watt was very simple. We have gotten a complaint, that complaint is from Ms. Grimes who previously made it to the EEO office which rejected it and frankly, sir, you need to do your job and tell the EEO office—

Ms. WATERS. Excuse me, let me stop you again.

Ms. WERTHEIMER. Please.

Ms. WATERS. The information about the possibility that you had informed Mr. Watt was prior to your conversation with Mr. Watt talking about what was happening at EEOC. It was Mr. Watt who revealed in a conversation to her, prior to that time, about her complaint having been filed on the hotline. And that is where I am trying to go. Let's not go all the way to this conversation that you are discussing about what you have referred to the EEOC.

The question is, did you, even prior to that, at any time and in any way, reveal to Mr. Watt that she had used the hotline? That is all I want to know.

Ms. WERTHEIMER. She used the hotline to raise an—

Ms. WATERS. Did you?

Ms. WERTHEIMER. Yes, ma'am. And—

Ms. WATERS. Thank you.

Ms. WERTHEIMER. As I—

Ms. WATERS. Thank you.

Ms. WERTHEIMER. As I am entitled to do—

Ms. WATERS. Thank you.

Ms. WERTHEIMER. Under the inspector—

Ms. WATERS. Reclaiming my time. Thank you. That is it.

Chairman HENSARLING. Time of the gentlelady has long since expired. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, Chair of our Oversight and Investigations Subcommittee.

Mrs. WAGNER. I thank you, Chairman Hensarling. Inspector General Wertheimer, could you pull the microphone up a little bit and close to your—thank you. Thank you for your testimony and your willingness to come before our Committee for the second time this year. Previously it was before the Subcommittee that I have the privilege of chairing, which is Oversight and Investigations. Ms. Wertheimer, I have always found you to be fair and honest in your assessment of FHFA and the GSEs.

You have cooperated with our oversight staff in our investigation and I very much appreciate that. However, our previous witness levied some very serious accusations against you and your office, so in an effort to be fair and transparent with all of today's wit-

nesses, I want to first ask you some very basic yes or no questions and give you an opportunity to respond.

Again, I will try and go through these because I do have another whole line of questioning that I want to get into here. Ms. Wertheimer, have you ever retaliated against a witness in an investigation you have conducted?

Ms. WERTHEIMER. No.

Mrs. WAGNER. Have you ever reported anything but the facts in your investigations?

Ms. WERTHEIMER. No.

Mrs. WAGNER. Have you ever altered a report that has been critical of Director Watt because he directly asked you to?

Ms. WERTHEIMER. No.

Mrs. WAGNER. To the best of your knowledge, has your staff ever done so?

Ms. WERTHEIMER. No.

Mrs. WAGNER. Thank you, Inspector General. And I am sure you will have more time to respond to some of the claims and allegations. Mr. Chairman, with my remaining time, I would like to follow up on some items I mentioned in my opening remarks.

Ms. Wertheimer, what circumstances led your office to undertake the investigation of Fannie Mae's consolidation and relocation of its Northern Virginia office?

Ms. WERTHEIMER. We received a whistleblower complaint in the spring of 2016, alleging that excessive spending by Fannie Mae in connection with consolidation and relocation of its offices. We understood from the newspaper that headquarters was clearly one of those offices, and so we rendered our first management alert, I believe, in June 2016.

Mrs. WAGNER. Your office determined that there was no event compelling Fannie Mae to move from its Northern Virginia offices, is that correct?

Ms. WERTHEIMER. That is what we determined.

Mrs. WAGNER. Do you believe that Fannie Mae, as four FHFA employees asserted, could operate out of its current buildings which they had owned, instead of spending nearly 3 quarters of \$1 billion on new remodeled offices?

Ms. WERTHEIMER. I have no opinion outside the record that our career investigators developed. We have the four individuals who are FHFA employees, who separately told us in interviews that they could remain for the indefinite future at no decrease to their operations and at no significant cost, but that management of Fannie Mae had adopted a strategy which FHFA endorsed and therefore the move went forward.

Mrs. WAGNER. FHFA which is in conservatorship that borrowed—what \$3-1/2 billion?

Ms. WERTHEIMER. Well Fannie Mae has gotten in excess of \$119 billion from taxpayers and took money in February 2018 because of the change in the tax code that caused them to revalue their deferred tax assets and therefore they reported a loss, but that is all correct.

Mrs. WAGNER. And then went forward with a \$727 million renovation of—and they don't even own this, they rent that. Is that right?

Ms. WERTHEIMER. That is correct, and I think that number is higher because factored into that was an estimate of \$140 million for the sale and—

Mrs. WAGNER. Yes, they only sold it for \$90 million, didn't they?  
Ms. WERTHEIMER. Yes, ma'am.

Mrs. WAGNER. I have so many questions, Mr. Chairman. Since there was no compelling event or reason, what reasons were offered by Fannie Mae to justify the move that we previously discussed?

Ms. WERTHEIMER. The strategy that management had adopted to get out of owning real estate, and to have an open workspace plan where their workforce could—

Mrs. WAGNER. An open workplace plan?

Ms. WERTHEIMER. Yes ma'am. In the early 2000's this became very popular in technology companies, and it became the rage, I think it is fair to say. What we looked at as our report makes clear, are scientific studies that have been done to show that in fact the proposed benefits are nil and the costs in terms of diminution and productivity—

Mrs. WAGNER. Did your investigation find that these reasons were supported by fact and hence were a valid justification for the move?

Ms. WERTHEIMER. I think we found that there was no evidence that they had to support the justification of open workspace, but the belief that it was positive. I think what we found was in fact the scientific evidence to the contrary.

Mrs. WAGNER. Mr. Chairman, I will yield back and I will to ask for any other Members to yield me time going forward, I thank you for your indulgence.

Chairman HENSARLING. Time of the gentlelady has expired, the Chair now recognizes the gentleman from Texas, Mr. Green, Ranking Member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the Ranking Member as well. And thank you Madam Inspector General for appearing today. Ma'am, you are a Yale Magna. You were on the law review at Columbia, you have your J.D. from Columbia. You are a member of multiple bars, in fact, it would not be inappropriate to call you a lawyer par excellence. Given your credentials, I need not explain to you the benefits and detriments associated with anonymity in litigation.

Ms. Grimes has made statements about her desire to maintain her anonymity. You have indicated that you were in an area where you could hear her commentary, is that correct? Could you hear her statements about her desire to maintain anonymity?

Ms. WERTHEIMER. I was aware that she had requested anonymity in her whistleblower complaint about racial inequality in the executive ranks, her EEO complaint that she sent to us, that is correct.

Mr. GREEN. Thank you. And she was quite explicit with her testimony today in terms of her desire to have anonymity. You probably didn't hear my commentary about persons being above and beneath the law. Being beneath the law is honorable. Ms. Grimes didn't say this but in my opinion she believes that she was beneath justice, in the sense that her desire for anonymity was violated.

If she made the request, and if it was received, why was the request not honored for her to have anonymity? Again, as a lawyer par excellence you really don't have to have me explain to you why her anonymity was important. So why was that request not granted?

Ms. WERTHEIMER. So there are two issues you have raised and I will address both of them. The request that she asked for anonymity involved her claim of racial disparity in the executive ranks, which sounds in EEO, I would maintain to you the Inspector General Act does not authorize us to look at that claim. It is a serious claim and her then-lawyer, on April 4, told us that the FHFA EEO office had rejected it, thrown her out of the office.

It seemed to me that the Inspector General Act sections four, five, and eight permit me to disclose where I feel it is necessary. Anonymity—

Mr. GREEN. May I kindly intercede, please?

Ms. WERTHEIMER. Yes sir.

Mr. GREEN. Why would you believe that it was necessary to expose her given that you and I know the benefits and detriments associated with exposure? We are both lawyers. Why was it necessary to expose her?

Ms. WERTHEIMER. This was an EEO racial disparity claim. The Director needed to tell the EEO office to do its job and look at this, not discard her claim and tell her to leave the office. But that isn't the claim that is the subject of her concern about being outed in court, OK?

We had no knowledge of any of the sexual harassment until July, on or about the 3rd, shortly thereafter, that Ms. Grimes had sent an e-mail three times to more than 100 FHFA managers that attached some transcripts of recordings and a segment of an audio recording, and a discussion of her harassment complaint against the Director.

She had sent it on her FHFA computer from her FHFA.gov address to her lawyer, but not only to her lawyer, to more than 100 FHFA managers. That is how I first became aware of her sexual harassment claims. That alone, sir, would not—let me—

Mr. GREEN. If I may just a moment because my time is about—Mr. Chairman, because we don't have an abundance of Members here, may I kindly have some additional time to explore this?

Chairman HENSARLING. The gentleman may proceed.

Mr. GREEN. Yes, ma'am. Assuming that what you have said is entirely correct for our purposes, whether that was done by accident or with intent, it still does not negate her desire to have her anonymity as it relates to litigation.

And there are reasons beyond what the eye can see initially that would benefit her in having her anonymity.

Ms. WERTHEIMER. Yes, sir. And let me address that as that is what I was going to get to until you wanted more—

Mr. GREEN. My apologies, I had to get the additional time.

Ms. WERTHEIMER. No, I completely understand. We learned from that exchange that there were recordings and transcripts. We made a request to her counsel who said she would be happy to give them to us.

We made a similar request to Director Watt for all of his relevant material and the team investigating the matter we had opened decided that it would be best to proceed by subpoena so that we weren't at the end of this process, someone didn't come up with a piece of evidence and that we were then held—why didn't you subpoena it, you didn't get all the materials.

So we issued what I would call friendly subpoenas, we told the lawyers in advance, they accepted service and her then-lawyer, who is now her current lawyer, said oh yes we will give you the recordings. Come and get them but bring your own IT person, which we were fully prepared to—

Mr. GREEN. You may have to abridge if you would please.

Ms. WERTHEIMER. Absolutely. Ms. Grimes subsequently got in touch with us and over a series of e-mails communicated to us that she was never going to give us the recordings.

And so the team that was handling this—

Mr. GREEN. May I kindly say this? It sounds like you are getting to a point where you are being vindictive.

Ms. WERTHEIMER. No, sir. No, no.

Mr. GREEN. Well I am just letting you know so that you can correct yourself.

Ms. WERTHEIMER. So I appreciate that.

Mr. GREEN. All right.

Ms. WERTHEIMER. I am trying to move quickly and I am sorry if my tone is incorrect. Ms. Grimes had indicated in a series of e-mails to these individuals working on this inquiry that she was not going to give us the recordings.

The decision was made by them in consultation with our office of counsel, as I understand it, to move to enforce the subpoena. We wanted to file that motion under seal.

I want to be clear about that and it is demonstrable in our e-mail to the Eastern District of Virginia U.S. Attorney's Office. What we got back was an answer that said no, exclamation point.

I have been told that there were then a series of conversations between our lawyers and the U.S. Attorney's Office for the Eastern District of Virginia in which they advised that Eastern District of Virginia local rule five, I believe favors filing under seal that the judge would—we would need, because of a duty of candor to the court, to present the e-mails that Ms. Grimes had sent to her hundred plus colleagues and the transcripts and that we would never, ever prevail in a motion seal and moreover, we were told—

Mr. GREEN. If I may intercede, Mr. Chairman, I beg just this please, if I may just ask you this.

Chairman HENSARLING. Mr. Green, I am—this does need to be your last point. It's an important line of questioning but votes are imminent on the floor. We do have other Members—

Mr. GREEN. I do apologize, Mr. Chairman, I do apologize. But ma'am, you have introduced hearsay, what someone told you about a meeting that took place, and you have also indicated that there was a seal but we are talking about a seal of an entire record and I am not talking about that.

We are talking about anonymity as it relates to her identity. That is the question. Now I appreciate—I have to yield back the

balance of my time. But I think that an injustice was perpetrated when she was outed.

Chairman HENSARLING. The time of the gentleman has long, long since expired. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTINGER. Thank you, Mr. Chairman. I yield my time to the gentlelady from Missouri.

Mrs. WAGNER. I thank the gentleman for yielding. Heading back to Northern Virginia, Inspector General, what is the status of the sale of the property owned by Fannie in Northern Virginia and have they signed the lease for the new building which includes the renovations and such up to \$727 million and then some?

Ms. WERTHEIMER. I do not know the status of the sale. When I had written to Director Watt to ask him to direct Fannie Mae to suspend any sale until our report issued, Mr. Ryan, who was the Acting Deputy Director of the vision of conservatorship assented to that.

But our report has issue, so I am not able to answer you on the question of have the properties been sold. With respect to the lease, my understanding is Fannie Mae did execute that lease months ago.

Mrs. WAGNER. The lease for the new properties?

Ms. WERTHEIMER. Correct.

Mrs. WAGNER. The new properties, the old property that they owned they tried to sell for \$140 million, only got \$90 million for it. But we don't know whether that sale has completed or anything?

Ms. WERTHEIMER. I do not know.

Mrs. WAGNER. Well I hope not, because I would sure like to see the taxpayers restored here. Going back, Inspector General Wertheimer, you appeared before my Oversight and Investigations Committee some months ago and we talked then about your concerns that you had highlighted about extravagant buildings and the lack of oversight.

In fact, recent renovations in their locations in Dallas, Texas, I believe you found that they had \$24.2 million in excessive cost, is that correct?

Ms. WERTHEIMER. As of the time we wrote the report, yes.

Mrs. WAGNER. There are properties in downtown D.C., \$32 million in additional upgrades that Director Watt approved. Is that correct?

Ms. WERTHEIMER. It is correct.

Mrs. WAGNER. And you had that in your report also.

Ms. WERTHEIMER. A separate report, but yes.

Mrs. WAGNER. I see quite a pattern of taxpayer abuse here on the elaborate and extravagant renovations of properties that they lease and don't even own. Going back again to something that I brought up, there was an investigation about the \$7.7 million that was spent to produce additional qualified examiners.

Yet, as I stated, after nearly 7 years, FHFA has in fact one less qualified commissioned examiner than they had back in 2011. Did you do a report on that, ma'am?

Ms. WERTHEIMER. We did, we issued it I believe earlier this month.

Mrs. WAGNER. And what did your investigations find?

Ms. WERTHEIMER. This was what I will call a capstone report. It followed on previous reports we had done starting in 2015. Back in 2011, we wrote a report about whether FHFA had a sufficient complement of qualified examiners to examine the entities they supervised, and we concluded they did not.

And one of the things we pointed out was they lacked a commissioning program. Their counterparts, the FDIC, the OCC, the Federal Reserve were all, they have very well established commissioning programs, commissioned examiners, and those Prudential Federal Financial Regulators are used to lead high-risk exams and exams of large financial institutions which we certainly have here.

FHFA agreed and they developed a program which they rolled out in 2013. And so in 2015, we did our first compliance review and found many shortcomings with that program, which FHFA agreed to address. We did a status report in 2017 and found they had done some of the things they had committed to do, but not others. And so we thought it was appropriate to now look in 2018, how far things have come in 7 years and what we found we reported. Not only do they have one less examiner, not only have they had problems with their exam, not only of the targeted exams of the enterprises in the last two supervisory circles—

Mrs. WAGNER. Ms. Wertheimer, I am about to run out of the gentlemen's time.

Ms. WERTHEIMER. Sorry. Sorry.

Mrs. WAGNER. Does Director Watt follow any of the recommendations that you, as Inspector General, put forward in your multitude, 103 plus reports?

Ms. WERTHEIMER. I think I have testified, yes he does agree to certainly well more than 50 percent. I believe, I would have to go back and give you the exact percentage on supervision but the real tell here is not only what he agreed to, Madam Chairman, but what is actually implemented and I think as I have testified when you look at supervision, he has accepted 71 percent of our recommendations or 45—

Mrs. WAGNER. But have they been implemented?

Ms. WERTHEIMER. Only 30 have been implemented. But remember, when we went—I mean that is the point of compliance testing and so your questions about the HFE program are important because what did we find? Wholesale lack of implementation.

Mrs. WAGNER. Wholesale lack of implementation. In fact, it went backward, one less examiner.

Ms. WERTHEIMER. They are redoing the program top to bottom.

Mrs. WAGNER. Again. Here we go. The gentleman's time has expired. I again thank the Chairman.

Chairman HENSARLING. If the gentlelady would suspend, the Chair was quite generous with the gavel with the previous Member if this gentlelady would like to ask another question or two to help balance the time, she is free to do so.

Mrs. WAGNER. That is all right. I will wait for some more additional time down the road sir. Thank you kindly.

Mr. PITTINGER. My time has expired, thank you.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, the Ranking Member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you Mr. Chairman. I just have one question and if my colleague, Mrs. Wagner, would like to have some of my time I would be certainly willing to do that.

My one question is what can be done to make certain that if someone comes up with a similar or, frankly, any complaint against the top levels of FHFA, can they be assured of anonymity and understanding that some the things that could happen as a result of that becoming public?

Ms. WERTHEIMER. I certainly understand the concern you raise. The issue that we had in this particular matter was, and I appreciate Representative Green's concern about anonymity. We, as I said, wanted to file under seal but we are lawyers signing the papers and we have court rules we must follow.

Assistant U.S. attorneys who were handling this matter were told we could not file it under seal in light of the facts presented to them which they would disclose to the court. If there were a different fact pattern, we would not have this issue with anonymity. We would have—

Mr. CLEAVER. If what, I am sorry?

Ms. WERTHEIMER. Had we had a different fact pattern here that we didn't have 1/6 of the agency with the information, we would have filed under seal.

Mr. CLEAVER. OK. Friedrich Nietzsche the German philosopher said, "the muddied the waters to make them seem deep," and I am not accusing you of anything, I just think we generate or we create all kinds of rules that appear to be too muddy for us to get the clear water back and see what is going on so we can make corrections.

And I understand you have to comply with the court. You made that, you swore that in. But something needs to be done. I don't know who needs to do it. Something needs to be done so that when people bring very sensitive matters up, they can be protected. I don't know—look I am just a preacher. I didn't go to law school. I went to the seminary. So our role every Sunday is to unmuddy the water. That is all I would like to know and like to see for some way, if this happens again, there has to be something to protect the person who came forth. That is not a question unless you have an answer but it is something that really troubles me. I just went through something with my niece within the military. It's taken us 3 or 4 years, my staff, everybody involved. She was raped in the military.

Ms. WERTHEIMER. I am sorry to hear that.

Mr. CLEAVER. Three or 4 years—I would have to ask my staff. Three or 4 years later we—I can say it publicly now. One time I couldn't get through this. But everybody in the military knew about it before she had a chance to finish crying.

It was something that was personal. I am glad this is not the same, I am just saying that bothers me on a personal level and I wish we could have some assurance that would not happen again, that which happened to Ms. Grimes. I don't need an answer.

Chairman HENSARLING. The gentleman yields back?

Mr. CLEAVER. I yield back.

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

Mr. DUFFY. Thank you, Mr. Chairman, Ms. Wertheimer. Welcome to the Committee. I want to talk about an article that was in the Wall Street Journal Thursday, I believe it was August 15th or 16th of this year, entitled, "U.S. Pursues One of the Biggest Mortgage Fraud Probes Since the Financial Crisis". Most people generally say that multi-family books of business are doing great, no problems. At least that is what I think the private sector would say. The story talks about how several owners took out mortgages on buildings under false pretenses.

When inspectors would stop by the buildings, the owners would make vacant units look occupied. Turn on the radio, turn on the lights, put shoes outside the door, all kinds of gimmicks to make units appear to be rented when they were actually vacant. I believe you are working with the FBI on the investigation of several bad actors in regard to these tactics.

But the story paints a pretty grim picture of apartment owners gaming the system. And I want to be clear, I don't think this is all, this is usually a really good space, but you do have people gaming the system to take out larger mortgages in order to expand their businesses even faster. I think there was an example of one developer who has about \$1.5 billion of securities issued by the GSEs. So the question is how did this happen? How does it happen?

Ms. WERTHEIMER. Representative Duffy, I am in no—that is an open investigation. I am really not at liberty to comment on that or any other investigations. Multi-family is a focus for us. It has been a safe space, but we are looking hard at it. And beyond that, I think it would be improper for me to go any further.

Mr. DUFFY. So, but if you look at maybe just—OK, fair enough. But policies and procedures to verify the units are occupied, is something missing in Fannie and Freddie's process.

Ms. WERTHEIMER. I don't think I have enough information right now to answer that question. Stay tuned and I am sure we will have a better answer when we have done more work on this.

Mr. DUFFY. Maybe I will just talk about my own experience, but I think when you get a mortgage—this can go to Fannie or Freddie—I believe I have to submit my bank records. And they want to actually verify that the money that I make they see going into my account. And they just don't want 1 month. I think they wanted 3 months of my bank records so they could verify that I make what I said I made.

But is that not the case for a multifamily owner? Do we not verify if you say listen, I got 120 units but 110 of them are rented, but we look at their bank records, we go where in the hell is the rent coming from because I don't see it going into your account.

Seems like a pretty—we have crafted a pretty smart solution for the average fellow in America, but the multi-family seems to have a different standard. Am I wrong on that?

Ms. WERTHEIMER. Again, I think it is premature for me to answer your question.

Mr. DUFFY. Well that is, no, this is not an investigation, this is policies and procedures that are used.

Ms. WERTHEIMER. It is not necessarily the policies being—that the policies are poor or weak or it may well be—

Mr. DUFFY. OK, so do we verify income?

Ms. WERTHEIMER. May be the—

Mr. DUFFY. Do we verify income? Do you know?

Ms. WERTHEIMER. Remember, I—remember, Fannie and Freddie, it is the—

Mr. DUFFY. Multi-families?

Ms. WERTHEIMER. I am sorry, they are not making the mortgages, it is the originators who are making the mortgages.

Mr. DUFFY. But do we also set up policies—

Ms. WERTHEIMER. There are policies on—

Mr. DUFFY. And do we have policy that comes from Fannie and Freddie that require that there is income verification of owners of multi-family units?

Ms. WERTHEIMER. I know there is verification but whether it is the pay statement says when you try to own a single family house, that I can't answer that question.

Mr. DUFFY. And I wanted—I know—I thought this was going to take less time than it is. I just, I didn't know that I got a clear answer from you. And I knew you were trying to say a lot of things and maybe someone else will ask you this question. The anonymity issue I think was important. I think you were trying to give us an explanation as to the circumstances and you couldn't fit it into 2 minutes, and I understand that complication takes time. I would hope that at one point you could explain that to us, the full circumstances without interruption.

And I know that Mr. Green was trying to move his time along. He didn't have much, but that is something that I am interested in because I think there's more to the story that we weren't hearing just because we are all limited in the amount of time that we have and I think all of us would be interested in hearing that from you. And also I can't ask it, but the cooperation from Mr. Watt has concerned me and I wish I could ask about that as well, but my time is expired. I yield back to the Chairman.

Ms. WERTHEIMER. As I said, I would be happy to explain that and Representative Green, I am sorry if my tone was wrong. It was more that I was trying to speak very quickly.

Chairman HENSARLING. We will grant the witness additional time to further address the issue. So the witness is recognized. If you wish to speak to Mr. Duffy's point.

Ms. WERTHEIMER. I would wish to speak to Mr. Duffy's point because I think they are two separate issues here, one that—well, maybe three. There was an investigation. We had multiple whistleblower complaints anonymously in 2017, alleging not that Ms. Grimes did anything wrong. I think there was a complaint that Ms. Grimes was encouraging people not to apply. Our human relations expert said to us, doesn't matter what she says, she is not the selecting official, she can say whatever she wants.

That was never something we looked at because there's no problem with that. What the claims were, were that FHFA had too many executive positions, but they created a new position expressly

for Ms. Grimes that the very senior leadership had told two senior managers not to apply for the position. The position announcement was a sham because it was only for Ms. Grimes and FHFA always intended to award the position to Ms. Grimes.

That was, if true, if we were able to find the facts and OSC was applying the law to the facts, that would likely be a prohibited personnel practice.

The Deputy Inspector General for investigations opened an administrative entry into those complaints. I was aware of those complaints, but those are run by career professionals. All I do is periodically ask how is it coming along.

Our Chief Counsel went to speak to the Deputy Chief Counsel of FHFA to say please do not fill the position until his inquiry is over, because if it is a prohibited personnel action, we have no idea if it is or it isn't, you would have to unwind it.

So rather than have to do that, please don't fill it. We note that Director Watt was advised of that legal hold and I did tell Director Watt that he and senior staff would be interviewed as part of this administrative inquiry.

Again, I believe that is appropriate under my duties under the IG Act. That is the sum and substance of what I told him with respect to the administrative inquiry.

Mr. DUFFY. Could I just inquire further clarification, Mr. Chairman?

Chairman HENSARLING. One point.

Mr. DUFFY. So just at this point, anonymity had not been violated at that point, to what you just indicated, correct?

Ms. WERTHEIMER. No.

Mr. DUFFY. Right, OK. So just wanted to be clear about that.

Ms. WERTHEIMER. No. So as I said, this team of rare government investigators, lawyers, their subject-matter expert conducted 12 interviews, reviewed documents, interviewed Director Watt, interviewed Ms. Grimes, was working in coordination with the OSC, and we sent them a letter on May 22 saying our fact-finding was done and we were going to send the matter over to them.

And on April 2, we in fact collected the documentary evidence, summaries of the interviews and sent it to the OSC. The OSC on May 3, notified us that their preliminary determination was there was no prohibited personnel action, if we wanted to challenge that decision, we had 13 days. We notify them we were not going to challenge or otherwise comment on their letter and we notified the agency promptly. So you can say we cleared the way for Ms. Grimes to get the position she sought.

With respect to what has been called an outing of Ms. Grimes, she did file a complaint with us on the 19th. Our senior investigative counsel reached out to her to ask if she would waive anonymity as well as has she been to the EEO office because this really sounded in EEO, and Inspectors General don't have authority to investigate EEO complaints.

And her then-lawyer wrote us back on April 4 saying yes, she had been to the EEO office and they told her because there were anonymous whistleblower complaints, they wouldn't hear her complaint. Her complaint wasn't about anonymous whistleblowers, it

was about racial disparity in hiring and promotion of African-American women. That is plainly an EEO issue.

In consultation with my staff and given the short EEO timelines and given the fact that no one had alerted us in this inquiry that there was any untoward relationship or improper conduct by Director Watt, I raised with Director Watt the fact that his EEO office had chewed out a claimant who appeared on her face to have a very valid claim, and he needed, if you will, legally to mandamus them, go do your job and I believe the IG Act permitted me to do that.

It wasn't until July that anyone in my office became aware of any claims of sexual harassment, which had nothing to do with our prior work.

Mr. DUFFY. Mr. Chairman, you thought you were doing your job as you exposed her name. It was required—

Ms. WERTHEIMER. To tell him that his EEO office had thrown her out improper.

Mr. DUFFY. Ms. Wertheimer, thanks Mr. Chairman for the time, because I think it is important.

Chairman HENSARLING. One more Member whose time has long since expired. The Chair now recognizes the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you, Mr. Chairman, and thank you for being here. I am going to try to be very brief because I have a lot of questions. So I am going to try to ask the short questions, ask you to say yes or no. So now the mystery is solved, we know you are the one that called Mel Watt. Had you ever about Ms. Grimes?

Ms. WERTHEIMER. I met with him.

Mrs. BEATTY. Met with him, shared with him—

Ms. WERTHEIMER. Shared—yes I did.

Mrs. BEATTY. Had you ever done that before with anybody else? With any other Director when something was anonymous, yes or no? Yes or no?

Ms. WERTHEIMER. No.

Mrs. BEATTY. OK, now you said it was an EEO claim which wasn't in your jurisdiction. We talked about tone here. Do you think your tone could be a message for "handle that?" Like, take care of her, make this go away.

Ms. WERTHEIMER. Absolutely not. It was—this is serious.

Mrs. BEATTY. OK, did that name mean anything to you? I am trying to follow the years of 2017 and then this came up. So when you heard it was Ms. Grimes, did that ring a bell on anything like the other—

Ms. WERTHEIMER. I knew we had looked—

Mrs. BEATTY. So you know that this was someone, and you had never before exposed anyone to a Director. In your mind, do you think that tone could be, this a problem person, now I am going to out her and tell the Director because you knew the name.

Ms. WERTHEIMER. But she had done nothing wrong.

Mrs. BEATTY. It didn't matter, it was anonymous. She went to something to protect her safety, to be anonymous. This wasn't even in your area of jurisdiction, something you even thought about or cared about, according to you, because it was EEO. It wasn't something that fell into your purview. So now you call a major Director

and you tell him, handle it. So let's fast forward. When you did become aware of this same person whom you knew something about, with a sexual harassment, did you call Mel then and say, handle it?

Ms. WERTHEIMER. No.

Mrs. BEATTY. OK, help me understand. Somebody, who you are now wanting me to believe, that you knew her name when it was EEO and you felt that she had been mistreated, now the same person that you were trying to help versus handle it, quiet her up, now she has—and you are a female—now she is going through sexual harassment, you know she has had EEO, you know she is a person of color. You now know that there's all this data about disparities. You didn't pick up the phone and call Mel then?

Ms. WERTHEIMER. Absolutely not.

Mrs. BEATTY. Why? Why?

Ms. WERTHEIMER. Because that complaint was clearly in our jurisdiction.

Mrs. BEATTY. Did you tell him we have a claim in our jurisdiction? Did you pick him up and not say handle it, say, I have a complaint in my jurisdiction.

Ms. WERTHEIMER. No. In fact, he wanted to meet with us to discuss—

Mrs. BEATTY. How did he know you knew?

Ms. WERTHEIMER. Because his chief of staff called the Associate Inspector General, and I was told Director Watt would like to meet to talk about how the process of the Inspector General will investigate and we said no.

Mrs. BEATTY. Did you think it seemed unfair, unreasonable, that someone who is working two jobs at a lower pay and is doing two jobs and a higher level job, did that seem strange to you? Not in your jurisdiction, maybe.

But did you call Director Watt and say, why? Look into this? I mean, you were comfortable enough to call him on an EEO complaint that wasn't in yours, so now when you get this whole composite of stuff, did you call anybody and say, what is going on with this?

Ms. WERTHEIMER. I think we are suggesting that we knew about everything in the EEO complaint—

Mrs. BEATTY. You said you know and cited her figures. You said 30 or 40, less than 5. You didn't know at that time if it was true, but later the numbers seemed accurate. So at some point you knew what she was saying.

Ms. WERTHEIMER. What I knew at the time—

Mrs. BEATTY. Well whenever, timing doesn't matter to me.

Ms. WERTHEIMER. But it does matter.

Mrs. BEATTY. No it doesn't to me, my time. When you found out at any time, did you call anybody and say, do something, this is a problem, is she really working two jobs? Is she not getting equal pay for equal work?

Ms. WERTHEIMER. We knew her EEO complaint had already raised those issues.

Mrs. BEATTY. Did you talk to anybody in EEO?

Ms. WERTHEIMER. No.

Mrs. BEATTY. But you called Mel. It's not your area.

Ms. WERTHEIMER. I did not call Mel.

Mrs. BEATTY. You met with him. You told him, same thing.

Ms. WERTHEIMER. I did tell him.

Mrs. BEATTY. What was his response when you told him?

Ms. WERTHEIMER. OK, thanks.

Mrs. BEATTY. What did that mean to you?

Ms. WERTHEIMER. He would look into it.

Mrs. BEATTY. OK. Did you follow up to see if he did?

Ms. WERTHEIMER. I didn't.

Mrs. BEATTY. Why? It was enough and important for you to do it. Why?

Ms. WERTHEIMER. Because I knew EEO investigations took a while. I knew that, I have never had a situation where the Director has said, I would do something—well, that is not true.

When he said he is going to agree to a recommendation, that we get a completion of corrective action memo, and they say they have done it. We have, subsequently, learned sometimes they haven't.

Mrs. BEATTY. OK, so I get it, and I am almost out of time. You are a very detailed person. You have said 103 reports—

Ms. WERTHEIMER. Yes.

Mrs. BEATTY. Seven times. Where we are now, how do you feel about this case in your role? Here's somebody that is working two jobs and not being paid. And—and may I have—

Mr. ROYCE [presiding]. The gentlelady's time is expired.

Mrs. BEATTY. People on both sides—

Mr. ROYCE. They weren't—

Mrs. BEATTY. I am—I am the last one sitting over here. And everybody else has had 9, 7 extra minutes and I have 2?

Mr. ROYCE. I am going to follow you, but you are wrapping it up. Could you respond? And then we will—

Mrs. BEATTY. Thank you. How do you feel about a female who is a scholar? I mean, her academics, her work, her commitment to community. How do you feel about somebody working two jobs and not being paid, equal pay for equal work? And we are still dealing with this and it appears that nothing has happened.

Ms. WERTHEIMER. I don't agree that nothing has happened, ma'am.

Mrs. BEATTY. Has she been paid? Is there equity?

Mr. ROYCE. I am going to ask—we are going to have a response. We are in the middle of votes.

Mrs. BEATTY. That is my last question, Mr. Chairman. Thank you.

Mr. ROYCE. OK, thank you.

Ms. WERTHEIMER. Ms. Grimes has pursued her claims, both, administratively and in Federal court. I am—I just—

Mrs. BEATTY. I was just asking your feelings.

Ms. WERTHEIMER. I cannot affect giving her any money. I have no power over FHFA, but the power of recommendation.

Mrs. BEATTY. I will yield back my time because that wasn't my question. Thank you, Mr. Chairman.

Mr. ROYCE. Thank you. I want to say, Inspector General, I would like to make a point. And that was, in the decade leading up to the financial crisis of 2008, Fannie Mae and Freddie Mac spent nearly \$200 million on lobbying activities and campaign contributions.

And that political pull that they had, had considerable impact here. In 2003, I introduced legislation, and again in 2005 in the form of an amendment which would have reined in these government-sponsored enterprises, allowing them to be regulated for systemic risk.

As you know, they were able to over-leverage with these portfolios. That over-leverage got to the point of 100 to 1. And their political pull on the process, here, was used to oppose changes that would have allowed them to be regulated for systemic risk.

The Federal Reserve Chairman, Alan Greenspan, backed the amendment. That was not enough to overcome the outsized political pressure brought by the GSEs themselves. The power and influence they wielded had few peers. You would have to go to Japan to see the power, then, of the government-sponsored enterprises that created the same political pull.

It was very difficult for that to be reformed as well. I think it is critical that we avoid this distortion in our housing finance system in the future, that comes about because these entities have that capability.

The GSEs are, currently, prohibited from lobbying in political activity due to the terms of the conservatorship. Do you believe the FHFA has properly enforced, and consistently implemented these regulations in terms of prohibition?

Ms. WERTHEIMER. As my understanding is, that it is not a regulation. It's a conservatorship directive that was put into place in 2008 that was an absolute ban, and has been modified over time. I think it is fair to say that it is no longer an absolute ban.

Mr. ROYCE. OK. Let me make this point. There have been numerous reports of senior executives at the GSEs meeting with Federal policymakers to advocate for being taken out of conservatorship, recapitalized, and released. Given the lobbying ban is not in statute, do you agree that it would be appropriate to make the ban on GSEs lobbying, permanent in law?

Ms. WERTHEIMER. So, my personal opinion or?

Mr. ROYCE. Yes. I will ask your personal opinion.

Ms. WERTHEIMER. We have done no work on that. We are in the—that is a mistake. We are in the middle of reporting on that. I don't have a basis, in the work we have done, to answer that question. Although, I would say to you, if you read the conservatorship directive, it gives the—under Fannie and Freddie, far more latitude than you might otherwise think.

Mr. ROYCE. Hope. Than I might otherwise hope. With this in mind, by the way, I plan to introduce legislation with two objectives: The first, to explicitly prohibit Fannie and Freddie from engaging in lobbying activities while in conservatorship, or receivership. And second, at such time that Fannie and Freddie are no longer in conservatorship, to require the GSEs to promptly and publicly disclose lobbying contracts.

And I would encourage my colleagues on both sides of the aisle to join me in this effort. And I think that, based on our experience, not here in the U.S. alone, but also with other government-sponsored entities in the past, that have been able to weigh in and influence judgment, and use political pull in order to over-leverage, which is what we have seen again and again around this globe.

This is a very prudent step. I yield back. And, at this point we have Mr. Budd from North Carolina.

Mr. BUDD. Thank you. Again, I thank you for being here. And I will try to be brief, and in a very different line of questioning than we have had most of this morning. Perhaps it will be a little bit of a relief.

I want to talk about cybersecurity, and the significant financial data, and personally identifiable information that the GSEs store. In 2016, FHFA failed to complete your cybersecurity examination, correct?

And in 2017, they improved and completed four out of six. But I am still concerned that the exams did not address some major deficiencies that were identified. Can you tell me, and please describe, some of the issues you have identified with FHFA's cybersecurity controls?

Ms. WERTHEIMER. Controls with respect to the GSEs?

Mr. BUDD. Correct, particularly in regards to personally identifiable information.

Ms. WERTHEIMER. What we have seen, as you have identified, multiple failures to perform the supervisory activities that they had planned with respect to cybersecurity and you have summarized the work we have done. We have an ongoing audit that is looking at updating what has happened since the prior reports and I don't know whether they have made improvements or not because we haven't finished our field work on that.

Certainly the findings of our prior reports gave me significant concerns.

Mr. BUDD. So are you going to take it, from what you have seen so far, are you going to take any action to correct the identified problems so far and will you be sure to review their promises to correct FHFA, the actions that they have agreed to undertake?

Ms. WERTHEIMER. We just don't have the ability to do anything in terms of take action. We can only recommend. We have made recommendations in terms of accessing whether they have enough people in our 2017 report for example, even though in 2016 they said they had plenty of people, we saw in 2017 with Fannie Mae they didn't do the exams they had planned and we said, "Hey you really need to look carefully at this." And we had a memo from the staff saying, "No, we don't have enough people," but that recommendation is still open.

Certainly when we hear from them we will take action to see whether they have implemented what they said they would do.

Mr. BUDD. So about not completing the exams, in your mind what improvements need to be made so that all scheduled examinations can be completed on schedule?

Ms. WERTHEIMER. Well there are two issues. One is the risk assessment process, because, while I have one in place as we have reported, it bears no relations to what the work is that they are actually undertaking.

So we have recommended again and again that they beef that up and that the risk assessments actually tie to their planned supervisory activities. The second thing is, we have said, having looked and again we looked at it in 2016, we needed to give them some

time. We will look again now, how can you complete less than half of your planned examinations?

Either you have filled the plate too big or you don't have the right complement of people. I am not here to tell you they don't have enough examiners. I don't know that. What I can tell you is they are not doing the work they planned to do and that is a problem.

Mr. BUDD. That is a problem. I appreciate your brevity and your clarity, so thank you. I am going to yield back my time.

Mr. ROYCE. And we will stand in recess. We have 20 seconds until the end of this vote and we will stand in recess until the two votes are over. We will return after that.

[Recess.]

Chairman HENSARLING. The Committee will come to order. The Chair now recognizes the gentleman from Colorado, Mr. Tipton.

Mr. TIPTON. Thank you Mr. Chairman, and Ms. Wertheimer I appreciate your willingness to be able to appear before the Committee again. The last time you were here in April, several of my colleagues and I asked you about the implementation of the Integrated Mortgage and Insurance program, or IMAGIN at Freddie Mac and the Committee and I were encouraged, I believe by your suggesting that you would look into the program and then report back.

Since that time, obviously Treasury and this Committee have learned a fair bit more about the program, and I would like you to be able to speak, because on September 12 your office released a white paper on the subject, offering an overview of the program's functions. And would you maybe explain in detail why your office chose to release a white paper instead of a proper investigation, either an Attorney General's audit or a report?

Ms. WERTHEIMER. Sure. We, as I have explained, established an Office of Risk Analysis to identify new and emerging risks as well as to look at existing risks and see if those risks have been heightened.

That is a function that I thought was incredibly important within housing finance because housing finance is an evolving industry and rules change very quickly. When I was here the last time, and asked about IMAGIN, after the hearing we looked at it. It's a pilot program that has barely begun, there would be nothing to report on.

