

DEPARTMENT OF VETERANS AFFAIRS LOAN
GUARANTY SERVICE

HEARING
BEFORE THE
SUBCOMMITTEE OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES
ONE HUNDRED SIXTH CONGRESS

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"Veterans Loses Loans in Servicing Transfer," <i>National Mortgage News</i> , April 5, 1999, submitted by Congressman Ackerman	
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DEPARTMENT OF VETERANS AFFAIRS LOAN GUARANTY SERVICE

THURSDAY, MARCH 16, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to call, at 10 a.m., in room 334, Cannon House Office Building, Hon. Terry Everett (chairman of the subcommittee) presiding.

Present: Representatives Everett, Brown, Hill, Spence, Udall, and Buyer.

OPENING STATEMENT OF CHAIRMAN EVERETT

Mr. EVERETT. The hearing will come to order.

Good morning. This Oversight and Investigations Subcommittee hearing will examine the Department of Veterans Affairs' Home Loan Guaranty Program.

The VA home loan program was established in 1944 with the World War II GI Bill. For more than 50 years, the zero down payment loan has enabled active duty military service members and veterans to purchase homes. The VA loan guaranty continues to be an important transition benefit provided to this Nation's veterans.

We are particularly interested in the management and efficiency of the home loan program. On balance, the program appears to be operating to the benefit of the veteran and the taxpayer.

However, I have some questions that have been raised by the testimony of the VA Inspector General's Office regarding the effective and aggressive oversight of lending institutions and contractors by the VA.

Our first witness today will be Congressman Gary Ackerman, who requested the opportunity to testify on concerns he has about changes to the Interest Rate Reduction Refinancing Program; also, representatives from the VA Office of the Inspector General, the VA and Veterans' Service Organizations will testify.

The Mortgage Bankers Association has submitted written testimony, and it will be made part of the record.

I now recognize our Ranking Democrat, Ms. Brown, for any opening remarks she may have.

STATEMENT OF HON. CORRINE BROWN

Ms. BROWN. Good morning. I appreciate your holding this hearing today to review the VA's Home Loan Guaranty Program.

Housing assistance is one of the most useful benefits that the Federal Government provides to servicemembers and veterans. It certainly is the subject of a lot of questions from my constituents.

Mr. Chairman, yesterday afternoon the VA's Chief Financial Officer called to tell me that the Department's Inspector General has completed a long-awaited audit of both the fiscal year 1998 and 1999 VA financial statements. The good news for all of us is that the VA received an "unqualified auditor's opinion." Since some of the VA's previous accounting weaknesses have been in the Loan Guaranty Program, this is a welcome sign that the program is improving. I hope that these clean audits will establish a new benchmark for the future.

With regard to today's hearing, Mr. Chairman, I am concerned with recent reports that Fannie Mae and Freddie Mac are buying fewer loans made to some minority groups, especially African Americans. This causes the credit costs for these groups to go up. I am interested in hearing about the participation rate of minorities in VA's home loan program. I understand it is high.

I look forward to hearing from Mr. Pedigo about his innovative steps with automation to make the Loan Guaranty Program run efficiently.

I am also looking forward to hearing from the Inspector General's Office. I am concerned with some of the issues that the IG witness will be raising. I am particularly concerned with the reported lax oversight of contractors who manage the VA property. This is especially worrisome if VA is thinking about contracting out more of its functions.

I am interested in the suggestions made last year by the Transition Commission and look forward to discussing these with the VA, as well as the military and veterans' service organization representatives.

Mr. Chairman, I have a large naval base in my district, and two others in the near area, and affordable family housing being available at military installations is very important to me.

So, with that, I am looking forward to this hearing.

[The prepared statement of Congresswoman Brown appears on p. 37.]

Mr. EVERETT. I thank the gentlelady.

Our first witness today will be Congressman Gary Ackerman, who requested the opportunity to testify on the concerns raised about changes to the Interest Rate Reduction Refinancing Program. Also, representatives from the VA Office of Inspector General, the VA and the veterans' service organizations will testify.

I would like to now welcome and recognize our colleague from the 5th District of the State of New York, Mr. Ackerman, who has asked to testify regarding a Loan Guaranty issue that concerns him. I would ask, as we do all our witnesses, please hold your testimony to 5 minutes.

STATEMENT OF HON. GARY L. ACKERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. ACKERMAN. Thank you, Mr. Chairman. Let me thank you, as well as the ranking member, for permitting me to appear here before you today. I will get right to it.

It is my considered opinion that the Department of Veterans Affairs Loan Guaranty Service is one of the most incompetently run organizations in the United States Government. As you know, that is not an easy accolade to earn. Nevertheless, through bureaucratic mismanagement and manipulation on the part of the VA Loan Guaranty Service Director, Mr. Keith Pedigo, it is an award that is indeed well-deserved.

Under the VA direct loan program, VA loan officers make approximately \$1.4 billion in vendee loans to buyers of the Agency's foreclosed properties. Most of these loans are sold to investors in these type of securities, but for some unknown reason, the VA has decided to enter into the mortgage banking business and to retain a rather large portfolio of non-marketable loans.

The GAO report shows that the VA lacks an internal accounting mechanism to track \$7 billion in transactions, and it depends on its trustee, the Banker's Trust of California, to perform that function.

The GAO states that the VA incorrectly calculated needed reserves and had to use funds from other accounts to cover \$14 million in losses in 1997 and \$40 million of losses in 1998.

Let me quote briefly from the GAO Report:

"We found that VA's financing and accounting for the guarantees associated with its loan sales, in effect, masked both the existence of the estimated liability for defaulted loans as well as sources of funds being used to finance those liabilities."

Now, that is a direct quote from the report. If a private lender would have masked the existence and liability for defaulted loans as well as the sources of those funds, I assure you they would have faced prison time for the financial services scheme as well as for other illegalities such as mail fraud, et cetera.

With your consent, Mr. Chairman, I would like to submit for the record two articles from National Mortgage News dated April 12, which give further details about this.

Mr. EVERETT. Without objection.

(See pp. 41-42.)

Mr. ACKERMAN. In 1980, Mr. Chairman, President Reagan signed into law the creation of the Interest Rate Reduction Refinance Loan Program, IRRRL, known as "Earl". The President did that so that veterans of our armed forces would be able to refinance their homes as interest rates got lower, without having to undergo the enormous amount of red tape required by conventional mortgages. One of the program's benefits was to allow veterans to refinance without underwriting, while the veteran was not more than 90 days delinquent on their loan payment. That 90 days becomes very important.

Those of us who have refinanced our home through the years know that the underwriting process involves collecting scores of documents and W-2 Forms and bank statements and business references and credit histories and property appraisals.

The streamline process allowed veterans who desired to refinance, the opportunity to do so with much less hassle. The program also allowed those veterans who were getting behind in their mortgage payments, which are the ones who needed to finance, very

often because of the high interest rates, to catch up again and to save their homes from foreclosure.

All of that changed when Rule number RIN-2900-AI192—which I will refer to as the rule—went into place. That rule required the veterans to be current at the time of the application and closing—no more could he be delinquent by 30, 60 or 90 days. The VA's rationale for the rule was that it would prevent what it called deceptive advertising practices, whereby some lenders would advertise the ability to refinance the veterans' home and allow them to skip up to three payments if they were not already three payments behind.

If stopping the practice of promoting this skipped repayment advertisement was a problem for the VA, why not just stop that? If deceptive advertising, as they thought it was, or specific lenders were the culprits, as some of them might have been—and there were some—why just get rid of them instead of eviscerating the entire program?

The answer is simple. The VA Loan Guaranty Office has been attempting to erode this congressionally mandated program for years. Until this rule, they have been unsuccessful. The sad reality is that now, by their artfully explaining this rule and not providing the following details to either the veterans' service organizations or even their own superiors at the VA, Mr. Pedigo, although unelected and unconfirmed, has succeeded in destroying the IRRRL Program.

You may be interested to learn that during the public comment period, thousands of letters from veterans who refinanced their homes and opposed the change in the rule were not in the public record rooms as required by law, but were, rather, diverted to Mr. Pedigo's office. When this illegality was discovered by one of the lender's lawyers, it took 2 weeks to return those letters to the public inspection room.

It is also relevant to note that Chairman Dan Burton, Chairman Ben Gilman, Representative Doug Bereuter, Representative Tom Lantos, have all joined with me in opposing this rule change. When we wrote, it took a minimum of 6 months for the VA to respond to our correspondence and the answer was not at all germane to the questions that our colleagues raised.

In addition to our letters, more than 10,000 veterans joined us in writing in during the public comment period, many representing local and State veterans' service organization chapters. The VFW conventions of Louisiana, Florida and Texas all passed resolutions asking the VA to repeal the rule.

I would like to submit for the record an op-ed piece that appeared in *The Hill*, by Mr. Calvin Patton. I will not explain it now, but I call it to your attention.

Mr. EVERETT. Without objection. If you could, please summarize.

Mr. ACKERMAN. I just have another moment or two, but it is very important, Mr. Chairman.

Representative Brown, you may be particularly interested to learn that the former largest provider of IRRRL loans in the country is located in St. Petersburg, FL. They had a large regional office located in the heart of your district in Jacksonville. Because of the rule change, they make no—that is zero—no VA loans, whereas in 1998 they loaned \$6 billion to veterans.

The company is owned by a disabled Vietnam recon Marine named William Edwards, who has now reconfigured his company, and he is doing very well with other mortgage products. But they are not, however, providing loans through the VA program, as that is no longer viable, because they have changed the rules.

Do not let anyone from the VA tell you that the reason for the lack of interest to provide IRRRL loans is the higher interest rates that are now available. There are literally tens of thousands of veterans sitting on loans of upward of 9 percent, some as high as 16 percent, who could save tens of thousands of dollars over the life of their loans for instance, if the rule were repealed.

This program was not broken until the VA tried to fix it. You may be told today the VA acted because they were at greater risk through the refinancing of VA loans. That is more than not true. You will be surprised to learn that IRRRL foreclosure rates are dramatically below the industry norm. With the foreclosure rate at roughly .04 percent for IRRRLs that were purchased by Fleet mortgage, who was the largest purchaser of IRRRLs in the United States, you compare that to .1 percent for conventional mortgages, you discover that the foreclosure rate among IRRRLs is half of what it is for other kinds of loans.

One aspect of the rule which we all support was the provision that the monthly payment in every case be reduced, so the veteran was not putting himself or herself into greater debt by refinancing. In the case of Mortgage Investments Corporation—I cite them because they are by far the largest provider of—were, the largest provider of these loans in the country—every single one of their loans resulted in less interest rates and a reduced monthly payment. The only exception was in the limited case where somebody, some veteran would change from an adjusted rate mortgage, or an ARM, to a fixed rate mortgage. But that was his choice, for more stability.

It is also telling to note that this company's average interest rate was 7.59 percent in 1997. The only lower rate of any entity doing IRRRL loans was 7.57 percent for the Navy Credit Union which is, of course, a non-profit organization.

Mr. Chairman, Ms. Brown, in 1999 veterans in the United States had approximately 151,419 VA loans at exactly 10 percent, and another 141,849 veterans had loans of over 10 percent. That is unconscionable, considering in 1998 the major private sector player reduced 38,622 veterans' loan interest to an average of about 7.5 percent. In 2000, they have provided no, zero, no loans to veterans because of the VA's ill-conceived rule that makes it impractical to do so.

Other companies like them are also out of the VA financing business. And it is costing veterans a ton of money.

Mr. Chairman, you will undoubtedly be privileged to hear Mr. Pedigo's smooth obfuscation of this story. He will tell you that private refinancers charged points. So what? If a veteran paid 4 points and reduced his mortgage from 14 percent to 7 percent, he could save tens if not hundreds of thousands of bucks. The only one to lose out were the folks that Mr. Pedigo and his rule protect, and that is the original lenders who were now, and still are, getting 10, 12, 14 and 16 percent interest from veterans.

Mr. Chairman, Mr. Pedigo and his agency pulled their flim-flam on The American Legion, telling them that veterans were being duped into putting their homes at risk and that they were being seduced into skipping payments, paying too many points, paying higher monthly payments and increasing risking their home.

The American Legion is a great organization. As we know, it is highly dependent on Mr. Pedigo's bureaucracy. And they bought in, and they came out in favor of the rule change, and Mr. Pedigo used that great organization to try to make his case. After reading the very concerned statements of The American Legion's spokesman in the press, I called him directly and asked how many veterans actually complained to him that they had a problem of this. And he told me, Oh, nobody, not one veteran, not a single veteran, had complained. But he had gotten his information from Pedigo's shop. Let them not deceive you, too.

Briefly, what is the new rule, and why did it kill the private sector's ability to participate in the program? The rule says a veteran cannot refinance his home by the streamline process unless his mortgage is current. Well, the reason it is not current is because he cannot make the payments of 10, 12, 14 and 16 percent in the first place. A guy falls behind a few payments—

Mr. EVERETT. I would again ask my colleague, please sum it up. And also, to reduce the testimony to a personal attack on people, I would suggest that that is not welcome before this committee. This committee has been more than generous with its time, but I would ask you to sum it up.

Mr. ACKERMAN. Mr. Chairman, the veterans had a very good program going for them. And this is not meant to be a personal attack; it is meant to be a personal attack on the personal policy of one individual that has changed this policy that has now hurt veterans. Veterans were able to refinance their loans under this program. The private sector has been pushed out of this program and is no longer able to participate. The Veterans Administration, that when they wind up taking over one of these homes, winds up getting the 10 percent interest, which is even way above the market interest that the veterans would be paying if they were participating in the old program. And that provides an income for this agency that I do not know that this committee contemplated.

I would ask this committee to give very serious consideration to legislation that would change back to the old rule to allow the private sector to get back in, so that veterans can get loans, as was intended by President Reagan and this Congress. I thank you very much, Mr. Chairman. I would be glad to answer any questions.

[The prepared statement of Mr. Ackerman, with attachment, appears on p. 38.]

Mr. EVERETT. Thank you for your testimony. I only became aware of your concerns, as perhaps you know, late last night after we had requested some advance copies of your testimony and did not receive it. I am not fully familiar, I would have to say, with the issues you are raising regarding these interest rate reductions and financing loans.

However, Bob Stump, our full Committee Chairman, and our full Committee ranking Democrat, did send out a Dear Colleague letter on June 24, 1999 supporting the VA's new regulations. Therefore

I am going to make the Dear Colleague letter a part of the record, and ask the VA to respond to you when they testify later this morning.

[The letter follows:]

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U.S. House of Representatives

COMMITTEE ON VETERANS' AFFAIRS

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CHAIRMAN

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June 24, 1999

Dear Colleague:

The Department of Veterans Affairs (VA) recently made a regulatory change to its popular Interest Rate Reduction Refinancing Loan (IRRRL) home loan program.

The intent of the law authorizing IRRRLs was to provide veterans the opportunity to gain relief from the record high interest rates that prevailed in the early 1980s. Since 1980, veterans have been able to take advantage of falling interest rates and reduce their existing monthly mortgage payments using their VA home loan entitlement to refinance their VA-guaranteed mortgages. These loans are limited to a veteran's outstanding mortgage balance, plus fees, and may not be used to provide cash.

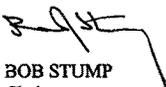
Recently, some lenders have been encouraging veterans to refinance under other circumstances not in the veterans' best interests. Some lenders, in fact, have encouraged veterans to skip up to two mortgage payments and use this cash for shopping or vacationing. The missed payments would be rolled into a new loan. That not only violates the intent of the law, but also increases the indebtedness of these veterans. As a result of this practice, veterans sometimes actually had a higher monthly payment after refinancing or found the new loan amount exceeded the value of the property. Not surprisingly, VA has seen a rising rate of foreclosure on IRRRLs. According to a March 25, 1999, VA Inspector General Report, in one vicinity "40 percent of the defaulted loans were for interest rate reduction refinancing loans (IRRRLs) a substantially higher default rate than the 18 percent nationwide average for IRRRLs."

VA's new regulation addresses these outcomes. The new regulation requires that the monthly payment on the refinanced loan be lower than the payment on the previous loan and that the refinanced loan be current so that missed payments are not rolled into the IRRRL. Veterans who have difficulty paying their home loans will still be able to obtain IRRRL loans, but will have their applications reviewed to assure that IRRRL refinancing is appropriate in their cases. We expect that VA will provide appropriate counseling to veterans who are in danger of foreclosure.

As reported in an article in the June 9, 1999, edition of *The Hill* titled *Company Lobbies Congress to Reverse VA's Loan Rule*, one lender is making a major effort to overturn the new VA regulation. We believe VA's action to circumscribe the questionable activities of certain lenders is in the best interest of veterans and taxpayers. The new regulation also has the support of the leaders of the major veterans service organizations.

As you may be receiving communications in opposition to the regulation, we hope you will find this information helpful. We fully support VA's efforts to provide appropriate home loan management services by implementing the new regulation.

Sincerely,


 BOB STUMP
 Chairman


 LANE EVANS
 Ranking Democratic Member

Mr. EVERETT. As you know, The American Legion also supports the VA's position on this. And I have no questions at this time. Ms. Brown?

Ms. BROWN. Well, this is the first that this has been brought to my attention. I will commit that I will look into it. If the major participant in the program was right there in Jacksonville, it seems to me they would have come and talked to me. I have an open-door policy.

But that is not the point. If there is a problem, I will definitely look into it and see what we can do. And I will be looking forward to the VA's testimony concerning it. Thank you for your statement.

Mr. ACKERMAN. Thank you very much. And I thank the Chairman and the subcommittee.

Mr. EVERETT. And I can assure you that Ms Brown's word is her bond.

I would like now to recognize Panel 2. I would like to welcome and recognize Mr. Michael Slachta, Assistant Inspector General for Auditing, Office of the Inspector General, Department of Veterans Affairs. Mr. Slachta is accompanied by Mr. Jon Jonson, Director, Financial Audits Division, and Mr. Thomas Cargill, Director, Bedford Operations Division.

Mr. SLACHTA. Good morning, Mr. Chairman.

Mr. EVERETT. Good morning, gentlemen. And as you observed with my colleagues, we extend the most courtesy to you. We do ask you to keep your testimony to 5 minutes, and the entire statement will be made a part of the record.

STATEMENT OF MICHAEL SLACHTA, JR., ASSISTANT INSPECTOR GENERAL FOR AUDITING, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF VETERANS AFFAIRS; ACCOMPANIED BY JON E. JONSON; DIRECTOR, FINANCIAL AUDITS DIVISION, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF VETERANS AFFAIRS; AND THOMAS L. CARGILL, JR., DIRECTOR, BEDFORD OPERATIONS DIVISION, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF VETERANS AFFAIRS

STATEMENT OF MICHAEL SLACHTA

Mr. SLACHTA. Thank you, sir. Mr. Chairman, members of the subcommittee, today I will present to you the Office of the Inspector General's views on the Department of Veterans Affairs Loan Guaranty Program. On my left is Mr. Jon Jonson, Director of our Financial Statement Audit Division; to my right is Mr. Thomas Cargill, Director of our Bedford Operations Division.

I will summarize the results of our audit for the VA's accounting systems, for the Loan Guaranty Housing Credit Assistance Program, audits and investigations of Loan Guaranty Program Fraud, and our audit of the Loan Guaranty Service's quality control system.

During fiscal year 1999, the Department substantially completed corrective actions on conditions we reported on in prior years concerning serious weaknesses in the direct loan portfolio accounting, loan sales accounting, and Credit Reform subsidy model accounting issues.

However, material internal control weaknesses remain that impede timely completion of financial statements and reduce the effectiveness of safeguards over Housing Credit. • Housing Credit Assistance General Ledger System that is not compliant with Federal financial systems requirements; • Detailed foreclosed property information not being periodically reconciled to the control accounts; • About \$30 million of refunded loans that were not recorded in the General Ledger System; • The inability to timely prepare estimates for loan guarantees, liability and related Credit Reform subsidies because of the Housing Credit program assistance and financial system weaknesses; and • Finally, weaknesses in the oversight of the contractor managing VA's \$1.9 billion direct loan portfolio, which increased the Government's vulnerability to losses.

The Veterans Benefits Administration has a number of organizational and system changes underway to address these weaknesses. Management officials have informed us that their goal is to complete all corrective actions by the end of fiscal year 2000. Timely implementation is important.

Accurate, reliable, and timely financial reports are essential to enable managers to carry out their fiduciary and stewardship responsibilities to VA beneficiaries and the public. Without them, the Housing Credit Assistance financial statements will continue to be prepared untimely and are vulnerable to error. Additionally, program assets and resources may not be efficiently used or adequately safeguarded. During the fiscal year 2000 consolidated financial statement audit, we will follow up on the Department's actions to correct the identified material weaknesses.

The Office of Inspector General also conducts proactive and reactive reviews of defaulted and foreclosed VA loans to identify possible loan origination fraud and property management fraud. Loan origination fraud results when incorrect or falsified information is used to obtain or sell a guaranteed or insured mortgage.

Our reviews of defaulted and foreclosed VA loans have focused on certain geographical areas with high default rates. Audits of the underwriting practices of six lenders, three in North Carolina and three in Georgia, found potential fraud indicators in four of the six audits. Lenders may not have disclosed some of the borrowers' debts, or underreported the borrowers' dependents, which requires more family income to qualify for a loan in the loan analysis documents. These cases involving possible fraud are under investigation by our office at this time.

Investigations in property management fraud focus mostly on equity skimming. Equity skimming involves profiting by assuming or purporting to assume, existing loans, renting the homes to tenants, not making payments, and stealing the rental proceeds while the loan foreclosure is being processed. An example:

An individual was recently sentenced to 78 months' imprisonment, a fine of \$15,000, and court ordered restitution in the amount of \$571,000 after conviction on charges of equity skimming, mail fraud, bankruptcy fraud and money laundering. Our investigation disclosed that the individual fraudulently assumed 61 properties with mortgages guaranteed by VA or insured by HUD, rented the homes, kept the rent monies for himself without making the required mortgage payments. His actions caused all of the

loans to go into default and eventual foreclosure. In addition, he delayed foreclosure proceedings by filing multiple bankruptcies under fictitious names.

A recent review of Loan Guaranty Service's quality control system concluded that several quality control conditions required management attention. Among the issues found was that while Loan Guaranty's Lender Monitoring Unit actively reviewed lender underwriting and sent timely draft reports to Loan Guaranty Services management, management had not issued timely final reports to the lenders. For fiscal year 1999, the Monitoring Unit had completed eight evaluations and draft reports, but as of August 1999, Loan Guaranty Services Management had not issued any of the reports. The reports are important because they frequently result in improved underwriting and in lenders indemnifying VA for egregious underwriting resulting in foreclosure or VA having to pay the guarantee.

In addition, VA's oversight of the contractor servicing VA's direct loans had not insured that loans were actively serviced. In 1997, Loan Guaranty Service contracted for the servicing of its direct loan portfolio. As of September 30, 1999, the portfolio included about 29,000 direct loans with an unpaid principal balance valued at \$1.9 billion. About 3,200 of these loans, with an unpaid principal balance valued at \$209 million, were in serious default. Serious default is five or more months delinquent. The borrowers who are in serious default would need to pay approximately \$36 million to clear their outstanding delinquencies.

Our review of a sample of these seriously defaulted direct loans revealed a number of contractor performance deficiencies. In 67 percent of the cases tested, the contractor had not actively serviced the loan. In 33 percent of the cases, the contractor had not timely referred seriously defaulted loans for foreclosure. And in 24 percent of the cases, the contractor had not routinely monitored bankruptcy.

The 3,200 seriously defaulted direct loans in the portfolio included about 1,700 with an unpaid principal balance valued at \$110 million, where the borrower had filed for bankruptcy protection. Foreclosure action had not yet been initiated on the remaining 1,500 seriously defaulted loans with an unpaid principal balance valued at \$99 million.

On the loans in our sample, where the contractor had not made a timely foreclosure referral, the average delinquency was 11 months, with an average unpaid principal balance of \$66,900. The average amount necessary to clear the delinquencies on these loans was \$6,400. For the loans where bankruptcy was not routinely monitored, the average delinquency was 47 months, with an average unpaid balance of around \$72,400. The average amount necessary to clear delinquencies on these loans was \$27,000.

In June 1997, at the time loan servicing was outsourced, Loan Guaranty Service had established a Portfolio Loan Oversight Unit to monitor the contractor's performance. We found that the Unit currently relies on the contractor's self-generated reports to evaluate its performance. However, the contractor's reports contain data that the PLOU could not validate. The Unit also planned quarterly

site visits to the contractor's headquarters, but due to limited travel resources only two visits were made during fiscal year 1999.

As Loan Guaranty Service reorganizes, and in some instances, outsources its activities, it is essential that program integrity is maintained through close oversight of not only its own operations, but those of contractors and program participants as well.

This completes my summary, Mr. Chairman. I would be pleased to answer any questions you and the subcommittee may have.

[The prepared statement of Mr. Slachta appears on p. 56.]

Mr. EVERETT. Thank you very much. What has VA done to correct these internal control weaknesses of the Loan Guaranty Program that you outlined in your testimony on Page 2, and that you gave briefly?

Mr. SLACHTA. These are new internal control weaknesses that we have identified this year. So what we have are reports of actions that they have taken.

John, would you prefer to——

Mr. JONSON. Okay. Some of the main things that they have done to correct the actions, like one of the material weaknesses in the prior audit dealt with loan sales accounting, was to hire a contractor during fiscal year 1999. And the contractor basically went in and reconstructed the loan sales accounting efforts. And it is through this process, and we have tested the new entries, a large number of adjusting entries had to be made. The credit subsidy estimates had to be refined and rerun, and it resulted in major adjustments and changes in the financial reporting.

