S. HRG. 113–81

THE FHA SOLVENCY ACT OF 2013

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING LEGISLATION RECENTLY RELEASED BY CHAIRMAN JOHNSON AND RANKING MEMBER CRAPO INTENDED TO STABILIZE THE MUTUAL MORTGAGE INSURANCE FUND

JULY 24, 2013

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C O N T E N T S

WEDNESDAY, JULY 24, 2013

WITNESS

Additional Material Supplied for the Record

THE FHA SOLVENCY ACT OF 2013

WEDNESDAY, JULY 24, 2013

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:01 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I call this hearing to order.

Thank you, Commissioner Galante, for joining us today to provide your insights and reaction to the FHA Solvency Act discussion draft Ranking Member Crapo and I have released. I want to thank Ranking Member Crapo and his staff for working with me and my staff on this bipartisan legislation. I would also like to thank Senator Brown, Senator Menendez, and Senator Vitter for their earlier efforts to provide the FHA with additional tools and flexibility.

Earlier this year, Ranking Member Crapo and I agreed that addressing the stability of the FHA's finances would be first on our housing agenda, followed closely by a broader housing finance reform effort. Like our FHA bill, we will seek the input of all the Members of the Committee to reach a similar bipartisan agreement on housing finance reform legislation in the coming weeks and months. To that end, I would encourage the Committee to focus on the stability of the FHA during today's hearing.

The FHA serves a critical role in our housing market by insuring affordable, well-documented and underwritten mortgages for families across the country. That insurance maintains liquidity in the mortgage market during a recession, fulfilling the FHA's countercyclical mission. Without the FHA, the housing crisis would have been much deeper—by as much as 25 percent—because mortgage credit would not have been available to most qualified borrowers.

While the fiscal year 2012 Actuarial Report projected a negative capital ratio for the MMI Fund, recent data show the weakest books of business—the years 2006 through 2009—are stabilizing, and the most recent data show serious delinquency rates falling since the report was released. These improving trends contribute to the future stability of the FHA, and the bill that Senator Crapo and I have drafted would provide the FHA with tools to strengthen its finances and maintain stability into the future.

The FHA Solvency Act of 2013 would provide the FHA with many of the tools Secretary Donovan requested in HUD's 2012 Report to Congress and in his testimony before this Committee. Our discussion draft would better equip the FHA to hold lenders accountable for fraud or inappropriate loans. The bill would also require annual reviews of loan performance and premium levels to ensure that pricing and underwriting standards are appropriate.

Commissioner Galante, I would like you to give us greater insight into how these tools and other provisions of the bill will help stabilize the MMI Fund and strengthen the program for current and future homeowners. I look forward to continuing to work with you, Senator Crapo, Members of the Committee, and all stakeholders as we proceed to a markup of this important bill next week. I am encouraged by the positive response the bill has received from the National Association of Realtors, the Mortgage Bankers Association, and the Mortgage Insurance Companies of America, and I hope the Committee can move swiftly to approve this legislation.

With that, I will turn to Senator Crapo.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman.

The Federal Housing Administration, or FHA, has helped millions of Americans achieve the dream of owning a home. Unfortunately, the FHA has also experienced higher than expected default rates over the last several years. In addition to placing severe financial stress on the Insurance Fund, these defaults have caused hardships for the very people the FHA was designed to help.

Concerns about the solvency of the FHA have been building for quite some time. The capital reserve ratio has been declining since 2006, and the FHA Fund has been in violation of statutory mandates for minimum capital levels for the last 4 years.

The last independent Actuarial showed a negative economic value of more than $16 billion and a capital reserve ratio of negative 1.44 percent. Therefore, Chairman Johnson and I have released the discussion draft before us today.

This draft attempts to address a number of the problems facing the FHA through three overarching approaches:

First, it gives the FHA the tools it needs to better protect the Fund from participants who do not follow the FHA guidelines or who consistently do not perform to appropriate standards;

Second, it ensures that personnel and experts with the appropriate backgrounds will review, revise, and annually reevaluate the FHA standards to make its lending more sustainable;

And, third, it will increase the FHA's capital allocation and better incentivize leadership to meet those capital requirements so that the taxpayer is better protected in the future.

This bill is intended to put the FHA in a better position to function as an actual insurance fund. It will also place a renewed emphasis on the FHA ensuring sustainability mortgages. When the FHA helps people obtain a mortgage which they actually have the ability to repay, it is helpful to the solvency of the FHA.

We should also be clear that the bill is not the last discussion this Committee will have on the reform of FHA. The Chairman and I have indicated that, upon completion of the Committee action on this bill, we plan to immediately turn our attention to broader housing finance reform legislation. It will be necessary to address many of the broader questions surrounding the scope and mission of the FHA as a part of that effort as well.

I look forward to working with the Chairman and all of my colleagues on the Committee regarding both the FHA and the broader housing market. However, before us today is a bill that we can consider now, one that would take many needed steps toward changing the disturbing negative trends the FHA has experienced through the last several years.

I thank HUD for being here today to discuss this draft with us. I also thank the number of industry, consumer, and taxpayer advocate groups who have reviewed this draft and taken the time to get back to us directly with their thoughts and comments. I encourage continued public comment aimed toward further strengthening this bill as we move forward.

As I previously noted, nearly every American has a stake in our actions. Whether they are looking to buy or sell a home or they are simply taxpayers who are weary of seeing news about another bailout, our decisions today and beyond will impact them. I hope that we can take this much needed first step soon.

Thank you very much, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Crapo.

Are there any other Members who wish to make a brief opening statement?

[No response.]

Chairman JOHNSON. Thank you all.

I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other materials you would like to submit. Now I will briefly introduce our witness.

The Honorable Carol Galante is the Commissioner of the Federal Housing Administration. She has been at HUD since May 2009, first serving as Deputy Assistant Secretary for Multi-Family Housing.

Commissioner Galante, please begin your testimony.

STATEMENT OF CAROL J. GALANTE, ASSISTANT SECRETARY FOR HOUSING/FEDERAL HOUSING ADMINISTRATION COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. GALANTE. Chairman Johnson, Ranking Member Crapo, thank you for having me here to testify today. The Secretary and I greatly appreciate the work you and your staffs have done on this bipartisan bill intended to give HUD many of the tools necessary to ensure that we have a fiscally sound and vibrant FHA that continues to support responsible home ownership and maintains access to affordable mortgage credit for future generations of homeowners.

Keeping the Mutual Mortgage Insurance Fund on the road to full fiscal health is critical to this mission. So before I discuss how this bill helps achieve our shared goals of improved risk management and replenishing the capital reserve account, as well as the sections HUD feels require additional discussion, I want to provide the Committee with a update on the status of the Fund.

Our latest data shows that the Fund is continuing its positive trajectory, experiencing significant improvements in the forward loan portfolio in particular, as a result of both the economic recovery and decisive actions taken by this Administration. In the June 2013, the percentage of seriously delinquent loans—that is, loans past due 90 days or more or in foreclosure or bankruptcy—was down to 8.38 percent from a peak of 9.83 percent in January 2012, a 15-percent improvement in less than 18 months. This is also a nearly 1¼-point improvement since the November 12 Actuarial Report.

Early payment delinquencies have fallen to 0.25 percent, their lowest level in 26 months, down from a historic high of 2.6 percent in July 2007. Meanwhile, real estate loss severities have dropped 27 percent since their peak in 2011, and average loss severities across all disposition methods are down 10 percent since 2011, and this figure does not account for the impact of FHA's new streamlined short sale program, which we formally announced this month.

But we know our work is not done, and these encourage trends can be accelerated if we are given the tools we have requested from Congress. We are grateful for the inclusion of these tools, some of them which were first brought to this Committee in 2010 by Senators Brown, Begich, and Vitter, and more recently Mr. Menendez, since they are critical to the responsible management of the Fund. Expanding indemnification to include direct endorsement lenders gives FHA the ability to treat all lenders who fail to comply with FHA guidelines equally, ensuring compliance and strengthening the financial position of the Fund.

Other tools provided by the bill would improve FHA's ability to identify and mitigate risk, helping us to better protect the Fund. These tools include broader authority to terminate lenders, a revised compare ratio, institutionalizing the position of a chief risk officer, and the ability to quickly make structural changes to the HECM or reverse mortgage program. All of these tools are vital to the responsible stewardship of the Fund, and we thank Chairman Johnson and Ranking Member Crapo for their inclusion.

In particular, the ability to make necessary changes to the HECM program will not only help secure the Fund and support Americans who choose to age in place, but it also supports HUD's mission of creating and preserving affordable, inclusive communities.

That said, I would also like to take this opportunity to say that if we are unable to obtain statutory authority to make these immediate changes to the HECM program by August 1st, FHA will have to take further blunt changes to the program which will not properly address the identified risks and harm access and effectiveness of the product for consumers. For that reason, I do urge the Senate to pass H.R. 2167.

Now, while FHA is looking forward to working with the Committee to achieve our shared goals of continuing to strengthen the Fund and better manage risk, there are several areas where additional conversations with Members of this Committee will be important to producing the most effective legislation possible.

For instance, Section 7 outlines the plan for recapitalization, which relies exclusively on mortgage insurance premium increases. While FHA shares the Committee's desire to return the Fund to full fiscal health, I would point out that premium increases are just one of many methods to achieve that recapitalization. I am concerned that relying on an inflexible approach here could actually hurt the Fund under certain economic conditions and would unduly penalize future homeowners.

For this reason, I would ask that we continue to work with the Committee to craft language that best facilitates recapitalization using the full range of options available.

To better mitigate risk, FHA also requested authority to ensure that servicers of FHA-insured loans are being held accountable for their performance. The authority to transfer the active servicing would allow FHA to direct servicing to a specialized sub-servicer when the original servicer is not fulfilling its obligation under the contract of insurance. The addition of this authority would improve loss mitigation outcomes.

Finally, given an increasingly complex mortgage market, aging FHA systems and infrastructure, a need for additional skills and expertise, and difficulty responding quickly to major risk issues as a result of contractual and statutory limitations, FHA would benefit from additional statutory changes to provide new risk management and operational tools to the Fund. Therefore, we look forward to discussing the inclusion of additional operational authorities that would best position FHA to carry out its mission.

