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BAILOUT, BUST, OR MUCH ADO ABOUT NOTHING?: A LOOK AT THE FEDERAL HOUSING ADMINISTRATION'S 2012 ACTUARIAL REPORT

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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BAILOUT, BUST, OR MUCH ADO ABOUT NOTHING?: A LOOK AT THE FEDERAL HOUSING ADMINISTRATION'S 2012 ACTUARIAL REPORT

Wednesday, February 13, 2013

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

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

Members present: Representatives Hensarling, Bachus, Royce, Lucas, Capito, Garrett, Neugebauer, McHenry, Campbell, Bachmann, Posey, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Grimm, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Cotton; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Hinojosa, Clay, Scott, Green, Cleaver, Ellison, Perlmutter, Himes, Carney, Sewell, Kildee, Murphy, Delaney, Sinema, Beatty, and Heck.

Chairman HENSARLING. The committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time. The Chair will now recognize himself for 5 minutes for an opening statement.

The American people deserve and demand a healthy economy. They deserve it today. What they do not deserve is the anxiety of stagnant jobs and paychecks that shrink in the face of higher gas prices, health insurance premiums, and the list goes on.

And they particularly do not deserve the anxiety of wondering whether their children and grandchildren will drown in a sea of debt.

To my left and to my right, I have up the National Debt Clock. For those who are unfamiliar with it, this Nation has racked up more debt on a nominal basis in the last 4 years than in the previous 200 years. It stands at—at least before we turned it on, it stood at $136,178 per household. For many constituents in the 5th District of Texas, that is more than they will ever amass in savings in their lifetime, and they owe it as their share of the Federal debt.

The spending-driven debt crisis that we have today is the great existential threat to our Nation of this generation. For us to have a healthy economy, we must put the Nation on a sustainable fiscal path, and to have a sustainable fiscal path, we must also have a sustainable housing finance system.

I have grave fears that FHA, as it is operating today, is an impediment to both, and that is why this committee is holding the second in what will be a series of hearings on the financial health, stability, and mission of the Federal Housing Administration.

As was well established in last week's hearing, the FHA is currently facing some tremendous financial challenges stemming from its dramatically increased market share and the dramatically deteriorating economic value of its insurance portfolio. I am very pleased that we have Carol Galante, the FHA Commissioner and Assistant Secretary for Housing at HUD, here today to help us sort through some of the issues that challenge and surround the status of the FHA.

In response to the housing crisis of the late 2000s, the FHA has morphed into a mortgage insurer of last resort to a dominant component in our mortgage finance system. In fact, the FHA now controls more than 56 percent of the total mortgage insurance market in terms of new loan endorsements, crowding out its private competitors with extremely low downpayment requirements and expanding its insurance to higher-income individuals and houses in the upper end of the marketplace.

The policy of cheap, up-front pricing and elevated maximum loan limits as high as $729,000 has allowed the total size of FHA's insurance book of business to explode by more than 64 percent, up to $1.13 trillion in Fiscal Year 2012, making FHA the largest mortgage insurance company in the United States.

And what is the result for the FHA and taxpayers of this unprecedented mission creep? The FHA is broke. The FHA is flat broke, and I fear soon the FHA will prove to be bailout broke.

Now, that is not just my conclusion; it is the conclusion of the annual independent actuarial study of FHA's Mutual Mortgage Insurance Fund—the government fund that insures the FHA single-family mortgages—that was released last November.

I quote: "The economic value of the fund as of Fiscal Year 2012 is negative $13.48 billion." And the study did not even factor in the FHA's money-losing book of home equity conversion mortgage, and I quote from the same report, "The economic value of the HECM portion of the Mutual Mortgage Insurance Fund to be negative $2.8 billion."

Clearly, the FHA is in a dire financial predicament where its projected future insurance claims far exceed its current cash on hand, a situation that ought to concern both critics and proponents of the FHA.

So the conclusions of the annual independent actuarial study give rise to several fundamental questions regarding the FHA that I hope Commissioner Galante can shed light upon. As I have said before, hardworking Americans demand a healthy economy, and we cannot have a healthy economy until we have a sustainable path to fiscal sustainability for our Nation, and until we have a sustainable housing finance system that is also competitive.

I now recognize Ranking Member Waters for 2 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman, for holding this hearing this morning, which is the second in your series of hearings about the health of the Federal Housing Administration.

We all agree that we need to closely monitor the health of FHA in light of the 2012 report from the agency's independent actuary, and we want to make sure that we remain focused on our long-term goals to help revive the mortgage market, bolster the economy, help qualified borrowers, and protect American taxpayers.

As I said at the hearing last week, we must recognize the tremendous value that FHA has contributed to our economy, particularly since the financial crisis. And we must be cautious about moving too precipitously to constrain FHA's role, being mindful of the fact that constricting credit too quickly could harm our housing recovery.

Let's be clear about what FHA is and what it is not. Emerging out of the foreclosure crisis that occurred during the Great Depression, the FHA was instrumental in creating the long-term, fixed-rate mortgages that form the backbone of our housing finance system, and that millions of middle-class families have used to build their long-term economic security. In the wake of a 2008 financial crisis caused by poorly underwritten loans from the private sector, FHA was able to ramp up from its tiny pre-crisis market share and provide crucial liquidity.

One estimate from Moody's Analytics found that if FHA went out of business in October of 2010, housing construction would have plunged 60 percent, home prices would have dropped an additional 25 percent, and our economy would have lost 3 million jobs and a half-trillion dollars of economic output. So with that in mind, I am eager to hear from Commissioner Galante on how FHA is fulfilling its statutory mission while also taking steps to boost its finances in the wake of the financial crisis.

I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, the chairman of the Housing and Insurance Subcommittee, Mr. Neugebauer, for 2 minutes.

Mr. NEUGEBAUER. I thank you, Mr. Chairman.

Oversight is an important aspect of what people in America expect from Congress, and this committee has tried to do oversight on a number of agencies, including FHA.

An important part of that oversight process is making sure that we have information that is factual and that we can count on. And when we look at FHA, what we notice is that over the last 2 or 3 years, we have had people come and testify that things are okay at FHA, that they are getting better, and yet the facts don't prove that out. And each year, in fact, the projections were missed. What we have now learned is that this agency is in much more terrible financial shape than we were told it was going to be.

It kind of reminds me of the story about the doctor who called his patient and said, "I have some good news and I have some bad news." The patient said, "Well, what is the bad news?" The doctor said, "Well, those tests that we did a few months ago, I misinterpreted them, and in fact, it turns out that you do have a terminal illness and you only have 6 months to live." The patient asked, "Well, if that is the good news, what is the bad news?" And the doctor said, "Well, the bad news is I should have called you 6 months ago."

And I think where we are today is that it has been represented to us that FHA is on the course of recovery and being healthier, but in fact, it is not. If a CEO of a major company kept telling his shareholders that things were getting better, and they kept having poor earnings, that CEO would soon be removed.

I think what is a cause of concern and hope that we will gain from this hearing today is, what is the true condition of FHA? But more importantly, what steps are being taken to remedy this so that we can put this entity back on track and take the taxpayers off the hook for having to fund another bailout.

With that, Mr. Chairman, I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, for 2 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I am extremely pleased that we have the Commissioner here today. I was a bit concerned last week because, whether intentionally done or not, there were those who at least suggested that in part the recession was caused by FHA or that FHA played a major role. And I always think we ought to laud loudly and allege lightly.

My concern today is that when you look at the facts, when the recession began we, FHA had almost 4 percent of the market, and I don't know how 4 percent of the market could essentially ransack the entire housing market. But the issue is that FHA, as Mr. Neugebauer said, does come before this committee and we have a responsibility for oversight. And I think we ought to do that. I think that it is important for the best information to be brought forward.

And I will just suggest to everybody on the committee that if we eliminate FHA and CRA, we won't have anybody to blame. So let's at least get FHA healthy so that we can blame FHA in order to have somebody to blame. We need a scapegoat, and I think we can probably lay it on FHA.

If we give up our power to change things, we do so because we are blaming instead of fixing.

Thank you, Mr. Chairman.

Chairman HENSARLING. The Chair now recognizes the gentlelady from Minnesota, Mrs. Bachmann, for 2 minutes.

Mrs. BACHMANN. Thank you so much, Mr. Chairman.

I think it is important for us to know where we are going, and for us to know where we are going, it seems to me prudent to know where we have been. And if there is anything that the years 2006, 2008 forward has shown us is that it isn't a very good idea for government to be forcing mortgage lenders to make loans to people who either: (a) can't pay the loan back; or (b) aren't willing to pay the loan back.

One thing that is very concerning about FHA and its process of insuring loans is that loans that are being made to people who either have bad credit or have nearly no downpayment or nearly no income. And my question is, who is being helped by this situation? Especially when in 2008, FHA had something like 28 percent of all of the mortgage insurance market, now they have doubled that to about 56 percent, and we are seeing that we could be on the hook—the taxpayers—for something like $16 billion at a time when we

are the brokest nation in the history of the world. And so it seems to me that we have to get a grip on this because it is deja vu all over again if we are going to continue this practice that could keep putting us back into bailout broke status.

It is a good thing to have people at all income levels be able to get into a house, but it is only a good thing if they can keep that house, if they can pay for that house. So it is important for us to look at strategies. Maybe it would make more sense for people to have a little bit more skin in the game when they put money down; maybe it would make a little bit more sense to make sure that their income is stable; maybe it would make a little more sense to make sure that they have a good credit score.

We want this industry to absolutely succeed wildly, but what government is doing right now is hurting the housing industry, and let's see how we can turn it around.

Ms. WATERS. Is it appropriate for me to ask for—to clear up the record on the statement of the gentlelady? Did she say we are the brokest nation in the history of the world?

Chairman HENSARLING. We could pull the record at a later time for the ranking member, but otherwise that question is not in order unless you want to take it out of the time of your—

Mrs. BACHMANN. And, Mr. Chairman, I would love to—

Chairman HENSARLING. I understand. I am sure you two could have a wonderful conversation after we get through opening statements—

Mrs. BACHMANN. I will be happy to offer substantiation for the record.

Chairman HENSARLING. —but we do want to get to the Commissioner in due time.

The gentleman from Colorado, Mr. Perlmutter, is recognized for 2 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I think we need to have a little lesson in history here, and I thank the Commissioner for being here, and really I want to thank the FHA for keeping the housing market alive from 2008 until 2011, when the private sector has finally decided to get back into the housing market business. But the abuses under the Bush Administration from 2003 to 2007, when there was zero down, and no income showing, and the private sector was buying these kinds of loans and then we have the crash at the end of 2007, 2008, where the whole housing market shrunk, and the only game in town was to get an FHA loan for most Americans. Without that, there would have been no housing market, and the recession would have been deeper than it was.

And so clearly, the book of business between 2003 and 2007 for the private sector or the public sector was bad. In Colorado, we see our housing market coming back pretty substantially.

But the private sector still wants the best credit. I don't blame them. They want to make sure that everybody has a 750 or 800 FICO score. I don't blame them.

Most Americans don't have a lot of cash to be able to buy that home but they do have an income, and if we don't abuse the system, as we saw in the Bush Administration during those years of 2003, 2007, where people were getting loans that they never should

have gotten, then we will have a strong housing market and the FHA needs to play a substantial role. The private sector will grow as the economy stabilizes.

But thank goodness loans were being made during the time when the market fell apart. So clearly, like any government agency or any institution, it isn't perfect and there are things that can be fixed, but I just want to thank you for your testimony today in advance of what you have to say.

Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 2 minutes.

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

First of all, the American people are pretty much sick and tired of this antigovernment, antigovernment. We need FHA today more than we ever needed it.

When this economy went through the turmoil that we went through over the last 4 or 5 years, it was due to the downturn in the real estate market, the downturn in housing. No sector of our economy was affected more than housing. That is what dragged it down.

But it was because we had an FHA that we were able to turn this thing around. If we have an example of where government works, FHA is at the center of this. The soundness of FHA is particularly vital to our national housing market.

Why? Because it plays a critical role as a backstop to lenders if borrowers are unable to pay their mortgages through no fault of their own. We went through an extraordinary downturn in the employment. Thank God we had an FHA there.

The guarantee that FHA offers enables banks to offer mortgages to potential borrowers with less desirable credit scores or lower incomes. This is America. We have a variety of income stratas.

In 2010, FHA had a 19.1 percent share of the mortgage market, representing a substantial portion of the housing sector. And FHA is especially critical to minority homebuyers. Listen: No sector of our population was hit as hard as the African-American market, and through no fault of their own. They were steered into abusive lending practices, primarily because they were Black.

Now, let me tell you something. In my State of Georgia, we ranked fourth in foreclosure in 2012. Each year in the last 4 years, we gave foreclosure prevention programs. Without FHA, we would not—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Westmoreland, for 1 minute.

Mr. WESTMORELAND. Thank you for having this hearing, and I hope that we can get FHA back to the original intent that it was created for: to help the first-time homebuyer and people who might not otherwise be able to attain a mortgage. But at the same time, I hope that we can also get the private sector—private mortgage insurance writers—into the game because if they ran their business like the FHA has run their business, they would be out of business.

And so, while we are trying to make sure that we keep a secondary market or availability for certain homebuyers, I think we

need to do more to turn it back over. And I think if you look at what Secretary Donovan said in 2009: "Based on current projections in absence of any catastrophic home price decline, FHA will not need to ask Congress and the American taxpayer for any bailout. Indeed, because of the quality of loans FHA is making today, the independent actuary expects this drop to be temporary and return about 2 percent within the next 2 to 3 years."

And I hope there will be an explanation of why it said minus—

Chairman HENSARLING. The time—

Mr. WESTMORELAND. —44—

Chairman HENSARLING. —of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 2 minutes.

Mrs. MALONEY. Thank you.

And welcome Commissioner Galante, and congratulations on your confirmation.

As one who represents one of the hardest hit areas by Hurricane Sandy, I want to thank you for the steps that you took to help the victims of the hurricane, including moratoriums on foreclosures, rental assistance to those who were displaced, and other significant assistance. We know that FHA was established after the Great Depression to be a backstop to housing, and it was designed to act as a countercyclical force in the market, ballooning in times of economic stress and contracting in times of economic prosperity.

And we have seen a great flux in their market share. It has been as low as 3 percent of the market and it is currently 14.6 percent of the market, but very importantly, it is down from 21 percent in 2009.

So there is no question that it plays a critical role in our housing finance system. We have a bipartisan, strong support that—and know that FHA fills a very important role for first-time homebuyers.

Now, some have expressed some concern about the health of the fund. I share that concern and I wrote the Commissioner in November. I received her response of the steps that they are taking. I would like permission to place my letter and her response into the record and to note that they have taken important steps, specifically: raising the insurance premium 5 times; selling distressed assets at an increased pace; implementing new downpayment and credit score requirements; and making changes to its reverse mortgage program.

I would like to note and place into the record a Moody's analysis that has said that if FHA had closed its doors in October of 2010, home prices would have dropped an additional 25 percent, and we would have lost an additional 3 million jobs. No one is keeping the private sector from coming in and helping, but if they are not there, FHA is there to help the housing and first-time homebuyers.

Thank you.

Chairman HENSARLING. This morning, we welcome Carol Galante as our sole witness. She is the Commissioner of the Federal Housing Administration and the Assistant Secretary for Housing of the U.S. Department of Housing and Urban Development. She first joined HUD in May of 2009 as the Deputy Assistant Secretary for Multifamily Housing. Among other things, the Commis-

sioner has direct responsibility for oversight and administration of the FHA's trillion dollar insurance portfolio.

The witness will be here until 1 p.m.; thus, I will be very strict with the gavel for all Members.

Commissioner Galante, you will be recognized for your requested 7 minutes to give an oral presentation of your testimony. And without objection, your full written statement will be made a part of the record.

Commissioner Galante, you are now recognized.

STATEMENT OF THE HONORABLE CAROL J. GALANTE, COMMISSIONER AND ASSISTANT SECRETARY FOR HOUSING, FEDERAL HOUSING ADMINISTRATION (FHA)

Ms. GALANTE. Thank you.

Good morning, Chairman Hensarling, Ranking Member Waters, and members of the committee. I appreciate the opportunity to appear before you to discuss the FHA and the critical role it has played in our Nation's housing finance system as well as policy changes enacted and needed to further strengthen the Mutual Mortgage Insurance (MMI) Fund.

This is an important moment for our housing market and our Nation's economic recovery. There are encouraging signs: housing construction growing faster than it has since 2008, the strongest year of home sales since the economic crisis began, and rising home values lifting 1.4 million families above water in 2012.

FHA's programs have been a critical component of this recovery. That should come as no surprise, given the program's goals and history. With the dual mission of providing access to homeownership to underserved and low-wealth populations, and acting as a stabilizing force during periods of economic stress, the FHA is designed to fill gaps in the market.

It is clear that FHA has done just that. By ensuring needed liquidity in the Nation's mortgage finance markets, FHA was a vital stabilizing force as we experienced the worst economic decline since the Great Depression. In the last 4 years, the FHA has made homeownership possible for 3.5 million families, including 2.8 million first-time homebuyers, and for 50 percent of all African-American and Latino homebuyers in the last year. And Moody's Analytics estimates that were it not for the FHA's presence during the crisis, home prices would have fallen another 25 percent.

While FHA has acted as a critical support, it was not immune to the stresses of falling home values and rising unemployment. According to the independent actuary's annual report on the MMI Fund, in 2012 the capital reserve ratio fell below zero to negative 1.44 percent, representing a value of negative $16.3 billion.

Now, we take these findings extremely seriously. As stewards of taxpayer dollars we have, since the start of this Administration, made it a priority to strengthen the fund, and we are continuing to take aggressive action to return the fund to fiscal health, including action discussed in our annual report to Congress as well as additional changes announced last month.

It is important to understand, as well, that the actuary's report does not in and of itself mean that it will be necessary for FHA to use its authority to draw from Treasury to reserve for projected

losses over the next 30 years. While this is a possibility, it is dependent on several factors, including the estimates in the President's upcoming budget submission and the actions and activities of FHA throughout the remainder of the fiscal year.

And let me assure you that: one, FHA has $31 billion in current reserves; and two, we remain committed to taking every action appropriate to protect taxpayers while continuing to ensure that FHA supports the stabilization of the housing market and that families have access to sustainable mortgage credit options.

With the help of Congress, this Administration has already taken significant actions to protect and strengthen the fund, including: five separate premium increases; changes to credit policies such as increasing downpayments for certain borrowers, and ending seller-financed downpayment assistance; and better oversight and enforcement of FHA lenders. Were it not for the flexibility granted by Congress to FHA in 2010 in setting premium pricing, the current economic value of the MMI Fund would be more than $2 billion—I am sorry, $10 billion lower than it is today.

Additionally, Congress paved the way for us to establish FHA's first ever office of risk management, which has been instrumental in strengthening oversight and implementing policies to better protect the fund. Together, our efforts to strengthen and protect FHA have added well over $32 billion to the fund, to date.

As attested to by the actuary in its report and which can be seen in the slide shown here, the strong efforts of FHA to improve the quality of new FHA-insured loans have worked, as loans insured since 2010 are expected to be the most profitable and strongest in the agency's history. The reason for this is that we have made substantial progress in reducing losses from defaulted loans while simultaneously increasing revenues through premium increases and policy changes.

These improvements are visible on the next slide, as you see here, as a result of loans insured since 2010 are projected to generate $20 billion in additional value for FHA.