Mr. SLACHTA. Mr. Chairman, most of the actions they took required a lot of manual manipulation. They had to go back to the systems and manually make the corrections.

For example, we had about \$30 million of refunded loans, and these loans were refunded at the regional office levels. The regional offices had to manually account for these loans and then submit the data to be put back into the automated accounting system.

Mr. EVERETT. So why did they manually have to do that?

Mr. SLACHTA. It is a problem with the accounting system. The accounting system is antiquated.

Mr. EVERETT. Does it have anything to do with the computer modernization program that VA has been on for the last few years?

Mr. SLACHTA. I cannot say it directly has something to do with the accounting program. I would think it is part of it.

What VBA's problem is, they have to move into a general ledger system. They have to move into VA's core financial system. Instead of having all of these little subsystems, we have to move into the main system. And they are in the process of doing it. It is going to be a long process, though.

Mr. EVERETT. As a result of these weaknesses, would you—does the Government or taxpayer have much exposure liability here?

Mr. SLACHTA. There is always an exposure. The exposure increases as accountability decreases. We would like to see better accounting, better stewardship. To put a dollar value on that exposure is difficult. We believe that, from our audit and in our opinion, their balances are reasonable. It does not mean they are accurate. They are reasonable. And they need to continue working to limit that exposure.

Mr. EVERETT. Does your office have an opinion regarding the VA's housing program budget submission, whether the IG believes it is important that non-OMB personnel should be able to easily read and understand the housing program financial statements? I tell you, in my previous life when I had one, I was the chairman of the board of a savings and loan. And I am used to reading financial statements. And I tell you, it is kind of tough to know what these things say.

Mr. SLACHTA. I agree with you. It is very difficult. A financial statement is prepared for a reasonably informed audience. Some of the Government's financial statements are very complicated, you have to be very well trained in order to understand them.

If the financial statement is not meeting the needs of Congress, then they need to be changed.

Mr. EVERETT. Thank you. Ms. Brown.

Ms. BROWN. Thank you. The AFGE is concerned about the VA consolidation of its loan management activities from 45 regional offices to 9 regional loan centers. They believe that the debtors will not be able to receive the type of counseling they need. What, if any, effects do you think the Loan Guaranty restructuring plan will have on the quality of VA service delivery to the veterans?

Mr. SLACHTA. Ms. Brown, the Office of Inspector General has not reviewed the new organization at this time, so I am unable to answer that question.

Ms. BROWN. You testified regarding your audit and investigation of the Loan Guaranty fraud—that loan originator fraud occurred in the VA Home Loan Program. Have you determined any pattern that would indicate a VA system weakness? Are the cases you found the individual types of things that you would unfortunately expect in any home loan program?

Mr. SLACHTA. I think it is fair to say it is the kind of thing you would unfortunately expect in any home loan program. There are good monitoring tools. Both the Department and we, the IG, are using those tools. We are looking at early default rates. We try to analyze defaults by geographical area or by lender. We are not seeing any pattern yet.

Ms. BROWN. I will yield.

Mr. EVERETT. Mr. Spence.

Mr. SPENCE. Thank you, Mr. Chairman. I do have one question that we would like to get into the record.

What is the average default rate among private sector lenders, and how does that compare with the VA foreclosure rate?

Mr. SLACHTA. I do not have the private sector default rate. We use a figure of 1.5 percent for our early default reviews. When we see default rates of around 1.5 percent, we become concerned. It might be—we will be glad to get the information for you, but it might be a good question to ask the program officials.

Mr. SPENCE. If you could, just for the record.

Mr. SLACHTA. Sure.

Mr. SPENCE. Thank you.

Mr. EVERETT. Thank you, that was the distinguished Chairman of the House Armed Services Committee, and now the Chairman of the Subcommittee on Personnel, Mr. Buyer.

Mr. BUYER. Thank you, Mr. Chairman. Mr. Slachta, the last portion of your statement for the record, beginning on Page 5, recounts problems with the contractor servicing VA's direct housing loans. The loans not actively serviced, seriously in default loans are not timely referred; both foreclosure and bankruptcy cases are not being routinely monitored, among other things.

Now, was this contractor fired?

Mr. SLACHTA. No, sir, the contractor is still in place.

Mr. BUYER. And what has VA done to improve the oversight of this contractor?

Mr. SLACHTA. The VA has reported to us they have established an Oversight Review Team. That Review Team consists of members of the Loan Guaranty Service, the Chief Financial Officer's Service, and some central office accounting functions that are looking at the contractor. The VA has also engaged a private accounting firm to do a review of the contractor's operation. That audit, as I understand, is in process at this time.

Mr. BUYER. When was the team assembled?

Mr. SLACHTA. I think it was in February this year, sir.

Mr. BUYER. Was it a timely response?

Mr. SLACHTA. To our review it was, yes, sir.

Mr. BUYER. How much did all this cost the taxpayers and the people in trouble on the home loans, essentially left in the lurch without servicing help, that might have allowed them to avoid foreclosure?

Mr. SLACHTA. I can say that the cost to the taxpayer is a range. It would range up to about \$36 million if everything went bad. It would be very hard to put a dollar figure to the cost to the taxpayers. Because the VA—when a loan goes bad, the VA can sell that property, and it can realize, hopefully, its guarantee and the mortgage value. So there could or could not be a loss to the taxpayer.

Mr. BUYER. Could you—we are not going to hold you to that figure, but just sort of a guesstimate for us. Can you say how many people might have lost their homes as a result of this? You had 3,200 homes in jeopardy; 1,700 of those were in serious default. Servicing, contacting the veterans, seeing what you could do, or the mortgage holder, because these are not all veterans. How many were veterans?

Mr. SLACHTA. That is hard to say. Because these are what we call vendee loans and veteran loans, you have got a mixture. When we did our review, we did not try to separate them out. But it is probably about 50-50 at this time. And it is going to become—I would say in the future, probably more veterans than vendee.

Mr. BUYER. You have got about 1,700 homes that were in jeopardy. Servicing the home, contacting the vet, seeing what you can do to possibly refinance the loan, or lower the rate, or get a lower payment.

Mr. SLACHTA. Potentially, 750, possibly 800 veterans may have lost their homes as result of this?

Mr. BUYER. Ouch. Thank you, Mr. Chairman.

Mr. EVERETT. Thank you. Mr. Udall.

Mr. UDALL. Thank you, Mr. Chairman. I am concerned about your report of the VA's lax oversight of the Loan Guaranty Pro-

gram, particularly the oversight of contractors. Would you elaborate on the risks involved and any recommendations you have for correcting this serious deficiency?

Mr. SLACHTA. When we did our review, we found that the contractor was not in compliance with the contract. There was a Portfolio Loan Oversight Unit set up. They were supposed to go out and make quarterly visits to the contractor. They were unable to do so because of travel funds, a lack of travel funds. The data that they were using to look the unit over was contractor-provided data.

We recommended that they needed to provided direct oversight. They needed to get in there and see what was going on. Their response, the Department's response was the establishment of the Oversight Review Team, which is a good response. Their current activity of having a management audit, actually, being performed on the contractor, at this point is a good step.

But it cannot stop. I mean, you cannot go in there and just do the one job and say, okay, we have got the problem straightened out. It has got to be a constant monitoring situation. And I understand the Department is going to evaluate whether or not this contract would be renewed.

Mr. UDALL. I was glad to hear of the VA's unqualified audit opinion. What were the lessons learned in that whole audit process that should help the VA establish a new benchmark for the future?

Mr. SLACHTA. They have got to improve their accounting systems. The accounting systems just did not provide adequate audit trails, timely audit trails. I believe the biggest lesson was the process of the audit itself. The audit process demonstrates what needs to be done and what kind of records need to be kept.

Mr. UDALL. Your Loan Guaranty Program review found that loans to active duty servicemembers defaulted more often than loans made to veterans, and also tended to default earlier in the loan period. Do you have any recommendations on how to reduce the default rate among active duty servicemembers?

Mr. SLACHTA. That audit demonstrated that first-time enlistments were the biggest risk. And generally speaking, what occurs is a GI who is in a position to buy a home for the first time and does not realize the implications of the debt load. What we have suggested to the Department and the Department has agreed, is that you give them counseling, pre-loan counseling, teach them debt management.

Some of the things that we saw, was that the servicemen would have sufficient income to qualify for the loan, but he would be right on the border. He would buy the house and the next thing he does, he goes out and he buys a car and he buys furniture. And that puts him over the debt limit, and as a result he's not able to handle the debt load.

What we suggested was that VA counsel them, make sure they understand the need to make the payments, and that there is a finite amount of money, and it has got to be stretched to meet their debt load.

Mr. UDALL. Thank you very much. Good to have you here today. Yield back any time.

Mr. EVERETT. Let me yield to Ms. Brown for further comment.

Ms. BROWN. Thank you. I had one of these cases in my office last week. I just want to point out that these are real people. I mean, they are not just statistics. And this is a family, a veteran's family, that came in about 3 or 4 months behind and had been evicted and was made homeless. I wish they could have come in earlier.

There has got to be a way that we can deal with this problem up front.

Mr. SLACHTA. It is a debt issue. You have to counsel the people. They have to understand what they are doing.

I mean, home ownership is an American dream. But they have to understand that there are sacrifices you have to make to achieve that. That is the best you can offer a first time buyer.

Ms. BROWN. But there are other factors, you know. If your income is such and your mortgage is too high, there are just things that we need to do up front before it gets to this critical situation.

Mr. SLACHTA. Yes, absolutely.

Ms. BROWN. I am hoping that we are willing to work out these solutions up front and not make veterans homeless.

Mr. EVERETT. Let me add to that that I assume that you agree that early counseling on this could save perhaps up to 15-20 percent of these families being put homeless?

Mr. SLACHTA. Absolutely, sir. That is why we made that recommendation.

Mr. EVERETT. Okay. Any other Member have any additional questions?

Well, thank you very much. Let me dismiss this Panel, and we thank you very much for your testimony.

Mr. EVERETT. I would now like to welcome and recognize Mr. Keith Pedigo, Director, Loan Guaranty Service, Veterans Benefits Administration, Department of Veterans Affairs. Mr. Pedigo is accompanied by Ms. Judith Caden, Deputy Director, Loan Guaranty Service.

Mr. Pedigo, again, I ask you to hold your testimony to 5 minutes, and we will be happy to put your complete testimony into the record. Please proceed.

STATEMENT OF KEITH PEDIGO, DIRECTOR, LOAN GUARANTY SERVICE, VETERANS BENEFITS ADMINISTRATION, DEPARTMENT OF VETERANS AFFAIRS; ACCOMPANIED BY JUDITH CADEN, DEPUTY DIRECTOR, LOAN GUARANTY SERVICE, VETERANS BENEFITS ADMINISTRATION, DEPARTMENT OF VETERANS AFFAIRS

STATEMENT OF KEITH PEDIGO

Mr. PEDIGO. Thank you, Mr. Chairman, and good morning to everybody. I am pleased to be here this morning to discuss the operation of the VA home loan program.

Mr. Chairman, the Loan Guaranty Program has been going through a period of significant change. In the 1990s, staffing in the program was reduced by 35 percent. In order to continue providing quality service to veterans, as well as VA lenders and other program participants, we are making major changes to incorporate automation, delegation and consolidation. Our vision is of a Loan Guaranty Program that will quickly, efficiently and cost-effectively

deliver the Loan Guaranty benefit to our nation's veterans. This will be done, in part, with the active participation of our private sector partners.

The use of information technology has become a primary focus in determining how the Loan Guaranty benefit will be delivered. We recently implemented an electronic data interchange application, or EDI, which permits lenders to submit the information VA requires to obtain a guaranty certificate electronically. In fiscal year 1999 alone, VA personnel made approximately 24 million entries into our systems in order to process 485,000 guarantees. When other electronic processes, mostly in the servicing area, are fully operational later this year, we will eliminate the need for a tremendous number of paper documents and manual entries.

Another new application is the VA Assignment System, which enables lenders to go on line to obtain VA case numbers and appraiser assignments without any VA involvement. And on April 3rd, 2000, we will begin testing the feasibility of accepting appraisal reports electronically. This pilot program will take place in the State of Florida. This new system will eliminate mail delays associated with hard copy submissions of completed appraisals.

We also have in development an automated eligibility system that will allow lenders to access VA records and receive decisions concerning a veteran's eligibility for home loan benefits without submitting a written application to VA.

Mr. Chairman, we have also improved customer service by delegating processing authority to our private sector partners. Just a few years ago, the typical VA home loan transaction required that VA personnel perform most of the processing work. Today almost all veterans are able to obtain a home loan by dealing solely with their lender. This provides faster service than VA was generally able to provide.

In the area of delegation, we have contracted out the servicing of our portfolio loans. We estimate that the savings to VA nationwide was 154 FTEE, and this has already been realized through reassignments and retirements at the Regional Office. A Portfolio Loan Oversight Unit has been established at the Indianapolis Regional Office to oversee the contractor's performance and to offer special assistance to veterans with direct or refunded loans.

I would now like to address the restructuring and consolidation that has been taking place in the field. The loan processing and servicing functions supporting the program are being consolidated from 45 offices to 9 Regional Loan Centers. The consolidation will be complete in June. Consolidation makes VA consistent with the mortgage industry.

The processing of veterans' requests for certificates of eligibility has also been consolidated to two Eligibility Centers. Both Eligibility Centers are currently processing requests in less than 5 days.

Mr. Chairman, I would like to turn your attention to the Property Management Operation, which is responsible for the acquisition and sale of real estate acquired by VA under the Loan Guaranty Program as a result of foreclosures. VA is in the process of conducting an A-76 Cost Comparison Study to determine whether it would be more efficient and cost-effective to continue to perform the commercial work of the VA Property Management operation in-

house using government employees and resources, or to obtain such services through commercial services. We anticipate having a decision regarding whether the commercial work should remain in-house or be contracted out by August of 2000.

Mr. Chairman, while we have delegated considerable processing authority to the private sector, we are responsible for assuring program integrity. Consequently, we must be vigilant in our oversight of their activities. In the last year, we have implemented a revised quality control system that is carried out by both employees in the field and here in headquarters, and we have reinstated on-site audits of field operations. We also have a Lender Monitoring Unit which was established in 1990. This operation conducts on-site audits of lenders and servicers to determine the level of compliance with laws, regulations and policies governing the Loan Guaranty Program. We have recovered or avoided nearly \$25 million from these efforts.

Training is another area in which we have concentrated considerable effort. Training is conducted using interactive satellite broadcasts, computer-based and Internet-based, self-paced learning programs, and a number of classroom courses. Last year, satellite training broadcasts were reviewed by over 6,000 lender employees.

In your letter of invitation, you specifically requested information on our loan servicing efforts. VA takes an active role in working to protect the interests of the veteran borrower and the Government by initiating an outreach effort to personally contact the borrower and perform personal supplemental servicing. VA intervened and achieved reinstatements in approximately 5,994 cases during fiscal year 1999 for a savings to the Government of \$118 million.

In order to measure our success in assisting delinquent borrowers, we have developed a measure known as the Foreclosure Avoidance Through Servicing Ratio, or FATS. In fiscal year 1999, the FATS Ratio was approximately 37 percent; meaning that without VA involvement, there would have been 37 percent more foreclosures.

Finally, Mr. Chairman, let me address the Housing Credit Assistance Plan. The VA Inspector General and GAO audited the agency's financial statements for fiscal year 1997 and issued a qualified opinion listing five reportable conditions, three of which were in the Loan Guaranty Program. These were in the areas of program financial reporting, the direct loan portfolio, and accounts related to guaranteed sales of vendee loans. Our considerable efforts in the last year and a half have resulted in our recently receiving an unqualified audit opinion for fiscal year 1999. We are actively working to resolve the internal control weaknesses cited in that report.

Mr. Chairman, that ends my formal statement. I would be happy to address the issues that Mr. Ackerman raised either now or later in the questioning.

(See p. 82.)

Mr. EVERETT. Well, we can begin with those.

Mr. PEDIGO. Okay.

Mr. EVERETT. Briefly, if you will, though.

Mr. PEDIGO. I will be brief.

Let me start by going back to the 1996 period, when we were seeing a lot of instances where veterans who were getting Interest Rate Reduction Refinancing Loans were being charged excessive points. There were some instances where veterans were being charged 8 to 10 discount points and were not getting interest rates that were commensurate with the number of points that they were paying. We also were seeing some evidence that there was a slight increase in early foreclosures on Interest Rate Reduction Refinancing Loans.

Consequently we implemented some regulations in 1996 that limited the number of points that can be included in an Interest Rate Reduction Refinancing Loan to 2. Shortly after those regulations went into effect, we saw that there were some other situations that were becoming fairly commonplace in the industry that also appeared to be detrimental to veterans and to the VA.

We started seeing many instances where lenders were advertising to veterans that they could get an Interest Rate Reduction Refinancing Loan and skip mortgage payments on their current mortgage and roll those delinquent payments into the new loan. We saw instances where the mortgage payment on the refinanced loan was actually going up instead of coming down. The law clearly states that the main purpose of this program when Congress enacted it in 1980 was to help veterans reduce their mortgage payments.

We also started seeing a more rapid increase in the short-term default rate on Interest Rate Reduction Loans compared to non-Interest Rate Reduction Loans.

Given these situations, we decided that it was time to quickly craft some regulations to address this issue. We put out some interim final regulations in October of 1997 that did, basically, two things. Number 1, the regulation required that any Interest Rate Reduction Loan must carry with it, a reduction in the principal and interest payment; and, Number 2, a requirement that if a veteran is more than 30 days delinquent on his or her current loan, in order to get that refinancing loan, that loan would have to be sent in to the VA for review. VA would either approve or disapprove that loan.

The rule was issued in October of 1997. But because of a technical glitch in the way it was issued, we had to pull it back in December of 1997. At that point we began the process of putting out the same rule for comments. We received comments from the general public, we considered those comments, and in June of 1999, we put out the final regulation that was substantially similar to the interim regulation published in 1997.

Mr. Chairman and members of the committee, I would like to point out to you that when this rule went out in June of last year, at that same time, as you probably know, interest rates started to go up fairly significantly. So, in fact, some companies who might have been focusing their business opportunities strictly on the VA Interest Rate Reduction Refinancing Program, or any refinancing loan program, probably saw a dramatic drop-off in their business. Our business went from a high of 30,000 refinancing loans in some months earlier in 1999, to fewer than 1,000 in the latter part of 1999. We believe that that was due to the rapid escalation in interest rates, and that it had nothing to do with the regulations that

we put in place. Mr. Chairman, we have not received one complaint from either veterans or lenders since we have put these regulations in place in June of last year. Thank you.

Mr. EVERETT. I am going to ask that the clock be restarted.

Mr. Pedigo, the Congress finds it difficult to track the cost of VA housing programs. And, if you can, just give me a figure, tell us what was the total amount the United States spent last year to support the VA housing program, and the previous year.

Mr. PEDIGO. Well, Mr. Chairman, I can appreciate the difficulty in tracking. The credit reform accounting process is extremely complex, and difficult for people who do not deal with it literally on a daily basis to be able to easily work with.

To answer your question specifically, our appropriations were somewhere around \$500 million last year. I think that you would have to probably spend a considerable amount of time looking at the budget document in order to come up with those figures on your own, but that would be the amount that you would finally come up with.

Mr. EVERETT. Well, it does concern me greatly that most senior managers in VA cannot explain the cost accounting associated with the VA's major credit programs. It also concerns me that the VA is unable to comply with Section 602(c) of Public Law 105.368, which requires a simple, concise and readily understandable financial statement for VA's housing credit programs. The VA's housing programs did over \$29 billion in business last year.

What would be the effect on your program—only your program if we repealed the credit reform law? As I say, I was chairman of a savings and loan before I came to Congress, and I am used to reading financial statements. And I must say this is very difficult.

Mr. PEDIGO. Yes.

Mr. EVERETT. My question is, what would be the effect if we repealed the credit reform law?

Mr. PEDIGO. I think the effect on veterans would be nil. The effect on the Government would be that we would probably have to go back to the old cash method of accounting and compiling the budget, which sometimes did not allow us to anticipate the cost that we would incur over the life of loans when we made them. Under the old methods prior to 1992 when credit reform went into effect, we did not go to Congress for appropriations to cover all of the future losses that we projected we would suffer on loans being made in a given year.

Credit reform has forced that discipline on us. So now, even though the credit reform accounts are difficult to read, it does require that we get appropriations each year to cover the present and future costs on the loans we make in that given year.

So, the impact on the Government would be greater difficulty tracking the true costs of the program's operations.

Mr. EVERETT. Well, that was one of my questions, tracking the cost of VA credit programs. It seems to be a requirement you ignore, the future cost of loans at the time the budget is prepared. Then each year you revise the estimates of the cost. This does not seem to sit very well with the purpose of the credit reform law, which is intended to more accurately inform Congress of the cost of the credit programs.

Let me also ask you, when would VA have corrected the internal control weaknesses that Mr. Slachta testified about? And also, please inform the subcommittee when that has been done.

Mr. PEDIGO. Yes, Mr. Chairman. Our goal is to have those material weaknesses corrected by the end of fiscal year 2000—

Mr. EVERETT. Well, please inform—

Mr. PEDIGO. We will inform you as soon as that happens.

Mr. EVERETT. And this year's budget for VA is requesting \$532,000 to administer the Native American Housing Loan Program. This amount is to administer an program that only plans to make 20 loans.

Does this cost seem a little high to you?

Mr. PEDIGO. No. I think that seems like a fairly reasonable cost for making the 20 loans.

Mr. EVERETT. In other words, it costs \$25,000 each to make a loan?

Mr. PEDIGO. Some of that is administrative cost, the salaries for the employees who are actually processing the loans and doing the outreach that we have to do under the law that implemented this program.

Mr. EVERETT. Well, if my figure is correct, it does cost \$532,000 to administer 20 loans?

Mr. PEDIGO. Well, no. That whole cost is not for administering the loans. But I will tell you that we have not adjusted the subsidy amount for the Native American Direct Loan Program in recent years. We have had good experience with the performance of the 212 loans that we have made. It is quite possible that the subsidy appropriation that we are requesting for those 20 loans is on the high side.

Mr. EVERETT. Also, you asked \$220,000 to administer the VA's Education Loan Program, which is only projected to make two loans. Is there something about the accounting under the credit reform law that causes this figure to look that way?

Mr. PEDIGO. Mr. Chairman, I believe that the reason for that is that the \$220,000 is primarily to cover the administration of the education loans that are already on the books, not to provide for administrative costs for new loans.

Mr. EVERETT. And how many loans on the books?

Mr. PEDIGO. I do not know, Mr. Chairman.

Mr. EVERETT. Would you get us that information?

Mr. PEDIGO. Yes, we will.

(See Question 1 from Chairman Everett on p. 90.)

Mr. EVERETT. By request of my ranking Member, she would like to defer to Mr. Udall for questions at this point.

Mr. UDALL. Thank you. And thank you very much to the ranking Member, and also Mr. Chairman.

I am interested in the Native American Veterans Housing Loan Program, and I am concerned about its limited activity, especially in the Southwest. I note from the President's fiscal year 2001 budget that you are projecting only 20 direct loans nationwide under this program next year. How many of those 20 do you expect to be on southwestern tribal land rather than in Hawaii or the South Pacific?

Mr. PEDIGO. Mr. Udall, that is a tough question to answer. But based on our experience to date, I would say that the number of loans that we would make in Indian country would be in the single digits. If we make 20 loans, probably not much more than 5 of those would be made in Indian country. I could not specifically project how many would be in the Southwest.

Mr. UDALL. Why is there such low participation in this program in general and on tribal land or in Indian country in particular?

Mr. PEDIGO. We have pondered that issue for several years. The purpose of having a Native American Direct Loan Program is to address the lack of funding that has been a problem on the reservations for many years. When we implemented this program in the early 1990s, we did a significant amount of outreach with the tribal organizations in Indian country in an effort to get them to enter into memoranda of understanding with the VA so that they could make these loans available to their tribal members.

To date, notwithstanding our aggressive efforts, we have only executed 57 MOUs, with the approximately 600 Native American tribes in this country.

Our experience tells us that the major hurdle to making this program successful in Indian country is the lack of sufficient income and good credit on the part of many Native American veterans. Having said that, we also know that another problem is the reluctance of some tribes to engage us in negotiating a memorandum of understanding.

We have done several things in recent years to try to promote this program, to include requiring all of our offices to specify an individual who would be a liaison on this program and provide outreach to the Indian tribes in Indian country as well as the Pacific Islands in an effort to generate more business in the program. We also recently completed the making of a video that we will be sending out to all of the Indian tribes, that attempts to explain the application process for executing an MOU with the VA, and encourages the tribes to consider this program.

But, Mr. Udall, I am not sure that there is a panacea for curing this problem. And I wish I could give you more hope. I would like to point out one other thing. There is a task force that the White House convened more than a year ago. It is called the One-Stop Mortgage Initiative. This task force is made up of personnel from several agencies who are involved in providing home loans to Native Americans.

The purpose of the task force is to try to identify the barriers to home ownership on tribal lands, and to come up with recommendations to address those barriers. My understanding is that this task force will be issuing a final report shortly that will contain some useful recommendations on how the level of activity might be increased on tribal lands. I am not totally familiar with the detail of the recommendations, but we should know shortly.

Mr. UDALL. What you are talking about is the Interagency Task Force on Ways to Improve Native American Access to the Federal Housing Program—

Mr. PEDIGO. Yes.