We remain committed to continuously improving our stewardship of the Fund and look forward to working together to create a 21st century FHA, one best able to serve the American people.

Again, I want to thank the Committee for their hard work and look forward to partnering with you on this legislation. I look forward to your questions.

Chairman JOHNSON. Thank you, Commissioner Galante, for your testimony.

As we begin questions, I will ask the clerk to put 5 minutes on the clock for each Member.

Commissioner Galante, with the changes to the compare ratio and the national termination authority proposed in the discussion draft, will the FHA have the tools necessary to identify and suspend noncompliant lenders?

Ms. GALANTE. Yes, thank you for the question, Chairman Johnson. The changes in the compare ratio as well as the additional indemnification authority for direct endorsement lenders will certainly give us increased capability to both terminate and hold lenders accountable for defects in the manufacturing of these loans.

Chairman JOHNSON. How will the expanded repurchase authority granted to the FHA in the bill better protect the MMI Fund from fraudulent lending practices going forward?

Ms. GALANTE. Yes, thank you. Today we have a situation where the lenders that participate in our lender insurance program, which is—they do about 70 percent of the FHA business, but the direct endorsement lenders that do about 30 percent of the FHA business do not—we do not have the same authority over those lenders. And if we want to seek a repurchase, as you put it, or an indemnification, we actually need to negotiate with them over that repurchase or indemnification as opposed to having the direct authority to require indemnification from those lenders.

And so this will give us additional authority over a significant portion of our business that right now is a long negotiation process that is very difficult to achieve on an ongoing, regular basis. So that will substantially improve the enforcement of lenders.

Chairman JOHNSON. In your testimony you raised concerns regarding the premium increases that are required if the Fund is undercapitalized. What alternatives would you recommend that will give us confidence that the FHA has taken action to achieve the required capital ratio?

Ms. GALANTE. Yes, so this is a challenging issue. I fully appreciate that Section 7 is trying to ensure that future Administrations' feet are held to the fire in terms of increasing premiums when they are necessary to be increased, and so we certainly support that general direction.

The concern that we have is that sometimes in a countercyclical situation, if you took the situation today, if this were in effect, we have already increased premiums five times very significantly, and we clearly are at a tipping point here, that if we increase them more, we would actually both shut out additional home buyers. But we also would lose those future homeowners from FHA, and, therefore, we would lose volume, which would also hurt our activities.

So the kinds of things that I think could be added are, one, some flexibility in how those premium increases happen. So maybe it is not just annual but also up front, so there are some changes there. We made changes in policy, for example, last year on how we treated cancellation of future premium increase, so that was not an actual premium increase, but that policy change actually generates more money to the Fund over the long term than a simple premium increase would.

So that plus other ideas around how we deal with recoveries, for example, I think would be examples.

Chairman JOHNSON. Can you comment on how requiring the FHA to initiate a risk-sharing program with private market participants would impact the MMI Fund?

Ms. GALANTE. Yeah, so I would simply say this about risk share: FHA does not have a great history doing a risk-share program. We had a program in Multi-Family in the 1980s that actually ended up costing the Fund significant dollars.

So one of the challenges with thinking about a risk-share program is ensuring that FHA has the right analytic capability, the right staffing capability to deal with what is, frankly, a counterparty risk here of the private mortgage insurer.

So I would say that, you know, we can look at it seriously as we go down the road, but we are concerned that how one structures a risk-share program, you know, we could have some very unintended consequences that actually could have FHA coming out on the wrong side of such a program, and we would want to be very cautious about how one might proceed to do that.

The last thing I would say on this question is, as you know, under the existing private mortgage insurance model with the GSEs, there were some serious challenges during the crisis with that model, and FHFA is working on new kinds of risk-share ideas with the GSEs today. I certainly think looking at how they resolve some of those issues would be very helpful for FHA, you know, who would be tackling this kind of anew.

Chairman JOHNSON. Thank you.

Senator Crapo.

Senator CRAPO. Thank you Mr. Chairman.

Commissioner, I just want to cover a couple of preliminary matters. Some in the industry have expressed concerns that the changes we make to HUD's authority around indemnification on a prospective basis might be used by HUD to justify that same treatment on a retroactive basis. Section 3 of the text quite clearly states that that authority shall only apply to mortgages insured under this title that were originated on or after the date of enactment of this bill.

I just want to allay any remaining fears out there with regard to that understanding and get your confirmation for the record that you understand that HUD understands this authority is prospective and that Congress would not be granting retroactive indemnification authority.

Ms. GALANTE. Yes, we do understand that.

Senator CRAPO. Thank you. And I want to follow up a little on the Chairman's questions about your question about the need for mandatory premium surcharges. And as I understand your point, you indicate that there are other ways and other actions that can be undertaken to deal with the issue.

The concern or the question that I have is that, as I understand it, nothing in this bill prohibits the FHA from undertaking any number of the alternatives that I heard you suggest when the FHA is meeting its capital obligations to ensure that it continues to do so. And so to me the question becomes this—it really relates to the point in time that you are addressing the circumstance. When the capital levels of the FHA are in violation of Federal law and Congress needs assurances that actions will be taken, it would seem to me that the actions you are talking about should have already been undertaken before we get to that point. But that when we are at the point where literally the law is being violated, is not that a reason to have a mandatory surcharge? Or are you suggesting that there should be no requirement for a surcharge even in that circumstance?

Ms. GALANTE. Yes, so, again, I think we have to look at when we are certain that we are going to be below the capital ratio, whatever that is, whether it is 2 or 3 percent, depending on where we are in time in the bill.

Senator CRAPO. Yes.

Ms. GALANTE. You know, that will be calculated by the Actuarial each year, maybe more often as we go down the road here. But as we see that happening, it is going to take time to institute policy changes.

So some of the policy changes at the moment in time that we hit that capital ratio or being below it will take some time to implement policy changes that could include some things that are not specifically a premium increase. And if we do that at a time—if we just simply go right to the premium increase at that point in time, again, we could be cutting off borrowers at the wrong time and, you know, worsening the economic situation for them and for the market.

So we want to be careful about when and how we, you know, add premium increases, and we certainly—you know, just to be clear, we get that that is a very important tool, and this Administration, to the chagrin of many, you know, we have increased premiums five times, and very significantly, during this crisis to get us back to a point where we are appropriately pricing for the risk that we are taking on.

Senator CRAPO. Thank you. It seems to me there is a tension, because I understand your point that the premium increases can have an impact on volume and could actually have an impact on the ability of the FHA to manage with the flexibility that it needs.

I also see the point, though, that at some point, if the other actions that you are talking about are not working, at some point there needs to be the assurance that the capital in the Fund will be protected, and the premium increases seem to be that final assurance.

And so although I can see the need for the flexibility, I can also see a concern if we simply have no point at which we have an assurance that the capital in the Fund will be protected. We will need to visit with you and others further about that, I assume, as we move forward.

One other quick question. I hope we will have a couple of rounds here today, Mr. Chairman. You have asked the Committee to give the FHA broad authority to transfer servicing rights, and some have suggested that even if we make it part of the evaluation for termination from the program. Some industry participants and experts have suggested that this authority could in some scenarios drastically reduce the value of these servicing rights.

Understanding why you want this authority, do you acknowledge the possibility that this could impact the value of servicing rights?

Ms. GALANTE. So I would say we are asking for authority when servicers are not meeting their obligations, their performance obligations, as outlined in our servicing requirements; we would do this through a rulemaking process where we would lay out very clearly what the benchmarks are before this type of activity would be triggered. And I do believe that we can have this authority without having it in a way that will impact the value of servicing rights. What we are really talking about is getting servicers who are not performing to say—you know, bring in a sub-servicer. You know, we are looking for the tools to kind of force the activity to be what it needs to be. We are not trying to impact the value of servicing rights here.

Senator CRAPO. Thank you. My time has expired. I may come back and visit with you a little further about that.

Thank you.

Chairman JOHNSON. Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, Commissioner.

I first want to commend Senator Johnson and Senator Crapo for their proposal and for moving very thoughtfully and very aggressively on this issue; what is alarming is the capital situation of FHA; and although there appears to be improvement, this is an issue that has to be addressed; and I commend both of them for doing it.

Let me follow up on Senator Crapo's question about servicing. Have you done some analysis suggesting how much you could save or avoid in terms of cost if you have the authority to essentially redeploy servicing rights from a nonperforming entity to a performing entity?

Ms. GALANTE. So, let me say this and I want to be clear. We are not talking about transferring the actual servicing rights. We are talking about, you know, the act of servicing could be subserviced, could move pools of loans that need specialized attention; and, you know, lenders are doing this today, some of them on their own, so just to be clear about what we are trying to help people get to here.

We have done some analysis. I do not have the numbers in front of me but I would say it varies by servicer substantially and that what we do see is those servicers who deploy these specialized techniques, subservicers, specialized servicers for defaulted loans. Higher touch servicers actually see much better loss mitigation helping borrowers stay in their home, for example, and then protecting losses to the fund.

Senator REED. And again, I do not want to present a conclusion, but it seems to be that this practice is being used by commercial lenders rather frequently of, you know, compelling or advising or suggesting that servicers find qualified subservicers; and you are simply asking for what appears to be the commercial, prevailing commercial practice right now. Is that fair?

Ms. GALANTE. That is correct. This is a common practice outside of FHA right now.

Senator REED. Very good. In your testimony, you allude to many factors; and one of the aspects is the FHA's aging systems and infrastructure that you mentioned which would require, you know, investment improvement.

Can you talk about that? Is that contributing to some of the difficulties you are having?

Ms. GALANTE. Yes, indeed it is. There are really two aspects of the aging infrastructure system that I would mention. One is just we literally are operating a 1970s technology and the inability to have people give us electronic file applications or just the ease of doing business needs to be, you know, brought up to the 21st Century.

But, I would say more importantly, you know, given how complex that mortgage market has become, we need much better internal risk analysis, you know, your own models, you know, to be able to monitor the portfolio in a very detailed way, better electronic tools to detect fraud. We have made some progress in that area.