There would be no ability for us to have findings of a program that has barely gotten off the ground. What I thought was useful for us to do is, for purposes of transparency, explain the program, explain how it was authorized by FHFA because I believe I had questions at the last hearing about how is this possible without public notice and comment.

And then explain the program itself, because we have identified it as a new and emerging risk, it is something we are going to watch, and we will subsequently report when we have some data to report on.

Mr. TIPTON. OK, well when you were putting together the white paper, did you weigh whether or not this is a new program, a new activity, or should it be considered under HERA?

Ms. WERTHEIMER. I believe the white paper explains that the agency has, what I think it calls interim final regulations in which it says, if it is new—and I don't want to misstate this so just give me 1 second, I have it here.

The Director has discretion under his regulation to the extent that there it is at page eight of our report, under their regulation new—public comment is required for new products.

When there are new activities, not new products, they do not require public comment that is at the discretion of the Director. As we explained, the Office of General Counsel wrote opinions saying the activity should not be considered a new product. It went through the considerations. And the Director decided on November 7, 2017 that it was not a new product, therefore public comment was not required and they did not object to the new activity.

Again, we are in the business of valuating against standard, the standard is their IFR. They had an opinion from the General Counsel, and that opinion was not unreasonable.

Mr. TIPTON. Were you comfortable, not to interrupt, because I am going to be running out of time here, the white paper did adequately cover whether or not there was necessary transparency—it was included in rolling out the program, was there transparency did you feel? Did the paper cover that?

Ms. WERTHEIMER. I think the paper discussed the roll-out, it did not opine as to whether or not there was transparency.

Mr. TIPTON. And just to follow up here before we do run out of time, does your office intend to be able to conduct an investigation or have an actual full report on the IMAGIN program?

Ms. WERTHEIMER. When we have some data to look at, yes.

Mr. TIPTON. OK, I think as you are describing here, I believe it is probably a challenge for many of us, there's some real concern in terms of some of the complexity of determining whether or not you issue a white paper is going to be required under HERA.

And I think that we need to maybe have some real guidelines moving forward and have those put into place to be able to prevent some further abuse and make sure that we are making sure those taxpayer dollars are actually not being put at risk with necessary transparency, I believe you will probably agree is absolutely crucial.

Ms. WERTHEIMER. Absolutely. Which is why we publish absolutely all of our work product.

Mr. TIPTON. Thank you, I appreciate your answers and Mr. Chairman, I yield back.

Chairman HENSARLING. Time for the gentleman has expired, the Chair now recognizes the gentleman from Michigan, Mr. Trott.

Mr. TROTT. Thank you, Chairman and I thank you Ms. Wertheimer for being here today. I apologize if it was covered earlier, but I was not here. This morning, Ms. Grimes commented that she thought your office had either ignored or undermined her complaint with respect to Director Watt. I wonder if you could just comment on her concerns in that regard?

Ms. WERTHEIMER. I heard her say that she questioned our independence for several reasons, one because he was aware of her whistleblower complaint and two because we outed her in a court filing.

With respect to her whistleblower complaint, let me be clear, perhaps I was not earlier. In what I will call the first phase of our investigation, we were looking at the allegations of prohibited personnel conduct by senior FHFA executives in the alleged pre-selection of Ms. Grimes.

We, as I mentioned, had career law enforcement, career lawyers do the inquiry. Mr. Watt was interviewed on February 12, Ms. Grimes was interviewed on March 16. Had either of those individuals suggested, implied, reported that there was this pattern in practice of harassment as Ms. Grimes has now alleged, I would never, ever in a million years have mentioned anything to Director Watt. Why is that?

Because we would have launched our own investigation into misconduct by Director Watt. What I knew was, having read the memorandum of interview, there was absolutely nothing in there, in any interview, about a potential sexual harassment issue. So when I became aware of Ms. Grimes' whistleblower complaint and her lawyer's report on the 4th of April that she had been told by the EEO people they couldn't look at it, I was outraged.

The statistics that were quoted; 4 women, 40 some odd, I think 3 white men were outrageous in 2018, and I didn't tell Director Watt to handle it. I told Director Watt this is your job. This is what the E.O. function does. Don't tell them to get back in touch with her. Remember I didn't out her; she had already gone to the EEO office and made the complaint.

Her identity was well known. What I said was make them open it and do something about it.

Mr. Trott. Thank you. She apparently has roughly 15 tapes with conversations with Director Watt. Have you heard the tapes?

Ms. Wertheimer. That is the subject of the second allegation Ms. Grimes has made. We have asked for those recordings. We have asked multiple times. Our subpoena asked for them. She has refused. She told us in writing, no. That is why we moved to compel. Or to enforce; I misspoke. I think there is something that has been lost somewhat here. Let me try to explain it.

Our Office of Counsel understood we needed to move to compel. After all it is very difficult to have a fair investigation when someone has recordings and you haven't heard them and you can't get them. So she is the only one—she is a material witness to our inquiry. She has evidence; she won't give it to us. So we have subpoena authority which we went to use. We wanted to file it under seal, OK?

Speaking with the U.S. Attorney who was signing the papers, we explained the facts to the U.S. Attorney, the Office of Counsel, the Chief Counsel and his lawyers and explained that Ms. Grimes, in three separate e-mails on her government computer, sent to more than 100 FHFA managers, transcripts and a recording and then a long discussion of her complaint. And what we were told was, you cannot, this court disfavors sealing unlike some other courts and with this history, you don't have a good faith basis to move to seal.

Mr. Trott. Thanks for clarifying. I want to, my time is running out, and I want to clarify, before we recess, there was a conversation about how exactly her name became public and I wonder if you could add any clarity to that and your role and any information

that would be helpful and how her name became public through this process.

Ms. WERTHEIMER. My limited understanding is when we moved to enforce the subpoena, her name was in the papers because we could not seal it and that is how it became public.

Mr. TROTT. Thank you so much. I yield back Chairman.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Georgia, Mr. Loudermilk.

Mr. LOUDERMILK. Thank you Mr. Chairman. Thank you Ma'am for being here. I also want to thank you for your testimony that you gave to the Oversight and Investigations Subcommittee a while back. Both of these have been very useful especially in our role, as yours is, oversight over various agencies which is extremely important especially when it comes to taxpayer funded entities and to our government.

And I want to say that I appreciate your frank perspective. I know it is not an easy role being in oversight capacity and I have seen in other agencies that have not held their independences as independently as we would hope and I think you have done that exceptionally well.

Oversight is a difficult process and quite often we just have legitimate differences of opinion but nonetheless oversight is very important. And with that said, I was a very disturbed by the reaction of some at Fannie Mae the last time that you testified here before this Committee, and I would like to read from Exhibit 1, which is an e-mail. It's from Bart Harvey, the head of the Nominating Governance Committee to the Chairman of the board, another Fannie board member, Mr. Mayopoulos. Do you have a copy of that?

Ms. WERTHEIMER. I believe it is in this binder. Yes I have it. Could you just give me a minute to get it from—

Mr. LOUDERMILK. Absolutely.

Ms. WERTHEIMER. OK.

Mr. LOUDERMILK. It's dated April 16 I believe.

Ms. WERTHEIMER. Yes.

Mr. LOUDERMILK. If you will indulge me, I will read what is said in this e-mail from Mr. Harvey. "Vince, I have seen it all now, that the OIG could report this to the House Financial Subcommittee is astonishing in Mel's placation regime. That OIG quotes as the FHFA agreeing with the majority of its reports on MRAs gives rise to another potential wave of regulation by the FHFA."

If I were a Member of the Committee and I got this report, I would have a cow that \$5 trillion plus of assets may not be operated in a safe and sound manner as we know on the board, financial oversight exceeds anything the private sector gets by a multiple degree, even if a lot of it is wasted time and energy.

The single best waste of time, money, and talent are the dueling agencies. Someone, Mel, ought to tell the House the load of crap that the OIG has heaped upon them but he won't. The games being played are a waste and abuse of taxpayer's money and stymied the real progress and we accept them; getting out of conservatorship is the only answer to this foolishness. Best, Bart."

My question to you is really simply, would you like to respond to that e-mail to us?

Ms. WERTHEIMER. Thank you for giving me that opportunity, yes I would like to. I have a few things to say.

This is not a game for us. OK? It's, as my chief counsel likes to say, is as serious as a heart attack. We take this mission incredibly seriously. We take the more than \$191 billion of taxpayer money to keep these enterprises going seriously and we are here to protect that and protect their interests.

I understand they like to say they have paid it all back, but plainly they haven't read the terms of the PSPAs. They haven't paid it back. They have paid back the investments on that \$191 billion but they haven't paid it back, number one.

Number two, I think Mr. Harvey misunderstood what I was doing last April 12th. The article, pardon me, the report to which he refers is a report we issued in December 2016. It went to our oversight Committees, it was on our website, I was asked about it at this hearing and happy to discuss it.

That is a roll-up report of 12 reports we issued previously in which we found significant deficiencies with every element of FHFA's supervision of the enterprises save one which we didn't think was very important, it is an annual plan. And we called out those deficiencies and we made recommendations to remediate them.

And the roll-up report was to say to our stakeholders, "Wait a minute, don't think these enterprises are being operated safely and soundly, just because they have a supervisor, because this program has deficiencies."

I was questioned about the use of the term, and I know I was admonished that I used my language loosely. I, respectfully, I don't think I used my language loosely. Mr. Harvey seems to take issue with MRAs. MRAs, in short, are matters requiring attention. They are the most serious deficiencies the FHFA can find.

Yes, some of our underlying reports were on MRAs, but not all of them. It was on risk assessments, the quality of the work, the report of the exam. I could go on and on. And we have identified those reports, previously. They are all public.

But most importantly, HERA sets a standard which says, while in conservatorship, Fannie and Freddie are to be regulated—or subject to enhanced supervision. Now because they, if they were not in conservatorship, they would be SIFIs, which SIFIs are regulated by the Fed, because they are in conservatorship.

The assumption is, and I think Director Watt testified to this before this Committee in October 2017, they are subject to enhanced supervision. And certainly, we haven't seen that enhanced supervision. When Mr. Harvey talks about it is the single biggest waste of time, money, and talent, well, read our reports.

If you think we are talking about pins on the back of elephants, then it is a waste of time and money and talent. I, frankly, don't think we are, and I think our reports have laid it out for stakeholders to see the problems. And they don't end with that roll-up. We have issued reports subsequent to the roll-up, which are pretty critical of the supervision program.

In fact, we discussed the HFE Program. I mean FHFA's own standard is, you need commissioned examiners to conduct high-risk

exams, as Chairman Wagner points out, and they have won fewer than they had in June 2014.

Mr. LOUDERMILK. Yes, ma'am. I see that my time has expired. And I will yield back, but another colleague would yield some time to—

Chairman HENSARLING. The time of the gentleman has expired. There are no other Members in the hearing room who have requested time. Ms. Wertheimer, we thank you for your testimony. You are excused now. We will recess for approximately 10 minutes, so that we can seat the next panel.

Ms. WERTHEIMER. Thank you.

Chairman HENSARLING. We stand in recess.

[Recess.]

Chairman HENSARLING. The Committee will come to order. We now welcome our third panel. On this panel, we welcome our former colleague, the Honorable Mel Watt, Director of the Federal Housing Finance Agency. He has testified before our Committee before, and needs no other introduction.

Next, we have Mr. Timothy Mayopoulos, Chief Executive Officer of Fannie Mae. Mr. Mayopoulos earned an A.B. from Cornell University and a J.D. from New York University School of Law. He has been with Fannie Mae since 2009, serving first as Executive Vice President, General Counsel, and Corporate Secretary and then as Executive Vice President and Chief Administrative Officer.

Prior to joining Fannie Mae, Mr. Mayopoulos was Executive Vice President and General Counsel of Bank of America Corporation. Mr. Donald Layton, Chief Executive Officer of Freddie Mac. Mr. Layton earned his bachelor and masters degrees in economics from MIT and his MBA from Harvard Business School. Prior to joining Freddie Mac, he was Chairman and CEO of E-Trade.

Each one of you will be recognized for 5 minutes to give an oral presentation of your testimony without objection. Each of your written statements will be made part of the record. To ensure that all Members can hear clearly, please pull the microphones very close to you, when you speak.

And reverse order, Mr. Layton, you are now recognized for 5 minutes for your testimony.

#### **STATEMENT OF DONALD LAYTON**

Mr. LAYTON. Thank you Chairman Hensarling, Ranking Member Waters, and Members of the Committee, thank you for inviting me here today. Let me begin by highlighting my main theme. The mortgage system we have today is fundamentally better than the one we had 10 years ago, plain and simple. It's more safe and sound, more efficient and does a far better job of protecting tax payers.

Freddie Mac is similarly better, with a substantially improved business model. We are absolutely not the GSE of the past. As CEO, my job is clear, to create the best company and the best housing finance system possible under current law, especially the mission Congress assigned to us in our charter, which we summarize in three simple words, liquidity, stability, affordability.

In my long career in banking, I saw a lot of good done under the charter, especially making 30-year, fixed-rate mortgages widely

available to the broad, middle, and working class. I also saw critical flaws that eroded public confidence in us. As a result, I am no apologist for the historic GSEs.

I accepted the challenge of leading Freddie Mac to perform a public service, with the understanding that the conservatorship would not maintain the flawed status quo. Instead, FHFA would actively reform the GSEs to build upon the good and to remedy the flaws, as much as possible, under current law. That is why working closely with both Acting Director DeMarco and Director Watt, we spent much of the last decade addressing four major weaknesses of the historic GSEs. Those weaknesses were the large subsidized investment portfolios, the inadequate capital regime, the bias toward large lenders, and the massive concentration of mortgage credit risk in just two companies.

We have made fundamental changes that address those weaknesses. We downsized our retained portfolio by more than 70 percent. We also repurposed it to solely support our mission rather than generate discretionary profits. We created a modern SIFI-consistent capital framework to enhance safety and soundness, and ensure our decisionmaking is in the true interest of the taxpayers who support us. We leveled the playing field for community banks and other small lenders, and we created entirely new markets to efficiently transfer most of the credit risk of both single family and multi-family mortgage guarantees to private capital markets.

My written testimony highlights the creation of the credit risk transfer markets, arguably the most important development in the housing finance system over the past decade. Credit risk transfer has also created a greatly improved business model for Freddie Mac.

We now buy and distribute risk instead of simply holding it. This puts a large and growing amount of private capital at the heart of the mortgage finance system and ahead of taxpayers. And this significantly reduces systemic risk.

Additionally, the mortgage industry has long been inefficient in ways that harm borrowers, renters, lenders, and investors. We set out to improve the efficiency and safety and soundness of the system increasingly through technology-based innovation.

Three examples cover it: Major reforms of the representation and warranty requirement for lenders, an automated alternative to some traditional appraisals to save lenders time and borrowers money, and an innovative form of improved mortgage insurance.

Each of these efforts improves safety and soundness, lowers cost, supports our mission, and are clearly within our charter. And they were approved by FHFA. As we make these improvements, Freddie Mac continues to fulfill its mission. We buy loans from lenders each and every day. We help stabilize the market. And we responsibly provide access to credit.

And we have dramatically reduced taxpayer exposure to our risk. Finally, your invitation asks for my views on housing finance reform. I offer three suggestions. First, make certain that any proposed reform will work as intended. As we all know, it has to work in practice, not just theory.

Second, minimize the potential for disruption or harm during a transition period. And finally, build on the progress achieved dur-

ing conservatorship to minimize that transition risk, and unintended consequences.

In closing, I am proud of the work Freddie Mac has done to serve our mission, and to fundamentally reform and improve the housing finance system under current law. Thank you, again, for inviting me here today.

[The prepared statement of Mr. Layton can be found on page 101 of the appendix.]

Chairman HENSARLING. Thank you, sir. Mr. Mayopoulos, you are now recognized for your testimony.

#### STATEMENT OF TIMOTHY MAYOPOULOS

Mr. MAYOPOULOS. Thank you, Chairman Hensarling, Ranking Member Waters, and Members of the Committee for the opportunity to testify today. Ten years ago this month Fannie Mae was placed into conservatorship.

Before the crisis, Fannie Mae enjoyed implied government backing, profited from a large mortgage portfolio, was weakly regulated, and exerted substantial political influence to preserve these advantages.

By the mid 2000's, in an effort to maintain its declining market position in the face of competition from Wall Street, the company lowered its underwriting standards, and made imprudent investments in private label mortgage-backed securities.

Then, as we all know, the bottom fell out of the housing market. That collapse signaled the end of one chapter for Fannie Mae, and the beginning of another. I was hired in early 2009 after the company was placed into conservatorship to help stabilize it.

At the time, the CEO and Chairman told me that my period of service would, likely, be 12, at most, 18 months. And that the future of Fannie Mae would be resolved in that time. What was supposed to be a temporary timeout has lasted more than 10 years.

My focus as CEO for these past 6 years has been: One, to repay taxpayers for their investment in the company; two, to stabilize the housing and mortgage markets; three, to reduce the company's risk and improve its operations; and four, to fulfill our traditional role of providing access to affordable mortgage options for Americans to purchase and refinance their homes.

I am proud that during my tenure, we have accomplished more than most people would have thought possible a decade ago. Since 2012, the company has been profitable every single year, generating average profits of \$11.4 billion, even if we exclude our extraordinary \$84 billion profit in 2013.

Fannie Mae's rate of serious mortgage delinquencies has declined from a peak of 5.6 percent in 2010, to a rate of less than 1 percent today. We have paid \$167.3 billion to taxpayers in dividends. Nearly \$50 billion more than the company received in support.

That profit is more than twice as much as taxpayers received in aggregate from all U.S. banks that received assistance during the crisis. We have transformed Fannie Mae's business model. Today's Fannie Mae is out of the business of holding a large investment portfolio of mortgages. Instead of holding all credit risk, today we distribute a significant portion of that risk to private investors in markets that did not even exist 6 years ago.

Our transformation encompasses nearly every aspect of the company. Fannie Mae today is the most productive company in the world as measured by profits per employee. We are leading the adoption of innovative technology to reduce credit risk while, simultaneously, expanding access to credit.

We have developed tools for the industry to minimize the risk and magnitude of foreclosures whenever the next downturn comes. Our investments in multi-family initiatives allow us to play a role in affordable housing that neither overemphasizes nor under-emphasizes home ownership.

We did all this while providing \$6.5 trillion of liquidity to the housing finance market, much of it when other private capital sources had retreated altogether. Fannie Mae and, indeed, the entire system is now more resilient than at any time in recent history pre- or post-conservatorship.

None of these outcomes were preordained 10 years ago. They are the result of choices made by our management team, and by our conservator and regulator. They are also the product of the support provided by taxpayers in the depths of the crisis.

And none of these outcomes would have been possible without the many remarkable people who work at Fannie Mae. This team not only weathered the storm, but succeeded beyond all reasonable measure.

I am grateful to have had the opportunity to lead extraordinary people in a truly extraordinary time. Fannie Mae is a different company from the company I joined in 2009. It is more profitable, less risky, more innovative, non-political, and more humble.

Whether it is the right model for the future is up to you and your colleagues to decide. It is not my job, and it has never been my aspiration to preserve the Fannie Mae of old. Instead, it has been to help to lay the foundation for a housing finance system that will serve this country well for decades to come.

We will continue our hard work as you chart a course forward. Thank you. And I am happy to answer any questions you may have.

[The prepared statement of Mr. Mayopoulos can be found on page 119 of the appendix.]

Chairman HENSARLING. Thank you for your testimony. Director Watt, before we yield to you, as everyone in this room knows, a serious accusation of sexual harassment has been lodged against you. Your accuser testified earlier as I am sure you are aware.

We wanted to give her all due fairness and we want to offer you the same opportunity. So if you need to go beyond your 5 minutes to explain your position, we want to accord you that time.

Director Watt, I now yield to you for your testimony.

#### STATEMENT OF THE HON. MELVIN WATT

Mr. WATT. Chairman Hensarling, Ranking Member Waters, and Members of the Committee, thank you for inviting me to testify today about FHFA's role as conservator and regulator of Fannie Mae and Freddie Mac.

Since I last testified before this Committee, Fannie Mae and Freddie Mac have marked their 10th anniversary under the con-

servatorship of the Federal Housing Finance Agency, a conservatorship of unprecedented scope, duration, and complexity.

FHFA has worked to appropriately manage and oversee these enterprises both as conservator and as regulator. I am honored to appear on this panel with the CEOs of both enterprises and to have the opportunity to thank them publicly for the critical roles they have played.

Both recently announced that they will be leaving their post in the coming months. Both have provided visionary, innovative leadership and their boards, management teams, and employees have worked closely with FHFA to reform the enterprise's operations, improve the U.S. housing finance system, and return significant dividends to the U.S. taxpayers.

Because of them, these enterprises are substantially better on every measurable criterion than they were when these CEOs started and the taxpayers are a lot better off for it. Because of them, the enterprises are far different today than they were 10 years ago.

I have described many of the reforms we have made and how FHFA has managed in this protracted period of conservatorship in my 16 page written testimony and in well over 200,000 pages of documents FHFA and the enterprises have provided to the Committee in response to document requests, letters, and subpoenas over a number of months.

While responding to these requests has sometimes taken substantial time away from other responsibilities, we have always tried to be responsive because as a former Member of this Committee, I have the highest regard for the Committee's oversight responsibilities.

I am also happy to appear today to answer the Committee's questions. While we believe FHFA has made good decisions, both as conservator and as regulator, about how to manage the enterprises in their present state.

It is still the case that it remains absolutely essential for Congress to enact housing finance reform legislation. As I said during my confirmation process in 2013, and as I have repeated even more vigorously based on experience since then, conservatorship is not sustainable.

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

Since I left Congress to become the Director of FHFA, I have tried to avoid expressing my views or trying to exert influence over what role, if any, the enterprises should play in housing finance after conservatorship.

After repeated requests from Members of Congress, we released a document that we considered, quote, "responsible, balanced, viable, and important to consider" close quote. And I am happy to respond to any questions about it.

However, I think it is important for me to plainly and unequivocally reiterate my view that it is the responsibility of Congress, not FHFA, to decide on housing finance reform, and my hope is that Congress will do so as expeditiously as possible.

Since this could possibly be my last appearance before this Committee before my term ends on January 6, 2019, I would be

remised to close without saying what an honor it was to serve as a Member of this Committee and what an honor it has been to serve as Director.

Mr. Chairman, I was not made aware until 2 days ago that this hearing would involve the charges Ms. Grimes has made or that she would be a witness here to make her case in a political forum in addition to in the courts, where she already has claims pending.

In light of these recent revisions, I was going to ask the Chairman for an additional period of time and I think he has already granted me that, so I won't ask him for additional brief period to make a separate statement about that matter.

Chairman HENSARLING. No, you may proceed, Mr. Watt.

Mr. WATT. First let me quote what is not in dispute directly from the top of page 47 of the part of the Postal Investigator's report that was leaked to the press by somebody. Quote, "Ms. Grimes acknowledged that Director Watt never groped her nor touched her."

Ms. Grimes testified, quote, "we have never been intimate in any fashion, specifically we have never held hands, kissed, or engaged in any sexual activity." That seems to be something that the press has managed to avoid reporting or if it has, I certainly haven't seen it anywhere.

Second, beyond these facts that are not in dispute, there are two lawsuits in progress that will sort through and resolve all factual and legal issues related to her claims. Those issues include who said what to whom and under what circumstances, whether someone tampered with tapes and transcripts or what was said and if so, who did so? And whether anyone at FHFA denied Ms. Grimes equal pay or otherwise discriminated against her in her employment.

When these issues are resolved through the legal process, I am confident that the resolution will confirm, as I have previously stated, that I did not take any actions or engage in any conduct involving Ms. Grimes that was contrary to law.

I am disappointed that it appears that Ms. Grimes is now attempting to use my efforts to advise and mentor her, and my efforts to be clear about the limits of our friendship, specifically that it would have no impact either positive or negative on her employment aspirations as the basis of a legal claim.

Those who know me well, know that I have a long history of having successfully mentored numerous employees, both male and female, over 22 years in the practice of law and 21 years in Congress. And I have continued that practice during my time as Director of FHFA.

I am proud to say that some of the people I have mentored, are also among my very best friends. I am also perhaps even more disappointed that someone that I considered a friend and mentee, would for years be systematically trying to lay the groundwork to file a lawsuit by recording what Ms. Grimes' verified affidavit says are, all conversations with me, and then selectively leaking parts of them to the press while at the same time, refusing to produce all of them to investigators or in court.

Obviously no fair and impartial resolution of this matter can be made without all of these recordings being produced and evaluated.

Finally, I know this matter puts Members of this Committee, both those who consider themselves personal or political friends, and those who may consider themselves political adversaries, in an awkward position. For that reason, and because experience has shown me that over the years the judicial process is the only process that has the capacity to resolve contested factual and legal matters of this kind. I was hoping that this Committee would understand that it cannot deal with this matter fairly, or with due process either to Ms. Grimes or to me.

Due process cannot be dispensed in 5-minute exchanges of questions and answers, or by politicians who either rightly or wrongly will be perceived to prioritize being Democrats or Republicans over getting the facts. Or by friends or former colleagues, some of whom have known me and my family for years, and know that I will be celebrating 51 years of marriage this November to the most beautiful woman in the world.

Unlike what is going on in the Senate, this Committee's process cannot resolve this matter, and Ms. Grimes has already started the legal process to resolve the claims. But here we are, and I offer this statement for the record, and will try to answer questions without compromising the ability of the courts to get to the real facts and a real resolution of this matter.

[The prepared statement of Mr. Watt can be found on page 138 of the appendix.]

Chairman HENSARLING. The Chair yields to himself. Director Watt, this is awkward for all of us. You and I have served on this Committee together, albeit on opposite sides of the aisle. But you have always commanded respect. And so I don't savor this moment, I hope you believe that.

But it is this Committee's responsibility to conduct oversight over FHFA and that includes your conduct as well. And again, we started today out, not just with an accusation, but an accusation that included evidence. Now I agree with you, this is not a court of law and I doubt we will get to the bottom of it, and we are not the ultimate trier of fact and we are not the ultimate dispenser of justice.

But I do have a number of concerns, and frankly I wanted to talk to you about other aspects of your stewardship at FHFA. But I cannot deal with the matter that is in front of us. And if you could please put up the exhibit?

Here's the first concern I have, Director Watt. The language, quote, "each of us is responsible for treating one another with professionalism and respect, and we must all cooperate to maintain a workplace free from harassment." Can I safely assume that you have seen that language before?

Mr. WATT. Yes, sir.

Chairman HENSARLING. You have seen it before, because it is contained in the FHFA anti-harassment policy statement that you signed on August 16 of last year, is that correct Mr. Watt?

Mr. WATT. That is correct.

Chairman HENSARLING. And as I understand it, you have maintained that you are not covered by that policy, is that also correct?

Mr. WATT. That is correct.

Chairman HENSARLING. So even though we have language that says FHFA will hold all employees accountable for harassment and related misconduct, you state it does not apply to you, correct?

Mr. WATT. That is correct.

Chairman HENSARLING. Who are you employed by Director Watt?

Mr. WATT. I am employed by the Federal Government as Director of the Federal Housing Finance Agency.

Chairman HENSARLING. Well you are getting a paycheck from somewhere, your benefits are coming from somewhere? So if you are not an employee of FHFA, again, who are you an employee of?

Mr. WATT. I don't know who I am an employee of but I know who the policies of the agency cover and I have explained that fully in a correspondence that the Chairman, I am sure has, which I will be happy to read to him and tell him why I think the policies don't apply to me. If the Chairman—

Chairman HENSARLING. When you signed—

Mr. WATT. If the Chairman would allow me? I will read it to him, it is an e-mail to Mr. Pierce, who was the Postal Inspector, in which I say on July 16, 2018, I verbally communicated to Don McLellan he is our EEO person. And my attorney communicated to Mr. Tom Magnetti FHFA's counsel retained in relation to Ms. Grimes' claim that it would be inappropriate to submit to an interview by you.

Chairman HENSARLING. Mr. Watt if I could—

Mr. WATT. This decision is based on the advice of my legal counsel that the FHFA anti-harassment policy and the FHFA conduct and discipline policy in which allegations of harassment if—to which allegations—

Chairman HENSARLING. OK, Mr. Watt, I get the gist of it, and now it is very generous—

Mr. WATT. No, no you don't get the gist of it until I—

Chairman HENSARLING. I understand—

Mr. WATT. Until I get to why—

Chairman HENSARLING. Sir I was very generous with your time. I was very generous in giving you time, but as you well know, I control the time.

Mr. WATT. OK, well—

Chairman HENSARLING. When I speak, and so I understand. You are asserting a legal exception, so I will take that at face value. You are asserting a legal exception. As we both know, many others do not recognize that legal exception. For argument's sake—

Mr. WATT. Mr. Chairman, the public needs to understand—

Chairman HENSARLING. For argument's sake—

Mr. WATT. That I am not asserting that I am above the law. I am cooperating fully with—

Chairman HENSARLING. I have to tell you, Director Watt, it sure sounds like it.

Mr. WATT. All other investigations, and they need to understand why I didn't—

Chairman HENSARLING. Director Watt, it sounds like you are.

Mr. WATT. Didn't cooperate with this investigation.

Chairman HENSARLING. Director Watt, we will be generous with the time, but again, when I am asking the questions, I get to control the time. We both know that, sir.

So here's the question I have to ask. Let's say for purposes of argument that you have asserted or your legal counsel has asserted a proper legal protection. Why wouldn't you, as leader of this organization, voluntarily bind yourself to a policy that you expect every other employee to be bound by? Why would you not do that?

Mr. WATT. Mr. Chairman, if you would allow me to get to the bottom of what I wrote, I think—

Chairman HENSARLING. We—I just wish you, when you wrote it you wrote it for yourself, but please proceed.

Mr. WATT. OK, I will read the rest of it if with your permission, or, I—you are asking me why I am—why I didn't participate in this, and I am trying to answer.

My decision is based on the advice of legal counsel, and I have read that the anti-harassment policy and the FHFA conduct and discipline policy, to which allegations of harassment is subject, apply only to employees, quote, "who meet the definition of an employee as stated in 5 U.S.C. Section 7511," close quote. Under that section, Presidential appointees confirmed by the U.S. Senate are specifically excluded from this definition.

FHFA's policies clearly contemplate that the proposing official, the deciding official, and anyone who could determine and take any corrective action that may be deemed appropriate in response to the investigation you complete, would be someone in the chain of command above the person against whom the allegations of harassment have been made.

In this case, there is no one inside FHFA with the authority to exercise these functions. It was for that reason that I expressed to Don McLellan, in an e-mail dated June 25, my concerns about what he intended to do with the report of investigation you will be expected to generate when you complete your work.

His response to my e-mail raises serious concerns about whether your investigation could be completed in parallel to an investigation being conducted by the FHFA Office of Inspector General without jeopardizing my due process rights and without substantial duplication of expense and effort, the very things that Ms. Grimes has actually complained about also, which some of what she testified I actually agree with.

Chairman HENSARLING. OK, Director Watt, you read the entirety of the relevant portions of the letter. I go back to my previous question: Was there anything in that letter that legally prohibited you from voluntarily adhering to the standards that you expect every other employee under your watch to abide by?

Mr. WATT. Not a thing in there that would have prevented me from voluntarily doing that, but—

Chairman HENSARLING. That is the question I was looking for. You also cited earlier in your comments you alluded to the Postal Inspector's report, but at the same time as you draw conclusions from that report, you did not cooperate with that investigation. Isn't that true? You refused to submit yourself to interviews and to participate in that investigation and you just cited it as a source. Is that correct, Director Watt?

Mr. WATT. That is correct. I have one page in that report. It is the page that I just read to you. All the rest of it in this book is their investigation, and Mr. Chairman, I did nothing to try to ob-

struct that investigation. I just didn't participate in it. I didn't tell any other employee in our agency not to participate, I didn't tell my legal counsel that I thought he was wrong in, or anybody that they were wrong in applying this, in following this process.

What I did was said, look, there's nobody in the agency when we get this report who will be able to exercise the responsibilities that the report contemplates that they would exercise. The only person who has the authority to do that would be the President of the United States. Now the report could be forwarded to him, but the IG's report can be forwarded to him. So—

Chairman HENSARLING. Well Director Watt, I—

Mr. WATT. Why would I duplicate efforts here?

Chairman HENSARLING. I want to be fair to you. I also want to be fair to other Members, so I want to wrap this up. Again, you are on record citing a legal privilege that others do not recognize. You did not cooperate with the first investigation. There is an ongoing investigation within the FHFA Inspector General's Office.

I believe you have stated that you will fully cooperate with this investigation.

Mr. WATT. I am fully cooperating with this.

Chairman HENSARLING. And I don't wish to make threats, Mr. Watt, particularly to a former colleague, but please know that this Committee will be monitoring this very, very closely. And even though you and I are getting ready to depart office at the same time, I will not hesitate for a moment to use my power of subpoena if we have any scintilla of evidence that you are not cooperating fully in this investigation. I hope that this is not how we spend our last few months in office.

I now yield to the Ranking Member.

Ms. WATERS. Thank you very much, Mr. Chairman. While I would like to have deep discussion about Fannie and Freddie and the conservatorship, which has gone on now for 10 years, and you are absolutely correct, Mr. Watt, that it is Congress's responsibility to do whatever reform that we have talked about.

We cannot get at that today. We cannot talk about it today, because the accusations that have been made against you are overriding this entire hearing. And I want to share with you some of what I said this morning in my opening statement. I said basically that we have been friends for years. That I have dined at your home with you, your wife, and your mother.

And I have visited your son's home in California and I have given gifts to your first grandchild. And so we have been friends for many years. And I went on to say despite that friendship, I find myself with the responsibility to allow Ms. Grimes to come before us today, as other Members of this Committee have agreed with, to have her say and to be able to share with us ways in which she believes she has been harmed basically by you.

And I just want to say that you raised a question about why we would allow her to come and use this forum to present her case when in fact there's a lawsuit pending. And while that has been the regular order of business, not entertaining those who would like to come before the Committee who have losses pending.

Let me just share with you this is a different day and a different time. And what women have come to realize is that many of the

processes that are in place absolutely work against them being able to not only present their case but to fight for what they believe is justice and equality and to tell what is happening to them, particularly as it relates to sexual harassment.

In the House, we have some of our Members who are taking a look at the way that we have dealt with these complaints over the years and they are changing all of that.

They are changing all of that because they find that they have worked to their disadvantage. So any questions about why she is here, it is because again it is a new time and a new day where we are not complying with or continuing with existing policies and procedures that have worked against them and left them silenced when they have complaints about discrimination and harassment.

Sexual harassment and discrimination are wrong and against the law. And so I and others responded to the request. I have also said that because of our relationship and our friendship, if this was a court of law I would have to recuse myself because of that relationship.

This is not a court of law, this is a Committee of Congress with oversight responsibility and we have deemed with this hearing that we would use our oversight responsibility to allow Ms. Grimes to come today and share with us her complaint about that which she has experienced and to let us know that perhaps we need to do some corrections in law.

Gave us some advice and pointed out things that could be done to avoid the situation that she has been involved with. Now you have given us your side of this story, you have explained to us why you have acted in the way that you have acted, you have talked about the investigations that are still going on and the fact that lawsuits are pending.

Having said that, is there anything else that you would like to add to your response that would help us to understand why you have taken the steps that you have taken and the way that you have decided to deal with this issue other than what you have already said and what I have recounted to you?

Mr. WATT. Madam Ranking Member, first of all let me just say how much I appreciate your friendship and my first grandchild certainly appreciates you, he thinks the world of you because you did give him his first California gift.

So, and I would be remised not to say that. I heard Ms. Grimes' testimony, and there were some things in there that I actually agreed with very much. I mean one of the concerns here is the duplication of processes makes litigating these cases extremely expensive.

The Ranking Member well knows that I practiced law in a civil rights law firm for 22 years. And one of the biggest impediments that we saw was the ability of litigants to finance litigation in this area and in every other area.

But to have multiple duplicative processes for dealing with these cases adds to the expense. In this case, we had the Postal Inspector's report investigation, we then have the IG's investigation, we will next have an EEO investigation.

And that every time you have an additional investigation, and if the EEO investigation doesn't resolve it and people get together

and resolve it through compromise, there will be litigation that will go on for years.

And I found myself in the practice of law having to tell plaintiffs look, don't get involved in these processes if you don't understand that. The old adage that justice is slow is an absolutely true adage.

And to it has been added, the notion that justice is also expensive. And it actually got more expensive in this case because of these allegations that were made against me, because at that point our inside counsel couldn't deal with it, that is why people have been tipping around and not talking to each other.

I was very sympathetic to that part of Ms. Grimes' testimony. Nobody can talk to each other about what is going on anymore. I can't provide leadership because I have been recused from every aspect of it, including the process of whether and when she will get promoted.

That can be very frustrating and that part of it I can relate to very much to her frustrations. So anything that could be done to streamline this process and cut out some of the duplication, which is why I pointed to the expense and duplication in the last sentence of my e-mail to Mr. Pearce.

Ms. WATERS. OK, Mr. Watt, let me just say this. Just as you are experiencing your frustration, she has been experiencing frustration also.

Mr. WATT. Absolutely.

Ms. WATERS. And when we talk about that kind of frustration, we cannot help but witness the confirmation process in the Senate, in which several women have come forth with grave accusations against Judge Kavanaugh who has been nominated for a seat on the Supreme Court. That hearing process is a travesty and questions remain about whether all of the women who have made allegations will be allowed to testify before the Senate Judiciary Committee.

In this atmosphere and in this time where women have come forth and they have decided that they are going to step out, they are going to tell their story, they don't care what the processes are because of this frustration. We have allowed her to come here today and guess what, Mr. Watt? These kinds of processes are going to be undone in the future over and over again in ways that we have never seen before. And so we are at that point in time where she came, she told her story, she was very articulate in telling her story, you are extremely articulate as a lawyer in telling your story.

We have oversight, perhaps we will come up with even some laws that will deal with some of what we are learning. But the fact of the matter is, I think there is one lesson in all of this maybe for you, and that is, it is a new day, it is a new time, and the old processes don't work well anymore. We can say if you have a lawsuit pending, you can be heard in this Committee, that is different. And so I would hope that you would have an appreciation for that and I thank you for your testimony, and he is about to gavel me to shut. And I will yield back the balance of my time.

Chairman HENSARLING. Time of the gentlelady has expired. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, Chairman of our Oversight and Investigations Subcommittee.

Mrs. WAGNER. Thank you, Mr. Chairman. Director Watt, I have some very important policy and oversight and investigation questions, and in my capacity as Chairman that I have to ask. But I would be remiss if I didn't start by staying that earlier today, Ms. Grimes testified that you would not submit to the internal investigation because you believe that you could not be disciplined.

Ms. Grimes testified that you refused to abide by the internal investigation because no outcome of that investigation would be able to hold you accountable. Additionally, the Fifth Circuit ruled that your office and your agency are unconstitutional because of your isolation from oversight. I have a very simple question. Director Watt, who do you report to? Is there anyone who you believe has oversight of your actions?

Mr. WATT. I report to the President of the United States, and I can be removed if he finds that I have done something improper with cause. And that is the problem we have here. But even if my agency were organized in a different way, that would still be the case. Suppose I had a three-person commission—

Mrs. WAGNER. You do not—I reclaim my time. You do not hold yourself to the same standard that you hold your employees to?

Mr. WATT. I do, yes.

Mrs. WAGNER. But you refuse to have participated in any investigation and do not believe that anyone has oversight? You cannot be disciplined for any of the allegations? You cannot possibly even participate in that investigation?

Mr. WATT. Mrs. Wagner, I am fully participating in these investigations. I wish I didn't have to, but I am—

Mrs. WAGNER. No, I don't think you are, sir. You were asked if you have admitted you could voluntarily participate but you are not participating in the sexual harassment proceedings and you have held yourself to a different standard. I am going to move on.