Mr. UDALL. Okay.

Mr. PEDIGO. It is known as the One-Stop Mortgage Initiative.

Mr. UDALL. I look forward to seeing what is in that report and in working with your agency to see that it is implemented.

And I also think the authority for the Native American Veterans Housing Loan Program expires on December 31st of 2001. The next Congress will consider extending that program, and I would support such an extension. I wonder if you have any other suggestions about raising the level of participation other than what you have just outlined?

Mr. PEDIGO. No, Mr. Udall. I think that those are the only suggestions that I can make at this point. But I am hopeful that something very useful will come out of that task force report.

Mr. UDALL. Thank you very much, and thank you to the graciousness of the Chair and the ranking Member.

Mr. EVERETT. You are right, the ranking Member is a gracious person.

The full House Armed Services Committee Chair, Mr. Spence.

Mr. SPENCE. Thank you, Mr. Chairman. The way I understand it, the VA selects lenders, and they grant—delegate processing and decision-making authority to these lenders.

How do you select those lenders?

Mr. PEDIGO. There are approximately 4,500 lenders who do business with the VA. The lenders have two options. One option is that, they can send all of their loan applications in to the VA and we will make the decisions. Under the second option, is if the lender meets certain requirements with respect to experience, capitalization of the company etc., that we will delegate to them the authority to make underwriting decisions on VA's behalf.

So, we do have a set of criteria that lenders must meet in order to receive this delegated authority.

Mr. SPENCE. And how do you oversee that after you grant them this authority? Do they have to report back?

Mr. PEDIGO. Yes. We have oversight requirements in place. Our nine Regional Loan Centers are required to review a 10 percent sampling of all the loans that these lenders make using delegated authority.

We also require that they do a more in-depth post-audit of 5 percent of those cases. And in this post-audit, they have to actually reorder verifications of employment and verifications of deposit to make sure that the documentation that the lender submitted was accurate.

And then the third audit function that they are required to go through is what we call the RPO-23 review which, simply put, is a requirement that our field offices look at every case that goes into serious default within 6 months after the loan is made. The thinking here is that if it goes into default early, that sometimes is indicative of underwriting deficiencies on the part of the lender.

Those are the primary requirements that we have in place to provide oversight.

Mr. EVERETT. Thank you. At this point, I think we have a vote underway, and we will recess and call the Panel back as soon as we return from our vote.

[Recess.]

Mr. EVERETT. Come to order.

Mr. BUYER. Thank you, Mr. Chairman.

Going back to my question to the IG of the VA, I am curious as to why the contractor was not fired; and is the VA taking legal action against the contractor?

Mr. PEDIGO. We have been reviewing the contractor's performance very closely in the last few weeks and we have made the decision to rebid the contract.

Mr. BUYER. That is good judgment.

Mr. PEDIGO. We are in the process of obtaining the services of a private consulting firm to help us put together a more performance-based contract that we would put out for bids later this year.

We will be extending the current option year to this contractor through December in order to get us through the contracting process. Our hope is that we will be able to avail other companies of the opportunity to bid on this contract and that the best party will be selected. We will then be able to proceed without many of the problems that this current contract carries with it.

Mr. BUYER. I compliment you on that. I like performance-based contracts. Sometimes they also require a little more oversight, for many of the inherent reasons, so it can hit certain guidelines and time lines and wickets, so that you get compensations. But in general, I think performance-based contracts are very good. I would love to have them for the weather man, too.

Mr. PEDIGO. Yes.

Mr. BUYER. Were the people left in the lurch without the servicing help they needed to avoid foreclosure because a contractor did not do the job it was supposed to do for the VA?

Mr. PEDIGO. I think that that may have been the case to some extent. We do not know what that extent is. As the Inspector General said, there were 1,700 cases that were in serious default. Perhaps some of those borrowers could have saved their homes if they had had the opportunity to receive active servicing from this contractor. But we simply cannot get a handle on how many might have slipped through the cracks on that.

Mr. BUYER. What can be done to identify and help these individuals who lost their homes because the VA did not adequately supervise the contractor?

Mr. PEDIGO. Let me start by saying that we have different types of loans in this portfolio. Probably 25 percent to maybe a third of these loans are to veterans whose loans had originally been VA-guaranteed loans that were headed to foreclosure. We bought those loans back from the lenders under our refunding program, and then turned them over to the contractor for servicing. The second category of loans would be the vendee loans. These are loans offered to the general public to buy our foreclosed properties. And then we have a smaller segment which are the Native American direct loans, approximately 212 loans.

So, only a limited percentage of these were actually veteran borrowers, and I am not sure that there is much that we can do now. If loans went to foreclosure that could have been saved with active servicing, and those properties have already been disposed of by the VA, then there is probably not much that we can do for these borrowers. There would not have been any debts established against these borrowers, because we no longer establish debts on

loans unless there is evidence of fraud or misrepresentation on the part of the borrower.

Mr. BUYER. Is there an anticipation of a class action lawsuit?

Mr. PEDIGO. I do not anticipate that that will happen.

Mr. BUYER. Should there be any advice to this committee that money should be set aside for future, or potential liability here on this? I mean, if I had a VA loan, and the VA was negligent in its oversight, and I am now homeless, I am now out—I am not happy. So there is recourse for happiness.

Mr. PEDIGO. I understand your point. And I guess I would simply say that I would be unhappy, too. But it is not that there was a total lack of servicing taking place on those loans. What was missing was what we call active servicing. Active servicing constitutes a situation where the VA or the contractor actually takes the initiative to make calls to these borrowers.

There were undoubtedly many instances where these borrowers called the servicer and were provided with assistance. In addition to that, the servicer also was sending out letters. We do not consider letters to be active servicing. Nonetheless, letters to borrowers is a form of servicing. So it would be unrealistic to view this as a situation where there was a total lack of servicing.

Mr. BUYER. Mr. Chairman, I know my light is on. May I have some latitude for a few more questions? Thank you.

I think this question—well, let me just ask it. Do you know what the average default rate is among the private sector lenders, approximately? And then I would like to know how it compares to the VA foreclosure rate.

Mr. PEDIGO. I have in front of me the National Delinquency Survey that is published by the Mortgage Bankers Association. This is for the third quarter of 1999, which ended September 30th of 1999. And in the narrative part of this report, they indicate that the delinquency rate for conventional loans was 2.63 percent, that same rate for the VA was 6.9 percent, and for FHA, 8.72 percent.

Mr. BUYER. Now, break that 6.9 out for me. Who is of the higher risk; veterans who carry that loan, or when it is assumed by someone other than a veteran?

Mr. PEDIGO. Higher risk in terms of what—

Mr. BUYER. I would like to know if that 6.9 percent in default, is that occurring with veterans who carry the loans or is that based on when someone assumes the loan?

Mr. PEDIGO. I could not answer that.

Mr. BUYER. Could you get that answer for us, please?

(See Question 2 from Chairman Everett on p. 90.)

Mr. PEDIGO. We will try.

Mr. BUYER. Would be able to do that? You do not track that? So do we have a system whereby you say, well, the veterans go ahead and have their loans; we will permit those loans then to be assumed on the marketplace, and if there is a higher default rate, well, so be it. That is just what we do?

Mr. PEDIGO. No. What we have is a situation where, prior to March 1, 1988, VA loans were freely assumable. In 1988, a law was put in place that required that in order to have a loan assumed, that there had to be credit underwriting on the assumer. So we have a large number, couple of million loans in all likelihood out-

standing, that were made prior to this change in the law, and a large number that were made subsequent to that change in the law. So, we would not be in the position to determine what the numbers are in terms of how many assumptions there have been where VA either did or did not approve the credit of the new borrower.

Mr. BUYER. A default rate that is twice the market average costs the Federal Government approximately how much annually?

Mr. PEDIGO. I cannot give you that answer. But I would like to comment on that if——

Mr. BUYER. Is it an answer that you can get if you research it, or do you have a system that cannot calculate that?

Mr. PEDIGO. We can tell you that there were 24,000 foreclosures in fiscal year 1999, and we can tell you to the penny what those foreclosures cost the taxpayers.

Mr. BUYER. And could you——

Mr. PEDIGO. I do not have similar information available on those conventional loans.

Mr. BUYER. Here is what I would like to see. I would like to see if these foreclosures are occurring on the loan itself, on the assumption, or both.

Mr. PEDIGO. Okay. We will do our best to provide some information on that.

Mr. BUYER. All right, then let me ask you this. Would that answer be helpful or non-helpful?

Mr. PEDIGO. In terms of determining what?

Mr. BUYER. I would say in terms of the system for which we are operating for the country, perhaps it is not the best thing to do.

Mr. PEDIGO. I do not think that that would be helpful.

Mr. BUYER. All right.

Mr. PEDIGO. Because, in the first place, whether it is an assumption or not, the lender services the loan. The private sector servicers service a loan whether it is a veteran borrower or an assumer.

Mr. BUYER. Let me ask you this. Why do we permit this to continue? Why don't we just say to the veteran community, we are going to take care of you and we are going to permit you access to a loan? But when you sell it, you sell your property. No more loan assumptions.

Tell me what is wrong with that?

Mr. PEDIGO. I think that you would significantly reduce the flexibility that veteran borrowers would have in selling their homes.

Mr. BUYER. I got a commercial loan on my mortgage. You want to buy my house; you cannot assume my loan. That is not going to happen.

Mr. PEDIGO. I understand. But this is a benefit program, and the law provides that part of the benefit is the opportunity to sell your home under a loan assumption; but, it carries a requirement that you must obtain a release from liability from the VA.

Mr. BUYER. But, we are doing it at a high cost. And we have been doing it for a long time. At some point don't we step in and exercise some judgment here to say, is this good to the taxpayer or not?

Mr. PEDIGO. I am not sure that it is at a high cost, because there may be an even higher cost if we eliminate the flexibility that the veteran currently has to sell under a loan assumption. If you eliminate one of the options, then it is quite possible that you are going to make it more difficult for that veteran to sell the home and avoid a foreclosure when he or she encounters financial difficulty.

Mr. BUYER. Not necessarily. I think I would buy all of that. It depends on the market.

Mr. PEDIGO. I agree.

Mr. BUYER. Depends on the marketplace. Depends on where you are in the country.

Mr. PEDIGO. I agree with that.

Mr. BUYER. All right. Thank you, Mr. Chairman.

Mr. EVERETT. You are welcome.

Mr. BUYER. You will get that information for us?

Mr. PEDIGO. We will.

Mr. BUYER. I appreciate that, thank you.

Mr. EVERETT. Let me go into an additional round.

How does VA oversee these lenders who have the decision-making authority?

Mr. PEDIGO. We have several oversight processes in place. I commented earlier on some of the processes that we have in the front end of the program with respect to lenders who have automatic underwriting authority. That would be the 10 percent reviews, the post-audit reviews, which are 5 percent, and what we call the RPO-23 reviews, which are the reviews of the loans that go into foreclosure, or into serious default within 6 months after the loan is made.

We also have some oversight requirements in the appraisal part of our operation. Under those requirements, we have our field offices review 10 percent of the appraisals that are processed by lenders under what we call the Lender Appraisal Processing Program. We require that our personnel go out and do a 5 percent field review on those cases.

In the servicing area of our program, we require that our employees at Regional Loan Centers review the lenders' notices of default in order to determine that lenders perform the proper level of loan servicing.

And then in our property management operation, we have a requirement that a certain percentage of cases where management brokers do work for us—these are private sector individuals—be field-reviewed by our personnel.

In addition to that, we have a statistical quality control system in place that is used by both our field offices and our headquarters staff, that contains eight different sets of questions that these employees have to apply to selected cases that have been processed in the program, in order to assure that both employees as well as private sector partners have performed appropriately.

Mr. EVERETT. You had a comment, please?

Mr. BUYER. Mr. Chairman, I want to thank you for the hearing. And I would also like to make a suggestion, that the VA give the subcommittee a full and detailed report on this whole matter. I think it would be very important, because this is very disturbing.

(See Question 3 from Chairman Everett on p. 91.)

Mr. EVERETT. So ordered.

Mr. BUYER. Thank you.

Mr. EVERETT. In the past, VA management has not issued timely reports to lenders identifying loan underwriting deficiencies. Is the VA management now issuing these reports in a timely manner?

Mr. PEDIGO. Mr. Chairman, we have just recently put some revised time standards in place for our monitoring unit. Under those new standards, we will be dramatically reducing the time frame required from the point that we do the audit to the point that we get that report to the lender. Under these new standards, we will be getting the report to the lender within 90 days after the audit team leaves that lender's site.

Mr. EVERETT. Does the Portfolio Loan Oversight Unit at the VA still allowing contractors self-reporting to evaluate its performance?

Mr. PEDIGO. No, we do not. We are now requiring that our Portfolio Loan Oversight Unit in Indianapolis visit the contractor once per quarter. We are going to assure that they have the appropriate travel funds to carry out that mission. We also will be doing an annual performance and financial audit of the contractor using the services of a Big Five accounting firm.

We presently have the firm of Price Waterhouse Coopers at the contractor site performing a financial audit. This will become an ongoing part of our oversight process with respect to the portfolio loan servicing contractor.

Mr. EVERETT. Will the consolidation of the loan processing and servicing functions affect the veterans in a negative way? Just a short answer.

Mr. PEDIGO. It will not. In fact, we believe it will improve the services we provide to veterans.

Mr. EVERETT. In the Mortgage Bankers Association statement, which will be made a part of the record, they state that the VA low-bid program discourages many lenders from participating in the VA program. Mortgage Bankers suggests that the VA convert its program to a full insurance program similar to FHA.

[The statement of Mortgage Bankers Association appears on p. 62.]

Mr. EVERETT. What is the VA's response to the Mortgage Bankers?

Mr. PEDIGO. If we were to do as the Mortgage Bankers suggested, we would have to do one of two things. We would either have to increase the funding fee that the veteran has to pay to use this program, which is currently 2 percent of the loan amount, or we would have to come to Congress each year and ask for higher levels of appropriations. Currently, we have a partial guarantee, but if you go with a full insurance program or a full guarantee, that connotes a much greater cost to some party.

Mr. EVERETT. Mr. Pedigo, that completes the questions we have, additional questions will be submitted for the record. Let me also say that this Chairman has not minced words in making statements about policy for those testifying before this committee. And some folks are displeased at some times, and other folks at other times have been displeased. I am not concerned about that.

However, this committee and this Chairman have never made a personal attack on any VA employee or witness, and never intends

to. Nor does it intend to allow such attack to be made if it has any awareness of that. So I apologize to you, because this committee did not have the statements, although we did ask for them from our colleague prior to his testimony. Certainly, we all may have policy differences, and I understand that. And I do not pretend to understand the issues that our colleague was speaking about completely.

However, I do accept the position of The American Legion; I do accept the position of the full Committee Chairman, Bob Stump and the full Committee ranking Democrat, Lane Evans, in supporting the VA's policy. So, you have my apologies if that occurred. Had the committee known that in advance—and I can assure you in the VA this is known as a very tough committee—we do not make personal attacks in this committee, nor do we permit it.

So, thank you for your testimony.

Mr. PEDIGO. Thank you, Mr. Chairman. It was a pleasure to appear before you today.

Mr. EVERETT. Thank you. Now I would like to welcome and recognize Mr. James Hubbard, Director, National Economic Commission, American Legion; Mr. Peter Gaytan, Legislative Director, AMVETS; and Mr. Benjamin Butler, Associate Legislative Counsel, National Association for Uniformed Services.

Mr. Hubbard, we are struggling to keep this testimony within 5 minutes. If you could accommodate us, I would appreciate it, and we will start with you and, obviously, your complete statement will be made a part of the record. So, please proceed.

STATEMENTS OF JAMES B. HUBBARD, DIRECTOR, NATIONAL ECONOMIC COMMISSION, THE AMERICAN LEGION; PETER S. GAYTAN, NATIONAL LEGISLATIVE DIRECTOR, AMVETS; AND BENJAMIN H. BUTLER, ASSOCIATE LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION FOR UNIFORMED SERVICES

STATEMENTS OF JAMES B. HUBBARD

Mr. HUBBARD. Thank you, Mr. Chairman. I will let my statement stand on its own as submitted for the record.

But I feel compelled to respond to the allegations made by Mr. Ackerman earlier this morning. I will tell you categorically that The American Legion is not dependent on any Federal agency for anything whatsoever. As a staff member, I am dependent on the will of my membership. That is where I get my marching orders. And what I told Mr. Ackerman over the phone represents the will of my membership. I am frankly outraged by his allegations.

In fact, with regard to Interest Rate Reduction Refinancing, veterans can still refinance. No benefit has been pulled in any manner whatsoever. Even the Mortgage Bankers Association agree that veterans can still refinance. The only difference that I have been able to detect that the Mortgage Bankers have is that the time line for a loan not being current should be extended from 30 days to 59 days. That is a policy discussion that people can have and a difference of opinion that professionals can have, and there is no reason for personal attacks on that basis. In fact, interest rates do have an effect on the ability of a veteran to be able to refinance.

We were the recipients of form letters, and I told Mr. Ackerman that they were form letters when he talked to me. They are in the same language, which led me to believe that they were generated by one lender; that is, Mortgage Investors Corporation, which Mr. Ackerman mentioned this morning. I have seen some of the comment letters that were sent to the VA in response to the publication of—the pre-publication of the regulation.

Those letters, most of them, said exactly the same thing. I cannot verify this, but I am told by some people that a signature on those letters was required at the loan closing. So if a veteran wanted to close a refinanced loan, he or she had to sign that letter, and the lender then sent it off to Congress in response to a request for comments.

That is not ethical, in the first instance.

Now, if this committee really wants to do something for veterans, let us look at the funding fee. That fee was instituted as a deficit reduction measure. Well, the deficit is not there anymore and we now have a surplus. So I would respectfully ask you to consider, this body and this Congress, to consider the elimination of the funding fee that Mr. Pedigo talked about a few minutes ago.

I will stop there, Mr. Chairman. Thank you.

[The prepared statement of Mr. Hubbard appears on p. 67.]

Mr. EVERETT. Thank you for your testimony. Mr. Gaytan.

STATEMENT OF PETER S. GAYTAN, NATIONAL LEGISLATIVE DIRECTOR, AMVETS

Mr. GAYTAN. Mr. Chairman, it is a pleasure for me to appear before you today on behalf of AMVETS, to provide our recommendations for the Department of Veterans Affairs Loan Guaranty Service.

Originally established by the Servicemen's Readjustment Act of 1944, the VA Loan Guaranty Service has enabled millions of American veterans to purchase their own homes. With its no down payment feature, the Department of Veterans Affairs Loan Guaranty Service makes mortgage credit available to many veterans who otherwise would not have been able to become homeowners. We at AMVETS believe this to be an important benefit for veterans, and as important today as it was when it was first implemented to help World War II veterans readjust to civilian life.

AMVETS is encouraged by the efficiency of the VA Loan Guaranty Service and the timeliness in which veterans are receiving assistance in processing VA guaranteed home loans. One AMVET member and first-time home buyer in the State of Delaware was overwhelmed by the assistance he received recently from his State VA Loan Guaranty office. This AMVET is also an active duty staff sergeant stationed at Dover Air Force Base who, due to mission requirements, was unable to travel to the State VA office in Wilmington to receive his certificate of eligibility. Knowing that the loan process would be delayed until the certificate was received, the State VA Loan Guaranty representative delivered the certificate to the family readiness center on the Air Force base, allowing this active duty servicemember to proceed with his home purchase in a timely manner.

We are further encouraged by the proactive approach being taken by the national office to streamline the VA loan process and to further automate their services through the use of the Electronic Data Interchange, which Mr. Pedigo mentioned earlier, and by providing forms and information on the Internet. EDI allows members to transmit loan data to VA loan offices and receive notification of guarantee of the loan electronically, which will eventually lead to a paperless process.

Many commercial lenders and mortgage companies have already converted to electronic systems of loan processing. We believe VA must continue to move forward in this area to remain consistent with the abilities of the private sector partners, thereby ensuring the availability of this important veterans benefit in years to come.

The VA loan underwriting process has been approved in recent years by the use of automated loan underwriting system. The VA now allows lenders to enter data into the system over their computer and receive an underwriting recommendation electronically within 4 minutes of transmitting the data. This allows veterans to take advantage of the same processes that are available to conventional borrowers. AMVETS applauds the VA Loan Guaranty Service for recognizing the trends in the commercial lending arena and implementing this valuable new service for veterans.

One of VA's critical functions is to assist veterans in keeping their homes, or, when needed, helping a veteran through the foreclosure process. Once a lender has reported to VA that a veteran is seriously delinquent on their mortgage payments, VA will contact the veteran and offer assistance in retaining the home or resolving the issue at the lowest possible cost to the veteran and the VA. Costs to the Government are reduced when VA is able to pursue an alternative to foreclosure, and veterans are helped by either saving their home or avoiding the expense and damage to their credit rating caused by foreclosure.

AMVETS again applauds VBA for implementing the Loan Service and Claims System last year. This system automates routine service activities, improves efficiencies and allows employees to concentrate on supplemental servicing that directly benefits veterans. It also provides valuable support on the ongoing effort to consolidate guaranteed loan servicing at the 9 Regional Loan Centers.

We agree with VA's position on purchasing foreclosure properties when it is in the best interests of the Government to do so. Before VA will purchase a property to avoid foreclosure, a review is made of the net value of the property and the unguaranteed portion of the debt. VA accepts conveyance of the property if, by purchasing the property, it reduces the maximum claim payable to the lender.

In 1997, VA reduced its claim liability by \$136 million by acquiring foreclosure properties. This fiscal efficiency results in an overall benefit for all veterans. Additionally, AMVETS supports the A-76 cost comparison being conducted by the VA. When completed, this study will provide a cost comparison of VA's nationwide Property Management Operation to determine whether it would be more efficient and cost-effective to continue to perform the work of the operation using government employees and resources, or to obtain property management services through commercial sources.

We support system changes that lead to more timely and efficient benefit processes for veterans. We do recognize the fact that foreclosure rates are very high among the veteran population, and we hope that the VA Loan Guaranty office will remedy this problem.

VA measures its successes in assisting veterans who are facing foreclosure through the Foreclosure Avoidance Through Servicing ratio. This measures the percentage of foreclosures that are avoided after VA intervention. Through continued automation of services, sufficient staffing, and cost-effective operations, AMVETS believes that VA's foreclosure avoidance goals can be achieved. It is our opinion that the VA Loan Guaranty Program is effective, and accomplishes its objectives of effectively assisting veterans and active duty servicemembers in purchasing and retaining homes.

Mr. Chairman, that concludes my report.

[The prepared statement of Mr. Gaytan appears on p. 71.]

Mr. EVERETT. Thank you very much. Mr. Butler.

STATEMENT OF BENJAMIN H. BUTLER, ASSOCIATE LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION FOR UNIFORMED SERVICES

Mr. BUTLER. Mr. Chairman, the National Military Veterans Alliance would like to express our appreciation to you for holding this important hearing.

The NMVA is a loosely confederated group of 21 different military and veterans associations with a combined membership of 3.5 million nationwide. The testimony provided here represents the collective views of our members.

Mr. Chairman, the National Military and Veterans Alliance strongly supports the Veteran's Loan Guaranty Program. A benefit program is still necessary to assist veterans with obtaining home loans.

The no down payment provision of the Loan Guaranty Program gives the program a significant advantage over commercial lending institutions. Further, the qualification criteria used in determining eligibility for a DVA-guaranteed loan is less stringent than for a commercial loan. These items give veterans a distinct advantage in loan qualification in DVA that is not commercially available.

First, we would like to recommend that fees, closing costs and down payment requirements should be restructured to attract all veteran buyers, thereby reducing the overall risk to the program.

In addition to the structure of the benefit, the structure of the program itself also needs to be changed. If DVA is going to remain in the home loan business, they should be more competitive. DVA should be able to write its own loans and maintain a portfolio of income producing loans like the commercial home loan industry.

NMVA supports any program that provides housing assistance to veterans. We believe that programs should preserve the no down payment feature, as well as the more liberal qualification criteria of the current DVA program.

We feel reusability is another important feature, particularly for active servicemembers who are required to relocate many times during a career.

In the past it has been recommended that this program be administered by an agency other than the Department of Veterans Affairs, such as the Department of Housing and Urban Development. Although we have no objections, experience cautions us not to give this notion a blanket endorsement. Within the DVA, veterans are the focus and the priority. That is not necessarily the case for veterans programs within other agencies. Under the National Housing Act loan program, HUD currently administers a loan program for veterans, but few veterans even know it exists.

If veterans housing programs were transferred to HUD, an assistant secretary for veterans programs would have to be established, and the legislation authorizing such a transfer would have to be very clear and explicit as to the priorities to be accorded to veterans.

Finally, we would like to make the following suggestions:

We believe the Loan Guaranty Program for members of the Selected Reserve has been a success. However, this program was authorized as a temporary initiative. We believe the program should be permanent. In addition to making the Reserve Loan Guaranty Program permanent, we believe two other changes should also be made.

We see no logical basis for the disparity in funding fees between the regular program and the Reserve Loan Guaranty Program. Funding fees for reservists are three-quarters of a percentage point higher. In our view, funding fees should be identical for all Loan Guaranty Program participants.

We also believe that eligibility for the Selected Reserve Loan Guaranty Program should be revised. Currently, a Guard or reserve member can only qualify for the benefit by drilling for 6 years. It seems to us that qualification for the benefit should be established if the member honorably satisfies the terms of their enlistment of period of obligated service regardless of length. Today there are less initial enlistment programs that require a full 6 years of drilling participation in the Selected Reserve. The governing criteria to establish eligibility should be honorably satisfying the terms of enlistment or obligated service.