However, as the actuarial further protests, with fully $70 billion in claims attributable to the 2007, 2009 books of business, there remains substantial additional work to be done to mitigate the impact of legacy loans insured during that time. That is why we have devoted significant attention to addressing the severe stresses placed on the fund by these loans, employing a number of innovative approaches to enhance the effectiveness of FHA's loss mitigation policies and reduce FHA's losses resulting from nonperforming assets.

Under our existing authority, we have confronted FHA stresses at every point in the lending cycle, and in doing so, we have both strengthened FHA for the long term and set the stage for the return of private capital to the market. And in fact, our market share has been declining steadily since its peak in 2009 from a level of nearly 30 percent at that time to less than 15 percent today. At the same time, we recognize that this housing recovery is fragile, that access to credit remains critical to solidifying the recovery, and that FHA must balance these important goals as we proceed with changes that protect the fund.

That said, with your help we could do even more to protect the fund while not damaging access to credit for responsible borrowers. We have developed a comprehensive list of additional risk management and lender enforcement authorities that will further enhance FHA's risk management and fiscal health. Many of these were included in the bipartisan reform legislation initiated by this committee and passed by the full House in the last Congress.

I sincerely hope that we will once again be able to work together with Congress on efforts that protect FHA and strengthen its programs.

Mr. Chairman, in addition to strengthening FHA's financial picture, there does remain a broader question as to FHA's role over the long term as we begin to look to a new system of housing finance in this country. As we work to create a safer, stronger, and more robust system of housing finance, where private capital plays a primary role and taxpayers are protected from unnecessary losses arising from the activities of private lenders, we must consider the place of FHA in that system. It is critically important that this work be done in a coordinated and comprehensive way where all components of the system are addressed in an interrelated manner.

I believe that just as it has for nearly 80 years, FHA's mission will continue to remain relevant and important in providing a pathway to the middle class and quality, affordable housing opportunities for American families. And I look forward to working with this committee to strengthen, protect, and equip FHA to play this important role.

I thank you very much, and I am happy to answer your questions.

[The prepared statement of Commissioner Galante can be found on page 62 of the appendix.]

Chairman HENSARLING. Thank you, Commissioner.

The Chair will yield himself 5 minutes at this time.

Commissioner Galante, as bad as the picture appears from the independent actuary report, I fear that the true finances could potentially be even worse. Last week, we had testimony from Mr. Ed Pinto, a resident fellow at the AEI, who said, "Under Generally Accepted Accounting Principles, FHA has a current net worth today estimated at a negative $26 billion, meaning it has a total capital shortfall today of $47 billion, based on its 2 percent capital requirement."

Professor Joe Gyourko, who is a professor of real estate finance and business and public policy at the Wharton School of Business says, "The FHA's main insurance program is materially undercapitalized with the likely amount of capital infusion required being in the $50 billion to $100 billion range."

Dr. Mark Calabria, who is the director of financial regulation studies at the Cato Institute, said, "Relatively small changes in the performance of FHA's portfolio could result in significant losses to the taxpayer. Reasonably foreseeable changes to the FHA's performance could easily cost the taxpayer tens of billions of dollars, surpassing the ultimate cost of the Troubled Asset Relief Program bailouts, otherwise known as TARP."

Are you familiar with the studies and analysis of these economists?

Ms. GALANTE. Some of them, yes.

Chairman HENSARLING. And do you have a critical analysis of them? Do you find them accurate or inaccurate?

Ms. GALANTE. Mr. Chairman, what I would say is that the FHA is accounting for its projected losses over a 30-year period of time, and that is done under the Federal Credit Reform Act, put in place in 1990, which is when the first capital reserve ratio was also instituted for FHA. So—

Chairman HENSARLING. No, I understand that. But do you find the analysis correct or incorrect?

Ms. GALANTE. I would say that they are trying to interpolate, from my understanding, how you would project losses under a totally different accounting system, so—

Chairman HENSARLING. Okay. If I could move on, can I have the chart I requested, please?

With respect to projections, Commissioner Galante, my concern here is that for over a 4-year period the projections—and one of these days this committee room will get larger screens—but this is not the first time that we have heard similar testimony. And in fact, last year the HUD Inspector General testified that FHA continues to project that current and future year books of business will be profitable and make up for these past year losses. But we have seen in the past 3 years, it is a troubling trend whereby the point at which the fund is expected to reach its mandated capital level is pushed further into the future.

So, if you look at the slope that goes down, that is the actual ratio in the fund, and the four lines that move upward are the predictions. And unfortunately, Commissioner Galante, not only has FHA been wrong, it has been wrong for 4 years in a row, and I started this hearing showing our National Debt Clock. It reminds me of the book written by Professors Reinhart and Rogoff entitled, "This Time is Different" about nations who encounter financial crises.

And so I guess the question is, after 4 years of being wrong, why is this testimony different?

Ms. GALANTE. Thank you, Mr. Chairman, for your question. Let me be clear about the actuarial projections. First of all, these are independent—it is an independent actuary and they rely on independent economic forecasts that are predicting—forecasting—30 years' worth of house price appreciation, trends in interest rates, and how those economic forecasts will impact—

Chairman HENSARLING. But do you find fault with the audit?

Ms. GALANTE. I would say this: projecting, you could ask 100 different economists in 2008 what the house price projections were going to be and you would get 100 different answers. There are a couple—when you are projecting over 30 years and you are projecting over 30 years at the depth of a crisis, being able to make those—

Chairman HENSARLING. I understand that, but it has been 4 years in a row, and I am going to attempt to set a good example. I only have 30 seconds left.

The Housing Act of 1934 says that the FHA "shall ensure that the Mutual Mortgage Insurance Fund maintains a 2 percent capital ratio at all times." It doesn't say "may," it doesn't say "might,"

it doesn't say "try;" it says "shall." What should the consequences be that for 4 years running the agency has violated the law?

Ms. GALANTE. Again, Mr. Chairman, the 2 percent capital ratio is a—not meeting it is a finding in our audit. We take that seriously. We have been working as hard as we can to make policy changes so that we can get back to that capital ratio.

Chairman HENSARLING. I thank you.

The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much.

Ms. Galante, I am very pleased that you are here today because this is one of the subjects on which we have had so much misleading information. For example: the FHA is crowding out competing with the private market; the FHA has an unfair advantage over the private market. It was suggested in the last hearing that FHA represents 56 percent of the market, but I understand and I think your testimony just a moment ago said it is closer to 15 percent. Is that correct?

Ms. GALANTE. Yes, Ranking Member Waters. Let me just say this: There is the total housing market, which is the refinance and home purchase market, so we have gone from the peak of 30 percent down to less than 15 percent of the total market. On the purchase market, we have also receded—we were higher. We have also receded significantly.

And of the private mortgage—of the mortgage insurance market, I think the number quoted of 56 percent, we are now more like—and there is a slide in your deck—slides four and five—that clearly demonstrate that we have been coming down even as a share of the mortgage insurance market down to more like 42 percent, and you can see that the private mortgage insurers are on their way back up.

Ms. WATERS. Thank you. I think it is important to get that into the record.

The other statements we have heard basically—and as our chairman just pursued this discussion—the FHA, and specifically the Mutual Mortgage Insurance Fund, is broke. Now, according to data from the FHA actuarial report in fiscal year 2012, the capital reserve ratio of the agency's primary insurance fund fell below zero to negative 1.44 percent and the fund's economic value stands at negative $16.3 billion.

The economic value refers to the amount that would be needed for FHA to meet all its expected claims over the next 30 years if FHA closed its doors tomorrow and had no business to offset those claims. The FHA still has—I will let you say it. How much money does the FHA still have to settle insurance claims as they come in?

Ms. GALANTE. A couple of points on that, Congresswoman. First, we have $31 billion in reserves against those projected losses. And as you stated, there is additional revenue coming in every year from these very profitable books of business from 2010 on. So on an ongoing basis, on a cash flow basis, there is certainly money there to pay the claims.

Ms. WATERS. And is it true that in addition to the $30.4 billion to settle insurance claims as they come in, you basically have enough cash for at least 7 to 10 years?

Ms. GALANTE. Yes. Again, we have ongoing business and the actuarial, by the design of the way the capital ratio is calculated, does not include any future revenue from future business.

Ms. WATERS. And finally, the FHA is essentially a subprime lender. That is what some of my friends on the opposite side of the aisle have been saying, that it gives risky loans to low FICO score borrowers. Would you comment on that, please?

Ms. GALANTE. I would just say this: FHA has always been 30-year, fixed-rate, fully documented, serving a broad range of borrowers with a focus on lower-wealth individuals. These are sustainable mortgages for the families who are taking them out. Now, during the—

Ms. WATERS. Madam, in the few minutes that you have, where you are being accused of being subprime lender, did you do-no documentation loans?

Ms. GALANTE. No, we did not.

Ms. WATERS. Do you do resets with teaser loans?

Ms. GALANTE. No, we do not.

Ms. WATERS. Do you do all of your loans going to jumbos, or how—would you explain exactly what the mission is and what you are trying to do?

Ms. GALANTE. Yes. Again, our mission is dual, both to be a countercyclical force when needed in the market, and also to serve lower-wealth borrowers to access credit and be able to purchase or refinance a home.

Ms. WATERS. What would you ask this Congress to do legislatively that would make your job easier, to help you fulfill the mission?

Ms. GALANTE. Yes. We have put forth a number of items in our report to Congress, including additional authority to enforce against lenders on a wider geographic basis. There is a whole class of lenders for which we do not have indemnification authority. And I would also add, in particular, we have not talked a lot about the reverse mortgage program, but it has some serious challenges, and we are asking for some emergency authority there.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. I thank the chairman. Mr. Chairman, just for the record, I wanted to clear that there have been some numbers thrown around. According to GAO, this is the third quarter 2012 FHA's market share of insured market in terms of numbers of loans: the Federal Housing Administration, 56.4 percent; private mortgage insurance, 19.7 percent; and Department of Veterans Affairs, 23.9 percent. So obviously, the taxpayers are the big insurers of mortgages in this country.

Ms. Galante, thank you for coming. I enjoyed our visit the other day.

I really don't know where to start other than in my opening statement, I think the point I tried to make is, do you actually know where you all are? When we see the numbers that the chairman put up there where we see projections, we come back next year and it turns out those weren't the numbers, and you have an entity that, according to the study, actually has a negative net worth, but you reported that you have about $38 billion in re-

serves, but you are running a $1.1 trillion entity, so you are running an entity that is leveraged 36 to one, and so that is a 2.7 percent capital ratio.

Any kind of financial institution in this country that had those numbers would be under some sort of cease-and-desist order. And then you look at the numbers currently right now of your delinquency rates. For example, in 2012: first quarter, it was 12 percent; second quarter, it was 11.89 percent; and third quarter, it was 11.14 percent. So an entity that is making financial transactions with those kinds of delinquencies with, according to the study that was done, has a negative net worth but according to you has a 2 percent net worth.

The question is—and I think the other point I would make is, you don't even pay your operating expenses out of that fund. The taxpayers pay the operating expenses. So does the accounting that we are using now allow you to actually manage this entity?

Ms. GALANTE. There are a number of different questions embedded there, Congressman. Let me just talk about the delinquency rates. To be clear, you have to divide this by cohort year, because we have serious—if you look, again, back at that original chart—we have some serious stress from older books of business, and those delinquencies are much higher. The delinquencies in our new book that we are writing insurance on now are extremely low.

Mr. NEUGEBAUER. But, Ms. Galante, I don't—I have a limited amount of time. A delinquency is a delinquency. Just because it is not as bad as it used to be, but it is bad over here, I have to look at—my oversight is the entire entity, and so you have some problems here. And the question is, do you have enough reserves to carry that? Some people say that you don't. I question whether you even know what reserves you need, so how do you then price your product if you don't know where you are?

Ms. GALANTE. That is a very good question. Let me just be clear. These long-term economic projections have volatility. That does not mean that we are not monitoring the portfolio for the delinquency rates and getting rid of policies like the seller-assisted finance program that cost $14 billion. We would be above zero. We would have an economic value of almost $2 billion if it weren't for that seller-financed program. So, we got rid of it.

We are monitoring the portfolio for that kind of activity all the time. One of our actions that we just took was to ensure that we did not cancel the mortgage insurance premium prematurely, that again was a policy that was being done in the past that negatively affected economic values.

So we are, with our new risk management activities, clearly monitoring this portfolio on an ongoing basis.

Mr. NEUGEBAUER. Thank you. And I think the question is, the reason accounting is so important—and I am an old bean counter; I have an accounting degree—is that knowing what your product costs is an important part of pricing it. And you have some tools that are available to you that you are not necessarily using. I know you just raised the G.P. about 10 basis points but you actually could have raised it 30 basis points. The up-front premiums—you still have some room to charge additional premium there.

I just question, if you don't know where you are, then how can you utilize those tools effectively, and shouldn't—given the financial picture that is painted before you today, shouldn't you be more aggressive in trying to restore this fund to at least the congressionally requested levels?

Chairman HENSARLING. The time of the gentleman has expired, so an incredibly brief answer, Ms. Galante?

Ms. GALANTE. My answer on the premiums is that we have raised premiums 5 times, and we think that is the right place for the pricing of the risk that we are taking on for these new loans. And we have to be careful about pricing new borrowers to pay for the challenges of the past. We will clearly damage access to credit if we do that.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you.

I know that FHA worked very hard in response to the devastating effects of Superstorm Sandy, which hurt New York and my district particularly hard, as well as 23 other States, primarily New Jersey and Connecticut. Can you talk about some of the actions that FHA took to respond to help people? Specifically, what did you do to help homeowners who were affected?

Ms. GALANTE. Yes, thank you. You know that Secretary Donovan leads the Sandy Rebuilding Task Force and he is very concerned that we help homeowners and renters alike during this crisis. And FHA, in conjunction with Fannie Mae and Freddie Mac, extended moratoriums another 90 days on both evictions as well as foreclosures that were already in process.

And today, I am pleased to say that we are expediting—we are putting out guidance that we are going to expedite processing for multifamily properties that would like to come in for FHA multifamily insurance. So we are doing everything that we can to help the storm victims.

Mrs. MALONEY. Earlier, you responded to some questions from the ranking member on really abusive practices—predatory practices that came from the private sector and cost many homeowners their homes, which ended up in foreclosures. Another predatory practice that I am hearing complaints about from my constituents is the practice of a—when they do try to pay down their loan, they are getting a prepayment penalty. What is the policy of FHA on prepayment penalties? Do you have—

Ms. GALANTE. I don't believe we have prepayment penalties.

Mrs. MALONEY. That is another example of how FHA is really helping first-time homeowners and homebuyers by not practicing these abusive practices. It was not FHA that came out with the no-doc loans; it was not FHA that said you didn't have to put anything down; it wasn't FHA that came out with the predatory practices that contributed so heavily to the financial crisis that FHA is helping us respond to and helping homeowners to stay in their homes.

Can you go over some of the steps that you have taken in terms of improving risk management that some of my colleagues seem tremendously concerned about?

Ms. GALANTE. Yes. As I have said, we have increased premiums 5 times. We have revised downpayment requirements for borrowers

with 580 FICO scores or below to 10 percent. We recently have tightened on borrowers with credit scores of 620 and under that they need to have a demonstrated no greater than 43 percent what we call debt-to-income ratio without additional compensating factors. So, we have looked at areas where the credit box needs to be tightened a bit.

We have also looked at increasing premiums to ensure that we are paying for or compensating for any risks that we are taking. Those are just a few of the actions that we have taken over the past couple of years.

Mrs. MALONEY. Both the chairman and the ranking member have placed GSE reform as one of the top priorities for this committee to address and try to settle and to make a priority of our work on the committee. Many have said that you can't have GSE reform without a strong FHA program. Could you elaborate on that?

Ms. GALANTE. I—

Mrs. MALONEY. What role—

Ms. GALANTE. I think it is critically important as we go into looking at GSE reform, broader housing finance reform, that we look at the role of FHA simultaneously, and moves that might be made relative to restructuring the housing finance system with respect to the GSEs, that we also ensure that we understand what the role of FHA is as part of that entire system, as opposed to trying to take this in piecemeal.

Mrs. MALONEY. Thank you. I think your comments are very relevant to the task that we have with GSE reform.

Thank you for your service.

Ms. GALANTE. Thank you.

Chairman HENSARLING. The gentlelady yields back.

The Chair now recognizes the gentleman from North Caroline, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman.

Ms. Galante, I certainly appreciate your testimony and thank you for your service to your government.

Now, in looking at the FHA delinquency rate, your delinquency rate was 11.14 percent and the seriously delinquent rate was 8.54 percent. Together, that is almost 20 percent.

Your delinquency rate is 2½ times that of the whole mortgage industry, and so added together, that 20 percent delinquency rate means that nearly one in five FHA-insured loans goes into default. In looking at this statistic, I look at something that Senator Elizabeth Warren once said to justify the creation of the Consumer Financial Protection Bureau: "It is impossible to buy a toaster that has a one-in-five chance of bursting into flames and burning down your house, but it is possible to refinance an existing home with a mortgage that has that same one-in-five chance of putting the family out on the street."

Now, since FHA performs no better than that one-in-five chance that Senator Warren references, that unacceptable default rate, how can you justify that FHA is actually helping rather than hurting average homebuyers?

Ms. GALANTE. Congressman, just to be clear about these numbers, because I think we are conflating a couple of different things,

our seriously delinquent rate is a little over 9 percent—9.5 percent—

Mr. MCHENRY. I am sorry. I referenced 8.54 percent, so that is higher. I am sorry.

Ms. GALANTE. But you are adding to that people who are not seriously delinquent, they may be 30 days delinquent, and adding those together to get to your numbers. We have one in 10 who actually fail and go into some kind of foreclosure. So you can be seriously delinquent, you can be 30 days delinquent, and we have loss mitigation programs for folks, we have modification programs. We work with borrowers to get them out of delinquency, and that—just because you have missed a payment and you are "30 days delinquent," does not mean that you have failed in making—

Mr. MCHENRY. I certainly appreciate your response, but your rate is 2½ times that of the rest of the industry. That is my comparison.

Ms. GALANTE. I would like to address that. Let's be clear. We don't have as good a delinquency rate as the lenders who will only lend to people at an 800 FICO score and who have lots of wealth to put down—20, 30 percent downpayment, who don't need our help. We do generally focus on a borrower population that still can be very successful but—

Mr. MCHENRY. I appreciate the fact you don't have the numbers in front of you. But my point of reference here is that for your prime loans—that portfolio of prime loans—and I appreciate getting the message; perhaps you can give more flesh to what you just said—but the comparison for FHA prime loans to the mortgage industry's prime loans, your default—your delinquency rate is 2½ times that. Is that acceptable?

Ms. GALANTE. Again, FHA is designed to fill in market gaps. We are designed to provide access to credit and—

Mr. MCHENRY. I understand your design. I have read the law.

Ms. GALANTE. Yes.

Mr. MCHENRY. With all due respect, I have read the law. I am giving you statistics from the DBA Delinquency Survey for the third quarter of 2012. So I understand you are quibbling with my statistics. Tell me what the acceptable delinquency rate is for FHA.

Ms. GALANTE. I would just say this: We have borrowers who ultimately, on average, over time are not successful, so they are subject to foreclosure is a 10 percent number.

Mr. MCHENRY. And is that acceptable?