So, we do have a project called the FHA Transformation that, you know, was funded partially a couple of years ago, and we have been working to change systems. But, we have a long way to go here and it will be very important, you know, in the future to have these kind of systematic tools and have the staffing capabilities and the, you know, the strength to really be able to analyze this portfolio in a much more detailed way than we have had in the past.

Senator REED. So in the context of the proposed legislation, you would need some authority or support for these efforts is that within your current authority and now you just lack resources?

Ms. GALANTE. Well, certainly resources would be great but understanding the difficulty in this budget environment—a HUD Bill is being discussed today as well—I think there are some changes in legislation that could help get us there.

So, enabling us, for example, to actually, you know, tap into FHA receipts before they go into the general budget for certain kinds of critical investments is an example.

You know, changing the pay scale for at least a subclass of FHA employees that deal with the risk management. FHFA, FDIC, all of these institutions are on a different pay scale than our economists are, for example.

Senator REED. Just following up your point which is the budget environment, it would be extremely helpful to myself if you could quantify the savings, the increased efficiencies, you know, if we are going to invest in modernization of FHA. We want to make sure that the return is several multiples of the investment. That is the nature of our environment. That is the nature of good business practice everywhere.

Ms. GALANTE. Absolutely, I agree with you.

Senator REED. Thank you, Commissioner.

Ms. GALANTE. Thank you.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Mr. Chairman, thank you and thank you and the Ranking Member for producing a piece of legislation. I think all of us came here to solve problems and we know we have a major housing finance problem. We know this is a piece of that. We thank you again for having this hearing.

Ms. Galante, I appreciate your service and glad you are in the position you are in, and I know that in April, the FHA suspended a fixed-rate, full-draw HECM product, reverse mortgage. It was by far the biggest money loser by volume. It is my understanding you all have no intentions whatsoever of reinstating that product. Is that correct?

Ms. GALANTE. That is absolutely correct.

Senator CORKER. And I assume that if we were to try to add up an amendment to this piece of legislation that ensured that that was the case from the FHA standpoint anyway, that would be not objectionable. Is that correct?

Ms. GALANTE. That is correct. I just want to say we are really looking for authorities as quickly as possible to make additional changes to the overall HECM program that would help that situation even more and, you know, be able to have a financial assessment of borrowers so they understand what, you know, what they can afford and have better limitations on what they can take out.

Senator CORKER. Listen, thank you for that.

I was interested in your testimony toward the end where I guess this piece of legislation gives you some abilities to deal with some solvency issues but you talked about additional considerations and the fact is that there are other things with this highly complex housing finance system that we have in this country that you need to have the ability to do. So, the bill we are looking at deals with an important piece of housing finance but there are other pieces that FHA would like to discuss with this and have the authority to do just to better manage risk. Is that correct?

Ms. GALANTE. That is absolutely correct.

Senator CORKER. Let me ask you the question. I assume that whatever Congress happens to do relative to GSEs because of guarantee fees and those kinds of things, all of those things work together. Is that correct? In other words, if we do something with GSEs that, you know, drives a bunch of volume to FHA, that could be good or that could be bad or vice versa. So, the two very much work hand-in-hand. Is that correct?

Ms. GALANTE. Absolutely, Senator. I have said in multiple testimonies at the end of the day, these things that we are talking about here today are just things that we need in any event under any circumstances, right, to ensure that we can manage our risk better.

But as we move into discussions of housing, finance reform more broadly which I know you are quite involved in, you know, we need to be sure that FHA's role, that we do not leave a void in the market that we have, you know, a new system doing this and FHA doing that and there is some gap in the middle. You know, that we need to be sure that these efforts are synced up at the end of the day.

Senator CORKER. Well, I think everybody in the industry has said that. I know the House is taking up all of this in a combined way, and I would just say, Mr. Chairman, I was interested in Ranking Member Crapo's comments about coming back to deal with some of the other FHA issues.

I think it would be real important for the Committee to know before the markup next week, look, I appreciate this effort taking place, but I think we all know this is just one component. All of this has to tie together well for it to be successful, and I think all of us want to deal with this issue that has been 5 years in the making.

So, I would hope that we get some direction from the leadership of the Committee as to what we are going to do on the floor. I would assume there is no effort or thought that we would try to take up one piece on the floor but that we would do housing finance in general on the floor to deal with the complications that the FHA Director is laying out right now.

In other words, if we just deal with one component, we can grate tremendous weaknesses in other components of housing finance, especially those components that the Federal Government is involved in.

So, I appreciate the effort. I thank you. I always like it when the Chairman and Ranking Member work together and we have bipartisan consensus on something. I believe there is a way to develop bipartisan consensus not just on this piece but also on GSEs and some of the other pieces that Carol needs to have implemented, and I hope as a Committee we will be committed to doing all of it at once so we do it the right way, because again one piece can really get another piece greatly out of sync.

So, I thank you very much for this and I look forward additional testimony.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and Mr. Chairman and Ranking Member Crapo, thanks for holding this hearing today and thank you for the work on this bill.

Even as our housing markets continue to recover, the FHA is under severe capital strain. During the crisis, the FHA played an important role in maintaining our housing market liquidity but the funds capital ratio has taken a significant hit.

The FHA solvency legislation is an important way to provide the agency with greater authority to manage and price for the risk it is assuming to mitigate losses on its current book business and to hold lenders accountable for proper underwriting and it is important that it is done while ensuring that the FHA can play an ongoing role in supporting housing for underserved markets.

So, Mr. Chairman and Ranking Member Crapo, thanks for taking this issue up. I also want to say just briefly that it is my hope that after we finish this bill, we can turn to other piece of the puzzle and that is GSE reform in a similarly balanced, thoughtful, and bipartisan way. I think the issues fit closely together and the interplay between each is very important to the housing market.

Assistant Secretary Galante, in recent years FHA's single family business shows a high average FICO scores and lower delinquency rates which is positive for the health of the insurance fund. However, concerns have been raised that some deserving borrowers are being shut out of FHA because lenders are imposing overly strict credit overlays to avoid indemnification risk.

As Commissioner, what legislative safeguards do you think need to be included in this legislation to ensure an appropriate balance?

Ms. GALANTE. Thank you for that question. That is the question that we struggle with everyday particularly through this crisis which is ensuring continued access to credit for creditworthy borrowers and at the same time ensuring that we are rebuilding our capital reserves after, you know, the worst recession the country has had since the Great Depression. So, that is a balancing act we do everyday.

I would say the kinds of authorities that we are talking about in this bill in terms of indemnification and repurchase are very reasonable in terms of the lender's side of the equation.

I think the changes to the compare ratio or there is some flexibility. The compare ratio is how we measure lenders against each other. The changes we are asking for here would help us really be able to hone in on and target what I would call things that are the manufacturing era of the lender as opposed to the credit box of FHA.

As lenders can feel more comfortable that we are not going to go after them because they lend to the whole range of the credit box but we are going to, you know, deal with their challenges when they make errors that they should not make or skip steps that they should not skip in doing underwriting of these loans.

The new compare ratio will give us a better ability to look at that and compare lenders on that basis. So, that is something that we are hoping will both, you know, decrease the, quote, lender overlays that we are seeing today.

Senator HAGAN. The past FHA solvency legislation has included a programmatic review of early period delinquency. What has been done to investigate and review these delinquencies that become 90 days or more delinquent in the first 24 months since the origination?

Ms. GALANTE. Yes. So, we now partly as a recommendation from the IG and the GAO and partly because we got some systems help through this FHA Transformation, we actually do monitor all early payment delinquencies, any loan that, you know, claims or is 90 days down in the first 6 months is reviewed on an ongoing basis; and then we also have an algorithm where we are looking at a percentage of all loans on an ongoing basis to ensure that we are catching earlier patterns or problems we are seeing from——

Senator HAGAN. Then what action do you take if you notice the ongoing delinquencies?

Ms. GALANTE. Yes. So again we can require indemnification from certain lenders. We can not require indemnification from other lenders which is part of the authority we are asking for here.

So, in those other situations, we are essentially in a negotiation with them on whether we are going to, you know, come after them with a big hammer of lawsuits versus being able to deal with this on a ongoing, one-by-one way.

Senator HAGAN. In your testimony, you mentioned that the FHA plans to launch a large scale, proactive marketing campaign to promote the modification in short sale strategies for delinquent borrowers. Can you describe that program in a little more detail and when and where do you expect to focus your efforts in these programs?

Ms. GALANTE. Yes, thank you. So, now that we have spent some significant time. I think having the right programs in place like an expedited short sale process and changed our loss mitigation waterfall, we really want to make sure that our servicers are actively seeking out borrowers for those tools and not just doing this on automatic pilot.

And so, the strategy is designed to take some of the, pilot it with one or two particular servicers where we think could use some additional encouragement in this area and work with them to see how much more uptake we can get on these loss mitigation tools and the short sale tools.

So, that is what we are embarking upon.

Senator HAGAN. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Moran.

Senator MORAN. Mr. Chairman, thank you. Thank you and the Ranking Member for this hearing and thank you for working together to produce a bill. I hope that the stories that I have read that GSE reform is the next step in this Committee are accurate and I look forward to working with both of you to accomplish a change in the current circumstance we find ourselves in in trying to make certain that housing markets continue to recover.

I have always thought that in the absence of a housing recovery, our ability to have an economic recovery is significantly diminished and I am pleased to see our Committee focusing the attention that it is on this topic.

Ms. Galante, the FHA at least according to the President's budget request could potentially draw down up to a billion dollars in Federal dollars to solve the solvency problems of FHA. Does this legislation reduce the probability of the need for that to occur.

Ms. GALANTE. So, let me say this just to frame. The President's budget, you know, is an estimate. There is a reestimate that happens every year; and then based on both volume and policy changes, there is an estimate of how much we might need to draw from the Treasury.

That budget reestimate was set when the budget came out and so these policies will not actually directly impact today, whether we need to draw or not draw, but what it will do is ensure that the next time the reestimate is done when these tools are in place and we will be able to employ them, that, you know, you will see the results of it down the road.

So, it will help the FHA's long term financial health. Whether or not there is a draw which again is to not a cash need, it is to, quote, I like to use the term top off our reserves, that is a time, you know, if we need to draw that that will be what it is for.