Director Watt, in the 2018 IG report concerning FHFA's Housing Finance Examiner Program, the IG states that not only has a new training program not produced new examiners, but the entire program has now been suspended after receiving an anonymous online tip about the quality of the training. The anonymous tip talked about the lack of professionalism with training, et cetera, et cetera.

The IG reports that after this anonymous tip, FHFA suspended the training program. Director Watt, FHFA spent \$7.7 million of taxpayers' money on a crucial training program, which apparently lacks professionalism among other things, but more importantly cannot complete its mission to train even one more commissioned examiner. What steps has FHFA taken to remedy these problems, sir?

Mr. WATT. We are constantly engaging in efforts to upgrade our examiner capabilities.

Mrs. WAGNER. How many years will it take Director Watt? It's been over 7, and you don't have one new examiner? And you have spent \$7.7 million.

Mr. WATT. Let me give you a little history if you don't mind.

Mrs. WAGNER. I don't have much time and I have a lot of ground to cover, sir.

Mr. WATT. This agency, FHFA, was a brand new agency, stood up as a combination of prior agencies. We inherited all of the examination staff from those prior agencies.

Mrs. WAGNER. Have you added any new examiners? Are you in fact, one less down?

Mr. WATT. Yes we have.

Mrs. WAGNER. All right. I am going to let you submit the rest of this in writing. I am going to move on. FHFA—I will move on. Mr. Mayopoulos, let me revisit some questions I had for the Inspector General. Did Fannie Mae, and these are yes or nos, very quickly, did Fannie Mae recommend to FHFA, in 2017, that Fannie Mae consolidate and relocate its Northern Virginia offices to a new office built to Fannie Mae's specifications? Yes or no?

Mr. MAYOPOULOS. With respect, Congresswoman, I don't think I can answer it yes or no, but we did make a recommendation to consolidate our offices.

Mrs. WAGNER. Is it true that the primary reason Fannie Mae wanted to move to these new offices was because moving to these new offices would enable Fannie Mae personnel to work in a quote, "open workspace environment?" Yes or no.

Mr. MAYOPOULOS. No. That was one factor, but it was not the primary factor.

Mrs. WAGNER. Director Watt, did you approve using and spending \$727 million, \$727 million, three quarters of \$1 billion, while in your conservatorship, let me remind you, of the taxpayers' money to relocate the Northern Virginia workforce from buildings that you owned to renovated buildings that you now rent?

Mr. WATT. The net effect of that move was to yield more than \$300 million to the tax bill, Mrs. Wagner.

Mrs. WAGNER. You said you could sell your own properties for \$140 million, how much did they sell for, Director Watt?

Mr. WATT. Net effect of that decision was to return over \$300 million.

Mrs. WAGNER. It does not add up. How much did you sell that building for, Director Watt?

Mr. WATT. I don't know how much—

Mrs. WAGNER. \$90 million, let me remind you, is what you sold it for. And you spent over \$727 million of the taxpayers' money moving to a rented building.

Mr. WATT. Yes ma'am.

Mrs. WAGNER. On top of money—

Mr. WATT. That is absolutely consistent with what we have been trying to do.

Mrs. WAGNER. Director Watt, wow.

Mr. WATT. Downsize Fannie Mae, reduce the number of employees they have—

Mrs. WAGNER. The statutory response. Reclaiming my time. Your statutory responsibility sir, is to—

Chairman HENSARLING. Time is up.

Mrs. WAGNER. Preserve and conserve the assets and property of Fannie Mae.

Chairman HENSARLING. Time.

Mrs. WAGNER. And I would say that you have—

Chairman HENSARLING. Time of the gentlelady.

Mrs. WAGNER. Statutory responsibility. I yield back.

Chairman HENSARLING. Time of the gentlelady has expired. The Chair wishes to alert all Members. There is currently a vote on the floor. There is a series of two votes. We will clear one more Member in the queue. We will temporarily recess and then reconvene. The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you Mr. Chairman. Mr. Watt, I certainly take no pleasure in today's hearing. In fact, it deeply saddens me to have a former colleague to come before us while confronting such profoundly disturbing allegations. I think that our Nation is entering a watershed moment. Women are stepping forward and they are making their voices heard.

The fact is, any time there is an imbalance of power, there exists the possibility for abuse and for sexual misconduct. So I would like to say to you, Mr. Watt, that it is my hope that you comply completely and wholly with all the ongoing investigations. So my question to you is, it is my understanding that the U.S. Postal Service conducted an investigation into these allegations made against you and I understand exemption that you are asserting.

But in retrospect, do you believe not submitting to an interview was a mistake?

Mr. WATT. No, I don't believe that because the statute says the policies don't apply to me. I don't know how many more times I can tell you that. And I have tried to explain why they don't apply because the Postal Inspector does the report. The Postal Inspector sends the report to our agency. If I had done something wrong and the Postal Inspector found that I had done something wrong, there's nobody in our agency who would have the authority to do anything about it and that is the bottom line of what we are talking about here.

Now, if the Postal Inspector's report was prepared for the President of the United States for him to make a determination, that would be an entirely different thing because he would have the authority to do something about it.

Ms. VELAZQUEZ. I guess you also understand the type of example that you believe this demonstrates to other employees. How do you think they take the fact that asserting a legal exception, allowing you not to be interviewed, is taken by the rest of the employees? I understand your explanation. I guess that at some point we will have to address this issue.

Mr. Watt, what type of leader do you believe you are?

Mr. WATT. Congresswoman Velazquez, I think if you look at my record throughout my whole life, from the day I started in the practice of law in a civil rights law firm, you will find nobody, or few people, who are more committed to the things that you all have talked about today which is erasing all the disparities between African-Americans and other minorities and the majority community; erasing disparities between women and men, which is why I have always tried to conduct myself in a way that does exactly that.

I am a big supporter of the MeToo Movement. I think it is a wonderful thing, but it cannot be a substitute for going through the legal process because, to be quite honest, this Committee can't deal

with this in a legal way and redress Ms. Grimes' claims; the courts can. There's a whole EEO process to do that.

I share, and to be clear with Representative Waters, I didn't object to the hearing. What concerned me was that I got 2 days' notice and we changed the whole course of a hearing that I thought was going to be about oversight and things that I have been trying to do for the last 5 years. I have not criticized anybody about having this hearing. I am just telling you there is a process about which Ms. Grimes' claims will be adjudicated. This Committee doesn't have the authority or capacity to do that.

Ms. VELAZQUEZ. We understand that. I yield back Mr. Chairman.

Chairman HENSARLING. Time of the gentlelady has expired. There are two votes pending on the floor. Pending those votes, the Committee stands in recess.

[Recess.]

Chairman HENSARLING. Committee will come to order. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, Chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. And I am going to move to our other witness here in a bit, but I have one quick question for you Mr. Watt. Do you believe that you have run the FHFA properly and in a professional and positive and proper manner?

Mr. WATT. I do, and I could give you some statistics on that.

Mr. HUIZENGA. OK, that is OK.

Mr. WATT. But I won't bother, but yes, my answer is yes.

Mr. HUIZENGA. Yes. And a little while ago, you acknowledged it has become dysfunctional. You said nobody's talking to each other. You have recused yourself. Earlier, Ms. Grimes said that she was a direct report to you. You have said—

Mr. WATT. She is not a direct report and—

Mr. HUIZENGA. You have—

Mr. WATT. Never has been.

Mr. HUIZENGA. You have said they removed—I checked with counsel. My understanding is that you have delegated that authority to your chief of staff which is still connection to you. So it seems that there are still some things that need to be cleared up there. But Mr. Mayopoulos, I have a question for you, please.

As I understand, your new downtown office building was built to above Class A standards appropriate for a major financial institution, that is above the standards prescribed for the quote, "most prestigious building competing for premier office user with rents above the average area." Is that correct?

Mr. MAYOPOULOS. No, I don't think that is correct, Congressman. I appreciate the question, but to the extent that there were enhancements made, they relate to serve business resiliency and redundancy needs.

Mr. HUIZENGA. I am not sure what business resiliency means.

Mr. MAYOPOULOS. So for example, we had to install backup generators to make sure that our operations would not go down, and we built a trading—

Mr. HUIZENGA. I am reclaiming my time. As I understand, Fannie Mae justified the level of amenities to the FHFA, as a necessary and substantial part to attract and retain talent and maintain existing employees. Is that true?

Mr. MAYOPOULOS. One of the factors that went into this was being able to attract and retain talent, yes.

Mr. HUIZENGA. OK. Director Watt, I understand that FHFA has agreed with this rationale. Is that true?

Mr. WATT. That is correct. And there a number of other rationales for what we did, but we also agree with those rationales, yes.

Mr. HUIZENGA. OK. Mr. Layton, turning to Freddie and recognizing that not all things are the same, Freddie plans to continue operating its D.C. headquarters in space that is Class A but not, quote, "large financial institution fancy," correct?

Mr. LAYTON. Yes.

Mr. HUIZENGA. In fact, Mr. Layton, your headquarter's buildings are—I understand now that some are described as a relatively frugal Class A office space. Is that accurate?

Mr. LAYTON. I would say it is average.

Mr. HUIZENGA. Average? OK. I think we have a few pictures up here with that, on the slides. And now with this slide, in a strategic facility planning deck, from this June, I find it interesting.

My family's in construction. Earlier, at a previous hearing I, maybe this is a technical term, I freaked out when I saw some of the construction that was going on, including the lunch huts that were there, and a number of other things.

But we have a picture of the current headquarter facility next to the new Fannie Mae headquarter building, and note that you have a bullet comparing our building to the new Fannie headquarters that says, quote, "very functional Class A space, but not glamorous." How do you manage with that space? Are you losing—yet, you are losing employees. Is that correct?

Mr. LAYTON. Are you addressing this question to me?

Mr. HUIZENGA. Whoever wants to take this, I guess, yes, sure.

Mr. LAYTON. We are not losing employees. We have a relatively low turnover rate. The buildings were inherited from many years ago. They are adequate, and we attract our employees by a combination of the nature of our work, we think, the culture we have.

Many are attracted, in fact, almost everyone's attracted by the mission component, as opposed to just being a commercial company, and the space is adequate for that.

Mr. MAYOPOULOS. And Congressman, to the extent you are addressing that question to me. What I would say is that our old spaces were actually quite poor, in terms of condition. We have been in them for a very long time.

Mr. HUIZENGA. Justifying the bridges.

Mr. MAYOPOULOS. I'm sorry?

Mr. HUIZENGA. I mean the previous justification to the bridges going across was workflow and flow of employees. I mean do you still feel that way?

Mr. MAYOPOULOS. With respect to the bridges, first, two of the bridges are there by part of the base building. We don't own the building and the developer put it up.

Mr. HUIZENGA. We are distinctly aware you don't own the building.

Mr. MAYOPOULOS. And second, that was by design, frankly. We understood that we were to put ourselves in a position where, if we

needed to be wound down, we would be able to exit these spaces and we can do that since we lease these spaces.

We sold our spaces in D.C. at the top of the market, and we have sent \$118 million to the taxpayers as part of our quarterly dividends from those proceeds. But with respect to the bridges we did have an additional third bridge installed so that we could organize our business units that is both vertically and horizontally in a way that would allow the best use of the space.

It was an effort to make it efficient. Overall, we have gone from 3 million square feet nationwide in our real estate portfolio to 2 million square feet. We have eliminated 80 percent of our offices, what offices we do have are 30 percent smaller. Almost all of our people work in 6 foot by 8 foot workstations made out of plastic.

Mr. HUIZENGA. Being home to the three largest office furniture makers in the world, that is not a surprise. You go in to most new places they have workstations with no cubicles at all. So I still believe that you are behind the curve on that. With that, Mr. Chairman, my time has expired.

Chairman HENSARLING. Time of the gentleman has indeed expired. The Chair now recognizes the gentleman from Missouri, Mr. Clay, Ranking Member of Financial Institution Subcommittee.

Mr. CLAY. Thank you Mr. Chairman, I thank the panel for being here today. I have a question in the area of appraisal waivers. And here's—I represent St. Louis, Missouri and we have a challenge with appraisals as far as being able to get the correct comparables for certain neighborhoods, especially underserved neighborhoods.

And so I notice that the FHFA IG recently published a white paper that provides an overview of GSE appraisal waivers. And the paper states that the waiver programs that are currently structured are modest in size and include stringent eligibility standards making the risk from these programs small.

However, advocates have raised concerns that these appraisal waivers could present significant risk for GSEs as well as borrowers, and that these waivers could be a slippery slope in the wrong direction. I don't necessarily buy into that concept, but can you talk about the risks that these appraisal waivers present to the GSEs and to borrowers? I guess we will start with Mr. Layton and move down.

Mr. LAYTON. Certainly. We look at appraisals as a piece of information, so we can have comfort in the credit quality of the loans we buy and then put our guarantee on, that is their purpose. They're expensive, the history of appraisals as a technique is they are often good but they have some uncertainty and inaccuracy.

And in the financial crisis they often didn't do very well. So our people put attention to alternative ways to do it. And we have come up with a less expensive—that is to the borrower—way to do it for a modest percentage. Over time we will see how it goes, and we think it is as good, or better than traditional appraisals for that small segment. So we think it is very little incremental risk to us and it is quite a saving to the borrower.

Mr. CLAY. Mr. Layton, I am totally in agreement with that approach. Mr. Mayopoulos, anything to add?

Mr. MAYOPOULOS. I think Mr. Layton has described it very well. We likewise feel very comfortable about this. We have limited the

use of appraisal waivers to circumstances where we think there are appropriate factors to ensure that we have an accurate picture about the collateral value.

Mr. CLAY. And, Mr. Watt, the white paper found that in the majority of cases where a loan was eligible for an appraisal waiver from Fannie or Freddie, the lender or borrower chose to get an appraisal anyway.

Fannie and Freddie claim that these waivers provide benefit for lenders and borrowers by reducing cost and delays, but lenders and borrowers appear to be foregoing these benefits. What does this say about the value of these appraisal waivers?

Mr. WATT. I think it says more about the history of appraisals and the way housing has been done in the past because everybody assumes that appraisals have sometimes more value than they actually provide to the buyer, or to the lender.

So the notion that we could do a modest, small appraisal waiver program and that would eliminate people going and getting appraisals, probably, it is just not happening. But over time, if the appraisal waiver process proves to be effective and people start to understand what it does, it could have some impact.

Mr. CLAY. And as I mentioned earlier, that is a challenge in the St. Louis community in particular because you cannot get fair comparables. Especially when you have someone who has invested in a property, have put a couple \$100,000 into a property and the immediate neighborhood has no comparable properties and so I think it just gives an opportunity for people to get a true reflection of their value. And I thank the three of you for your responses, and yield back Mr. Chairman.

Chairman HENSARLING. OK. Time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTINGER. Thank you, Mr. Chairman. Thank each of you for being here today. Mel, good to see you. We both have served the same district, we know many of the same people. You have had some serious allegations charged against you, I commended Ms. Grimes for the manner in which she processed this out.

At the same time I would say to you, that you are due a due process and you should have your day to fully explain in a court your position and your side of this. So I am not one who jumps to conclusions, and allows the rampant jumping on of an issue to bring a conclusion to any issue.

So with that in mind, I do thank you for the service that you offered, I do have concerns over oversights and abuse of expenditures and moneys. But at this moment I am going to defer to the Chairman of the Committee and give him the balance of my time.

Chairman HENSARLING. I thank the gentleman for yielding. Mr. Watt it is old ground, I don't want to necessarily re-plow it. I would just say this, when we were discussing your legal theory on why you did not have to participate in the first investigation or under the EOC guidelines you published. I know you to be a very intelligent lawyer, but sir it just doesn't pass the smell test and it doesn't pass the American people's outrage test that there are people in Government who expect others to adhere to different standards than they are willing to adhere to.

And I, sir, I just believe that you have made a big mistake, please don't make it on the next investigation. My next question, Mr. Watt, my first question is, there was a scorecard in 2014 that FHFA put forward.

And the goals were set totally at the Director's prerogative in turning, maintaining credit availability, foreclosure prevention, reducing taxpayer risk, building new secondary market infrastructure.

Again, we know that your term is up I think you said January 6th. There will be a new Director. And I guess my line of questioning is geared toward what can that new Director do, and I agree with you, ultimately through three Administrations and five Congresses, I am appalled that we have not been able to find common ground on reforming the GSEs.

But isn't it true that the new Director would be free to eliminate Fannie Mae's HomeReady and Freddie Mac's Home Possible Advantage that has what many people view, including myself, as a risky 3 percent down payment programs?

You are requiring all GSE-purchased loans to have LTVs over 95 or higher. Isn't it true that a new Director would be free to set new goals?

Mr. WATT. That is true, the Director of the FHFA has a lot of discretion.

Chairman HENSARLING. Isn't it true then also a new Director could discontinue the GSE's HARP, or Home Affordable Refinance Program, that enables borrowers with little or no equity to refinance their loans once the program hits its January 2019 eligibility deadline?

Isn't it true that a new Director could discontinue that program?

Mr. WATT. Well the HARP program is going to be discontinued anyway because the usage of it is diminishing over time and we have already set a date. But the director could advance that date, yes.

Chairman HENSARLING. Isn't it true that a new director can increase g-fees?

Mr. WATT. That is correct.

Chairman HENSARLING. Isn't it true that a new Director could suspend all GSE contributions to the Housing Trust Fund and Capital Magnet Fund as required under HERA after a finding that they, quote, "would contribute to the financial instability of Fannie and Freddie?"

If a future Director made that finding, could they indeed suspend all GSE contributions to the Housing Trust Fund?

Mr. WATT. That is correct.

Chairman HENSARLING. Isn't it true that a new Director could set the sole criteria for all GSE REO disposition programs like the Neighborhood Stabilization initiative that the sale of foreclosed homes maximized financial returns to the Government?

Mr. WATT. That is correct.

Chairman HENSARLING. Isn't it true that a new Director could require the sale of the common securitization platform currently jointly owned 50-50 by Fannie and Freddie, and they could sell it into an open market competitive auction to the highest bidder?

Could a new Director do that, Mr. Watt?

Mr. WATT. I am not sure the director would have that authority without serious consultation and approval by the Secretary of Treasury and probably legislative approval, because that would involve disposal of assets.

Chairman HENSARLING. The point is that we have entrusted housing finance reform and concentrated all the risk in two institutions, and we have put one unelected relatively unaccountable individual in charge and given them plenary powers, and this is where we are.

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. I want to thank the Chairman and Ranking leader for calling this hearing and I know that I was in other meetings and not able to be here for the testimony that concerned harassment, but I did want to put in the record that this Congress has taken the issue very seriously and passed a resolution that requires, every year, Members of Congress and their staffs to take anti-harassment information protection to understand what it is, how to prevent it, how to report it, and this is required each year.

We have also passed a bill that tasks the Committee on House Administration with coming out with new regulations to ensure that there is transparency and compliance in the offices and has a lot of protections for victims.

It used to be that a harasser or a Member of Congress would have a free attorney, but the victim would not. Now attorneys are supplied to both for their positions and for getting a resolution to it.

It's a crime that has incredible damage on women, many never ever recover from it. It should be treated seriously and I am pleased that under the leadership of Jackie Speier who authored this and Lois Frankel and really Nancy Pelosi that this legislation has moved forward and been enacted.

I do have one policy question, Fannie and Freddie are known for creating housing, but after the financial crisis, many people were losing their homes and were not able to finance it.

And I would like to ask anyone on the panel, what are you doing to help people stay in their homes? Do you have flexibility to help them pay back their loan, to reach out to them and help them?

They did not cause this financial crisis and many of them have suffered from it and have lost their homes, and I would like to know, are you making efforts to help people stay in their homes and if you are, what are they?

Mr. WATT. I actually address that at some length in my written testimony. I think the industry and the GSEs and FHFA learned a lot from the housing meltdown about mitigation and how to deal with the prospect of default.

So we have revamped all of the mitigation programs to try to speed up the process, first of all to try to anticipate when people are about to default before they default and try to deal with getting to them and figuring out alternatives for them to be able to continue to make their payments.

It used to be that if somebody didn't make their payments, it was perceived to be advantageous to lenders to foreclose. I think that

perception has completely gone 180 degrees in the other direction. It is not either beneficial to the borrower nor is it beneficial to the lender, nor is it beneficial to the GSEs and the investors who back these loans.

So the whole attitude toward dealing with the prospect of default and default after it occurs as has changed over this time.

Mrs. MALONEY. Would the other gentleman like to comment?

Mr. MAYOPOULOS. One thing I would just add to the Director's comments is that you can see these programs in action recently with respect to the terrible hurricanes and other natural disasters that have affected the country, last year and this year. So in the past, we would have and our servicers would have made it much more difficult, frankly, for borrowers to gain relief.

Now automatically both Fannie and Freddie authorize our servicers to give relief to borrowers for up to 3 months without any communication whatsoever and can enter into longer-term forbearances up to a year with communication with the servicer, so there is much greater flexibility and hopefully much greater responsiveness by servicers when people end up in trouble especially for reasons beyond their control.

So I think you can see those kinds of things working very effectively in response to some of the recent natural disasters.

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

Chairman HENSARLING. Time of the gentlelady has expired. The Chair now recognizes the gentleman from Michigan, Mr. Trott.

Mr. Trott. Thank you Chairman. I want to thank the CEOs from Fannie and Freddie for all the progress that the organizations have made over the past 10 years. I have a question on GSE reform but I hope they will have time to get to it. Mr. Watt, this whole discussion today is a bit sad. You have over 30 years of dedicated public service, the North Carolina Senate, 20 years in Congress. You have been at FHFA for 4 or 5 years now and now we are having a discussion presumably in the twilight of your career in public service about Ms. Grimes.

And with that being said, a few things you have said today bother me. So first, we have already discussed that you believe the harassment policy doesn't apply to you because, as you explain it, you are a political appointee and you have no boss. Second, you said you didn't cooperate with the investigation because you didn't have to and then you proudly pointed to page 47 of some document where you said that Ms. Grimes said you never groped, touched, or had been intimate with her. So I will accept that as true since she said it, but omitted in that statement is that you never verbally harassed her or propositioned her noticeably absent.

If I was your lawyer, I would say of those, if that is your defense so far, we have not mounted a very good explanation to refute these allegations. So do you care to provide me any other explanation as to why what Ms. Grimes says is not true?

Mr. WATT. I already provided that explanation in the second point. The first point that you referred to I did say. But the second point was there's ongoing processes that will determine what I did, what I said, what I didn't do, and what I didn't say, whether somebody has tampered with the tapes or not, will be decided in the EEO context—

Mr. TROTT. Absolutely, as the Chairman said, I will reclaim my time sir.

Mr. WATT. Subject to those—

Mr. TROTT. I am going to reclaim my time, Director. As the Chairman said, we are not a court of law that is for sure. But let's talk about some of the things you said and did then. So you mentioned that Ms. Grimes was your mentee. Is that correct?

Mr. WATT. Yes.

Mr. TROTT. OK, so should a mentor comment in a sexually provocative way regarding a mentee's experience, yes or no.

Did you ever comment to Ms. Grimes about her sexual experience?

Mr. WATT. I would not think so but—

Mr. TROTT. But did you—you have a summer home correct?

Mr. WATT. Pardon?

Mr. TROTT. Do you have a summer home in North Carolina?

Mr. WATT. Yes.

Mr. TROTT. Did you ever invite your mentee to your summer home?

Mr. WATT. I have invited male and female—

Mr. TROTT. We are just talking about Ms. Grimes right now.

Mr. WATT. Mentees to—

Mr. TROTT. Did you invite Ms. Grimes to your summer home?

Mr. WATT. I did not.

Mr. TROTT. Ms. Grimes has never been to your summer home.

Mr. WATT. No.

Mr. TROTT. OK.

Mr. WATT. And I did not invite her to my summer home. I told her if she wanted to use it for her own purposes or if she was going to North Carolina and I have offered that to other employees, male and female.

Mr. TROTT. Just to reclaim my time sir. Have you ever been at your summer home, however fortuitous it may have been and Ms. Grimes was there as well?

Mr. WATT. No.

Mr. TROTT. Did you ever suggest to Ms. Grimes that you meet outside work to avoid any staff perceptions?

Mr. WATT. Yes.

Mr. TROTT. OK, and did you have dinner just one on one with Ms. Grimes a few times?

Mr. WATT. Yes.

Mr. TROTT. Did you ever ask Ms. Grimes to call you off the books?

Mr. WATT. No.

Mr. TROTT. No, OK. During one of the dinners with your mentee, did you ever say to her, Well you probably wanted to know what I wanted to talk to you about? I mentioned to you there is an attraction here that I think needs to be explored. In my experience there are four types of attraction: Emotional, spiritual, sexual, or friendship. So the exercise here is to find out which one exists. Did you ever make such a comment?

Mr. WATT. I absolutely think if you are going to mentor somebody, you have to know what they are thinking—

Mr. TROTT. About attraction?

Mr. WATT. I don't have any recollection.

Mr. TROTT. I have a lot of mentees, I have never discussed attraction with any of them.

Mr. WATT. Well then you haven't mentored them and figured out if they are giving the wrong vibrations and you are not clear with them what the expectations are, I think you have problems.

Mr. TROTT. I am pretty confident I am a pretty good mentor over the years. Did you ever ask Ms. Grimes about her tattoo?

Mr. WATT. I don't recall.

Mr. TROTT. Don't recall, OK. So I thank you sir. I hope this process plays out and after 30 plus years, you have a few months to go and I am surprised you haven't resigned from FHFA but I will leave that to you.

I have a quick question in my last 20 seconds for the GSEs. So a good friend of mine from Fannie Mae, Mike Quinn, suggested many years ago to me—he was the head of credit risk at Fannie Mae, that the easiest way since Congress can't get GSE reform done since it is so political and so partisan is to get Fannie and Freddie out of the refi business. Wouldn't that be a simple way? I recognize the liquidity in the secondary market for middle-class families trying to refi, but on balance that would be an easy way because I think 2/3 of your portfolios are refi. Just a quick comment on that solution, as simple as it may be.

Mr. MAYOPOULOS. That is obviously a policy decision for a body like this to make. We are in the business of providing liquidity and that is what we do currently today. It's obviously up to policymakers to decide how broad and wide that program should be.

Mr. LAYTON. There are really two separate issues. Refis are, as Tim said, a policy issue whether we are allowed in the business, but whether we are in it or not, that is not going to end conservatorship. That doesn't raise capital. That doesn't give a government guarantee or change the unpaid implicit support.

Mr. TROTT. Thank you, I yield back.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentlelady from Arizona, Ms. Sinema.

Ms. SINEMA. Thank you Mr. Chairman and thank you to the witnesses for being here today. Mr. Chairman, no one, no matter how powerful they are or to which political party they belong, is above the law. And when a Government official is accused of wrongdoing, we, on this Committee, must be committed to finding the facts, conducting rigorous oversight, and holding those who do wrong accountable.

Director Watt, I am deeply concerned by allegations that you sexually harassed an employee at your agency, while serving in your capacity as Director. These allegations require a full and impartial investigation so that we can learn the facts and take actions.

Sexual harassment is always wrong, and those who engage in this hurtful behavior do not deserve our trust and should resign. My question is not on the claims, but on your refusal to cooperate with an independent investigation of the allegations against you. The Office of Equal Employment Opportunity at FHFA requested an independent agency investigate and report on these claims.

They tasked the U.S. Postal Service investigators with producing the report, but you refused to comply with their investigators. You

argued, in part, that because you are a Presidential appointee, you are not subject to your own anti-harassment policy. But current law and the EEOC's own website make clear that our laws prohibiting discrimination and harassment apply to all employers and apply in every aspect of employment.

Common sense dictates that this law covers everyone, from the most junior hire to the most senior executive. My question to you is, can you cite specific statute or court precedent that concludes that you, as a Presidential appointee, should be treated differently for the purposes of Federal employment law?

Mr. WATT. I have cited the statute, and that has been made a part of the record in response to a question that the Chairman asked. But, be clear that I am not above the law. I don't believe that I am above the law. The EEO process will play itself out. It will—if you think I am not going to be part of a process by which these allegations are determined, you are just wrong.

I am not part of that Postal process, but I am cooperating with the OIG and there will be an EEO process that will apply to me and everybody else in this case.

Ms. SINEMA. So Director Watt, you believe that the anti-harassment policy statement that you signed in August 2017 does not apply to you in the same way it applies to other employees at your agency.

Mr. WATT. In this enforcement, it does not apply to me, and as obligations not to harass, it does apply to me. But, and I have explained this, I have tried to explain this as well as I can. When the Postal Inspector investigator finished his report, the report then comes to our agency.

If there's a determination that something has been done wrong, there's nobody in the agency who has the authority to take action against me.

If that investigation was being done for the President of the United States, it would be a whole different thing, because there's somebody above me who has the authority to take action. But there's nobody in our agency to accept that report and take any action based on it.

And I have tried to explain that. I am trying to avoid participating in multiple investigations, to be quite honest, because they are expensive and they are time consuming. But I am—if you think I am going to—I am trying to avoid or will avoid all investigations, that is just not the case.

Ms. SINEMA. So Director—

Mr. WATT. Equal employment opportunity law applies to every employee in the world, in the United States. Federal employees, private employees, they—I still have to go through that process.

Ms. SINEMA. So Director, you believe that, since you were not legally required to follow the anti-harassment policy, in this instance, do you believe that you have an ethical or professional duty to do so?

Mr. WATT. I think I have followed the policy. I haven't followed the process that policy anticipates, and I have tried to explain why.

Ms. SINEMA. Mr. Chairman, I know my time is expired. If I might, a few more moments?

Chairman HENSARLING. The Member may proceed.

Ms. SINEMA. Thank you. Mr. Chairman, I am not satisfied with the Director's answer, and I don't think that the folks that I serve back home would be satisfied with this either. Frankly, people back home are sick and tired of politicians and bureaucrats who think they can play by a different set of rules.

So if we need to tighten our laws to clarify that everyone must follow the law and comply with these investigations, then, Mr. Chairman, I would call on my colleagues, anyone who is willing for us to join together and do just that. Thank you, Mr. Chairman.

Chairman HENSARLING. Time of the gentlelady has expired. The Chair now recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. I thank the Chairman for the time. And one of the obligations of the Congress, under the Constitution, is oversight. And I want to thank you and the Ranking Member for the way you have conducted the hearing today.

It's a difficult topic, and I think the Ranking Member and the Chairman deserve the recognition of our Members, joint Members in organizing and holding this hearing. It's been a difficult one, and I appreciate your leadership.

I would like to start with Mr. Mayopoulos about a Fannie Mae question I have. It applies to both Freddie and Fannie, but let me start with you. Back in the Dodd-Frank debate, Chairman Frank said that the profligate availability of credit is a major reason for the current problem. That is the housing crisis.

Too many loans were made to people who shouldn't have gotten them. We need to reduce the pattern of people getting loans who shouldn't have gotten them because they couldn't repay them. And he was talking about the obligations under Dodd-Frank to limit the debt-to-income ratio and create the definition of a qualified mortgage that all financial institutions are obligated to have when they originate a loan.

But as I understand it, there's an exception in the bill that is referred to—if a loan is eligible for purchase by one of the GSEs, they don't have to follow that rule that Mr. Frank felt was so very, very important and such a compelling part of bad organization policies leading up to the crisis.

So I would like to understand why you have gone, at Fannie, from 12 percent of loans that are over 50 percent debt-to-income—not 43 percent, which is the qualified mortgage test, but 50 percent in 2013 to now 36 percent of loans in March 2018. Why is it that you have such an appetite for loans that are well above the 43 percent DTI?

Mr. MAYOPOULOS. Thank you for the question, Congressman. I appreciate it. And certainly, I would agree with you that loan origination standards, before the crisis, were quite poor. Credit standards deteriorated quite substantially, and there were lots of participants in that deterioration.

But I do think some of the blame also lies with Fannie and Freddie, leading up to that. We have certainly taken that to heart, we have learned our lessons, and we have imposed what we believe are good, sustainable credit standards.

We don't believe, and I think the evidence bears this out, that there is one and only one factor that determines whether a loan is a good loan or not.

Mr. HILL. Well look, I think a lot of bankers agree with that. But, the U.S. Congress didn't agree with it. I had a real problem with it when I was in the private sector, but that is what the law is in Dodd-Frank.

Why is what is good for the goose not good for the gander in this instance?

Mr. MAYOPOULOS. That's been a policy judgment that—

Mr. HILL. Who made that policy judgment?

Mr. MAYOPOULOS. Fannie and Freddie did not make that policy judgment, that was—

Mr. HILL. Did the Director of FHFA make that policy judgment?

Mr. MAYOPOULOS. No, I believe that the Congress made that policy judgment.

Mr. HILL. And based on what facts?

Mr. MAYOPOULOS. I don't know, I wasn't present for that debate and that decision. But what we have attempted to do is to apply good credit standards. So we consider debt-to-income, we consider loan-to-value, we consider people's ability and willingness to repay, we consider their credit history—

Mr. HILL. Isn't this a loophole right now that is allowing that market to creep up in a way that is not available to community banks across the country, and I would turn to Director Watt and seek your view on that from a prudence point of view as the conservator of these two organizations, that even if it were permitted by law in this GSE patch as it is referred to colloquially, isn't it a poor financial practice to let it go from 12 percent of loans purchased to 36 percent in a very short period of time?

Just an answer based on your knowledge as Director, but I mean—or you can answer personally. But either way, I would like an answer.

Mr. WATT. My answer both personally and as Director is that does not necessarily mean that is imprudent going—

Mr. HILL. Well I think a lot of bankers wouldn't say it was prudent either. A lot of factors that go into it, but that is not what the Congress determined for originators.

Mr. WATT. But understand that neither Fannie nor Freddie makes loans, so if bankers have that opinion, nobody is forcing them to make those loans. So neither Fannie nor Freddie make loans.

Mr. HILL. But they used to set the gold standard. My time has expired, Mr. Chairman.

Chairman HENSARLING. 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. Duffy, who was here earlier today, and I have had a number of meetings, our offices are across the hall from one another. And so we have gone over to each other's offices quite a bit, talking about GSE reform.

And, I made myself clear, I think that the secondary market has to take steps to make sure that we can continue to produce more affordable housing, particularly in States like mine where the Governor unilaterally discontinued low-income tax credits.

And, of course, I believe in the Government backstop. There are a lot of folk who have a lot of ideas and many of them have shared those with Mr. Duffy and I.

I am wondering Mr. Watt, as well as the two CEOs from Fannie and Freddie, do you believe that we need GSE reform, and if so, what would be most critical?

Mr. WATT. I have been beating that drum for 5 years as the Director, and probably was beating it as a Member of Congress before that. But yes, I definitely think the conservatorship is not a sustainable form.

And a lot of the issues really that are being raised today about what Fannie and Freddie should or should not do, this is the result of this protracted period of conservatorship where you have basically staffs of 600 to 700 people, which is what is in my agency, trying to micromanage the housing finance market, which has thousands and thousands and thousands of participants in it to a conservatorship.

It's just not a sustainable model, and until Congress takes steps to get us out of it, I just don't—we are doing everything that we can do to maintain a good, vibrant, efficient market.

And to make sure that Fannie and Freddie are doing their part of the market responsibly. But this degree of uncertainty about what the future of housing finance in this country is, is just not good for anybody.

Mr. CLEAVER. Mr. Mayopoulos, should we just label the GSEs as SIFI and be through with it?

Mr. MAYOPOULOS. Well thank you for the question, Congressman. Clearly there has been a lot of reform at Fannie and Freddie under the leadership of FHFA, both under Director Watt and Acting Director DeMarco before him and Director Lockhart before him.

So lots and lots of positive change has occurred, but the tax-payers are still exposed to what seems to be an ill-defined potential exposure. The amount of private capital that is willing to come into this market I think is substantially reduced so long as this uncertainty exists, and we will continue to have some of the debates that we are having today, so long as we continue to operate in conservatorship.

So to me, housing finance reform is absolutely essential if what we want to have is a vibrant housing finance system, because we won't get market participation otherwise. The other thing I would say is we spend a lot of time talking about housing finance reform.

The fact of the matter is the country has a serious housing challenge, the country needs a housing strategy. There are many people who cannot get access to good, affordable housing whether it is housing they own or housing that they rent.

And we are spending too much time debating housing finance as opposed to how do we give people good housing. That should be a primary focus.

Mr. CLEAVER. Mr. Layton.

Mr. LAYTON. Yes, sir. I will just add two points to what has already been said. There are many ways to do GSE reform, it is absolutely necessary in the long run. As per my testimony, there's certain minimum flaws in the old system which should not carry over.

Any version should have those flaws removed. Inadequate capitalization was not a good idea, the unlimited investment portfolios was not a good idea, the unpaid for implicit Government support was not a good idea.

Those things should be a minimum, so I just put that out there. Building on Tim's comment about the housing problem, the problem is housing production of units whether rented or owned, this country, based on averages, should be producing 1.5 to 1.6 million a year and we are only producing about 1.3 million. That is the problem.

Mr. CLEAVER. Well thank you, Mr. Chairman.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentleman from Georgia, Mr. Loudermilk.

Mr. LOUDERMILK. Thank you, Mr. Chairman. I thank the panel for being here. Director Watt, I actually have a different line of questioning I want to get into. But you said something a minute ago that is just weighing on my mind so heavy.

I am having a hard time getting over this as a father and as a husband. Mr. Trott asked you about your line of questioning in mentoring someone regarding attraction that do you think that is an appropriate response, much less the responsibility of mentoring, is probably the most ridiculous thing I have ever heard since I have been in Congress.

I can't imagine that anyone in a management position would think that would be a part of mentoring, much less, appropriate. So I don't expect you to respond. In fact, I just needed to say that to get that off my mind so we can move on to other issues.

Director Watt, I don't know if you saw the previous panel with the FHFA IG, but I discussed an e-mail among Mr. Mayopoulos and Fannie board members that I believe shows a profound lack of respect and understanding for a company that is in FHFA conservatorship and has taken more than \$116 billion in taxpayer funds. I will read the e-mail again which is from Bart Harvey, the head of the nominating and governance Committee and Chairman of the board.

The e-mail says, gents, I have seen it all now, that the OIG could report this to the House Financial Subcommittee is astonishing in Mel's placation regime. That OIG quotes, as the FHFA agreeing with the majority of its reports on MRAs gives rise to another potential wave of regulation by FHFA.

If I were a Member of the Committee and got this report, I would have a cow. That 5-plus trillion of assets may not be operated in a safe and sound manner.

As we know on the board, financial oversight exceeds anything the private sector gets by a multiple degree even if a lot of it is wasted time and energy. The single biggest waste of time, money, and talent are the dueling agencies, someone, Mel, ought to tell the House the load of crap the OIG has heaped on them, but he won't. The games being played are a waste and abuse of taxpayers' money and stymie real progress and we accept them, getting out of conservatorship is the only answer to this pollution foolishness—best, Bart.

My question Dr. Watt is, I realize you often have legitimate differences of opinion with the IG and I respect that, but are Mr. Harvey's comments an appropriate response to oversight?

Mr. WATT. Certainly not an appropriate external response, but I don't know the circumstances under which this was written, whether it was internal, whether it was just blowing off steam. He certainly couldn't have expected me to come over here. I think the e-mail actually says Mel is not going to do that. But he puts his finger on a very serious thing, which is the very thing that I have been saying, conservatorship is not sustainable.

Mr. LOUDERMILK. That is a difference of opinion.

Mr. WATT. I can't control every single thing that people say internally, we don't have that capacity. And I am not subscribing to what he said, but his final point was, we have to get out of—

Mr. LOUDERMILK. And I understand that. And that is why I said I think a difference of opinion, I can understand that. My question is about the appropriateness of this response. Mr. Mayopoulos, are Mr. Harvey's comments an appropriate response to oversight?

Mr. MAYOPOULOS. No, Congressman, they are not. They don't reflect my personal views, they don't reflect the views of the board or the management team. I don't think that is an appropriate thing for Mr. Harvey to have communicated in the way that he did. But, as Director Watt said, it was an internal communication among a very small number of Directors, and—but you didn't see me concurring with Mr. Harvey's comments.