Ms. GALANTE. I believe that on average, across 40 years, across all different kinds of borrowers—if 90 percent of our borrowers are going to be successful, a 10 percent rate is—we would like to get it lower. It is certainly lower for our new populations moving forward. But I don't think that is unacceptable, no.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

And, Commissioner, thank you for your testimony. I would like to give you an opportunity to once and for all discuss whether or not FHA forces lenders to make loans or make loans to unqualified borrowers.

Ms. GALANTE. Thank you. Certainly, FHA does not force lenders to make any loans. We make insurance available to lenders who are willing and able to underwrite loans to our standards. I would actually say that one of the biggest challenges that we haven't talked about here today is that we have lenders who won't lend even to the FHA standards, that they are creating lender overlays on top of that because of concerns that they have.

Ms. VELAZQUEZ. Thank you.

The Fiscal Year 2012 actuarial report emphasized that the predicted default within FHA's portfolio was focused on loans endorsed between 2007 and 2009. Would you please explain the characteristics of these loans and the borrowers?

Ms. GALANTE. The characteristics of those borrowers?

Ms. VELAZQUEZ. Yes.

Ms. GALANTE. So the characteristics of those—

Ms. VELAZQUEZ. At risk of default.

Ms. GALANTE. At a risk of default?

Ms. VELAZQUEZ. Yes.

Ms. GALANTE. I would just say that these borrowers are often in places that have been subject to the greatest economic distress that has occurred in this country, so areas of high unemployment that they were impacted by, where jobs have left and they lost jobs. They are concentrated in areas where there has been the most serious economic distress.

Ms. VELAZQUEZ. Can we discuss the loans that FHA insured from 2010 onward that have been performing extremely well? Why have these loans insured between 2010 to 2012 been so successful?

Ms. GALANTE. They have been successful for a number of reasons. One, we have increased our premiums so we have more revenue coming in to protect ourselves from the risk. The other reason they have been successful is they are fully underwritten and they are being underwritten at a time when economic circumstances are better, and they are successful for those reasons.

Ms. VELAZQUEZ. And do you believe that the success of these types of loans between 2010, 2012 insured by FHA can be replicated in future business?

Ms. GALANTE. Yes, I do. And again, I would just go back to say one other element, which is, to some extent we would like to see lenders lend to a broader range than they are currently lending to in terms of the overall FHA population of loans.

Ms. VELAZQUEZ. Many critics of FHA believe the private sector can effectively duplicate the agency's mortgage insurance services when it returns to the market. Do you believe that this is the case, particularly for low-income, minority, and first-time homebuyers?

Ms. GALANTE. I do not believe that the private market can fully take care of all the borrowers that FHA takes care of, and I think you are going to witness that at the height of the crisis. That private capital fled and it really was FHA that was there for minority homebuyers.

Home purchase mortgages dropped 50 percent for the entire White population. It dropped 65 percent for African Americans and Latinos. Those borrowers were even more negatively impacted than the broader market.

Ms. VELAZQUEZ. During the hearing last week, some of the witnesses argued that FHA is crowding out private investors. Do you believe that is the case? Is the private sector in fact ready to return to the market?

Ms. GALANTE. I think that the private market is starting to return and they are starting to return because they are seeing some economic recovery. They are seeing some strength in the housing market and that is a positive sign. And I think the charts that I have showed indicate that is continuing to come back.

But one point that I think is really important here is that the total market shrunk during this crisis and it has not come close to coming back. So while FHA went up a little bit and now it has come down, there is a whole area we didn't step into but no one else has either.

Ms. VELAZQUEZ. Thank you.

I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from Minnesota, Mrs. Bachmann.

Mrs. BACHMANN. Thank you so much.

I really was troubled by these delinquency rate numbers that Mr. McHenry brought up, because it really concerns me when I am reading that the MBA Delinquency Survey for all loans nationwide is 7.4 percent, and then you look at the FHA and it is over 11 percent, 2½ times the rate of prime loans, and the seriously delinquent rate is 8.54 percent.

Delinquency is a big deal, because in my home State of Minnesota, we had 13 private banks that fell below their capital requirements, and when that happened the FDIC came in, and they were put in receivership. But when the FHA has fallen below their capital requirements, their market share has only grown.

So this makes me very, very nervous and I think it is making taxpayers very, very nervous. And so my question is, is the FHA meant to be funded by the taxpayers?

Ms. GALANTE. Thank you, Congresswoman.

FHA is intended to, again, price its risk and be able to—

Mrs. BACHMANN. But your funding. Are you intended to be funded by the taxpayers?

Ms. GALANTE. Over the long term, we are intended on a day in, day out basis to be able to be self-sustaining.

Mrs. BACHMANN. But you would agree that you are not self-sustaining right now?

Ms. GALANTE. What I would say is that we have a negative capital ratio, right—

Mrs. BACHMANN. And that is what makes me nervous.

Ms. GALANTE. Yes.

Mrs. BACHMANN. So what I want to know is, what percentage chance do you think that taxpayers will have to bail out the FHA sometime in the next 15 years if this trend continues on defaults?

Ms. GALANTE. First of all, again, we have been—we have talked about this. The trend is much, much better than it was as a result of the economic crisis, and now that we are in recovery those trends are—

Mrs. BACHMANN. But the trend on default isn't good. The trend on default is over 11 percent.

Now, let me ask you this: The FHA does have risk assessment practices, right?

Ms. GALANTE. That is correct.

Mrs. BACHMANN. You have them. That would include things like credit scores, downpayments, people's income. I would assume those are things that you take into account?

Ms. GALANTE. Yes. Again, lenders make these loans under our requirements.

Mrs. BACHMANN. Right. And you said that you changed these risk requirements about 5 times, I think you said. You increased premiums and you talked about the FICO score, if they are below 580, they have to have a 10 percent downpayment; if they are 620—so you are talking about those scores. But when you look at conventional lending, usually your credit score has to be above 700, a minimum 650, usually with 20 percent down.

So if the FHA is going to keep on taking risks by insuring so many people who have low credit scores, almost no downpayment, and almost no income to pay for a mortgage, how does the FHA differ from predatory lending practices?

Ms. GALANTE. Again, Congresswoman, FHA is designed to deal with lower-wealth borrowers and it is appropriate for us to be taking different kinds of risks than the private market in and of itself would do. That is the point of having an FHA.

Mrs. BACHMANN. But wouldn't you agree that poor people are better off if they could be able to hold onto their home and stay there and live there? And wouldn't you agree that it would be far better practice for our government if we would want to help people to own the assets that they put in their home so that we are rewarding people who are able to pay their bills? Because wouldn't you agree that it really hurts a person to lose their home and it hurts their credit?

Ms. GALANTE. It is devastating for a person to lose their home, and I just want to be clear: Again, 90 percent of our FHA borrowers are ultimately successful. You cannot look at what FHA does and who it helps and not see that we have really helped millions of families—

Mrs. BACHMANN. But your default rate is 2½ times worse. That is really what the problem is, isn't it? Because it is devastating right now and we are looking at putting the taxpayers on the hook for that unconscionable level of default. That is what we are nervous about is this trend and trajectory that it seems like you want to continue because your lending practices are in the realm of predatory lending that we have been trying to mitigate against.

Ms. GALANTE. You really—I am sorry, but you have this backwards, okay? We have had higher defaults through the economically distressed books of business where default rates are higher. You trend those forward, you blend those with now what are very, very low delinquencies, and our borrowers are going to be even more successful moving forward because we got rid of—

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognized the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you.

Just a couple of opening statement remarks.

Yes, but, my colleague in Minnesota, you can close down this or that bank because it doesn't have the capital. The depositors are insured and people needing banking services can just walk down the block and go to a different bank.

If we shut down the FHA—if we had done that, we would have had a 25 percent further decline in home values, a cost to American families of well over $3 trillion, a double-dip recession, and the effect on our debt would have been so big that when the chairman put up the debt on the screen, we would need to equip this room with bigger television sets, if you imagine what our debt would be if there was no FHA, if there was an additional 25 percent decline in home values.

You have indicated to us that you would like additional tools to manage the risk of the Mutual Mortgage Insurance Fund, but many of those tools were in legislation passed by this committee and passed by the House. Could you just quickly outline what are the tools that you need and were most or all of them in that bill?

Ms. GALANTE. Yes, thank you. Most of them were in that bill, and again, that includes indemnification authority for certain lenders so that we can hold lenders accountable if they don't follow our underwriting standards, a greater ability to terminate FHA approval of lenders on a larger geographic basis than just individual areas, more flexibility in how we deal with our compare ratio, so again, we can hold lenders accountable.

So those are the actions that we are asking for, and then to deal with the reverse mortgage program. Those are the actions we are asking for moving forward. The reverse mortgage program one was not in the prior reform bill but is something that we are asking for today.

Mr. SHERMAN. This recession is something beyond what most Americans have lived through in the past, but in the 1980s, in the big oil-producing States, we had a big downturn in the 1980s, not for the whole country but for Texas, Oklahoma, and Louisiana. And isn't it true that at that time the FHA was the primary lender in those States? The FHA helped stabilize prices and over time the private market returned on its own?

Ms. GALANTE. Yes. My understanding is that is correct and it is a perfect example of FHA staying in a market when others leave and receding as appropriate.

Mr. SHERMAN. So, like the gunslinger—like the hero of western movies, you came into town—a place like Texas or Oklahoma—restored order, and pretty much left town.

Ms. GALANTE. I like the image.

Mr. SHERMAN. Now, some say that the FHA has gone beyond its mission, but aren't you actually serving exactly what your mission is designed for, and that is to serve private market when the private market is unable or unwilling to participate?

Ms. GALANTE. Absolutely. And I think if you were to look at slide 5 on the deck that I handed out, if you look at how private capital literally precipitously just fell off in 2007 through 2008 and FHA was there to pick up as much of the volume as we could in that very short period of time, and that is exactly what we were designed to do.

Mr. SHERMAN. I represent an area that the statisticians would say is a little wealthier than the rest of the country. It is really just our—the home prices are higher, and one of the 12 high-cost areas in the country where your limit is at $729,000. If it wasn't for your limit being that high, all the nicer homes in my area would have dropped precipitously in value and then the homes a few blocks or miles away would have also dropped as well.

Are you pricing your current guarantees, and particularly for those up between $625,000 and $729,000, high enough so that you are charging a bit more than the risk you are taking and making a profit for the Federal Government?

Ms. GALANTE. Yes, sir, we are. And, again, we—it is a bit of an aberration that FHA has those high limits but it was necessary during the crisis. And we have instituted both higher premiums than the rest of our book of business for those higher loans, and we also just recently increased downpayment requirements for those loans as well.

Mr. SHERMAN. So you are making money for the Federal Government that—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Alabama, the chairman emeritus, Mr. Bachus, for 5 minutes.

Mr. BACHUS. In the first 20 years of FHA's existence, there were 5,000 claims made. In other words, 5,000 mortgages fell into default or foreclosure, and that was out of almost 3 million that were made. Today, you are making—there are over 7 million mortgages outstanding and yet you are having 12,000 claims every month.

You had 5,000 in the first 20 years of existence of FHA, so you are actually having more about every 10 or 12 days than you had in the first 20 years. And let me show you—I don't know if you can see—you have in front of you two charts. One shows that the default rate—now, this is on the 2010—that families with FHA mortgages are defaulting at about what appears to be over 10 times the amount of Fannie mortgages and the same for MGIC.

Does that greatly disturb you—that foreclosure rate?

Ms. GALANTE. Again, I am not sure which chart we are referring to. On this one with the large spike, one thing that troubles me about this chart is it is not to a reasonable scale. You have left off 1967 through 2006—

Mr. BACHUS. No, 1967 is—this is all in there. Didn't it start going up in—when did it start—when did you take this chart increase?

Ms. GALANTE. I think that if you put this on a proper scale, it is not as sharp an increase as it would otherwise appear—

Mr. BACHUS. Let me ask you this: From 1954 to 2003, it was less than two. Now on any scale it is above—it is above 18 today. Is that not correct?

Ms. GALANTE. I am not sure that is correct.

Mr. BACHUS. So you are saying—

Ms. GALANTE. Again, I am just looking at this for the first time so it is a little hard to look at these numbers—

Mr. BACHUS. So you are saying there has not been a great increase in foreclosures?

Ms. GALANTE. Again, you have to look at this over time. Were there significant—

Mr. BACHUS. I am trying to do that.

Ms. GALANTE. —increases in foreclosures at the height of the economic crisis? Absolutely.

Mr. BACHUS. Let's go to the second one, then, okay? Let's just take 2000—let's just take the 2010 book. Now, you don't have a problem with this chart, do you? And it shows a delinquency rate of above 5 percent.

Ms. GALANTE. Yes. Again, I don't know the definition of the seriously delinquent in this chart compared to the way we do seriously delinquent—

Mr. BACHUS. If you will see up there, it defines it. It is 5 percent. Do you consider that 5 percent of the insured loans in the 2010 book is a serious delinquency? If it is not above 5 percent, it used to be almost, as you can see from this first chart, even in 1954, it was almost nonexistent. But what is the delinquency rate today of the 2010 book? And that is the last one I think we have any records of. Can you—

Ms. GALANTE. So again, our overall seriously delinquent rate is 9.4 percent—

Mr. BACHUS. 9.4?

Ms. GALANTE. —today. "Seriously" means 90 days. But I do want—

Mr. BACHUS. So the way I computed it, actually it is greater than—and I was trying to be conservative.

Ms. GALANTE. I am just—I am trying to be direct with you here. Again, I will go back to the point I made to Congresswoman Bachmann. Seriously delinquent, 90 days late, does not—is not a failed loan. It is not a loan that ultimately goes into foreclosure. That is a different rate.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Commissioner, it is good to see you. And I am walking in and this is the second hearing that we have had, and I know if it wasn't for FHA, I might not even be sitting here, because my experience was with my parents when they first bought their home if it wasn't for FHA—their mission was to get individuals. We were in public housing and it was the dream of my parents to own a home, and they could not get a conventional loan or anything of that nature. The only way that they were able to own a home was through an FHA loan.

And I understood that was the mission of FHA, to help individuals who may otherwise not be able to enjoy or live the American dream, help make that happen. And so they did that and my parents never missed a mortgage payment and going forward.

So just listening back and forth sometimes I get confused. Has the historical role of FHA—has that changed or is that still the same today?

Ms. GALANTE. It has not changed.

Mr. MEEKS. So it is still today, and could you give us an idea of what the housing market would look like today, particularly for a

family like mine, an African American who comes from public housing, or a Hispanic who—their parents are working hard every day trying to make a living—what would that market look like today? Would my parents have a chance today to get a mortgage or something of that nature without an FHA?

Ms. GALANTE. Again, today 50 percent of all African-American and Latino families are using FHA in order to purchase a home, so we are a very large share of credit availability for the minority community.

Mr. MEEKS. And what about individuals, no matter what their ethnicity is, this is their first time they want to buy a house? They have been struggling and they just got out of college, and just got married or something, and the first time they want to buy a house—is the FHA—will they—is that part of their mission, too? Can they be helpful in that?

Ms. GALANTE. Absolutely. First-time homebuyers are very much a part of our mission. Close to 80 percent of the mortgages we make in the purchase area are for first-time homebuyers.

Mr. MEEKS. So, and that also, then, stimulates the economy, wouldn't you say? That, in fact, I think that there was a Mark Zandi from Moody's who said that in 2010, without the FHA, we would have had 3 million fewer jobs and a 2 percent decrease in GDP, and that in 2011, approximately half of all African Americans and Latinos who purchased homes did so, as you have indicated, through FHA.

So it is clear, I think, then, that FHA has been playing a positive and supporting role in helping and moving the economy forward and making—I think you just testified that the Federal Government, at least while President Obama has been President, has been making a pretty good return on its rate to the taxpayers and to the Federal Government. Is that not correct?

Ms. GALANTE. Yes. Again, the loans we have been making and the premiums that we have been charging for those loans since 2010—again, with the help of Congress, in order to be able to increase those premiums, are extremely profitable and are projected to be extremely profitable for the Federal Government moving forward. And we really just have this challenge of dealing with the crisis and the challenges that remain from there.

And just to go back to Congressman Bachus' point for a minute, our seriously delinquent rate overall is 9.5 percent. It is now much lower. For 2010, it was 5 percent; it is even lower for 2011 and 2012.

Mr. MEEKS. Let me ask—at last week's hearing also, one of the witnesses questioned the necessity of having FHA provide a 100 percent insurance guarantee and suggested that Congress reduce the guarantee to 25 or 50 percent, which is currently the policy used by the V.A. Could you discuss some of the key factors for why it is important for the FHA to provide a 100 percent guarantee and some of the key differences between the FHA and the V.A. programs?

Ms. GALANTE. Yes. So the V.A. program obviously is limited to eligible applicants from the—from Federal service in the military and so they are a smaller population of people who are eligible for the V.A. I think the idea of how much a government guarantee

should be on any particular loan, there is a reasonable conversation to have there in terms of the pros and cons, right? And I do believe that the V.A. has a totally different structure for how they underwrite their population.

Mr. MEEKS. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Westmoreland, for 5 minutes.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

And, ma'am, my first two questions are just simple yes or nos. Are you familiar with the GAO high-risk list?

Ms. GALANTE. Yes.

Mr. WESTMORELAND. Is FHA on that list? Are they included in the high-risk category?

Ms. GALANTE. Not today, no.

Mr. WESTMORELAND. Let me say that there is some type of misconception that maybe this side wants to do away with FHA. We do not want to do away with FHA.

We really agree with your statements about phasing out the countercyclical role of reducing FHA's footprint in the marketplace. We agree with the President when he says that going forward, we will coordinate reforms of Fannie Mae and Freddie Mac with changes at FHA to help insure the private market, not FHA fills the market opportunities created by reform.

But for some reason, the other side seems to think we want to do away with FHA. We want to strengthen FHA. We want to make sure FHA is there. I am a builder by trade. I want FHA there. I want people to buy homes.

And so, that is some type of misconception. We just want it to be on good, sound footing, just like you do and just like the President does.

The other comment that the President made in the White Paper that he issued on GSEs in 2011 says the Administration will make sure that creditworthy borrowers who have incomes up to the medium level for their area have access to these mortgages, but we will do so in a way that does not allow FHA to expand during normal economic times to a share of the market that is unhealthy and unsustainable. Now, last night in his speech, he said that today our housing market is finally healing from the collapse of 2007. Home prices are rising at the fastest pace in 6 years, home purchases are up nearly 50 percent, and construction is expanding again.

Do you think that was what he was saying last night, that we are getting back to normal economic times?

Ms. GALANTE. I do. I think we are clearly on a path of recovery, both in the housing market and the economy overall, but it is fragile and we do need to ensure that we understand that and manage to that fragility at this moment as we proceed.

Mr. WESTMORELAND. So your goal is to get back to where typical FHA has been in the private mortgage insurance. Is that correct?

Ms. GALANTE. We are looking forward to receding over time here, and we have—we—as I have mentioned in my testimony now several times, we have done that. But we do need to do it in a careful way, given where the economy is going. There are still risks to the

economy, including something like sequestration, which would clearly be a risk to the economy and a risk to FHA.

Mr. WESTMORELAND. So you agree that FHA having 56.4 percent of the market share private mortgage insurance outsized the role of FHA and should be decreased, right?

Ms. GALANTE. I do, and it has declined. I think it is about 42 percent today. It was higher than 56 percent at the peak, so we are steadily declining.

Mr. WESTMORELAND. Now, let me ask you another question. Supposedly in 2013, FHA—the President had put in his budget a bailout of $688 million, but according to the DOJ settlement, you were put in for $1 billion. So you are not projecting a shortfall for 2014?