But this bill absolutely will help ensure that as we continue down the pike, we are, you know, getting the indemnifications and those kind of activities from lenders that we need to ensure that we are properly being compensated for the risk that we are taking.

Senator MORAN. When does that next estimate occur?

Ms. GALANTE. It will occur with the 2015 President's budget which normally comes out in February.

Senator MORAN. What factors, what circumstances have arisen since the last estimate, since the estimate that is in the President's current budget that are favorable or unfavorable to the solvency of the FHA?

In broader terms than just this piece of legislation, what else is occurring?

Ms. GALANTE. Sure. A lot of different things are occurring. One is you have seen house price appreciation significantly more than was estimated both at the budget reestimate and the actuarial that was done last November. So, that is a positive.

So, there are things happening in the economy that are positive that will help the long term trajectory of the fund. And then, all the policy actions that we have been taking including particularly the change in loss severities. When you go from, you know, losing 70 cents on the dollar to, you know, losing closer to, you know, 55 or 57 cents on the dollar and that continues to improve both as a result of the economy but also as a result of policy changes that we have made. Those kinds of things will impact ultimate results down the road.

Senator MORAN. Are you aware of any factors, circumstances moving us in the other direction creating greater challenges for the FHA?

Ms. GALANTE. I am not at the moment. I mean, interest rates have a big impact, you know, interest rates going up, you know, hurts some access to credit. It helps the FHA in other ways.

Senator MORAN. Thank you very much.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. Thank you, Mr. Chairman and Ranking Member Crapo.

I am very impressed by the FHA reforms you have put together and very much admire your having come out and put something to try to solve this very difficult problem. I just want to ask about some other areas that relate to this.

Ms. Galante, one of the things we have learned in the 2008 financial crisis is how important it is for different institutions, public and private, to have an accurate assessment of their risk exposure, and as part of them, to be able to aggregate reliable data about the loans they issue or insure.

Now, the FHA faces particularly big challenges in assessing risks because of the decentralized program. As you know, the FHA's knowledge about its insurance exposure is only as good as the quality and consistency of the data given to it by approved banks along with the work it does to audit then, after the fact, the information that it receives.

So, as you may know, the FHFA and the Consumer Financial Protection Bureau have been working to put together a uniform mortgage data base program to track more loan level data about origination and performance. And if it succeeds, I think it could be very helpful in mortgage insurance pricing and increasing general market efficiency by making it easier to evaluate the riskiness and profitability of different pools of mortgages.

So, I just wanted to ask about the FHA's role in that? Have you been participating in that?

Ms. GALANTE. We are very interested in this issue and I will just mention two items. One is that Ginnie Mae, which is, you know, the securitizer, so go speak, for FHA, it is working on making much more loan level data available to their servicers, to their investors of those loans. I think that additional data availability is imminent and that will be extremely helpful for people evaluating the risk of FHA, VA, and rural loans that are in those.

Senator WARREN. Have you considered participating along with FHFA and CFPB so that we, it helps us get apples to apples comparisons all the way through.

Ms. GALANTE. Yes. So, we are very interested in participating.

Senator WARREN. Good.

Ms. GALANTE. I do not want to continue to whine about money and systems.

Senator WARREN. Go ahead.

Ms. GALANTE. But that is a challenge for us right now. We are actually, you know, trying to work on, we need some contractual help in order to participate in that actively. But we are very interested.

Senator WARREN. Good. But you feel like you have adequate authority. You do not need any additional authority to do it. You just need the resources.

Ms. GALANTE. Correct.

Senator WARREN. OK. Good. I want to ask about another part two. Under a recent FHA guideline, it is Mortgagee Letter 2012–22, it appears that homeowners must be currently employed in order to be eligible for certain loss mitigation options, in other words, helping people who are in trouble on their mortgages.

This concerns me because it seems to arbitrarily discriminate against people who live on unearned income like Social Security, veterans benefits, child support. Am I missing something here or what is going on with this policy from FHA?

Ms. GALANTE. Yes, I appreciate the concern here. I would just say I have just recently been made aware of this particular issue and I am looking into it. I do agree that what we are, you know, the intent of what we are looking for here in order to be eligible for some loss mitigation activities including modifications, we do need to see that there is a stream of income that supports that obligation.

Senator WARREN. I certainly understand.

Ms. GALANTE. I do think this is a reasonable concern for us to go back and look at the employment versus source of income but we will look at that.

Senator WARREN. Excellent. Thank you very much.

Just in the few minutes I have left, the few seconds I have left, I just want to ask you a brief question about the FHA's role in being countercyclical in the housing market, and we had some discussion. I heard you talking about the tension with premium increases that as the market goes down is the time you may need to rachet up premiums but then you are behaving in a way that is procyclical, that is, making the booms higher and the busts lower.

So, if you could just speak very briefly to the question of how the proposed legislation would affect your ability to be countercyclical and thus help us both tamp down a little on booms and help us even out a bit on busts.

Ms. GALANTE. Yes, I appreciate the question, and it is wide. I think the current Section 7 is pretty inflexible about when that premium increases must be put in place, and we think that will hurt in the countercyclical situation if we are at a place where we have already, for example, raised those enough to be covering our risk and we have other tools to get to the same place, that we should be looking to those other tools as much as possible.

Senator WARREN. Because you would like to see more flexibility there?

Ms. GALANTE. Yes.

Senator WARREN. Thank you very much. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman, and thank you for being here, Ms. Galante.

As you know, last week, on July 17th, I wrote to you about a stress test that was conducted but not disclosed to Congress or the American people, and I have not gotten anything back in response, so I want to ask you about that.

It is really troubling to a lot of us that the only reason we know about it is the *Wall Street Journal* happened to report on it. The *Wall Street Journal* wrote that it was a, "hidden report based off of annual tests done by the Federal Reserve Board, and it projected losses over 30 years that could reach as high as $115 billion."

First of all, will you submit the full, unredacted stress test report for the record of this hearing in the next few days?

Ms. GALANTE. Senator, let me say first thank you for the question and also say that there is no, quote—and I am going to use the quotation marks here for the transcriber, there is no "hidden report." If I could give you the background on, I believe, what the *Wall Street Journal* article was referring to, the annual actuarial review is an 8-month-long process, and there is substantial conversation back and forth between FHA staff and the independent Actuary performing the Actuarial on our behalf and one that we, you know, submit to Congress and also write a report on. That back-and-forth includes data collection, data analysis, conversations of what model changes we might want to deploy this year from their perspectives, what model changes FHA might want to deploy from our perspective. You know, they have got IG input, GAO input into what happens to the—what goes into the Actuarial each year. And I think what this report is referring to is the Actuary at one point in an early draft did provide an economic scenario that included a Fed stress test. By the way, it is not a report. It is a line or a column in a chart with a variety of other economic range of factors.

Senator VITTER. Let me back up. Is there a Fed stress test?

Ms. GALANTE. Again, the independent Actuary, in an early draft of the report, showed two FHA staff a chart that had a "Fed stress test" as one of the scenarios in that report. As conversation——

Senator VITTER. Will you submit for the record all of the information regarding that Fed stress test that FHA has?

Ms. GALANTE. So, again, I would say we have—you know that the *Wall Street Journal* article that you are referring to is subject to Congressman Issa's Oversight Committee. We have been very cooperative with his Committee in providing all of that data that they have asked for, and so anything that, you know, we have provided that—you know, I defer to him in terms of——

Senator VITTER. I will defer to him, too, and he tells me that they have not gotten the Fed stress test and everything regarding it that they have asked for. Will you make everything FHA has with regard to that Fed stress test part of the record of this hearing?

Ms. GALANTE. So, again, all I can say is we have given them everything that we have around this——

Senator VITTER. Forget about them. Will you make part of this record that Fed stress test and any material you have regarding it?

Ms. GALANTE. I do not—you know, we have been responsive to every request that they have asked for. We do not have any additional——

Senator VITTER. I am making a request. Forget about them. Will you make the Fed stress test and any information you have regarding it part of this record?

Ms. GALANTE. Again, I would defer to Congressman Issa on that.

Senator VITTER. So if he says you will, you will?

Ms. GALANTE. We have given them everything that we have.

Senator VITTER. I am not asking about his request. I am making a request to make part of this Senate Committee record the Fed stress test and material you have regarding it. I think that is a reasonable request for the oversight Committee of FHA.

Ms. GALANTE. Senator, what I am trying to say is that I do not have that information. I have what was given to us in a draft report with a chart——

Senator VITTER. Whatever you have regarding the Fed stress test, whatever that is, whatever universe that is, will you make it part of the record of this hearing?

Ms. GALANTE. We can do that.

Senator VITTER. Thank you. OK. I would also note with regard to this, a senior FHA official was quoted in this article as saying, "While the agency still wanted to present the results of the Fed stress test to other Government agencies, we just do not want that analysis to be in the Actuarial Review Report. In congressional hearings, it is quite possible that we will be required to present this information on the record, but that will be well after the Actuarial Review is released and the initial media coverage takes place.

Again, my time is up, but let me just say that is very concerning. Did you approve this strategy, this decision, the decision that is reflected in that quote?

Ms. GALANTE. So, again, I cannot speak to the quote. I am not even sure who it was from. But I can say that, you know, there was back-and-forth between FHA staff and the Actuarial, not just on this but on many, many items about what would ultimately be included in the report. It is an independent Actuary. It is their decision at the end of the day what information they are going to include in that report.

Senator VITTER. Thank you.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. Commissioner, welcome.

Let me start off with HECM. I heard your comments. I read your testimony. I appreciate your acknowledging our work in this regard on making sure that seniors can stay in their homes as they get old, thereby borrowing against their equity. But I get a sense when you say that your support moving the House bill that has been sent over here is primarily because for you time is essential. Is that a fair statement? Because there are elements of our bill that I think are better, with all due respect to our House colleagues, and I think give you some greater tools to try to achieve the goal. But when you say move the House bill, I get the sense that you are saying that because time is of the essence. Or is that an unfair characterization?