Mr. LOUDERMILK. Thank you for your direct response. Last question, Director Watt, on a different topic, have you ever stated that the hiring process at FHFA can be a charade process due to your ultimate power to make decisions one way or the other or for any reason whatsoever, and have you ever engaged in a charade process as it pertains to hiring?

Mr. WATT. I have certainly tried not to engage in a charade process and I think when the full text of these conversations comes out, you will see that was a totally different set of circumstances, that didn't even apply to Ms. Grimes in fact.

Mr. LOUDERMILK. Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. Director Watt, this morning, I have said, and I have said it previously, that the allegations that are against you are of course deeply concerning and should be treated as such and that there should absolutely be a thorough and expeditious investigation to get all the facts, and action should be taken accordingly after all the facts are in. I have also said this morning that I have three daughters, as you know, and that is very worrisome to me when you hear any allegations like that particularly, and I admitted, is when it comes from friend. But that is how I feel, I said I know how it would feel if something as alleged by Ms. Grimes was my daughter, I would be very upset about that.

I have been at another hearing, in and out all day, I haven't had a chance to hear all of your statements, et cetera, and what the questions were. So what I will simply do right now is just to ask you if there's anything else that you would like to say that may have not been asked or anything at that time, because as I said

we want to hear all the facts from everyone in that regard. And so I don't know if there's anything else that you would like to say at this particular time.

Mr. WATT. I would certainly emphasize that if anybody here has the notion that I believe that I am above the law, they should dis-suade themselves of that notion. I have explained why I did not participate in the Postal Investigator's process but there is an FHFA IG process that I am fully participating in and there is an EEO process that has already started that I will participate in.

So there's going to be plenty of opportunities for the facts to come out and for Ms. Grimes to be heard and for me to be heard about the context of whatever was said. And I fully appreciate the process. So I will stop there. I just think, I am as disturbed, I guess, as you are about if these allegations were true. But I just don't think this Committee is going to be able to determine that, that is going to have to be determined in a legal process.

And I think that is the appropriate place for it to be determined, because there are rules of evidence, there are requirements, there's a whole set of due process that is associated with that that will give both Ms. Grimes, and me, the opportunity to be given due process.

I participated in that due process, legal process, for 22 years before I came to Congress, and I know that it is probably the best for sorting through contested facts and law.

Mr. MEEKS. Thank you. I wanted to get in a substantive question, I don't know if I can have the time. But because there was May 22, DOJ indicted four individuals for a multi-dollar mortgage fraud in New York.

And it was applied—I am talking about multi-family housing. So my question really was, is the issue that the Congress should revisit to include multi-family housing so they could make sure it still fits under Dodd-Frank? Something specifically on multi-family housing there.

Mr. WATT. Well I think in single family housing, and in multi-family housing there's always a small group of people who are going to try to game the system or defraud, or do something illegal.

There are laws on the books that say you shouldn't do that, of course. And these people will be caught in the great majority of cases but assessment of whether apartments are occupied or not occupied—generally done by the lender, not by Fannie or Freddie—individually.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes gentleman from Florida, Mr. Ross.

Mr. Ross. Thank you, Chairman. Mr. Chairman, as a lawyer I have been a student of the law and I have always had a strong passion for the independence of judiciary as well as the fundamental nature and right of due process.

And regardless of the outcome, Director Watt, I hope that at the end of the day that, with this matter before you and those that are contemporaneously occurring and may ensue later on, for whatever reason—and I hope not, but that we as a body can say that due process was never denied and that justice took its course.

What I would like to do now is talk to you a little bit more about responsibilities of your business, and specifically with credit risk

transfers. We all know that the GSEs have amassed amazing amounts of liability and risk to the detriment of taxpayers.

And to your credit, Mr. Watt, you have engaged in and started a credit risk transfer program that, from one who believes in responsible risk management and for the opportunity for the Federal Government to cede some of that risk elsewhere to the capital markets, because I firmly believe there is sufficient capacity out there to meet the need to reduce that risk.

I would like to ask a few questions related to that program today. Mr. Watt, in your testimony, you say that a portion of credit risk has been transferred on more than \$2.47 trillion of unpaid principal balance since 2013.

You also note that, in 2017, the enterprises transferred a portion of credit risk on \$689 billion of single family mortgages. These are impressive numbers, but what concerns me is the qualification of a portion has been ceded to the credit risk transfers. What you have told us is there's some amount of risk that has been transferred from the total portfolio for unpaid balances and single family mortgages.

But you have not actually given us an amount of what that portion is, or into that insight. So I wanted to give you some opportunity now, and Mr. Mayopoulos or Mr. Layton, you may also speak to this of, what is the quantification of that portion of credit risk transfers that has been employed with the GSEs?

Mr. LAYTON. Might I go first?

Mr. ROSS. Sure.

Mr. LAYTON. My testimony, the written testimony gave the numbers. The quantification is hard to do, but the FHFA has recently put out a proposed capital system, and in there a quantification is possible. For new flow single family mortgages, for the last few years, 60 percent of the capital that would be required for the credit risk has been laid off to the private markets. We just did a new and enhanced structure where—

Mr. ROSS. Sixty percent of the liability—

Mr. LAYTON. The credit—the capital we would need for the credit risk has been laid off—to the private market. We just did a new enhanced structure where the number is over 80 percent in our multi-family business, the number is 80 to 90 percent.

Mr. ROSS. Now are these frontend or backend? Are these where we see the risk on the securitized mortgages, or—

Mr. LAYTON. The answer is the vast majority is backend because they have proven more efficient to do.

Mr. ROSS. But doesn't that adversely impact the market? I mean, if we are not doing—shouldn't we have a balanced portfolio? Shouldn't we have those on the backend being seated as well as those on the frontend through the private mortgage insurance organizations?

Mr. LAYTON. Doing credit risk transfer on behalf of and officially for the taxpayer, means a lot of math and a lot of issues about what investors are willing to charge us to take the risk off their hands—

Mr. ROSS. But that is all the market, we have to have the market forces play into that. What you are essentially doing is you are saying you are taking the less credit risk—the ones that are the

cherry picked if you will, and give it to the market without allowing for the upfront—the ones that have the greater risk, to be assessed and managed by the markets by putting everything in the backend. You have 95 percent in the backend.

Mr. LAYTON. The backend just means it is done later in the process, the risk taking is exactly the same at the end.

Mr. ROSS. It's the same. So you are telling me that the backend risks don't take any of the frontend risks? That they don't take the first percentage of risk?

Mr. LAYTON. I think there's a communication problem here.

Mr. ROSS. Yes.

Mr. LAYTON. Backend and frontend means when it is done in the process, you are talking about whether it is first loss, near first loss—how far out it is. And so if I wanted to buy private mortgage insurance and require that, that would be a frontend risk. That is a—they tend to do a first dollar loss risk—

Mr. ROSS. Right, but how much have you acceded of that? How much of first dollar loss have you ceded?

Mr. LAYTON. I don't have the numbers, but the largest credit risk transfer traditionally has been, in fact, that kind of private mortgage insurance on all our high, on virtually all our high LTV, that is already sent, LTV business.

Mr. ROSS. One last question, just because I want to make sure that this charter creep. You all have been playing the—you are the market. I mean, you said that in your testimony earlier. Can you comment on what GSE's role is in how to ensure that lenders, mortgage insurers, service appraisers, and other market participants are not pushed to the sidelines by GSEs? Anyone?

Mr. MAYOPOULOS. First I would say I think what we provide is, actually both companies provide a platform for lots of market participants to participate in this market. I mean, the reality is that, as Mr. Layton pointed out in his opening statement, small and medium-sized lenders get to spend in this market in a way that they—

Mr. ROSS. And I know my time is up, but you have an unfair competitive advantage is the bottom line.

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

Mr. HECK. Thank you, Mr. Chairman. Mr. Layton, you are my new guy. Thank you.

Mr. LAYTON. OK.

Mr. HECK. Thank you for saying succinctly that which I have been trying to get more people to say louder in more places for some time. We have a housing crisis in this country that is caused by a severe underproduction of housing units of all kinds. We need to build more houses of all kinds and shapes and sizes for all our neighbors. Period. Now let me tell you a quick story as a preface to a question I will ask.

I have a friend who sold his very modest three-bedroom home in Northwest Seattle a couple years ago. An older home. A nice little home. Not big at all. He chose from among—I believe the number was 17 competing offers on day one of listing and he ended up selling his home for \$150,000 more than he asked for it. The reason, we don't have enough inventory.

We don't produce enough housing units. And I want to remind everybody why this is important. Failure to correct the break between demand and supply—this isn't a demand problem; this is a supply problem—holds back the growth of the economy. Every recession in modern history has been led out of by housing construction until this one, which is part of why it was so anemic and lasted so long. And the reason's obvious, as I like to say. When you buy a home, that transaction doesn't stop when they hand you the key to the door because you replace the doorknob and the curtains and you do landscaping and you do furniture, et cetera.

It's a very powerful propellant of our economic engine. But even more insidious and important, is that when we make it unaffordable for people to be able to purchase a home—and this is a rental and homeownership question—it defers the beginning of the single most powerful and important net worth building program that most Americans have. This is a crisis and it is under-production for the very facts you stated earlier. So here's my question. Why and what can we do about it?

Mr. LAYTON. Well thank you for the question.

Mr. HECK. You are my new guy.

Mr. LAYTON. Yes. It is overwhelmingly not a housing finance issue. The GSE's can at the margin, and do at the margin try to help, but it is primarily a production problem. In the usual way people point—

Mr. HECK. Excuse me, Mr. Layton. When I say what can we do about it, I didn't mean that this is miserable. I want to say what can we do about it. I did not mean the GSEs. I mean what can we do about this serious underproduction problem?

Mr. LAYTON. My understanding of the problem and big problems like this don't have one single cause. I have seen the problem laid at the feet of everything from shortage of labor, which went to other jobs after the financial crisis and house production, shortage of materials, NIMBY-ism, extensively—

Mr. HECK. Which relates the availability of land for construction.

Mr. LAYTON. Yes. Or zoning, allowing more dense housing versus less dense housing, a preference for urban housing in the country, that has been a big shift, and it takes a lot longer to produce housing in urban areas than usually in the suburbs, in terms of clearing land and getting permits, towns charging very large amounts for building permits because—

Mr. HECK. The smallest home in my hometown, before you even begin construction, has an average of \$42,000 in impact fees.

Mr. LAYTON. Right. So—

Mr. HECK. Now factor that into the affordability of starter homes.

Mr. LAYTON. So I have given talks as part of my job, in which I call for, I hope that policymakers do a broad-based look at all this because it is many things causing this problem.

Mr. HECK. So as it relates to the GSEs, what, if anything, do you do with respect to construction loans? Because I am with you, this isn't a housing finance issue for the consumer but it is for production. So what you do with respect to ADC any of them—for multi-family units?

Mr. LAYTON. There are two things related to specifically supply in multi-family. One we do and the other is a discussion with the FHFA, some additional things we might do in pursuit of our mission. What we currently do today is we have an emphasis on redevelopment or refurbishment loans to prevent housing from falling out of the housing stock through not having enough money to be maintained. That is both something we like doing and have some programs on.

Part of them are under the new Duty to Serve regulations. One of them is the just announced pilot we have to do mezzanine financing, which is exactly targeted at this kind of housing to be fixed up and maintained. And construction lending is an ongoing topic. It has not been a tradition of the GSEs to do that.

Mr. HECK. I would simply encourage you to do anything and everything you can to promote increased production. And I thank you for accurate and important and compelling problem statement. I yield back, Mr. Chairman.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you. I would like to yield to the Chairman.

Chairman HENSARLING. Well I thank the gentleman for yielding. Mr. Layton, it has been a long time since you issued this comment. And let me say that I could not admire your credentials more and my understanding is you did not seek this job, the job sought you.

Thank you for taking it on, sir. I don't want to put words precisely in your mouth, but I think in your opening statement you said either we have a far safer and sounder housing finance system or we have a safe and sound housing finance system, something along those lines.

Mr. LAYTON. I said we had a safer, sounder housing system than we had 10 years ago.

Chairman HENSARLING. I would just say for the record, we did have a previous hearing on the GSE topic and we heard from Mr. Watt's predecessor, Ed DeMarco, who believes that systemic risk is growing in the system, not fading.

We also heard from Ed Pinto, who is a former chief risk officer of Fannie Mae who believes that basically the same thing, that he is seeing risk increase within the system and believes we have a risky government housing policy and an unsustainable home price boom. So I just wanted to let you know there are some other informed opinions who believe that maybe things aren't quite as rosy. Director Watt, another question for you.

In May, Bloomberg reporter, Joe Light, issued a story entitled, "Fannie Mae Advocacy Ban doesn't Stop Lawyer from Pushing Views." I trust you are familiar with the story. Are you familiar with the story?

Mr. WATT. I am generally familiar with the issue. I don't know about the specific story.

Chairman HENSARLING. It has been reported that despite your ban, and when I say your ban, it was put in place by one of your predecessors on quote, "all political activities including lobbying."

The story says that quote, "a top Fannie Mae executive has done just that over the past few months, quietly meeting with people inside and outside President Donald Trump's Administration."

The story went on to state that such lobbying happened on multiple occasions with multiple parties, with a Fannie executive stating quote, "he believes that many of FHFA goals can be achieved without Congress through modification to the companies' bail out contracts with the Treasury."

So Mr. Watt, when did you first become aware of these allegations that Fannie officials have been engaged in lobbying activities?

Mr. WATT. These specific allegations I have found out recently when we started to produce documents in response to the Committee's request. There is a ban as we as you—

Chairman HENSARLING. So you acknowledge the ban.

Mr. WATT. Yes.

Chairman HENSARLING. That is the current policy.

Mr. WATT. Yes. That is the current policy and we have gone out of our way to say to both management and boards that neither they nor we should have a position on housing finance reform.

Chairman HENSARLING. Director what—

Mr. WATT. You have heard me say that over and over again.

Chairman HENSARLING. But what does FHA do to monitor this and what are the consequences for violating the lobby ban?

Mr. WATT. The notion that 600 people could monitor everything that is being done by both of these enterprises is one of the fallacies of conservatorship. So we tell them not to do it. When we find out that they violated it, we try to take action and reinforce it and tell them again not to do it.

Chairman HENSARLING. I am not saying there's a challenge. But I think what I hear you saying, there's not really a formal monitoring process then, correct?

Mr. WATT. There is. The requirement is that if they are going to have meetings, we expect them to notify us. We expect them to take one of our staff with them.

Chairman HENSARLING. And how about consequences? What are the consequences for violating the ban?

Mr. WATT. There are no real consequences other than, what do you say if somebody says hey, I have a personal opinion. I was in a meeting, somebody asked me my view. I don't know that there's a real consequence.

Chairman HENSARLING. The time of the gentleman has expired. He was kind enough to yield to me. But I think, Director Watt, that is part of the problem. And listen, it goes beyond you but when I look at this system, what I think I am hearing is, again, there's no consequence for violating a lobby ban if you work for GSEs.

Heightened credential standards applied to every systemically important financial institution but the GSEs. The qualified mortgage applies to all financial institutions but the GSEs, and the FHFA policy on any harassment applies to all employees but the GSEs regulator, the head of FHFA. I would just submit for the record this is a problem.

The time of the gentleman has expired. The Chair now recognizes the the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you Mr. Chair and to the Ranking Member. To the panel who are here today. I had originally planned to come today and ask questions about the oversight of the Federal Housing and Financial Agency's role as conservator and regulator of GSEs.

You may or may not know, I have long history in housing. Unfortunately after sitting through the first panel, I decided that I would not talk about the housing issues and I would really make an opening statement and then direct a question to you Director Watt.

It was difficult this morning when I walked in here and listened to Ms. Grimes' statements, read much of the information she had provided, and listened to tapes. As a woman, as a woman of color, a woman who had to work my way up the ladder to success; the time that we are in now with women fighting, with me marching for MeToo, today is very sad and difficult and painful.

To you Director Watt, someone who mentored me, helped guide me through this very Committee that I am on, makes it even more difficult. When I think about her three complaints that she listed, I was very disturbed when she asked for her anonymity.

I was very clear in the panel too that I did not like that the Office of the Inspector General had called and shared with you her name. Nor was I pleased with the answers that she provided me. As a matter of fact, I was appalled. I was sad.

More importantly, I have fought for equal pay for equal work as a hallmark and in the forefront of my advocacy. While I appreciated your comments, Director Watt and Ms. Grimes, stating that there was no sexual contact; she was very clear in her statements matching yours.

Further she applauded you for your housing work. But she felt that she has been sexually harassed. She felt that there was hostility in the work place and uneasiness for her to come to work.

She also stated that she had worked two jobs and not been compensated with equal pay for equal work. She also has provided to us and others that there was some disparity with white men and their pay and African-American or minority women.

She asked us for resolve. She did not appear to be bitter or angry; she appeared to be disturbed and I am disturbed. I have a few questions.

I would like to ask you Director Watt, does Ms. Grimes still report to you and do you think it is a problem for an organization or an agency that someone who has alleged sexual harassment should still have to report to the people she alleges harassment?

And would you be willing to allow Ms. Grimes, if she still does report to you, to directly report to a third party? You can answer that, and then last if there are any comments that you would like to make.

Mr. WATT. Ms. Grimes has never reported directly to me.

Mrs. BEATTY. Does she report up to you in any way?

Mr. WATT. Everybody in the agency reports indirectly to the Director. I mean, the Director is in that sense everybody reports to me. But she has never reported directly to me.

Mrs. BEATTY. But do you all have direct contact about her work or her promotions or her path—

Mr. WATT. Very little contact. And that is what makes this so difficult, because unless you know the factual circumstances of all of this, you really can't assess it.

And it will be assessed. I mean I hear exactly the frustration that you are feeling. I feel the same frustration. You asked me can I move in such a way that she doesn't report to me? Well—

Mrs. BEATTY. Let me ask this because I am going to have to reclaim my time. Is there any way you could have or could get her the equal pay for the work, change her title to as the top. Would there not be some influence if you were aware of this?

And assuming from what we have read and the tapes, that you all have had conversations about her employment.

Mr. WATT. I have made a number of efforts to try to be of assistance to Ms. Grimes to move her through the process. But there are certain things that I—

Mrs. BEATTY. So any reason she didn't get through the process? Is there any reason that she didn't get equal pay for equal work?

Mr. WATT. I don't know that. I do not know that. And I don't have the capability to determine it on my own. And now I have been removed from the process because I don't—there's really nobody in the agency who really can make these decisions anymore.

So, it is frustrating to me. I can't reorganize the agency, especially with reference to her complaints because I have had to disqualify myself from any decisions in this process.

So, I mean I can understand her frustration, I understand your frustration. But to presume, before there's a fact-finding process, there has in fact—

Mrs. BEATTY. I think my time is up, Director Watt. I yield back my time.

Chairman HENSARLING. The gentlelady's time has expired. The Chair now recognizes the gentleman from Maryland, Mr. Delaney.

Mr. DELANEY. Thank you, Mr. Chairman. And I share the same sentiments as my friend and colleague from Ohio. I would like to ask Mr. Layton and Mr. Mayopoulos questions about comprehensive housing finance reform.

As you are probably aware, the Chairman and I introduced bipartisan legislation. But after this morning's testimony by Ms. Grimes which I found to be credible and highly persuasive, I am going to direct my questions to you Director Watt.

But I do want to thank Mr. Layton, Mr. Mayopoulos for being here. And thank you for leadership in these organizations. You and your fine teams have done a great job stabilizing these institutions for the benefit of all Americans.

And I hope you continue to be a strong voice for housing finance reform into the future. So thank you for being here.

Director Watt, this is a disappointing hearing because I, like most of the colleagues on this panel, know you as a man who has dedicated most of your life to fighting against injustices. And you should be commended for that.

But the testimony of Ms. Grimes this morning was very disappointing to me and I know to my colleagues. And as someone who spent my life prior to coming to Congress starting and leading two companies that ultimately became public companies, I believe that the tone at the top is incredibly important in any organization.

Whether it be a business, a nonprofit, and certainly the Government. And I think we are lacking of the right tone at the top in Government in particular these days. And I just wanted to ask you some questions to see if you agree with that assessment.

Do you believe that a leader should do everything they can to cultivate a workforce or workplace that is free of harassment?

Mr. WATT. Yes.

Mr. DELANEY. Do you believe that a leader should act in a way that sets a clear example for the entire organization?

Mr. WATT. Yes.

Mr. DELANEY. And do you believe that the personal conduct of leadership personnel is important to that mission?

Mr. WATT. Yes.

Mr. DELANEY. So in light of the way you answered those questions, I would like to ask you, why do you then hide behind language or quibble with whether a standard that is very clear should also apply to you, because we are going to actually change the norms in society, so that we live in a world where women are not harassed in the workplace.

Have equal pay for equal work, all the things that so many people fight so hard for. We cannot have people in a position of trust like yourself, not subject yourself to any investigation that comes forth. And not explicitly say that a very clear policy that you signed, does not apply to you.

How can that be a defensible position in light of the fact that you believe that the tone does matter?

Mr. WATT. So let me distinguish between the standards applying to me, which I fully endorse and the process applying to me which explicitly, the law says it doesn't.

And I have tried to explain that on several occasions, and the reason—

Mr. DELANEY. Reclaiming my time Director, out of respect. But don't you get the sense that no one is buying that argument? At its core, you as the leader could have embraced this investigation.

You could have said, technically speaking this doesn't apply to me, but I am an open book. I want this investigation. Technically speaking, these particular—

Mr. WATT. And that is exactly what I am saying in the IG's investigation. I am saying it in the EEO investigation. But to get a report that nobody can do anything about is, to be quite honest, a waste of taxpayer money.

Mr. DELANEY. It wouldn't have been a waste of taxpayer money because we would have sat here and we would have had a more fulsome report knowing you participated in it. And we spend a lot of taxpayer money sitting here and having this hearing.

Mr. WATT. But this Committee couldn't do anything about it either. I mean, the report that the only person really who has the capacity under the—

Mr. DELANEY. Don't you see that everyone is watching, sir. And it is still not too late to fully embrace this. I mean the testimony of Ms. Grimes this morning, as I said, was credible and it was persuasive.

Mr. WATT. A court will determine that Mr. Delaney. It might be credible to you, it may not be credible, I don't know. But I am not

trying to assess whether it is credible or not. I am just saying that there are processes in place that will make that determination.

And I don't think this Committee can really make that determination. And I didn't think the Postal investigation was going to be able to make the determination. They would have gathered facts. They would have given them to who in the agency? Nobody was in the agency who could do anything about it.

Mr. DELANEY. I encourage you, Director Watt, particularly in the context of your career, as a very dedicated public servant, as I have said, who's fought against injustice his whole life, to think about this concept of the tone of the top and ensure that his organization that you lead and the position you continue to hold in public trust, that you are embracing a full change of the norms in our society, for the benefit of all women and subjecting yourself to not only that you believe, from a legal perspective, are appropriate, but from an optical perspective, are appropriate.

I yield back.

Chairman HENSARLING. Time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green, Ranking Member of the Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. Again, I thank the witnesses for appearing today. I do have an affordable housing question that I will be asking. But before getting there, Mrs. Beatty has touched upon something that is quite sensitive, in that, we now have someone who appears to be in a twilight-zone, wherein, she can't get help because of circumstances that exist currently, in terms of equal pay, or adjusting, depending upon circumstances.

Is there any way, I know, I heard your prior testimony, but is there any way to separate that circumstance from other circumstances?

Mr. WATT. I don't know what the other circumstances are. I mean there is a process available to assess all of this. It is the equal employment opportunity process, and it will be addressed. And if there have been equal pay disparities taking place, Ms. Grimes will be compensated for that.

Now is there any way to make that happen before we go through that process? Mr. Green—Judge Green, you were in the legal process, you understand the legal process. I don't have any way to waive that magic wand and address that. I just don't.

And that is why the legal process is set up, for that very purpose, to allow all of these determinations to be made, whether, in fact, there was a disparity, and if so, what it was and order then, whoever is responsible for that disparity, to make the payment.

Mr. GREEN. I understand your point, and appreciate your scholarly recitation. The unfortunate circumstance that Ms. Grimes is still without benefits that she would accrue, assuming a lot of things—and I don't want to assume too many things.

And the reason I am asking is because, in about 4 months, you will be gone. Will, at that time, there be a circumstance such that she can get at least through that process or is that process going to go on, no one knows how long? Is that the way we will find ourselves dealing with it?

Mr. WATT. If you understand the equal employment opportunity process, it could be a protracted process. I think, perhaps the next

Director would not be in a position where he or she would have to disqualify themselves from making any decisions about it.

That might speed up the process, but the process is set up to make these kinds of determinations. And short of going through that process, there's no way to really resolve this, I think.

Mr. GREEN. One more shot at the dead horse, if I may. Is there a deputy? I don't know your hierarchy, in the sense of who has authority when you do not have the authority for any reason. Is there as deputy or someone else that could do this?

Mr. WATT. What happened is because a number of people were alleged to be participants in making decisions about this, including our own general counsel and his office. It was necessary to get outside counsel.

I don't know who would be making the decision down in the organization. And that is a frustrating thing. I am sure it is frustrating for Ms. Grimes, and obviously, it is frustrating for Members of this Committee.

But it will get addressed through the legal process, and all of these, if there are disparities, all of these will be taken into account, in the compensation that Ms. Grimes gets. But the old adage that justice is slow is unfortunately true.

Mr. GREEN. Mr. Chairman, my time having expired, I would just like to indicate, for the record, that I will submit my question with reference to the housing trust fund, for later answer.

Chairman HENSARLING. So note it for the record, there are no other Members remaining in the queue without objection. 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.

This hearing stands adjourned.

[Whereupon, at 6:02 p.m., the subcommittee was adjourned.]

## **A P P E N D I X**

September 27, 2018

September 27, 2018

**Testimony by Simone Grimes, Special Advisor, FHFA**

Chairman Hensarling, Ranking Member Waters, and Members of the House Financial Services Committee (the Committee).

Thank you for the opportunity to testify today regarding y complaints of sexual harassment, retaliation and violations of federal laws, including the Equal Pay Act at the Federal Housing Finance Agency (FHFA). I appreciate the Committee taking these maters seriously and working expeditiously to get through the tremendous volume of evidence presented to you.

I began my career with FHFA in September of 2010. I enjoyed my early career, was and continue to be committed to its mission. I quickly moved up the ranks with the highest level of performance rating for 7 consecutive years.

I have found the agency to be mostly populated with bright, talented and enthusiastic employees who want to make impactful policy decisions that serve the best interests of homeowners, market participants, taxpayers, and the housing markets systems.

**I'd like to provide a little background on my circumstances and then cover three points which I believe have consequences beyond my individual case:**

**Background:**<sup>1</sup>

- In early 2015, I was asked to temporarily take on the role of Executive Special Advisor in the Division of Conservatorship, but I was not given pay or benefits commensurate with the position as had been paid to my predecessor.
- As time passed and I continued to serve in that “temporary” role I raised the issue of equal pay within my supervisory chain.
- I was advised the decision would need to be approved by Former Congressman and FHFA Director Melvin Watt.
- Beginning in September of 2015, Director Watt made multiple unwanted advances towards me and insisted we meet in unusual locations in order to discuss my professional issues to include my equal pay complaints.
- The frequency of these advances, coupled with advice from friends in the security industry, led me to begin recording many of our interactions. I felt vulnerable, and unsafe. Director Watt more than once implied that his advances were linked to promotions and pay increases.

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<sup>1</sup> The Committee has been provided with a detailed investigative report which includes the full details of this case.

- When I attempted to pursue other career advancement opportunities within the Agency they were blocked through the use of the OIG hotline complaint process, which I believe were initiated at the direction of Director Watt.

My three points are as follows:

1. **Lack of communication or corrective action after an investigation concludes:**
  - When an employee submits a complaint, they are looking for answers and resolution.
  - The USPS investigation of my complaints concluded on August 13, 2018, and the Agency was given a 600 page report plus a 73 page summary report.
  - I was not made aware by the Agency that the report was complete.
  - When I finally obtained a copy of the report two weeks ago, I was alarmed to learn that the Agency had been sitting on the report for more than 30 days with no action.
  - I reached out to the Human Resources Director, and my attorney reached out to FHFA's counsel to ask the status of the report and next steps. We have never received a response .
  - *The act of not providing a timely response to an aggrieved party of a harassment complaint serves the same effect as the harassment itself, it is dismissive, demeaning and serves to de-legitimize the complaints and the complainant.*
2. **The refusal of a government official to participate in an independent investigation into their own misconduct**
  - In an email to the USPS investigator, Director Watt indicated that he does not see himself as an employee of the agency, and therefore is not subject to its policies.
  - By not participating in the initial investigation, Director Watt has tainted the process by allowing himself to have several months to fully review my evidentiary file before making any sworn statement about his role in the harassment. This is an intentional manipulation of the process to allow him to make false statements and omit key facts without any risk of perjuring himself.
  - My fellow employees have shared with me the atmospheric shift they have felt inside the agency. Having a leader who refuses to be accountable to the very policies he signs has had a chilling effect.
  - I have been further disappointed that none of the agency officials who own these policies, have issued a statement to FHFA staff to directly address what has become a very public matter or offer any assurance that the Agency takes its own standards seriously.

- The actions of Director Watt, and by extension his senior staff, have served to chip away at the culture of pride, high ethics and integrity that existed at FHFA.

**3. The culture of fear that is established when an agency and its inspector general retaliate against victims for filing complaints.**

- It is never easy to file allegations against your current employer. It is even harder to codify your concerns about your inspector general
- To be clear, my complaints have always included the lack of independence between FHFA senior officials and the OIG, and that OIG processes were used to contribute towards the Agency's ability to effect discriminatory harassment against me.<sup>2</sup>
- My interactions with Inspector General Wertheimer and her staff surrounding my complaints have been that of hostility, intimidation, bullying, laden with gossip, and public shaming.
- In early July after learning that the OIG was doing a parallel investigation, I raised questions to Leonard DePasquale, chief counsel for Mrs. Wertheimer regarding the ability of the FHFA OIG to investigate a matter to which it was a named party.
- The OIG denied my requests for more information, refused to tell me what specific complaints it was investigating and decline to acknowledge or opine on the inherent conflict of interest with their office and my compliant. Instead the OIG worked with the FHFA to take the following three retaliatory actions against me:
  1. The OIG made my identity as the victim of sexual harassment a matter of public record to the full United States population by suing me in court under my full legal name;
  2. On August 1, 2018<sup>3</sup> I was informed that the Agency had been advised by the OIG to delay any Alternate Dispute Resolution mediation settlements until the OIG investigation concluded and the Agency had time to evaluate the results; and

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<sup>2</sup> I filed an EEO case of sexual harassment against the Federal Housing Finance Agency (the Agency) Director Melvin Watt on May 9, 2018. My allegations included "*a nuanced and unusual engagement by FHFA Office of Inspector General (FHFA OIG) and senior Agency officials which resulted in false allegations being lodged against Ms. Grimes and FHFA withholding rights and privileges from Ms. Grimes as a result of said allegations which were found to be false;*

*AND*

*FHFA OIG contributed to the Agency's ability to effect discriminatory harassment through their conduct in the investigation of hotline complaints, refusal to investigate Ms. Grimes' anonymous complaints, and subsequent disclosure of her identity to FHFA officials despite her explicit refusal to waive her right to anonymity when requested by the FHFA OIG.*

<sup>3</sup> This letter has been provided to the Committee.

3. In the same letter dated August 1, 2018, I was advised that the Agency would decline to put me in the executive level promotion for which I was selected in January of 2018 until such a time as the OIG report was concluded.
- In the above actions, the OIG has worked with the FHFA to violate a series of federal employment laws including *5 U.S. Code § 2302 - Prohibited personnel practices* which specifies that an employer cannot “*take or fail to take, or threaten to take or fail to take, any personnel action against any employee or applicant for employment because of—the exercise of any appeal, complaint, or grievance right granted by any law, rule, or regulation*”.
- All investigations into my complaint surround whether Director Watt did or did not commit acts of sexual harassment against me, whether FHFA COO, Larry Stauffer did, or did not violate employment laws (prohibited personnel practices) that resulted in the initial Equal Pay Act violation, and whether the FHFA OIGs relationship with senior agency officials was used to harass and discriminate against me.
- I am not the subject of any of these complaints nor of the subsequent investigations. If an employment action were to be taken, it could only be legally taken against the accused parties which in this case are Director Watt, Laura Wertheimer and COO Larry Stauffer.<sup>4</sup>
- These retaliatory and aggressive actions pursued by Mrs. Wertheimer coupled with Director Watt’s public statement that “he believed the investigation would clear him” while simultaneously refusing to participate in the investigation; have led me to surmise that the OIG’s participation in this investigation was solely to provide Director Watt with a “clean report.”

Thank you for your time. I believe hearing these issues is an important step forward in re-establishing the trust and faith that public servants place in the systems that are designed to protect us and hold leaders accountable.

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<sup>4</sup> Through consultation with the Office of Special Counsel, we have confirmed that act by the FHFA (at the request of the FHFA OIG) to withhold a promotion from me, AND withhold my right to go through an Alternate Dispute Resolution process to settle my claims are both employment actions that are prohibited by law (5 U.S. Code § 2302 p Prohibited Personnel Practices; AND 5 U.S.C. ch. 23 § 2301 et seq – The No-FEAR Act.)

## Resolutions Sought:

- *Compel the FHFA (and all Federal Agencies) to adjust the pay of all of its female employees who are paid less than their male counterparts who perform substantially equal work under substantially equal circumstances.* Specifically, the Equal Pay Act provides that employers may not pay unequal wages to men and women who perform jobs that require substantially equal skill, effort and responsibility, and that are performed under similar working conditions within the same establishment. Each of these factors is summarized below:
- *We humbly ask the committee to remove this investigation from the hands of Ms. Wertheimer and place it in the hands of a neutral third party – such as another OIG office or the FBI:* Inspector General Laura Wertheimer, and her OIG staff have an inherent lack of independence in this specific matter. Further, Inspector General Wertheimer and her staff have in the course of their investigation to date, violated at least two provisions of the Inspector General Act of 1978 which prohibits breaking the anonymity of a witness, and have violated several provisions of the Quality Standards for Federal Offices of Inspector General and Quality Standard for Investigation and Evaluationas issued by the Council of Inspectors General on Integrity and Efficiency. Ms. Wertheimer's willingness to cast aside laws, rules, regulations and quality standards to which she is bound, only serve to further demonstrate that her sole purpose in this investigation is to provide Director Watt with a "clean report." It is normal practice for an OIG that is conflicted, to defer the investigation to another third neutral party. We recommend the FBI. *We further request that Director Watt be made to subject himself to a Polygraph test.*

*Compel the FHFA to quickly resolve this, and all similar harassment and federal employment law complaints lodged against it, through the use of quick, fair, impartial and all-inclusive investigations (which may include the use of polygraph tests as needed) and the Alternate Dispute Resolution (ADR) process as recommended by the Equal Employment Opportunity Commission.* Victims of harassment, sexual harassment and pay violations should not have to personally bear the financial expense of unnecessary protracted processes imposed on them by an Agency. In these instances, the accused parties (Watt, Wertheimer, Stauffer) receive free and unlimited counsel out of the Agency's budget and through insurance policies which only protect accuse parties (not aggrieved parties). The only person who suffers the severe financial consequences of an Agency who is unwilling to quickly settle a dispute is the aggrieved victim.<sup>5</sup>

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<sup>5</sup> Equal Employment Opportunity Commission's "Enforcement Guidance on Vicarious Employer Liability for Unlawful Harassment by Supervisors" asserts that employers must exercise reasonable care to ensure complainants are not subject to a harasser who is "a supervisor with immediate (or successively higher) authority over the employee." In my instance I report to COO Staffer, who was named in my initial EEO complaints and a subsequent retaliation addendum, and my second line supervisor is Director Watt.

**Statement of Donald H. Layton  
Chief Executive Officer, Freddie Mac  
Before the Committee on Financial Services  
U.S. House of Representatives  
September 27, 2018**

Chairman Hensarling, Ranking Member Waters and members of the Committee, thank you for inviting me to appear at this hearing.

Before getting into the details of my testimony, I wish to highlight my main theme: **The mortgage system we have today is fundamentally better than the one we had ten years ago, plain and simple. It is more safe-and-sound, more efficient and does a far better job of protecting taxpayers. Freddie Mac is similarly much better, with a substantially improved business model. We are absolutely not the government-sponsored enterprise (GSE) of the past.**

Working closely with the Federal Housing Finance Agency (FHFA) and at times the U.S. Treasury, we spent a good part of the last decade addressing what are widely regarded as major weaknesses of the pre-conservatorship GSE business model. We have also worked, and continue to work, to address material and costly inefficiencies in a mortgage system that has long been well known for being behind the times. The results have helped borrowers, renters, lenders, investors and mortgage market participants more broadly – and, most of all, the U.S. taxpayer.

**These improvements also have paved the way for policymakers considering the future of housing finance.**

My testimony is divided into four parts.

**First**, I will briefly discuss how we have served our Congressionally-mandated mission over the past ten years.

**Second**, I will set out the four major weaknesses of the pre-conservatorship housing finance system, and what we have done to address them. They were: (1) large investment portfolios used to enhance profits with subsidized funding, (2) an inadequate capital regime, (3) a bias towards large lenders, and (4) a massive concentration of mortgage credit risk in the two GSEs. The changes we have made to address these weaknesses are creating a fundamentally different and better housing finance system.

Specifically, working with FHFA, we have

- **Reduced our retained investment portfolio** by more than 70%, and repurposed it to support the core mission under the Charter, rather than to generate discretionary profits.
- **Created a modern, SIFI-consistent capital framework** to enhance safety- and soundness and enable our decision-making to be in the true interest of taxpayers.
- **Leveled the playing field** for community banks and other small lenders.
- **Created entirely new markets to efficiently transfer most of the credit risk** of both single-family and multifamily mortgage guarantees to private capital markets – on a cost-efficient basis and structured so that it is nearly certain that the risk transfer will be completed as intended.<sup>1</sup> My testimony will particularly highlight the creation of the credit risk transfer (CRT) markets, arguably the single most important development in the housing finance system over the past decade. Freddie Mac has played a well-recognized leadership role in that development, in both the single-family and multifamily businesses.

Essentially, CRT has created a greatly improved business model for the GSEs; we now buy and distribute most of the credit risk of new guarantees instead of simply holding it. It has successfully put a large and ever-growing amount of private capital at the heart of the mortgage system to absorb losses before taxpayers could be called upon to cover them. That has clearly been a top priority for many working on housing finance reform. This change in business model also has the potential to reduce Guarantee Fees (G-Fees) over time, and has already substantially reduced the systemic risk to the U.S. financial system represented by what prior to CRT was an extreme concentration of mortgage credit risk.

**Third**, I will discuss our efforts to improve the efficiency and safety and soundness of the mortgage finance system, especially through technology-based innovation. The mortgage industry had long been inefficient in ways that harmed borrowers, renters, lenders and investors. I will note that those efforts are in support of the statutory mission given to us by Congress, within the four corners of our charter and fully approved by the FHFA as our conservator and safety-and-soundness regulator.

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<sup>1</sup> An explanation of the issue of transaction completion certainty is on page 12.

**Finally**, per the Committee's specific request in its invitation to testify, I will provide some brief comments regarding housing finance reform.

I come to the conclusions in my testimony based on my background, my experience with the pre-conservatorship GSEs, my experience running Freddie Mac for the past six years and my fiduciary responsibility to the FHFA and taxpayers.

In terms of my background, I am a career financial services executive with broad experience, over four decades long at this point, in wholesale banking and capital markets, both domestic and international, as well as U.S. retail banking and the securities industry. I gained this experience after spending almost 30 years at JP Morgan Chase and its predecessors, rising from a trainee to being one of its top three executives, retiring in 2004. I later served as Chairman and then CEO of E\*TRADE during the Financial Crisis, and was also appointed to the Board of American International Group (AIG) by the U.S. Treasury as part of its rescue of the company.