Ms. GALANTE. The President's budget is not out for 2014, so I—

Mr. WESTMORELAND. It was due last week, wasn't it?

Ms. GALANTE. I am not in charge of putting out the President's budget. But I would just say, back to your comment about last year, yes, we did get settlement dollars that helped offset what would have been a potential draw from the budget, but that was not what really impacted us. We made premium changes, we made policy changes, we ended up actually having $3 billion more.

Mr. WESTMORELAND. Okay. So you haven't requested a—FHA hasn't requested anything in the President's budget?

Ms. GALANTE. The President's budget is not out—

Mr. WESTMORELAND. But you have made your request to the budget, right?

Ms. GALANTE. We have made—direct appropriations requests are part of the budget—

Mr. WESTMORELAND. Mr. Chairman, one final question.

Do you believe that FHA should be considered on the high-risk list?

Chairman HENSARLING. The time of the gentleman has expired.

The gentleman from Massachusetts, Mr. Capuano, is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Thank you, Madam Commissioner, for being here. I think you actually answered all the questions pretty clearly and pretty fairly and openly, and I will tell you that the questions I have really are more repetitious, to clarify a few things more than anything else.

First of all, the delinquency rate. Everybody—not everybody, but some people are pointing out this 9.4 percent rate. Am I wrong to think that most of that rate is made up of loans made in the 2007 and 2008 years and that since that time the delinquency rate is well below that number?

Ms. GALANTE. That is correct, and thank you for saying that. I think I got a little jumbled there earlier, but yes, that is the overall seriously delinquent rate, which takes into account the whole book of business—

Mr. CAPUANO. I guess I want to be clear, too, about FHA's mission, or what they have historically done, not necessarily even what they are doing now countercyclical. In the normal course of events, before the current crisis, did FHA compete with prime lending entities? If I was able to—if I had a score of 800 and had a gazillion dollars in the bank would FHA take me on or would I just go to a private entity?

Ms. GALANTE. Theoretically, we could take you on, but from a price perspective and from an underwriting perspective it was much better for you to go somewhere else. That is right.

Mr. CAPUANO. The mission of FHA, as I understand it, has always been to the more moderate-income people who might have difficulty getting into the housing market or are maybe on the cusp, not necessarily the most difficult because those people can't afford to buy a home no matter what; that is what public housing is for. But the people on the cusp is where FHA has been at the sweet spot for historical purposes. Is that a fair statement?

Ms. GALANTE. Yes. That is a fair statement. And again, our loan limits are one of the things pre-2008 that would—which keeps FHA in that sweet spot.

Mr. CAPUANO. At any given time, your delinquency rates or your seriously delinquency rates, or whatever term you want to use, have always been and will always be higher than prime lenders. Is that a fair statement?

Ms. GALANTE. I think that is a fair statement.

Mr. CAPUANO. Because you are dealing with different clientele. You are dealing with people who are working-class people as opposed to people who are clipping coupons—well, Wall Street coupons, different kinds of coupons. And that is my understanding of it as well.

I guess I also want to talk about the $30.4 billion or $31 billion you have. It is my understanding that if you were to close your doors today, which, of course, I think is a ridiculous assumption—if I lost my job today, I couldn't afford to pay my bills either, but I guess for the purposes of discussion, for a nice, aesthetic discussion, we will presume that you close your doors—it is my understanding that $31 billion would still last for about 7 years to pay off the normally expected bills if nothing else were happening. Is that a rough estimate?

Ms. GALANTE. That is correct. And again, we do ongoing business, so we pay out claims but we have new money coming in—

Mr. CAPUANO. I have always thought that was a ridiculous assumption at all levels to presume any government entity is going to shut down because we have to have fully funded pensions, we have to—we are not shutting down, period, so therefore it is a ridiculous assumption, but I also know that we have to make it for the purposes of making our accounting friends happy.

At the same time, it is my understanding that the current Federal budget rules might require you to access certain Treasury funds at some point, as opposed to actually needing and using the money. Is that the right assumption?

Ms. GALANTE. Yes. Again, under the Federal credit reform accounting, we would potentially need to draw from Treasury to put money in reserves to add to that—

Mr. CAPUANO. Money that you would not use—you would not need to use?

Ms. GALANTE. We would not need to use, again, if we are continuing to have ongoing business.

Mr. CAPUANO. So the current Federal budget rules are kind of like the original bailout where we forced certain people to take some money. And therefore, why don't we just change some of

these rules to make it so that—it is one thing to have the full faith and credit of the Federal Government behind you, which I think is a good idea. It is another thing to make you access money that you don't need.

I actually think that is a stupid rule, and whoever put that rule together should change it. You should be able to access money when you need it, not before you need it.

Who do I talk to about that?

[laughter]

Ms. GALANTE. Maybe yourself, I guess.

[laughter]

Mr. CAPUANO. Jeb and I will have a long discussion. If that is the case, certainly I think it is something we should be considering, because again, I believe in the full faith and credit of the United States Government being behind the FHA; I don't believe in forcing people to take loans that they don't need. And my fear is that at some point if you are required by our budget rules to access money, some will call that a bailout. I call it ridiculous because you don't need the money.

If you need a bailout we will have our debate and we will—some of us will support it, and some of us won't. But if you don't need a bailout, you shouldn't be accessing taxpayer dollars, and you shouldn't be required to do so by some ridiculous accounting rule.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, and asks that he yield to the chairman for a brief moment?

Mr. LUETKEMEYER. I will yield to the chairman for a brief moment.

Chairman HENSARLING. Ms. Galante, quickly, you were asked the question about whether or not FHA qualifies for GAO's high-risk series. You said, "Not currently." Do you believe, as you understand the definition, that it should? Yes or no, or do you have any knowledge of that?

Ms. GALANTE. Pardon me?

Chairman HENSARLING. Does FHA qualify for GAO's high-risk series? Yes or no, or do you not know?

Ms. GALANTE. I am not sure what you mean by, do we qualify? I understand the GAO is releasing a report tomorrow—

Chairman HENSARLING. Okay, so you have no knowledge that GAO considers you a high-risk agency?

Let me move on to the second question, then: In the President's last budget request, he did request a taxpayer bailout. I understand you do not write the President's budget. You have no knowledge that the President in his next budget submission will request a taxpayer bailout for FHA, or do you have any knowledge?

Ms. GALANTE. I do not.

Chairman HENSARLING. Okay. Thank you.

I yield back to the gentleman from Missouri.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Ms. Galante, I am just kind of curious here. Your book of business has grown exponentially over the last several years and the

top loan is $729,000 now. Whenever you look at a loan of that size, is it really fulfilling your mission to be making loans of that size?

Ms. GALANTE. Congressman, that was a loan limit increase that was done in 2008 as part of the Housing Recovery Act, and those loan limits were extended by Congress last year. They expire at the end of this year. I do not think that is a typical traditional place for FHA but we are implementing the congressional mandate to have those—

Mr. LUETKEMEYER. Okay. If you don't believe it is a traditional place for FHA, then where do you think it should be?

Ms. GALANTE. Again, I think loan limits should recede over time. I think they should go back to the $629,000 first, and I think as we proceed we—

Mr. LUETKEMEYER. It has doubled from what it was back in 2008, I believe—is that a good place to go back to, $363,000, is that a—

Ms. GALANTE. Again, I think these are questions that we should work on together. I think that the loan limits should recede over time, and an appropriate role and an appropriate way of constraining FHA's ultimate market share, loan limits is a good way to do that.

Mr. LUETKEMEYER. This is a concern of mine. It seems like, with the book of business that you keep talking about, which is improving now as we go along, which is great, but I have some questions about that. Number one, the book of business you are taking on are these higher loans, which are not necessarily what I believe and you just admitted to as—and testified to as not really where your mission should be, number one; and number two, it looks to me like you are using these larger loans as a way to underwrite and pay for a lot of the smaller loans that are where the problems are at.

I think this is something that we need to get back to. I am not arguing with your mission. I think you have a mission and I know I would like to see FHA get back into that niche or where you need to be.

That being said, in your testimony you made the comment twice on page three that you think we need to be financing creditworthy borrowers, and to me that—and qualified borrowers is another term that was used. And I agree with that. If we are doing that, I think that we are looking at a borrower who can afford to make the payment. And when you are looking at people who are getting homes of this size, they are not low-income individuals. With a $729,000 loan, you are looking at somebody who is going to have to make probably a $3,000-a-month payment. That is not a low-income person.

Even if you go back down to where we need to be with this, we still need to get back to the sound tenets of lending. People have to be able to pay for what they are going to get involved in, and if we don't do that, would you agree that we have a problem, that we have a moral risk there, a moral responsibility to people to not put them in something they can't afford?

Ms. GALANTE. Certainly. But I think what we really need to focus on together is what does that prudent underwriting look like? What is the right—

Mr. LUETKEMEYER. Let's be honest here now. When you look at people who don't have a downpayment, why do they not have a downpayment? Are they somebody who is just getting into the market, somebody who just got out of school, somebody who doesn't have a job? Is it somebody who has had a financial hardship, a medical problem, and suddenly all their money is gone? Are they somebody who can't physically manage their money, and then they can't save anything? Or are they just somebody who is struggling to make ends meet and don't have the wherewithal to get there?

Those are all different scenarios. Some of them are worthwhile, some of them aren't, but I think the moral responsibility that we have is to provide that service but not to put people in homes who can't afford it, and I think we have—we are doing that.

Chairman HENSARLING. Regrettably, since the chairman took some of his time, the time of the gentleman from Missouri has expired.

The Chair now recognizes another gentleman from Missouri, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. Thank you for conducting this hearing. And this gentleman from Missouri has a different take on the FHA than the previous questioner.

And let me thank the Assistant Secretary for coming today.

Critics of the FHA falsely state that loans insured by the agency are just like subprime loans. Can you help us to debunk that notion? And moreover, how did FHA's market share change during the subprime boom and what is FHA's current market share?

Ms. GALANTE. FHA did not do low-doc, no-doc, no documentation for a loan. We did not do loans that reset. We do 30-year, fixed-rate, fully underwritten mortgages. During the subprime boom years, those other kinds of instruments were available to people, and what happened is that, frankly, FHA's market share went to about 2 percent because people were solicited and took these very abusive loans rather than coming to the FHA. So that is what happened in the ramp-up to this crisis that frankly engendered the crisis and put the whole economy at risk.

So when that bubble burst, FHA was there again to help a broad range of borrowers be able to buy a home and to refinance, sometimes out of those very toxic mortgages that they had, unfortunately, gotten themselves into.

Mr. CLAY. So the FHA is now experiencing an uptick in loans during this recent bounce-back of the U.S. housing market?

Ms. GALANTE. I would say this: FHA, during the depths of the crisis, took on more activity. We are now receding. Our loan volumes have been going down as private capital starts to come back to the marketplace. So we are now down to about 15 percent market share.

Mr. CLAY. And currently, FHA has an active portfolio of $1.13 trillion in insured loans. Can you discuss whether you think FHA has the appropriate level of resources and staffing to manage this book of business both in terms of lender enforcement, servicer monitoring, and oversight of the firms that handle REO management?

Ms. GALANTE. We could certainly use additional financial resources. We are working on technology changes so that we can do

our business better and we could certainly use some additional enforcement authority to both monitor our portfolio and our lenders.

Mr. CLAY. Okay. Thank you.

And how does the low interest rate environment impact FHA's finances?

Ms. GALANTE. Yes, well, under the actuarial report, if the interest rates remain as low as they are, frankly, we do see some people refinancing out of FHA into other things or so there is a—there can be, actually, a negative if the low interest rates—to our total economic value as a result of low interest rates. But low interest rates are a good thing for current borrowers and, frankly, helps them absorb some of the mortgage insurance premiums that we have needed to put on our new loans.

Mr. CLAY. Thank you for that response.

And how have both the annual and up-front mortgage insurance premiums at FHA changed since this Administration took over in 2009? Do you believe that the FHA is changing its pricing to facilitate a return of private capital to the market?

Ms. GALANTE. I do believe that the pricing changes that we have made over time are increasing private capital availability and essentially, for most borrowers now, our rates are, frankly, high, and that is helping facilitate private capital coming back for those who can go there.

Mr. CLAY. And so competition is good?

Ms. GALANTE. Yes.

Mr. CLAY. Thank you for your responses.

Mr. Chairman, I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Ohio, Mr. Stivers, for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman. I appreciate you holding this very important hearing.

I do believe that FHA poses a risk to taxpayers because they mispriced their risk—the premiums they charge for their risk. And you said in your testimony that you have raised your premiums, but I am curious about a few things. I have a few questions.

Number one, does FHA charge the maximum premium that is authorized by law?

Ms. GALANTE. We charge the maximum premium on the very large—the loans over $629,000.

Mr. STIVERS. But for these other risky loans that you talked about, does FHA charge the maximum amount authorized by law for all loans?

Ms. GALANTE. We do not charge the maximum premium, but we believe we are priced now appropriately for the risks that we are taking on.

Mr. STIVERS. And second, the FHA has had the authority to use a tiered pricing structure for more risky loans. For example, condos are more likely to default than single-family housing. But has FHA in that instance charged more for the more risky loans, such as condos?

Ms. GALANTE. I think you are making an assumption that condos are inherently more risky. Certainly, our data doesn't—

Mr. STIVERS. The historical data backs that up though, doesn't it?

Ms. GALANTE. Not the FHA data.

Mr. STIVERS. The historical data in the broader marketplace does back that up. Go ahead, ma'am?

Ms. GALANTE. So again, we don't charge a different premium based on the geography or the loan type.

Mr. STIVERS. But you are authorized to by law?

Ms. GALANTE. I am not certain that is the case, but—

Mr. STIVERS. You have been since 2008.

The next question: In answering Mr. Luetkemeyer's question you admitted that you have sort of strayed from your basic mission of affordable housing, and in 2006 FHA controlled about 4.5 percent of the new purchase market; today, give or take, it is about 30 percent—might be 28, 29, but almost 30 percent of the new purchase market. What is the right amount for your niche market that you are supposed to serve and what is your transition plan to get there?

Ms. GALANTE. I don't think we have strayed from our mission. We have a dual mission, including playing the countercyclical role. Congress asked us to take on loans up to the higher limit and we have done that, and we have done it in a way that still tries to get those loans to go to the jumbo market. So we have played that role and we do believe that over time, we should be receding. But those loan limits are authorized—not authorized, required by Congress at this time.

Mr. STIVERS. So what do you think is the average income of somebody who buys a $725,000 house?

Ms. GALANTE. I would have to do the math, but probably $100,000.

Mr. STIVERS. And would you call that person somebody who is low- to moderate-income?

Ms. GALANTE. Again, our incomes are based on area median income, so whether you are low- or moderate-income depends on the area median income of your jurisdiction. I am from the San Francisco Bay area where the moderate-income definition probably is $100,000.

Mr. STIVERS. And certainly, that $700,000 in San Francisco is not what it is in some other places, but it is still a very expensive home by American standards.

The next question I have is about your mortgage insurance. You now write about 50 percent, in round numbers, of the mortgage insurance market. Is that correct?

Ms. GALANTE. We are down to 42 percent.

Mr. STIVERS. Okay, so almost 50 percent. And what are you doing to make sure that the premiums that you charge are less than what is charged in the private mortgage insurance market. Is that correct?

Ms. GALANTE. Again, the private mortgage insurance market prices their insurance differently than we do. And, by the way, it is a different product. It is a top loss; it is not a full mortgage insurance. So they price it differently than we do. And you have to combine that pricing with securities pricing to really get to any kind of appropriate comparison.

Mr. STIVERS. Sure. Do you think it is appropriate to have—to insure dollar one losses and not have any insurance and insure up

to 100 percent, unlike the private mortgage insurance market, that usually insures about 20 to 30 percent of the loss—you insure 100 percent of the loss?

Ms. GALANTE. I'm sorry, what is the question?

Mr. STIVERS. Do you think that is appropriate?

Ms. GALANTE. We do insure 100 percent of a loss and we have just changed a policy to ensure, for example, that we keep our mortgage insurance premiums in place for the totality of the period of time that insurance is in force.

Mr. STIVERS. My time has expired.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

And thank you, Commissioner and Assistant Secretary Galante. Let me also thank you and FHA and HUD for your strong support with me in our efforts. Each year, as you know—I think you were at one of our home foreclosure prevention events in Atlanta, Georgia. I appreciate you for doing that. As you know, I represent seven counties around Atlanta, the suburbs, which is the epicenter of so much of the home foreclosures. So I appreciate your involvement with that.

I want to go back for a moment, because I don't think you were given the necessary opportunity to really respond to Mrs. Bachmann's, my colleague from Minnesota's, concerns, and you made the statement that you felt that she had gotten it backwards. And I sort of agree with you on that, with all due respect.

Let's get the record straight on this in terms of your mission and your role. I think it is profound—and these statistics I am about to give I want you to concur with, and very revealing so it helps tell the whole picture, and that is this: In the last year—in Fiscal Year 2011 is it not true that over half of all African Americans who purchased a home—not in one area but 52 percent, over half of all African Americans who purchased a home in the United States of America and 50 percent of all Hispanics who purchased a home in the whole Nation of America did so with FHA financing. Is that correct?

Ms. GALANTE. That is correct.

Mr. SCOTT. And also, 78 percent—nearly 80 percent of all FHA borrowers were first-time buyers. Is that not correct?

Ms. GALANTE. That is correct.

Mr. SCOTT. That is phenomenal. Now, I would like for you to kind of elaborate on this, because these statistics are very telling. Why is this so?

Why is it that one agency, the FHA—if it were not for the FHA, where would the African-American community be in homebuyership? First-homeowners? And the Latino community? And is it not other factors that are at play here so that we can tell the full story on the mission and the role that FHA—and you have the opportunity to set the record straight on how this relates to the FHA mission. Would you please?

Ms. GALANTE. Yes. Thank you.

There are a couple of points I would like to elaborate on. The first is that FHA has played a particularly strong role in this crisis

in particular. Again, home purchase mortgage availability dropped for everyone, but it dropped more for African-American and Latino homebuyers. It also dropped more for low-income neighborhoods.

It has fallen off 75 percent in low-income neighborhoods, 50 percent for more middle- and upper-income neighborhoods. So again, as the private market left, FHA stayed in the market, continued to be there to serve this broad clientele.

Mr. SCOTT. Now, I want to talk to you about, because there have been some other significant misunderstandings about FHA's market share and how that has shifted over time. For example, at the hearing last week it seems that as if some members on our committee have not fully recognized how FHA has reduced its footprint in the mortgage market as we have slowly but surely recovered from the housing crisis.

Can you please explain to the committee, first of all, traditionally what kind of market share has FHA had?

Ms. GALANTE. Historically, FHA has been 10 percent, maybe a little bit less, maybe a little bit more. Pre-ramp-up to the bubble, as I had mentioned earlier, we dropped to maybe a 2 percent market share as people went to the subprime, toxic mortgage market, unfortunately.

So we do think—and again, market share is a funny statistic as well, because you have to look at the fact that the entire market dropped during these past number of years.

Mr. SCOTT. And finally, before the hammer comes down on me, many of my colleagues have said they are interested in helping continue to support FHA, which I am glad to hear on the—on my Republican side. But let me ask you your fear of sequestration.