Ms. GALANTE. Senator, that is a very fair characterization. The elements in your bill are quite good, and we appreciate them greatly. But time is of the essence here. It is unfortunate, but if we cannot make these more nuanced changes that, you know, get to the core problems of the reverse mortgage program through mortgagee letter before the beginning of the next fiscal year when we have a new calculation of how the reestimate will work or how the budget subsidy for this program will work, we are going to have to make some really radical changes to the program that I do not think ultimately get to the core of the problem.

Senator MENENDEZ. So while I appreciate the Chairman and the Ranking Member looking at our provisions in the context of this, if I were to take the House bill, substitute it with mine and send it back to the House, assuming I could get that done, you would not be opposed, you would be supportive of that?

Ms. GALANTE. Yes, sir.

Senator MENENDEZ. All right. So understanding the urgency, can you elaborate on some of the factors that are driving the program's current financial situation so people understand and what the consequences of inaction would be? You say you would have to make some pretty dramatic changes. Maybe you could give us a sense of that.

Ms. GALANTE. Sure. There are a couple of major things.

First of all, you know, the economy, both for the forward mortgage and the reverse mortgage program, house price changes, for example, certainly have hurt the performance of the reverse mortgage program, in some ways more than the forward program because it looks at—long-term house prices are more important than shorter-term house prices. But we cannot change that fact.

But the biggest challenge is that the program has allowed people to frankly draw more up front—and I am not talking about how much they ultimately can take out on their reverse mortgage, but take more money out than they really need to live on or to pay their obligations. The program, the way it is currently structured, encourages them to take more out up front than they should. And, frankly, lenders are encouraging them to take more out up front than they should.

So the changes that we are trying to make are to put in financial assessments to make it much more clear and require that you can only take out, you know, what you need for what you are going to need over the projected life. And if we cannot make those nuanced changes, we are just going to have to say the entire amount that you can take out on this reverse mortgage is going to be just lowered substantially for everybody across the board, which is going to make it a much less effective program and much less useful for far fewer people. So we would rather try to make the more nuanced changes to get at the right problem than to take that blunt across-the-board cut in how much you can take out in a reverse mortgage.

Senator MENENDEZ. OK. And then just moving for a moment to FHA, you know, preserving the opportunity for affordable ownership for American families is, in my mind, one of the critical roles of the FHA. And another critical role of the FHA has had is as a countercyclical stabilizer for the housing market during times of economic stress.

So I have heard you generally testified favorable as to the bill that is proposed here. What provisions that are included in the current bill—what elements of the program, I should say, are essential to preserve? And what changes should we not make in order to allow FHA to continue serving those important market roles?

Ms. GALANTE. A very good question. I appreciate that.

Senator MENENDEZ. I only ask good questions.

[Laughter.]

Senator MENENDEZ. I am just kidding.

Ms. GALANTE. So I would say this: I think the core mission of FHA is both to be able to play a countercyclical role when necessary, but when that is not necessary, to be serving lower-wealth borrowers. So it means, you know, we want to be able to keep the ability to do lower downpayments, for example. We think that is an important element of providing access to home ownership in this country, as long as it is done well and the downpayment is considered along with other factors in ability to repay. We certainly want people who, you know, can afford to repay their mortgages. But we would not want severe programmatic restrictions on who we can serve, you know, literally put into legislation and not allow us to look at the compensating factors that make a good borrower.

So I do not think that bill—I do not think this bill damages our ability to do any of that, so we support the changes that are being requested here. But that countercyclical element with the, you know, kind of automatic premium increase I think is something that we do need to work on.

Senator MENENDEZ. All right. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Manchin.

Senator MANCHIN. Thank you very much, Mr. Chairman, and mine is more basically philosophical, where we are going, and we have talked about this before, the high-end loans are being made when it had changed, I think back in 2008; 217 to 729 I think is where the loan range.

Ms. GALANTE. So, again, for high-cost markets, we go up to 729. That is correct.

Senator MANCHIN. 729. The only thing, when you look at basically nationally, the figures of 2011, borrowers with an income of over $75,000 made up 32 percent of your loans, I think. And in West Virginia, that number is about 28 percent. But that is substantially higher than it was in 2006. It looks like we are moving away from the mission that FHA had, which was basically in the 1940s it was helping the veterans; in the 1950s, 1960s, and 1970s helping the elderly, handicapped, and lower-income Americans. it seems that we are more focused on a target that is much higher. And I know everything has moved, but perceptually, we are not there for that person on that lower end, but we are of more help to the higher end.

Ms. GALANTE. Yes, so——

Senator MANCHIN. Do you find that troublesome?

Ms. GALANTE. Senator, I do not for this reason, and it goes back to the conversation we were just having on countercyclical. When FHA stepped in, there was literally no place to get a mortgage in 2008, 2009, and Congress gave us authority to go to higher loan limits. They also gave the GSEs authority to go to higher loan limits. So that was an important countercyclical role that we were playing.

I fully expect—and as we, you know, continue down this path, those higher loan limits do expire at the end of this fiscal year. They were extended once. But, you know, as we are coming out of the crisis, we should dial back to playing the more traditional role. But that said, I think having the ability for FHA to play the countercyclical role is an important one for the country.

Senator MANCHIN. The other thing I would say, based on that reply and the other replies I have heard, are we relying on the pure hope that the housing market is going to recover? Or do you think we need to be taking steps in the event that the downturn continues based on the financial condition of FHA?

Ms. GALANTE. So, again, I would just say that the playing of the countercyclical role here in terms of particularly the larger loans, you know, they were not particularly problematic loans for us. I mean, the loans that were problematic are the loans that were made in the early part of the crisis, regardless of where they were on the loan spectrum, right? People lost their jobs, house prices declined significantly, and that is what caused by stress at FHA but certainly stress in other parts of the market.

But I would say decreasing the loan limits at the appropriate point in time—and I think given that they are expiring at the end of this calendar year, by the time we would go through that process, I do not think it will be necessary. Certainly not extending them would make sense given where we are in the market recovery.

Senator MANCHIN. But the mandated 2-percent line, you have been below that since 2009, right?

Ms. GALANTE. Yes, but we have taken, again, a large number of steps to increase our capital, five premium increases, major changes in our loss mitigation activities, major improvement in our recovery rate. So we are moving in the right direction.

The 2-percent capital ratio, I think just to make a point, I know that the bill talks about going to a 3-percent capital ratio over time. I think that is a recognition that the 2-percent ratio was not meant to withstand the most severe recession we have had since the Great Depression. It was meant to give us a cushion for a mild or a moderate recession.

So we, like other financial institutions, did not make it through this very severe period with a 2-percent capital ratio. So for more cushion, for more security in the future, you know, having a larger capital reserve ratio is certainly a reasonable thing that we can do.

Senator MANCHIN. Well, the legislation, I know that both our Chairman and our Ranking Member, the minority Ranking Member, have legislation which they are leading. You have a House piece of legislation. Do you as the agency believe that there is need for legislation for corrections to prevent what has happened? Are you supportive of change?

Ms. GALANTE. I have expressed I am supportive of a number of the measures here in this bill, and I think they will be very helpful to us in ensuring that we both can rebuild capital and hold lenders accountable and what-not moving forward. And I think that is, you know, a very important change. So we welcome that.

We also do see that, as we move with housing finance reform more largely, we need to be sure that we understand FHA's role in the larger housing finance system.

Senator MANCHIN. Thank you.

Chairman JOHNSON. I would like to thank Commissioner Galante for being here with us today. I look forward to continuing working with the Ranking Member and Members of the Committee to move this legislation quickly.

This hearing is adjourned.

[Whereupon, at 11:15 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR MARK KIRK

I want to first thank Chairman Johnson and Ranking Member Crapo for holding such an important hearing on the solvency of the Federal Housing Administration (FHA).

Since the National Housing Act was signed into law in 1934, the Federal Housing Administration (FHA) has helped millions of Americans achieve home ownership. Like most creations of the Government, the FHA's mission and statutory obligations have been muddled with increased demands over the decades, often by Congress, which have led to loosened lender underwriting demands and other negligent policies all in the pursuit to achieve higher and higher rates of home ownership.

While the goal of home ownership is laudable and does help promote financial stability, we have all seen the adverse effects of an over-stimulated housing market. We've also felt the pain caused when loans are not underwritten properly and when consumers who are not financially ready to have a mortgage are incented through Government programs to buy rather than rent.

We also know all too well that when private market participants know the Federal Government stands behind the risk, moral hazard is created and private market participants take more risk than they otherwise would if the Government didn't insure their loans. We have seen the disasters that occur from private shareholder gains that too often spell disaster for homeowners and the American taxpayer. We saw this with Fannie Mae, with Freddie Mac, and we are now on the brink of seeing this with FHA.

HUD promotes that, "FHA is the only Government agency that operates entirely from its self-generated income and costs the taxpayers nothing." However, with a more than $16 billion negative economic value,[1] the Federal Government is now faced with trying to make reforms to FHA to ensure that the taxpayer is not in fact on the hook to bailout the FHA.

Over the years and decades, new programs have been created and more mandates have been made for FHA to relax underwriting standards. One such program creation was the Home Equity Conversion Mortgage, or HECM program. The HECM program is the Government-insured reverse mortgage program. Again, while a laudable program that was designed to be a valuable financial tool for seniors, the HECM program is dangerously underwater, with nearly one in ten HECMs defaulting last year.

During the latest financial crisis, seniors around the country watched the equity in their homes plummet and saw their retirement plans—including their 401(k)s—devalued. Many retired seniors were forced out of retirement and back into the workforce. With limited options, many seniors turned to the largest asset they had, their home, and took out a reverse mortgage.

While I think that the FHA has done a poor job to date of managing the HECM program, it is not my intention to get rid of the FHA reverse mortgage program.

My rationale for examining the FHA program is simply this: if the FHA HECM program were designed to best meet the needs of and protect seniors, the rate of defaults and losses under the HECM program would be far less. Put simply; make a program that works for seniors—that is safe and fiscally sound—and the program will thrive and the risk to the American taxpayer will be far less.

American seniors have worked their entire lives to improve this country and pave a more promising path for future generations. We owe it to them to provide safe, reliable tools so they too can meet their financial needs.