Next issue, the 1984 Tax Act, imposed several restrictions on the issuance by the States of tax-exempt bonds to fund home loan mortgages made to veterans. Specifically, the Act provided that a veteran must have served on active duty before 1977 to be eligible for the loan. This restriction was enacted as part of a general cut-back in the authority of States to issue tax-exempt bonds.

The rule requiring pre-1977 active duty means that fewer veterans are eligible for loans under the State veterans mortgage programs, especially veterans of Gulf War service. In our view, the pre-1977 active duty rule is unfair in forcing the States to exclude these veterans from mortgage programs. We believe that eligibility should be established for all veterans.

Mr. Chairman, the National Military and Veteran's Alliance thanks you again for this opportunity. We believe that the DVA Loan Guaranty Program is a valuable and important benefit that should be retained. The attention of this committee to help restore the DVA Loan Guaranty Program to its full potential, as a tangible benefit for all veterans, is genuinely appreciated. Thank you.

[The prepared statement of Mr. Butler appears on p. 76.]

Mr. EVERETT. Thank you very much. Obviously the Home Loan Guaranty Program is popular and has strong support from the veterans' service organizations and the military associations. Your testimony is positive about the changes in the program, and its management to keep up with the times.

However, this raises a question about consolidation of the Loan Guaranty operations into fewer locations. The question is about adequate customer service for veterans.

Consolidation makes sense to achieve greater efficiency, but it should not be at the expense of good service.

Are the members of the Panel satisfied that the VA is doing all that it should to ensure customer service is maintained?

Mr. Hubbard, we will start with you, please.

Mr. HUBBARD. Mr. Chairman, I am not aware of any degradation of customer service based on the consolidations that have taken place so far. I do wonder, however, since the Los Angeles operation has not been quite shut down and moved to Phoenix, yet the figures I have seen are that about 10 percent of this country's veterans live in California and were supported by that Los Angeles home loan operation. And I question whether moving from Los Angeles to Phoenix is the right thing to do.

I cannot tell you that there will be a degradation in service or customer service to the California veterans, but I wonder about the decision.

Mr. GAYTAN. Mr. Chairman, I can only comment on the members that I have discussed this loan process with who are members of AMVETS. And one of the members had received his home loan over 20 years ago, and his compliments on the service that he received are exactly the same as the member I spoke to who received his home loan guaranty just a month ago.

So I can say to you that, no, we have not seen any degradation of service due to consolidation.

Mr. BUTLER. Mr. Chairman, the members that I deal with have not brought any problems to my attention. And if there had been any problems, they would have brought it to my attention. So, we have not heard any yet.

Mr. EVERETT. I know the feeling.

I find myself again offering this committee's apology to The American Legion and to you, Mr. Hubbard. I would point out to you that, while we requested the testimony of Mr. Ackerman, we did not get it until actually he had left the committee room.

As I said earlier, and I think those of you who attend the Investigation Oversight hearings, I am pretty plain spoken. But I take this job very seriously. It really does not bother me if we have policy differences. I recognize the fact that in the end we are all working for the same thing, and that is our veterans. So I want to assure you and offer you the apology of the committee and this Chairman, that we had no idea that that was going to take place, although, as I said, we had asked for the testimony to be given to us in advance and it was not. You are a congressionally chartered advocate of the veterans, and I recognize that and this committee recognizes that. I do not think anybody would say that we would let anybody out of these witness chairs easily. We ask pretty point-

ed questions, but that is our job, as your job is to do something else.

But never have we ever made the attack personal. And had I know that that was going to happen, I would not have allowed the testimony, and I think I demonstrated that during Mr. Ackerman's testimony.

In conclusion, let me thank all our witnesses today for giving the subcommittee the benefit of their testimony. The VA's Home Loan Guaranty Program clearly remains popular with veterans and active duty members of our military forces. It provides a valuable benefit for them and their families. The Loan Guaranty Service is increasingly utilizing commercial mortgage lending practices in delegating functions to lenders, so its own oversight and accountability practices must continue to be strengthened.

As the saying goes, an ounce of prevention is worth a pound of cure.

And it also saves all those explanations to the IG and the Oversight Subcommittee.

I want to remind the VA that they are to report back to the subcommittee when, as outlined by the IG, all corrective actions have been taken. I request that the report include an explanation and detailed description of all actions taken to remedy the material and internal control weaknesses found by the IG. Also, we want to be informed of the results of the A-76 study on contracting out property management as soon as the study is completed, around August, I think, of this year.

So, thank you again, all of you, for attending. And finally, the subcommittee will be expecting a report from the VA on the situation involving the contract for servicing on direct loans.

Thank you again. This hearing is adjourned.

[Whereupon, at approximately 12:20 p.m., the subcommittee was adjourned.]

APPENDIX

PREPARED STATEMENT OF CONGRESSWOMAN BROWN

Mr. Chairman, I appreciate your holding this hearing today to review the VA Home Loan Guaranty Program. Housing assistance is one of the most useful benefits that the Federal Government provides to servicemembers and veterans. It certainly is the subject of a lot of questions from my constituents.

Yesterday afternoon the VA's Chief Financial Officer called to tell me that the Department's Inspector General had completed his long-awaited audits of VA financial statements for fiscal years 1998 and 1999. The good news for all of us is that VA received an "unqualified audit opinion." Since some of VA's previous accounting weaknesses had been in the Loan Guaranty program, this is a welcomed sign that the program is improving. I hope that these clean audits will establish a new benchmark for the future.

With regard to today's hearing, I am concerned with recent reports that Fannie Mae and Freddie Mac are buying fewer loans made to some minority groups—especially African Americans. This causes the credit costs for these groups to go up. I am interested in hearing about the participation rate of minorities in VA's home loan program. I understand it is high.

I look forward to hearing from Mr. Pedigo about his innovative steps with automation to make the Loan Guaranty Program run efficiently.

I also am looking forward to hearing from the Inspector General's Office. I am concerned with some of the issues that the IG witness will be raising. I am particularly concerned with the reported lax oversight of contractors who manage the VA property. This is especially worrisome if VA is thinking about contracting out more of its functions.

I am interested in the suggestions made last year by the Commission on Servicemembers and Veterans Transition Assistance and look forward to discussing those with the VA as well as the military and veterans' service organization representatives.

Mr. Chairman, I have a large naval base in my district and am concerned with adequate, affordable family housing being available at military installations. A March 1999 VA Inspector General report identified the nearby presence of large military bases as a major contributing factor to higher default rates. The report also says that loans made to active-duty service members defaulted more often than loans made to veterans and also tended to default earlier in the loan period. I will be interested in hearing the IG and VA suggestions regarding this serious problem.

This should be a very interesting and useful hearing.

PREPARED STATEMENT OF CONGRESSMAN EVANS

Thank you, Mr. Everett and Ms. Brown for holding this hearing today. The VA Home Loan Guaranty Program remains a pillar of the veterans benefits system authorized by Congress. It needs to be conducted on a sound basis, and in a customer-friendly manner. It is important that Congress review it periodically.

I noticed in this morning's paper that Fannie Mae, the nation's largest provider of mortgage funding, now plans to earmark \$2 trillion over the next decade for loans to minorities. This is long overdue.

Housing and Urban Development (HUD) Secretary Andrew M. Cuomo, who is mandated by Congress to set housing goals for Fannie Mae, says Fannie Mae needs to do more for under-served groups. I note this because, in contrast to Fannie Mae, VA has an excellent record of serving minority veterans. Still, VA must not be the last resort of veterans who are shut out elsewhere. I expect to hear more on this important aspect of VA's services this morning.

Just yesterday we learned that VA has received its eagerly-awaited audits from the Inspector General. VA received a clean audit for fiscal years 1998 and 1999. My hope is that VA will use these excellent audits as a benchmark, and that such audits will become a new part of VA's culture and its performance goals.

I look forward to hearing from VA and from the Inspector General's Office. The input of our customers, from the non-profit veterans' service organizations and military organizations is always helpful in making improvements, and in knowing what VA is doing right.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF CONGRESSMAN ACKERMAN

Let me begin by thanking the distinguished Chairman, Mr. Terry Everett, as well as the Ranking Democratic Member of the subcommittee, Ms. Corinne Brown for permitting me to appear before you today to testify on this important matter.

General Mismanagement in the VA Loan Guaranty Service

Mr. Chairman, Ms. Brown and colleagues: It is my considered opinion that the Department of Veterans Affairs Loan Guaranty Service is one of the most incompetently run organizations in the United States Government. As you all know, that is not an easy accolade to earn. Nevertheless through bureaucratic mismanagement and manipulation on the part of VA Loan Guaranty Service Director, Mr. Keith Pedito, it is an award that is indeed well-deserved.

Under the VA direct loan program, VA loan officers make approximately \$1.4 billion in vendee loans to buyers of the Agency's foreclosed properties. Most of these loans are sold to investors in these type of securities, but, for some unknown reason, the VA has decided to enter into the mortgage Banking business and retains a rather large portfolio of non-marketable loans.

The GAO report shows that the VA lacks an internal accounting mechanism to track \$7 billion in transactions, and that it depends on its trustee, Banker's Trust of California to perform that function.

The GAO states that the VA incorrectly calculated needed reserves and had to use funds from other accounts to cover \$14 million in losses in 1997 and \$40 million in losses in 1998.

Let me quote from the GAO Report:

We found that VA's financing and accounting for the guarantees associated with its loan sales, in effect MASKED both the existence of the estimated liability for defaulted loans as well as sources of funds being used to finance those liabilities.

That is a direct quote from the GAO Report. If a private lender would have "MASKED" the existence and liability for defaulted loans as well as sources of funds, such a private lender would be face a lengthy prison sentence for the financial services scheme as well as for other illegalities such as mail fraud and misuse of government funds.

Mr. Chairman, with your consent, I would like to submit, for the record, two articles from *National Mortgage News*, one dated April 12, 1999, and the other April 5, 1999, which provide further details of this outrageous malfeasance.

The Interest Rate Reduction Refinance Loan (IRRRL) Program

In 1980, President Reagan signed into law the creation of the interest Rate Reduction Refinance Loan (IRRRL) Program so veterans of our armed forces would be able to refinance their homes as interest rates got lower, without having to undergo the enormous amount of red tape required by conventional mortgages. One of the program's benefits was to allow veterans to refinance without underwriting, while the veteran was no more than 90 days delinquent on their mortgage payments.

Those of us who have refinanced our homes through the years know that the underwriting process involves collecting scores of documentation such as W-2 forms, bank statements, business references, credit histories and property appraisals.

The "streamline" process allowed veterans who desired to refinance the opportunity to do so with much less hassle. The program also allowed those veterans who were getting behind in their mortgage payments, often because of the high interest rates, to catch up again and save their homers from foreclosure.

That all changed when Rule number RIN-2900-AI92 went into place. That rule required the veteran to be current at the time of application and closing. The VA's rationale for this rule was that it would prevent "deceptive advertising practices,"

whereby some lender would advertise the ability to refinance the veterans home and allow them to skip up to three payments. If stopping the practice of promoting "skip up to three payments" was a problem for the VA, why not just stop that? If deceptive advertising or specific lenders were the culprits—and there were some—why not get rid of them, instead of eviscerating the entire program?

The answer is simple. The VA Loan Guaranty Office has been attempting to erode this congressionally mandated program for years. Until this rule, they have been unsuccessful. The sad reality is that now, by artfully explaining this rule and not providing the following details to either Veterans' Service Organizations or even to his own superiors at the VA, Mr. Pedigo, although unelected and unconfirmed has succeeded in destroying the IRRRL Program.

You may be interested to learn that during the public comment period, thousands of letters from veterans who refinanced their homes and opposed the rule were not in the public records room as required by law, but rather, were diverted to Mr. Pedigo's office. When this illegality was discovered by one of the lender's lawyers, it took 2 weeks to return the letters to the public inspection room.

It is also relevant to note that Chairman Dan Burton, Chairman Ben Gilman, Representative Doug Bereuter and Representative Tom Lantos all joined me in opposing this rule change. It took a minimum of six months for the VA to respond to our correspondence and the answer was not at all germane to the questions and concerns our colleagues raised.

In addition to our letters, more than 10,000 veterans joined us in writing in during the public comment period, many representing local and State Veterans' Service Organization Chapters. The State VFW conventions of Louisiana, Florida and Texas all passed resolutions asking the VA to repeal the rule.

I would like to submit, for the record, an op-ed piece which appeared in *The Hill* newspaper, by Calvin Patton. Mr. Patton is Chairman of the Maryland State Veterans Commission and would likely be in this room today if he did not have to testify in Annapolis. Mr. Patton sums it up when he says: "Serving in the American military and defending human freedom throughout the world is a high risk job. It is particularly difficult to encourage military service during good economic times. Gradually, we are eliminating the recognition of the veteran as a special class of citizen."

Representative Brown, you may be particularly interested to learn that the former largest provider of IRRRL Loans in the country is located in St. Petersburg, FL. They had a large regional office located in the heart of your district in Jacksonville. Because of the rule change, they make no VA loans, whereas in 1998 they loaned \$6 billion to veterans.

The company, owned by a disabled Vietnam recon Marine named William Edwards, is now reconfigured and is doing very well with other mortgage products. They are not, however, providing loans through the VA program because it is no longer a viable product to sell.

Do not let anyone from the VA tell you that the reason for the lack of interest to provide IRRRL Loans is the higher interest rates now available. There are literally tens of thousands of veterans sitting on loans upward of 9 percent, some as high as 16 percent, who could save tens of thousands of dollars over the life of their loans if the rule were repealed.

This program wasn't broken until the VA tried to fix it. You may be told today the VA acted because they were at greater risk through the refinancing of delinquent loans. That's more than not true. You will be surprised to learn that IRRRL foreclosure rates are dramatically below the industry norm. With foreclosure at roughly 0.04 percent for IRRRLS purchased by FLEET mortgage (who was the largest purchaser of IRRRLs in the United States), compared to about 0.1% for conventional mortgages, the IRRRLs SAVED the United States government money and saved the veterans home from foreclosure.

One aspect of the Rule which we all support was the provision that the monthly payment in every case be reduced, so the veteran was not putting him or herself into greater debt by refinancing. In the case of Mortgage Investors Corporation, by far the largest provider of these loans in the country, EVERY single one of their loans resulted in a reduced interest rate AND a reduced monthly payment. The only exception to this was the limited circumstance where the veteran went from an adjustable rate mortgage (ARM) to the less risky fixed rate mortgage.

It is also telling to note that MIC's average Interest rate was 7.59 percent in 1997. The only lower rate of any entity doing IRRRL loans was 7.57 percent for Navy Federal Credit Union, which is, of course, a non-profit operation.

Mr. Chairman, Ms. Brown, in 1999 veterans in the United States had approximately 151,419 VA loans out at exactly 10 percent interest. Another 141,849 veterans were over 10 percent. That is unconscionable, considering in 1998 the major pri-

vate sector player reduced 38,622 veterans' interest to an average interest rate of about 7.5 percent. In 2000, they have provided no loans to veterans because the VA's ill-conceived rule makes it impractical to do so. They and other companies like them are out of the VA refinancing business. And its costing Vets a ton of money. Mr. Chairman, you will undoubtedly be privileged to hear Mr. Pedigo's smooth obfuscation of this story. He'll tell you the private refincancers charged points. So what? If a Veteran paid 4 points and reduced his mortgage from 14 percent to 7 percent, he could save a hundred thousand bucks. The only one to loose out were the folks Mr. Pedigo and his rule protects—the original lenders who were, and now still are, getting that 10, 12, 14 and yes 16 percent.

Mr. Chairman, Mr. Pedigo and his agency pulled their "flim-flam" ON THE American Legion, telling them that veterans were being duped into putting their homes at risk. . . . that they were being SEDUCED into skipping payments, paying too many points, paying higher monthly payments and decreasing their investments in their home.

The American Legion, a great organization, highly dependent on Mr. Pedigo's bureaucracy bought in and came out in favor of the new rule and Mr. Pedigo USED that great organization to make his case. After reading the very concerned statements of The American Legion spokesman in the press, I called him and asked him directly, how many vets complained about the supposed problems that were referenced. He said: "Oh no veterans complained, but he was aware of the dangers from Mr. Pedigo's shop!"

Let them not deceive you too.

Now briefly, what is this new Rule and why did it kill the private sector's ability to participate in the Program? The Rule says a veteran cannot refinance his home by the streamlined process unless his mortgage is current. Well, the reason he is not current is because he cannot make the payments at 10 to 16 percent in the first place! A guy falls behind a few payments is precisely the one who needs to refinance at a lower rate.

The private sector cannot participate because they cannot certify that the vet is current, because no one gets reported until they miss the next month! Therefore, the lender cannot certify who is current when the veteran comes in to refinance. You can only certify that he was current last month. Mr. Pedigo will tell you that all the lender must then do is to submit documents to the VA for underwriting. That right there means the vet cannot streamline refinance his home. The lender must collect all of the required documents and by the time all of that takes place, our veteran will certainly not be "current." You can certify that he is no more than 60 days late and we proposed that. The Mortgage Bankers Association of America agrees with us., but the VA was not willing to compromise. This forced the vets to stay with their high interest rates.

Some time back, Mr. Henry Cohen of the VA General Counsel's Office informed my former Chief of Staff that we Members of Congress are only involved with this issue because we are being lobbied to do so. And we do get lobbied. But I would be most appreciative if someone from the VA here today could tell Mr. Cohen that my district includes one of the largest veterans populations in the United States. Ben Gilman is a decorated World War II hero. We are all involved with this because the VA is wrong.

Mr. Chairman, Ms. Brown and colleagues, I intend to introduce a bi-partisan, pro-veteran legislative remedy to this absurd bureaucratic debacle.

I hope you will help me to restore the ability of a veteran to refinance her/his home while in a period of no more than 60 days late. It will address legitimate concerns of the VA and require the monthly payment on the new loan to be lower than the old in all cases except where a vet goes from an adjustable rate mortgage to a fixed rate mortgage. It will also put safeguards on the type of advertising that would seem to be misleading, or would urge a veteran to do something not in their family's financial interests. The VA's approach is to throw the baby out with the bath water.

I hope you will join me in helping the half million veterans sitting on loans of from 9 percent to 16 percent refinance their homes by allowing lenders to once again enter the VA IRRRL market.

Thank you for holding this important hearing today and for allowing me to appear before you.

NATIONAL MORTGAGE NEWS

Volume 23 / Number 30

The Unwoveness for America's Mortgage Industry

April 12, 1999

VA's Direct Loan Program Under Scrutiny

BY TOMMY COLLIER

Huntington-The Department of Veterans Affairs direct loan program has come under scrutiny due to loose accounting procedures and poor monitoring of its servicers.

Under the direct loan program, VA loan officers make about \$1.4 billion in vendor loans to buyers of the agency's foreclosed properties.

Most of these loans are sold to investors in REMIC securities, but the VA also retains a sizable portfolio of non-marketable loans.

The GAO report shows that the VA lacks an adequate internal accounting system to track \$7 billion in REMIC transactions, and that it is dependent on its trustee, Banker's Trust of California, for financial information about the VA-guaranteed REMICs.

GAO says VA incorrectly calculated needed reserves and had to use funds from other accounts to cover \$14 million in losses in 1997 and \$40 million in losses in 1998.

"We found that VA's financing and accounting for the guarantees amounted with its loan sales in effect to shift both the existence of the estimated liability for delinquent loans as well as the amount of funds being used to finance those liabilities," the GAO says.

Kerth Poelgen, director of the VA loan guarantee service, contends the GAO report "overstates" the problem, and he disagrees with its findings. The agency is working to improve its accounting systems to be in compliance with Federal government accounting standards, he said.

In October, VA hired the accounting firm of Ernst & Young to develop an internal automated accounting system for its REMIC transactions. A prototype has been developed and should be operational by the end of the summer.

GAO also cited VA for poor monitoring of its REMIC servicers - Countrywide Home Loans, Calabasas, Calif.; Bank of America Mortgage, Charlotte, N.C.; GE Capital Services, Cherry Hill, N.J.; and First Nationwide Mortgage, Frederick, Md.

GAO found servicers were not reporting sales of foreclosed properties in a timely manner and the trustee was not aware that payments of principal and interest should be reduced.

GAO also found a VA audit that showed GE was collecting fees from Realtors for the right to sell foreclosed properties, which had the effect of increasing VA costs and reducing net sales proceeds.

"We made these findings internally and we are in the process of taking corrective action," Mr. Poelgen said in an interview.

GAO estimates that some \$6 million is in dispute, but Mr. Poelgen said, "It won't be proper to get into a detailed discussion because it could compromise some of the negotiations" with GE.

VA is hiring a private auditor to monitor its REMIC servicers and trustee. The GAO report also cites VA for marketing loan portfolio to a private contractor, Seasons Mortgage, Richmond, Va., in the summer of 1997.

originated new vendor loans to facilitate the sale of foreclosed properties. The program supported loans, which used a 30-year-old originating system that was being phased out, could not communicate with Seasons Mortgage and new loans had to be processed manually, instead of automatically.

"It didn't take long to find that they didn't readily interface," Mr. Poelgen said. However, errors in the recording of the new loans made it difficult to pay taxes



Kerth Poelgen

on time. And borrower payments could not be properly deposited because there was no automated feed from VA to Seasons Mortgage.

"We had a heck of a time," Mr. Poelgen admitted. "Written a month after signing the contract we were aware of the glitches and began working to improve the exchange of information," he explained.

So far, VA and Seasons have reduced the error rate from 40% to 6%, but the 6% rate is still too high, the VA director said. "We are not happy with that," he added.

"The important thing to note is that we were aware of all these deficiencies before GAO did its review. And we had already set up a plan to resolve these deficiencies," Mr. Poelgen stressed.

NATIONAL MORTGAGE NEWS

Volume 23, Number 29

The Newsweekly for America's Mortgage Industry

April 5, 1999

VA Loses Loans in Servicing Transfer

Washington—The Department of Veterans Affairs botched the transfer of its mortgage servicing portfolio to a private contractor, and now the VA cannot properly account for nearly \$3 billion in assumed and vendee loans that have been sold to investors.

The agency started the transfer in June 1997, but it also shut down its own internal loan tracking system at the same time, according to a U.S. General Accounting Office report.

"As a result, VA was unable to appropriately manage its loan portfolio, including knowing the composition and value of its loan portfolio, reconciling the cash flows, or properly monitoring the contractor's work," GAO said.

Errors in the accounting and record keeping systems apparently made it difficult for the private servicer to pay property taxes or allocate funds properly.

For example, \$1.6 million in loan payoffs recorded in February 1998 were still unallocated six months later, according to the GAO auditors.

GAO director Gloria Jarmon noted that VA has hired an accounting firm to help it recreate its records, but it will probably take a year to correct.

"They do seem to be trying to address the problem. But it definitely is not fixed as of now," Ms. Jarmon said.

VA officials could not be reached for comment at press time.

STATEMENT OF
NORA EGAN
DEPUTY UNDERSECRETARY FOR MANAGEMENT
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATION
COMMITTEE ON VETERANS' AFFAIRS
HOUSE OF REPRESENTATIVES
MARCH 16, 2000

Mr. Chairman and members of the Subcommittee:

I am pleased to be here this morning to discuss the operation of the VA home loan program. Today I will discuss our initiatives to restructure the Loan Guaranty Program by automating processes, delegating authority, and consolidating functions into fewer locations. I will also cover current topics such as our A-76 study on whether to contract-out property management, the program's financial audit, training, program oversight, and the impact of loan servicing efforts.

Mr. Chairman, VA guaranteed more than 485,000 loans, totalling approximately \$54 billion, in this past fiscal year, the second highest loan volume since 1956. The subsidy appropriation to support this loan volume was \$198.2 million. While this is a significant cost to the taxpayers, it is substantially less than the \$612.5 million in fees paid by veterans to the VA. In effect, veterans pay a major portion of costs for providing this benefit.

Mr. Chairman, the Loan Guaranty Program has been going through a period of significant change. In the 1990's staffing in the program was reduced by 35 percent. In order to continue providing quality service to veterans, as well as VA lenders and other program participants, we are making major changes to incorporate **automation, delegation, and consolidation**. A critical byproduct of delegation is, of course, the expanded need to focus on training and program oversight. Our vision is of a Loan Guaranty Program that, with the active participation of our private sector partners,

quickly, efficiently, and cost effectively delivers the Loan Guaranty benefit to our nation's veterans.

Automation

The use of Information Technology has become a primary focus in determining how the Loan Guaranty benefit will be delivered. We have established a very comprehensive and easy to use Loan Guaranty Website on the Internet, at www.homeloans.va.gov, that provides veterans and the general public a great deal of information. In addition to containing the answers to frequently asked questions, the site has an interactive map to enable veterans to have an e-mail question routed to the appropriate VA Regional Loan Center for direct and rapid response. The website also contains information specifically designed for program participants such as lenders, servicers and real estate sales professionals.

An initiative that we are particularly proud of that was implemented in December of 1999, will permit lenders to submit the information VA requires to obtain a guaranty certificate via electronic data interchange or EDI. Prior to this initiative, lenders were required to mail hard copy information to VA, which then had to be manually entered into our computer systems before we could mail the lender its guaranty certificate. In Fiscal Year 1999 alone, VA personnel were required to manually make approximately 24 million entries into our systems in order to process the 485,000 guaranty certificates that we issued. Once all lenders are participating in this initiative, virtually all of those entries will be done electronically with no need for human intervention. Additionally, the lender will receive the guaranty certificate electronically within 1-2 days of their submission, instead of having to wait weeks as was often previously the case.