And while my career was outside of the specialized mortgage finance system, I did become very familiar with Freddie Mac and Fannie Mae, dealing with them routinely in both the capital markets and in the mortgage lending business. As a result, I saw first-hand what was good in their activities. In particular, they helped preserve relatively inexpensive mortgage loans for the broad middle and working class, with the 30-year, fully-amortizing fixed-rate loan as its core component.

However, I also saw critical flaws that eroded public confidence in the GSEs, as discussed above and more fully below. For these reasons, I am in no way an apologist for the pre-conservatorship GSEs. Quite the opposite; only by admitting their weaknesses can we effectively address and materially reduce them.

Moreover, as the CEO of a company in conservatorship that receives capital support from the U.S. Treasury, I have publicly stated from my first day that I took my position as a form of public service. In fact, as mentioned above, my fiduciary responsibility is not to private shareholders but to FHFA as our conservator, and behind it the American taxpayer. I take that responsibility very seriously.

I accepted the challenge of leading Freddie Mac with the understanding that the conservatorship would *not* maintain the flawed status quo. Instead, FHFA would actively reform the GSEs – to build upon the good and to remedy the flaws, as much as possible under current law. So, I am here to talk about the Freddie Mac and the GSE housing finance system *as they exist today*, after the extensive work we have done during the ten years of conservatorship to improve them *within the laws on the books today and under the policy directives given to us by FHFA as our conservator*.

The result has been substantially improved safety and soundness and efficiency of the company and the entire housing finance system, along with substantially reduced taxpayer exposure to our risks.

These efforts are vitally important to borrowers, renters, lenders, investors or anyone else with a stake in a liquid, stable and affordable housing finance system. They are unarguably vital to protecting taxpayers. And, they should be important to any policymaker considering the future of housing finance.

#### **I. FREDDIE MAC HAS SUCCESSFULLY SERVED ITS MISSION THROUGHOUT CONSERVATORSHIP**

Freddie Mac and Fannie Mae were placed into conservatorship at the height of the Financial Crisis with an overarching goal of keeping the mortgage finance system functioning. We achieved that goal across three vitally important dimensions.

- **We have provided critical liquidity to the primary mortgage market.** We continued to purchase mortgages from our lender partners each and every business day, despite very adverse market conditions in the early years. Over the past 10 years, we have provided *nearly \$4 trillion in liquidity* to the primary market, funding home purchases, mortgage refinances and rental housing for *more than 22 million families*. In so doing, we provided the counter-cyclical support to the mortgage market that was desperately needed in the conservatorship's early years, especially as private market sources of mortgage credit dramatically retreated during the crisis.
- **We have helped stabilize the housing market and communities.** We helped *more than one million families avoid foreclosure* through loan modifications, forbearance, short sales and other measures. We provided this assistance through the government-designed Home Affordable Mortgage Program (HAMP) and also through our own foreclosure prevention programs. We also gave *more than 1.4 million underwater or near-underwater homeowners* much needed financial relief by refinancing their mortgages through the government-designed Home Affordable Refinance Program (HARP) as well as our own proprietary offerings. Through these efforts we not only assisted financially stressed homeowners, we also helped stabilize the market and whole communities. I want to note these programs were also designed to properly respect the interests of the taxpayers who back us.
- **We have responsibly provided low and middle income (LMI) access to credit.** After the foreclosure crisis peaked and the housing market began to

recover, we worked with FHFA to responsibly increase access to credit for LMI borrowers. Promoting broad access to credit is core to achieving our mission – both in terms of supporting the overall mortgage market and in meeting our statutory affordable housing and Duty-to-Serve obligations. Doing it responsibly means we have done and continue to do the hard and creative work needed to provide LMI access to credit while maintaining safety and soundness in our credit quality.

- **And, we are achieving these goals while also properly managing credit risk quality.**

For the Single-Family book of business, our serious delinquency rate peaked in the early years of conservatorship at 3.98%; as of June 30, 2018 (the most recent public figures available), it was down to 0.82%, *a decline of nearly four-fifths* – the lowest level in more than a decade. (As a point of comparison, at its peak, the serious delinquency rate was more than 30% for the subprime market and 9.67% for the overall market.<sup>2)</sup>

Furthermore, our credit risk is still concentrated in our legacy portfolio (i.e. loans purchased before 2009, as well as HARP and other relief refinance loans purchased since 2009). These loans comprise 20% of our total single-family guarantee book, and have a serious delinquency rate of 2.14%, accounting for 91% of our credit losses. By contrast, our non-legacy Single-Family loan portfolio (loans purchased since 2009, excluding HARP/relief refinance loans) now comprises 80% of our book, but accounts for only 9% of our losses. It also has a serious delinquency rate of just 25 basis points (0.25%), a level regarded as quite good, aided in no small part by rising house prices since 2011.

At an aggregate level, these statistics show that our Single-Family credit quality is being responsibly managed. That is the result of the success of our policy of making our “credit box” the consumer equivalent of “investment grade” – rather than “speculative” grade, also known as “junk” quality. It also balances our goals of broadly supporting the mortgage markets and LMI access to credit while operating responsibly on behalf of the taxpayers.

Similarly, in our Multifamily business, which has been meeting the strongly rising demand for rental housing, the credit quality of our guarantee book of business is not just good, it is superb. Our Multifamily delinquency rate as of June 30 was *just 0.01%*, an extraordinarily low level.

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<sup>2</sup> Source: Mortgage Bankers Association's National Delinquency Survey.

Please note that because of our CRT program, discussed below, losses from these delinquencies increasingly are charged directly to private market investors, rather than to us. This further protects taxpayers.

## **II. WE HAVE ADDRESSED THE FOUR KEY WEAKNESSES OF THE HISTORIC GSE SYSTEM**

I have occasionally heard or read statements to the effect that nothing has changed at the GSEs during the past 10 years. I know first-hand nothing could be further from the truth – the conservatorship has become anything but a “status quo operation.” In fact, to further protect taxpayers during an extended conservatorship, we have made many improvements to the structure and operations of Freddie Mac. These include addressing what I believe are the four most important and broadly recognized weaknesses in the old GSE system. We have implemented these reforms in close concert with and under the supervision of FHFA (and sometimes in coordination with the U.S. Treasury), led by three FHFA directors serving under Presidents from both parties, while keeping fully within the bounds of our charter and the terms of the conservatorship.

Our business activities also are strongly shaped by FHFA’s annual Conservatorship Scorecards, which set specific policy goals for Freddie Mac each year. Broadly speaking, these goals are aimed at making both Freddie Mac and the broader housing finance system work better for homeowners, renters, taxpayers, the American economy and the overall financial system.

As you have asked my views of the FHFA, it should be noted that FHFA is a relatively “young” financial institutions regulator compared to those with which I have previously dealt, and at the same time serves as a conservator operating in totally uncharted territory. Notwithstanding, I have found it to broadly conduct its affairs diligently and honorably, true to its statutory obligations and professional rather than political in orientation. Its senior people with whom I personally deal, in my experience, are smart, hard-working and knowledgeable. Indeed, the proof of the pudding is that its direction of Freddie Mac and Fannie Mae while in conservatorship has ensured that they remain reliable sources of liquidity for housing finance as well as agents for reform of the mortgage system. I believe this view is shared broadly within the mortgage banking industry, based upon my interactions with its leaders.

Working with FHFA, we have addressed all four major weaknesses.

- 1. We reduced the retained portfolio by more than 70% and now use it to support our mission.**

The original Preferred Stock Purchase Agreement (PSPA) with the U.S. Treasury, put into place at the time the conservatorship was established, substantially addressed the GSEs' previously unlimited ability to build up discretionary investment portfolios, funded by borrowings that were inexpensive because of the unpaid-for implied guarantee by the U.S. government. At its peak, Freddie Mac's retained portfolio exceeded \$800 billion; today it is under \$250 billion, as mandated by the PSPA.

As one key example of this decline, our investment in private-label mortgage-backed securities (PLS) – which was clearly an independent and discretionary investment – peaked at \$180 billion in 2006, making us possibly the single largest owner of PLS in the world at that time. (PLS are mortgage-backed securities not issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae.) Our PLS holdings have shrunk 98% since then, and today we have just \$3 billion.

Today, we use the \$250 billion limit in the retained portfolio to support the guarantee businesses, for example, purchasing defaulted loans out of securitizations to facilitate modifications and make good on our guarantee to investors in those securities. The PSPA and FHFA requirements prohibit us from once again taking on independent and discretionary investments, a restriction that I feel is totally right and proper.

**2. We now have a modernized, SIFI-based capital framework to enhance safety and soundness, which enables us to make decisions in the interest of the taxpayers who support us.**

Another well-recognized weakness of the pre-conservatorship GSEs was inadequate capitalization, even judged by the standards of that time, when financial system capitalization generally was not strong. There is consensus on the need for strong capital standards for the GSEs upon potentially exiting conservatorship.

While we remain in conservatorship, the amount of capital we are permitted to have on our books today – \$3 billion is our allowed “buffer” – is quite small versus what would be required to support our risks. Because of the capital support provided by Treasury under the PSPA, the market nonetheless has confidence in us to be a near-Treasury-quality debt issuer. In practical terms, then, we have a lot of capital behind us residing at the US Treasury. And we pay for that support via the “profit sweep” clause of the PSPA rather than an overt fee.

However, our lack of capital on our own books creates a challenge for management in operating our business. A well-developed regulatory capital system has two core

purposes. The first, and more commonly discussed, is to generate a level of capital in the aggregate that is the minimum amount the regulated financial institution should hold to help ensure safety and soundness and market confidence. The second purpose is to give management a framework to make everyday risk-versus-reward decisions properly and efficiently. This requires a capital system that can drive such day-to-day decision-making. For us, it will answer core questions like “Is the price of a particular CRT transaction a good deal for the taxpayer who supports us, or a bad deal?” or “Is selling this package of non-performing loans a good deal for the taxpayer, or a bad deal?” Without such decision-making being made on a high-quality economic basis, it cannot be truly safe and sound nor in the interest of the taxpayer.

Accordingly, Freddie Mac developed a modernized GSE risk-based capital system in 2012 and 2013, based upon the principles behind what Systemically Important Financial Institutions (SIFIs) must use in the broader financial system. (The SIFI requirements primarily require capital needed to withstand a “severe adverse” economic and market scenario plus a going-concern buffer that will retain market confidence.) While the system Freddie Mac developed indicates generally how much capital we would need if we were not under conservatorship, it just as importantly gave us the needed rules to drive our everyday risk-versus-reward decision-making in all our CRT transactions, all our legacy asset sales and more. It is this system that gave us the confidence to do such transactions, knowing that we were not asking the taxpayer to overpay to have risk taken off our books. It is this system that helps ensure we are being good stewards of the taxpayers’ money.

In 2017, the FHFA finished development of its own version of a modern, SIFI-consistent capital system, which it called the Conservatorship Capital Framework (CCF). It then mandated that the GSEs use CCF while in conservatorship for decision-making, for the precise reasons I cite above. Because our homegrown system was very similar to the CCF in almost all major aspects, we were able to adopt it fairly easily.

**3. We have leveled the playing field for community banks and other smaller lenders.**

A third major deficiency prior to conservatorship was a bias towards large lenders in the single-family market. This manifested itself most importantly in lower G-Fees for the very largest lenders. FHFA has ended this practice, requiring “*level G-Fees*.”

We also maintain a robust cash window, which enables small lenders to access the global capital markets, even when selling us one or two loans at a time. The alternative for them is to sell their loans to the large aggregators with whom they

may compete. And, we have dedicated more technology, customer support and other resources to smaller lenders than prior to conservatorship. This has contributed to the growing share of our business coming from outside our ten largest lenders (52% as of June 30, 2018).

We believe that level G-Fees, a vibrant cash window and enhanced support are essential to ensure that community banks and other smaller lenders retain equal access to the secondary market. Small lenders also value knowing that, given our role as a GSE under our charter, Freddie Mac will not cross-market other products or services to their customers, as aggregators may.

4. **We now transfer most of the concentrated credit risk of new single-family and multifamily mortgages to private capital markets - on a cost-efficient basis and structured so that there is a near certainty that the risk transfer will be completed as intended. This has the potential to be the biggest single improvement in the housing finance markets in decades and is putting private capital increasingly at the heart of the housing finance system for the first time in many years.**

As I have stated, the development of CRT arguably is the biggest improvement in the GSE system in at least a decade. That is because it represents a change to a fundamentally new and improved business model that delivers large and important benefits at three policy levels:

**CRT has substantially reduced systemic risk**

The concentration of monoline mortgage risk at the two GSEs of approximately \$5 trillion has long been regarded one of the largest systemic risks in the financial system. The GSEs, in the 1970s, changed their business model with the development of the pass-through mortgage-backed security ("MBS") to shed the interest rate and liquidity risk of the mortgages they owned and sell them to investors, with the GSEs acting as operating intermediaries between borrowers and the buyers of those pass-through MBS. Today, such securities represent over 80% of our entire balance sheet. Nevertheless, the retention of the credit risk by the GSEs – by guaranteeing the investors in those MBS that they would not suffer credit losses – still left a near-\$5 trillion concentration of mortgage *credit* risk with the two GSEs, and this was the underlying cause of the need for the government to put the companies into conservatorship. Simply put, when the mortgage asset class caught a severe cold, the GSEs got pneumonia.

This was regarded by many as an unavoidable consequence of being a mortgage monoline by our charters, with no way to avoid it. But in reality, given the evolution of the global capital markets in the last several decades, holding onto the credit risk

in the historic manner became a business model choice. And we have chosen to change our business model.

With CRT, a large majority of this credit risk is increasingly being passed through to investors, just as we do with interest rate and liquidity risk. When the business model transition is complete, with the credit risk transferred to diversified investors in the global capital markets, this source of systemic financial risk will have been reduced to a minimum.

At this time, Freddie Mac's Multifamily business has almost completely converted to the new business model, having begun in 2009. New flows of multifamily mortgages have roughly 90% of their credit risk – as measured by the requirement for capital on that credit risk according to the FHFA's CCF system – passed through to private market investors. Since it has been doing this since 2009, its entire book of business has almost turned over and about 80% of the credit risk that it would require on its entire guarantee portfolio has been put into investors' hands.

At this time, the Single-Family business is following a similar path, but it only began in 2013 and deals with a larger and more complex guarantee business. New flows of single-family mortgages have, for the last few years, had about 60% of their mortgage credit risk passed through to private market investors; but with further development of the transactions to transfer such risk, we have now just begun to do transactions that pass through 80% to 90% of the risk. On the entire book of single-family business, about 25% of all capital required to support credit risk has been laid off to private market investors, with this ratio expected to grow by close to 10 percentage points a year. This means, on present trends, it will reach the roughly fully-converted status our Multifamily business has attained in just five years or so. And by that time, Freddie Mac plans to transfer in the range of 75% of the credit risk on its entire book of both single-family and multifamily mortgages to a diversified set of private investors.

#### **By using CRT, we have increased returns to taxpayers**

In conservatorship, there is a fundamental question to be asked: *Is the taxpayer earning a good return on its support of the company's risks through the PSPA?* There is much focus on whether draws under the PSPA occur and how much money we have paid Treasury above the amount we borrowed – \$112.4 billion paid on \$71.6 billion borrowed to date. However, there is also the question of whether the underlying profitability of the company is adequate compensation to the taxpayer for the risks taken. This question will also be very important to policymakers as they

contemplate housing finance reform because it directly relates to the key question of whether sufficient private capital can be raised on reasonable economic terms to re-privatize the companies or their activities, in whole or part.

In both cases, CRT is a key tool by which Freddie Mac has raised the returns it earns on its risk. Simply put, for good and long-standing fundamental reasons, private capital markets investors of many types have a lower investment return hurdle than a large, leveraged and systemic-sized financial institution such as Freddie Mac. As a result, a pool of mortgage loan guarantees has a return on the remaining risk after CRT that is higher than prior to the transaction – because the G-Fees paid away to CRT investors is proportionately lower than the amount of risk being reduced. As a result, the returns on our remaining retained risk rise, to the point where it is our belief that the taxpayer is currently getting a *good and reasonable return* on the support they provide to Freddie Mac.

To earn less than a reasonable return means the taxpayer is implicitly subsidizing our operations on an ongoing basis, rather than just being a backstop in an extraordinary distressed situation. Given our financial performance of late, with returns bolstered by CRT, there is no significant implicit ongoing subsidy of this type by the taxpayer, and the PSPA is only functioning as a distress market backstop.

#### **CRT may lead to lower Guarantee Fees**

Third, focusing on single-family guarantees, CRT allows us to finance those guarantees at a lower cost than would otherwise be the case. So, in the long run, Guarantee Fees can be lower than they otherwise would be in almost all market situations. That obviously is a major potential benefit of switching to a CRT-based business model.

#### **Realities and limitations of CRT**

There are three additional points to be made to fully understand, at a policy level, the realities and limitations of CRT, especially in the single-family business which is, I have found, the overwhelming focus of policymakers.

**First, credit risk transfer has a cost which can be acceptable or not.** We pay part of our G-fee to investors for them to take the risk. At all times, we need to ensure that the cost is not too high. To pay too much would be, in conservatorship, a case of taxpayers paying private markets too high an amount to reduce their exposure to our risks – and that would not be a good thing. Using the CCF, we always ensure that the cost of such risk transfer is economic and a good deal for the taxpayer. Since

Freddie Mac began the program five years ago, excepting a few pilot transactions, the cost to the taxpayer has always been properly low.

**Second, in most CRT transactions, the private market provider of the risk transfer - usually a capital markets investor or an insurance company - does not take on the risk of non-payment directly from the borrower.** Instead, Freddie Mac incurs the credit loss first, and the provider of the risk transfer must then reimburse us for the loss. (This structure is necessitated in order to leave in place, in the single-family guarantee business, the existing pass-through MBS business model with the associated TBA market, which is a key policy goal.) Thus, there is a risk that such CRT transactions will be ineffective if Freddie Mac does not receive such reimbursement, on time and in full, as required by the transaction documents – which can be many years, even decades in the future.

Thus, in order to be of any practical value, a CRT transaction must have a structure where the certainty of the performance of that reimbursement in full and on time is nearly certain. Without such near certainty, the CRT is really just “on paper” and not a true transfer of risk. In the most common CRT transaction, Freddie Mac ensures that near certainty by, at the outset of the transaction, obtaining cash or cash equivalents equal to the maximum amount it could be reimbursed; unused amounts are returned to the CRT counterparty at the final maturity of the transaction. (Such cash may also be held by a trustee on our behalf.)

Freddie Mac will only enter into CRT transactions where there is a near certainty of on-time and in full reimbursement, as a classic safety and soundness matter and also to protect taxpayers from exposure to our risks. The Financial Crisis demonstrated that such mechanisms had not been properly developed in the past (in particular with respect to mortgage insurance), with consequent major losses to the company, and so it is now understood to be an on-going requirement in the future.

**And third, CRT is still an evolving field.** The specifics of our transactions are constantly evolving to appeal to more types of investors, to be more efficient and certain and to lower costs. There are also specialized accounting requirements to be addressed. For Freddie Mac, it is most of the way to being fully mature in the Single-Family business – and closer every year. CRT is substantively fully mature in Freddie Mac’s Multifamily business.

In summary, working with FHFA, we addressed the four major deficiencies of the historic GSE system while in conservatorship. In this sense, we have provided a template that policymakers may wish to consider using in creating the future system.

### **III. FREDDIE MAC HAS INNOVATED TO IMPROVE THE EFFICIENCY AND SAFETY AND SOUNDNESS OF THE MORTGAGE FINANCE SYSTEM**

Freddie Mac also has undertaken a number of efforts, working with FHFA, to help improve the efficiency and safety and soundness of the portion of the housing finance system that sells mortgages to the GSEs. These efforts fall broadly into two categories: those led by FHFA as conservator and those developed by the GSEs through competitive innovation. Below are illustrative examples of both categories. The ultimate intended beneficiaries of our initiatives are borrowers (who can enjoy cost savings and/or improved service from greater efficiencies) and taxpayers (who face reduced risk of loss in a safer and sounder system).

#### **FHFA-led efficiency and safety and soundness initiatives**

**Representations and warranties (R&W) reform.** One housing finance system weakness revealed during the Financial Crisis was a very poorly designed R&W system. It allowed poor quality mortgage “manufacturing” to go undetected for years, and was addressed only after a loan went into default. Once this was broadly understood, lenders viewed it as a source of additional – and unnecessary – risk in the mortgage lending process. In response, lenders selling loans to the GSEs created “overlays” (additional requirements on top of GSE requirements), which restricted their usage of the full credit boxes of the GSEs and reduced lending. Working with FHFA, Fannie Mae and the industry, we made significant improvements to our R&W framework. Today, the quality of loans sold to us is very much improved, based partly upon frequent quality-control review feedback the GSEs provide to customers.

Additionally, early or even immediate relief from liability for breach of certain representations and warranties provides lenders with much greater certainty that the loans they sell to us meet our requirements. This, in turn, has dramatically reduced overlays, and the mortgage banking marketplace now broadly utilizes the full credit boxes of the GSEs. That is particularly helpful in our responsibly to meet affordable lending goals.

**Mortgage data standardization.** Since May 2010, at FHFA’s direction, Freddie Mac and Fannie Mae have been working to standardize information and data provided by the mortgage industry. This was a visionary initiative led by FHFA, which recognized that the mortgage finance system lagged other parts of the financial system in terms of both efficiency and innovation. The initiative mandated standard datasets for both mortgage origination and other key parts of the mortgage process, including servicing. It also mandated electronic instead of paper-based

transmission to the GSEs. This boosts industry efficiency, improves the quality of data for the GSEs and lenders, and provides greater clarity and certainty for loan purchases. It also provided the basis for many GSE-led efficiency initiatives, as noted below.

#### **Competitive innovation-led efficiencies**

Freddie Mac competes for the business of its lending customers, mainly with Fannie Mae but also broadly with others. And as in other industries, this competition has been the source of innovation, based heavily on advances in data and technology. It ultimately can lead to improved service to borrowers at lower cost. Furthermore, losses suffered during the Financial Crisis and the Great Recession have made Freddie Mac keenly aware of the risks we face, and much of our innovation is explicitly intended to reduce those risks and thereby protect taxpayers.

**Loan Advisor Suite.** Freddie Mac's Loan Advisor Suite (LAS) is a set of integrated software applications that help lenders originate high quality mortgages for sale to Freddie Mac. It includes tools for underwriting new loans, evaluating risks on existing loans, valuing collateral, pricing loans, tracking R&W relief on loans, and post-funding quality control. These tools are designed to substantially increase operational efficiencies, to reduce origination costs to lenders by, we roughly estimate, up to \$1,000 per loan, and can enable many loans to be closed in as little as 15 days or less. In a competitive market, these savings eventually should pass through to borrowers.

**Automated Collateral Evaluation.** Last year, Freddie Mac launched an online digital tool that offers an automated appraisal alternative for us to employ in our risk analysis when consumers are buying homes or refinancing existing mortgages. Our Automated Collateral Evaluation (ACE) tool assesses the need for a traditional appraisal by leveraging proprietary models, data from multiple listing services, public records as well as a wealth of historical home value data. For a modest percentage of loans, ACE determines that a traditional appraisal is not needed because the automated valuation of the collateral provides equal or improved accuracy. In these cases, borrowers can save roughly \$500, and closing times can be reduced by up to 7-10 days. Based on the expected percentage of times a traditional appraisal is waived, applied to our entire book of business as it turns over, we estimate borrowers in the aggregate could save between \$500 million and \$1 billion.

**IMAGIN mortgage insurance pilot.** Freddie Mac's recently launched Integrated Mortgage Insurance (IMAGIN) pilot features an enhanced form of Charter-compliant mortgage insurance on high-LTV loans. Insurance coverage is provided by an

affiliate of the country's largest mortgage insurer, with reinsurance provided by a panel of Freddie Mac-chosen and -approved insurers and reinsurers. IMAGIN addresses several structural weaknesses with traditional mortgage insurance that pose significant risks to Freddie Mac and thereby taxpayers. It does this by:

- **Reducing wrong-way risk** (i.e., a mortgage monoline GSE being insured by a mortgage monoline mortgage insurer, so that the MI will be under stress just when needed most by the GSE), by attracting additional and more diversified sources of private capital.
- **Improving safety and soundness** in two key ways:
  - Reducing counterparty risk by enabling us to fully control with whom and in what amounts we run the risk that monies due us under the insurance policies might not be paid in full and on time.
  - Increasing the certainty of being paid for insured losses (via collateralization, prohibiting independent MI rescissions and denials), by having the insurers agree to use our standards for payment of claims.
- **Primary market lenders also benefit** under IMAGIN versus traditional MI.
  - Lenders will be more willing to lend to low-down-payment borrowers, due to the certainty of coverage being higher.
  - IMAGIN also reduces costs to lenders by eliminating duplicative loan document and data submissions to MIs.
  - And by not allowing selective MI pricing discounts for large lenders, IMAGIN supports a level playing field for community banks and other small lenders.

I have heard concerns that our work here amounts to "Charter creep" or "expanding our market footprint." In reality, each and every one of our efforts is consistent with the letter and the spirit of our Charter, a fact confirmed by FHFA. Moreover, each goes through an extensive FHFA review process that takes months and sometimes years. Once approved, FHFA closely supervises to ensure that innovations are carried out in a safe and sound manner and remain foursquare within the bounds of the Charter.

These reviews are also designed to ensure that our initiatives serve good public policy. We do not undertake, and in my experience the FHFA does not approve, initiatives which are primarily aimed at enhancing our bottom line by utilizing privileges we have but which are not available to private market competitors.

#### IV. HOUSING FINANCE REFORM

The Committee asked for my thoughts on housing finance reform. My role and that of my colleagues at Freddie Mac in such efforts is to be a technical adviser to policymakers and others in the policy community. As the members of the Committee know all too well, this is a highly complex issue that ultimately requires policymakers to make a series of social, economic and political tradeoffs. There is no technically "right" or optimal solution. There are, however, solutions that, in their basic design or specific details, have key features:

- A good likelihood of operational success, where the intended results actually occur as promised and intended,
- A transition to the new system which does not cause undue disruption or collateral damage to homeownership and financing, and
- "Unintended consequences" are minimized.

I respectfully offer three suggestions to help inform Congress's deliberations.

**Be reasonably certain reform will work as intended.** This requires thoroughly examining (1) the objectives for a reformed housing finance system proposal, (2) exactly how those objectives will be met and (3) the reasonableness of the underlying assumptions. For example, if one objective is to place private capital in a first loss position ahead of a government guarantee, a number of questions need to be answered. These include how capital is defined, how much capital will be required and who sets that requirement, where does that capital come from, what is the cost and terms on which it will be provided (and what is the resulting impact on Guarantee Fees), whether the capital is sufficient to enable mortgage demand to be met, and how much it be available at various stages of the economic cycle. These types of critical design questions, in my view, have not been fully addressed by most of the reform proposals I have seen. Any reform that does not clearly answer questions such as these, or relies on unsubstantiated or overly optimistic assumptions, has a substantial risk of not working as intended. Reform needs to work in practice, not just in theory.

**Minimize the potential for disruption or collateral damage to homeownership and housing finance during the transition.** Not only do policymakers need to decide where they want to go, they also must carefully consider how they plan to get from here to there, and what obstacles they might encounter along the way. In general, the greater the number, scope and breadth of changes policymakers make to the current housing finance system, the greater the risk that the current system

performs poorly during a transition, which is likely to take several years at a minimum. Successful reform depends on the current system functioning well until a new one is in place. Similarly, it will take time to provide clear “rules of the road” to would-be participants in a reformed system, whose willingness to invest or otherwise commit to the new system will be critical to the success of any reform effort. Simply put, you can build it, but without clear rules, they may not come, and it also will be very hard to predict how and when they will come.

Policymakers also should recognize that the success of any reform approach will be tied in part to maintaining the functionality of the current system throughout the transition. You cannot decimate the current system to create the new system – for example, taking away key operational assets – and expect the current system to run well (or at all) until the new system is functional and investors arrive in sufficient number, a process likely to take many years.

**Build on the progress achieved during conservatorship.** In the earlier years of conservatorship, mortgage reform proposals were oriented toward a “clean sheet of paper” approach. However, all such proposals so far have been stymied by a variety of concerns, including (1) the difficulty of going from a high-level idea to the actual detailed mechanics, with consequent loss of confidence that it could be implemented without undue collateral damage or that it would work as intended and (2) the realization by many industry participants, especially smaller mortgage lenders, that a “clean sheet of paper” approach would be very risky for their business models and potentially to homeownership as well.

Today, from my position in the housing finance system, it appears that business people who make a living in the mortgage industry, their trade associations and many other stakeholders increasingly favor the incremental or “evolutionary” approach of keeping what works or has been already reformed, and fixing the remaining problems with the system. As detailed above, a great deal of reform has taken place during the past 10 years, addressing many of the weaknesses of the GSEs and the overall housing finance system. Building on these successes makes the task of legislative reform easier to achieve because a major portion of the work has already been done. It also increases the likelihood that reform will work as intended, while minimizing the potential for disruption.

I believe that the following reforms, many of which have already been developed by the FHFA and the GSEs during conservatorship, are among the key elements necessary to make the housing finance system function smoothly while minimizing both costs for the borrowing public and risks for taxpayers:

- Strong, modernized and SIFI-consistent risk-based minimum regulatory capital requirements
- CRT based upon sound economics and risk management, rather than non-economic statutory requirements
- A functioning common securitization platform supporting a single security
- Limits on the retained portfolios (in part, through limits on approved assets)
- Level G-Fees across lender sizes and volumes
- Uniform (i.e., standardized) data requirements
- Robust cash windows
- A responsible regime for financing low-down-payment mortgages that is safe and sound as well as cost efficient.

## **CONCLUSION**

In closing, those of us tasked with improving the GSE system while it is in conservatorship have made extraordinary progress over the past ten years. The decision not to pursue a status quo conservatorship, but an active reformist one that advances the U.S. housing finance system, has been a major success in my view.

Speaking from my position as CEO of Freddie Mac, we addressed the major weaknesses of the old system and enhanced the efficiency of the market. We did that within the four corners of our Charter and invariably in service of our mission of increasing liquidity, providing stability and promoting affordability in America's primary mortgage markets.

However, as my testimony should make clear, this was not a solo activity. The mortgage lenders (who are our customers) and the broader mortgage industry were involved. Most of all, we did it working closely with, and under the supervision of, the FHFA as our conservator and regulator. That includes numerous FHFA staff and spans multiple agency directors. And none of this would have been possible without the capital support provided by taxpayers through the U.S. Treasury. We always remain mindful of this and have sought to be good stewards of that support.

As you debate the future of housing finance reform, I respectfully suggest that policymakers seriously consider incorporating into legislation the truly *non-partisan and professional* progress achieved during conservatorship – and the benefits it has created for borrowers, renters, lenders, investors and, most of all, taxpayers.

**Testimony of Timothy J. Mayopoulos  
Chief Executive Officer, Fannie Mae  
Before the House Financial Services Committee  
September 27, 2018**

Thank you, Chairman Hensarling and Ranking Member Waters for the opportunity to testify today.

My name is Tim Mayopoulos, and I am the Chief Executive Officer of Fannie Mae. I joined Fannie Mae as its General Counsel in April 2009, seven months after the company entered conservatorship. I became Chief Administrative Officer in September 2010, and I agreed to become the Chief Executive Officer of the company in June 2012, at the request of our Board of Directors and then Acting Federal Housing Finance Agency (FHFA) Director Ed DeMarco.

In all of my roles at Fannie Mae, I have viewed my primary responsibility as helping the company to fulfill the mission set forth in its Congressional charter: to provide stability and liquidity to the nation's secondary mortgage market and sustainably expand access to mortgage credit. Under my leadership, our management team has also been focused on the goals set forth by FHFA at the onset of the conservatorship: to restore confidence in Fannie Mae, to enhance the company's capacity to fulfill its housing mission, and to mitigate risk to the financial markets and taxpayers.

At every turn, we have sought to make Fannie Mae as safe and strong and capable as possible so policymakers would have a full range of options as they consider the future of housing finance, and that taxpayers would receive the greatest benefit for their investment in the company. We are acutely aware taxpayers did not want to make an investment in Fannie Mae, and that they should not be called upon to make another such investment in the future.

On September 6, 2008 –10 years ago this month – the government seized the company and placed it into conservatorship. As Conservator, the Federal Housing Finance Agency installed experienced professional managers to run the company under its supervision. Notwithstanding the magnitude of the job we collectively undertook a decade ago, it is no exaggeration that we have achieved more than most people would have thought possible.

What have we accomplished over these 10 years of conservatorship?

- We stabilized the company and helped to stabilize the housing market. Both Fannie Mae and the state of the housing market are vastly improved over the dire conditions of a decade ago.
- We built what is probably the strongest book of business in the company's history, using improved credit standards and prudent risk management.

- We became sustainably profitable for the benefit of taxpayers, not private shareholders. We returned to positive earnings in 2012, have been profitable every year since then, and expect to remain profitable on an annual basis for the foreseeable future.
- As of June 2018, we have returned nearly \$50 billion more to taxpayers than we received in taxpayer support during the financial crisis. In addition, Fannie Mae has returned more profits to taxpayers than any other company, measured on both an absolute basis and net of the support received. Whatever our political affiliation, we are all taxpayers, and this is a happy result. We expect to continue to distribute profits as dividends for the foreseeable future.
- We significantly improved Fannie Mae's business model, making it more reliable and less risky. We moved away from making most of our money from a portfolio of investments in mortgage assets, a subject of considerable criticism before the crisis. As a business line, purchasing and holding mortgages as investments no longer exists at Fannie Mae.
- We similarly improved our business model by programmatically transferring a portion of our credit risk to private investors and away from taxpayers. We were instrumental in creating markets for doing this that did not even exist a few years ago.
- We actively supported FHFA's efforts to make agency mortgage-backed securities more fungible and eliminate the historical advantage of Fannie Mae securities compared with Freddie Mac securities. The goal is to make the secondary mortgage market even more liquid.
- We built new capabilities based on the lessons of the financial crisis. These new capabilities are helping us better serve today's market and the market of tomorrow. They include new technology solutions to verify the quality of the loans delivered to us and that make the mortgage process more efficient, less expensive, and safer. These new capabilities are becoming permanent features of the housing finance architecture, making it stronger and sturdier.

In short, in these past 10 years we have made our conservatorship, in spite of its origins, a clear success for taxpayers, homeowners, and renters. That was not a foregone conclusion on September 6, 2008.

Throughout conservatorship, we have recognized that our job is not to make housing finance policy, but to ensure that our company and the housing market perform as well as possible. We have executed our responsibilities with a spirit of stewardship and a strong commitment to transparency and accountability. After 10 years of hard work in conservatorship,

Fannie Mae has turned out to be a very good investment for taxpayers. This is a tribute to the dedication and perseverance of the people of Fannie Mae who have pledged their talents and careers to reforming and strengthening the company and the housing finance system.

Let me provide some detail on the major areas of our progress over the past decade.

#### **Stabilization**

First, we stabilized the company and the housing market we serve. We helped millions of people stay in their homes in the wake of the crisis, and helped millions more buy, refinance, and rent homes in the years of recovery.

##### **Ensuring Liquidity through the Crisis**

The lead-up to the financial crisis and its impact on the housing and mortgage markets are well known, but are worth recalling.

What began as an easing of the rate of home price increases in 2006 became a collapse of home prices in 2008, when home prices nationally fell by 18 percent, according to the widely used S&P/Case-Shiller Index. Some states fared far worse. In Florida, for example, which accounted for 7 percent of Fannie Mae's single-family mortgages at the time, home prices had fallen 38 percent by 2008 from their peak a few years earlier.

Fannie Mae was not immune from the wreckage. In 2007, we lost \$2 billion, and in 2008, primarily driven by an increase in combined loss reserves, we lost \$58.7 billion. Meanwhile, private capital was retreating from the market. In the two years leading up to mid-2007, the volume of private-label mortgage-related securities backed by subprime and so-called Alt-A loans outstripped the combined issuances of Fannie Mae, Freddie Mac, and Ginnie Mae. By the spring of 2008, however, private-label issuances had all but ceased.

As private capital retreated, Fannie Mae, Freddie Mac, and the Federal Housing Administration became the principal sources of liquidity in the market. By the fourth quarter of 2007, Fannie Mae's market share of single-family mortgage-related securities issuances surged to 48.5 percent. Private market financing and liquidity for multifamily housing also retreated, and Fannie Mae and Freddie Mac became the largest providers of apartment financing.

As intended, conservatorship allowed Fannie Mae and Freddie Mac to keep the nation's mortgage market functioning smoothly, in the darkest hours of the downturn and through the recovery. Since the beginning of 2009, Fannie Mae has supplied \$6.5 trillion of liquidity to the market. This financing supported 8.4 million home purchases, 17.2 million home refinances, and 5.1 million multifamily rental units.

Helping Homeowners Avoid Foreclosures

With the financial crisis, many homeowners were unable to meet their mortgage payments, and we dedicated enormous resources to preventing foreclosures. While we were obviously unable to keep everyone in their homes, our sustained efforts achieved results. From the beginning of 2009 through the second quarter of 2018, we helped save 8.8 million homes from foreclosure through refinancing, loan modifications, and other workouts. We also set new industry standards and practices that remain in place to this day for helping struggling homeowners.

From the onset of the crisis, we were a thought leader in helping Department of the Treasury and Department of Housing and Urban Development (HUD) develop the government's cornerstone Making Home Affordable Program. We served as the program administrator from the beginning, and we continue to do so. We were also integral in designing and implementing the Home Affordable Refinance program, perhaps the single most successful homeowner assistance program in the history of housing.

However, we were not content with the programs initiated by Treasury and HUD. We created our own industry-leading modification and other workout options to help people keep their homes and avoid foreclosure. We were a leader in creating modification options that substantially reduced the borrower's monthly payment. As we learned more, we improved our solutions and incorporated many of these improvements into the government programs. For example, when we saw that many qualified homeowners were getting stymied by all the paperwork involved, we created a proprietary Streamlined Modification that simplified the qualification process.

To provide free counseling and assistance to struggling homeowners trying to understand their potential options for avoiding foreclosure, we worked with local non-profits to establish Mortgage Help Centers in a dozen of the hardest hit areas across the country. To contact and educate borrowers who had yet to connect with their servicers, we held outreach events. We also encouraged post-modification counseling for borrowers to help them stay on a path of keeping their homes.

At the outset of the crisis, the mortgage servicing industry was unprepared to address the flood of delinquent loans and, too often, vacant homes. We created new industry standards for mortgage servicers for helping struggling homeowners and managing foreclosure timelines. We reinforced these standards with incentives and compensatory fees.

For example, through our Servicer Total Achievement and Rewards (STAR) program, we started grading our servicers' work according to industry standards and leading practices. We now evaluate servicers by factors such as their effectiveness in contacting borrowers early in their delinquency, providing borrowers with a single point of contact, and helping struggling

borrowers know their options. We identify servicers who are outperforming their peers, and when a servicer underperforms we put it on a performance improvement plan. When needed, we transfer servicing.

Our ongoing foreclosure prevention and servicing programs are rooted in the lessons of the crisis, and we continue to improve upon them 10 years later. Today, both Fannie Mae and the mortgage servicing industry are much better prepared for adverse mortgage conditions than we were before the crisis.

*Handling Property Maintenance and Disposition Responsibly*

Of course, despite everyone's best efforts, some borrowers are unable to take advantage of a home-retention workout option or otherwise cure their delinquencies. In those cases, Fannie Mae may acquire the homes through foreclosure or a deed-in-lieu of foreclosure. We market and sell our foreclosed homes, also known as Real Estate Owned (REO), through local real estate professionals. Our primary objectives are both to minimize the severity of loss by maximizing sale prices and to stabilize neighborhoods by minimizing the impact of foreclosures on area home values.