Chairman HENSARLING. I am sorry. The time of the gentleman has expired. The proverbial hammer did come down.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

I don't come from a wealthy part of the country. There are a lot of my constituents who have used FHA to purchase a home. They are low- and moderate-income individuals. And I have seen the program work for a lot of people. So I—what we talk about here today, I don't want that to be taken away. It has been a helpful program.

But over the last several years there have been a lot of questions that have been asked from this committee and others about the solvency of FHA. Some have compared it to Fannie and Freddie and have inquired as to whether FHA is going to need a Federal taxpayer bailout.

And so as those questions have been asked, many have come in and told us not to worry. The program is fine, it is solvent. Be assured, we are not Fannie and Freddie.

For instance, Secretary Donovan was testifying before the Senate Banking Committee in 2009 and he indicated that within 2 to 3 years the capital reserve would be back up to 2 percent. Last year, in February, you were here and you told us that we expect to be at a capital reserve of $8 billion by the end of 2013.

And so, as I am looking at the statements that have been made in regard to the questions that have been asked, I have some con-

cern now that we have a shortfall of $16.3 billion and a negative capital reserve of 1.44 percent. And as I sit here I wonder, have we been misled in Congress? Have you in HUD been negligent? Incompetent?

How can we ask these pointed questions that we had concerns about, outside individuals had concerns about, and we have not been given the appropriate information until today? What is it? Is it incompetence? Have we been misled? What has the issue been?

Ms. GALANTE. There are two different analyses of FHA's book of business, so you have to start with—this is, unfortunately, more complicated than any of us would like. The actuarial studies which you are referring to in terms of the economic value and the capital ratio, done independently on long-term economic forecasts and long-term projected losses. Set that aside.

Whether we need to draw any funds from Treasury is based on the President's budget, which is done by different economic analysis and comes up with a budget re-estimate. And again, even if we needed to draw, it is to put money into reserves.

So to be clear, this is totally different than a Fannie or Freddie that were private entities taking private risk, taking profits privately and giving them to shareholders, and then the government comes in years later after they have spent those funds—

Mr. DUFFY. I want to be clear—I only have 2 minutes left.

Ms. GALANTE. Yes.

Mr. DUFFY. You are saying it is complicated, okay?

Ms. GALANTE. Yes.

Mr. DUFFY. And you are the Commissioner. Listen, there are outside people who don't have the access to information that you have, who have been raising the red flag saying, "Hey, we have a problem at FHA." They have come in, we have had hearings on it. So how can you come in and tell us, "We don't have any problems. We are going to be fine?"

And outsiders who don't have your information knew that we were going to have this very problem that we are talking about today and you didn't share that with us. That gives me great concern. Have you talked to the President about needing dollars in his budget? Have you communicated with him?

Ms. GALANTE. No, sir, I have not.

Mr. DUFFY. So if the President is going to offer money to FHA as a way of a bailout, he is going to be shooting in the dark. Or has the agency talked to him about dollars that are going to be needed for him in his budget?

Ms. GALANTE. Congressman, I just want to say a couple of things. We have been totally transparent with this committee; we have been totally transparent with Congress. We have an actuarial study. We describe in that actuarial study the risks of going one way or another. We have—

Mr. DUFFY. What happened in the last year? Last February, you were here, and you were telling us that we were going to have a reserve of $8 billion by the end of 2013. And lo and behold, we are $16 billion short. How did you get it wrong in a mere 12 months to have this analysis completely wrong?

Ms. GALANTE. Congressman, we didn't get it wrong.

Mr. DUFFY. You didn't get it right.

Ms. GALANTE. We provided you an actuarial study that had a range of things that could happen depending on economic circumstances. The economic circumstances—house prices—did not match what the independent actuary predicted would happen. These are long-term forecasts that they make and we are reporting to you those results.

Mr. DUFFY. You got it wrong. Outsiders got it right. That makes me concerned about how honest or competent you guys have been.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the ranking member, as well.

And I would like to assure those persons who are viewing this at home that we really do love FHA and that we really do want to save FHA. FHA, seriously—let me ask a question so that you may say it, Madam Commissioner. Has FHA ever been bailed out before, ever?

Ms. GALANTE. I want to be clear that FHA has what we call permanent and definite budget authority, so these are 100 percent guaranteed loans by the government. We have been self-sustaining through the 80 years of our existence.

Mr. GREEN. Founded in 1934 or 1935, and since that time you have not received what is being called a government bailout. Is this correct?

Ms. GALANTE. Again, I have a challenge with the whole concept of thinking about any potential draw from the Treasury being a "bailout."

Mr. GREEN. Yes, ma'am.

Let's continue with another proposition. One of the things that you are trying to correct and you are correcting has to do with your premiums and the fact that you at one time, after a buyer had a certain amount of equity there was—it had an impact on the premiums paid. Is this correct?

Ms. GALANTE. That is correct, yes.

Mr. GREEN. Could you kindly and quickly explain this circumstance?

Ms. GALANTE. Yes. When borrowers pay a mortgage insurance premium—we had a previous—we had a policy that we just changed last month, but prior to last month, when your loan automatically self-amortized down to essentially 78 percent loan-to-value, we would be cancelling that premium even though we still were 100 percent—

Mr. GREEN. Let's do this, if I might ask, Madam Commissioner, explain to us what cancelling means. What does that mean to the borrower? Do you continue to pay the premium or do you cease to pay a premium?

Ms. GALANTE. If the premium is cancelled, it means you cease to pay the premium.

Mr. GREEN. And as a result, the borrower would now have more money in his pocket, of course, but FHA would have less money to capitalize it. Is this correct?

Ms. GALANTE. That is correct.

Mr. GREEN. And you have now changed this, and as a result are you projecting that this will help you to stabilize FHA?

Ms. GALANTE. That is correct, and we are—we obviously continue to have the risk of that loan.

Mr. GREEN. You have the risk of that loan but you have made that change?

Ms. GALANTE. Yes.

Mr. GREEN. And you are making other changes to stabilize and secure FHA, correct?

Ms. GALANTE. That is correct.

Mr. GREEN. Would you give us one additional significant change that you are making, please?

Ms. GALANTE. Yes, one additional change is that we are now requiring that if you have a 620 FICO score or credit score or less, we require no more than a 43 percent debt-to-income ratio, and without additional compensating factors for that borrower.

Mr. GREEN. Now, much has been said about how FHA has been a benefit to persons in this country who are known as minorities. Quite frankly, it is a term that I don't particularly like, but I use it to communicate.

But is it true that the overwhelming majority of the loans in your portfolio are held by Anglo-Saxons?

Ms. GALANTE. That is correct.

Mr. GREEN. Would you guess that of the loans in your portfolio that are held by people who we in this country call White, would you guess that it is probably upwards of around 70 percent or more?

Ms. GALANTE. I think it is more in the 60s, 60-plus percent range.

Mr. GREEN. 60-plus percent. So FHA is not a welfare program, is it?

Ms. GALANTE. It is not.

Mr. GREEN. Okay. It has been a program that has been of great benefit to people across all lines—it wasn't designed to accommodate any particular ethnic group, was it?

Ms. GALANTE. No, it was not.

Mr. GREEN. And FHA, throughout its history, has pretty much complied with the will of Congress, has it not?

Ms. GALANTE. Absolutely.

Mr. GREEN. So if FHA is making loans at $729,000, it is doing so because of Congress, correct?

Ms. GALANTE. Correct.

Mr. GREEN. And I mention this to you because listening to this argument, one would think that FHA has been a renegade, you have just been out there doing all sorts of dastardly things, you created the yield spread premium, you created 3-27s, 2-28s, no-doc loans, prepayment penalties that coincided with teaser rates, that you have just been ugly. But this is not true, is it?

Ms. GALANTE. No, it is not. Thank you.

Mr. GREEN. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The gentleman from Michigan, Mr. Huizenga, is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. And I would like to submit into the record a couple of things. One is a letter from the National Association of Federal Credit Unions, and I wanted to talk a little bit about the content there. And another is an ad called, "My FHA," regarding FHA mortgages, and I would like to submit that into the record.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. HUIZENGA. All right. Thank you.

Commissioner Galante, I appreciate you being here. My background is in real estate and developing. My family is still involved in construction.

And I have a couple of concerns and I think we were hearing two lines of discussion from two friends over there, Mr. Green and Mr. Scott, about who actually benefits from these programs. And it seems to me that as we are looking at claims, half of all of the loans are to African Americans, half are to Hispanics, is what you had said earlier, and when I got my REALTORS® license, the Elliott Larson Act says that we cannot discriminate. One of those things that it says is we cannot discriminate on race and creed.

Low- and moderate-income is not a Black issue, it is not a White issue, it is not a red issue, and it is not a yellow issue; it is a green issue. And what I learned is you are green when you come and make that application. Can you afford it or can you not afford it? Do you have enough green to buy that product that you are out trying to buy?

And I am concerned that we have seen sort of both sides of the argument on the other side of the aisle that this is sort of meant to benefit, or at least the implication is that it benefits one particular race over another, and I just want to make sure that we do not accept—because I believe that the—certainly the law demands it, morality demands it, and we must have equal treatment under the law. And if we are not doing that, then we cannot allow some sort of separate but equal system occurring here, which seems to be the implication from Mr. Scott's line of questioning.

Now, on to this advertisement—and I know you don't encourage these ads or particularly control them at all, but I am going to read this to you: FHA bad-credit home loans. Many people don't realize that FHA loans can help people with bad credit. Need a home mortgage but concerned about bad credit? You have come to the right place. An FHA mortgage can get you into a new home even if you have bad credit because the loans are insured by the Federal Government. If you have had accounts forwarded to collections, if you have filed bankruptcy in the past, if you have high debt, you may still qualify for an FHA loan. And it says at the end, if you—there are much better choices in very expensive financing that banks call subprime.

And it seems to me that, based on some of the questioning that we heard earlier from Mrs. Bachmann and others, I am afraid that this industry—people with bad credit are being encouraged to go in and use FHA as a vehicle for a subprime type of loan. And I have to believe that cannot be acceptable, because we know how devastating losing a home is. We know how devastating that can be.

And the letter from NAFCU here, the Federal credit unions, we know that FHA's current policy with respect to strategic default,

which—strategic default would be someone literally making the choice to default, to walk away—is barring such borrowers from obtaining an FHA loan for a minimum of 3 years. So they are barred from getting another FHA loan for 3 years.

Comparatively, Fannie Mae has instituted a policy that would prohibit such borrowers for 7 years. Can you explain to me why you would have a 3-year gap versus Fannie Mae having a 7-year gap if we are trying to make sure that people aren't compounding bad decisions?

Ms. GALANTE. Let me address both of your points. You are correct that we do not condone the kind of ads that you talked about there that you have seen on the Internet, and I just recently issued to our lenders a reminder that we will enforce against any FHA lenders for advertising. We do require borrowers to meet our credit criteria, so we want to be very careful about that. We will refer people to the I.G., to the Department of Justice—

Mr. HUIZENGA. I have 30 seconds left, just quickly, if you can address the 3 years versus 7, and then I want to hear your opinion: If this was a private company, would it be in receivership? Because my suspicion is that it would be.

Ms. GALANTE. On the 3-year versus 7-year, again, our requirements are at 3 years, you can apply to return—or to come into the FHA but you still have to meet our credit criteria, including the restrictive credit criteria that I have mentioned that we have tightened up on—the 620, the 43 percent DTI as an example restriction. So not anybody can come back into—or come into FHA as a result of having been through—and let's be clear, particularly in this recent circumstance, some of these folks have been through a very devastating experience and they are not—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman.

And thank you, Commissioner Galante, for coming in. I have found in the 2-plus years that I have been sitting on this committee that the most challenging thing is to seek some light with all the heat that has been going on, and I thought we had arrived at that point when my friend, Mr. Westmoreland, was speaking and he started off by saying that we on their side didn't want to do away with FHA. We recognize that there was an important role in the marketplace. We want to make it stronger; we want to protect the taxpayers. And I think those are things that both Democrats and Republicans on the committee agree on.

Mr. Duffy started off the same way and then went off on a little bit of a rant about the—you and the FHA not being straight-up with the committee. It is my understanding that we had hearings last year and legislation that was passed here by the House to address some of these issues that we are talking about today. Isn't that the case?

Ms. GALANTE. That is the case, and I think there are many things that all sides of the aisle can agree on with respect to strengthening FHA. And I really appreciate that.

Mr. CARNEY. We had a couple of witnesses last week who came in and they had a whole list—I asked my staff to put it together

and it is two or three pages—of things that they suggested, policy proposals to help address the financing issue that FHA faces. Is there anything among those ideas on those lists that got your attention that we should really think about as Democrats and Republicans who care a lot about FHA and its important mission?

Ms. GALANTE. I would say this: What we are focused on in terms of strengthening FHA right now are immediate actions that we can take, like the enforcement with lenders, like the emergency authority for the dealing with the reverse mortgage program.

I think there are other ideas, some of them that are on this list, that are worth talking about in terms of future conversation—where is FHA play in the broad new housing finance system? And so I want to spend time on a number of those, whether it is looking at our appraisal board versus the way we currently do appraisals. Those are quite interesting things for us to go back and take a look at.

Mr. CARNEY. So let's talk about that in the 2½ minutes that I have left. You mentioned this at the top about looking more broadly about housing finance in this country and the GSEs and somebody before me said that is a priority for both sides.

Where do you see FHA fitting into a new framework for housing finance in this country?

Ms. GALANTE. So again, I think this could be a longer conversation—

Mr. CARNEY. Obviously.

Ms. GALANTE. —amongst all of us, but we have been very clear, the Administration has been clear that we do believe that FHA should be playing a smaller role, a more targeted role, that loan limits should come down over time, and that we should focus on those more targeted credit needs in the country.

Mr. CARNEY. What might they look like—more targeted—

Ms. GALANTE. Yes, more targeted. So back to, again, an area home price, something in a range around the median home price, a little above, a little less, that is the typical—

Mr. CARNEY. That was one of the suggestions that one of the—

Ms. GALANTE. Yes.

Mr. CARNEY. —folks last week talked about.

How about market share? I think it was maybe Mr. Green or somebody else who mentioned, what do you see as the appropriate market share for FHA?

Ms. GALANTE. So again, I hate to—market share I think really is a difficult challenge but—

Mr. CARNEY. You mentioned 10 percent as a historical number or something in that—

Ms. GALANTE. 10 percent is a historical number. Again, it changes over time, and I think you want a—you want the ability to be in a range in 10, 15 percent of the market.

Mr. CARNEY. So I see a little bit lower than—by the way, I think this chart that you provided is a great illustration of the appropriate role of FHA insurance where you see the PMI just dropping right precipitously off the table and FHA moving in at a very critical time in the housing market and filling that void.

But it looks like the historical level was somewhere above 15 percent and below 30 percent. Any sense of where it might be in an

ideal world going forward? I guess it would depend on economic conditions as well.

Ms. GALANTE. Yes. And again, that particular chart is for a small portion of the overall mortgage market. It is for purchase only and only mortgage insurers, so it is a particularly shrunken piece of the overall pie.

Mr. CARNEY. Thanks very much.

Chairman HENSARLING. The Chair now recognizes the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman.

And thank you, Ms. Galante, for being here. It has been a very informative hearing.

First of all, my question is, do you understand why all of the red flags around FHA? Do you understand why we are so concerned about FHA? And I think one of the big red flags is that the President is suggesting including money for FHA in his budget.

Ms. GALANTE. I think it is absolutely reasonable and important to look at FHA's long-term financial health, and the actuarial gives some indication about what kind of money we need over the long term and that we are short of that under the actuarial. So this is—absolutely we understand the importance of this.

Mr. STUTZMAN. Okay. You said earlier that you think the low limits should recede, and I appreciate that. What I am concerned about—and I am new to this committee, but as I sit here and listen and try to absorb what is happening, it seems that FHA is outside of its original charter, and a lot of that is due to the recession and the housing collapse. But what I—it seems to me that as FHA is trying to get out of this hole that it is in, it is now moving outside of its original intent.

As I look at this chart here that compares FHA's operations in 2008 compared to today, the average FICO score in 2008 was 647, and today it is 696. Is that roughly correct, do you know?

Ms. GALANTE. Sounds correct.

Mr. STUTZMAN. To me, that says that we are trying to move—that FHA is trying to move into market area that it is not designed to be in. Also, the loan sizes have moved up.

What I think that is happening here is not entirely your fault, but is the result of policies on a macro level where we have now seen—since 2009, when President Obama took office, we have seen a huge decline in median household income. In 2009, it was $55,198; today, it is $50,678.

You talked about the premium increases and I guess I don't—I understand you are going to those you are serving and increasing the insurance premiums, but do you understand, when median household incomes are dropping and the increase on premiums are increasing, we are squeezing people to where they are going to be put in a position where they cannot afford to be in their homes. Any comment?

Ms. GALANTE. Again, you have made a number of points there. Let me say a couple of things.

First of all, on the credit scores of FHA borrowers going up in this recent period of time, we would be, frankly, delighted if lenders would lift some of their credit overlays that they have been putting on top—FHA enables loans to creditworthy borrowers but at

lower credit scores than lenders are currently lending to, so this is not something that FHA is trying to induce. This has to do with a broader concern on the part of lenders and that is something that we want to work with them on to ensure that they are giving access to FHA loans to as broad a prudent population as possible. So that is one point I want to make.

The other thing is that again, we do think that these premium increases have been important for the health of the fund. They have also been important in terms of "pricing our risk correctly." We do believe that because interest rates are so low, borrowers are able to absorb those increases.

Mr. STUTZMAN. But when you are asking for only 3.5 percent down, people are getting into homes very possibly that they just cannot afford. Mortgage insurance premiums go up, median household incomes decline. You said earlier that you think we are on the road to recovery. The President said the same thing last night in his State of the Union address.

What I see coming from the Midwest is that maybe the DC Metro area is doing fine, but the rest of the country is not, and so my comment to you is that we have to get back to your original charter which you are originally designed for, lowering the caps and really helping those who do need the help.

With that, I will yield back, Mr. Chairman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Florida, Mr. Murphy, for 5 minutes.

Mr. MURPHY. Thank you.

Commissioner, thank you for your time and your service and for answering our questions today. I ran for Congress because I believe in a smarter government, and at the same time, my background in the construction industry informs me of the critical role the housing market plays in my own State of Florida and across the country.

Whatever we do to resolve the problems at FHA must be done with a mindful eye on how it could affect middle-class homeowners, as we have discussed today.

Two years ago, the Obama Administration outlined its proposal to limit GSE involvement in the housing market while preserving the Federal Government's role in a more limited capacity.

Commissioner Galante, do you think that the answer to the problems faced by the GSEs and FHA is as simple as narrowing the scope of borrowers?

Ms. GALANTE. I think it is much more complicated than that, but that is part of the issue.

Mr. MURPHY. There has been talk of the max loan size. Would you agree that this isn't a one-size-fits-all? That this should be tied to some sort of a formula for maybe the location, for the market, for the location of that house?

Ms. GALANTE. Yes, absolutely, and to be clear, the high loan limits that people have been talking about, the $729,000, that is only for higher-cost areas, and to be clear, that only represents about half a percent of FHA's business at the moment.

Mr. MURPHY. So, the million-dollar question or I guess because of the size of what we are talking about, perhaps the trillion-dollar question is, how do we help stabilize the overall market faster to

reduce the expected future claims on FHA, but most importantly to restore the dream of homeownership that has fallen out of reach to so many middle-class families because of this recession?