I look forward to continuing to work with my Banking Committee colleagues to legislatively enhance the safeguards and protections for seniors under the HECM program and to holding FHA's feet to the fire to ensure the program returns to solvency.

[1] Based on the last independent actuarial showed a negative economic value.

PREPARED STATEMENT OF CAROL J. GALANTE

ASSISTANT SECRETARY FOR HOUSING/FEDERAL HOUSING ADMINISTRATION COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

JULY 24, 2013

Thank you, Chairman Johnson and Ranking Member Crapo, for this opportunity to discuss the proposed FHA Solvency Act of 2013. First, I would like to thank the Committee, particularly the Chairman, Ranking Member, and their staffs, for all their hard work on this bill. This effort addresses many longstanding legislative requests of the Federal Housing Administration (FHA) in an evenhanded and forward-looking manner. The Secretary and I greatly appreciate the introduction of a bipartisan bill that will give HUD the tools to ensure a fiscally sound and vibrant FHA continues to support responsible home ownership and affordable housing for generations to come. We look forward to working with the Committee to help FHA better respond to current and future challenges.

As the Administration has said consistently, a strong FHA is vital to the success of our Nation's housing market and critical to its ongoing recovery. As we see signs of recovery, this bill represents an important step forward, turning our collective focus away from responding to the immediate crisis to strengthening the market by applying lessons learned from that experience and giving FHA the necessary tools to better protect the Fund and the market in the future.

Historically, FHA's role has been to provide access to mortgage credit for creditworthy borrowers not otherwise served by the market and play a necessary countercyclical role during times of economic stress. As recently as my testimony before your colleagues on the Senate Appropriations committee in May, I have articulated the steps we have taken, and continue to take, to ensure that FHA, and particularly the MMI Fund, would be able to continue to play that role in a responsible fashion while reducing risk to taxpayers and borrowers alike. I can now report that these steps have had a significant positive impact on the fund, and that major indicators show strong, encouraging trends. However, our work is far from finished and we look forward to partnering with this Committee to ensure that these trends continue.

Changes to FHA Already Resulting in Positive Trends

FHA, along with the Government National Mortgage Association (GNMA), continues to have a significant impact on the Nation's housing market and economic recovery. The activities of the Federal Government are critical to both supporting the market in the short term and providing access to home ownership opportunities over the long term, and doing both in a way that minimizes risks to taxpayers.

As has been true throughout its history, FHA is particularly important to borrowers that the conventional market does not adequately serve, including qualified first time homebuyers and minority borrowers who historically have been underserved. According to the latest Home Mortgage Disclosure Act data, half of all African Americans and 49 percent of Hispanics who purchased a home in 2011 did so with FHA insured financing. Seventy-eight percent of the home-purchase loans insured by FHA go to first time homebuyers.

Despite ongoing stress from legacy loans, FHA has made significant progress and is on a positive trajectory moving forward as a result of numerous policy changes by this Administration. The housing market, and thus the performance of the Mutual Mortgage Insurance (MMI) Fund, is closely linked to the state of the economy and improvements in the housing market combined with these policy changes have placed FHA in a stronger position.

Recently implemented changes continue to have their desired effects—improving loss mitigation, increasing recoveries and decreasing FHA's share of the market. Of the changes made since 2009, FHA's lender oversight and credit policies have yielded substantial improvements in the quality of new loans endorsed by FHA, and premium flexibility given to us by Congress has allowed us to price appropriately for future risk. Today, our newest books of forward loan originations are the most profitable in Agency history.

Improving Loss Mitigation and Increasing Recoveries

FHA has always had mandatory loss mitigation requirements for its lenders, designed to protect borrowers and taxpayers alike, but we implemented substantial improvements in recent years to enhance the effectiveness of this program. Serious delinquencies continue to fall, declining from 9.59 percent in December 2012 to 8.27 percent in May 2013. Based on data from April 2013, cures—loans that reperform—are surpassing new serious delinquencies. Our efforts to provide effective and efficient loss mitigation, in combination with improving economic conditions, are working—reducing loses to the Fund.

A Mortgagee Letter published on November 16, 2012, outlined changes to FHA's loss mitigation home retention options. One of the key elements of this update was moving FHA's Home Affordable Modification Program (HAMP) product up in FHA's loss mitigation waterfall so servicers could more quickly offer deeper payment relief to struggling FHA borrowers, resulting in an increase in the number of borrowers being able to retain their homes. FHA has also targeted deeper levels of payment relief for borrowers earlier in the delinquency cycle and provided greater clarity for servicers.

In addition to improving FHA loss mitigation procedures, housing counseling plays an important role in reducing losses to the Fund. A 2011 study by the Urban Institute revealed that borrowers counseled by HUD-approved agencies through the National Foreclosure Counseling Mitigation program were 89 percent more likely to receive a modification cure compared to similar, noncounseled borrowers. In addition, counseled homeowners were at least 67 percent more likely to remain current on their mortgage 9 months after receiving a loan modification cure. HUD-approved housing counseling agencies provided foreclosure prevention services to 774,000 families in fiscal year 2012. Looking forward, the Homeowners Armed With Knowledge (HAWK) initiative seeks ways to embed housing counseling in FHA origination and servicing in order to reduce losses to the MMI Fund and improve household economic and social well-being.

Although FHA is deeply committed to providing loss mitigation alternatives to borrowers which permit them to retain their homes, home retention is simply not an option for some borrowers. For these borrowers, preforeclosure sales, also called short sales, offer an opportunity to transition out of their homes. This enables both FHA and borrowers to avoid the costs and damage of the foreclosure process. Just this month, FHA introduced a streamlined preforeclosure sale policy which removes certain barriers for borrowers in obtaining a short sale on an FHA-insured mortgage. Because losses from short-sales are substantially lower than from the traditional FHA Real Estate Owned (REO) process, the shift of greater numbers of distressed homeowners to short-sale dispositions rather than foreclosures is anticipated to yield better results for the MMI Fund while allowing distressed borrowers to start anew without having to go through the difficult and costly foreclosure process.

Throughout the past fiscal year, FHA has been executing an overall asset management strategy aimed at ramping up REO alternatives. FHA is expanding a pilot in which properties secured by nonperforming FHA-insured loans are offered for sale by the lender who has completed the foreclosure process and sold to third party purchasers without ever being conveyed to FHA. This method of disposing of these properties is expected to yield lower losses for the MMI Fund than selling them through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing an REO property are eliminated.

The Distressed Asset Stabilization Program, another REO alternative that improves Fund performance, has successfully scaled up operations and is now selling approximately 10,000 loans per quarter. FHA is able to dispose of the nonperforming loans, while recouping as much or more than would be recovered from REO disposition and contributing to community stabilization initiatives in cities hit hardest by the recession.

Beginning in 2013, FHA plans to launch a large-scale proactive marketing campaign to promote modification and short-sale strategies for delinquent borrowers. This effort is expected to increase utilization of these programs, which will permit more borrowers to become aware of and take advantage of these opportunities, while reducing foreclosures and decreasing associated losses for FHA.

Again, in combination with improved market conditions, our efforts are producing better results. Loss severity across PFS and REO are down from their historic highs of 48 and 72 percent, respectively, in 2011, to 45 and 61 percent today.

And while we have taken aggressive steps to reduce losses on legacy loans, we have also taken measures to ensure that future books are appropriately priced, so that if there is a default, FHA will have sufficient reserves on hand. These policies include raising mortgage insurance premiums five times since 2009 and reversing a policy that canceled mortgage insurance premium (MIP) collections when the principal balance of an FHA-backed mortgage reached 78 percent of the original home value.

Improvements in Early Loan Performance

Our most recent monthly and quarterly data shows the combined results of the housing market recovery and FHA's efforts. The 60-day Early Payment Default (EPDs) rate continues to trend down—to .25 percent—the lowest it has been since

2007. Compared to 2012, EPDs have fallen 9 basis points, demonstrating that the credit policy changes made since 2009 are improving the quality of loans endorsed by FHA.

FHA has also made significant changes to credit policy, including establishing a minimum credit score, as well as a two tiered down payment/credit score requirement wherein borrowers with scores less than 580 are required to have a larger downpayment. In addition, we now require manual underwriting for borrowers with credit scores below 620 and debt to income (DTI) ratios over 43 percent, have enhanced FHA's TOTAL Scorecard, and have increased both downpayments and premiums for borrowers seeking loans in excess of $625,500.

These steps, as seen through the reduction in EPDs, ensure that home buyers using FHA-insured financing are capable of meeting their mortgage obligations and will not put undue stress on the Fund.

Simultaneously, our portfolio growth continues to slow, resulting in a declining market share, encouraging the return of private sources of mortgage capital to the market.

In fact, the number of FHA single family loan endorsements by loan count, has declined to levels comparable to those seen in fiscal years 2002 and 2003, when FHA's market share was lower than it is today, indicating that FHA's current market share is primarily due to a substantial decrease in the size of the total mortgage market rather than exceptionally high FHA loan volumes. As the market continues to recover, FHA's role will naturally recede further.

Tools for Management of the Fund and Additional Considerations

Tools for FHA

The FHA Solvency Act of 2013 provides many tools and changes that FHA has requested to better manage the Fund—and we thank the Committee for its commitment to their inclusion. FHA has long believed them to be necessary in order to create a more responsive business model, better able to react to stress in the market. The Committee's support for these tools will provide flexibility, resources, and enforcement mechanisms that will result in a stronger, more secure MMI Fund.

- Indemnification Authority for Direct Endorsement Lenders will allow FHA to seek indemnification from these lenders, which account for 70 percent of all FHA approved lenders. With this authority, FHA will be able to obtain indemnification from all its approved lenders for loans that fail to comply with its guidelines.
- The revised compare ratio will allow comparison on origination and underwriting criteria, defaults and claims, as well as some other factors the Secretary determines increase risk to the MMI Fund—enabling FHA to respond appropriately to changes in the market and mitigate risk.
- The authority to structurally change the Home Equity Conversion Mortgage (HECM) program through Mortgagee Letters will allow FHA to make critical changes quickly, preserving this program, which is a vehicle that allows seniors to age in place. These changes will help FHA ensure that new HECM originations, now limited to three product lines, meet the needs of the target population, reduce risks to the MMI Fund and avoid dramatic actions that would harm the very consumers these loans are intended to help in order to ensure actuarial soundness. Given the high pace of change within the reverse mortgage market and its impact on the MMIF, it is vital that FHA be able to make program improvements quickly.