As with mortgage servicing, we improved our own practices and raised the standards for the entire industry with respect to the maintenance and sale of foreclosed homes. Let me share a few examples:

- We can use drones and satellites to assess damage on thousands of properties at a time in situations where we have limited human capacity. We developed this capability in responding to natural disasters.
- We began using clearboarding, a new polycarbonate alternative to unsightly plywood boarding. Fannie Mae's adoption of clearboarding has made it an industry standard.
- We are using new ways and new technologies to protect and enhance the value of our properties, including the installation of energy efficient appliances and Nest thermostats.

Over the past 10 years, Fannie Mae sold more than 1.6 million homes in total. On average, we sell properties at a price that is 98 percent of their established value, an execution rate that ranks first or second in most markets.

In cases where the property does not sell, we use alternative methods of disposition, including selling to municipalities, other public entities, or non-profits. Since 2007, we have sold more than 13,000 properties to 2,000 different public entities and non-profits in more than 300 different markets across the nation. Working with FHFA, we also launched the

Neighborhood Stabilization Initiative. This provides non-profits and public entities in the hardest hit markets with an Enhanced First Look period for purchasing REO properties.

As of the end of June 2018, our inventory stands at approximately 22,000 homes, which is below pre-crisis levels. With stronger underwriting and stronger capabilities for managing delinquencies, we estimate that even with a new downturn as severe as the last, our inventory would peak at less than a third of our previous high of 171,000 properties from October 2010.

*Setting Sustainable Credit Standards*

As we helped struggling homeowners navigate the crisis, we were also working to ensure that future homeowners had access to sustainable mortgages. In late 2008 and 2009, we significantly strengthened our underwriting and eligibility standards to improve the quality of loans we guaranty.

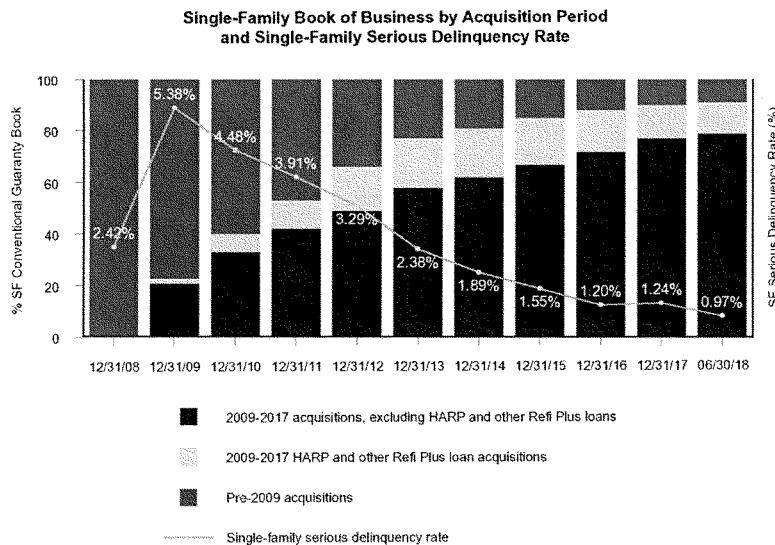
The result is a very strong book of business. For instance, our Single-Family mortgage credit book at the end of June 2018 had a weighted average loan-to-value ratio of 75 percent and a weighted average FICO credit score of 745.

We do not accept newly originated low- or no-documentation, negatively amortizing, or interest-only single-family loans, nor single-family loans with prepayment penalties or balloon payment features. Shortly after the crisis began, we took steps to reduce the unsound layering of risk that was at the root of much of the poor credit practices that led up to the crisis.

Applying improved credit standards helped to decrease dramatically the serious delinquency (SDQ) rate of our single-family loans from a peak of 5.59 percent in February of 2010 to below 1 percent at the end of June 2018. Importantly, our single-family mortgage SDQ rate has continued its overall downward trend even as we have introduced low down payment options such as our HomeReady® product.

Indeed, the SDQ rate for loans we have acquired since 2009 is substantially lower than our overall SDQ rate, which includes loans we acquired before the crisis. Most of the loans that go delinquent are those we acquired before 2009. The SDQ rate for new acquisitions (those acquired since 2009) is 0.41 percent, which reflects the very strong credit quality of our more recent business.

Economic conditions that affect mortgage credit performance, such as home prices, employment, and interest rates, are beyond Fannie Mae's control. Therefore, our focus since the crisis has been on developing better ways to monitor, manage, and mitigate credit risk as it changes, always with an eye on sustainability for homeowners, lenders, and taxpayers.



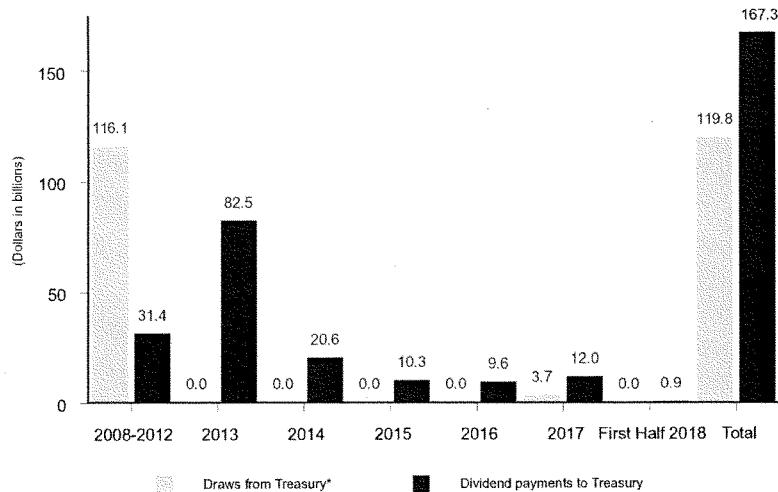
#### Returning to Profitability

As a result of our actions and the economic recovery, Fannie Mae returned to profitability in 2012, and we have been profitable on an annual basis ever since. Since I became CEO in June 2012, the company has reported nearly \$150 billion in profits. We have been profitable every quarter since I have been CEO except for the fourth quarter of 2017 when, like many companies, tax legislation adversely impacted our earnings.

In fact, the company has actually been more profitable during my tenure as CEO than it was pre-crisis. From 2002 through 2006, Fannie Mae averaged \$5.5 billion in annual profits. From 2012 through 2017, we averaged \$11.4 billion in profits, even if we exclude the anomalous year of 2013, when we earned an extraordinary \$84 billion primarily due to the release of our valuation allowance against deferred tax assets. While we expect some volatility in our quarterly and annual results due to factors beyond our control, we expect to remain profitable on an annual basis for the foreseeable future.

Since the beginning of conservatorship, we have returned more than \$167 billion in dividends to the Treasury Department, which is nearly \$50 billion more than we received in taxpayer support.

Treasury Draws and Dividend Payments: 2008- Q2 2018



\* Treasury draws are shown in the period for which requested, not when the funds were received by Fannie Mae.

#### Talent, Management and Governance, and Compliance

Over the past 10 years, we have also ensured that the company has the right people, the right management and governance, and a strong commitment to our regulatory responsibilities, compliance, and transparency.

Let me speak to each of these areas, starting with our people.

Every member of our Board of Directors joined the company after September 6, 2008, the beginning of our conservatorship. This is also true for me, our Chief Executive Officer, as well as our Chief Financial Officer, General Counsel, Chief Audit Executive, Chief Communications Officer, Chief Human Resources Officer, Chief Information Officer, and Chief Information Security Officer. Overall, 73 percent of our current employees joined the company after September 6, 2008.

What has not changed is Fannie Mae's long-time commitment and industry leadership in diversity and inclusion. We have retained our position in the top quartile among SIFMA financial services firms for minority and women representation across all levels, including senior management. We have been recognized by a wide array of prominent organizations for our

diversity and inclusion efforts. We encourage employees to interact with colleagues who share common interests and backgrounds through our 12 employee-initiated and employee-led Employee Resource Groups that provide important peer support and identify potential issues that could hinder inclusion. In addition, our 2017 employee engagement score ranks in the top decile of our industry.

We have also maintained focus on our affordable housing regulatory obligations. Our work with lenders to meet our housing goals has financed nearly 5 million affordable housing mortgages in the last 10 years, and more than 4.2 million affordable rental units.

To maximize taxpayers' return on their investment, we have kept our administrative expenses low relative to the size of our business. In fact, *Business Insider* magazine reported this year that Fannie Mae has fewer employees relative to our net income than any company in the world. From 2008 through 2017, the annual average growth rate of our administrative expenses was 1.1 percent; this compares to an annual average inflation rate over that period of 1.8 percent. This is a testament to our commitment to staying lean and managing the company smartly and responsibly.

We have strengthened the resiliency of our business to ensure we are able to sustain operations in the event of almost any type of disruption. We have geographically distributed our people, processes, technology, and facilities to decentralize our risk and help ensure continuity of our critical capabilities. Currently, 87 percent of our critical assets have redundant back-up capabilities in our out-of-region data center and by the end of the year it will be 100 percent.

While not permitted to retain more than \$3 billion in capital reserves, we endeavor to run the company with the same risk management discipline of other major financial institutions. As required by law, we submit capital reports to FHFA on a regular basis. We are also implementing FHFA's new Conservator Capital Framework, which includes specific requirements relating to risk on our book of business and modeled returns on our new acquisitions.

Like many other financial institutions, the Dodd-Frank Act requires us to conduct annual stress tests to determine the impact of adverse economic conditions to our business. We published our most recent stress test results for the severely adverse scenario on our website in August. Of course, our results are greatly impacted by our inability to retain more than \$3 billion in capital reserves. While the stress scenarios vary from year to year, our estimated loss in the severe scenario has decreased by almost 60 percent since the inception of the tests, as we have reduced the size of our retained mortgage portfolio and improved the credit quality of our guaranty book.

We have strengthened our management and governance structures. In 2015, following a comprehensive review, we implemented a new Management-Level Committee (MLC)

Governance structure. We reduced the number of committees from 43 to 11 to more effectively oversee risks and clarified our delegations of authority to improve accountability.

We also adhere to FHFA's rule establishing prudential standards relating to our management and operations across 11 critical areas. When FHFA identifies risk and control matters, we resolve them within established timeframes or mutually acceptable extensions.

#### **Strengthening Fannie Mae and Housing Finance**

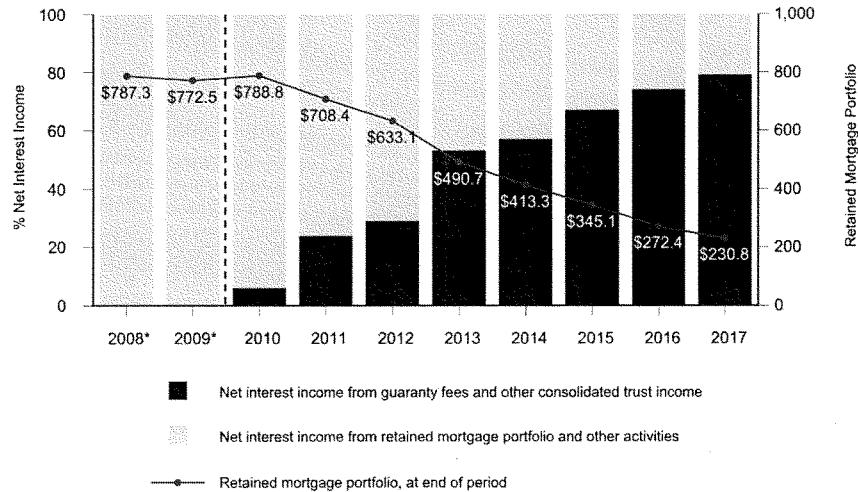
The second area I want to address is how we have made fundamental reforms to Fannie Mae's business model. These reforms have made Fannie Mae and housing finance stronger and safer.

Most importantly, we have transitioned from a portfolio-focused business to a guaranty-focused business.

We reduced the size of our retained mortgage portfolio, reducing a source of potential risk to the company and taxpayers. In 2004, we had more than \$900 billion of mortgage assets on our balance sheet, nearly all of it investment assets. Through a steady program of selling these assets at an accelerated pace, we wound down the portfolio faster than required by our agreement with Treasury. By July 2017, we had reduced the overall portfolio size below the final Treasury cap of \$250 billion, more than a year earlier than required. Excluding the portion of our portfolio used to provide lenders with short-term liquidity and help with foreclosure prevention and other loss mitigation activities, the investment portfolio stood at \$47 billion at the end of June 2018.

Today, Fannie Mae no longer has a stand-alone investment business. Instead, guaranty fees are a stable and reliable primary driver of our revenue, providing more than 75 percent of our net interest income.

**Sources of Net Interest Income and Retained Mortgage Portfolio Balance**  
(Dollars in billions)



\*Effective January 1, 2010, we prospectively adopted new accounting guidance, which had a significant impact on the presentation and comparability of our consolidated financial statements. Prior to 2010, our guaranty fee income was reported as a separate line item in our Consolidated Statements of Operations and not included as a component of Net Interest Income.

We have also reformed our business model through our credit risk transfer programs. In the last five years, we have evolved from being a company that only buys and stores credit risk to one that also sells and distributes credit risk to private investors. Our credit risk transfer programs move risk away from taxpayers and attract global capital to the U.S. mortgage market. This credit risk transfer market did not exist a few years ago.

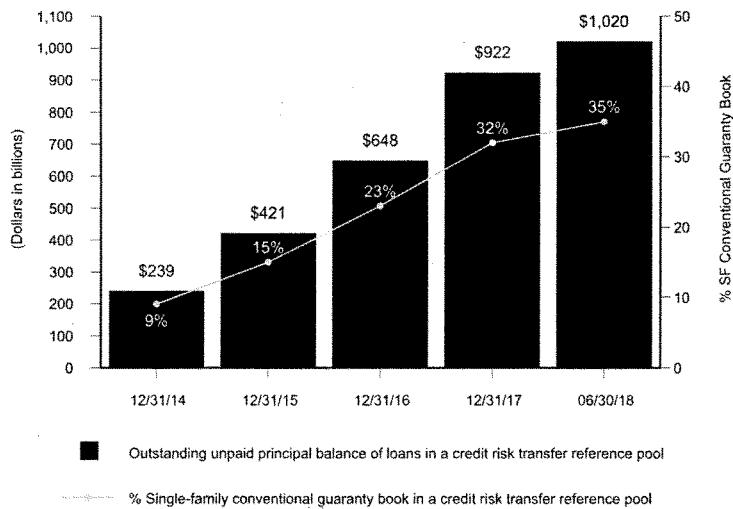
We formally began distributing Fannie Mae's credit risk to private investors in 2013. That year, Fannie Mae introduced its first Connecticut Avenue Securities transaction, or CAS®, wherein investors agree to bear a portion of the risk of a mortgage's loss in exchange for a portion of the guaranty fees our business generates on that mortgage. These securities cover large and geographically diversified pools of mortgages that have relatively consistent, strong credit risk profiles.

In 2014, we structured our first Credit Insurance Risk Transaction, or CIRT™, which shifts credit risk on a pool of loans to a panel of domestic insurers and/or reinsurers, again in exchange for a portion of our guaranty fees generated by the loans. Thus, we brought an entirely new source of institutional capital into the conventional market.

A third form of risk transfer involves front-end (or upfront) lender risk sharing. In these deals, a lender assumes some of the default and loss risk in exchange for a lower guaranty fee. This means that credit risk is reduced for Fannie Mae and the taxpayer before a loan is even delivered to us.

Lastly, in 2017, we announced plans to structure future CAS offerings as notes issued by a Real Estate Mortgage Investment Conduit (REMIC) to expand the investor base of CAS securities by making them more attractive to real estate investment trusts.

#### Single-Family Loans Included in Credit Risk Transfer Transactions



In the last five years, our credit risk transfer programs and investor base have grown. Our disclosures and transparency around the deals have been consistently enhanced. The market has become larger and more liquid. In addition, we have accomplished this without disruption to our lenders, nor to the TBA market upon which our secondary market functions and the overall mortgage market depend. Our credit risk transfer programs have been recognized in the industry for their excellence, receiving seven industry awards over the past two years.

Our credit risk transfer programs have made housing finance safer and more resilient, and have provided a crucial way for the private market to assume mortgage credit risk – instead of the taxpayer. Over the past five years, we have transferred a portion of the credit risk on nearly \$1.4 trillion of single-family loans, measured in unpaid principal balance at the time of the

transaction. At the end of June, 35 percent of our single-family conventional guaranty book of business was covered by a credit risk transfer transaction.

In our Single-Family business, we continue to explore new ways of distributing credit risk to lenders, reinsurers, mortgage insurers, and other institutional investors, always with an eye toward protecting the TBA market, strengthening the liquidity and stability of the system, and protecting lenders and borrowers from any disruption to the mortgage lending process.

Our Multifamily business incorporates risk sharing as an essential feature of its business model and it has done so since it began 30 years ago. In this business, we share risk with our customers on nearly 100 percent of our new acquisitions. Our unique Delegated Underwriting and Servicing (DUS<sup>®</sup>) program works with a select group of high-quality lenders who originate the vast majority of our multifamily loans, and each of them shares the risk of loss and the benefit of success with Fannie Mae. We believe this is one key reason our credit performance in Multifamily has been superb in the last decade.

Our work to improve the strength and resiliency of the secondary mortgage market extends to our collaboration with Freddie Mac and FHFA to create a Common Securitization Platform (CSP). The platform will be used to issue a new Uniform Mortgage-Backed Security (UMBS) that is expected replace the securities currently issued by Fannie Mae and Freddie Mac in order to improve the liquidity of the overall market. We are on track to issue our first UMBS in June 2019 using the CSP. Importantly, this platform is designed to allow for the integration of additional market participants in the future.

#### **Building Capabilities for Tomorrow**

The third important area I want to cover are the capabilities we are building to serve the mortgage market of tomorrow. These new capabilities extend across our businesses and encompass our work to develop innovative new technology solutions for our customers. They begin, however, with our people.

##### *Becoming More Customer-Centric*

We recognized several years ago that Fannie Mae needed to be more agile and customer focused. We needed to be a company that was easier to work with, quicker to solve problems for our customers, and quicker to pursue opportunities for improvement.

In 2015, we started a program we called Simplify. Our goal was to make our organization and processes simpler and less complicated. We collected and acted on more than 700 ideas for streamlining or eliminating unnecessary or redundant processes and improving our way of doing business. These ideas came from all over the company, most from front-line employees. Over the course of two years, we broke down silos, eliminated low-value or

duplicative work, and ended up saving \$547 million. We reinvested much of these savings and redeployed people toward higher priorities.

We did not stop there. Out of Simplify came a multi-year effort to introduce lean management principles to every team at Fannie Mae. This program is reorienting the way Fannie Mae employees work. We are developing a common set of tools and language across the company. We are becoming more collaborative, open, and accountable. By the end of this year, approximately 30 percent of Fannie Mae's employees will be using these lean management principles and tools, and we anticipate that everyone in the company will be using them by 2021.

Most of all, our adoption of a new way of working is making Fannie Mae more customer focused. In 2015, we adopted a new business strategy that explicitly puts the customer at the center. Like customers throughout the business world, mortgage lenders and mortgage investors want a secondary market customer experience that is streamlined, simple, and certain. We are striving to deliver that experience, and our customer survey results demonstrate we are making great strides. The scores we receive from both our Single-Family and our Multifamily customers place us in the top quartile of financial services companies, with scores from our Single-Family customers rising dramatically over the past two years.

*Innovations to Make Housing Finance Smarter, Safer, and Better*

To better serve our housing mission and to make housing finance stronger and safer, Fannie Mae has become a leader in the new technologies that are starting to transform housing finance. We are doing this by delivering innovations to our customers that are making mortgage lending more transparent while mitigating risk for lenders and taxpayers. These solutions are squeezing time, cost, and inefficiency out of the mortgage process. They are also helping make complicated financing processes easier and simpler for lenders and ultimately buyers.

During the crisis, many of our customers had to repurchase loans sold to us because they did not meet the representations and warranties contained in our Selling Guide. In response, we developed new capabilities and tools to help lenders verify the quality of loans before they are delivered to us. Because of these tools and other quality control practices, loan defects have plummeted in the last decade. As of June 30, 2018, single-family loans delivered to Fannie Mae during 2017 had an identified eligibility defect rate of less than 0.5 percent.

Let me share how some of these new tools drive down costs and reduce risk.

The starting point is the work over the past decade to standardize mortgage data, an ongoing effort led by FHFA, Fannie Mae, and Freddie Mac. The Uniform Mortgage Data Program (UMDP) is improving the quality, consistency, and accuracy of all data elements associated with conventional, conforming mortgages. It laid the groundwork for digitization and significantly improved data quality and efficiency for the mortgage process.

For instance, less than a decade ago, residential appraisal reports were not even digitized, and data elements were recorded in widely divergent ways from form to form. The Uniform Appraisal Dataset (UAD) standardized appraisal data, and in 2012 Fannie Mae began requiring digitized appraisal reports.

This laid the groundwork for our creation of a tool we call Collateral Underwriter® (CU®), which has vastly reduced a range of appraisal risk issues for our lenders and for Fannie Mae. CU automates the appraisal review process and provides lenders with more certainty on appraisals free of charge. It helps lenders identify appraisals that might be problematic, and identifies loans that are eligible for relief from representations and warranties on property value. In addition, thanks to CU, refinances and some purchase transactions may be eligible for an appraisal waiver. This saves money for lenders, which they can pass on to borrowers.

In late 2016, we introduced Desktop Underwriter® (DU®) validation service, another tool enabled by uniform mortgage data standards. This service allows lenders to replace traditional paper-based processes with a digital process that reduces the risk of inaccurate loan data. Using the service, accessible through our regular DU automated underwriting system, they can digitally validate a borrower's income, assets, and employment. Lenders may opt into the service, which uses verification reports from authorized third-party data providers. In addition to reducing the risk of inaccurate data, the service drives operational efficiency in the loan origination process and provides a better borrower experience. Instead of gathering paper documents and providing them to their lender, borrowers give the lender permission to access information electronically. The reduction in time and increased efficiency makes it more cost-effective for lenders to originate loans, including smaller loans that are more common for very low- to moderate-income borrowers. In 2017, lenders reported a 14 percent average reduction in time from application to close when assets are validated through our DU validation service, and a 17 percent reduction when employment and/or income are validated this way.

We call these data validation tools our Day 1 Certainty® initiative, and they are helping to change the process of mortgage origination, making it faster, cheaper, and safer for lenders.

In addition to introducing new technology solutions, we are also delivering innovative solutions that meet the needs of today's borrowers, especially borrowers of modest means and first-time homebuyers.

In 2015, for example, we introduced HomeReady, a low down payment product designed to help lenders serve more very low-, low-, and moderate-income borrowers. HomeReady includes underwriting flexibilities that are intended to provide sustainable mortgage credit without adding substantial risk. Since 2015, we have continued to improve and simplify HomeReady, and we have an outreach program to increase awareness of the product. We are also continuously looking for opportunities to introduce sensible underwriting flexibilities, such as the flexibilities we introduced in 2017 to help borrowers burdened by student debt. All told,

in 2017, nearly half (48.9 percent) of all single-family, owner-occupied home purchase loans financed by Fannie Mae were to first-time homebuyers.

*Innovation and Leadership in Multifamily Rental Housing*

We are also building new capabilities to serve the evolving needs of the nation's multifamily rental market.

Key among these has been our Green Financing program, which incentivizes property owners to improve the energy efficiency of apartment buildings in ways that ultimately make properties less costly to operate and rent, benefiting the owners and families who live there. Begun in 2012 as a pilot, our Green Financing program has succeeded dramatically. In 2017, we issued \$27.6 billion in green bonds backed by Multifamily properties, making Fannie Mae the world's largest issuer of such debt. Through last year, more than 248,000 rental units received energy and water efficiency upgrades through our Green Financing, and families renting them are projected to save \$131 a year.

We have also adapted our work to meet the growing need for financing smaller multifamily properties, meaning loans up to \$3 million (\$5 million in high-cost markets). At the end of 2017, 43 percent of our multifamily loans were small loans, and we continue to focus on building this part of the business.

Last year, we introduced Healthy Housing Rewards™ to provide financial incentives for borrowers who incorporate health-promoting design features, practices, or resident services in new or rehabilitated multifamily affordable rental properties. Importantly, earlier this year we resumed making equity investments in Low-Income Housing Tax Credit properties, providing crucial funding for affordable housing nationwide.

*Enterprise-Level Improvements*

Many of the new capabilities we are building for the future are the product of work that is taking place at the enterprise level, as opposed to the individual businesses.

Working with FHFA and housing partners across the country, we are moving forward aggressively with our Duty to Serve plans for those in hard-to-serve rural markets, for manufactured housing, and for preserving our supply of affordable housing.

We are also developing solutions to make housing's capital markets more resilient and more responsive to today's needs. In July, for example, we issued the world's first-ever securities indexed to the Secured Overnight Financing Rate, a new benchmark alternative to the London Interbank Offered Rate index, long known as LIBOR.

We are moving forward with our strategy for Fannie Mae's workplaces that will save money for taxpayers, provide the company and policymakers greater flexibility, and support Fannie Mae's implementation of a lean management system. Overall, we are reducing our square footage by approximately 25 percent, saving taxpayers over \$600 million over the next 15 years when compared to alternatives, such as renovating existing facilities. In addition, we are moving from being owners of buildings to tenants, which increases flexibility for the company and for policymakers due to flexible lease terms that allow us to decrease our space and/or sublease as needed.

In 2014, beginning with our Washington, DC buildings, we undertook an extensive analysis of our existing workplaces, our future needs, and the DC commercial real estate market. The analysis revealed that letting the leases expire in our two leased DC buildings, selling our three owned DC buildings, and leasing one consolidated space in downtown Washington would save taxpayers \$150 million over the course of a 15-year lease when compared to staying and renovating our five existing buildings. In August 2014, before we selected the Midtown Center site, we briefed the House Financial Services Committee and the Senate Banking Committee on our intention to move from our existing five buildings to one consolidated headquarters in downtown DC, and shared the \$150 million estimate of taxpayer savings.

Today, with our move to Midtown Center more than 60 percent complete, the entire project is on schedule, under budget, and on track to save taxpayers much more than the originally estimated \$150 million. Based on site selection, our need for less space than we originally thought, and our ability to negotiate highly favorable lease terms, we are on track to save taxpayers almost \$300 million over the term of our lease in Midtown Center. In addition, we also received \$118 million of proceeds from the sale/leaseback of our three owned buildings (3900 Wisconsin Avenue, 3939 Wisconsin Avenue, and 4250 Connecticut Avenue) in 2016, and profits from the sales contributed to Fannie Mae dividend payments.

In so doing, we consolidated from five aging buildings, three of which we owned and all of which required significant investment to improve infrastructure, into one leased, multi-tenant building with very flexible lease terms. We were able to dispose of assets in a seller's market and save money we would have needed to spend to renovate the aging infrastructure of those buildings. At the same time, we were able to take advantage of significant softness in the DC commercial rental market and negotiate very favorable lease terms. The move to a consolidated leased building provides flexibility to us and to policymakers to adjust the organization if necessary, since we negotiated provisions that will allow us to reduce the leased space through subletting and assignment. In Midtown Center, we have 80 percent fewer offices, offices are 30 percent smaller in size, and there is no dedicated executive floor.

We are realizing similar benefits at our other locations. In Texas, we moved from three separate, aging leased buildings in need of repair and maintenance to one consolidated leased building expected to save taxpayers approximately \$95 million over a 15-year lease term. We

decreased the number of offices by 90 percent, and we also successfully negotiated subleasing and assignment rights for the entire lease term in case our needs change.

In Northern Virginia, Fannie Mae has approximately 4,500 staff in three owned buildings and one leased building with an expiring lease in 2022. Our legacy buildings are aging and require extensive renovation. Nonetheless, market demand for our owned buildings is strong, and we recently closed on their sale with an agreement to lease them until we are ready to move to new quarters in Northern Virginia. We expect that consolidating our workspace in Northern Virginia in a new project known as Reston Gateway will save taxpayers more than \$200 million over the 15-year lease term versus renovating the existing buildings. Once again, under the terms of our lease we will have the flexibility to reduce our Northern Virginia space through subletting, assignment, or termination, if needed.

Our new spaces throughout our footprint follow a set of principles we set forth early in our workplace efforts: Design an open space environment that would significantly limit the number of offices; limit offices to the interior core (no offices on the perimeter); provide much more collaborative meeting space; and democratize the best spaces (i.e., front-line staff workstations are in the center and perimeter of the floors). Putting these principles into practice will be critical to Fannie Mae's adoption of lean management, which will help us support our customers and become an even more effective organization. All of this has been done while preserving flexibility for policymakers to change or reduce our role without incurring substantial loss.

### **Conclusion**

In conclusion, building a strong, effective organization has been the primary focus of the Fannie Mae management team this past decade. To achieve this goal we have implemented fundamental changes and reforms. Our changes have addressed areas that needed attention, reinforced areas of strength, and built new capabilities that continue to make housing finance stronger. As a result, today's Fannie Mae is a company far removed from the one that entered into conservatorship 10 years ago.

It is true that Fannie Mae received more taxpayer support than any other company during the financial crisis. Yet it has also returned more profits to taxpayers than any other company, measured on both an absolute basis and net of the support we received. Beyond the dollar returns, the nation has a strong and vibrant asset to show for its investment. A company that delivered \$570 billion in mortgage financing in 2017 alone. A company that finances 1 in 3 single-family homes and 1 in 5 multifamily loans. A company operating at a more effective and high-performing level, with greater capabilities and expertise, than at any time in our history. And one that plays a vital role in a vital sector of our national economy.

Resolving our conservatorship remains an important piece of unfinished business for the nation. We well understand that this is a job for policymakers, not Fannie Mae. We are

disappointed that policymakers have not finished this work, but we have made good use of conservatorship. This past decade has been one of fundamental reform at Fannie Mae. We have implemented these reforms understanding that our role as professional business managers is to make the company as safe and as capable as possible, to maximize the benefit to taxpayers, and to maximize choices for policymakers.

The people who work at Fannie Mae do their very best, every day, to advance these purposes. I am very proud to lead them, and I am proud of what they have achieved on behalf of the taxpayers, homeowners, and renters we serve.

I again thank the committee for the opportunity to testify today. I am happy to take your questions.

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

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

**“Oversight of the Federal Housing Finance Agency’s Role as Conservator and Regulator of the Government Sponsored Enterprises”**

**September 27, 2018**

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

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

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

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

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

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

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

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

Another way of stating the principle that will be guiding us is that FHFA is focused on how we manage the present – the present conservatorships of the Enterprises and the present housing finance market under the present statutory mandates.

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

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

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

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

#### **Reducing Fannie Mae and Freddie Mac's Risk Exposure**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### **Maintaining Housing Finance Market Liquidity and Access to Credit**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### **Building New Infrastructure for Single-Family Securitizations**

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

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

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

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

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

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

#### **FHFA Approach to Oversight and Monitoring of the Enterprises**

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

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

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

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

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

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

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

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

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

#### **Ongoing Challenges in Overseeing Fannie Mae and Freddie Mac**

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

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

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

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

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

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

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

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

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

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

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

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

Thank you for the opportunity to provide this written testimony.



Written Testimony of Laura S. Wertheimer  
Inspector General, Federal Housing Finance Agency  
*before the*  
U.S. House Committee on Financial Services  
*concerning*  
Oversight of the Federal Housing Finance Agency's  
Role as Conservator and Regulator of the Government Sponsored Enterprises

September 27, 2018

This testimony contains redactions of information that is protected under the Privacy Act of 1974 (Pub.L. 93-579, 88 Stat. 1896, enacted December 31, 1974, 5 U.S.C. § 552a).



Chairman Hensarling, Ranking Member Waters, and Members of the Committee, thank you for inviting me to testify regarding the work of the Office of Inspector General (OIG) for the Federal Housing Finance Agency (FHFA).

FHFA was established by the Housing and Economic Recovery Act of 2008 (HERA), which authorizes FHFA to conduct examinations, develop regulations, and issue enforcement orders for Fannie Mae and Freddie Mac (the Enterprises) and the Federal Home Loan Banks (FHLBanks) (collectively, the regulated entities), and the FHLBanks' fiscal agent, the Office of Finance.

HERA also authorized the FHFA Director to appoint FHFA as conservator or receiver of the regulated entities. In September 2008, FHFA used its statutory authorities to place the Enterprises into conservatorship, after it determined that a substantial deterioration in the housing markets severely damaged their financial condition and left them unable to continue without government intervention. Now in their 11th year, FHFA's conservatorships of the Enterprises are of unprecedented scope, scale, and complexity. The Enterprises, by asset size, are among the largest financial institutions in the U.S. and dominate the secondary mortgage market and the mortgage securitization sector of the U.S. housing finance industry.

As a result of FHFA's dual responsibilities as regulator of the Enterprises and the FHLBanks and as conservator of the Enterprises, FHFA-OIG's responsibilities are broader than those of OIGs for other prudential federal financial regulators. Not only do we examine the Agency's programs and operations but we also examine the Enterprises' execution of revocable delegated responsibilities because FHFA, as conservator, is ultimately responsible for all decisions made and actions taken by the Enterprises.

### **The Value of Independent Oversight in Improving Government Operations**

Effective oversight makes government better and fosters positive change. Healthy skepticism through independent reviews of programs and operations, both by inspectors general and by Congress, acts as the “disinfectant of sunlight” and is critical to positive and constructive change and to identifying problems, abuses, and deficiencies.

When I joined FHFA-OIG in October 2014, I explained my guiding principles for the independent oversight work of an OIG to staff: to follow the facts—wherever they may lead, without fear or favor; report findings that are supported by sufficient evidence in accordance with professional standards; and recommend practical solutions tied to our findings. While the independent oversight authority in the Inspector General Act of 1978, as amended, (IG Act) is



substantial, it is not self-executing. It requires the career professionals in FHFA-OIG (and every OIG) to have the dedication and courage to exercise independence of mind, objectivity, and professional skepticism, and to ensure they are not injecting personal opinions or beliefs into their fact-finding. We are a trusted change agent because of our demonstrated independence and objectivity: we ask difficult questions and are not persuaded by rote answers; we critically assess the evidence we obtain during our fieldwork; and we challenge FHFA to improve its oversight over its conserved entities, enhance its supervision, put more rigorous internal controls into place, and look for and eliminate fraud, waste, and abuse.

Like all OIGs, we have had to develop a thick skin. When we are critical of the Agency, which we often are, or identify misconduct, it is not unusual to hear one or more of the following refrains: we are too hard on FHFA for its supervision of the Enterprises; we seek to substitute our judgment for that of the Agency; or we are out “to get” particular people. On the other hand, when our fact-finding does not provide cause to be critical, some wonder if we are being too soft on the Agency, or if we have glossed over an issue because we have grown too close to the Agency.

As demonstrated by the 103 reports issued during my tenure, neither is true. My senior staff and I understand that both varieties of criticism come with the job. My guiding principle has always been, and continues to be, that we follow the facts, wherever they lead, thoroughly, aggressively, and objectively, and that we base our findings on the facts, not on feelings or personal opinions.

Again, our work demonstrates that FHFA-OIG has followed this guiding principle. Read the reports issued during my tenure as Inspector General, all of which are on our website: each report evidences our independence and objectivity. Because we follow the facts wherever they lead, we report the good and the bad, sometimes in the same report. For example, in our recent audit on quality control reviews conducted by FHFA’s Division of Federal Home Loan Bank Regulation (DBR), we found that safety and soundness quality control reviews were conducted in compliance with FHFA’s standards during the 2017 examination cycle but its community investment quality control reviews were not.<sup>1</sup>

When our fact-finding identifies deficiencies in FHFA’s programs or operations, shortcomings in FHFA’s implementation of policies and guidance, inadequate internal controls, or wrongdoing by FHFA employees or by senior executives of the conserved entities, we report the evidence

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<sup>1</sup> *DBR’s Safety and Soundness Quality Control Reviews Were Conducted in Compliance with FHFA’s Standard During the 2017 Examination Cycle but DBR’s Community Investment Quality Control Reviews Were Not* (August 17, 2018) (AUD-2018-010).



that demonstrates the deficiencies, shortcomings, or wrongdoing. We make the hard judgments about actions or inactions of FHFA and do not sugar-coat our findings.

We propose common-sense, practical, and actionable recommendations to correct the deficiencies we identify, with the goal of helping to improve FHFA's efficiency and effectiveness. Take, for instance, a recent evaluation in which we reviewed whether FHFA examiners independently assessed the adequacy of Enterprise remediation of significant deficiencies, as FHFA's guidance requires.<sup>2</sup> While examiners reported to us that FHFA required them to independently analyze the sufficiency of the remedial actions, we found, from our review of workpapers, that examiners generally relied on the assessments by an Enterprise's internal audit function of remediation sufficiency. We recommended, and FHFA agreed, that FHFA should remedy this failure by adopting clear guidance for examiners to follow when assessing the sufficiency of remediation of significant deficiencies by the Enterprises – guidance that identifies the work steps that should be included in examiners' independent assessments of internal audit's work and specifies the conditions under which independent examiner testing is expected.

We fulfill our obligations, under Section 4 of the IG Act and applicable professional standards, to keep the FHFA Director "fully and currently informed" through regularly scheduled meetings with the Director and his senior staff and through issued reports, which contain our assessments of the Agency's effectiveness as conservator and regulator and on their internal operations. We seek to keep the lines of communication open with the FHFA Director and senior Agency officials, informing them of the audits, evaluations, compliance reviews, and, when appropriate, investigations that are being conducted.

To date, the 103 reports issued during my tenure included 131 recommendations to address identified shortcomings. Of those 131 recommendations, FHFA fully agreed to 105, or 80%.

In those 103 reports, we questioned costs of more than \$111 million and identified \$776.3 million in funds that could be put to better use.<sup>3</sup> Additionally, our civil investigations during this

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<sup>2</sup> *FHFA's Adoption of Clear Guidance on the Review of the Enterprises' Internal Audit Work When Assessing the Sufficiency of Remediation of Serious Deficiencies Would Assist FHFA Examiners* (March 28, 2018) (EVL-2018-003).

<sup>3</sup> In our recent management alert on Fannie Mae's relocation of its Northern Virginia workforce, we explained that \$776.3 million (amounting to Fannie Mae's \$727 million net present value estimate of its cost to consolidate and move its Northern Virginia operations, increased by \$49.3 million for the smaller than projected amount from the sale of its three owned buildings), less the net present value of the cost to maintain the status quo, which Fannie Mae



period resulted in more than \$29 billion in settlements and other monetary results, and our criminal investigations resulted in more than \$858 million in forfeitures, restitution, and other monetary results.

Every month, we publish, on our website, a compendium of open recommendations from all of our reports that FHFA has agreed to implement. In our view, this monthly compendium keeps FHFA focused on implementing open recommendations and provides timely and accurate information so that the public and the Congress may assess and understand, among other things, what American taxpayers are getting for their investments in the Enterprises.

As I explained when I testified before the Subcommittee on Oversight and Investigations earlier this year, my experience leading internal investigations as a lawyer in private practice taught me that recommendations to address identified deficiencies require diligent follow-up and oversight. To provide that follow-up and oversight, we created, in 2014, the Office of Compliance and Special Projects (Office of Compliance), which has conducted validation testing of 15 closed recommendations. For example, we found in a 2016 evaluation that FHFA informed only Enterprise management of the most serious safety and soundness deficiencies and left management to decide whether or not to communicate those deficiencies to the board of directors (board), even though the board is charged by FHFA with oversight of remediation of those deficiencies. We recommended, and FHFA agreed, to provide notice of such deficiencies both to the affected Enterprise management *and* to the chair of the board's Audit Committee. We closed the recommendation after FHFA issued supervisory guidance requiring all supervisory correspondence containing such deficiencies to be addressed to the responsible Enterprise management official(s) and to the affected Audit Committee chairs.