Ms. GALANTE. Thank you for that question. One of the things that we are doing that we have not talked much about today, so I appreciate the question, is what are we doing to ensure that with policies that we currently have in place and are putting in place, the best thing that is going to help FHA in terms of moving forward is to deal with these legacy loans and we have very substantial policies in loss mitigation and asset management activities being able to dispose of distressed assets, distressed loans more quickly. All of that will help our recovery. All of that will help FHA's dollar recovery, which will help FHA in terms of its overall financial picture.

Mr. MURPHY. Do you mind outlining a couple specifics there for what you are doing not only to help what happened but to prevent it from happening again?

Ms. GALANTE. Yes, so there is both. There is both dealing with the damage that has been done and on that front, again, we are making it easier for borrowers to do a short sale when they are in distress for example.

We are making loss mitigation and doing modifications easier for people to get. So we are selling our distressed loans in the market faster. We have an overhang. Moving forward, we have increased premiums to price risk appropriately for the risk that we are taking on with borrowers.

We have made some underwriting changes that I have talked about here today in terms of ensuring that borrowers are prepared for the financial obligations they are taking on.

Mr. MURPHY. Thank you, Commissioner.

I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman.

And thank you, Commissioner Galante. I have a couple of questions. I heard a lot over the last couple of hearings about the dual mission of the FHA, and I have been able to find one. I have been able to find the one that says you are supposed to serve as the lower economic groups, the first-time homebuyers, provide gaps where private credit markets don't exist, and I can find that.

I can't find any legal justification, any basis for what everyone talks about is the second half of the mission, which is this automatic economic stabilizer, this countercyclical mission of the FHA. Where are you drawing that from?

Ms. GALANTE. Congressman, if you go back and look at the original founding of FHA, you can see quotes from the Federal emergency administrator talking about the purpose of that, so the congressional intent talking about the purpose of FHA at the time was actually to get the economy back on its feet again—

Mr. MULVANEY. It is fair to say it is not in the statute, right? That mandate is not in the statute. It is implied perhaps in many of the things that we do, from having hearings like this to raising the borrowing rates, but it is not the same as the other mandates.

Ms. GALANTE. It probably isn't in the wording of the statute, that word countercyclical, but the fact is that it was created to be a source of credit availability when nothing else was there so that it would be steady and available.

Mr. MULVANEY. But I think you would agree with me that in an ideal—while that first mandate to serve that underserved market is consistent and permanent, the countercyclical mandate is supposed to come and go, right?

Ms. GALANTE. Yes, but again, underserved, you can be underserved at different points in different ways, right? So underserved because capital has left or underserved because capital is never interested in a particular whether it is a rule—

Mr. MULVANEY. But there was no countercyclical purpose to the—it was not serving that mission during the first half of the 2000s, right, the first decade? You were not serving a countercyclical mission when the market was overheated, were you?

Ms. GALANTE. That is correct.

Mr. MULVANEY. Okay.

Ms. GALANTE. And in regional distress, we have played a countercyclical role—

Mr. MULVANEY. So let me ask you, as the housing market comes back, and we understand that it is and we are hopeful that it continues to do so, what affirmative steps are you taking to lower your market share?

Ms. GALANTE. We have already taken a number of affirmative steps, as I think you have heard today, including raising premiums 5 times on new borrowers moving forward. That certainly is helping private capital come back in to, and if you read the Washington Post over the weekend, and you can see quotes from all kinds of mortgage brokers, et cetera, they are very concerned that FHA—

Mr. MULVANEY. All right. So you have raised rates a couple of times. I understand that. I have put a graph up that the chairman used earlier. I have also provided you with a copy so that you can actually see it, and I recognize the fact that you have some concerns with some of the previous estimates.

Are you more comfortable with the estimate of 2012, the line that is shown in dotted red? I recognize that the fact you said you had a difficults because of the difficulty of making a 30-year projections and so forth. Granted, this is only a 5- or 6-year projection, not a 30-year production, but are you more comfortable with a 20-year graph curve on this graph?

Ms. GALANTE. So again, I would just say, I am not sure where these numbers are—

Mr. MULVANEY. This is the independent auditor report. You have seen this several times today.

Ms. GALANTE. Yes. This is an actuarial report projecting based on economic conditions. This economic—

Mr. MULVANEY. Are you comfortable with it?

Ms. GALANTE. I don't think that economic conditions are ever going to be exactly as what was predicted—

Mr. MULVANEY. Do you do your own projections?

Ms. GALANTE. We do—not to the level of complexity that are done—

Mr. MULVANEY. Can we see the projections that you have done? Everything you have given us today is backward-looking. It stops in the second quarter of—third quarter of 2013. Can we see your projections?

Ms. GALANTE. So, again, we don't do long-term—

Mr. MULVANEY. I am not interested in long-term, I am interested in short-term. You said you are going to get back above the 2 percent line in the next couple of years. Can we see those projections?

Ms. GALANTE. Those are based on the actuarial report.

Mr. MULVANEY. So you are relying on this line?

Ms. GALANTE. The—

Mr. MULVANEY. You said you had concerns with this line, but when you say that we are going to be back at 2 percent in the next couple of years, you are relying on this graph.

Ms. GALANTE. To be clear, we are statutorily required to do an independent, to have an independent actuarial done and to present that information and what it shows in terms of the economic value of the fund based on that independent actuarial and to provide that to Congress.

Mr. MULVANEY. Does this graph assume that you go back down to a historical level of roughly 10 percent market share?

Ms. GALANTE. The actuarial report does over time project that we go back down. I don't know to what volume.

Mr. MULVANEY. Does this report assume that you have what you called a roughly 10 percent failure rate relatively; that your average failure rate. I think Mr. McHenry asked you about seriously delinquent. Does this assume that you maintain a roughly 10 percent failure rate?

Ms. GALANTE. Yes.

Mr. MULVANEY. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Maryland, Mr. Delaney.

Mr. DELANEY. Thank you, Commissioner, and thank you for your service during this very important time. Housing is obviously central to our recovery.

My first question relates to the standard that we hold FHA to, and there is something that has confused me across this hearing and the prior hearing that some of my colleagues mentioned, and I think this started with Mr. Pinto's testimony.

There seems to be a sense that FHA is a private business and it should be held to public company standards. As someone who ran a large financial services company that was publicly traded, which I started, I think I understand how people think about private businesses and how they think about public company standards, and in addition to running it ethically and in a responsible manner, you focus on your shareholders and you have a profit motivation and you have all kinds of incentive structures in your management team to pursue those objectives.

Did I miss something? Is FHA a private company that is held to public company or private company standards? I just want to give you an opportunity to respond to that because perhaps I missed that somewhere.

Ms. GALANTE. No, you are correct. FHA is part of the Federal Government.

Mr. DELANEY. Got it, because I think it is important when people talk about a private company or a public company that they have an understanding as to what that means. And I think one thing you may want to mention in future testimony is that practically every publicly traded financial services company trades as a multiple of its projected earnings, which inherently means people are looking at the future prospects, which is one of the things I think you are looking to, to buttress some of the losses you have incurred.

And so even if you were to be held to a private company standard, I think this notion that doesn't exist, which I think was in Mr. Pintos testimony, is flawed. So just a comment there.

My second question is, do you have economic data to show that if FHA would have stayed at its historical market share and not increased its market share and housing prices would have inevitably continued to fall, what the overall economic impact would have been on the taxpayers, and how that relates to the additional costs FHA clearly incurred by stepping into the breach after the financial crisis? And we should be reminded that across the financial crisis, 19 of the 20 largest financial institutions in the United States either failed or required massive government support.

So it was not an inconsequential breach. It was a never-seen-before breach. So I was wondering if you have economic data to show what FHA actually saved the economy by stepping in the way that the way it did. And if so, maybe you could provide that to us or if you have any comments on that?

Ms. GALANTE. Yes, I would just say that Mark Zandi of Moody Analytics has done a certain amount of that work. I don't have detailed projections, but clearly, house prices would have declined further. So not only would have FHA been hurt by that, but the broader economy would have been hurt by that.

Mr. DELANEY. Do you have a sense as to the multiples? In other words, if we think about the additional losses in the book of business that you, that FHA underwrote during a time of declining housing prices, which is definitionally something a private market participant would never do, and you clearly incurred losses higher that you, than the organization would have liked. Do you have a sense as to what the payback has been to the economy?

Ms. GALANTE. I don't have specific numbers on that.

Mr. DELANEY. It might be relevant to put some of these things in context going forward. And then my last question is—because I am concerned about this notion of crowding out the private market because I do think we want to leg into a much more robust private market.

And it seems to me the private market hasn't been participating in the mortgage industry for two reasons. The first is credit, meaning they were concerned about how prices were falling when you come from an industry where prices had historically rose across all the data you could measure, there were no real underwriting models to allow these institutions to step into a falling home price market.

That, I think, in many markets we are starting to get away from that. Housing prices are stabilizing, improving. There is a lot more work to do. So we may be past the credit concerns that these institutions have.

The second concern is that they have this pricing. In other words, it may not be economical for them to compete at the levels you, in the GSE's are, and that is a product-specific analysis, right, it relates to single-family; it relates to multifamily. Do you have a sense as to how far the private market is off your pricing and where pricing would need to be for them to be more robust players?

Ms. GALANTE. I would say where this gets a little complicated is some of the private markets charge different pricing for different kinds of credit characteristics for most borrowers to whom they are interested in lending.

So for higher credit score borrowers, for example, we believe we are priced higher than they are at the present time. So I don't think it is a pricing issue at this point. I think it goes back to credit quality, credit concerns, housing, housing market recovery concerns—

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from California, Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

And Commissioner Galante, for all of the kind of sparks and so forth, I think I heard at least one area of general agreement that something you said in response to a question from the other side of the aisle that although FHA, as you know, went to a really low market share for a while and then for very high market shares and we know the reasons why, but you said, and I wrote this down as close as I could, that you would like to see it go to a smaller, more targeted role and that loan limits should come down. Correct?

Ms. GALANTE. That is correct.

Mr. CAMPBELL. Okay. So now let us talk a little bit about how we do that. And I guess the first question is, would you see that as being somewhere around a historical 10 to 15 percent area?

Ms. GALANTE. Ten to—of market share?

Mr. CAMPBELL. Yes, market share.

Ms. GALANTE. I think that is a reasonable assumption, yes.

Mr. CAMPBELL. Okay. I really don't think there is much debate about that anywhere, so let us talk about how to get there. First of all, where are we? GAO said in what they said was the latest available third-quarter 2012 that FHA had 56.4 percent of the insured market.

I think I heard you say 40 or 42 percent. Is GAO wrong? Because I have that they said 56.4 percent in the third quarter of 2012.

Ms. GALANTE. Our data that I am using shows us at 42 percent. We would have to do a double check with that data if that is coming from the GAO.

Mr. CAMPBELL. Is that over the same period of time? You can look at the sheet—

Ms. GALANTE. I think our—

Mr. CAMPBELL. I think you have to—I know how that works.

Ms. GALANTE. I am not sure what quarter of—it is in 2012, but I am not sure what quarter our data is from. I think it is the third quarter.

Mr. CAMPBELL. Okay, I would like to suggest, Mr. Chairman, that is something we ought to try and figure out. That is not a small discrepancy, 56 to 42 percent. So it would be nice to know where we are and where we are actually beginning.

Chairman HENSARLING. Would the gentleman yield?

Mr. CAMPBELL. Yes, I would be happy to yield.

Chairman HENSARLING. Just for the record, this comes from HUD's U.S. Housing Market Conditions report.

Mr. CAMPBELL. From the GAO, yes. Okay. So apparently, you are saying the GAO numbers are wrong, so we need to talk to somebody to figure out where we are starting from. But then, when we look at other things, if you look at private insurance, they have to have a 25:1 leverage ratio. You guys are at 36:1. We have QM and QRM from which FHA would be exempt from underwriting and risk retention requirements.

Might that not be a place to start in order—and I know the gentleman from Maryland who I guess left now mentioned he is concerned about FHA crowding out the private market, and so if the private mortgage insurance market has much tougher standards then you are required to have, isn't that going to crowd them out to some degree?

Ms. GALANTE. I think the only rule that we have right now is the Qualified Mortgage standard and so I am not quite sure and again, that is not a place yet, but I am not quite sure what you are referring to in terms of how that affects the private market versus FHA.

Mr. CAMPBELL. Okay. Under the QM and QRM proposals, FHA would be exempt from various risk retention, elements of that and some of the underwriting provisions. So FHA wouldn't have, an originator wouldn't have to have risk retention, and you wouldn't have to follow certain underwriting principles.

Wouldn't it be better if that were not the case if you were following similar rules to the private mortgage market if we want—and again, keeping you at your original mission, but if we want private mortgage insurance to start to step in and take over where you are right now in some places.

Ms. GALANTE. Again, the only rule that we have is the Qualified Mortgage and FHA will be writing its own qualified mortgage standard. The QRM is still under discussion in terms of, in rule making so I can't speak to and we don't know what the terms and conditions of those QRMs will be.

Mr. CAMPBELL. Okay, but regardless of where they are, should you have a different standard than the private mortgage insurance market on things like risk retention, et cetera?

Ms. GALANTE. Again, we are a government agency. We don't have the same kind of capital requirements. We are not borrowing, we are not getting equity from private entities that we need to pay a return on. So to—

Mr. CAMPBELL. No, but you are getting equity from the taxpayers, and you don't need to pay a return, but we need to protect that money. We need to be as judicious with it as possible, understanding the mission of FHA.

Ms. GALANTE. And again, we have our requirements under Federal credit reform in terms of what kinds of capital we need to be reserving for.

Mr. CAMPBELL. Thank you, Mr. Chairman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman. I wasn't sure this would happen until April or May, but I appreciate it very much.

Commissioner Galante, again, thank you very much for your service. I would just like to start by noting that it was 40 years ago this year that I bought my first home with the help of the FHA.

I would like to ask you a little bit about the reverse mortgage activity, and I am prompted to do so because in your testimony you set forth what appears to be a significantly disproportionately negative impact on your balance sheet as a result of activity in that area.

So, if you could please briefly describe utilization of this over the last 5 to 10 years, briefly describe what actions you are taking today to ameliorate that negative impact, answer whether or not you need congressional action in order to take additional action, and if so, will you be seeking it?

Ms. GALANTE. Yes, thank you. The reverse mortgage program I think has a very important mission objective, which is to help seniors who have limited income but some equity in their homes to be able to stay in their homes.

Having said that, over the past number of years, for a variety of reasons, we have gotten into a situation where seniors are taking out up-front in a fixed lump sum much more money than they frankly can afford over the period of time and not having money on an ongoing basis for property taxes and insurance and important elements of maintaining their home.

The actuarial projects that even though the reverse mortgage program, which was put into the MMI fund in 2009, is only 7 percent of the portfolio, it is generating 17 percent of the losses or 17 percent of the negative economic value. So that is a major problem, and it needs to be fixed, moving forward.

We issued a mortgagee letter, guidance where we essentially disallowed those large up-front draws on a fixed-rate basis moving forward and that goes into effect this spring.

Frankly, there are more things that we would want to do including financial assessments of borrowers, whether they can afford to pay the taxes and insurance or set aside for the taxes and insurance, and we can do those via regulation, but that takes a year-and-a-half or more to go through that regulatory process.

So what we are asking Congress for is authority to make those through guidance mortgagee letters and come back and do the rulemaking over time and that would help is very much in terms of putting this program on the right foot moving forward.

Mr. HECK. And I began with asking, what has happened to utilization over time of this program?

Ms. GALANTE. The utilization actually went up over the past few years and it has started to come back down again. I don't have the numbers right in front of me—

Mr. HECK. Thank you.

Ms. GALANTE. —but I can get them for you.

Mr. HECK. I yield back.

Chairman HENSARLING. I am always happy to have those 2 minutes back. The gentleman from Virginia, Mr. Hurt, is now recognized for 5 minutes.

Mr. HURT. Ms. Galante, thank you.

And Mr. Chairman, thank you. Mr. Chairman, one thing I wanted to point out is the figure that we have been using, and I think this committee has been operating on, comes from HUD's US Housing Market Conditions quarterly report, which indicates in the third quarter of last year, the FHA percentage of the mortgage insurance market was 56.4 percent.

Now, that is what we are dealing with, and it doesn't seem like you know where your 42 percent comes from, but I think I would ask the chairman to follow up to make sure that we know what the correct information is. That is very important, I think, for the work of this committee.

I come from Virginia's 5th District and we have, I think by your figures, 13,500 citizens, people who are in my district who are in or have benefited from the FHA program. Of the 13,500, it appears to me when you add up 30-, 60-, and 90-day delinquencies, foreclosures, and bankruptcies, we are talking about 17.2 percent of that 13,500.

So you have about 2,300 people who are in those 5 categories; understanding that is a wide variety. I think when we talk about the full story, which we have heard a lot about or heard mentioned here today, I think it is important to remember that the American dream of owning a home does not derive from Washington, D.C., and I think if you spend enough time in this room and around these vaunted halls, one might think that is what drives homeownership in this country.

It is working 16 hours a day; it is working 80 hours a week. It is having two jobs or three jobs to be able to achieve that dream. That is, if you ask the people, probably the 13,500 people that FHA affects and all the other homeowners, and thousands of others who reside in my district.

If you asked them about homeownership, that is what they would tell you, and I am sure you know that, but I think it makes your mission particularly important because what we are dealing with are those people and their dreams, and I think that encouraging people, having policies that encourage people to do things that are not in their best interests and that they can't live up to hurts them far more than it helps them.

And I think if you asked those 2,300 people in my district who face these circumstances, they would say that they are not better off, and I would assume that you would agree.

But talking about the big picture as you seem to have invited the conversation of the big picture, I was just wondering, from a big picture, we talk about the FHA wanting ultimately to have 10 to 15 percent of the market share, is that correct?

Ms. GALANTE. I am not saying we want—that is an important point. I am not saying we want to have 10 to 15 percent. I think naturally through—we were down to 3 percent and that is okay

with us to when that happens, when private capital is there to do it.

Mr. HURT. But you are—as the Commissioner, I assume you have goals. Do you have a goal to reach 10 to 15 percent? Is there a goal that you have in mind?

Ms. GALANTE. Just to be clear, we have a goal to reseed to 10 or 15 percent—

Mr. HURT. Okay, that is what I am asking.

Ms. GALANTE. —but not to try to always stay at 15 percent. We don't have an upward goal, I guess is what I am trying to clarify.

Mr. HURT. So you have a goal to get down to 10 to 15 percent, maybe even more, but at the same time you say that as an agency, you would like to believe it should also be a goal to be self-sufficient. Is that right?

Ms. GALANTE. That is correct.

Mr. HURT. Can you do those two things at the same time? Can you be have only 10 to 15 percent of the market and have the private market come in and take up the slack, which I think we all want, and I think you want? Can you still be self-sufficient and be at 10 to 15 percent? Are those things inconsistent?

Ms. GALANTE. They are not inconsistent. Again, if you look at FHA over time, historically, except for regional ramp-ups because of an economic distress, we have had historically a lower market share. We are not trying to drive that market share up in order to be "self-sustaining."

Mr. HURT. But you say you have taken steps to drive that market share down.

Ms. GALANTE. We have, yes.

Mr. HURT. And you will continue to do that?

Ms. GALANTE. Yes, we will.

Mr. HURT. Do you believe the private sector better prices risk than the public sector, than FHA as a maxim?