In the area of Loan Administration, we are making active efforts to develop and implement EDI-based procedures for submitting a variety of documents such as Notice of Default, Default Status Update, Notice of Intent to Foreclose, Notice of Election to Convey property to VA, and Invoicing (Property Acquisition and Claim under Guaranty). These are processes that involve reporting of information between private sector loan servicers and VA offices that currently require the submission of over a hundred thousand hard copy documents per year. We will implement the EDI process for Default Status Updates in the third quarter of FY 2000, and the others in early FY 2001. When these electronic processes are fully operational, we will eliminate the need for a tremendous number of paper documents.

Another initiative that we are extremely proud of is the first internet based system implemented in VBA. The new VA Assignment System (VAAS) enables our lenders and other program participants to go on line from their own computers and obtain VA case

numbers and appraiser assignments without any involvement by VA staff. This new system has been in place since July of 1999, and I can tell you that it has been applauded by our lenders. Currently, 90% of all appraiser assignments are being made without any need for VA staff involvement.

We have also implemented the Loan Service & Claims System (LS&C) in the past year. This system enhances our ability to provide assistance to veteran borrowers who are delinquent on their loans, to pay claims to lenders and to automate substantially other payment and accounting processes. We also are developing other enhancements to this system that provide significant assistance to our Loan Servicing Representatives in providing financial counseling to delinquent veteran borrowers.

Another new system in use is the Property Management Local Area Network (PLAN). This is a distributed application providing automated support for the acquisition, maintenance, and disposition of properties VA acquires after foreclosure. This system was implemented in 1999. It has significantly improved a VA function that sells nearly \$2 billion worth of properties per year.

A system that has been in use for 2 years which we continue to enhance is our Expanded Lender Information (ELI) system -- a repository for all lender information. ELI also provides the means by which to track lender personnel who are subject to VA approval, including credit underwriters and Staff Appraisal Reviewers (SARS).

We have other new applications in development. For example, on April 3, 2000, we will begin a pilot at our St. Petersburg Regional Loan Center to test the feasibility of accepting appraisal reports electronically. Presently the hundreds of thousands of reports that are completed each year must be mailed from the appraiser to either VA or the lender. This new system will eliminate mail delays associated with hard copy submission of completed appraisals. The result will be improved service to veterans and participating lenders.

Another initiative we have in prototype development is an Automated Eligibility System. This initiative will allow lenders to access VA records and make determinations concerning a veteran's eligibility for home loan benefits and determine the availability of sufficient entitlement for the loan amount under consideration. The current process requires veterans or lenders to submit a written application to VA. A VA employee must then review the application, make a determination and mail the eligibility certificate. We expect to have an in-house prototype operational by the end of this fiscal year, and to begin making the system available to the industry in the first quarter of FY 2001.

Still in the area of developing systems, we are seeking to upgrade the method by which we receive and account for funding fees. Funding fees are currently paid to VA

via electronic funds transfers handled on VA's behalf by the Mellon Bank Automated Clearing House (ACH). At the present time, VA is working with Treasury and the Mellon Bank ACH to develop a replacement application which will provide significantly better tracking, control, and oversight capabilities.

Mr. Chairman, I would now like to talk about another area in which VA is involved in new technology. The mortgage industry is taking advantage of emerging technologies to assist in the processing and approval of loan applications. Automated Underwriting Systems (AUS) are used as a tool to underwrite loan applications and provide rapid loan approval decisions. In addition to faster decisions, use of AUS provides improved risk management. It also avoids any intentional or unintentional bias from becoming part of the underwriting process.

Some of these systems have been developed in-house by individual lenders, while other lenders subscribe to those developed by a third party such as Fannie Mae or Freddie Mac. The systems are developed based on the evaluation of data taken from a very large number of loans and the resulting performance of those loans. These systems do not disapprove loans; they assign a risk classification. Those that are rated "Approve" or "Accept" are considered to be low-risk and are generally approved without further underwriting. Those rated "Refer" are sent to a human underwriter for further analysis before a decision is made. The theory is that by using these systems, human underwriters can devote more time to difficult cases and ultimately approve a greater number of loans than might otherwise be possible.

To ensure veterans realize the same opportunities as non-veterans regarding these systems, VA has tested several and approved their use in connection with VA guaranteed loans. In November 1997, we approved the Loan Prospector system developed by Freddie Mac. In March 1999, we approved the CLUES system, which was developed by one of our largest lenders, and in December 1999, we approved the Desktop Underwriter (DU) system developed by Fannie Mae. VA has made it clear that the final decision to disapprove a loan must be made by a human underwriter, not the automated computer system.

Delegation

Mr. Chairman, just a few years ago the typical VA Home Loan transaction required that VA personnel perform most of the processing work involved. Today, most veterans are able to obtain a home loan by dealing solely with their lender. Direct VA involvement in the processing of their loan is generally no longer required. We have accomplished this by selectively delegating processing and decision making authority to

our private sector partners. For example, currently over 99 percent of our loans are made by lenders on an automatic basis; that is, without prior underwriting of the loan by VA staff. Under 38 U.S.C. 3702(d), these loans can only be made by lenders who are subject to examination and supervision by an agency of the United States or any State, or who have been approved for this privilege by VA under the criteria we have established.

We have also developed, under the authority of 38 U.S.C. 3731(f), a Lender Appraisal Processing Program (LAPP). Under this program, the property appraisal is reviewed and the value is established by an employee of the lender who has been approved by VA to perform these reviews. This enables lenders to close VA loans faster by receiving and processing appraisal reports without VA involvement, other than assignment of the case number and the appraiser. This saves both mailing time and VA processing time, especially during heavy workload periods. Currently 70 percent of our loans are being processed under LAPP. We have an effort underway to increase the participation rate to 90 percent.

In the area of loan servicing we have implemented a Servicer Loss Mitigation Program (SLMP) which delegates to servicing companies, the authority to process compromise sales and deeds-in-lieu of foreclosure. These are alternatives to foreclosure that can be offered to certain veterans whose loans are in jeopardy of being foreclosed. Both involve labor intensive work processes which require significant staff time to accomplish. Under SLMP, we are able to place most of the work involved in these cases on these servicers. This frees up VA staff to focus their efforts on loans that have a reasonable prospect of being brought current.

Another example of delegating authority to process work is our 1997 initiative to contract-out the servicing of our portfolio loans. These loans are of three types: (1) Vendee Loans: direct loans made to finance the sale of foreclosed properties, (2) Refunded Loans: delinquent guaranteed loans that VA buys back from lenders, and (3) Native American Direct Loans: loans made by VA to Native American veterans to buy a home on trust land.

For many years VA serviced a portfolio of loans, most of which were originated to finance the sale of properties acquired by VA as a part of its guaranty program. The staff was spread among 46 regional offices, and the computer system supporting this activity was created almost 30 years ago, was not user friendly, and could not comply with recent changes in statutory and regulatory requirements. It was cost prohibitive to make system changes, or to consolidate servicing to achieve the economies of scale needed to make

efficient use of limited personnel resources. Thus, VA decided to contract for the subservicing of its entire loan portfolio.

In January of 1997 we completed a competitive process and began, in June of that year, using a private sector servicing company to process these portfolio loans. We estimate that the savings to VBA nationwide was 154 FTEE, and this has already been realized through reassignments and retirements at the Regional Offices. A Portfolio Loan Oversight Unit has been established at the Indianapolis Regional Office to oversee the Contractor's performance (including review of cases recommended for termination), and to offer special assistance to veterans with direct or refunded loans.

Consolidation

I would now like to address the restructuring and consolidation that has been taking place in the field. The loan processing and servicing functions supporting the VA Home Loan Program are being consolidated from 45 Regional Offices (ROs) in the continental U.S. and Alaska to 9 Regional Loan Centers (RLCs). Hawaii and Puerto Rico are not included in this plan due to their remote location, time zone differences, and language barriers. The consolidation is essentially complete, with the exception of the loan servicing function in Los Angeles, which is scheduled for August, 2000. Direct service provided to veterans who personally visit ROs has not been significantly affected.

- Veterans who personally visit a VA Regional Office can continue to do so. Each office continues to retain personnel knowledgeable in the home loan program who are able to offer these veterans assistance and work as a liaison with the RLC.
- Veterans needing assistance by phone are able to call the RLC using a toll-free number. They are simply connected to the RLC rather than the local RO.
- The RLCs are large enough to take advantage of new technology such as auto-dialers and reengineered work processes. They have sufficient personnel available to answer telephone inquiries and offer longer hours for phone service.
- Consolidation to RLCs improves mail and telephone contacts with industry partners. Industry representatives have contact with a smaller number of offices, and the information provided is more consistent. This is especially important for national lenders which, prior to restructuring, had to deal with up to 47 different offices which often operated with varying procedures.
- Consolidation facilitates consistent staff training of the highest quality. This tends to reduce variations in the quality of service received by lenders and servicing companies and allows VA to be more responsive to their needs.

- Consolidation makes VA consistent with the mortgage industry. Most loan servicing companies service a large number of loans from centralized servicing centers. Most lenders operate from regional underwriting centers. Service will be improved as the number of different offices involved in the process will be reduced.

In a similar way, the processing of veteran's requests for certificates of eligibility has also been consolidated. Veterans who mail their requests for a COE will simply mail it to one of two Eligibility Centers (Winston-Salem or Los Angeles) instead of mailing it to the nearest RO. Both eligibility centers are currently processing such requests in less than 5 days.

Turnaround time for mailed requests will be quicker on average and much more reliable due to economies of scale at the central location(s). Veterans who can currently visit a VA Regional Office or out-based location to receive a COE can continue to do so; however, surveys indicate that less than 20 percent of veterans requesting a COE do it in person at a Regional Office.

Property Management

Mr. Chairman, I would like to turn our attention to the Property Management Operation, which is responsible for the acquisition and sale of real estate acquired by VA under the Loan Guaranty Program. The nationwide operation employs approximately 275 full-time employees at the 45 VA Regional Offices and Loan Centers with Loan Guaranty Activities. In Fiscal Year 1998, VA acquired 24,765 properties and sold 21,859 for an 89% sales to acquisition ratio. In Fiscal Year 1999, VA acquired 24,217 properties and sold 24,758 for a 103% sales to acquisition ratio.

When VA takes custody of a foreclosed property, we use the services of Management Brokers to care for the property. Management brokers are private sector firms and/or individuals who are assigned responsibility for custody of acquired properties up to the point of disposal. These brokers secure the property once it is vacant and perform a comprehensive property inspection. The results of this inspection, including recommended repairs and a marketing analysis provide the basis for VA's strategy for property disposition. Management brokers also supervise repairs made by private contractors as authorized by VA. Supervision and oversight of management brokers and repair contractors are in the form of field reviews by VA staff on a sample basis to ensure that work is performed as reported. In addition VA's internal quality control system requires reviews of property disposition cases including management broker performances.

VA is in the process of conducting an A-76 Cost Comparison to determine whether it would be more efficient and cost-effective to continue to perform the commercial work of the VA Property Management (PM) operation in-house using government employees and resources, or to obtain such services through commercial sources. This study is being conducted in accordance with Executive branch policy, as expressed by Office of Management and Budget (OMB) Circular A-76, Performance of Commercial Activities. The basis for this Study is our recent determination, made in accordance with the Federal Activities Inventory Reform Act of 1998, Pub. L. No. 105-270, that much of the work of this operation is commercial in nature.

The A-76 Cost Comparison process is a contracting competition between in-house government employees and private sector contractors and it involves usual and customary FAR contracting requirements. The official start date for this Study was August 9, 1999. VA anticipates completing the Study, that is, having a decision regarding whether the commercial work should remain in-house or be contracted out, by August 2000.

VA has hired Booz-Allen & Hamilton as the consulting contractor on this initiative. Booz-Allen brings a wealth of expertise and practical experience in conducting A-76 Studies. In addition, an in-house subject matter team has been established to provide necessary program and operational expertise. This in-house subject matter team includes Property Management employees, program managers, representatives from both the American Federation of Government Employees and the National Federation of Federal Employees, and others.

Oversight

Mr. Chairman, because we have delegated significant responsibilities to program participants, we must be vigilant in our oversight of their activities. There are a number of tools we use. For example, in the Construction and Valuation area, we strive to appoint only qualified appraisers and inspectors to VA fee panels. We conduct an office review of all fee appraisal reports and value notices issued by VA staff or LAPP lenders. We field review at least 10 percent of cases processed by lenders under LAPP, and at least 5 percent of all fee appraisal reports. Our focus is on new fee appraisers and those with quality-related problems. Office reviews of all inspection reports are also done, either by VA staff or by the lender, to assure that there are no unresolved problems reported by the inspector. We also field review inspection reports. We process construction complaints by veteran homebuyers against builders, and implement administrative sanctions, as necessary and appropriate, against any program participant who fails to meet program requirements.

In the loan production area, VA conducts full reviews on a 10 percent random sample of guaranteed loans. A full review involves obtaining a complete origination package and verifying that all aspects of the loan are in compliance with the published credit standards. We verify that fees and charges were appropriate, and that all appraisal requirements were satisfied. Lenders are notified when deficiencies are found.

VA also conducts post audits on a randomly selected 5 percent sample of closed loans. A post audit involves reverifying documents sent in by the lender. For example, the employment and deposit verifications are reverified to make sure there was no fraud involved.

VA conducts full reviews on newly closed defaulted loans in which 6 or less payments have been made. These loans are carefully scrutinized to determine if there were underwriting deficiencies that the lender should be alerted to.

VA also conducts additional reviews of cases from lenders who have been identified by station management as lenders who have exhibited a pattern of failing to process loans completely or accurately. VA personnel also conduct lender visits and routine lender training to ensure lenders are aware of current policy.

In the last year we have implemented a revised Quality Control System that is carried out by both employees in the field and here in Headquarters and we have re-instituted on-site surveys of field stations.

Mr. Chairman, another very important component of our oversight effort is our Loan Guaranty Service Lender Monitoring Unit. Since the establishment of the Loan Guaranty Service Monitoring Unit in 1990, we have been conducting onsite audits of lenders and servicers to determine the level of compliance with required laws, regulations, and policies governing VA's Loan Guaranty Program.

Approximately 4500 lenders participate in our program. We have averaged 60 audits a year over the past 10 years. We use a multi-agency shared computer program, called C-PADS, in our process of selecting the lenders for audit. This computer program identifies the lenders who have a high rate of defaults. In addition, we also utilize our own database of lenders. We make every effort to ensure program integrity by identifying and selecting lenders who pose a higher risk to VA.

We have taken several different types of actions against program participants as a result of their noncompliance with the required laws, regulations and policies governing this program. As a result of actions taken by the Monitoring Unit:

- We required lenders to refund overcharges to approximately 1,280 veterans, with refunds on these overcharges ranging from \$10-\$3,000.
- We required indemnification agreements on approximately 190 loans, protecting VA against payment of future foreclosure claims and/or property disposition losses. The potential loss avoidance on these cases is estimated to be approximately \$16 million.
- We have recovered payments of approximately \$8 million for foreclosure claims and collection of property disposition expenses borne by VA. These payment recoveries are in connection with loans determined to have been closed in egregious noncompliance with VA's credit standards.

Training

I mentioned training as an important byproduct of delegation. Loan Guaranty Service maintains an active and innovative training program, both for its own employees and for its partners in the private sector (lenders, servicers, real estate professionals, etc.). Nationwide training is sponsored by Headquarters, and utilizes the Veterans Benefits Network of interactive satellite broadcasts, computer-based and Internet-based self-paced learning programs, and a number of classroom-based courses. In addition, each Regional Office and Regional Loan Center also offers training for VA employees and program participants on a local basis.

Three new videotapes have recently been produced: *The American Dream for America's Veterans* explains the VA home loan program for a general audience (including veterans and real estate professionals); *Special Homes for Special Veterans* is provided to veterans eligible for a Specially Adapted Housing Grant to explain the grant process; and *Coming Home – Native American Veteran Home Loans* describes the direct loans offered to Native American veterans living on trust lands. It is designed for tribal councils as well as eligible veterans.

During the current year Loan Guaranty will offer four two-hour broadcasts specifically tailored for lenders, and one for real estate professionals. Last year these training broadcasts were received by over 6,000 lender employees. The A-76 Study of Property Management has been explained both to VA employees and private sector property management firms by means of interactive televised broadcasts, which enabled all to ask questions as needed.

Mr. Chairman I would like to devote the final few moments to some current issues.

Loan Servicing

First, let me discuss the impact of VA's loan servicing efforts. It has been VA's long standing policy to encourage mortgage holders to extend forbearance to borrowers who find themselves in temporary financial difficulties. In loan default cases, the mortgage holder is responsible for contacting the borrower, determining the reason for the default, and making arrangements for repayment of the delinquency. If this cannot be accomplished by the time three installments are due and payable, under existing regulations the default must be reported to VA, together with the holder's explanation of the reason for the default and a summary of its servicing efforts. Upon receipt of such notice, VA takes an active role in working to protect the interests of the veteran-borrower and the Government by initiating an outreach effort to personally contact the borrower and perform supplemental servicing.

VA closely reviews the holder's servicing of the account and follows up by attempting to contact the borrower by letter or telephone. Once contact has been established and based upon the facts in the case, VA personnel may offer financial counseling and/or may intercede with the holder on behalf of the veteran in order to obtain forbearance or arrange a reasonable repayment schedule in appropriate cases.

When our efforts to secure additional forbearance are unsuccessful, VA has discretionary authority to "refund," i.e., to purchase a loan from the mortgage holder. The law providing this authority to VA does not vest borrowers with any right to have their loans refunded or to apply for refunding. Nevertheless, VA considers whether refunding is in the best interests of the veteran and the Government in every case before foreclosure. When VA refunds a loan, it may be reamortized to eliminate a delinquency and the interest rate may be reduced up to 3 percent below the prevailing rate for new VA portfolio loans in order to lower the monthly installment payments. VA intervention through refunding is exercised in situations where the borrower has the ability to maintain the mortgage obligation or clearly will have that ability in the near future, but the holder has determined it would not be in its best interest to continue to extend forbearance.

When a borrower has no realistic prospects for maintaining even reduced mortgage payments, VA will encourage a private sale of the home to avoid foreclosure. We realize such a sale can be difficult to arrange if the property is worth less than the total amount owing on the loan, as is often the case in certain areas around the nation which have depressed housing markets. In such a situation, VA may be able to offer assistance by using a procedure which enables us to compromise a loan guaranty claim. This procedure can be considered if the difference between the loan indebtedness and the purchase price is less than the amount of VA's maximum

guaranty. If a veteran finds a buyer who will purchase the property for its fair market value, and the proceeds of the sale are applied to the existing indebtedness, a compromise agreement would enable VA to pay a claim for the difference between the sale price and the loan indebtedness.

When a borrower is unable to cure the default, refunding is not appropriate, and a private sale cannot be arranged, VA considers approving the acceptance of a deed in lieu of foreclosure. If acceptance of the deed will be in the best interests of both the borrower and VA, then VA will approve it. If a deed in lieu of foreclosure is not feasible, the holder will generally proceed with foreclosure.

VA's program is well-established and its success is being carefully measured. For each case where VA intervenes with a loan holder and arranges a repayment plan or other alternative which successfully avoids foreclosure, the Government avoids paying a claim under guaranty, which for Fiscal Year 1999 averaged over \$19,700. VA intervened in approximately 5,994 cases which achieved loan reinstatements during FY 1999 for a savings to the Government of \$118 million. VA employs about 300 Loan Service Representatives nationwide at a cost of approximately \$15 million, so the net savings are \$103 million.

In order to measure our success in assisting delinquent veteran borrowers, we have developed a measure known as the Foreclosure Avoidance Through Servicing Ratio (FATS). This measure calculates the impact of VA's successful interventions, deeds-in-lieu of foreclosure, compromise claims and refunded loans on the overall level of foreclosures. Simply put, it measures the extent to which foreclosures would have been greater if VA had not assisted veterans in accomplishing one of these alternatives. In FY 1999, the FATS ratio was approximately 37 percent. In other words, without VA involvement there would have been 37 percent more foreclosures.

At the end of FY 1999, VA had 122,288 loans in a seriously delinquent status (in danger of foreclosure) out of 3,171,862 loans outstanding. This translates to a current default rate of 3.86 percent. From fiscal year 1971 through fiscal year 1999, VA guaranteed 8,307,818 loans of which 648,844 were foreclosed. For that period the foreclosure rate was 7.8 percent.

Financial Audit

Finally, Mr. Chairman, let me address the Housing Credit Assistance Plan. The VA Inspector General (VAOIG) and GAO audited the agency's financial statements for FY 1997, and issued a "qualified opinion" listing 5 reportable conditions, 3 of which were related to the Loan Guaranty program. These were the in areas of program

financial reporting, the direct loan portfolio, and accounts related to guaranteed sales of vendee loans. VBA established a task force of Loan Guaranty, VBA Office of Resource Management, and VA Finance personnel, facilitated by the Associate Deputy Secretary for Financial Policy, to review these conditions and develop a plan of action to correct them. The plan has been developed and carried out and the OIG is again conducting its audit. We believe that our considerable efforts in the last year and a half will result in a favorable audit opinion for FY 1999.

Mr. Chairman, this ends my statement. I will be pleased to answer any questions you or the other members may have.

**STATEMENT OF
MICHAEL SLACHTA, JR.
ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF VETERANS AFFAIRS
BEFORE
THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON VETERANS AFFAIRS
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
HEARING ON LOAN GUARANTY IN VETERANS AFFAIRS
MARCH 16, 2000**

Mr. Chairman and Members of the Subcommittee, today I will present to you the Office of Inspector General's (OIG) views on the Department of Veterans Affairs (VA) Loan Guaranty Program. I will focus on Loan Guaranty Housing Credit Assistance Program Accounting, audits and investigations of Loan Guaranty Program Fraud, attributes of defaulted home loans, and the Loan Guaranty Service's quality control system.

Housing Credit Assistance (HCA) Program Accounting

At the end of Fiscal Year (FY) 1999, the Housing Credit Assistance (HCA) program loan guaranty liability totaled \$5.8 billion, and direct loans receivable and foreclosed properties awaiting sale totaled about \$3.6 billion; program subsidy costs totaled \$890 million for the year. The Department substantially completed corrective actions on conditions we reported on in prior years concerning serious weaknesses in direct loan portfolio, loan sales accounting, and Credit Reform subsidy model issues. Following the end of FY 1999, VA also began processing HCA program expenditures directly through VA's core financial system to resolve a Federal Financial Management Improvement Act noncompliance issue.

However, material internal control weaknesses remain that impede timely completion of financial statements and reduce the effectiveness of safeguards over HCA program resources. These six weaknesses are:

- The HCA General Ledger System is not compliant with Federal financial systems requirements.
- Detailed foreclosed property information in HCA program systems was not periodically reconciled to the HCA control accounts.
- About \$30 million of refunded loans which were processed at VA Regional Offices was not recorded in the HCA General Ledger System.
- Time lags existed in recording program transactions in HCA general ledger accounts.
- The liability for loan guarantees and related Credit Reform subsidy re-estimates could not be prepared timely because of HCA program and financial system weaknesses.
- Weaknesses in oversight of the contractor managing VA's \$1.8 billion direct loan portfolio increased the Government's vulnerability to losses.

The Veterans Benefits Administration had a number of organization and system changes underway to address the internal control weaknesses. Management officials informed us that their goal is to complete all corrective actions by the end of FY 2000. Timely implementation is important. Accurate, reliable, and timely financial reports are essential to enable managers to carry out their fiduciary and stewardship responsibilities to VA beneficiaries and the public. Without them, the HCA financial statements will continue to be prepared untimely and are vulnerable to error. Additionally, program assets and resources may not be efficiently used or adequately safeguarded.

Audits and investigations of Loan Guaranty Fraud

A goal of the Office of Inspector General is to ensure that all indications of serious criminal matters, impacting the loan guaranty program, are thoroughly investigated and referred to the Department of Justice or appropriate state agency for prosecution. The Office of Inspector General is conducting proactive and reactive reviews of defaulted and foreclosed VA loans to identify possible loan origination fraud and property management fraud.

Loan Origination Fraud

Loan Origination fraud occurs in VA's home loan program. Loan origination fraud results when incorrect or falsified information is used to obtain or sell a

guaranteed or insured mortgage. The Office of Inspector General's proactive and reactive reviews of defaulted and foreclosed VA loans have focused on certain geographical areas with high default rates. As a follow-on to this review of high default areas, we audited the underwriting practices of six lenders (three in North Carolina and three in Georgia). We found potential fraud indicators in four of the six audits, in which lenders may have underreported the borrowers' dependents (which requires more family income) and may not have disclosed some of the borrowers' debts in the loan analysis. We also identified other practices that may or may not have been intentional but which contributed to the perception that the applicants were acceptable risks. The cases involving possible fraud are under investigation by our office. An example of a recent investigation is:

- A joint investigation by VA OIG, U.S. Postal Inspection Service, and HUD OIG resulted in the arrest of four individuals on charges that they engaged in a loan origination fraud scheme for properties with loans being guaranteed by VA and HUD. An attorney and a real estate agent were both arrested after an investigation disclosed that they submitted documents to the Government which contained false information regarding applicant's income, assets, and liabilities. Also arrested was an individual formerly employed by a new home developer after investigation disclosed that the individual allegedly produced fraudulent Internal Revenue Service W-2 forms and other employment verification documents for the potential homebuyers. The fourth person arrested thus far was a real estate appraiser, arrested after it was disclosed that the individual allegedly appraised properties above market value. With the appraised value of the home inflated, the mortgage bank was able to issue a loan for greater than the actual value enabling the buyer to pay off personal debt with the difference. Although the total loss to the Government is unknown at this time, the exposure is in excess of \$1.2 million. The investigation continues.