Subsequent validation testing by the Office of Compliance found that the written notices of the 29 deficiencies issued during our 17-month review period were addressed to affected Enterprise management and to the Audit Committee Chair of the affected Enterprise, but the notice was sent only to the Enterprise management and no notices were actually provided by FHFA to the Audit Committee chair of the affected Enterprise. Because this supervisory guidance, as implemented, failed to carry out the agreed-upon recommendation, we re-opened that recommendation.<sup>4</sup> That

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did not calculate, were funds that could be put to better use. *Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce* (September 6, 2018) (OIG-2018-004).

<sup>4</sup> *Compliance Review of FHFA's Communication of Serious Deficiencies to the Enterprises' Boards of Directors* (September 5, 2018) (COM-2018-005).



re-opened recommendation will now appear in our monthly compendium of open recommendations until FHFA takes action to effectively implement it.

Overall, our validation testing conducted since January 2015 has found that FHFA has fully implemented 8 of the 15 recommendations (53%) and has not fully implemented the remaining 7 (47%).

As you know, the authority vested in all OIGs under the IG Act is to recommend corrective actions, not to direct and implement such actions. While FHFA must respond to our recommendations and state whether or not it agrees and will implement corrective action, it is not required to adopt those recommendations. Therefore, our monthly compendium also identifies the recommendations that FHFA has rejected, which we closed as “unimplemented.” Transparency in the form of this monthly public reporting can lead to positive change, especially when a congressional oversight committee focuses attention on the deficiencies we have identified that the Agency has not agreed to fix.

#### **Recent Work**

The remainder of my written testimony will focus on two of the critical challenges facing FHFA: its conservatorship of the Enterprises and its supervision of the regulated entities.

#### **FHFA’s Conservatorship of Fannie Mae and Freddie Mac**

The Enterprises are among the largest financial institutions in this country and have been under the conservatorship of FHFA since September 2008. Putting the Enterprises into conservatorships has proven to be far easier than ending them, and the conservatorships have now entered their 11th year. FHFA’s stakeholders—including the Congress and the American taxpayers—expect FHFA, as conservator, to ensure that both Enterprises are effectively governed and employ sound risk management practices.

As conservator of the Enterprises, FHFA owes duties to the U.S. taxpayers, the largest shareholders in the Enterprises who, through Treasury, have invested more than \$191 billion in them and must ensure that the Enterprises achieve their statutory purpose. FHFA has delegated authority for many matters, both large and small, to the Enterprises and can revoke delegated authority at any time (and retains authority for certain significant decisions).

Given that FHFA has delegated to the Enterprises a significant portion of day-to-day management, I have made FHFA’s conservatorship of Fannie Mae and Freddie Mac one of



the principal risk areas of focus for FHFA-OIG. Because FHFA, as conservator, is ultimately responsible for all decisions made and actions taken by the Enterprises, pursuant to FHFA's revocable grant of delegated authority, our work during my tenure has looked at corporate governance for delegated matters at the Enterprises and FHFA's oversight of those delegated matters. During my tenure, FHFA-OIG has issued 37 reports that address FHFA's conservatorships of the Enterprises. See Appendix A.

Read together, the facts found in these reports reflect that FHFA has limited its oversight of delegated matters largely to sending FHFA employees to observe Enterprise internal management and board meetings, and to discussing matters with Enterprise executives and directors. **Our findings show that FHFA, as conservator, has not assessed the reasonableness of Enterprise actions taken pursuant to delegated authority nor has it assessed the adequacy of director oversight of management actions. Our reports show that FHFA also has not clearly defined the Agency's expectations of the Enterprises for delegated matters and has not established the accountability standard that it expects the Enterprises to meet for such matters.**

In addition, our work has identified **internal control systems at the Enterprises that fail to provide directors with accurate, timely, and sufficient information to enable them to exercise their oversight duties. Likewise, we have found a lack of rigor by some Enterprise directors in seeking information from management about the matters for which they are responsible. We have also identified instances in which corporate governance decisions typically reserved to a board of directors have been delegated to Enterprise management.**

Two of our recent reports, issued after my testimony in April of this year, are illustrative of these issues.

- *Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce*  
(September 6, 2018) (OIG-2018-004)

We received information from an anonymous source alleging excessive spending in connection with Fannie Mae's consolidation and relocation of its offices in the metro Washington, D.C., and in the metro Dallas, Texas, areas. In two management alerts issued in June and December 2016, we found a lack of oversight by FHFA as to the reasonableness of the budgeted build-out costs in the newly leased Class A office space by Fannie Mae in each area. As Fannie Mae's conservator, FHFA had a statutory duty to determine whether the efficiencies of the upgrades specified by Fannie Mae justified their estimated costs, and whether such upgrades were cost-effective or appropriate for an



entity in a federal conservatorship with an uncertain future to install in leased commercial space. We found no evidence that FHFA performed either assessment. With respect to the build-out costs for its newly leased office space in Washington, D.C., our June 2016 Management Alert made two specific recommendations to assist FHFA in performing those assessments, which FHFA accepted and committed to “implement them to the extent that [it was] not already doing so.”

In September 2017, we issued a special report that set forth our assessment of FHFA’s oversight of the costs of the build-out of this leased space over the previous year. We reported that FHFA advised us that Fannie Mae management was better able to select appropriate features and finishes for the build-out, and that it relied on Fannie Mae management to make those selections and keep FHFA informed. FHFA retained an expert that reviewed the reasonableness of certain individual upgrades when compared to the upgrades in the headquarters of major financial institutions and large public-sector agencies, including FHFA. **We found that FHFA, as conservator, never determined whether any, or all, of the individual upgrades “over and above” Class A space were appropriate expenditures for an entity in conservatorship with an uncertain future to install in leased commercial space.**

Most recently, on September 6, 2018, we issued a Management Alert in which we reviewed FHFA’s oversight of Fannie Mae’s decision to consolidate and relocate its workforce in Northern Virginia from three owned and one leased office buildings into leased space built out to Fannie Mae’s specifications in a new building to be constructed at the Reston Town Center. In its prior decisions to consolidate and relocate into rented space in Washington, D.C., and in Plano, Texas, Fannie Mae faced “action-forcing” events (such as lease terminations and significant downsizing of its regional workforce) and undertook a reasoned analysis of its options in order to make its decision. Because Fannie Mae documented those “action-forcing” events and its analysis of options for these two locations, we did not take issue with its decision to consolidate and relocate. We confined our analysis to FHFA’s failure to oversee the reasonableness of the build-out costs for leased space in both locations by a conserved entity.

With respect to Fannie Mae’s Northern Virginia offices, four FHFA officials responsible for oversight of Fannie Mae’s consolidation and relocation of its offices separately reported to us that the driver for the consolidation and relocation of the Northern Virginia



offices was implementation of a workplace strategy adopted by management.<sup>5</sup> All four FHFA officials acknowledged that Fannie Mae could continue to operate out of its current Northern Virginia offices for the indefinite future without substantial additional costs and without a negative impact on operations, an option that would avoid the significant costs associated with the office relocation plan.

All Fannie Mae directors should have been aware of our prior reports challenging the build-out costs for newly leased office space in Washington, D.C., and Plano, Texas. And yet, **we found no evidence that any director questioned management about whether it was feasible for Fannie Mae to continue to operate out of its three owned buildings in Northern Virginia for the indefinite future, and whether the cost of such an alternative would be lower than the cost of management's proposed plan to consolidate and relocate into newly leased space.** We also found that FHFA approved management's plan, with a projected cost of more than \$750 million, although that plan lacked any analysis whether Fannie Mae could continue operations in its existing, owned buildings at a significantly lower cost.

As conservator of Fannie Mae, FHFA has a statutory duty to "preserve and conserve" Fannie Mae's assets while operating it in a manner consonant with the public interest. Based on the information learned during our inquiry, we concluded that Fannie Mae failed to demonstrate that consolidation and relocation of its Northern Virginia offices into newly leased space, built out to its specifications, would be in the best interests of the taxpayers. As Fannie Mae documents showed and FHFA officials acknowledged, the sole driver of the consolidation and relocation of these offices was the desire by Fannie Mae management to implement its workplace strategy, even though Fannie Mae did not demonstrate the reasons why this strategy should be implemented for these offices or

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<sup>5</sup> Management explained to the Board its goals for its workplace strategy:

- A standard template for an open collaborative office environment with less rentable square feet/person;
- Robust technology that permits working from anywhere and fosters safety, soundness, and resiliency;
- Move from owned to leased facilities in one consolidated location per region;
- Locate in dynamic areas that attract and retain employees and provide features that Fannie Mae can use but does not have to build (e.g., auditorium, fitness center, food services); and
- Floor plans that produce organizational efficiency and are flexible to grow or contract based on business requirements and staffing demands.



quantify any associated cost savings in light of the actual condition of the owned buildings.

We stressed, as we did in our 2016 Management Alert regarding Fannie Mae's proposed build-out of its new headquarters, that Fannie Mae "arguably has little incentive to cabin its costs" because "any positive net worth it does not spend on itself will be swept into the Treasury as a dividend." We reported that the cost to consolidate and move Fannie Mae's Northern Virginia operations, with a net present value in excess of \$750 million, less the cost of continuing to operate in its owned buildings (which Fannie Mae did not calculate), are funds that could, and should, be put to better use.

In its response, FHFA objected to our findings and recommendations, claiming that we sought to substitute our judgment for that of FHFA. We have long recognized that FHFA, as conservator for the Enterprises, has delegated responsibility for a significant portion of day-to-day management to each Enterprise, which it can revoke at any time. FHFA, as conservator, must do more than monitor management's execution of delegated authority because FHFA itself is ultimately responsible for such actions. Unfortunately, FHFA simply deferred to the decision by Fannie Mae management to consolidate and relocate, rather than to determine whether management's decision was the most cost-effective option that would be in the best interest of the U.S. taxpayers, who have invested \$119.8 billion in Fannie Mae.

- *Administrative Review of a Potential Conflict of Interest Matter Involving a Senior Executive Officer at an Enterprise* (July 26, 2018) (OIG-2018-001)

We received information from an anonymous source alleging that Fannie Mae's [REDACTED] failed to make timely and complete disclosures about a potential conflict of interest involving [REDACTED] who was employed as the [REDACTED] of a Fannie Mae counterparty. In March 2017, we issued a Management Alert in which we found repeated failures by [REDACTED] regarding the timeliness and completeness of [REDACTED] conflicts disclosures. We found that [REDACTED] failures to disclose were consequential, both because they demonstrated repeated breaches of duty and because they deprived the board committee of the ability to exercise its essential oversight responsibilities to address [REDACTED] actual or apparent conflict of interest arising from [REDACTED]. We made two recommendations to the FHFA Director to address the repeated failures, including a recommendation for appropriate disciplinary action.



The FHFA Director reported to us that he did not need to decide whether [REDACTED] breached [REDACTED] duties as a [REDACTED]. Instead, he advised that he [REDACTED] and that [REDACTED] would [REDACTED]  
 [REDACTED]  
 [REDACTED] We closed our recommendations as rejected.

Less than two years later, [REDACTED] made conflict of interest disclosures in [REDACTED] regarding the employment of [REDACTED] as the [REDACTED] of [REDACTED]. In a Management Alert issued on July 26, 2018, we found that [REDACTED] did not disclose critical information about [REDACTED] that was known, or should have been known, by [REDACTED] that was significant to any conflicts of interest analysis and controls to mitigate the conflict.

At the time of [REDACTED] disclosures, [REDACTED] knew, or should have known, that [REDACTED], one of the credit score models then under active consideration for adoption by FHFA. FHFA, in a public request for information issued in December 2017, stated that Vantage Score was "equally co-owned" by the three largest credit reporting agencies, [REDACTED]. The FHFA Director characterized the decision whether to update the Enterprises' credit score requirement as the "most difficult issue that I have had to deal with" during his tenure.

While [REDACTED] disclosed the potential and actual employment of [REDACTED] as the [REDACTED] of [REDACTED] and characterized [REDACTED] as an "interested party," we found that [REDACTED] failed to disclose the nature of [REDACTED] interest or how its interest could give rise to a potential, apparent, or actual conflict of interest. In [REDACTED] interests were understood – erroneously – by Fannie Mae's ethics function and the board committee to be solely that of a potential vendor on a matter unrelated to [REDACTED]. The draft recusal agreement, prepared by Fannie Mae's ethics function, reflected the limited scope of Fannie Mae's relationship with [REDACTED]. When [REDACTED] reviewed the draft recusal agreement in [REDACTED] knew, or should have known from the scope of the agreement, that neither Fannie Mae's ethics function nor the responsible committee of the Fannie Mae board was aware of [REDACTED].



In [REDACTED], when [REDACTED] updated [REDACTED] disclosure to report that [REDACTED] had accepted the [REDACTED] position with [REDACTED], [REDACTED] did not identify [REDACTED]. After receipt of [REDACTED] updated disclosure, the ethics function identified [REDACTED] solely as a current vendor of services unrelated to [REDACTED]; again, [REDACTED] to [REDACTED], which would have required recusal with respect to [REDACTED], was not identified. **We found no evidence that the ethics function or the board committee was aware of [REDACTED], which stood to reap significant financial benefits if selected by the FHFA Director as an alternative credit score model.**

After review of our draft Management Alert, FHFA recognized that the existing recusal may not have been understood within Fannie Mae to reach [REDACTED] participation in the assessment whether [REDACTED] should be adopted as an alternative credit model and any discussion between [REDACTED] and FHFA on this issue. It reported, in its Management Response, that it "conducted a preliminary review to determine the extent, if any, to which [REDACTED] has been involved in any business decisions related to [REDACTED] and/or [REDACTED] since the date of the recusal" and its "preliminary review has not found any involvement by [REDACTED]" It further reported that the board committee, which was informed of [REDACTED] by our draft alert, would consider at an upcoming board meeting "revisions to the recusal."

Fannie Mae announced that [REDACTED] decided to step down [REDACTED] [REDACTED]; that announcement was on [REDACTED]. FHFA provided a management response to our draft alert, which we issued in final form [REDACTED]. The board committee responsible for conducting a comprehensive review of the matter reported to FHFA on [REDACTED], that [REDACTED] disclosures to Fannie Mae's ethics function regarding [REDACTED] potential and actual employment at [REDACTED] were timely, complete, and consistent with applicable Fannie Mae policies. The committee reached this conclusion, notwithstanding (1) [REDACTED] failure to disclose [REDACTED] and (2) its understanding that the Fannie Mae ethics function, and the employees with whom the ethics function spoke, were unaware of [REDACTED] or of the potential financial benefit from Enterprise adoption of [REDACTED] as an alternative credit score model. Our recommendations, with which FHFA agreed, remain open.



### **FHFA's Supervision of its Regulated Entities**

FHFA has long recognized that effective supervision of the entities it regulates is fundamental to ensuring their safety and soundness. During my tenure, FHFA-OIG has issued 46 reports involving FHFA's supervision of its regulated entities. See Appendix B.

As FHFA Director Watt has observed in prior Congressional testimony, Fannie Mae and Freddie Mac would be Systemically Important Financial Institutions (SIFIs), but for the conservatorships, and are subject to the heightened supervision requirements for SIFIs, except that they are supervised by FHFA, not the Federal Reserve. Because the asset size of the FHLBanks and Office of Finance, together, is a fraction of the asset size of the Enterprises and because the Enterprises are in conservatorship, we determined that the magnitude of risk is significantly greater for the Enterprises and, accordingly, during my tenure at FHFA-OIG, the majority of our work on supervision issues has focused on FHFA's supervision of the Enterprises. Many of those reports identified shortcomings, which I discussed in my testimony earlier this year before the Subcommittee on Oversight and Investigations, U.S. House Committee on Financial Services, and incorporate by reference here.

One of our recent reports, on the status of FHFA's commissioned examiner program, *FHFA's Housing Finance Examiner Commissioning Program: \$7.7 Million and Four Years into the Program, the Agency has Fewer Commissioned Examiners* (September 6, 2018) (COM-2018-006), highlights shortcomings in FHFA's supervision of its regulated entities.

A September 2011 evaluation report on the Agency's capacity to examine the Enterprises found that only about one-third of FHFA's examiners were commissioned, and the Agency lacked a commission program. Agency officials reported to us at that time that the efficiency and effectiveness of the Agency's examination program was impeded by an insufficient number of commissioned examiners. When the 2011 report was issued, FHFA was in the early stages of developing an examiner commission program, patterned after programs at other federal financial regulatory agencies. We recommended that FHFA management "[m]onitor the development and implementation of the examiner [commission] program, and take needed actions to address any shortfalls."

FHFA agreed with our recommendation; in October 2012, we closed that recommendation based upon the Agency's development of the program as of that date.

FHFA completed the development of its Housing Finance Examiner (HFE) Program in 2013 and opened enrollment to Agency employees in August of that year. According to FHFA, the goal of



the HFE Program is to produce examiners with “broad-based knowledge to conduct successful risk-based examinations” and “the skills and technical knowledge necessary to evaluate the condition and practices of the entities that FHFA supervises” in “approximately four years.” Examiners could also receive HFE commissions based on having been commissioned previously by other financial regulators. During the first half of 2014, FHFA awarded the first HFE commissions to 59 examiners, based on commissions issued from other financial regulators. The Agency’s acknowledgement of the importance of commissioned examiners is further underscored by its requirement that all non-commissioned examiners hired after July 17, 2013, are required to enroll in the program and to obtain their commissions.

Between July 2015 and March 2017, we issued two reports in which we assessed whether the HFE Program was on track to produce commissioned examiners; on both occasions we found it was not. Almost seven years after the 2011 evaluation issued, we launched a third study to assess whether the HFE Program has increased the number of commissioned examiners on the FHFA staff and to determine how FHFA uses its commissioned examiners. We found that, **during that almost seven-year period, the Agency invested approximately \$7.7 million in developing, implementing, and staffing its HFE Program but, since the Agency began awarding HFE commissions in 2014, the total number of its commissioned examiners has decreased from 59 (as of June 2014) to 58 (as of June 2018).**

The evidence obtained during our work reflects that the Agency’s HFE Program suffers from a high non-completion rate. Of the 66 examiners who enrolled in 2013, only 6 completed the HFE Program and passed its final examination. By June 2018, more than half (36) were no longer enrolled in the HFE Program. The remaining 24 continued to be enrolled as of June 1, 2018, almost five years into the approximately four-year program, and one-third (8) had completed less than 75% of the Program’s requirements after five years. (Three additional examiners who enrolled in the HFE Program after 2013 completed it and passed the final examination.)

Our study also sought to assess the Agency’s deployment of its commissioned examiners. FHFA acknowledges that “Congress virtually duplicated the examination regime applicable to banks when it designed the examination regime” for the Enterprises and FHLBanks. We learned that the Office of the Comptroller of the Currency, which is responsible for the supervision of all national banks, requires a commissioned examiner to lead examinations, and the Federal Reserve, which is responsible for the supervision of bank holding companies, states that “[a]s a general policy, a commissioned examiner” should lead all “examinations and inspections.” However, we found that **of FHFA’s 53 targeted examinations of the Enterprises for the last two supervisory cycles – examinations defined by the Agency as a “deep or comprehensive**



**assessment” of areas of high importance or risk, *not one* was led by commissioned examiners.** By comparison, we found that roughly 75% of the examinations of the FHLBanks have been led by commissioned examiners.

We also learned that most of the HFE Program has been suspended or is under internal review. It remains to be seen whether the ongoing internal review will produce substantive changes to the HFE Program that will increase its effectiveness and produce HFE commissioned examiners within a four-year window. To date, the Agency’s investment of approximately \$7.7 million in developing, implementing, and staffing the HFE Program has not yielded the anticipated results.

### **Conclusion**

Currently, FHFA serves in a unique role: it is both conservator of and regulator for the Enterprises and regulator for the FHLBanks. Its duties as conservator of the Enterprises, which together own or guarantee more than \$5 trillion in mortgages, are fundamentally different from its responsibilities as their supervisor. FHFA’s stakeholders, including the Congress, American taxpayers, and others, expect FHFA, as conservator, to ensure that both Enterprises are effectively governed and employ sound risk management practices; they also expect FHFA, as regulator, to exercise vigilant supervision of its regulated entities to ensure that they operate in a safe and sound manner. As our work demonstrates, FHFA has been challenged by numerous shortcomings in carrying out its dual roles. While accepting many of our recommendations to address the identified shortcomings, FHFA has rejected others, and, as our compliance testing shows, has not fully implemented 47% of the promised corrective actions that we tested.

I thank this Committee for the opportunity to testify today. I am happy to answer any questions that you may have.



**APPENDIX A: FHFA-OIG REPORTS ISSUED FROM OCTOBER 28, 2014, THROUGH SEPTEMBER 25, 2018, ON FHFA'S CONSERVATORSHIPS OF THE ENTERPRISES**

*Audit of FHFA's Oversight of the Enterprises' Affordable Housing Set-Asides and Allocations* (September 24, 2018) (AUD-2018-012) (online at [www.flfaoig.gov/Content/Files/AUD-2018-012%20FHFA%20Oversight%20of%20Affordable%20Housing.pdf](http://www.flfaoig.gov/Content/Files/AUD-2018-012%20FHFA%20Oversight%20of%20Affordable%20Housing.pdf))

*An Overview of Enterprise Appraisal Waivers* (September 14, 2018) (WPR-2018-006) (online at [www.flfaoig.gov/Content/Files/WPR-2018-006.pdf](http://www.flfaoig.gov/Content/Files/WPR-2018-006.pdf))

*Freddie Mac's IMAGIN Pilot* (September 12, 2018) (WPR-2018-005) (online at [www.flfaoig.gov/Content/Files/WPR-2018-005.pdf](http://www.flfaoig.gov/Content/Files/WPR-2018-005.pdf))

*Management Advisory: Freddie Mac's Reimbursement of Certain Employees' Commuting Expenses* (September 6, 2018) (OIG-2018-003) (online at [www.flfaoig.gov/Content/Files/OIG-2018-003%20Management%20Advisory%20on%20Freddie%20Mac%20Reimbursement%20of%20Commuting%20Expenses.pdf](http://www.flfaoig.gov/Content/Files/OIG-2018-003%20Management%20Advisory%20on%20Freddie%20Mac%20Reimbursement%20of%20Commuting%20Expenses.pdf))

*Consolidation and Relocation of Fannie Mae's Northern Virginia Workforce* (September 6, 2018) (OIG-2018-004) (online at [www.flfaoig.gov/Content/Files/Management%20Alert%20OIG-2018-004.pdf](http://www.flfaoig.gov/Content/Files/Management%20Alert%20OIG-2018-004.pdf))

*Administrative Review of a Potential Conflict of Interest Matter Involving a Senior Executive Officer at an Enterprise* (July 26, 2018) (OIG-2018-001) (online at [www.flfaoig.gov/Content/Files/Management%20Alerts\\_OIG-2018-001\\_Redacted%20with%20Redaction%20Codes%29.pdf](http://www.flfaoig.gov/Content/Files/Management%20Alerts_OIG-2018-001_Redacted%20with%20Redaction%20Codes%29.pdf))

*FHFA Letters of Instruction to the Enterprises* (July 23, 2018) (WPR-2018-004) (online at [www.flfaoig.gov/Content/Files/WPR-2018-004.pdf](http://www.flfaoig.gov/Content/Files/WPR-2018-004.pdf))

*Compliance Review of FHFA's Process for Making Changes to Conservatorship Scorecard Targets* (June 20, 2018) (COM-2018-004) (online at [www.flfaoig.gov/Content/Files/Conservatorship%20Scorecard%20%28COM-2018-004%29.pdf](http://www.flfaoig.gov/Content/Files/Conservatorship%20Scorecard%20%28COM-2018-004%29.pdf))



*Update on FHFA's Implementation of its Revised Standards for Overseeing the Enterprises' Single-Family Mortgage Underwriting Standards and Variances* (March 27, 2018) (COM-2018-003) (online at [www.fhfaoig.gov/Content/Files/Update%20on%20FHFA%20Procedures%20for%20Overseeing%20Enterprises%20Single-Family%20Mortgage%20Underwriting%20Standards%20%28COM-2018-003%29.pdf](http://www.fhfaoig.gov/Content/Files/Update%20on%20FHFA%20Procedures%20for%20Overseeing%20Enterprises%20Single-Family%20Mortgage%20Underwriting%20Standards%20%28COM-2018-003%29.pdf))

*Enterprise Counterparties: Custodial Depository Institutions* (March 27, 2018) (WPR-2018-003) (online at [www.fhfaoig.gov/Content/Files/WPR-2018-003.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2018-003.pdf))

*Audit of FHFA's Oversight of Freddie Mac's Compliance with the Required Risk Mitigants of Automated Underwriting, Mortgage Insurance, and Homeownership Education for its Purchases of Mortgages with a 97% LTV* (March 8, 2018) (AUD-2018-004) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-004%20FHFA%27s%20Oversight%20of%20Freddie%20Mac%27s%2097%20LTV%20Program%20%28public%29.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-004%20FHFA%27s%20Oversight%20of%20Freddie%20Mac%27s%2097%20LTV%20Program%20%28public%29.pdf))

*Audit of FHFA's Oversight of Fannie Mae's Compliance with the Required Risk Mitigants of Automated Underwriting, Mortgage Insurance, and Homeownership Education for its Purchases of Mortgages with a 97% LTV* (March 8, 2018) (AUD-2018-003) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-003%20FHFA%27s%20Oversight%20of%20Fannie%20Mae%27s%2097%20LTV%20Program%20%28Public%29.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-003%20FHFA%27s%20Oversight%20of%20Fannie%20Mae%27s%2097%20LTV%20Program%20%28Public%29.pdf))

*Enterprise Counterparties: Mortgage Insurers* (February 16, 2018) (WPR-2018-002) (online at [www.fhfaoig.gov/Content/Files/WPR-2018-002.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2018-002.pdf))

*Compliance Review of FHFA's Review Process for Transfers of Enterprise Mortgage Servicing Rights* (February 6, 2018) (COM-2018-001) (online at [www.fhfaoig.gov/Content/Files/MSR%20Transfers%20-%20COM-2018-001.pdf](http://www.fhfaoig.gov/Content/Files/MSR%20Transfers%20-%20COM-2018-001.pdf))

*Corporate Governance: Review and Resolution of Conflicts of Interest Involving Fannie Mae's Senior Executive Officers Highlight the Need for Closer Attention to Governance Issues by FHFA* (January 31, 2018) (EVL-2018-001) (online at [www.fhfaoig.gov/Content/Files/EVL-2018-001%20%28Redacted%29.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2018-001%20%28Redacted%29.pdf))



*Fannie Mae and Freddie Mac Purchases of Adjustable-Rate Mortgages* (January 4, 2018) (WPR-2018-001) (online at [www.fhfaoig.gov/Content/Files/WPR-2018-001.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2018-001.pdf))

*Special Report: Update on FHFA's Oversight of Fannie Mae's Build-Out of its Newly Leased Class A Office Space in Midtown Center* (September 28, 2017) (COM-2017-007) (online at [www.fhfaoig.gov/Content/Files/pw%20DC%20Lease%20Update%209%2028%2017.pdf](http://www.fhfaoig.gov/Content/Files/pw%20DC%20Lease%20Update%209%2028%2017.pdf))

*Management Alert: Need for Increased Oversight by FHFA, as Conservator, to Ensure that Freddie Mac's Policies and Procedures for Resolution of Executive Officer Conflicts of Interest Align with the Responsibilities of the Nominating and Governance Committee of the Freddie Mac Board of Directors* (September 27, 2017) (OIG-2017-005) (online at [www.fhfaoig.gov/Content/Files/OIG-2017-005%20%28Redacted%29.pdf](http://www.fhfaoig.gov/Content/Files/OIG-2017-005%20%28Redacted%29.pdf))

*Compliance Review of FHFA's Revised Process for Reviewing the Enterprises' Annual Operating Budgets* (September 19, 2017) (COM-2017-006) (online at [www.fhfaoig.gov/Content/Files/COM-2017-006\\_Redacted.pdf](http://www.fhfaoig.gov/Content/Files/COM-2017-006_Redacted.pdf))

*Fannie Mae and Freddie Mac in the Multifamily Market* (September 7, 2017) (WPR-2017-002) (online at [www.fhfaoig.gov/Content/Files/WPR-2017-002.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2017-002.pdf))

*Existing Statutory Capital Requirements for Fannie Mae and Freddie Mac* (August 17, 2017) (WPR-2017-001) (online at [www.fhfaoig.gov/Content/Files/WPR-2017-001.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2017-001.pdf))

*NPL Sales: Additional Controls Would Increase Compliance with FHFA's Sales Requirements* (July 24, 2017) (AUD-2017-006) (online at [www.fhfaoig.gov/Content/Files/AUD-2017-006%20NPL%20Sales%20Additional%20Controls%20Would%20Increase%20Compliance%20with%20FHFA%27s%20Sales%20Requirements.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2017-006%20NPL%20Sales%20Additional%20Controls%20Would%20Increase%20Compliance%20with%20FHFA%27s%20Sales%20Requirements.pdf))

*Administrative Investigation into Anonymous Hotline Complaints Concerning Timeliness and Completeness of Disclosures Regarding a Potential Conflict of Interest by a Senior Executive Officer of an Enterprise* (March 23, 2017) (OIG-2017-004) (online at [www.fhfaoig.gov/Content/Files/Administrative%20Investigation%20into%20Anonymous%20Hotline%20Complaints%20Concerning%20Timeliness%20and%20Completeness%20of%20Disclosures%20Regarding%20a%20Potential%20Conflict%20of%20Interest%20by%20a%20Senior%20Executive%20Officer%20of%20an%20Enterprise\\_0.pdf](http://www.fhfaoig.gov/Content/Files/Administrative%20Investigation%20into%20Anonymous%20Hotline%20Complaints%20Concerning%20Timeliness%20and%20Completeness%20of%20Disclosures%20Regarding%20a%20Potential%20Conflict%20of%20Interest%20by%20a%20Senior%20Executive%20Officer%20of%20an%20Enterprise_0.pdf))



*Fannie Mae's Dallas Regional Headquarters Project* (December 15, 2016) (OIG-2017-002) (online at [www.fhfaoig.gov/Content/Files/OIG-2017-002.pdf](http://www.fhfaoig.gov/Content/Files/OIG-2017-002.pdf))

*Update on the Status of the Development of the Common Securitization Platform* (December 9, 2016) (COM-2017-001) (online at [www.fhfaoig.gov/Content/Files/COM-2017-001\\_0.pdf](http://www.fhfaoig.gov/Content/Files/COM-2017-001_0.pdf))

*Shale Oil Boom and Bust: Implications for the Mortgage Market* (September 7, 2016) (WPR-2016-003) (online at [www.fhfaoig.gov/Content/Files/WPR-2016-003.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2016-003.pdf))

*Management Alert: Need for Increased Oversight by FHFA, as Conservator of Fannie Mae, of the Projected Costs Associated with Fannie Mae's Headquarters Consolidation and Relocation Project* (June 16, 2016) (COM-2016-004) (online at [www.fhfaoig.gov/Content/Files/COM-2016-004\\_Revised%209\\_22\\_16.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-004_Revised%209_22_16.pdf))

*Corporate Governance: Cyber Risk Oversight by the Fannie Mae Board of Directors Highlights the Need for FHFA's Closer Attention to Governance Issues* (March 31, 2016) (EVL-2016-006) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-006\\_0.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-006_0.pdf))

*FHFA's Oversight of the Enterprises' Implementation of and Compliance with Conservatorship Directives during an 18-Month Period* (March 28, 2016) (ESR-2016-002) (online at [www.fhfaoig.gov/Content/Files/ESR-2016-002.pdf](http://www.fhfaoig.gov/Content/Files/ESR-2016-002.pdf))

*Review of FHFA's Tracking and Rating of the 2013 Scorecard Objective for the New Representation and Warranty Framework Reveals Opportunities to Strengthen the Process* (March 28, 2016) (AUD-2016-002) (online at [www.fhfaoig.gov/Content/Files/AUD-2016-002.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2016-002.pdf))

*Compliance Review of FHFA's Oversight of Enterprise Executive Compensation Based on Corporate Scorecard Performance* (March 17, 2016) (COM-2016-002) (online at [www.fhfaoig.gov/Content/Files/COM-2016-002\\_0.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-002_0.pdf))

*\$1.1 Billion Increase in Expenses for Fannie Mae and Freddie Mac from 2012 through 2015: Where the Money Went* (March 9, 2016) (WPR-2016-001) (online at [www.fhfaoig.gov/Content/Files/v2%20WPR-2016-001\\_0.pdf](http://www.fhfaoig.gov/Content/Files/v2%20WPR-2016-001_0.pdf))



*Compliance Review of FHFA's Implementation of its Procedures for Overseeing the Enterprises' Single-Family Mortgage Underwriting Standards and Variances* (December 17, 2015) (COM-2016-001) (online at [www.fhfaoig.gov/Content/Files/COM-2016-001\\_1.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-001_1.pdf))

*FHFA's Exercise of Its Conservatorship Powers to Review and Approve the Enterprises' Annual Operating Budgets Has Not Achieved FHFA's Stated Purpose* (September 30, 2015) (EVL-2015-006) (online at [www.fhfaoig.gov/Content/Files/EVL-2015-006.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2015-006.pdf))

*FHFA's Conservatorships of Fannie Mae and Freddie Mac: A Long and Complicated Journey* (March 25, 2015) (WPR-2015-002) (online at [www.fhfaoig.gov/Content/Files/WPR-2015-002\\_0.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2015-002_0.pdf))

*The Continued Profitability of Fannie Mae and Freddie Mac Is Not Assured* (March 18, 2015) (WPR-2015-001) (online at [www.fhfaoig.gov/Content/Files/WPR-2015-001.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2015-001.pdf))

*FHFA's Oversight of Governance Risks Associated with Fannie Mae's Selection and Appointment of a New Chief Audit Executive* (March 11, 2015) (EVL-2015-004) (online at [www.fhfaoig.gov/Content/Files/EVL-2015-004\\_0.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2015-004_0.pdf))



**APPENDIX B: FHFA-OIG REPORTS ISSUED FROM OCTOBER 28, 2014, THROUGH SEPTEMBER 25, 2018, ON FHFA'S SUPERVISION PROGRAM FOR ITS REGULATED ENTITIES**

*FHFA Should Re-evaluate and Revise Fraud Reporting by the Enterprises to Enhance its Utility* (September 24, 2018) (EVL-2018-004) (online at [www.fhfaoig.gov/Content/Files/EVL-2018-004.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2018-004.pdf))

*FHFA's Housing Finance Examiner Commission Program: \$7.7 Million and Four Years into the Program, the Agency has Fewer Commissioned Examiners* (September 6, 2018) (COM-2018-006) (online at [www.fhfaoig.gov/Content/Files/Compliance%20Review%20COM-2018-006.pdf](http://www.fhfaoig.gov/Content/Files/Compliance%20Review%20COM-2018-006.pdf))

*Compliance Review of FHFA's Communications of Serious Deficiencies to the Enterprises' Boards of Directors* (September 5, 2018) (COM-2018-005) (online at [www.fhfaoig.gov/Content/Files/Compliance%20Review%20of%20FHFA%20Communication%20of%20Serious%20Deficiencies.pdf](http://www.fhfaoig.gov/Content/Files/Compliance%20Review%20of%20FHFA%20Communication%20of%20Serious%20Deficiencies.pdf))

*DBR's Safety and Soundness Quality Control Reviews Were Conducted in Compliance with FHFA's Standard During the 2017 Examination Cycle but DBR's Community Investment Quality Control Reviews Were Not* (August 17, 2018) (AUD-2018-010) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-010%20DBR%20Quality%20Control%20Reviews%20During%20the%202017%20Examination%20Cycle.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-010%20DBR%20Quality%20Control%20Reviews%20During%20the%202017%20Examination%20Cycle.pdf))

*FHFA Failed to Ensure Freddie Mac's Remedial Plans for a Cybersecurity MRA Addressed All Deficiencies; as Allowed by its Standard, FHFA Closed the MRA after Independently Determining the Enterprise Completed its Planned Remedial Actions* (March 28, 2018) (AUD-2018-008) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-008%20FRE%20Cyber%20MRA%20Closure%20%28public%29%20Redacted.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-008%20FRE%20Cyber%20MRA%20Closure%20%28public%29%20Redacted.pdf))

*As Allowed by its Standard, FHFA Closed Three Fannie Mae Cybersecurity MRAs after Independently Determining the Enterprise Completed its Planned Remedial Actions* (March 28, 2018) (AUD-2018-007) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-007%20FNM%20Cyber%20MRAs%20%28public%29%20Redacted.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-007%20FNM%20Cyber%20MRAs%20%28public%29%20Redacted.pdf))



*FHFA's Adoption of Clear Guidance on the Review of the Enterprises' Internal Audit Work When Assessing the Sufficiency of Remediation of Serious Deficiencies Would Assist FHFA Examiners (March 28, 2018) (EVL-2018-003) (online at [www.fhfaoig.gov/Content/Files/EVL-2018-003.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2018-003.pdf))*

*FHFA Requires the Enterprises' Internal Audit Functions to Validate Remediation of Serious Deficiencies but Provides No Guidance and Imposes No Preconditions on Examiners' Use of that Validation Work (March 28, 2018) (EVL-2018-002) (online at [www.fhfaoig.gov/Content/Files/EVL-2018-002\\_Redacted.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2018-002_Redacted.pdf))*

*FHFA Should Address the Potential Disparity Between the Statutory Requirement for Fraud Reporting and its Implementing Regulation and Advisory Bulletin (March 23, 2018) (COM-2018-002) (online at [www.fhfaoig.gov/Content/Files/2018\\_03\\_23%20Enterprise%20Fraud%20Reporting\\_FINAL\\_.pdf](http://www.fhfaoig.gov/Content/Files/2018_03_23%20Enterprise%20Fraud%20Reporting_FINAL_.pdf))*

*FHFA Completed its Planned Procedures for a 2016 Representation and Warranty Framework Targeted Examination at Freddie Mac, but the Supporting Workpapers Did Not Sufficiently Document the Examination Work (March 13, 2018) (AUD-2018-006) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-006%20FRE%20RWF%202016%20Targeted%20Examination%20%28public%29\\_Redacted.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-006%20FRE%20RWF%202016%20Targeted%20Examination%20%28public%29_Redacted.pdf))*

*FHFA Completed its Planned Procedures for a 2015 Representation and Warranty Framework Targeted Examination at Fannie Mae, but Did Not Document a Change to Planned Testing (March 13, 2018) (AUD-2018-005) (online at [www.fhfaoig.gov/Content/Files/AUD-2018-005%20FNM%20RWF%202015%20Targeted%20Examination%20%28public%29\\_Redacted.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2018-005%20FNM%20RWF%202015%20Targeted%20Examination%20%28public%29_Redacted.pdf))*

*FHFA Did Not Complete All Planned Supervisory Activities Related to Cybersecurity Risks at Freddie Mac for the 2016 Examination Cycle (September 27, 2017) (AUD-2017-011) (online at [www.fhfaoig.gov/Content/Files/AUD-2017-011%20FRE%20Cyber%20Examinations%20%28redacted%29.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2017-011%20FRE%20Cyber%20Examinations%20%28redacted%29.pdf))*

*FHFA Failed to Complete Non-MRA Supervisory Activities Related to Cybersecurity Risks at Fannie Mae Planned for the 2016 Examination Cycle (September 27, 2017) (AUD-2017-010) (online at [www.fhfaoig.gov/Content/Files/AUD-2017-010%20FNM%20Cyber%20Examinations%20Redacted\\_Redacted.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2017-010%20FNM%20Cyber%20Examinations%20Redacted_Redacted.pdf))*