Points for Further Discussion

While the bill offers a measured approach that provides tools to manage the MMI Fund, there are some topics which warrant further discussion and clarification to more directly address our shared concerns.

- *HECM:* We thank the Committee for including the language in Section 13 which will allow FHA to make structural changes to the HECM product through Mortgagee Letter which will stabilize both the product and the Fund. During this work period, we urge the Senate to take up H.R. 2167—which has passed the House and accomplishes the same goals of this section—and the bill introduced earlier this year by Senator Menendez.
- *Servicing as a Recovery Tool:* As currently drafted, Section 4 does not give FHA the tools necessary to ensure servicers are being held accountable for their performance and to allow FHA to shift servicing to a specialized sub-servicer if they cannot fulfill their obligations under the contract of insurance. This addi-

tional authority would minimize losses to the Fund by facilitating more effective loss mitigation, yielding better results for both borrowers and FHA.

- *Capital Restoration:* Section 7 establishes mandatory premium increases during times when the capital reserve ratio falls below required levels. While we share the Committee's desire to ensure that future FHA leadership takes the appropriate steps to protect the Fund and satisfy the capital reserve ratio, as we have shown since 2009, premiums are only one factor to consider in rebuilding that supplemental account.

  As written, the language does not account for the impact increased premiums themselves will have on access to credit, endorsement values, and ultimately the health of the Fund—potentially undermining the goal of increasing the capital reserve. Especially when it is necessary to respond quickly during times of economic uncertainty or stress, this approach will have unintended consequences for the Fund. Therefore, we ask the Committee to continue to work with us in crafting language that best facilitates recapitalization using the full range of options available.

Additional Considerations

Despite many policy and organizational changes proposed in this bill there are a number of statutory constraints which FHA strongly feels limit our ability to manage risk appropriately and are having a negative impact on FHA's fiscal health. These constraints include an increasingly complex mortgage market, aging FHA systems and infrastructure, a need for additional skills and expertise, and difficulty responding quickly to major risk issues as a result of contractual and statutory limitations. For FHA to manage risk and maintain operations as 21st century mortgage insurer, these constraints must be dealt with appropriately. For that reason, we would like to continue to explore with the Committee tools which can be leveraged to allow FHA to minimize risk to the Fund and taxpayers while continuing to serve consumers.

Conclusion

Chairman Johnson, Ranking Member Crapo, I would again like to thank the Committee, under your joint leadership, for taking up the issue of long-term solvency of the FHA MMI Fund. The economic and housing crisis and recovery, as well as the new, multidimensional challenges facing our urban, suburban, and rural communities require an FHA that is more agile and responsive to real-time market dynamics. As such, we remain committed to continuously improving our stewardship of FHA. HUD stands at the forefront of the Federal response to the national mortgage crisis, economic recovery, Hurricane Sandy recovery, and the structural gap between household incomes and national housing prices—roles that require an agency that is sophisticated and market-savvy, with the capacity and expertise necessary to galvanize and direct a vast network of partners. Your efforts to ensure that is possible are both timely and necessary, and offer a strong start. I look forward to working with this Committee to continue to strengthen and preserve FHA for future generations.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM CAROL J. GALANTE

Q.1. Part of the *FHA Solvency Act of 2013* aims to ensure that problems with various FHA lending programs that result in negative effects for homeowners and solvency issues for FHA are identified early, and that FHA takes the necessary steps to ensure that the problems are appropriately diagnosed, reported on, and remedial measures are taken to mitigate possible affects of these problems. While these requirements are made for FHA's MMI fund no similar specific recommendations were required under the act for the HECM specific program.

Do you believe that a similar approach to identify problems early, appropriately diagnose and report the problems and recommend and implement remedial measures—should also be done within the HECM program?

A.1. FHA has worked proactively and aggressively to make changes to HECM to ensure program sustainability under its existing authority, and under the Reverse Mortgage Stabilization Act of 2013. With the support of Congress and using the authority of bill, FHA has been able to require a set aside for payment of property charges using HECM proceeds. FHA also requires a financial assessment, places limitations on the allowable draw during the first 12 months, and adds a new Initial Lump Sum Draw option. This is an addition consolidating the ARM Standard and ARM Saver programs and reducing the principal limit factor, which reduced risk by lowering the amount of equity that borrowers are able to access. These adjustments have helped place the HECM program on a positive and sustainable path forward.

We agree that it is important to identify solvency issues early in the process for our programs that impact the MMI Fund. The changes FHA has been focusing on achieving involve proactive management of its entire portfolio, rather than developing separate and specific recommendations for the HECM program. FHA is pursuing greater ability to respond to emerging needs and changing economic conditions. These tools would help FHA better identify risks across FHA programs in the future and adjust quickly to prevent the type of scenario which made HECM unsustainable.

Q.2. While I think that indemnification is appropriate where there are cases of mortgagee fraud and/or misrepresentation by the mortgagee, I am concerned that indemnification may have unintended consequences. In recent years, FHA's single-family business shows high average FICO scores and low delinquency rates, which is positive for the health of the insurance fund. However, concerns have been expressed that some deserving borrowers are being shut out of FHA because lenders are imposing overly strict credit overlays to avoid indemnification risks. FHA's current average FICO score is 695, while in May 2012, the OCC defined a prime loan as having a FICO score of 669. While we want to ensure that FHA does not revert back to loose lending standards that are not based on credit characteristics of borrowers that will be able to pay the loan and that could jeopardize the solvency of the MMI, do you think that the current standards are too tight? Do you have concerns that overly strict enforcement standards could actually be counterproductive to FHA's core mission? What legislative safeguards need to be included in this legislation to ensure the right balance on enforcement?

A.2. We share concerns about access to credit, and are constantly evaluating our policies to ensure that we are accomplishing our mission while simultaneously preserving the health of the MMI Fund. FHA's mission includes stabilizing credit markets in times of economic disruption while maintaining access to home ownership opportunities for responsible, creditworthy borrowers. Every policy decision made by FHA considers the important balance between these goals.

FHA has been working diligently to revise its quality assurance framework to help address concerns about enforcement standards and ensure that it incentives behavior that is aligned with FHA's mission while minimizing risk to the Fund. We have been engaging with various stakeholders in the lending industry as well as consumer advocacy groups and Federal regulators, on ways to improve the efficiency and effectiveness of the quality assurance process. These practices will balance the goals of protecting the consumer while creating clarity for lenders and mitigating the risk to the MMI Fund. FHA is working towards a framework that ensures that loans are reviewed in a reasonable time period, allows us to use loan quality findings to improve credit policy, and allows lenders to improve their FHA origination practices and ensures that access to credit is not being constrained for the responsible, creditworthy, underserved borrowers FHA is intended to serve.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR COBURN FROM CAROL J. GALANTE

Q.1. Many other countries around the world issue mortgages that have recourse. If the borrower defaults on the loan, and the house is not able to cover the losses, a lender can file a claim on the borrower's other assets. What is the Federal Housing Administration's (FHA) ability to use recourse to recover losses from single-family forward and reverse mortgages? In each of the last 5 years, in how many cases has FHA pursued recourse? How much did the agency recover in these cases? How would FHA benefit from increased pursuit of recourse to recover losses?

A.1. FHA has the ability to use recourse to pursue single family forward losses in some States, depending on State law. Reverse mortgages are nonrecourse.

Federal law prevents delinquent Federal debtors from obtaining Federal loans or loan insurance guarantees. HUD developed the Credit Alert Verification System (CAIVRS) to assist in these types of situations. It is a shared database of defaulted Federal debtors, and allows identification of potential borrowers who are in default, or are delinquent on Federal loans with any agency. Through the CAIVRS system, Federal agencies and financial institutions can prescreen applicants for delinquent debts. Using this system, HUD has avoided over $12 billion in potential claims and more than $4 billion in potential losses. The FHA Financial Operations Center is responsible for collecting deficiency judgments for mortgages that are assigned to HUD in connection with the foreclosure of FHA-insured loans. Only a very small number of these debts are currently being serviced, in compliance with the Debt Collection Improvement Act.

The Department's position on the pursuit and collection of deficiency judgments for recourse FHA-insured mortgage loans was outlined in more detail in Housing Notice 94-89. This makes it clear that HUD would require mortgagees to obtain a deficiency judgment only with "worst-case offenders" to deter program abuse. This policy focused primarily on investor mortgagors, and the majority of FHA single-family programs have not permitted investor mortgagors, thus Title II deficiency judgments against borrowers are rare. In light of the substantial costs incurred in pursing such judgments, the likelihood of recovery to FHA to recoup losses would be minimal in most cases. Where the likelihood of recoveries is higher, the guidelines outlined in the above referenced Housing Notice would be followed.

Q.2. In each of the last 5 years, how many times did FHA notify the Department of the Treasury about outstanding, legally enforceable debt? In how many cases did FHA collect a payment from a borrower's Federal income tax overpayment? How much did FHA receive?

A.2. HUD alerts all lending Federal agencies about outstanding, legally enforceable debt through the Credit Alert Verification System (CAIVRS). This Federal Database tracks all Federal debtors and notifies them of any Federal liens, judgments, Federal loans that are in default and foreclosure, and any claims paid by reporting agencies.

Nearly all collections related to FHA programs come from FHA approved lenders and are based on a variety of reasons including noncompliance with program rules and indemnification. Collection directly from borrowers is costly and generally results in little to no recovery to the FHA.

Q.3. The Federal Housing Administration (FHA) currently uses an accounting method prescribed by the Federal Credit Reform Act (FCRA). FCRA takes into account expected losses from claims and gains from premiums, but does not take into account for variations in market risk. Using fair-value accounting, for example, the Congressional Budget Office previously estimated that in 2012, FHA's insurance would cost $3.5 billion. Under FCRA, FHA estimated it would essentially save $4.4 billion. Fannie Mae and Freddie Mac already use fair-value accounting for their budget projects. Would using fair-value accounting improve budget projections for FHA, similar to the procedure of Fannie Mae and Freddie Mac? Would fair-value accounting help FHA better calculate premiums needed to maintain the required capital reserve during financial downturns?