Property Management Fraud

Investigations into property fraud focused mostly on equity skimming. Equity skimming fraud involves profiting by assuming or purporting to assume existing loans, renting the homes to tenants, not making payments, and stealing the rental proceeds while the loan foreclosure is being processed. For example:

- An individual was sentenced to 78 months' imprisonment, a fine of \$15,000, and court ordered restitution in the amount of \$571,000 after conviction at a jury trial on charges of equity skimming, mail fraud, bankruptcy fraud, and money laundering. A VA OIG investigation disclosed that the individual fraudulently assumed 61 properties with mortgages guaranteed by VA or insured by HUD, rented the homes, and kept the rent monies for himself without making the required mortgage payments. His actions caused all of the loans to go into default and eventual foreclosure. In addition, he delayed

foreclosure proceedings by filing multiple bankruptcies under fictitious names. He deposited and withdrew large sums of cash, so that he could launder the illegal proceeds of the scheme.

Attributes of Defaulted VA Home Loans

The Office of Inspector General reviewed the effect of the implementation of VA's Housing Credit Assistance program policies on loan defaults. Our review found that:

- (1) Loans made to active duty service members defaulted more often than loans made to veterans, and also tended to default earlier in the loan period. Service members may be more prone to default on loans due to several factors, including: inexperience at handling debt and difficulty in coping with mortgages when transferred to other duty stations or after being discharged.
- (2) Loan defaults were also higher in vicinities with declining home values. Borrowers in those vicinities were having difficulty dealing successfully with mortgages or disposing of properties when their income was curtailed. For properties we reviewed, the average loss in value from the original appraisal to the liquidation appraisal was about 19 percent. There is little that VA can do to prevent losses and reduce defaults in vicinities with declining home values.

Loan Guaranty Service's Quality Control System

A recent review of Loan Guaranty Service's quality control system¹ concluded that several quality control conditions required management attention:

Loan Guaranty Service Management had not Periodically Updated Their Management Control Plan or Completed Internal Control Reviews

Loan Guaranty Service management had not updated their Management Control Plan, identifying high-risk areas in over 5 years nor had they completed required Internal Control Reviews of those areas in over 3 years. Internal Control Reviews are a primary method of identifying waste, fraud, and abuse.

Statistical Quality Control Reviews had not Identified Many Deficiencies

Loan Guaranty Services recently revised Statistical Quality Control program had not identified a significant number of deficiencies concerning compliance with Loan Guaranty Services policy and procedures.

Timely Reporting Would Improve the Lender Monitoring Unit Effectiveness

¹ Evaluation of Loan Guaranty Service's Quality Review System, Report No. 99-00159-42, dated 2/28/2000.

The Lender Monitoring Unit had not issued timely reports identifying loan underwriting deficiencies. We found that the Monitoring Unit actively reviewed lender underwriting and sent timely draft reports to Loan Guaranty Services management, but management had not issued timely final reports to the lenders. For Fiscal Year 1999, the Monitoring Unit had completed eight evaluations and draft reports, but as of August 1999, Loan Guaranty Services management had not issued any of the reports. The reports are important because they frequently result in improved underwriting and in lenders indemnifying VA for egregious underwriting resulting in foreclosure or VA having to pay the guarantee. Lenders indemnify VA for the guaranteed amount of the loan resulting from egregious underwriting, currently a maximum of \$36,000.

Oversight of Direct Loan Servicing Needed Improvement

VA's oversight of the contractor servicing VA's direct loans had not ensured that loans were actively serviced. In June 1997, Loan Guaranty Service contracted for the servicing of its direct loan portfolio. As of September 30, 1999, the portfolio included about 29,000 direct loans with an unpaid principal balance valued at \$1.8 billion. About 3,200 of these loans, with an unpaid principal balance valued at \$209 million, were in serious default. VA defines seriously defaulted loans as those that are 5 or more months delinquent. The borrowers who are in serious default would need to pay \$36 million to clear their outstanding delinquencies.

Our review of a sample of seriously defaulted direct loans revealed a number of contractor performance deficiencies.

- In 67 percent of the cases tested, the contractor had not actively serviced the loans.
- In 33 percent of the cases, the contractor had not timely referred seriously defaulted loans for foreclosure.
- In 24 percent of the cases, the contractor had not routinely monitored bankruptcy cases.

The 3,200 seriously defaulted direct loans in the portfolio included about 1,700 with an unpaid principal balance valued at \$110 million, where the borrower had filed for bankruptcy protection. Foreclosure action had not yet been initiated on the remaining 1,500 seriously defaulted loans, with an unpaid principal balance valued at \$99 million. On the loans in our sample where the contractor had not made a timely foreclosure referral, the average delinquency was 11 months, with an average unpaid principal balance of \$66,900. The average amount necessary to clear the delinquencies on these loans was \$6,400. For the loans where the bankruptcy was not routinely monitored, the average delinquency was

47 months, with an average unpaid balance of \$72,400. The average amount necessary to clear the delinquencies on these loans was \$27,000.

In June 1997, at the time loan servicing was outsourced, Loan Guaranty Service had established a Portfolio Loan Oversight Unit (PLOU) to monitor the contractor's performance. We found that the PLOU currently relies on the contractor's self-generated reports to evaluate its performance. However, the contractor's reports contained data that the PLOU can not validate. The PLOU also planned quarterly site visits to the contractor's headquarters, but due to limited travel resources only two visits were made during FY 1999. We also found that Loan Guaranty Service did not monitor the servicing of potential foreclosure and bankruptcy cases to ensure appropriate and timely action was taken to prevent unnecessary loss of government funds.

As Loan Guaranty Service reorganizes and, in some instances outsources, its activities, it is essential that program integrity is maintained through close oversight of not only its own operations, but those of contractors and program participants as well.

This completes my statement Mr. Chairman. I would be pleased to answer any questions you and the committee may have.



**Statement of the Mortgage Bankers Association of America
On the Oversight Hearings on the
Department of Veterans Affairs Loan Guaranty Services
by the House Subcommittee on Oversight and Investigations**

March 16, 2000

The Mortgage Bankers Association of America (MBA)¹ is pleased to submit this statement for the record of the hearings by the House Subcommittee on Oversight and Investigations on the Department of Veterans Affairs Loan Guaranty Services.

The Department of Veterans Affairs Loan Guaranty Service (VA) guaranteed approximately 485,000 loans totaling nearly \$54 billion during the past fiscal year. As the organization whose members originate approximately 75% of all VA mortgages, the Mortgage Bankers Association of America (MBA) has an obvious interest in the oversight and improvement of the VA program and we appreciate this opportunity to provide written testimony to the Subcommittee on Oversight and Investigations.

MBA commends the VA for the improvements that it has made to its program in the last few years. In particular, MBA applauds the recent efforts by VA to automate various functions. VA approval of Freddie Mac and Fannie Mae automated underwriting systems for use with VA loans has been a major step forward in automation. The implementation this past December of the process to

¹ MBA is the national association representing exclusively the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and foster excellence and technical know-how among real estate finance professional through a wide range of educational programs and technical publications. Its membership of 3,100 companies includes all elements of real estate finance: mortgage companies, mortgage bankers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field.

allow lenders to obtain loan guaranty certificates by electronic data interchange (EDI) is a major improvement in customer service for lenders and borrowers. Lenders are receiving loan guaranty certificates in a few days, instead of several weeks. Also, the new VA Appraiser Assignment System enables lenders to obtain case numbers and appraiser assignments over the Internet, without any intervention from VA staff, and is a vast improvement over the prior process.

MBA and our members look forward to other automated systems that are planned by VA to improve customer service further. These include enabling appraisers to send appraisal reports to VA electronically and allowing lenders to access VA records to make determinations concerning a veteran's eligibility for home loan benefits. Increased use of technology can only enhance the VA program and we encourage the VA to continue to look for ways to take advantage of it. Lenders must meet the continuing demands of the marketplace and demands by borrowers for faster processing and more efficient program delivery and the VA must keep stride with lenders to meet these demands.

However, like all entities in the mortgage finance arena, VA faces many important challenges in the years ahead. Nevertheless, there are certain principles that should guide any reform of the VA program. These principals include preserving the no downpayment feature of the program and converting the program to a full insurance program similar to the Federal Housing Administration (FHA).

The no downpayment feature of the VA program is its single greatest advantage and must be preserved. It is our understanding that, currently, 91% of VA borrowers make no downpayment and that the majority of VA borrowers have less than \$3900 in cash assets. Clearly, without the no downpayment feature of the VA program, many veterans would be denied affordable homeownership opportunities and the ability to accumulate wealth through homeownership.

The main reason the VA program is not more successful, is because of its claim payment system. VA "no bids," where the VA pays the guaranty and leaves the lender to dispose of the property (instead of VA paying the full amount of the loan to the lender and acquiring the property), expose lenders to a higher risk of loss. This discourages many lenders from participating in the VA program. Converting the VA program to a full insurance program similar to FHA would eliminate the problem of "no bids" for lenders and, therefore, encourage greater lender participation in the program. By encouraging greater lender participation, the benefits of the VA program could be more far-reaching and more easily extended to rural and other under-served areas.

We also recommend the following short-term program changes to modernize and expand homeownership opportunities for veterans:

Index VA Guaranty Amount

The maximum VA amount of entitlement is \$36,000 (or for certain properties over \$144,000 the entitlement is \$50,750). Because of secondary market considerations, this results in a maximum VA loan amount of \$144,000 or in some cases, \$203,000. MBA believes that the entitlement amount should be increased to \$63,175 (a \$252,700 loan amount) to match the conforming loan amount and then be indexed so that it matches increases in housing costs in the future. In this way, veterans' housing choices will not be overly restricted because of increases in housing prices.

More Diversified Loan Products

MBA believes that VA must diversify its loan products if it is to continue to offer veterans adequate housing choices. In 1992, a VA Adjustable Rate Mortgage (ARM) program was established only to expire in 1995. We strongly support the reinstatement of a one-year ARM product with interest rate increase caps that will minimize risks associated with this product. In addition, prudent underwriting criteria can make ARMs safe for both borrowers and lenders. In addition, we would urge the Congress to consider a "hybrid" ARM product, where the initial interest rate would be fixed for a minimum period of three, five or seven years and then adjust annually thereafter. These hybrid ARMs are less risky than a regular one-year ARM and should be considered in conjunction with a one-year ARM product or at least, as an alternative product.

With the aging of the veteran population, the VA must also consider offering reverse mortgages. Reverse mortgages would allow elderly veterans to convert the equity in their homes into monthly income or cash to help them remain in their homes. MBA believes that this product would be useful to many older veterans.

Modernize the Appraisal Process

MBA strongly supports modernizing the VA appraisal process to conform to the way appraisals are managed in the rest of the marketplace. In virtually all other conventional and government loan programs, lenders have been given the responsibility to select appraisers and manage the appraisal process. This approach would standardize the process and be more efficient than the present VA system. Past VA concerns about possible poor appraisal quality are mitigated by the fact that all appraisers are now state licensed or certified. At the very least, under its

Lender Appraisal Processing Program (LAPP), VA could allow employees of the lender who are Direct Endorsement approved by FHA to review appraisals.

Interest Rate Reduction Refinancing Loans (IRRRLs)

MBA continues to oppose the provision that requires VA to approve an IRRRL when the loan being refinanced has a payment more than 30 days past due. Submission of these loans to VA for approval causes needless delays and increases costs to borrowers. MBA supports a compromise position to the 30 days past due requirement. We recommend that VA modify the definition of "current" loan to allow payments to be up to 59 days past due and thus allow these loans to be processed by lenders under the VA automatic process. This change will save time and reduce costs for borrowers, lenders and the VA.

Automation of Loan Administration Area

MBA encourages VA's continued efforts to automate its loan administration procedures. VA and servicers stand to benefit from greater automation by freeing up valuable personnel resources and reducing costs. VA has already developed a number of technological enhancements that will improve efficiencies both at the lender level and at VA. We would like to take this opportunity to offer some additional suggestions for a specialized website for servicers.

In particular, we encourage VA to allow servicers to:

- 1) access bidding instructions from VA websites. Such an enhancement would eliminate the need for lenders to contact VA staff, would reduce paper, and provide the information more timely. The end result is fewer delayed foreclosure sales and reduced losses for lenders, especially in no-bid cases. Several of the Regional Loan Centers currently offer this enhancement. We encourage the other regional offices to make this information available on the Internet as well.
- 2) submit Notices of Election to Convey to VA via the Internet or EDI;
- 3) access VA Payment Advices on the Internet to provide a more efficient cross reference to payments received from Treasury on Claims and Notices of Election to Convey. It would be helpful if the Payment Advice included the lender's reference number in addition to the VA's loan numbers.

- 4) obtain property values. MBA is pleased with the ability to order liquidation appraisals through the Appraisal Assignment System and we look forward to being able to view the appraised value on the Internet as well. We understand VA is working to provide this feature in the future. We encourage its development.
- 5) obtain basic information on VA records, such as the ability to verify VA loan number and guarantee amount.
- 6) submit the claim form electronically. Currently, the claim process is a manual, paper based process that requires submission of many original documents. The paper intensive process leads to errors and inaccuracies and is overly burdensome on VA staff.

Reimbursement of Bankruptcy Expenses

Lastly, the industry encourages VA to consider providing reimbursement for bankruptcy attorney fees that are reflective of the market cost. Currently, VA provides reimbursement in the amount of \$100 per court appearance (plus \$75 filing fee). Unfortunately, this is grossly inadequate to cover the expenses associated with bankruptcy attorneys' fees and results in the lender incurring losses of \$300-\$400 per bankruptcy.

MBA looks forward to working with the Congress and VA to improve the VA program and if any additional information is needed, please contact Elaine Z. Graham, Senior Staff Vice President, Government Affairs Group, (202) 557-2805.

**STATEMENT OF
JAMES B. HUBBARD, DIRECTOR
NATIONAL ECONOMIC COMMISSION
THE AMERICAN LEGION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
ON
SUPPORT FOR THE VA HOME LOAN GUARANTY SERVICE
MARCH 16, 2000**

Thank you, Mr. Chairman, for the opportunity to testify on behalf of the 2.8 million veterans of The American Legion. The Home Loan Guaranty Program continues to be of major importance to the people who have served honorably in the Armed Forces of the United States. The Home Loan Guaranty Program was a critical component of the Serviceman's Readjustment Act of 1944, the original GI Bill written by The American Legion. Over the years, not only have 16.5 million veterans benefited from this visionary program, but also both the home building industry and the financial community prospered. Clearly, the success of this program is well documented and must be continued for future veterans and their families.

At the outset, The American Legion is generally pleased with the operation of the Home Loan Guaranty Program. The American Legion believes VA has done its best to keep this program accessible and user friendly, while at the same time keeping the interests of veterans as the primary focus of its decision making process.

Ample evidence of this practice exists. Let me offer one example. In 1980, Congress authorized a program called Interest Rate Reduction Refinancing Loans that allowed veterans to take advantage of lower interest rates by refinancing their existing VA home loans. To encourage veterans to refinance, at least one lender contacted eligible veterans and offered a "deal." The lender suggested veterans to skip two or three payments on their existing mortgages. The lender would then refinance these loans at a lower rate, rolling in the missed payments and some "other fees" into the new

loans. In some cases, veterans found the total of the new loans were actually greater than their previous loans and the new monthly payments were actually higher.

In June 1998, VA initiated rulemaking to stop this irresponsible and unethical practice. The new rule prohibited lenders with automatic approval authority from approving any refinancing of loans delinquent more than thirty days. A private sector mortgage company began a national campaign to discredit VA's rulemaking effort. The new rule took effect in June 1999 even though the Mortgage Company filed a lawsuit.

The new rule does not prevent veterans from refinancing. It simply stops lenders from using predatory lending practices to gouge veterans. The new rule also discourages veterans from intentionally skipping one or more mortgage loan payments and unwittingly creating a bad mark on their credit histories. This is a prime example of VA's Loan Guaranty Service looking out for the best interests of veterans.

There is a move in the Federal government to make programs more useful to participants by using information technology. This is a laudable effort provided the proposed actions are advantageous, progressive, and taken with proper foresight. This new effort in the Loan Guaranty Program would help speed up the application process and allow lenders to submit information to VA for issuing a Certificate of Eligibility in an electronic format. The lender would receive certificates back in a more timely matter. This new technology would be a tremendous benefit to veterans. Currently, veterans have to plan for delays in settlement while waiting patiently for their Certificate of Eligibility to arrive. The American Legion heartily supports this initiative. Likewise, other technology efforts to improve the interface between veterans, lenders and VA, to enhance loan servicing, to improve financial counseling with delinquent veterans, to automated loan application, and to expedite loan approvals would significantly enrich this program for eligible veterans.

Mr. Chairman, with respect to consolidation, The American Legion is concerned that in the proposed plan to restructure the loan processing and servicing from its

current 45 regional offices to just 9 regional service centers, most of the existing West Coast regional offices disappear. The Los Angeles Regional Office is to be closed this August and the home loan operations transferred to Phoenix. The American Legion realizes there are efficiencies to be found in consolidating work of this nature; however The American Legion questions the wisdom of closing the office with roughly 10 percent of the nation's veterans population. The American Legion suggests VA reconsider this decision and evaluate the possibility of making one of the regional service centers in Los Angeles.

For some years now, VA's loan servicing program provided financial counseling for veterans delinquent in loan payments. The ultimate goal was to keep veterans in their homes. In some cases, VA would seek forbearance of the loan with the lender. In other cases, VA would purchase the loan from the lender and then counsel with the delinquent veteran to bring the payments up to date. In situations when there seems to be no realistic hope of bringing the loan up to date, a private sale is encouraged. In some extreme situations, a deed in lieu of foreclosure is proposed.

In all cases, VA has the interests of both the lender and the veteran in mind. Every effort must be made to protect the lender's financial investment and to preserve the veteran's credit rating, when other alternatives are available. The American Legion believes this program should definitely be continued, since it produces an annual net savings to taxpayers of over \$100 million.

Mr. Chairman, The American Legion appreciates the opportunity to take part in this oversight hearing on an important veterans' readjustment benefit program that has helped so many Americans become homeowners.

**The
American
Legion**



For God and Country

★ WASHINGTON OFFICE ★ 1608 "K" STREET, N.W. ★ WASHINGTON, D.C. 20006-2847 ★
(202) 861-2700 ★ FAX (202) 861-2728 ★

March 16, 2000

Honorable Terry Everett, Chairman
House Veterans' Affairs Subcommittee
On Oversight and Investigations
337-A Cannon House Office Building
Washington, DC 20515

Dear Chairman Everett:

The American Legion has not received any federal grants or contracts, during this year or in the last two years, from any agency or program relevant to the subject of the March 16 hearing concerning Support For The VA Home Loan Guaranty Service.

Sincerely,

James Hubbard, Director
National Economic Commission



S
SERVING
WITH
PRIDE

**STATEMENT OF
PETER S. GAYTAN
NATIONAL LEGISLATIVE DIRECTOR**

**U.S. HOUSE OF REPRESENTATIVES
BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS**

**DEPARTMENT OF VETERANS AFFAIRS
LOAN GUARANTY SERVICE**

**THURSDAY, MARCH 16, 2000
10:00 AM
334 CANNON HOUSE OFFICE**



A M V E T S

**NATIONAL
HEADQUARTERS
4647 Forbes Boulevard
Lanham, Maryland
20706-4380
TELEPHONE: 301-469-9600
FAX: 301-469-7924
E-MAIL: amvets@amvets.org**

Mr. Chairman and Members of the Subcommittee:

It is a pleasure for me to appear before you today on behalf of the more than 250,000 members of AMVETS to provide our recommendations for the Department of Veterans Affairs Loan Guaranty Service. Neither AMVETS nor myself has been the recipient of any federal grants or contracts during FY2000 or the previous two years. Originally established by the Servicemen's Readjustment Act of 1944, the VA Loan Guaranty Service has enabled millions of American Veterans to purchase their own homes. With its no down payment feature, the Department of Veterans Affairs (VA) Loan Guaranty Service makes mortgage credit available to many veterans who otherwise would not have been able to become homeowners. We believe this benefit continues to be an important one for veterans.

PROGRAM MANAGEMENT AND PERFORMANCE

Today, the VA Loan Guaranty Program provides housing credit assistance to veterans, active-duty personnel and eligible surviving spouses. VA guaranteed loans are made by private lenders to eligible veterans for the purchase of a home which must be for their own personal occupancy. Once the loan is approved by a lender VA will guarantee a portion of it to the lender. This guaranty protects the lender against loss up to the amount guaranteed and allows a veteran to obtain favorable financing terms. A VA guaranteed loan can be used by veterans to purchase a home, build a home, repair a home, refinance an existing loan or to buy a manufactured home.

AMVETS is encouraged by the efficiency of the VA Loan Guaranty Service and the timeliness in which veterans are receiving assistance in processing VA guaranteed home loans. One AMVET member and first-time homebuyer in the state of Delaware was overwhelmed by the assistance he received recently from his state VA Loan Guaranty office. This AMVET is also an active duty Staff Sergeant stationed at Dover Air Force Base, who due to mission requirements was unable to travel to the state VA office in Wilmington to receive his certificate of eligibility. Knowing that the loan process would be delayed until the certificate was received, the state VA Loan Guaranty representative

delivered the certificate to the family readiness center on the Air Force Base, allowing this veteran to proceed with his home purchase in a timely manner.

We are further encouraged by the proactive approach being taken by the national office to streamline the VA loan process and to further automate their services through the use of the Electronic Data Interchange (EDI) and by providing forms and information on the Internet. EDI allows members to transmit loan data to VA loan offices and receive notification of guaranty of the loan electronically, which will eventually lead to a paperless process. Many commercial lenders and mortgage companies have already converted to electronic systems of loan processing. We believe VA must continue to move forward in this area to remain consistent with the abilities of their private sector partners, thereby ensuring the availability of this important veterans benefit in years to come.

LOAN UNDERWRITING AND SERVICING

The VA Loan underwriting process has been improved in recent years by the automated loan underwriting system. VA, joined with Freddie Mac to develop a VA loan version of Freddie Mac's automated underwriting system called, Loan Prospector. The VA version of Loan Prospector allows lenders to enter data into the system over their computer and receive an underwriting recommendation electronically within 4 minutes of transmitting the data. This allows veterans to take advantage of the same processes that are available to conventional borrowers. AMVETS applauds the VA Loan Guaranty Service for recognizing the trends in the commercial lending arena and implementing this valuable new service for veterans.

One of VA's critical functions is to assist veterans in keeping their homes, or when needed, helping a veteran through the foreclosure process. Once a lender has reported to VA that a veteran is seriously delinquent on their mortgage payments, VA will contact the veteran and offer assistance in retaining the home or resolving the issue at the lowest possible cost to the veteran and VA. Costs to the government are reduced when VA is able to pursue an alternative to foreclosure and veterans are helped by either saving their

home or avoiding the expense and damage to their credit rating caused by a foreclosure. Alternatives to foreclosure can include refunding of the loan which allows the veteran to stay in the home and make loan payments directly to VA; VA intervention with the lender on behalf of the veteran to set up a repayment plan; a compromise claim for the difference of the loan when the lender is forced to sell at a cost lower than the amount of the loan; and accepting deeds in lieu of foreclosure.

AMVETS applauds VBA for implementing the Loan Service and Claims System last year. This system automates routine service activities, improves efficiencies and allows employees to concentrate on supplemental servicing that directly benefits veterans. It also provides valuable support to the ongoing effort to consolidate guaranteed loan servicing at the nine Regional Loan Centers (RLC's).

Although the new system has improved the efficiency of the servicing program, AMVETS supports VA's claim that a redesign effort is required to incorporate updated requirements and processes into the existing system. By further automating the servicing system, VA would improve overall efficiency, provide more accurate data, improve customer service and workload management and ultimately ensure that more veterans are able to keep their homes.

PROPERTY INVENTORY MANAGEMENT AND FORECLOSURE RATES

AMVETS agrees with VA's position on purchasing foreclosure properties when it is in the best interest of the government to do so. Before VA will purchase a property to avoid foreclosure, a review is made of the net value of the property, and the unguaranteed portion of the debt. VA accepts conveyance of the property if by purchasing the property it reduces the maximum claim payable to the lender. In 1997, VA reduced its claim liability by \$136 million by acquiring foreclosure properties.

Additionally, AMVETS supports the A-76 Cost Comparison being conducted by the VA. This study will provide a cost comparison of VA's nationwide Property Management Operation to determine whether it would be more efficient and cost-effective to continue

to perform the work of the operation using government employees and resources, or to obtain property management services through commercial sources.

VA measures its success in assisting veterans who are facing foreclosure through the Foreclosure Avoidance Through Servicing (FATS) ratio. This measures the percentage of foreclosures that are avoided after VA intervention. Through continued automation of services, sufficient staffing and cost effective operations AMVETS believes that VA's foreclosure avoidance goals will be achieved. The VA Loan Guaranty Program is effective and accomplishes it's objective of effectively assisting veterans and active duty servicemembers in purchasing and retaining homes.