*FHFA's 2015 and 2016 Supervisory Activities, as Planned, Addressed Identified Risks with Freddie Mac's New Representation and Warranty Framework* (September 22, 2017) (AUD-2017-009) (online at [www.fhfaoig.gov/Content/Files/AUD-2017-009%20FRE%20RWF%20Examinations%20%28redacted%29.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2017-009%20FRE%20RWF%20Examinations%20%28redacted%29.pdf))

*FHFA's 2015 Report of Examination to Fannie Mae Failed to Follow FHFA's Standards Because it Reported on an Incomplete Targeted Examination of the Enterprise's New Representation and Warranty Framework* (September 22, 2017) (AUD-2017-008) (online at [www.fhfaoig.gov/Content/Files/AUD-2017-008%20FNM%20RWF%20Examinations%20%28redacted%29.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2017-008%20FNM%20RWF%20Examinations%20%28redacted%29.pdf))

*The Gap in FHFA's Quality Control Review Program Increases the Risk of Inaccurate Conclusions in its Reports of Examination of Fannie Mae and Freddie Mac* (August 17, 2017) (EVL-2017-006) (online at [www.fhfaoig.gov/Content/Files/EVL-2017-006.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2017-006.pdf))

*FHFA Should Improve its Administration of the Suspended Counterparty Program* (July 31, 2017) (COM-2017-005) (online at [www.fhfaoig.gov/Content/Files/SCP%20Final.pdf](http://www.fhfaoig.gov/Content/Files/SCP%20Final.pdf))

*FHFA's Compliance with its Documentary Standards for Issuing Housing Finance Examiner Commissions* (July 25, 2017) (COM-2017-004) (online at [www.fhfaoig.gov/Content/Files/HFReport%2007-10-17.pdf](http://www.fhfaoig.gov/Content/Files/HFReport%2007-10-17.pdf))

*Closure of OIG Review of FHFA's Supervision of an Enterprise's Remediation of Matters Requiring Attention* (June 12, 2017) (ESR-2017-005) (online at [www.fhfaoig.gov/Content/Files/ESR-2017-005.pdf](http://www.fhfaoig.gov/Content/Files/ESR-2017-005.pdf))

*FHFA's Examination Program for the FHLBanks' Internal Audit Functions Was Adequately Designed and Executed* (May 5, 2017) (AUD-2017-003) (online at [www.fhfaoig.gov/Content/Files/2017%2005%2005%20AUD-2017-003.pdf](http://www.fhfaoig.gov/Content/Files/2017%2005%2005%20AUD-2017-003.pdf))

*FHFA's Practice for Rotation of its Examiners Is Inconsistent between its Two Supervisory Divisions* (March 28, 2017) (EVL-2017-004) (online at [www.fhfaoig.gov/Content/Files/EVL-2017-004.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2017-004.pdf))



*Update on FHFA's Implementation of its Housing Finance Examiner Commission Program*  
 (March 22, 2017) (COM-2017-003) (online at [www.fhfaoig.gov/Content/Files/Update%20on%20HFE%20Program-final.pdf](http://www.fhfaoig.gov/Content/Files/Update%20on%20HFE%20Program-final.pdf))

*Directives from the Audit Committee of the Freddie Mac Board of Directors Caused Management to Improve its Reporting about Remediation of Serious Deficiencies from October 2015 through September 2016* (March 22, 2017) (ESR-2017-003) (online at [www.fhfaoig.gov/Content/Files/ESR-2017-003.pdf](http://www.fhfaoig.gov/Content/Files/ESR-2017-003.pdf))

*Compliance Review of Federal Home Loan Bank Fraud Reporting to FHFA* (January 24, 2017) (COM-2017-002) (online at [www.fhfaoig.gov/Content/Files/COM-2017-002.pdf](http://www.fhfaoig.gov/Content/Files/COM-2017-002.pdf))

*FHFA's Examinations Have Not Confirmed Compliance by One Enterprise with its Advisory Bulletins Regarding Risk Management of Nonbank Sellers and Servicers* (December 21, 2016) (EVL-2017-002) (online at [www.fhfaoig.gov/Content/Files/EVL-2017-002.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2017-002.pdf))

*Safe and Sound Operation of the Enterprises Cannot Be Assumed Because of Significant Shortcomings in FHFA's Supervision Program for the Enterprises* (Roll-Up Report) (OIG-2017-003) (December 15, 2016) (online at [www.fhfaoig.gov/Content/Files/OIG-2017-003.pdf](http://www.fhfaoig.gov/Content/Files/OIG-2017-003.pdf))

*FHFA's Targeted Examinations of Freddie Mac: Just Over Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed* (September 30, 2016) (AUD-2016-007) (online at [www.fhfaoig.gov/Content/Files/AUD-2016-007.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2016-007.pdf))

*FHFA's Targeted Examinations of Fannie Mae: Less than Half of the Targeted Examinations Planned for 2012 through 2015 Were Completed and No Examinations Planned for 2015 Were Completed Before the Report of Examination Issued* (September 30, 2016) (AUD-2016-006) (online at [www.fhfaoig.gov/Content/Files/AUD-2016-006.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2016-006.pdf))

*FHFA's Supervisory Planning Process for the Enterprises: Roughly Half of FHFA's 2014 and 2015 High-Priority Planned Targeted Examinations Did Not Trace to Risk Assessments and Most High-Priority Planned Examinations Were Not Completed* (September 30, 2016) (AUD-2016-005) (online at [www.fhfaoig.gov/Content/Files/AUD-2016-005.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2016-005.pdf))



*DBR's Unwritten Procedures and Practices for Oversight of Efforts by Federal Home Loan Banks to Correct Deficiencies Underlying the Most Serious Supervisory Matters Are Inconsistent with the Written Oversight Requirements Promulgated by FHFA* (September 30, 2016) (COM-2016-006) (online at [www.fhfaoig.gov/Content/Files/COM-2016-006.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-006.pdf))

*FHFA Failed to Consistently Deliver Timely Reports of Examination to the Enterprise Boards and Obtain Written Responses from the Boards Regarding Remediation of Supervisory Concerns Identified in those Reports* (July 14, 2016) (EVL-2016-009) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-009.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-009.pdf))

*Compliance Review of FHFA's Implementation of its Consumer Communications Procedures* (July 14, 2016) (COM-2016-005) (online at [www.fhfaoig.gov/Content/Files/COM-2016-005.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-005.pdf))

*FHFA's Failure to Consistently Identify Specific Deficiencies and Their Root Causes in Its Reports of Examination Constrains the Ability of the Enterprise Boards to Exercise Effective Oversight of Management's Remediation of Supervisory Concerns* (July 14, 2016) (EVL-2016-008) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-008.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-008.pdf))

*FHFA's Inconsistent Practices in Assessing Enterprise Remediation of Serious Deficiencies and Weaknesses in its Tracking Systems Limit the Effectiveness of FHFA's Supervision of the Enterprises* (July 14, 2016) (EVL-2016-007) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-007.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-007.pdf))

*FHFA's Implementation of Its Automated System to Track Deficiencies Identified in Federal Home Loan Bank Examinations* (May 26, 2016) (COM-2016-003) (online at [www.fhfaoig.gov/Content/Files/COM-2016-003.pdf](http://www.fhfaoig.gov/Content/Files/COM-2016-003.pdf))

*FHFA's Supervisory Standards for Communication of Serious Deficiencies to Enterprise Boards and for Board Oversight of Management's Remediation Efforts are Inadequate* (March 31, 2016) (EVL-2016-005) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-005.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-005.pdf))

*FHFA's Examiners Did Not Meet Requirements and Guidance for Oversight of an Enterprise's Remediation of Serious Deficiencies* (March 29, 2016) (EVL-2016-004) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-004.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-004.pdf))



*FHFA Should Map Its Supervisory Standards for Cyber Risk Management to Appropriate Elements of the NIST Framework* (March 28, 2016) (EVL-2016-003) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-003.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-003.pdf))

*Merger of the Federal Home Loan Banks of Des Moines and Seattle: FHFA's Role and Approach for Overseeing the Continuing FHLBank* (March 16, 2016) (WPR-2016-002) (online at [www.fhfaoig.gov/Content/Files/WPR-2016-002.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2016-002.pdf))

*FHFA Should Improve its Examinations of the Effectiveness of the Federal Home Loan Banks' Cyber Risk Management Programs by Including an Assessment of the Design of Critical Internal Controls* (February 29, 2016) (AUD-2016-001) (online at [www.fhfaoig.gov/Content/Files/AUD-2016-001.pdf](http://www.fhfaoig.gov/Content/Files/AUD-2016-001.pdf))

*Utility of FHFA's Semi-Annual Risk Assessments Would Be Enhanced Through Adoption of Clear Standards and Defined Measures of Risk Levels* (January 4, 2016) (EVL-2016-001) (online at [www.fhfaoig.gov/Content/Files/EVL-2016-001.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2016-001.pdf))

*Intermittent Efforts Over Almost Four Years to Develop a Quality Control Review Process Deprived FHFA of Assurance of the Adequacy and Quality of Enterprise Examinations* (September 30, 2015) (EVL-2015-007) (online at [www.fhfaoig.gov/Content/Files/EVL-2015-007.pdf](http://www.fhfaoig.gov/Content/Files/EVL-2015-007.pdf))

*OIG's Compliance Review of FHFA's Implementation of Its Housing Finance Examiner Commission Program* (July 29, 2015) (COM-2015-001) (online at [www.fhfaoig.gov/Content/Files/COM-2015-001.pdf](http://www.fhfaoig.gov/Content/Files/COM-2015-001.pdf))

*Letter to Congress: Real Estate Owned Maintenance Vendors* (July 24, 2015) (online at [www.fhfaoig.gov/Content/Files/REO%20maintenance%20vendors.pdf](http://www.fhfaoig.gov/Content/Files/REO%20maintenance%20vendors.pdf))

*Cyber Security: An Overview of FHFA's Oversight of and Attention to the Enterprises' Management of Their IT Infrastructures* (March 31, 2015) (WPR-2015-003) (online at [www.fhfaoig.gov/Content/Files/WPR-2015-003.pdf](http://www.fhfaoig.gov/Content/Files/WPR-2015-003.pdf))



*FHFA's Oversight of Two Mission-Related Requirements for Federal Home Loan Bank Long-Term Advances* (March 31, 2015) (ESR-2015-005) (online at [www.fhfaoig.gov/Content/Files/ESR-2015-005\\_0.pdf](http://www.fhfaoig.gov/Content/Files/ESR-2015-005_0.pdf))

This testimony contains redactions of information that is protected under the Privacy Act of 1974 (Pub.L. 93-579, 88 Stat. 1896, enacted December 31, 1974, 5 U.S.C. § 552a).



## Manufactured Housing Association for Regulatory Reform

1331 Pennsylvania Avenue, NW • Suite 512 • Washington, DC 20004 • 202-783-4087 • Fax 202-783-4075 • mharrdg@aol.com

September 18, 2018

VIA FEDERAL EXPRESS

Hon. Jeb Hensarling  
 Chairman  
 Financial Services Committee  
 U.S. House of Representatives  
 Suite 2129  
 Rayburn House Office Building  
 Independence Avenue and S. Capitol Street, S.W.  
 Washington, D.C. 20515

Re: September 27, 2018 Hearing on FHFA and the Government Sponsored Enterprises

Dear Chairman Hensarling:

On behalf of the members of the Manufactured Housing Association for Regulatory Reform (MHARR), I am writing to request an opportunity to either testify in person or to submit written testimony for the consideration of the Committee and the Oversight and Investigations Subcommittee in connection with the above-referenced hearing.

MHARR is a national trade association representing the interests of federally-regulated producers of manufactured housing. MHARR's members, which are primarily smaller and medium-sized independent businesses, have been severely prejudiced and harmed in their respective businesses by securitization and secondary market policies at both the Federal Housing Finance Agency (FHFA) and the Government Sponsored Enterprises (GSEs) which baselessly discriminate against federally-regulated manufactured housing and, in particular, against the 80% (or more) of manufactured homebuyers who utilize personal property – or “chattel” – consumer financing to purchase a manufactured home.

In particular, MHARR wishes to bring to the attention of the Committee and Subcommittee the failure of both FHFA and the GSEs to properly implement, in a timely, effective and market-significant manner – the statutory “duty to serve underserved markets” mandate established by Congress in the Housing and Economic Recovery Act of 2008 in specific relation to manufactured housing, the nation’s most affordable source of non-subsidized homeownership.

Your consideration of this request would be greatly appreciated, as would the opportunity to present testimony, either in person or via written submission.  
Thank you.

Sincerely,



Mark Weiss  
President and CEO

cc: Hon. Maxine Waters  
Hon. Ann Wagner  
Hon. Al Green



Donald H. Layton  
Chief Executive Officer

Tel: (703) 903-3200  
don\_layton@freddiemac.com

8200 Jones Branch Drive  
McLean, VA 22102  
FreddieMac.com

November 20, 2018

The Honorable Blaine Luetkemeyer  
United States House of Representatives  
2230 Rayburn House Office Building  
Washington, DC 20515

Re: Question for the Record

Dear Representative Luetkemeyer,

I am writing in response to your request for Question-for-the-Record as it relates to the September 27, 2018, Housing Finance Reform hearing at which I testified.

You have asked us to share our concerns regarding the implications of the new Current Expected Credit Loss (CECL) rule for Freddie Mac and the impact it could have on the overall mortgage market. You will find our responses to these questions in the enclosed document.

Please let me know if I may be of further assistance.

Sincerely,

Donald H. Layton

Enclosure

CC: Charlie Schreiber (Counsel, House Financial Services Committee)  
Peter Brereton (Congressional Affairs, Federal Housing Finance Agency)

**Questions for the Record**  
**Rep. Blaine Luetkemeyer (MO)**

**“Oversight of the Federal Housing Finance Agency’s role as conservator and regulator of the Government Sponsored Enterprises”**  
**Committee on Financial Services**  
**September 27, 2018**

1. *In September, I convened a roundtable discussion regarding the Financial Accounting Standards Board’s (FASB) Current Expected Credit Loss (CECL) rule. My colleagues and I are very concerned about the CECL rule and its effect on the mortgage market. Is this of any concern to you?*
2. *Are the GSEs and FHFA subject to the CECL rule? If so, what will be the implications on the GSEs and FHFA?*

Freddie Mac continues to analyze the effect of CECL on its activities as a secondary-market purchaser of mortgage loans.

We are currently focused on four impacts:

- We expect there will be a one-time charge to our earnings when CECL takes effect, due to an increase in our reserve levels to comply with the new requirement. Our current belief is that this one-time charge has a low probability of causing the company to need a draw from the US Treasury under the PSPA, given the re-establishment of the \$3 billion net worth reserve at the end of 2017.
- After CECL takes effect, our earnings will have a new source of volatility, as the loan loss provision we will then take each quarter incorporates forecasts of house prices and interest rates, which cannot be included under current GAAP requirements. We are currently developing our CECL models to further understand the magnitude of this volatility. In addition, we are adjusting our Single Family credit risk transfer program to address this volatility and reduce its impact on our earnings over time, possibly to low levels. The structure of the current extensive risk transfer program for the Multifamily business means that CECL is not expected to have a material effect on earnings from this business.
- After CECL takes effect, our earnings level will also be impacted due to the increased reserve to be established each time a loan is purchased, net of the release of reserve each time a loan repays or is sold. Our CECL models will also inform us of this impact. We do not believe it will be material to our earnings level, however, because:

- Multifamily guarantees, as mentioned above, have such extensive credit risk transfer already in place.
- For Single Family guarantees, given the low riskiness of the mortgage asset class in general, and the expected relatively low growth rate of our book of such guarantees, the impact is not expected to be large, and it will be reduced as more extensive credit risk transfers take hold over time.
- The vast majority of the loans we purchase are sold to us soon after primary market lenders originate them, rather than after the lender has held them for a significant amount of time. Thus, this business model will not be materially affected by CECL, as the lender typically will not hold the loan long enough for the related reserves to be material to its earnings. For lenders who originate loans to hold in material size for a significant time, CECL will require them to establish accounting reserves on that origination flow, making it less profitable up front. It is unknown whether the resulting impact, while not a positive, will have a material negative impact on the liquidity or pricing of the mortgage asset class.



Fannie Mae

**Hugh R. Frater**  
Interim Chief Executive Officer  
202.752.4288  
hugh\_r\_frater@fanniemae.com

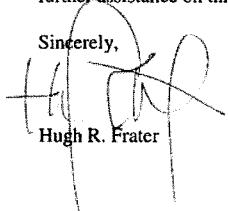
November 15, 2018

Representative Jeb Hensarling  
Chairman  
U.S. House of Representatives Financial Services Committee  
2129 Rayburn House Office Building  
Washington, DC 20515

Dear Chairman Hensarling,

Attached please find a response to the Questions for the Record for Tim Mayopoulos from Representative Blaine Luetkemeyer for the hearing held by the Committee on Financial Services on September 27, 2018. The questions relate to the implications of the Current Expected Credit Loss accounting guidance for Fannie Mae. As Mr. Mayopoulos is no longer employed at Fannie Mae, the attached response is on behalf of the company. Please let us know if we can be of further assistance on this matter.

Sincerely,

  
Hugh R. Frater



Questions for the Record

Rep. Blaine Luetkemeyer (MO-03)

“Oversight of the Federal Housing Finance Agency’s role as conservator and regulator of the  
Government Sponsored Enterprises”  
Committee on Financial Services

September 27, 2018

*Q1 - In September, I convened a roundtable discussion regarding the Financial Accounting Standards Board’s (FASB) Current Expected Credit Loss (CECL) rule. My colleagues and I are very concerned about the CECL rule and its effect on the mortgage market. Is this of any concern to you?*

*Q2 - Are the GSEs and FHFA subject to the CECL rule? If so, what will be the implications on the GSEs and FHFA?*

**A:** Fannie Mae is subject to the Current Expected Credit Loss guidance which goes into effect in 2020. For loans, held-to-maturity debt securities and other financial assets recorded at amortized cost, we will be required to use a new forward-looking “expected loss” model that will replace today’s “incurred loss” model and generally will result in the earlier recognition of allowance for loan losses. We expect the greater impact of the guidance to relate to our accounting for credit losses for loans that are not individually impaired.

The adoption of this guidance may decrease, perhaps substantially, our retained earnings and increase our allowance for loan losses, which could result in a net worth deficit when we adopt the guidance in the first quarter of 2020. We are continuing to evaluate the impact of this guidance on our consolidated financial statements. There is still some uncertainty as there are several implementation issues that are being discussed by the financial services industry, as well as regulators, that could have a significant impact on the manner in which we apply the guidance.

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**Questions for the Honorable Melvin L. Watt, Director, Federal Housing Finance Agency  
 from Representative Blaine Luetkemeyer:**

On September 11, 2018 five federal financial services agencies – the Federal Reserve Board, the FDIC, the OCC, the NCUA, and the Bureau of Consumer Financial Protection – issued a joint statement confirming that supervisory guidance does not have the force and effect of law for regulated institutions, and that the agencies do not take enforcement actions based on supervisory guidance. The statement included the following: “Examiners will not criticize a supervised financial institution for a “violation” of supervisory guidance. Rather, any citations will be for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions.”

The FHFA has issued a significant number of supervisory guidance’s (Advisory Bulletins) over the past eighteen months with more expected. For the just Federal Home Loan Banks, over the past 18 months there have been 12 advisory bulletins (guidance) either finalized or in process, with at least another seven expected to be issued through the first quarter of 2019. Can you explain the rationale for what appears to be regulation through guidance, and can you explain why the FHFA did not join with the agencies in this statement? Does the FHFA agree with the views in this statement on the role of supervisory guidance for the regulated entities it supervises? If not, can you explain and provide the rationale for the areas of disagreement?

*One of the main distinctions between regulations, which are binding, and supervisory guidance, which is not, is that guidance serves to inform the regulated entities and FHFA’s examination staff of expectations and positions that the agency has developed on supervisory matters, while providing flexibility to address practical situations and adapt to new developments. FHFA guidance is intended to provide transparency both for Agency supervision staff and for the regulated entities about supervisory expectations for the entities’ safe and sound operations. This function is described in the standard statement at the end of our Advisory Bulletins, which notes that, “Advisory bulletins describe FHFA supervisory expectations for safe and sound operations in particular areas and are used in FHFA examinations of the regulated entities and the Office of Finance.”*

*Over the last 18 months FHFA has issued nine advisory bulletins related to the Federal Home Loan Banks. At the same time, in June of this year FHFA completed a review of guidance related to the FHLBs and found that 12 Advisory Bulletins issued between 1997 and 2011 had been superseded by regulation or new guidance or is otherwise no longer relevant or applicable. FHFA rescinded this guidance and continues to review guidance for the purpose of reducing unnecessary burdens and enhancing regulatory effectiveness.*

*The banking agencies and Bureau of Consumer Financial Protection, who jointly developed the Interagency Statement to which you refer, all regulate banks and savings associations. FHFA*

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*has a different population of regulated entities and was not involved in the development of that Interagency Statement. Nonetheless, the Statement accurately describes the uses and legal status of supervisory guidance.*

**The proposed Conservatorship Capital Framework is inherently pro-cyclical. We have seen the dangers of a highly pro-cyclical housing finance policy in which bubbles are inflated and then burst with devastating consequences as homeowner wealth and homebuying capacity are destroyed. I believe it would be a big improvement if FHFA were to impose a counter-cyclical capital regime to ameliorate these boom and bust cycles in home prices, and potentially promote higher rates of homeownership and higher levels of personal wealth for average Americans over the long run. Will FHFA consider the benefits of incorporating a countercyclical capital buffer into its capital framework?**

*The risk-based capital (RBC) component of the proposed capital rule uses updated credit scores and loan-to-value ratios in determining the credit risk of single-family loans. Similarly, the RBC component uses updated debt-service-coverage-ratios and loan-to-value ratios in determining the credit risk of multifamily loans. The use of this updated information results in an accurate measurement of the Enterprises' risk profile throughout the business cycle. FHFA recognizes that the use of updated data in the RBC component of the proposed capital rule results in a pro-cyclical RBC standard. The proposed capital rule also includes a minimum leverage capital component, which, by setting an absolute floor for the amount of capital the Enterprises must hold, partially mitigates the pro-cyclical nature of the RBC component.*

*In the preamble to the proposed rule, FHFA specifically requests public comment on modifications or alternatives to the proposal to reduce the pro-cyclical nature of the proposed RBC requirement. FHFA also specifically requests public comment on the interaction between the RBC and minimum leverage capital components of the proposed rule. FHFA will carefully consider all public comments, including comments related to a countercyclical capital buffer, in the process of finalizing the rule.*

**We have seen both natural disasters and economic recessions inflict billions of losses on taxpayers during the last 15 years. I have long advocated the benefits of government credit risk transfer (CRT), or de-risking, across federal agencies to protect taxpayers and ensure programs utilizing CRT remain resilient during times of financial stress. For example, I introduced H.R. 2246 to mandate annual risk transfer in the National Flood Insurance Program.**

**We are making limited, but positive, progress. In 2017, FEMA paid \$150 million for reinsurance premium and recovered \$1.042 billion for NFIP losses incurred during Hurricane Harvey. This was a significant victory for taxpayers and an example of how CRT works.**

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**Fannie Mae and Freddie Mac have both engaged in CRT activity. Please outline the investment that your government-sponsored enterprise has made in CRT, your plans for future investment and why this activity is important to the future of your enterprise.**

*FHFA directed both Enterprises to explore credit risk transfer structures in 2012 in order to reduce their overall risk and, therefore, the risk they pose to taxpayers while in conservatorship. We would expect the practices and discipline developed during conservatorship to continue after conservatorship. Fannie Mae and Freddie Mac initiated their credit risk transfer programs in 2013 through the implementation of pilot debt-issuance programs designed to reduce taxpayer risk by increasing the role of private capital in the single-family mortgage market. In 2013, the Enterprises' single-family credit risk transfer (CRT) programs transferred a portion of credit risk on \$90 billion of unpaid principal balance (UPB).*

*Over the next several years at the direction of FHFA, the Enterprises' CRT programs have grown substantially as the Enterprises have significantly expanded the volume and types of transactions that transfer single-family mortgage credit risk from the Enterprises to the private sector. The Enterprises now transfer to private investors a majority of the credit risk of new acquisitions for loans in targeted loan categories. The programs not only include credit risk transfers via debt issuances, but also include insurance/reinsurance transactions, senior-subordinate securitizations, and a variety of lender collateralized recourse transactions. In 2017, the Enterprises' single-family CRT programs transferred a portion of credit risk on single-family mortgages with \$689 billion of UPB, over seven times the amount executed in 2013.*

*From 2013 through the end of 2017, Fannie Mae and Freddie Mac have transferred a portion of credit risk on \$2.1 trillion of unpaid principal balance (UPB), with a combined Risk in Force (RIF) of about \$69 billion. An additional \$972 billion of UPB and \$246 billion of RIF has been transferred to primary mortgage insurers from 2013 through the end of 2017. Through CRT and mortgage insurance, the majority of the underlying mortgage credit risk on mortgages targeted for CRT has been transferred to private investors.*

*FHFA's annual Conservatorship Scorecard encourages and directs the Enterprises to innovate and experiment with additional structures and sets targets for the volume of credit risk transfer as part of their efforts to reduce credit risk further where economically sensible.*

*Looking ahead, FHFA continues to work with the Enterprises, as well as insurers and reinsurers to reduce taxpayer risk by transferring a meaningful amount of credit risk to the private sector in an economically sensible manner.*

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**Questions for the Honorable Melvin L Watt, Director, Federal Housing Finance Agency;  
 Timothy Mayopoulos, Federal National Mortgage Corporation; and Donald Layton,  
 Federal Home Loan Mortgage Corporation from Representative Blaine Luetkemeyer:**

In September, I convened a roundtable discussion regarding the Financial Accounting Standards Board's (FASB) Current Expected Credit Loss (CECL) rule. My colleagues and I are very concerned about the CECL rule and its effect on the mortgage market. Is this of any concern to you?

Are the GSEs and FHFA subject to the CECL rule? If so, what will be the implications on the GSEs and FHFA?

*The FASB standard for CECL was published in June 2016, and is expected to be effective on January 1, 2020 for the Enterprises and all other financial institutions. The GSEs will be subject to the CECL rule. The CECL requirements are expected to change how the Enterprises record loan losses for mortgages they guarantee or hold in their retained portfolio such that each Enterprise should expect to record increased loan loss reserves after the effective date of the standard.*

*The Enterprises, working with FHFA, cannot finalize implementation plans until the FASB has finished its standard setting process on issues currently being raised by stakeholders. Some of these FASB decisions could materially affect the Enterprises' finances and expected losses. The Enterprises will not implement the new standard until January 1, 2020. Any estimate of the initial impact of the CECL rule will depend on (i) the market and housing conditions at the adoption date and (ii) the Enterprises' forecasts of future housing finance market and housing conditions.*

**Questions for the Honorable Melvin L. Watt, Director, Federal Housing Finance Agency  
 from Representative Gregory Meeks:**

Understanding the fundamental differences between the Fannie Mae and Freddie Mac single family and multi-family mortgage businesses, I am writing to ask about the Notice of Proposed Rulemaking for the FHFA's Proposed GSE Capital Rule. Director Watt, I am concerned the proposed capital changes in the multifamily arena may unintentionally effectively advantage the securitization model over the risk retention model. The risk retention model proved to be the best performing multifamily investor group through many real estate cycles and the Great Recession, while the Proposal would seem to preference the securitization model which is unproven in times of stress and low liquidity. Was this the intention, and if so, why?

*The Enterprises' multifamily business models differ primarily in the way they transfer risk. The proposed capital rule accommodates both Enterprises' multifamily business models. FHFA does*

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*not intend to favor one Enterprise's business over the others in the proposed capital rule. In fact, we see high value in the GSEs employing different business models.*

*Fannie Mae's multifamily business is based on the Delegated Underwriting and Servicing (DUS) program. Under the DUS program, Fannie Mae typically transfers about one-third of the credit risk under a "pari-passu" arrangement. Fannie Mae retains the remaining two-third portion of the credit risk plus the counterparty risk. Even after transferring one-third of the credit exposure, Fannie Mae takes a first dollar loss position on the remaining two-thirds.*

*Freddie Mac's multifamily model focuses on the K-Deal securitization program. Freddie Mac sells the vast majority of the credit risk to private market participants. After loans are securitized, Freddie Mac retains a portion of the credit risk through ownership and/or guarantee of senior K-Deal tranches. However, Freddie Mac's potential losses only take place after the subordinated tranches have been extinguished by absorbing losses.*

*The proposed capital rule accommodates both Enterprises' credit risk transfer (CRT) models. Before considering CRT, the multifamily capital requirement for any given loan would be equal for both Enterprises. Pre-CRT capital depends only on the risk associated with the Enterprises' multifamily acquisitions. Following CRT, multifamily capital is commensurate with the amount of risk transfer and how that risk is transferred. Given the Enterprises' current multifamily risk transfer approaches, Fannie Mae would generally have lower capital relief than Freddie Mac because Fannie Mae sells about one-third of the credit risk and Freddie Mac sells about 80 percent of the risk it acquires. In addition, Fannie Mae would face counterparty risk.*

*Fannie Mae's DUS loss sharing program performed well during the 2009 financial crisis. One important reason is that the Enterprise's multifamily underwriting was generally stricter than those of other financial institutions. Although Freddie Mac's securitization program was introduced after the financial downturn, it involves similar underwriting practices. We have solicited public feedback on this aspect of the proposed rule, and will carefully consider all substantive comments related to credit risk transfer when developing any final rule. By doing so, we expect to be able to ensure that neither of the GSE's multi-family business models is either advantaged or disadvantaged in comparison to the other's.*

**Questions for the Honorable Melvin L Watt, Director, Federal Housing Finance Agency  
 from Representative Bill Huizenga:**

**In 2016, FHFA issued a final rule that excluded captive insurance companies from membership in the Federal Home Loan Bank system. Since that time, various Real Estate Investment Trust (REIT) groups and some home loan banks with significant advances to those REITs have been urging Congress to pass a law that would nullify FHFA's rulemaking and permit captive insurers to become members again – in fact there are proposed bills in both the House and the Senate (H.R. 2890 and S.2361) that would permit them to regain admission.**

Committee on Financial Services  
*Oversight of the Federal Housing Finance Agency's Role as Conservator and Regulator of  
 The Government Sponsored Enterprises*  
 September 27, 2018

**Just last month Standard & Poor's issued a ratings report that identified the expansion of FHLB exposure to REITs as a weakness that could negatively affect not just the select Federal Home Loan Banks that allow captive insurance company membership, but all members of the FHLB system.**

**Can FHFA please explain the risks and concerns that led to the final rule and why allowing captive insurance companies to regain admission to the Federal Home Loan Banks would be a threat to the system?**

*On January 20, 2016, FHFA adopted a final rule revising its regulation governing FHLBank membership, with the primary goal of preventing entities that are not eligible for FHLBank membership from circumventing statutory requirements and thereby being able to obtain access to advances and other benefits of membership to which they are not legally entitled. FHFA had determined that a growing number of ineligible entities, a number of which were mortgage REITs, were establishing captive insurance subsidiaries for the primary purpose of their becoming FHLBank members and using their membership to act as conduits to FHLBank funding for the ineligible parents.*

*Captives are chartered under special state laws that generally bar them from selling insurance to the general public. That limitation generally makes captives subject to less onerous legal and prudential requirements than those that apply to traditional insurance companies. Captive insurers are generally owned by entities not otherwise eligible for FHLBank membership, which are the real parties in interest, i.e. the parent company provides the collateral for the FHLBank advances and obtains the proceeds of the advances, typically via an inter-company loan. Amounts that are borrowed by these entities are often disproportionately large in comparison to the investments and operations of the captives themselves, thus creating potential risks. FHFA has less access to information on the parent than it does on other members of the FHLB system. Therefore, FHFA has limited ability to require mitigating controls of the risks by the FHLBank. Finally, because the parent is generally not subject to regimes of "inspection and regulation" comparable to those of insured depository institutions or insurance companies, FHFA could not reasonably rely on a federal or state primary regulator to assess the financial condition of the parent. The final membership rule effectively made most captives ineligible for Bank membership as "insurance companies" by defining that term to include only insurers whose primary business is the underwriting of insurance for non-affiliates. We believe this is consistent with current statutory requirements which Congress could change if it desired to do so. We did not believe it was appropriate for FHFA, as regulator, to expand eligibility for FHLB membership in a way that was inconsistent with the current law.*



**OFFICE OF INSPECTOR GENERAL**  
**Federal Housing Finance Agency**

400 7th Street SW, Washington, DC 20219

October 30, 2018

The Honorable Jeb Hensarling  
 Chairman  
 Committee on Financial Services  
 House of Representatives  
 Washington, D.C. 20515

The Honorable Maxine Waters  
 Ranking Member  
 Committee on Financial Services  
 House of Representatives  
 Washington, D.C. 20515

Re: Response to Questions for the Record, "Oversight of the Federal Housing Finance Agency's role as conservator and regulator of the Government Sponsored Enterprises," Thursday, September 27, 2018

*By U.S. and Electronic Mail*

Dear Mr. Chairman and Ranking Member Waters:

Thank you for the opportunity to respond to the Questions for the Record (QFRs) submitted by members of the House Financial Services Committee (Committee), following this Committee's hearing on Thursday, September 27, 2018 entitled, "Oversight of the Federal Housing Finance Agency's role as conservator and regulator of the Government Sponsored Enterprises" (Hearing).

FHFA-OIG's mission is to promote economy, efficiency, and effectiveness and to protect FHFA and the entities it regulates against fraud, waste, and abuse through independent, relevant, timely, and transparent oversight. We strive to maintain the highest level of integrity, professionalism, accountability, and transparency in our work. As I explained during my oral and written testimony at the Hearing, the work product of FHFA-OIG during my tenure as its Inspector General demonstrates that FHFA-OIG has, and continues to, accomplish its mission.

Set forth below are FHFA-OIG's responses to these QFRs.

*Question for the Record 1: Based on the testimony of Ms. Simone Grimes, what actions would the OIG recommend FHFA take to ensure that employees can report violations of federal employment law or FHFA nondiscrimination/anti-harassment policy without fear of retaliation?*

Congress has established laws to protect individuals who report violations of federal law or Agency policy against retaliation and an independent federal investigative and prosecutorial agency, the U.S. Office of Special Counsel (OSC) with the primary mission of "protecting federal employees and applicants from prohibited personnel practices, especially reprisal for whistleblowing." <https://osc.gov/Pages/about.aspx>.

For example, federal law (5 U.S.C. § 2302(c)) requires each agency head to ensure that employees of the agency are informed of the rights and remedies available to them under the

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Civil Service Reform Act (CSRA), the Whistleblower Protection Act of 2012 (WPA), the Whistleblower Protection Enhancement Act (WPEA), and related laws. The OSC has implemented a certification program to ensure that “federal agencies [] meet the statutory obligation to inform their workforces” about their legal rights and remedies. <https://osc.gov/Pages/Outreach-2302Cert.aspx>. OSC has recognized that FHFA enrolled in and completed this certification program. <https://osc.gov/Pages/2302status.aspx>.

Consistent with federal law, FHFA has issued a Whistleblower Protection Policy. <https://www.fhfa.gov/AboutUs/Policies/Pages/Whistleblower-Protections.aspx>. That policy refers readers to the OSC website for a definition of activities that constitute protected whistleblowing. The OSC website explains that five types of disclosures are protected:

1. Violation of a law, rule, or regulation;
2. Gross mismanagement;
3. A gross waste of funds;
4. An abuse of authority; and/or
5. A substantial and specific danger to public health or safety.

<https://osc.gov/Pages/DOW.aspx>. For ease of understanding, FHFA could amend its Policy to specify the disclosures protected under federal law.

FHFA’s Whistleblower Protection Policy advises readers that they can make a protected disclosure to the OSC or to the FHFA-OIG, including to its hotline. <https://www.fhfa.gov/AboutUs/Policies/Pages/Whistleblower-Protections.aspx>.

FHFA Policy makes plain that retaliation against an employee or applicant for making a protected disclosure is prohibited. It instructs:

The Whistleblower Protection Act (WPA) prohibits taking or not taking a personnel action (or threatening either) with respect to any employee (or applicant) because of any disclosure of information by an employee or applicant which he or she reasonably believes evidences a violation of any law, rule, or regulation or gross mismanagement, a gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety . . . .

<https://www.fhfa.gov/AboutUs/Policies/Pages/Whistleblower-Protections.aspx>. Because this Policy does not expressly inform readers where to lodge a complaint for retaliation for protected whistleblowing, we recommend that FHFA revise this Policy to state that such complaints should be filed with the OSC or FHFA-OIG.

FHFA provides mandatory ethics training to its employees on an annual basis. In June 2018, the OSC provided mandatory training to all FHFA managers and supervisors which highlighted disclosures protected under federal law as well as the legal protections for whistleblowers against retaliation. The WPEA requires this training to take place annually. During FHFA’s mandatory annual ethics training for all employees, to be held on November 1, 2018, FHFA has committed that it will emphasize that retaliation against whistleblowers for protected disclosures is prohibited by law. To ensure that all employees understand these protections and prohibitions, FHFA could, beginning in 2019, include in its annual mandatory ethics training for all

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employees a discussion of the legal protections for whistleblowers against retaliation and the consequences to employees who are found to have engaged in prohibited retaliation.

FHFA-OIG understands that Ms. Grimes has filed a whistleblower retaliation claim against FHFA with OSC, alleging that her whistleblower complaint led FHFA to deny her the executive position for which she had been chosen. Should OSC determine that Ms. Grimes suffered retaliation by FHFA because of her whistleblower claim, FHFA-OIG recommends that FHFA take disciplinary action against any employees found to have engaged in the retaliatory activities.

*Question for the Record 2: Going forward, what changes can OIG make to ensure that those who report violations of federal employment law or FHFA nondiscrimination/anti-harassment policy with an understanding of anonymity do not have their names released publicly by OIG?*

This question appears directed at FHFA-OIG's federal court filing to enforce its administrative subpoena issued to Ms. Grimes for its administrative inquiry. That inquiry commenced in July 2018 after FHFA-OIG received allegations by anonymous, unknown whistleblowers of misconduct by Director Watt. FHFA-OIG notified Ms. Grimes, a current FHFA employee, both orally and in writing that she was not a subject of its current inquiry and allegations in her March 19, 2018 whistleblower complaint to FHFA-OIG were not part of this inquiry.

FHFA-OIG repeatedly sought Ms. Grimes' cooperation with its inquiry. On August 1, 2018, it advised Ms. Grimes in writing that her lack of cooperation with the subpoena would limit its options "to seeking to enforce our subpoena in Court, which we do not wish to do." In a written response that same day, Ms. Grimes affirmatively stated to FHFA-OIG that she had no intention of complying with the subpoena in the foreseeable future, if at all. She acknowledged in writing that her lack of cooperation could lead FHFA-OIG to "get a court ordered subpoena in the meantime" but never asked for anonymity in any enforcement proceeding in court. Instead, she warned FHFA-OIG that any effort to enforce its subpoena "would be a **horrible PR move for your office**" (emphasis in original).

On their own initiative, FHFA-OIG's lawyers in its Office of Counsel evaluated whether a motion to enforce the outstanding subpoena could be filed under seal. Case law from the U.S. Court of Appeals for the Fourth Circuit and Local Rule 5, which they were required to follow, establish a high bar that a party must meet to seek to seal pleadings. FHFA-OIG's Office of Counsel consulted with the U.S. Attorneys' Office for the Eastern District of Virginia, which advised that an attempt to seal the motion would not be successful. After consultation, FHFA-OIG's Chief Counsel determined that FHFA-OIG could not meet the sealing standard because Ms. Grimes had previously made public both her identity and her allegations of sexual harassment against Director Watt, through three emails and attachments sent to more than 100 FHFA managers.

\* \* \* \* \*

Thank you for your interest in FHFA-OIG.

Respectfully,



Laura S. Wertheimer  
 Inspector General, FHFA-OIG