Ms. GALANTE. I would say this crisis would teach us that no, that has not actually been the case and I would—

Mr. HURT. If that is the case, then why do we want to have the private sector get more of the marketplace?

Ms. GALANTE. Again, the private sector can do what it will to come in in front of the public. Why wouldn't you want the private sector to be taking that overall risk?

Mr. HURT. Thank you. I yield back what I don't have.

Chairman HENSARLING. The Chair now yields to the gentleman from New Jersey, the chairman of the Capital Markets Subcommittee, Mr. Garrett, for 5 minutes.

Mr. GARRETT. And I thank the chairman.

One of the points that was raised about whether you are a private entity or not, and of course you are not a private entity, and I agree with that, but you do have shareholders, and the shareholders of course are the American taxpayers.

And so one point is, I really see no reason why this entity should not have to comply with and abide by and be examined by the same accounting standards as any other private entity would be. Do you agree with that?

Ms. GALANTE. I do not.

Mr. GARRETT. You think that there should be an exception because you are a public entity serving the public good?

Ms. GALANTE. It is an "exception." It is that the FHA follows Federal credit reform which is how loan guarantee programs, credit programs for all Federal Government guarantee programs are done and that does calculate appropriately for the FHA's—

Mr. GARRETT. We can have a discussion on that because we are looking to move to provide for more transparency within the FHA to the public as far as what their potential losses are in the future.

But since you are a public entity and you are supposedly doing good for the American public as opposed to harm, can you tell me how many people the FHA loaned to back in 2009 and 2010, and how many of those are now in foreclosure? How many loans?

Ms. GALANTE. I don't have the exact numbers for 2009 in front of me. I can—

Mr. GARRETT. You can get that?

Ms. GALANTE. —probably grab those.

Mr. GARRETT. And could you also find out how many of those foreclosures were for minorities?

Ms. GALANTE. We can get you those statistics.

Mr. GARRETT. And you can—how many of those loans went into foreclosure also for people who fell below the watermark as they say, underwater within a year of receiving the loans. In other words, you issued them a loan and then 12 months later, they are already underwater. Do you know how many that is?

Ms. GALANTE. You would have to have the external market data for that particular point in time to do that.

Mr. GARRETT. But isn't that—that would be something you would want to know as far as the loans you are giving to people if they are actually falling underwater a year after, within a year after year you are losing them. Isn't that something you would like to know as far as being a public entity?

Ms. GALANTE. We track all kinds of statistics. Certainly it is important. In this economic crisis, there were a lot of people—

Mr. GARRETT. But the point here is if you are a public entity trying to do more good than harm, you are not really doing good to them if you are, if the number of foreclosures that are out there is high and the number between minorities is high and yet you are putting people into loans that they cannot afford and they are underwater within a year. Is that not part and parcel of the problem, that you provide for loans with loan downpayment requirements in a declining market?

Ms. GALANTE. So—

Mr. GARRETT. That is what you had in 2009 and 2010.

Ms. GALANTE. Again, as part of our countercyclical role, as home values were declining, people didn't know exactly how far homes—

Mr. GARRETT. So the market is going down and you are helping people to get into the market so they can see 6 or 7 months later that their house is worth less. Is that good for the people or is that bad for the people?

Ms. GALANTE. We help people get into the market. We didn't have perfect vision about where home prices were going—

Mr. GARRETT. So you really don't care—

Ms. GALANTE. —we help people refinance out of bad mortgages, so there was a lot of countercyclical work that was important for us to be doing in that period of time.

Mr. GARRETT. It seems like the answer to everything we say is that it is countercyclical. So it is okay for the government to help somebody to get into a mortgage that you know they can't afford, even though it is a declining market, and 12 months from now they will actually be underwater and go into foreclosure.

Is that maybe the reason why when this committee tried to provide some degree of reform for FHA back in 2009 and 2010, and with the Chair's permission, I would like to put this in the record—

Chairman HENSARLING. Without objection, it is so ordered.

Mr. GARRETT. —this is talking points or lobbying points by—not by you because you weren't here but by some of the people who are with you here—I had an amendment, which has downpayment requirements of 5 percent, and a prohibition of financing by closing cost.

The chairman had an amendment, a moratorium of FHA insurance until the MMIF meets capital ratio requirements. I had other requirements—one, two, three, four other amendments that we were trying to make sure that since you didn't have a view towards the future that you would not find yourself in the situation that you are finding yourself today.

Do you think it was appropriate that FHA came and lobbied against reform to the FHA in 2009 and 2010?

Ms. GALANTE. Let me be clear. We do believe that you can do quality, low-downpayment loans successfully. Over our history, we have done that.

Mr. GARRETT. Let me just give you one example. I was out of the room. Somebody asked you whether you would be able to give a loan for $755,000 to somebody making—you were asked what was the median income for somebody getting that loan and you said about $100,000. Is that correct?

Ms. GALANTE. I believe that is what I said, yes.

Mr. GARRETT. If you make $100,000, your take-home pay is around $6,500 a month, and that means your mortgage and tax payment on that is almost $4,000 a month to pay for that loan. Is that type of loan that you want to put somebody into, especially during a declining market?

Ms. GALANTE. Again, we are dealing with the loan limits that Congress has—

Mr. GARRETT. I am not talking about the loan limits. I am talking about your underwriting practices to put somebody who makes $100,000 into a house that is worth almost $800,000; $755,000. Is that a prudent use of taxpayers' money? And is it fair to put the person into that home when you know that he cannot afford $4,000 a month on a mortgage when he is only making $6,500 a month? Is that good?

Ms. GALANTE. So again, I was guessing at the median income required to make that mortgage payment—

Mr. GARRETT. The appropriate level of income, I would assume under the standard rule, would be around $250,000. If that was the level, would you think that would be appropriate then to help somebody making $250,000 to buy a $750,000 home?

Ms. GALANTE. If we are asked by Congress to go to $729,000 in high-cost areas, and we prudently underwrite that loan based on a debt-to-income ratio, based on the longevity of employment—

Mr. GARRETT. The question, Mr. Chairman, is whether that would be a prudent loan, I would assume.

Chairman HENSARLING. The time of the gentleman has expired. In order to accommodate Ms. Galante's schedule, the last questioner will be the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

And Commissioner Galante, thank you for your testimony today, and let me apologize in advance if I am covering territory you have already covered. I had to step out for a little bit, but I wanted to just get your feedback on some statements made by other regulators in the financial services sector.

A press release from the Consumer Financial Protection Bureau (CFPB) in January of this year indicated that it was the government's policy to make sure lenders offer mortgages that consumers can actually afford to pay back. I would assume you agree with that basic government policy.

Ms. GALANTE. Yes, it is the Ability-to-Pay Rule.

Mr. BARR. Right, exactly. And the same release stated that, "Unaffordable loans helped cause the worst financial crisis since the Great Depression." Would you concur with that statement?

Ms. GALANTE. Yes.

Mr. BARR. And in addition, the CFPB release stated that, "Lenders should not set up consumers to fail." I also assume you would agree with that basic statement?

Ms. GALANTE. Certainly, and when you talk about unaffordable and unsustainable, the CFPB clearly has written rules so that we don't get into this situation that we have gotten into today, not FHA, but as a society of no documentation and high rates—

Mr. BARR. No. I understand, but as a general policy obviously the government shouldn't be doing anything to set consumers up to fail. That is a policy that this Administration has advocated.

Ms. GALANTE. These policies are to assure that no one sets up consumers.

Mr. BARR. Sure, sure, and as I understand it, there are now, according to the GAO, 16 financial literacy programs across the Federal Government and there are 4 homeowner counseling programs across the Federal Government. I take it that the FHA is supportive of these financial literacy programs. Is that correct?

Ms. GALANTE. Absolutely. We actually have an Office of Housing Counseling.

Mr. BARR. Right, and so in just doing a little bit of homework on some of these financial literacy programs, I was looking at the Web site www.money.gov which is presumably a Web site set up as a part of the Office of Financial Literacy, a new government agency that was established as a result of Dodd Frank.

Is it fair to say that you support these efforts to counsel individuals and make sure that people are measuring their ability to repay before undertaking the obligation of homeownership?

Ms. GALANTE. We do, and we actually announced—and I don't know anything about that one—

Mr. BARR. Okay.

Ms. GALANTE. —so I am not endorsing whatever that site is, but we actually have in our report to Congress indicated that we want to bring back what FHA had many years ago: a robust housing counseling effort for new homebuyers to FHA.

Mr. BARR. In one of the links on this www.money.gov Web site, this new Web site I suppose, there is no substantive guidance for the consumer, but it does redirect the person to the FDIC site, which has the section on there to buy or not to buy a home. And I will just read it to you and have you respond to it.

"Homeownership may not be for everyone. It is a big financial commitment starting with the initial shock of your purchase including a downpayment and fees followed by years of monthly mortgage payments, real estate taxes, property, insurance, and maintenance costs."

That is the advice that the Federal Government is giving prospective homeowners. Do you agree with that advice?

Ms. GALANTE. Yes.

Mr. BARR. Okay. So the follow-up question then is—and I understand your testimony earlier. I did have the benefit of hearing what FHA is doing in part to address the negative capital ratio and some of the reforms that you are by administrative measures taking to try to deal with some of the challenges that the agency faces. I think you testified that there is some credit box tightening and premium changes and whatnot, which I applaud the agency for taking the steps.

But generally speaking, do you think that encouraging lending to individuals in this category, the category of low credit scores, people who can barely get by on cheap up-front pricing, the 3.5 percent downpayment, the low downpayment requirements, do you believe that encouraging lending to that category of individuals is consistent with the advice that the Federal Government is giving across all of these financial literacy programs?

Ms. GALANTE. Again, to be clear, FHA provides 30-year, fully-amortizing, fixed-rate loans, underwritten to borrowers' qualifications. Again, have we tightened up some in terms of how much income you need to have, how much after payment of debt that you need to have? Absolutely, and these are, including low downpayment, very sustainable mortgages for these families over time and we think these are affordable and appropriate.

Now, I am not saying there aren't further things that we should look at in terms of overall credit quality, but these are affordable, sustainable mortgages.

Chairman HENSARLING. The time of the gentleman has expired. There are no other Members in the queue.

I would like to thank Commissioner Galante for coming today, and again, thank you for your service to our country.

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

Without objection, this hearing is adjourned.

[Whereupon, at 1:06 p.m., the hearing was adjourned.]

A P P E N D I X

February 13, 2013

Opening Remarks of the Honorable Rubén Hinojosa

Committee on Financial Services
"Bailout, Bust, or Much Ado About Nothing?: A Look at the Federal Housing Administration's 2012 Actuarial Report"

February 13, 2013

Chairman Hensarling and Ranking Member Waters, I would like to thank you for holding this hearing.

Thank you to our distinguished panelist, Ms. Galante for your time and testimony.

We are here today to address growing concerns about the financial situation at the Federal Housing Administration, or FHA. Increasing defaults have led to a dramatic reduction in the Mutual Mortgage Insurance Fund's economic value and capital ratio. I look forward to hearing about the steps being taken by the F.H.A. to improve the MMI Fund's financial situation.

Last week we heard three of the four panelists argue that the FHA represents a failure of the federal government and that we all would have been better off, especially low-income families, if it never existed. That is a false assessment. As the National Realtors Association and many other industry supporters of FHA have indicated, if the FHA were not there during the housing crash to ensure the availability of credit, the crash would have caused an even greater recession, and perhaps a Depression.

Yes, we need to address the FHA's fiscal situation. But we cannot discount the value of the counter-cyclical role it played during the recession.

Again, thank you for holding this hearing today. I look forward to the testimony.

Statement of Randy Neugebauer
Full Committee Hearing
"Bailout, Bust, or Much Ado About Nothing?: A Look at FHA's 2012 Actuarial Report"
February 13, 2013

Thank you, Mr. Chairman, for holding this important hearing examining FHA's FY 2012 Actuarial Report. As you mentioned, this is the second in a series of hearings examining FHA. In a few weeks my Subcommittee will hold another hearing that will focus on the competitive advantages FHA has relative to private mortgage insurers and how those advantages drastically contribute to the crowding out of private capital in housing finance.

I would also like to thank Commissioner Galante for her testimony and extend my sincere appreciation to the Commissioner for what I believe was a very productive meeting with her a couple of weeks back. I look forward to working with you as we seek to reform FHA and nurse it back to financial health.

As we meet today, FHA's financial condition continues to deteriorate. The FY 12 actuarial report which we are examining today showed that FHA's MMI Fund capital reserve ratio fell to *negative* 1.44 percent – well below the Congressional mandated ratio of 2 percent. To put it simply, FHA currently does not have sufficient reserves to cover its expected losses. The report also noted that the MMI Fund's economic value was *negative* $16.3 billion - paving the way for another taxpayer funded bailout. This is on top of the roughly $190 billion taxpayer bailout of Fannie Mae and Freddie Mac.

The situation at FHA is pretty dire; however this won't be the story we will hear from our witness here today. We will hear how profitable FHA's new books of business are; how FHA is on a pathway to grow out of its past mistakes; and how FHA's new and improved underwriting standards will limit taxpayer risk.

But unfortunately, we have heard this story before. In October 2009, Secretary Donovan stated that because of the quality of loans underwritten by FHA, the drop below the Congressionally mandated reserve ratio would be "temporary" and would "return above 2 percent within the next 2 to 3 years." That same month former FHA Commissioner, Dave Stevens, came before this Committee and stated that FHA "would not need a bailout." Three years later, the fund has a capital ratio of *negative* 1.44 and we are well on our way for a taxpayer funded bailout.

The fact that FHA's public comments directly contradict the reality of its capital position has unfortunately resulted in a credibility gap with Congress and the American people.

But even if we take FHA at its word that it will grow out of its problems, we have to ask ourselves: is this the mission of FHA? Did Congress ever intend FHA to become a dominant component of our mortgage finance system? Did Congress ever intend FHA to expand its insurance portfolio to higher income borrowers with homes as expensive as $729,000? Did

Congress ever intend FHA to be greater than 50% of the mortgage insurance market; and to crowd out the private mortgage insurance industry? Did Congress ever intend FHA's insurance portfolio to balloon to over $1.12 trillion - making it larger than the P&C and Life & Health insurance industries combined? I would argue, no.

I do want to emphasize that I'm not advocating for the elimination of FHA. What I am suggesting, however, is that the agency has exceeded its historical mission and these actions pose a threat to the American taxpayer. There is a proper place for FHA, appropriately sized for the market and its historical mission, which is intended to complement rather than compete with the private sector in building a sustainable housing finance system.

I look forward to working with Chairman Hensarling, Ranking Member Waters and Ranking Member Capuano to address these important issues. I thank the Chairman for holding this hearing today and look forward to hearing the views of Commissioner Galante.

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Committee on Financial Services Hearing

"Bailout, Bust, or Much Ado About Nothing?: A Look at the Federal Housing Administration's 2012 Actuarial Report"

February 13, 2013

Statement for the Record

Again, thank you Mr. Chairman for holding this hearing today, and I thank Commissioner Galante for joining us.

I'd like to echo the concerns of Chairman Hensarling over Federal Housing Administration's (FHA) long-term stability. FHA-insured loans in my state of Florida – the state that's been the arguably the hardest hit in housing downturn – have underperformed FHA loans nationwide. Seventeen-percent of FHA-insured loans in Florida have been seriously delinquent for more than 60 days, yet nationwide, only 11 percent have been seriously delinquent. Furthermore, in Lakeland in my district, FHA loan limits are considerably higher than the HUD area median home price. FHA currently insures homes for as much as $271,050 but median home prices are $78,000 – this is a whopping 324% of the median home price. What I find even more disconcerting is that 26% of FHA insured loans in Florida are being given to people making over $75,000 when the median income in 2011 was only $47,827. That's a 12% increase since 2006, even though Florida is still well below the nation-wide median income of $52,762. These increases and numbers do not add up, nor do they represent any form of logic on behalf of FHA.

What they lead to instead is to further convince me that FHA is unnecessarily crowding out a perfectly good private market for mortgage insurance in Florida. In fact, I find it appalling that your own Web site boasts, "[FHA] is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934." A taxpayer-backed federal program shouldn't be the largest provider of anything, much less private mortgage insurance that can be found in the open market. In fact, it should be in FHA's interests to ensure homebuyers know about their options. FHA should be taking steps to encourage residents to go to the private market *first*, and the FHA *second*. The FHA should be the mortgage insurance provider of last resort.

Therefore, I look forward to hearing from you today to educate me and the other committee members on what you're doing to make that happen and move away from this push to remain the largest insurer of mortgages world-wide, US-wide, and certainly Florida-wide.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410

Written Testimony of Assistant Secretary for Housing and Federal Housing Administration Carol Galante
Hearing before the House Financial Services Committee

Wednesday February 13, 2013

Chairman Hensarling, Ranking Member Waters, and Members of the Committee, I appreciate the opportunity to appear today before the Committee to discuss the financial condition of the Federal Housing Administration, including the annual report on the Mutual Mortgage Insurance Fund (MMIF).

We are in an important phase of the recovery of America's housing markets. As 2013 begins, though there are regional variations, there are a number of encouraging trends that indicate that our economy in general and housing in particular, are moving in a positive direction. The number of families falling into foreclosure is half what it was in the early days of 2009. Housing construction is growing faster than at any time since 2008 and this has been the strongest year of home sales since the crisis began. In addition, increasing home values lifted 1.4 million families above water in 2012. While there is still a long way to go, these indicators suggest that the housing market is continuing to improve in a manner that will contribute positively to the overall economy.

On the other hand, despite these positive developments, it is still clear that the recovery is fragile, and there are a wide range of factors that could limit the progress that is taking place. Accordingly, we must remain focused on our efforts to restore the housing markets and assist families in returning to prosperity while also taking steps toward a new era of housing finance in this country.

I. Overview of Findings of the Independent Actuary with Regard to FHA's Single Family Programs

It is with this context in mind that I now want to turn to a discussion of FHA's single family programs. Much of the progress that we are seeing in the housing sector has been possible because of the FHA, which has provided access to homeownership for millions of American families and without which the crisis would have been much deeper. In fact, Moody's Analytics estimates that were it not for FHA's presence during the crisis, house prices would have fallen 25 percent further than they did already.

FHA's contribution has not been without stress, however. On November 16, 2012, HUD delivered its fiscal year (FY) 2012 Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance Fund, which is used for FHA's single family programs. That report summarizes the results of the independent actuarial review conducted by Integrated Financial Engineering (IFE) and provides a status

report on the fiscal health of the MMI Fund. Via its review, the actuary measures the economic net worth of FHA's portfolio at the end of the fiscal year– essentially, the total value of the portfolio after FHA pays all expected claims for the next thirty years in a run off scenario where no new loans are insured, based on an independent, commercially available, economic forecast. This economic value is then divided by the total value of the MMI Fund's insurance in force to derive an estimated capital reserve ratio for the Fund. According to the latest findings of the independent actuary, which Secretary Donovan testified about before the Senate Banking Committee on December 6, 2012, in FY 2012 the capital reserve ratio of the Fund fell below zero to negative 1.44 percent, and the Fund's economic value stands at negative $16.3 billion. Books of business originated from 2007-2009 continue to be the prime source of stress to the Fund, with fully $70 billion in claims attributable to these books of business alone. In contrast, the actuary attests once again to the high quality and profitability of books insured since 2010. Thus, this year's report shows that even though our books of business insured since 2010 are the strongest in agency history, there is still work to be done in mitigating the impacts to the Fund of losses stemming from older books of business which were most severely impacted by the recession and other risk factors, such as seller-funded down payment policies. Toward this end, a series of aggressive measures FHA will take in this fiscal year is discussed later in this testimony.