Mr. Chairman, that concludes my report. On behalf of the members of AMVETS, I thank you again for this opportunity to present our views before this committee

NATIONAL MILITARY AND VETERANS ALLIANCE

Telephone: (703) 750-2568

Fax: (301) 899-8136

STATEMENT OF

BENJAMIN H. BUTLER

National Association for Uniformed Services

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS
VETERANS AFFAIRS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

ON

Department of Veterans Affairs Loan Guaranty Service

16 MARCH 2000

NATIONAL MILITARY/VETERANS ALLIANCE

5535 Hempstead Way Springfield, VA 22151

CURRICULUM VITAE AND ORGANIZATIONAL DISCLOSURE STATEMENTS

Benjamin H. Butler
Associate Legislative Counsel
National Association for Uniformed Services

Master Gunnery Sergeant Butler, US Marine Corps, Retired, has been an Associate Legislative Counsel, the Director of Chapter Management and an Associate Director of the Legislative Political Action Team at NAUS since August 1996.

MGySgt Butler's military career spanned 21 years of active service. His years in the military started with the infantry, serving with the 2nd Marine Division at Camp Lejeune NC and as an instructor at Officers Candidate School in Quantico VA. He also spent several years working as a recruiter. He worked at all levels of recruiting for the Marine Corps starting as a canvassing recruiter. He also managed several different recruiting stations in both upstate NY and the Washington DC area. He also served as a Regional Recruiter Instructor as well as an Instructor at Recruiters' School in San Diego CA. MGySgt Butler then spent 4 years as a member of the national training team for Marine Corps recruiting in Washington DC. During this tour he traveled from coast-to-coast, assisting recruiters and recruiting commanders. He has had extensive training in sales and management and is certified as a sales and management trainer.

Disclosure

Neither the National Military Veterans Alliance, or the National Association for Uniformed Services (NAUS) have received grants (and/or subgrants) or contracts (and/or subcontracts) from the federal government for the past three fiscal years.

Mr. Chairman and distinguished members of the Committee, the National Military Veterans Alliance would like to express its appreciation to you for holding these important hearings. The testimony provided here represents the collective views of our members (See Exhibit A).

The National Military Veterans Alliance (NMVA) is a loosely confederated group of 21 different military and Veteran associations with a combined membership of 3.5 million nationwide. Collectively we represent all seven of the uniformed services, all ranks, all grades, all components, family members and survivors and we collectively work from an annual set of Alliance goals and objectives.

Mr. Chairman, the National Military and Veterans Alliance strongly supports the Veteran's Loan Guarantee Program. A benefit program is still necessary to assist veterans with obtaining home loans.

The no down payment provision of the DVA loan guaranty program gives the program a significant advantage over commercial lending institutions. Further, the qualification criteria used in determining eligibility for a DVA guaranteed loan is less stringent than that for a commercial loan. For example, the debt to income ratio is more lenient in DVA than in commercial lending and the residual income formula is also more generous. These items give veterans a distinct advantage in loan qualification in DVA that is not commercially available.

As currently structured, the DVA loan guaranty program primarily attracts only the marginally qualified veteran homebuyer. We would like to recommend that fees, closing costs, and down payment requirements should be restructured to attract all veteran buyers, thereby reducing the overall risk to the program. The best way to attract new veterans is to eliminate fees.

In addition to the structure of the benefit, the structure of the program itself also needs to be changed. If DVA is going to remain in the home loan business, they should be allowed to do so in a competitive way. There is no reason why DVA should write only high-risk loans. DVA should be able to compete across the mortgage spectrum. As opposed to the current structure of the program, DVA should be able to write it's own loans and maintain a portfolio of income producing loans. In short, DVA should be allowed to do the same things as the commercial home loan industry.

NMVA supports any program that provides housing assistance to veterans. We believe that any such programs should preserve the no down payment feature, as well as the more liberal qualification criteria of the current DVA program.

Reusability of the home loan benefit is another important feature. We believe the reusability feature is of tremendous importance, particularly for active service members who are required to relocate many times during a career.

In the past it was recommended that this program be administered by an agency, other than the Department of Veterans Affairs, such as the Department of Housing and Urban Development. As a general proposition, NMVA has no objections. Experience though cautions us to not give this notion a blanket endorsement. Within the Department of Veterans Affairs, veterans are the focus and the priority. That's not the case for veterans programs within other agencies. Under the National Housing Act loan program, HUD currently administers a loan program for veterans – but few veterans even know that it exists.

If veterans housing programs were transferred to HUD, an Assistant Secretary for Veterans Programs would have to be established, just as we established the Assistant Secretary position in the Department of Labor. Even an advocate in HUD, to make certain the interests of veterans are protected and visible within the agency, might not be enough in NMVA's view. The legislation authorizing such a transfer would have to be very clear and explicit as to the priority to be accorded to veterans.

Finally we would like to make the following suggestions on the appropriate "mix" of benefits for veterans in the 21st century.

NMVA believes the loan guaranty program for members of the Selected Reserve has been a success. As the Committee knows, the Reserve loan guaranty program was authorized as a temporary initiative. We believe the program should be permanent. In addition to making the Reserve Loan guaranty program permanent, NMVA believes two other changes should also be made.

We see no logical basis for the disparity in funding fees between the regular program and the Reserve loan guaranty program - funding fees for Reservists are three-quarters of a percentage point higher. In our view, funding fees should be identical for all loan guaranty program participants.

We also believe that eligibility for the Selected Reserve Loan guaranty program should be revised and clarified. Currently, a Guard or Reserve member can only qualify for the benefit by drilling six years. It seems to us that qualification for the benefit should be established if the member honorably satisfies the terms of their enlistment or period of obligated service. In other words, an enlistment for six or eight years, that requires three or four years of participation in the Selected Reserve, followed by either Individual Ready Reserve or Standby Reserve service, should satisfy the qualification criteria. Today, there are less Guard or Reserve initial enlistment programs that require a full six years of drilling participation in the Selected Reserve. The governing criteria to establish eligibility should be honorably satisfying the terms of enlistment or obligated service.

The 1984 Tax Act imposed several restrictions on the issuance by the States of tax-exempt bonds to fund home loan mortgages made to veterans. A major restriction was the narrowing of the class of veterans eligible to receive mortgage loans under a state program. Specifically, the Act provided that a veteran must have served on active duty before 1977 to be eligible for a loan. This restriction was enacted as part of a general cutback in the authority of states to issue tax-exempt bonds.

The rule, requiring pre-1977 active duty, means that fewer and fewer veterans are eligible for loans under state veterans mortgage programs. Obviously, the great majority of the servicemen and women in the Persian Gulf were not in the armed forces before 1977. In NMVA's view, the pre-1977 active duty rule is unfair in forcing the states to exclude these veterans from mortgage programs.

NMVA believes that section 143(1)(4) of the Internal Revenue Code should be deleted and thereby establish eligibility under state veterans mortgage programs for members who enlisted after 1976.

Conclusion

In conclusion Mr. Chairman, National Military and Veteran's Alliance thanks you again for this opportunity. We believe that the DVA Loan guaranty program is a valuable and important benefit that should be retained. Without question though, the program has eroded over the years. The attention of this Committee to help restore the DVA Loan guaranty program to its full potential, as a tangible benefit for all veterans, is genuinely appreciated.

Thank you.

NATIONAL MILITARY/VETERANS ALLIANCE

Air Force Sergeants Association
American Military Retirees Association
American Military Society
American Retirees Association
Catholic War Veterans
Class Act Group
Gold Star Wives Of America
Korean War Veterans Association
Military Order Of The Purple Heart
Military Order Of The World Wars
Legion Of Valor
National Association For Uniformed Services
Naval Enlisted Reserve Association
Naval Reserve Association
Non Commissioned Officers Association
Society Of Medical Consultants
The Retired Enlisted Association
TREA Senior Citizen League
Tragedy Assistance Program For Survivors
Veterans Of Foreign Wars
Vietnam Veterans Of America
Women In Search Of Equity

Exhibit A



THE UNDER SECRETARY OF VETERANS AFFAIRS FOR BENEFITS
WASHINGTON, D.C. 20420

MAR 30 2000

The Honorable Terry Everett
Chairman
Subcommittee on Oversight and Investigations
Committee on Veterans Affairs
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Everett:

I would like to thank you for your ongoing interest in VA's Loan Guaranty program and for your gracious comments at the recent Loan Guaranty hearing in response to the testimony of Congressman Ackerman before the subcommittee.

I am very concerned about the personal comments made by Congressman Ackerman regarding Keith Pedigo, Director of VA's Loan Guaranty Program. Mr. Pedigo is a well-respected and competent civil servant who won the Presidential Rank Award in 1998. That noted, I regret very much that Congressman Ackerman has such an unfavorable opinion of our Loan Guaranty program and believe that a number of the assertions made by the Congressman in his testimony are based on misinformation or misinterpretation of VA policies and procedures. As such, I am providing you with the attached information paper in response to Congressman Ackerman's testimony. The information paper provides clarifying information on VA's Interest Rate Reduction Refinancing Loan (IRRRL) program and addresses several other issues raised in the hearing.

We would appreciate it if you would make the enclosed information paper part of the Official Record of the March 16, 2000, Oversight Hearing. Thank you.

Sincerely,


Joseph Thompson

Enclosure

Information Paper
 Clarification Regarding the Management, Operations and Policies
 of the VA Loan Guaranty Program

In testimony before the HVAC Subcommittee on Oversight and Investigations, a number of issues and assertions were raised regarding the management, operations and policies of the VA Home Loan Guaranty program. This information paper provides clarifying information and corrects any misimpression's that may have occurred as a result of non-VA witness testimony.

1. Issue: Has the VA decided to enter into the mortgage banking business and does it retain a large portfolio of non-marketable loans."

VA Response: While VA does not consider itself to be in the mortgage banking business, our statute does provide authority to engage in certain types of direct financing. This results in a portfolio of loans. VA's loan portfolio consists of several types of loans. These loans may or may not be sold for various reasons.

(a) First are vendee loans, which are made to finance the sale of properties acquired as a result of the termination of VA-guaranteed loans to veterans. Numerous studies have demonstrated that VA is able to recover more of its investment in acquired properties through the use of vendee financing. In fact, at one point Congress required that a minimum percentage of properties be sold only for cash. The resulting losses on resale soon led to the non-renewal of this statute when it reached its sunset.

Most newer vendee loans are sold within six months of origination, during one of VA's scheduled securitized loan sales. If a loan is seriously delinquent, it is not sold because it could have an adverse impact on the performance of that loan pool, and possibly affect the price VA obtains in future sales. It is usually less costly to retain such a loan in portfolio until reinstated or terminated. Many older performing vendee loans have interest rates which are higher or lower than current rates, and it would be less beneficial to sell those loans than to retain them in portfolio and receive regular monthly payments.

(b) A second type of loan in VA's portfolio is the refunded loan. In some cases prior to termination of a VA-guaranteed loan, our experienced Loan Service Representatives may decide that the veteran's circumstances have improved to the point where he or she can resume making regular house payments, but the loan holder is unwilling to extend additional forbearance. VA then may refund (i.e., purchase) the loan from the private holder and retain it in the loan portfolio. VA has not made a practice of reselling these loans for

a number of reasons. In many cases the loans have been reamortized to make the monthly payments more affordable for the veterans, which in turn makes them less attractive for sale to private investors. Also, VA often reduces the interest rate to increase affordability, which decreases salability. And in some cases the veterans experience other problems which affect their ability to repay the loans, and decrease the market attractiveness of the loans.

(c) Third, VA also has direct loans to veterans in its portfolio. Some of these are very old loans with low balances, which are nearing maturity, and would be very unattractive to private investors. Others are newer loans that were made to Native American veterans under a statutory pilot program for loans on Trust lands. These loans require VA to enter into a memorandum of understanding with the Native American organization governing the Trust lands, and therefore it would be inappropriate to consider selling such loans to a third party.

2. Issue: The VA lacks an internal accounting mechanism to track \$7 billion in transactions and it is dependent on its trustee, Banker's Trust of California, to perform that function.

VA Response: In a recent report, the General Accounting Office reported that the outstanding balance of 31 loan sale trusts originated from 1988 through 1998 amounted to approximately \$7 billion. GAO expressed concern that financial data were not adequately shared with accounting and budget staff, and recommended that VA "develop and implement procedures to ensure that relevant data from servicers and the trustee is provided in a timely manner to VA offices responsible for managing or recording trust activities and transactions."

VA concurred with the GAO recommendation and took immediate steps to develop and implement such procedures. This was accomplished with the assistance of a private contractor who designed a system for recording loan sales transactions and all subsequent activity. The success of this effort has been verified by a preliminary report from VA's Office of the Inspector General which gives an unqualified audit opinion on the agency's Fiscal Year 1999 financial statements.

3. Issue: The VA incorrectly calculated needed reserves and had to use funds from other accounts to cover \$14 million in losses in 1997 and \$40 million in losses in 1998.

VA Response: A GAO report referred to VA's transfer of subordinate certificates from early American Housing Trust sales to act as credit enhancement for subsequent American Housing Trust sales. This practice was approved by the Department of Treasury, as it served to increase the

consideration to the Department from the subsequent sales. However, when the Credit Reform Act was passed, it required that each year have its own program and financing accounts for guarantees made beginning October 1, 1991. VA did not conform to this requirement, because of the earlier special approval from Treasury for its financing arrangements, and continued to pledge earlier subordinate certificates on sales made after the start of Credit Reform Accounting.

GAO recommended that VA record loan sale transactions and all subsequent activity associated with the trusts consistent with federal accounting standards and any related guidelines. VA contracted with a private accounting firm to design such a system and to reconstruct all past loan sale activity. This has been successfully completed, as indicated by the preliminary audit report from VA's Office of Inspector General showing that the agency's financial statement for Fiscal Year 1999 has received an unqualified opinion.

4. Issue: Is one of the benefits of the IRRRL program to allow veterans to refinance without underwriting, while the veteran was no more than 90 days delinquent on their mortgage payments?

VA Response: The IRRRL program was established by Public Law 96-385, October 7, 1980. The Congressional intent of the IRRRL program was expressed in the House Report (H. Rep. No. 96-1165, July 21, 1980, at p. 3): "[T]he bill is . . . intended to assist veterans by allowing their monthly payments to be reduced. . . .". Nothing in the law that established the IRRRL program indicates that Congress intended for veterans to be able to obtain IRRRLs without underwriting, let alone establish a threshold of 3 missed payments.

As discussed in the Federal Register publication of the Final Rule, (provide citation), there is nothing in the statutory provisions authorizing the IRRRL program or the relevant legislative history that requires or even suggests that VA is required to implement a streamlined procedure for closing loans. We, however, made an administrative decision to implement certain streamlined processing features. Under current policy, streamlined processing is still available for veterans who are not delinquent on their present loans. It should be noted that the vast majority of veterans who apply for an IRRRL are current on their loans. Nothing in the rule precludes a veteran who is not current (i.e., more than 30 days delinquent on his or her loan) from obtaining an interest rate reduction refinancing loan. The purpose of the rule, as drafted by VA, is to require that lenders who wish to close such a loan submit the loan to VA for review so that VA may be assured that the new loan will be a benefit to the veteran and not a pointless (and sometimes costly) exercise to postpone a foreclosure. The majority of IRRRLs are not

affected by this rule and those that are affected should be. We strongly believe that prudent lending requires a greater review of circumstances before approving the refinance of a delinquent loan and rolling in costs including delinquent interest. This position is entirely consistent with the mortgage lending industry.

5. Issue: In lieu of the rulemaking, should VA stop the practice of promoting the skipping of up to three payments or to get rid of the practice of deceptive advertising.

VA Response: VA cannot police all advertising. If VA had the capacity to conduct such oversight, lenders are not prohibited from advertising or otherwise soliciting veterans to skip payments and include missed payments, fees, and late charges in an IRRRL when such inclusion was allowable. This proposal would have VA regulate advertising and free speech of mortgage lenders. The VA Office of the General Counsel has determined that there is no way to police lenders' free speech. In addition, it is common practice for a loan that is refinancing another loan to include some fees, interest and usually the payment due on the old loan during the month the new loan closes.

6. It is alleged that VA intentionally diverted from the public inspection room thousands of letters from veterans who refinanced their homes and opposed the rule and that when the illegality was discovered by one of the lender's lawyers, it took two weeks to return the letters to the public inspection room.

VA Response: No such diversion occurred nor was it attempted. The Federal Register notice on this rule indicated that written comments should be mailed or delivered to VA's Office of Regulations Management. That office is located at 810 Vermont Avenue, NW, Washington D.C., and is responsible for sending copies of all comments to the office responsible for responding to the comments. When VA's Loan Guaranty Service, which is located at 1800 G Street, NW, Washington, D.C., received a box of comments, addressed to the Assistant Director for Loan Policy, it was assumed that these were copies of comments sent over by the Office of Regulations Management. The very day it was discovered that these were original comments, the entire package was hand-carried to back to the appropriate office. This discovery occurred in early June 1998, less than half way through the 90 day comment period.

7. Issue: It took a minimum of six months for VA to respond to correspondence from members of Congress written in opposition to this rule.

VA Response: VA received numerous letters from members of Congress concerning this rule. Of those letters, seven were sent directly to the Office of Regulations Management, with the indication that they were "comment letters"

on the Proposed Rulemaking. Those letters were treated as comments and the issues they raised were considered and addressed in the Final Rulemaking.

VA did receive other letters from members of Congress seeking information about the rule, expressing opposition to the rule, and even suggesting alternatives and compromises to the rule. Our records indicate that responses to most of this Congressional correspondence was issued within 2 months. One response did regrettably take as much as 6 months.

8. Issue: Did VA ignore over 10,000 letters written by veterans and local and state chapters of Veterans Service Organizations?

VA Response: VA did receive many thousands of comments. As Mr. James Hubbard, Director of the Economic Commission, of the American Legion, indicated in his oral statement at the hearing, most of these were form letters, apparently signed by veterans in the course of closing on their interest rate refinancing loan. In accordance with the requirements of the Administrative Procedures Act (APA), VA considered the issues raised by these comment letters in the development of the Final Rule. The APA requires that the Agency consider the substance of the comment letters submitted not the number of letters. We did, carefully consider and discuss the issues raised in these comments in our final rulemaking.

9. It was suggested that rising interest rates do not affect VA's IRRRL volume and that VA rulemaking is responsible for the decline in volume in IRRRLs.

VA Response: The final rule on IRRRL's became effective in June 1999. According to the Mortgage Bankers Association (MBA), in January 1999 interest rates on all 30-year fixed rate loans averaged 6.79 percent. By January 2000 that rate had climbed to 8.21 percent, and by the end of February 2000, to 8.33 percent. At the same time, for the 1st Quarter of 1999 (calendar year), MBA reports that refinancing loans comprised 54 percent of all loans closed in the country. For the 4th Quarter, refinancing loans comprised 21 percent of all loans. MBA forecasts that refinancing loans will comprise a mere 16 percent of loans closed in calendar year 2000. The effective date of VA's IRRRL rule coincided with these increases in interest rates.

10. Issue: Are VA IRRRL foreclosure rates dramatically below the industry norm.

VA Response: VA compiled the following information from our loan guaranty records in the course of developing the final rule. In 1995 the early foreclosure rate (i.e., within 2 years of loan closing) on IRRRLs was 25 percent higher than on VA guaranteed purchase-money loans. In 1997 the

early foreclosure rate on IRRRLs grew to 61 percent higher and at the time we published the final rule, in June 1999, that percentage had further grown to 63 percent higher. VA analysis showed that poor origination of some IRRRLs caused this disturbing trend. The final rule is narrowly tailored to address this issue and will not significantly impact most IRRRLs.

11. Issue: Every single one of the IRRRL loans made by Mortgage Investors Corporation (MIC), up until the increase in interest, resulted in a reduced interest rate and a reduced monthly payment except for IRRRLs involving adjustable rate mortgages (ARMS).

VA Response: VA's IRRRL rule was not prompted or directed by the conduct of one specific lender. Our rule was proposed in response to feedback from our field stations regarding increased instances of veterans not actually realizing the full benefit of the IRRRL program.

12. Issue: In 1999, did approximately 151,419 veterans have loans at exactly a 10 percent interest rate, and another 141,849 veterans have loans above 10 percent?

VA Response: Our records reflect that 253,568 VA loans are currently outstanding with interest rates of 10 percent or higher. Veterans who still own the properties financed with these loans can still benefit from an Interest Rate Reduction Refinancing Loan (IRRRL). However, there may be a variety of reasons why these loans have not been refinanced to lower the interest rate. For example, if a veteran sold the property to a buyer who was not an eligible veteran, that assumer would not be able to obtain an IRRRL, since the law limits such loans to the veteran whose eligibility entitlement is on the loan. Also, in 1994 (5 years before the subject regulation was promulgated) the Secretary of Veterans Affairs sent letters to veterans who had an outstanding loan with an interest rate of 8.5 percent or higher in order to inform them of the availability of the IRRRL program and its advantage to them. While many veterans did refinance high interest rate loans at that time, and many more have since refinanced as interest rates declined again in more recent years, many high interest rate loans remain outstanding. In spite of VA's efforts, as well as the very aggressive marketing efforts of numerous lenders seeking to identify veterans with these loans in order to convince them to obtain an IRRRL, this substantial number of loans at 10 percent and higher remain outstanding. We can only surmise that, in addition to those cases in which an IRRRL would be legally precluded because of a loan assumption, many veterans choose not to take advantage of the IRRRL program for reasons of their own.

13. Issue: It is suggested that the purpose of the IRRRL program is to enable a veteran who has fallen behind "a few payments" to refinance at a lower rate.

VA Response: Nothing contained in the statutory language creating the IRRRL program suggests that this was the purpose. A similar argument was put forth in the form comment letters, suggesting that the final rule could cause some veterans to lose their homes due to foreclosure by removing the ability to refinance during a period of delinquency. We agree that there are instances where being able to refinance a loan will make a difference between saving a home or losing it to foreclosure. The final rule does not preclude such a veteran from obtaining an IRRRL. If VA determines that the veteran is creditworthy and able to make the payments on the proposed IRRRL and thereby save the home, VA would approve the IRRRL. In cases where VA, after carefully considering the veteran's entire financial circumstances, concludes the veteran is unlikely to be able to make the payments on the IRRRL, it would not be approved. Such a loan may only delay for a short time an inevitable foreclosure, causing greater expense to both the veteran and the Government. If a veteran's current loan is delinquent and VA determines that the veteran does not qualify for an IRRRL because of financial difficulties, VA will use its supplemental servicing procedures, such as counseling, to determine if other viable alternatives to foreclosure exist.

14. Issue: The private sector cannot participate because they cannot certify that the veteran's loan is current is inaccurate.

VA Response: The modern loan servicing industry is highly computerized, and loan balances that include the latest payment are obtainable from holders within a day or two after their receipt of that payment. Lenders normally obtain pay-off figures from holders by fax or overnight express. Thus, as an example, there is no practical need for a lender who anticipates making an IRRRL in mid-October to urge the borrower to skip the payment due September 1st in order to obtain accurate payoff information

15. Issue: By the time a lender collects all of the required documents to submit the loan to VA for review, the veteran's loan would not be current.

VA Response: This would not necessarily be the case, since VA would hope that the veteran would make payments as they come due. It was suggested that VA agree to a compromise that the VA amend its definition of "current" to include 2 missed payments, or permit a veteran to get a streamlined IRRRL if he or she is up to 60 days behind in his or her mortgage payments. We know of no government-lending program which permits automatic refinancing of loans which are behind two months in payments.

WRITTEN COMMITTEE QUESTIONS AND THEIR RESPONSES
CHAIRMAN EVERETT TO DEPARTMENT OF VETERANS AFFAIRS

Post-Hearing Questions
Concerning the March 16, 2000, Hearing

on
The Department of Veterans Affairs Loan Guaranty Service

from
The Honorable Terry Everett
Chairman, Subcommittee on Oversight and Investigations
Veterans Affairs' Committee, U.S. House of Representatives

- 1. Please provide detailed information regarding the number of loans made under VA's Education Loan program and the approximately \$220,000 in administrative costs in order to make and process these loans.**

The administrative cost associated with the Education Loan Program reflects the resource requirement for servicing loans made many years ago, more so than any recent or future loan activity. There were almost 400 loans outstanding at the end of 1999. These loans generate the activities (collections, notifications, etc.) requiring our resources.

- 2. Please provide foreclosure rate information on assumed VA home loans compared to VA home loans**

The following table shows, by cohort year, for fiscal years 1988 through 1997, the number of VA loans closed that year, the number and percentage foreclosed, the number and percentage assumed, and the number and percentage foreclosed after being assumed, along with a comparison of the two foreclosure percentages.

Comparison of Fiscal Year Liquidation Rates
Assumed Loans versus All
As of EOM September 1999

Fiscal Year*	All Loans			Assumed Loans				Assumed versus all
	Number	Liq	%	Number	% of Total	Liq	%	
1987	259,731	2,904	1.12%	119	0.0%	0	0.00%	100.0% Lower
1988	314,065	9,070	2.89%	662	0.2%	1	0.15%	94.8% Lower
1989	249,397	10,376	4.16%	563	0.2%	2	0.36%	91.5% Lower
1994	493,295	20,659	4.19%	4,329	0.9%	53	1.22%	70.8% Lower
1993	474,617	21,341	4.50%	5,166	1.1%	48	0.93%	79.3% Lower
1992	302,499	14,058	4.65%	2,602	0.9%	40	1.54%	66.9% Lower
1991	183,012	11,769	6.43%	965	0.5%	24	2.49%	61.3% Lower
1990	188,498	15,889	8.43%	1,821	1.0%	84	4.61%	45.3% Lower
1989	184,157	18,329	9.95%	2,941	1.5%	184	6.48%	34.9% Lower
1988	192,637	21,442	11.13%	4,017	2.1%	242	6.02%	45.9% Lower
1987	390,800	34,866	8.92%	7,420	1.9%	415	5.59%	37.3% Lower
1986	436,922	46,091	10.55%	5,834	1.3%	425	7.54%	28.5% Lower
	3,659,660	226,804	6.18%	36,138	1.0%	1,518	4.20%	32.0% Lower

*Based on Date of Loan (Loans closed since 1998 not included - not enough time has gone by to develop a trend)

Note: Capturing Assumption date did not begin until FY 1988. Assumptions on loans with a loan date prior to 1988 were basically only recorded when a loan was in default with a different obligor - to show veteran not liable. Foreclosure rate on those earlier years thus is not statistically valid.