A.3. The Federal Credit Reform Act of 1990 (FCRA) greatly improved the accuracy of cost estimates for credit programs by reflecting the estimated lifetime costs of loans and loan guarantees up front on a net present value basis, requiring policy makers to budget for those lifetime costs when making programmatic decisions.

While fair-value analysis may offer some useful insights to inform decision, fair-value accounting would not be consistent with the goals of FCRA—to improve the accuracy of cost estimates and resource allocation. In contrast, fair-value accounting would include costs that are not relevant to the Federal Government and would make it more difficult to compare credit programs to each other, or to other Federal spending. Fair value would make budgeting less transparent by introducing a wedge between the cost estimates and deficit effects of the same program, would pose significant implementation challenges, and could introduce more distortion into cost estimates than valuable information. Thus, fair-value accounting would not represent an improvement over FCRA.

Q.4. The Federal Housing Administration (FHA) currently has very little risk-based pricing. Someone with a credit score of 600 would receive the same insurance premium as someone with a score of 800 making the same downpayment. FHA has had some positive movement toward increased risk-based pricing in the last few years. For example, FHA no longer insures people with credit scores below 500 and requires a higher downpayment from scores 500–579. FHA tried to implement stronger risk-based pricing in 2008 but was dissuaded by critics in Congress. How would FHA's financial solvency have been impacted if FHA were able to implement stronger risk-based pricing, which is used other insurance businesses? Would you support providing FHA flexibility to use more risk-based pricing methods?

A.4. Today, due to authority provided by Congress, FHA is able to appropriately price for the risk of the loans insured in its portfolio. The combination of appropriate pricing, revisions in FHA's credit and underwriting policies and the development of a more robust risk-analytics framework have improved the health of the MMIF. At the level of premiums FHA was legally able to charge in 2008, it is unlikely risk-based pricing would have improved the health of the portfolio. Today, due to the changes made since 2009 including a shift to risk-based underwriting, risk-based pricing would not be necessary to continue on this trajectory. If however in assessing the risk to the Fund and access to credit to creditworthy borrowers, FHA felt that risk-based pricing were appropriate, the agency has sufficient authority today to implement such an approach.

Q.5. The Federal Housing Administration (FHA) insures mortgages at a 100-percent level of coverage, even though private mortgage insurance is often significantly less. Please describe the differences in FHA's level of insurance to that of other Federal mortgage insurance programs the Departments of Veterans Affairs and Agriculture. As housing finance reform moves forward and private capital takes a more prominent role in the future, should FHA continue to insure the full value of mortgages?

A.5. The Department of Veteran Affairs' guaranty program insures 25 to 50 percent of the original principal in the case of a default. The USDA Section 502 Guaranteed Rural Housing Loan Program guarantees loans at 100 percent of the loss for the first 35 percent of the original loan and the remaining 65 percent at 85 percent of the loss. The maximum loss payable under the USDA program cannot exceed 90 percent of the original loan amount.

In general, both VA and the Department of Agriculture serve a different universe of borrowers than those accessing FHA insured mortgage financing. The USDA program only serves rural borrowers within certain income guidelines, and the VA loans are only available for honorably discharged military, current members of the reserves and the National Guard, and spouses of the military in certain circumstances. The VA provides supplemental servicing to borrowers that have trouble making mortgage payments. FHA programs serve a wider array of borrowers, and FHA has the critical mission of stabilizing credit markets in times of economic disruption. FHA also provides access to mortgage financing for underserved communities. In order to serve this role effectively, as it did before and during the financial crisis and continues to do today, FHA should continue to insure the full value of mortgages. If FHA scales back the full guaranty, it is likely lenders will be less likely to lend to many borrowers and, where they do, they will subject borrowers to higher costs of borrowing through increased fees and higher interest rates, having an adverse impact of credit access across the housing market. The increased risk could also further impact communities by causing some lenders to exit the market entirely, leading to a lack of competition and negatively impacting the housing market recovery. These effects would be at odds with FHA's mission. Of course, FHA must continue to serve this mission while protecting the insurance fund and taxpayer interest. To that end, since, FHA has taken significant steps to ensure that loans are properly priced, that credit policies facilitate access while managing risk and that counterparty risk is properly managed and enforcement actions taken where there are findings of noncompliance.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

STATEMENT SUBMITTED BY ENRIQUE LOPEZLIRA, SENIOR POLICY ADVISOR, ECONOMIC AND EMPLOYMENT POLICY PROJECT, OFFICE OF RESEARCH, ADVOCACY, AND LEGISLATION, NATIONAL COUNCIL OF LA RAZA

Chairman Johnson, Ranking Member Crapo, and Honorable Members of the Committee, I am pleased to have this opportunity to comment on the "FHA Solvency Act of 2013" (S.1376). I am a Senior Policy Advisor at the National Council of La Raza (NCLR) with over 10 years of experience conducting research, economic analysis, and policy development in both the private and the public sectors, and I have written on policy issues in traditional and social media, as well as in academic and nonacademic publications. At NCLR, I conduct research, policy analysis, and advocacy on issues that are critical to building financial security in Latino communities, including home ownership. NCLR—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans.

The NCLR Economic and Employment Policy Project promotes fair and accessible markets in which Latino families have the opportunity to obtain assets and build wealth sustainably so that they can be shared with the next generation. Through this project, NCLR (in partnership with the Center for American Progress) recently released Making the Mortgage Market Work for America's Families, a report on the need for a housing finance system that ensures access and affordability in the housing market. The NCLR Homeownership Network provides financial, homebuyer, and foreclosure prevention counseling to more than 65,000 families annually. Our subsidiary, the Raza Development Fund (RDF), is the Nation's largest Hispanic community development financial institution. Since 1999, RDF has leveraged more than $680 million in financing for local development projects throughout the country. This work has increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of Government regulation on financial services markets.

NCLR believes that one of the best opportunities for Latinos to build wealth and financial security is through owning a home. The Federal Housing Administration (FHA) plays an essential role in making home ownership a reality for first-time homebuyers and underserved populations, including Latinos. Therefore, NCLR supports legislation to reform FHA in order to strengthen its financial condition. However, the need for FHA reform must be balanced with the need to ensure access to affordable mortgages for creditworthy low- and moderate-income homebuyers. My statement will outline key priorities that NCLR believes must be part of any effort to strengthen the financial standing of the FHA.

Preserve Opportunities for Access to Affordable Credit

No one can deny the vital role FHA has played in helping the housing sector recover from the worst economic downturn since the Great Depression. In 2005, FHA had about a 5 percent share of the purchase mortgage market. By 2010, FHA's market share had increased to over 40 percent. As private capital fled, FHA-insured mortgages became the only credit option for first-time homebuyers, minorities, and those with limited downpayment capabilities. In other words, FHA has been fulfilling its mission of providing the Federal backstop to ensure that every creditworthy American has access to a stable mortgage product. Therefore, it is essential that any reform of FHA maintain an appropriate level of Government support to ensure liquidity and stability in the housing market, especially for Latinos and other minorities.

Do Not Solve the FHA's Fiscal Troubles Only on the Backs of Low- and Middle-Income Families

Over the past 3 years, FHA-insured mortgages have become more and more expensive. Increases in mortgage insurance rates and downpayment requirements, along with requirements to carry mortgage insurance throughout the life of a loan, are putting FHA loans out of reach for creditworthy low- and middle-income borrowers. Further increases in insurance premiums and over-tightening of underwriting standards will only continue to hurt creditworthy first-time low- and middle-income homebuyers.

Protect the 30-Year Fixed-Rate Mortgage

For nearly eight decades, 30-year fixed-rate mortgages have put home ownership within reach for America's middle class and first-time homebuyers. Without this flexible financing tool, home ownership would become a luxury reserved for the affluent. But this tool is under threat. Recent increases in downpayment requirements are already pricing out creditworthy first-time and low-income homebuyers. Research shows that higher downpayments are not good predictors of loan performance, yet downpayment increases are being used to reduce risk to the Mutual Mortgage Insurance (MMI) Fund. Research also shows that families who lack the cash for a high downpayment can be successful in a well-underwritten prime mortgage. Congress must preserve the 30-year fixed-rate mortgage by ensuring that FHA continues to provide low downpayment mortgages. The private market by itself will not offer a 30-year fixed-rate mortgage. The credit and interest rate risks for private lenders are too high without a Government backstop. Therefore, FHA reform must continue to provide a Federal support to ensure that the 30-year fixed-rate mortgage remains an available option for homebuyers.

Ensure That FHA Continues To Play Its Countercyclical Role

FHA's financial difficulties stem from loans made during the financial crisis. Loans made after the crisis are performing well and contributing positively to the MMI fund. It is therefore important that Congress does not overcorrect, introducing changes that may have unintended negative consequences. For instance, an overtightening of underwriting standards could reduce both FHA's volume and the overall size of the mortgage market. This reduction in volume could lead to a decrease in home prices, which will limit FHA's ability to play a countercyclical role in the housing market and adversely impact FHA's financial condition in the long run.

Avoid Imposing Severe Programmatic Restrictions on Who FHA Can Serve

The FHA was established to promote long-term stability in the housing market by assisting first-time low- and middle-income and other underserved homebuyers. Reform of FHA must not interfere with this mission. The need for financial solvency of FHA must be balanced with the need to keep reaching underserved homebuyers, especially Latinos and other minorities. FHA programs must not be available only to affluent buyers who can afford high downpayments. Insurance premiums, home price and income restrictions, and other underwriting standards must be flexible enough to ensure liquidity for all creditworthy buyers, not just the cream of the crop.

NCLR believes that FHA plays a significant role in the Nation's housing finance system and that its mission of reaching underserved populations, especially Latinos and other minorities, must continue. We support reform of FHA to address its financial challenges, but we urge Congress to balance this need for reform with the need to ensure access to affordable mortgage credit for creditworthy low- and moderate-income homebuyers. As the process continues, we look forward to working with this Committee, other members of Congress, and the Obama administration to achieve this goal.