3. Please provide a full and detailed report, to date, regarding the Loan Guaranty Program's contract for servicing on direct loans, and, no later than the end of the current fiscal year, please provide a follow-up report of all corrective actions taken to ensure proper supervision of all contractors, including but not limited to all matters described in the written hearing testimony of the Assistant Inspector General for Auditing at pp. 5 and 6.

One initiative approved by the National Performance Review as part of Phase II of the administration's program of reinventing the Government involved VA's portfolio of vendee, direct, and refunded loans. The purpose of the reinvention program in general, and this initiative in particular, was to make Government more effective by streamlining operations and focusing on the fulfillment of statutory missions—in VA's case, the delivery of benefits to veterans—rather than on operations which are not integral to the agency's purpose and which can be performed by the private sector.

For many years VA serviced a portfolio of loans, most of which were originated to finance the sale of properties acquired by VA as a part of its guaranty program. The staff was spread among 46 regional offices, and the computer system supporting this activity was created almost 30 years ago, was not user friendly, and could not comply with recent changes in statutory and regulatory requirements (e.g., the single item escrow analysis requirement under RESPA). It was cost prohibitive to make system changes, or to consolidate servicing to achieve the economies of scale needed to make efficient use of limited personnel resources. Thus, VA decided to contract for the subservicing of its entire loan portfolio.

VA issued an RFP (Request for Proposals) in June 1996 and received proposals from interested bidders. A protest was filed with GAO concerning the placement of our notice of intent to contract in the Commerce Business Daily, and this delayed the process three months. Then our Contracting Officer requested clarification on some bid prices, and this required negotiation with all bidders and the review of Best and Final offers. A contract was awarded in January 1997 and loan servicing was transferred in June 1997. We estimate that the savings to VBA nationwide were 154 FTEE, realized through reassignments and retirements at the Regional Offices. A Portfolio Loan Oversight Unit was established at the Indianapolis Regional Office to oversee the Contractor's performance, and to offer special assistance to veterans with direct or refunded loans.

Program responsibility for the contract comes under the jurisdiction of the Assistant Director for Loan Management, whose staff drafted a Statement of Work and participated in evaluating proposals, as well as preparing instructions for VA field stations to ready the portfolio for the transfer.

Planning for the transfer of servicing began well in advance of the initial conversion of loan records, and included preparation of detailed instructional materials, oversight of data processing record analysis, and conferences with the Contractor, its subcontractor, VBA Finance activities and VA's Portfolio Loan Oversight Unit (PLOU), which was more involved with handling the day-to-day liaison between VA field offices and the Contractor.

Since the contract was awarded, weekly conference calls have been conducted between Loan Guaranty Service (LGS), the Contractor, the subcontractor performing most of the "hands-on" work, and the PLOU. In order to address special issues, there have been other conference calls, as well as personal visits to and from the Contractor.

The financial data provided by the Contractor is a part of VA's agency financial statements, and both OIG and GAO have audited this data. This resulted in the development of a Housing Credit Assistance Action Plan and LGS having the responsibility for implementation of corrective actions.

Loan Guaranty Service continues to be involved with the development of policies and procedures for interaction among VA field stations, the PLOU, the Contractor and subcontractor. In addition, guidance is provided on highly complex issues, some

involving technical matters, while others involve jurisdictional questions between the PLOU, VA field stations, functional activities within those stations, and the Contractor and its subcontractor.

The PLOU has conducted periodic audits of the subcontractor and discussed its findings with both the Contractor and the subcontractor, both verbally and in writing, so that changes can be effected. In many cases the findings have become the topics of ongoing discussions with the Contractor about its need for improvement in specific areas. A recent (12/99) audit by the PLOU found a lack of active servicing by the subcontractor and resulted in the employment of additional personnel. Reports from the Contractor indicate these personnel made 4,792 additional outbound personal telephone calls to delinquent borrowers from the second week in February through the third week in March.

Currently, a performance and financial audit of the portfolio loan servicing contractor has been awarded to PriceWaterhouseCoopers and is underway. This audit should be completed by the end of April, and upon receipt of the final report VA will take appropriate action to correct any deficiencies. VA has also decided to recomplete the contract. The new contract, which is in the very early stages of development, will be written so that compensation is based on the performance, or outcomes achieved, by the contractor.

To ensure that portfolio loans are actively serviced, that seriously defaulted loans are referred for foreclosure timely, and that bankruptcy cases are routinely monitored to ensure timely request for relief from stay, LGS is establishing an Oversight Review Team (ORT). This team will be comprised of LGS, PLOU, VACO Finance, and Financial & Systems Quality Assurance Service (FSQAS) personnel. Input also will be routinely solicited from the Inspector General and Government Accounting Offices. The ORT will determine how many specialized onsite reviews and performance audits need to be conducted each year, as well as the scope of and organization responsible for performing each review/audit (i.e., outside contractor, PLOU, FSQAS, LM, etc.). These reviews and audits will enable Loan Guaranty Service to effect corrective change to ensure that the portfolio loan servicing contractor complies with the performance requirements of the contract. By ascertaining the needs and concerns of all parties involved in or charged with audit responsibility and/or oversight of the contractor, Loan Guaranty Service oversight reviews and audits will be broader, more informative/valuable, and will be less disruptive to contractors because governmental concerns will be addressed in fewer reviews/audits. This broad and aggressive approach to oversight will significantly decrease the Government's vulnerability to losses.

**Post-Hearing Questions
Concerning the March 16, 2000, Hearing**

on

The Department of Veterans Affairs Loan Guaranty Service

from

**The Honorable Corrine Brown
Ranking Democratic Member
Subcommittee on Oversight and Investigations
Veterans Affairs' Committee, U.S. House of Representatives**

1. A recent Washington Post article - citing HUD data - reported that only 3.2 percent of the loans Fannie Mae purchased and only 3 percent of the loans Freddie Mac bought were to African-Americans.

- **Over the last three years, what has been the African-American participation rate in the VA home loan program, and what has been the total minority participation rate?**

Minority participation rates are based on borrowers' self-identification of their racial background on loan application forms. Since the providing of this information is voluntary, participation rates may be higher than statistically shown. Our statistics indicate that the African-American participation rate in the VA home loan program was 14.4 percent for FY 1997, 13.6 percent for FY 1998, and 13.4 percent for FY 1999. The total minority participation rate in the VA home loan program was 21.5 percent for FY 1997, 20.6 percent for FY 1998, and 21.1 percent for FY 1999. Minorities would include African-Americans, Hispanic, Native Americans, Asian-American, etc.

2. If the minority rates of participation in the VA home loan program have been significantly higher than the rates at which minority loans have been purchased by Fannie Mae and Freddie Mac, to what do you attribute the higher VA levels?

We do not have any hard data to support a conclusion of why minority participation in the VA home loan program is higher than the rates at which minority loans have been purchased by Fannie Mae and Freddie Mac.

However, we would note that many persons with minority backgrounds view the military as an attractive option to attain upward mobility. By serving in the military, they become eligible for the VA home loan benefit. Also, through pamphlet distribution, internet websites, etc. VA makes an effort to inform veterans about their benefits, which may lead to greater use of the home loan benefit.

3. The AFGE—a major employee union at VA—is concerned that if VA were to contract out its property management function, the Department's fine record of minority participation in the Loan Guaranty Program could be jeopardized. This would be especially true, according to AFGE, if the contract were to go to an organization like Fannie Mae or Freddie Mac.

- **What is your response to this concern?**

VA is in the process of conducting an A-76 Cost Comparison Study of its Property Management Operation and all commercial bidders, regardless of their size and/or government affiliation, will be required to submit a small business plan along with their proposal. VA will utilize the contractor's small business plan—should the cost comparison result in an award to a contractor—to continue to address minority, veteran, and small business issues and initiatives. In addition, VA will continue to set annual small and disadvantaged business goals and aggressively pursue them.

4. I applaud VA's innovative use of automation to date and compliment the Loan Guaranty Service on its choice of Florida to test the feasibility of accepting appraisal reports electronically.

- **Please elaborate on the positive outcomes expected from this pilot program.**
- **If the pilot program is successful, when do you expect its nationwide implementation?**

The Appraisal Electronic Data Interchange (EDI) pilot initiative scheduled for implementation starting on April 3, 2000 in our St. Petersburg Regional Loan Center will allow fee appraisers, lenders and other program participants to send appraisal reports and other related documents to VA via e-mail. This will effectively eliminate the time normally associated with mailing and handling of paper documents.

If utilized to its maximum extent, which includes: lenders ordering appraisals and forwarding the package electronically to the fee appraisers; then the fee appraiser e-mailing their report to VA; and finally VA e-mailing the Certificate of Reasonable Value (CRV) to the lender, we expect that this process will save between eight to twelve days when compared to the current paper driven process.

Other efficiencies are expected to be gained in the storage of electronic medium (appraisal reports and related documents) versus the current file room(s) full of paper documents.

If after approximately three months this pilot program is successful, it will be tested at two additional VA Regional Offices. The second stage test is anticipated to last two to three months. If program goals are accomplished successfully, we will consider a national implementation in the first quarter of FY 2001.

5. The 1999 report of the Commission on Servicemembers and Veterans Transition Assistance had four recommendations for legislation concerning the Loan Guaranty Program. For the record, please briefly outline those recommendations and the response of the Department.

The Department of Veterans Affairs' response to these four recommendations, numbers 100 through 103 in the Department's May 1999 response, is as follows:

100. Limit VA home loan guaranty to a single use for person entering active duty on or after the effective date of legislation, except for refinancing.

Response: VA can support the limiting of the home loan benefit to one-time usage provided that we explore allowing these veterans to be exempt from paying a funding fee. However, we do have several concerns: (1) A substantial percentage of second-time homeowners use VA because they have not realized enough equity in their first home to make a minimal downpayment on a conventional or FHA loan; (2) Second and subsequent users are significantly better credit risks, i.e., foreclose at a lower rate than first time users; and (3) VA collects a three percent funding fee from these users which generates additional funds that can be used to offset losses on first time users. Most veterans add the funding fee into the loan amount. Enactment of the single use proposal without elimination of the funding fee is merely a reduction in the home loan benefit without any improvement in loan to value ratios that leads to accumulation of home equity.

101. Make Reservists' home loan guaranty eligibility permanent and direct DoD to provide easy-to-understand documentation of this eligibility.

Response: VA supports permanent eligibility for reservists. However, there are a number of questions that the Commission did not answer, such as funding fees, one-time use, etc. We are exploring these issues and plan to draft an

alternative proposal for consideration within the Department and potentially by the Congress.

Moreover, the housing loan entitlement for Reserve service does not sunset until September 30, 2007. In the meantime, VA is in the process of evaluating all our programs and will be better prepared to comment on continuing this entitlement for Reservists after our evaluation of the loan program is complete.

102. Eliminate the two-percent funding fee for those entering active duty on or after effective date of legislation.

Response: As stated in response to recommendation 100, VA can support the limiting of the home loan benefit to one-time use provided that these veterans are exempt from paying a funding fee.

103. Establish a two-year pilot program in one or more geographic areas to determine the effect of limiting VA's obligation under the guaranty to paying a claim, with lenders responsible for disposing of foreclosed property.

Response: VA does not agree with this recommendation as there are powerful arguments against conducting a pilot program as proposed by the Commission. The most important of these is that such a pilot would be detrimental to veterans in the geographical areas selected, and possibly have a negative impact on all veterans using their home loan benefit. Lenders have the right to negotiate interest rates and discount points based on their calculation of the risk involved. This change in the nature of the VA guaranty would shift a greater risk factor to the lender. Therefore, we believe veterans will be charged higher interest rates and discount points by lenders originating loans in the pilot localities to offset anticipated costs of property acquisition and sale. Most of the large lenders originating VA guaranteed loans are regional or nationwide lenders. They would be pooling "regular" VA loans and "nonacquisition" loans together in selling mortgage-backed securities. They may very well develop a blended price for VA loans, i.e., spread their risk from nonacquisition loans across all VA loans thus raising transaction costs on all veterans. Certainly, veterans in the pilot will pay higher costs and there would be a degree of confusion for both veterans and lenders. Veterans would have a legitimate question as to why they are paying more for their benefit than veterans outside the pilot localities. Lenders would have to contend with two different types of guaranteed loans which carry different risks.

VA is currently proceeding with a study on contracting out the property management function under OMB Directive A-76. This will allow VA to fully analyze the cost effectiveness of VA's property management function without impairing the veteran's opportunity to use the home loan benefit.

6. VA has long taken pride in its foreclosure avoidance program. When foreclosure is avoided, government costs are reduced, but more importantly, veterans are helped. Either their home is saved or they are able to avoid the expense and damage to their credit rating caused by a foreclosure. Counseling in the complex world of high finance, however, can be very confusing and, for some, requires face-to-face contact. I note that the Loan Guaranty Service restructuring plan would relocate Loan Management activities from 45 Regional Offices to 9 Regional Loan Centers. The AFGE has expressed the following concerns with the Loan Guaranty Service plan. Would you please address them?

- **First, that veterans will not be able to go to a Regional Office and receive face-to-face counseling if needed, and**

Direct service provided to veterans who personally visit ROs has not been significantly affected by the restructuring. Veterans who personally visit a VA Regional Office can

continue to do so. Each office will retain personnel knowledgeable in the home loan program who will be able to offer these veterans assistance and work as a liaison with the RLC.

Our experience has been that very few veterans actually come to VA offices for face-to-face financial counseling. During Fiscal Year 1995, which was near the beginning of VA's consolidation, over 120,000 defaults were reported to VA. Our statistics indicate there were 158,532 telephone contacts made by VA Loan Service Representatives to borrowers whose VA-guaranteed loans were delinquent, but only 3,145 made visits to VA Regional Offices. Based on the overwhelming number of telephone contacts compared to office visits, we believe that a majority of the financial counseling sessions were also performed over the telephone, which is the norm for private industry.

Our Regional Loan Center (RLC) personnel are highly trained and usually mail financial data forms to veterans to give them the time to accumulate their financial information and return the completed forms to the RLC so that an analysis can be performed before the actual counseling session is conducted. If a veteran has difficulty with some of the questions on the forms, he or she may call the RLC on a toll-free number for explanation. For those who need additional explanation and are close to a Regional Office, they may visit the RO and discuss the issue with the knowledgeable personnel there. And of course the RO employees may call the RLC to discuss unusual circumstances and help the veteran gain a clearer insight into their financial options.

- **Second, that VA employees at consolidated sites will not be able to remain knowledgeable about the real estate laws and procedures in all of the various states over which they will have responsibility.**

In the VA home loan guaranty program, a veteran's primary contact is with the lender or real estate broker, and not VA. These private sector professionals are normally familiar with local requirements and are able to assist veterans on most issues related to a VA guaranteed loan. VA does, of course, become involved in supplemental servicing of defaulted loans and will take appropriate action in those cases where special assistance is needed.

When VA has consolidated a particular function at a Regional Loan Center (RLC) with multi-state jurisdiction, the RLC will consult with the VA Regional Counsel in a neighboring state for guidance on that State's laws. For example, the Regional Counsels in Los Angeles and San Francisco are well-versed in California law, and will provide all necessary guidance to the Phoenix RLC regarding California legal issues appropriate to a particular case. Also, there will be continuous training efforts as needed.

7. I am concerned with continuing reports that adequate, affordable family housing may not be available at all military installations. In 1995, Congress authorized a test program for three years - ending September 30, 1998 - to supplement military housing allowances for active military by directly buying down the interest rate paid for the first three years of the loan. The program was to be administered by VA.

- **What were the results of that test program?**
- **What, if any, problems did the Department experience in the implementation of this Inter-Departmental test program?**

This test program was not implemented.

VA made an aggressive effort to implement this legislation. There were several staff level discussions and meetings within VA and between VA and DoD representatives on what steps would be needed to implement this pilot program. In the course of these discussions a critical problem appeared. Although Public Law 104-106 specifically earmarked DoD funds for this pilot program, there were no specific appropriations, and no specific instructions to DoD to reprogram other funds to support this test program. The Secretary of Veterans Affairs wrote to the Secretary of Defense on July 11, 1996,

requesting that DoD find the money in its accounts to implement the pilot program. The Secretary of Defense wrote back on January 21, 1997, advising VA that in his opinion, diverting funding and manpower from other ongoing DoD housing initiatives to support this VA pilot program would not be in the best interest of the majority of service members.

8. An Inspector General report of March 1999 on "Attributes of Defaulted VA Home Loans" reviewed a nationwide statistical sample of defaulted home loans to identify their characteristics. One of the major contributing factors to higher default rates was the nearby presence of large military bases. Among the areas noted was Jacksonville, Florida.

- **In your opinion, what needs to be done to provide active duty personnel and their families with the reasonable housing to which they are entitled?**

What needs to be done to provide the active duty personnel with the reasonable housing to which they are entitled is a question for DOD, not VA, to answer.

9. Another concern raised by the 1999 Inspector General report is the fact that loans made to active-duty service-members defaulted more often than loans made to veterans and also tended to default earlier in the loan period. It was pointed out that servicemembers do not receive formal counseling to offset the lack of an adequate credit history. The Inspector General believed VA should take the lead on providing counseling and work with the Department of Defense in establishing a counseling program where appropriate. The IG recommended that counseling be geared toward servicemembers who are in their first enlistment or are first-time homebuyers.

- **What has VA done in this area, and what have been the obstacles?**

We agree that counseling has value. It is for that reason that we have required lenders to provide counseling to all military homebuyers since 1990. The specific items to be covered in the counseling are contained on VA Form 26-0592, Counseling Checklist for Military Homebuyers. The form contains space for the military member to certify that he/she has been counseled and for the lender to also certify that the member has been counseled. The counseling checklist addresses most of the specific topics included in the recommendation. However, we also agree that it is likely that the Counseling Checklist is frequently handled in a purely administrative ("Here's another form you have to sign") manner, and its content is not truly conveyed to the military homebuyer, reducing its counseling value.

With respect to the suggestion contained in the report that VA ought to take the lead on providing counseling and work with DOD in establishing a counseling program where appropriate, we agree that a more formal counseling program will benefit many veteran-homebuyers, especially first-time homebuyers. There are counseling programs already available which generally focus on first-time homebuyers. We believe it would be more appropriate to establish a formal counseling requirement for all first-time homebuyers and not just for those who are also members of the active duty military. Therefore, we have begun the process of establishing a prepurchase counseling requirement for all first time homebuyers.

Based on an informal conversation with the Office of General Counsel, a regulatory change is required to establish a requirement for counseling. We are in the process of drafting a regulation, and trying to ensure there is no appearance of the imposition of an arbitrary and unjustified burden on veterans.

In the interim, we have revised VA Pamphlet 26-4, VA-Guaranteed Home Loans for Veterans, to include information about pre-purchase counseling. The language recommends counseling to first time buyers and includes a toll free number (maintained by HUD) to locate a HUD approved counseling center nearest the veteran. The

pamphlet is given to veterans when they obtain a Certificate of Eligibility for Home Loan Benefits. The revision is in the concurrence and review stage.

We have also included language on our Loan Guaranty website citing the advantages of pre-purchase counseling.

10. I noted the Department's FY 2001 Budget Submission assumes that VA will eliminate the vendee loan operations effective December 31, 2000.

- **Does VA make money on its vendee loan operations, thereby reducing the need for appropriated funds?**
- **Does the Veterans Benefits Administration believe that it is a good idea for VA to eliminate the vendee loan operations?**

The vendee loan program is part of a larger housing credit operation that also includes the initial guarantee to the veteran and another loan guarantee when the vendee loan is sold. Cash is exchanged among all three programs in accordance with the financial performance of each credit extended. As such, it is difficult to parse out how the cash flow of each individual direct loan or loan guarantee program influences the other programs. VA has conducted analyses of each individual program, but a comprehensive understanding of the larger housing credit operation will require intensive analysis which would be part of the home loan program evaluation.

11. The Inspector General, in a February 28, 2000, report evaluating the Loan Guaranty Service's quality control system, concluded "that the Loan Guaranty Service needed to improve its quality control system." The report made a series of recommendations to further strengthen quality controls over the Loan Guaranty Program. VA concurred in the findings.

- **What action has Loan Guaranty Service taken, and what action is planned, to strengthen its quality control system?**

The report made five specific recommendations. Loan Guaranty service accepted these recommendations, and is implementing corrective action as follows:

- a. Develop and maintain a current Management Control Plan to identify vulnerable LGS functions that need to be addressed. A new Vulnerability Assessment and Management Control Plan was completed on February 28, 2000.
- b. Schedule and complete Internal Control Reviews of vulnerable functions. Loan Guaranty Service will resume a regular cycle of internal control reviews according to the Management Control Plan completed on February 28, 2000. It is anticipated that at least one Internal Control Review will be conducted annually.
- c. Emphasize to field station and LGS staff the need to more fully comply with the requirements of Statistical Quality Control reviews. Loan Guaranty Service conducted an interactive televised training broadcast to Central Office and all field stations on *Program Oversight* on February 15, 2000. During that broadcast we reviewed the requirements for SQC reviews, and stressed the need for care in conducting them.
- d. Develop and implement timeliness standards for the Monitoring Unit's lender audit reports. Written timeliness standards for the final lender audit reports have been established and are now being implemented.
- e. Increase oversight of direct loan portfolio servicing to assure that the loans of delinquent borrowers are actively serviced and foreclosed when appropriate and bankruptcy cases are also monitored to allow timely foreclosure action. To ensure that portfolio loans are actively serviced, that seriously defaulted loans are referred for foreclosure timely, and that bankruptcy cases are routinely monitored to ensure timely request for relief from stay, Loan Guaranty Service (LGS) has established an Oversight

Review Team (ORT). This team is comprised of LGS, the Portfolio Loan Oversight Unit (PLOU), Central Office Finance, and Financial & Systems Quality Assurance Service (FSQAS) personnel. Input also will be routinely solicited from the Inspector General and General Accounting Offices. The ORT will determine how many specialized onsite reviews and performance audits need to be conducted each year, as well as the scope of and organization responsible for performing each review/audit (i.e., outside contractor, PLOU, FSQAS, LGS, etc.). These reviews and audits will enable LGS to effect corrective change to ensure that the portfolio loan servicing contractor complies with the performance requirements of the contract. By ascertaining the needs and concerns of all parties involved in or charged with audit responsibility and/or oversight of the contractor, LGS oversight reviews and audits will be broader, more informative/valuable, and will be less disruptive to contractors because governmental concerns will be addressed in fewer reviews/audits. Currently, a performance audit of the contractor is underway. This audit should be completed within the next several months.

On December 6-9, 1999, the PLOU conducted a periodic audit of the contractor's servicing activities. Presently, the PLOU is discussing corrective changes with the contractor regarding the issues identified in their audit report and the issues identified by the IG.

12. In a 1998 decision, the Court of Veterans Appeals for Veterans Claims criticized the Department for not issuing regulations addressing the information and notice requirements applicable to a veteran facing foreclosure on a VA financed home. In October 1998, Members of the House Veterans' Affairs Committee urged the Secretary to promulgate such regulations. The Secretary has refused.

- **Please describe the advantages to the VA and veterans of not having regulations that clearly specify the notice requirements applicable to veterans facing foreclosure.**

The Court in its decision noted the "absence of VA regulations pertaining to VA's giving notice of foreclosure" and stated that appeared to be "inconsistent" with the law, because in the Court's opinion "VA's providing such notice would seem to be a necessary prerequisite for VA's fulfillment of its statutory obligation ... to provide the veteran with information, and to the extent feasible, counseling regarding alternatives to foreclosure" Under this logic, the Court implies that in the absence of regulations directing it to do so, VA can not or will not provide notice to veterans, notwithstanding the existence of a statutory requirement to provide notice. This is not the case.

When Public Law 100-198 was signed on December 21, 1987, VA began developing a method to ensure that veterans receive notice about alternatives to foreclosure and the counseling available from VA. By January 12, 1988, VA had created language about alternatives to foreclosure and the availability of counseling to be added to the computer-generated letters which are sent to veterans upon receipt of a private loan holder's notice of default. This advice has been provided to veterans for the past twelve years, and we believe it has met the requirements of the law without the need for regulations describing what VA is doing to serve our Nation's veterans.

The primary advantage to veterans and VA of not having a regulation on this issue is that it helps the Government-wide effort to eliminate and reduce unnecessary regulations. The purpose of regulations is usually to "fill in the gaps" left by new laws, or to clearly state procedures for compliance with the law, principally where the law itself directs the promulgation of regulations for such purposes. There is no need to merely repeat a law in regulations. This law basically required that VA establish an internal procedure to comply with its directives, and this agency is complying with the law. Adding regulations to restate the law would only clutter the Code of Federal Regulations and could confuse a VA loan holder seeking guidance on the requirements for servicing VA home loans, because this requirement applies only to VA.