While the actuary's finding regarding the economic net worth of FHA's portfolio is obviously of very serious concern, it is not the determining factor for whether FHA will need to draw on permanent and indefinite budget authority from the Treasury. Any determination that such a draw is necessary will not be made until the end of FY 2013, and in any event, does not affect the full faith and credit of the Federal Government to pay any claims. In the intervening period, the President's budget will outline the Administration's expectation of whether or not FHA will need assistance by the end of the fiscal year. However, the ultimate need will be borne out in the actual performance of the FHA single family program over the course of the fiscal year, and will be impacted by the steps FHA takes over the course of the year to increase revenue or reduce losses.

While the magnitude of the figures involved in this year's budget re-estimate are large, as an example, the President's FY 2012 budget submission, issued in February of last year, anticipated that FHA would need to draw nearly $700 million in assistance from the U.S. Treasury, as provided for under the Federal Credit Reform Act, to cover expected claim obligations. Instead, at the end of FY 2012 the Capital Reserve Account held $3.3 billion – even after setting aside the necessary funds to cover the increase in expected costs over the prior year. The fact that the MMI Fund ended the fiscal year with this balance is due primarily to policy changes made during FY 2012 that substantially improved the value of the Fund. Likewise, the series of additional changes FHA has announced and which are described below are designed to reduce the likelihood that FHA will need to draw on Treasury assistance at the end of FY 2013.

Secretary Donovan and I will continue, as we have throughout this Administration, to be diligent in taking every action appropriate to protect taxpayers while continuing to ensure that FHA supports the stabilization of the housing market, and that families have access to sustainable mortgage credit options.

II. The Role of FHA's Programs in the Nation's Housing Finance System

As we discuss the current status of FHA's programs and finances, it is important to frame this discussion within the context of the role FHA has played historically in the nation's housing finance system. Throughout its history, FHA has supported access to affordable, sustainable mortgage financing to

persons and entities underserved by the conventional market. Through its single family, multifamily and healthcare loan guarantee programs, FHA has acted as a stabilizing force in the housing market during times of economic distress. At no time has this countercyclical influence been more pronounced than during the recent housing crisis. In the face of ongoing challenges in these sectors, FHA has continued to provide access to mortgage finance opportunities during a period of severe constriction in conventional markets. As a result, FHA has played a central role in bringing the housing market from the brink of collapse to a place where the outlook is positive and improving.

Since its inception in 1934, FHA has provided access to homeownership through its single family programs for credit-worthy lower wealth or otherwise underserved borrowers, enabling more than 40 million families who might otherwise have been denied access to credit to realize the American dream of homeownership. In addition to providing access to financing for credit-worthy borrowers by insuring mortgage lenders against losses on defaulted loans, FHA's single family programs have also offered crucial liquidity in the mortgage finance system during periods of market stress. Whether providing ongoing credit availability in areas experiencing regional recessions, or ensuring nationwide liquidity during broader economic crises such as we have recently experienced, FHA has repeatedly acted as a vital stabilizing force in the single family mortgage market when constriction in conventional lending threatens effective functioning of the market.

Likewise, FHA's multifamily and healthcare programs have been very important to facilitating credit availability in their respective sectors. These programs provide critical mortgage financing opportunities that strengthen communities by addressing specialized financing needs including insurance for loans to develop, rehabilitate and refinance multifamily rental housing, nursing home facilities and hospitals. These sectors faced a severe contraction in the availability of conventional financing, as well as a near collapse of the tax exempt bond market, making FHA's programs essential. FHA multifamily and healthcare mortgage insurance programs operate under FHA's General Insurance-Special Risk Insurance (GI-SRI) Fund, which is separate and distinct from the MMI Fund used for single family programs.

III. FHA Single Family Programs

Created in the aftermath of the Great Depression and designed to expand access to homeownership that would in turn stimulate the ailing residential housing markets, FHA played a central role in developing today's mortgage finance system. It redefined mortgage underwriting practices so that qualified borrowers could obtain mortgage financing, and it standardized construction and appraisal requirements so that mortgage contracts could be tradable across the country. Even more important than FHA's contribution to developing modern mortgage standards and practices, however, has been its role as a countercyclical force that ensured continued liquidity throughout the mortgage finance system during periods of economic stress. This has been true on a number of occasions at the regional level as FHA has offered support for mortgage financing in specific geographies experiencing localized recessions. For example, in many communities affected by the oil patch crisis of the 1980s FHA played a vital part in keeping credit flowing and regional real estate markets from shutting down entirely. And never has FHA's ability to act counter cyclically been more important than during the recent housing crisis, when FHA played a very prominent role in stabilizing the housing finance system and averting a total collapse of the housing market. By design, FHA's programs are meant to complement, not supplant, private capital. They are there to combat a lack of available mortgage credit when private capital retreats or underserves markets, and to step back when private capital returns or expands to serve previously underserved populations. And because of this unique role, its business cannot and should not be evaluated on the same terms as a private firm, as such a requirement would force FHA to

act as a private firm and therefore eliminate its value in providing countercyclical liquidity and credit to underserved markets.

A. FHA Single Family Activity in FY 2012

In 2012, FHA continued to play an important part in the ongoing recovery of the nation's housing market and broader economy. FHA insured nearly 1.2 million single-family forward mortgage loans during the fiscal year, with a total dollar value of approximately $213 billion. Of the over 700,000 thousand home-purchase mortgages endorsed during the year, 78 percent were for first-time homebuyers, reaffirming FHA's role in providing access to new entrants to the home ownership market. Indeed, over the past four fiscal years, FHA has insured mortgages for over 2.8 million first-time buyers.

FHA also continued to be a vital source of home financing for minority borrowers. While FHA insurance was used for approximately 27 percent of all home purchase mortgages in 2011, FHA accounted for 50 percent of home purchase mortgages for African American borrowers. For Hispanic and Latino populations which, according to the National Association of Hispanic Real Estate Professionals are expected to account for 40 percent of the estimated 12 million new household within the next 10 years, 49 percent use FHA to access homeownership.

Clearly, FHA has played a very crucial role in facilitating continued liquidity in the single family mortgage finance market, preventing even more severe economic circumstances during the recession. As Moody's Analytics Chief Economist Mark Zandi said in a Washington Post article[1], "If FHA lending had not expanded after private mortgage lending collapsed, the housing market would have cratered, taking the economy with it." Moody's estimates that were it not for FHA's presence during the recent crisis, house prices would have fallen an additional 25 percent, resulting in 3 million more job losses and a reduction of economic output of $500 billion.

Although FHA continues to be an important source of access to credit for American families, its market share continues to decrease as the economy recovers and private capital begins to return to the market. New insurance endorsement activity in FY 2012 fell once again from that of the prior year, continuing its decline from the peak levels seen in FY 2009. As a percentage of total market share, refinance and purchase transactions, FHA represents 14.6 percent of the nation's mortgage market. In terms of dollars of single-family loans insured, 2012 is the lowest volume since the start of the crisis. Indeed, FHA's volume by loan count is now at levels seen in 2002 and 2003 when it's market share was smaller than today. Thus, FHA's current market share is more indicative of the reduction in the total size of the market than it is of abnormal levels of FHA activity.

Home Equity Conversion Mortgage (HECM) insurance endorsements in FY 2012 were also down by 25 percent from FY 2011 levels, to 54,591 loans. FY 2012 marks the third consecutive year in which HECM volume declined, as the combined effects of policy revisions to the product and changes within the industry have reduced participation in the program.

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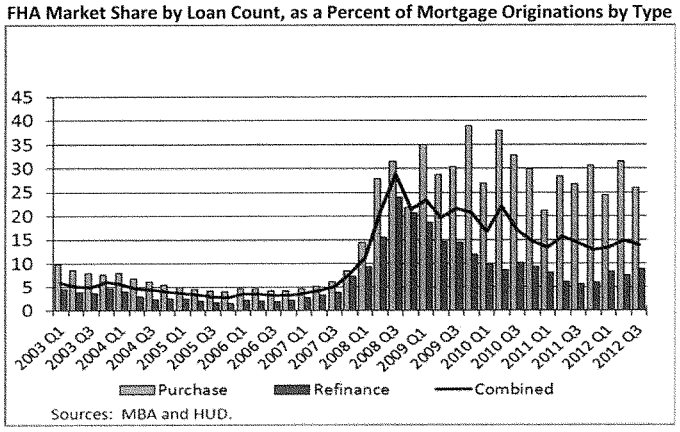
[1] Zandi, Mark. (2012, September 28). Obama policies ended housing free fall. *The Washington Post.* http://www.washingtonpost.com/realestate/obama-policies-ended-housing-free-fall/2012/09/27/20635604-0372-11e2-9b24-ff730c7f6312_story.html

FHA and Overall Market Originations by Loan Type						
	FHA			All		
	Purchase	Refinance	All	Purchase	Refinance	All
2003	629,919	638,542	1,268,461	7,426,006	15,677,677	23,103,684
2004	457,404	237,995	695,399	6,904,911	7,966,749	14,871,660
2005	322,915	133,261	456,176	7,233,456	7,251,637	14,485,093
2006	295,261	115,859	411,120	6,563,679	5,765,899	12,329,578
2007	317,181	211,093	528,274	5,222,266	5,071,725	10,293,991
2008	844,893	560,767	1,405,660	3,508,103	3,583,680	7,091,783
2009	1,088,356	896,558	1,984,914	3,338,302	6,052,223	9,390,525
2010	944,159	518,571	1,462,730	2,925,707	5,432,837	8,358,544
2011	759,386	312,385	1,071,771	2,864,629	4,774,054	7,638,683
2012	724,315	534,780	1,259,095	2,779,974	5,858,193	8,638,167
Source: HUD Estimates of Market Data and FHA Single Family Data Warehouse						

FHA Market Share by Loan Count, as a Percent of Mortgage Originations by Type



FHA served an important and necessary role in the nation's housing finance system throughout 2012. Because of the agency's importance to the overall health of the housing market and its responsibility to American taxpayers, FHA constantly seeks to balance efforts to provide access to credit for underserved borrowers and ensure continued liquidity in the system with its responsibility to prudently protect the health of the MMI Fund. Throughout the current Administration, we have continually sought such balance in establishing policies and practices for FHA.

B. The Mutual Mortgage Insurance Fund

The important services FHA single family programs provide to the nation's housing sector are made possible through FHA's Mutual Mortgage Insurance Fund. The MMI Fund operates with two primary sets of financial accounts:[2] a Financing Account, which reflects the business transactions related to insurance operations, and a Capital Reserve Account, which reflects secondary reserves to cover unexpected increases in program costs, including higher claim expenses, or lower fee collections. Both of these accounts are held at the U.S. Treasury. The Capital Reserve Account was established to assist in managing to the two-percent capital ratio requirement enacted by Congress in 1990. FHA's MMI Fund programs, however, are backed by the full faith and credit of the U.S. Government like all federal government direct-loan and loan-guarantee programs, its financing account operates with what is called "permanent indefinite budget authority" under the Federal Credit Reform Act to cover unexpected increases in program costs. This authority provides access to the U.S. Treasury for any funds needed to pay claim obligations, and provides assurance to lenders and investors that FHA programs are never in jeopardy of lacking sufficient funds to pay insurance claims. That would be true even in the absence of a Capital Reserve Account.

The Fund is subject to two distinct portfolio valuations each year. Both project all future revenues and expenses based upon a forecast of loan performance under defined economic conditions. One is performed by an independent actuary in accordance with requirements of Section 202 of the National Housing Act, and included in the FHA financial statement. The other is the annual subsidy re-estimate performed by the Administration under the terms of the Federal Credit Reform Act and published in the President's Budget.

The independent actuarial study uses statistical models to develop 30-year projections of default, claim, loss-on-claim, and prepayment rates on current and future books of business. Those models are estimated using historical patterns of FHA-insured loan performance under a wide variety of economic conditions. They are applied to active loans, and they use commercially-available forecasts of home prices and interest rates to predict loan performance in the future. The resulting projections determine business-operation cash flows needed to estimate the economic value of the Fund.

In 2012, the actuarial study applied a stochastic method to estimate the net present value (NPV) of future cash flows, implementing recommendations by the GAO and the HUD OIG. In previous studies, the net present value of cash flows was computed along a single path of house prices and interest rates. This year, model estimates reflect a wide variety of possible economic conditions

The outcome of the complete actuarial study is the estimated "economic net worth" of the MMI Fund, which is defined by the National Housing Act as capital resources plus the present value of future cash flows of the MMI Fund. The calculation of economic net worth is repeated for each of the next seven years by adding projected endorsements each year, forecasting their cash flows and

[2] There are two additional sets of accounts that are independent of the insurance operations, and for which funds are directly appropriated by the Congress each year. The first is the set of Program Accounts which cover all personnel and administrative expenses for FHA operations. The other is the Liquidating Account, which represents remaining cash flows each year on pre-1992 insurance endorsements. The year 1992 marks implementation of the Federal Credit Reform Act of 1990 and introduction of the Financing Accounts.

adding them to those of the current portfolio, and then reassessing economic net worth on the updated portfolio at the end of each fiscal year.

Economic net worth represents additional resources directly available to FHA for absorbing costs above-and-beyond lifetime expected costs, or if negative, the additional resources necessary to cover lifetime costs on outstanding guarantees. Those calculations are for the remaining life of all outstanding loan guarantees and can extend for more than 30 years on HECM loans. Economic net worth is the numerator of the statutory capital ratio measure. The denominator is the outstanding dollar volume of active insurance contracts.

The credit subsidy re-estimate is performed each year as part of the federal budget process in accordance with the budget valuation of all federal direct loan and guarantee programs. For FHA single-family programs, this evaluation uses a modified version of the actuarial study forecasting model, applying the economic assumptions common to the President's Budget. The estimate is used to determine any necessary transfers between the MMI Fund Financing and Capital Reserve accounts, based on projections of expected claim expenses, premium revenue, and recoveries on outstanding loan cohorts over their remaining lifetimes (up to 30 years). If resources in the MMI Fund Financing and Capital Reserve accounts fall short of expected lifetime costs to the Fund, FHA would draw on support from the Treasury as explained above. Permanent and indefinite authority from Treasury is only necessary if FHA is unable to satisfy the budget re-estimate requirements from the funds in the Capital Reserve at the end of the fiscal year.

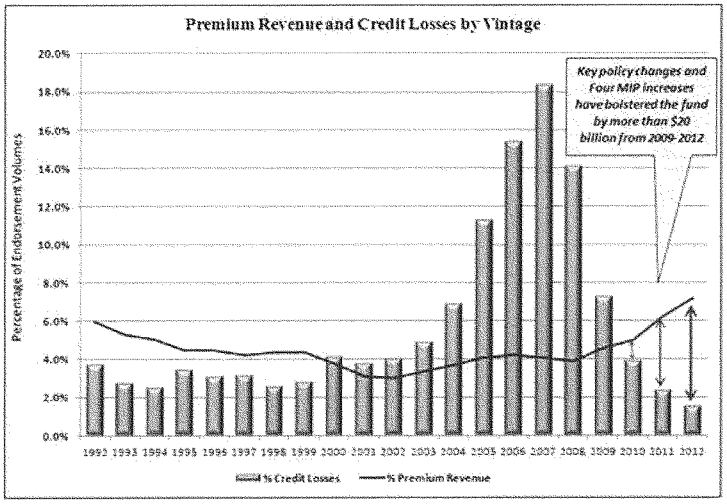
C. The FY 2012 Actuarial Review

In FY 2012, as noted above, the MMI Fund capital reserve ratio as calculated in the Actuarial Review fell below zero to negative 1.44 percent. The actuarial assessments estimate that the economic value of the Fund as of the end of FY 2012 is negative $16.3 billion against an active portfolio of $1.13 trillion. The economic value of the forward portfolio was estimated at negative $13.5 billion, the HECM portfolio at negative $2.8 billion. These economic values represent capital reserve ratios of negative 1.28 percent and negative 3.58 percent respectively. The actuary projects that the MMI Fund capital reserve ratio will be positive by FY 2014 and reach 2.0 percent during FY 2017 under its base-case estimate. These forecasts assume no changes in policy or other actions by FHA. Policy changes that were announced when the actuarial report was released are expected to accelerate the time to the Fund's recovery.

The low capital ratio today reflects an expectation that FHA's current pool of insured loans still has significant foreclosure and claim activity yet to occur. As stated previously, projected losses are particularly large for the fiscal year 2007-2009 loans, totaling $70 billion in claims for these books alone.

Loans using seller-funded down payment assistance have proven to place substantial stress on the Fund. Those loans are projected to cost the Fund $15 billion as they continue to experience elevated rates of insurance claim. In fact, the Actuary estimates that, if FHA had not insured any seller-funded-downpayment loans, the net economic value of the MMI Fund would be positive $1.77 billion today. Thus, we are very grateful for the action by Congress in 2008 to eliminate seller-funded down payment loans from the FHA program, avoiding substantial additional losses from these loans.

In contrast to the drain caused by those older loans, the actuary expects endorsements in fiscal years 2010 through 2012 to produce significant net revenues that can be used to partially offset losses from earlier books of business. The contrast in quality between these two vintage eras—pre- and post-2009—is based, at least in part, on the impact of key policy changes which have added over $20 billion to the Fund since 2009—as demonstrated by the following chart.



Source: FY 2012 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

While the general trends revealed in the 2012 actuarial report are consistent with those reported in the reports of the past few years – books of business insured through 2009 are placing a great amount of stress on the MMI Fund while those insured since 2010 are adding substantial value to the Fund -- the overall results in the 2012 actuarial report differ substantially from the expected status of the Fund as projected in the 2011 actuarial report. There are three factors driving the change in the estimated economic value of the MMI Fund compared to what was projected in 2011:

- First, the house price appreciation forecast used in the 2012 actuarial study, predicted significantly lower levels of appreciation in the near term than the projections built into the forecast underlying the 2011 actuarial study. This yielded a cumulative difference in projected house price appreciation of 8 percentage points over the first five years. Thus, the downward revision in house price forecasts from 2011 to 2012 accounted for an estimated $10.5 billion in reduced economic value compared to the actuary's 2011 and 2012 projections of what the Fund's economic value would be as of the end of FY 2012. Further, near-term house-price movements in the index used by the actuaries were depressed by high levels of refinance activity in 2012, and therefore, they do not reflect improvements seen this year to home prices

in other measures of housing market strength. Additionally, because the forecast utilized only covers the period through June 2012, it does not include substantial improvements to home prices seen since that time. Second, the continued decline in interest rates since last year, while good for the overall economy, causes a substantial loss of revenue. The reasons for this are two-fold. First, because of the higher interest rates being paid by borrowers on loans made before 2009, the actuary projects that these borrowers will default at marginally higher rates than would otherwise be expected.

- Second, the actuary projects that FHA loans would be paid off earlier than expected through refinances that take advantage of the lower rates—leading to lower premium revenue, and because the methodology required by statute that the actuary utilizes assumes that none of these loans will refinance back into FHA. The effect of the house price assumptions and low interest rates is a reduction of $8 billion in estimated economic value for the Fund from what was anticipated in last year's report.
- Third, based on recommendations made by the GAO, HUD's Inspector General, at FHA's direction $13 billion in reduced economic value is attributable to refined methods to better capture shares of Pre-foreclosure sale (PFS or short sales) and REO in claim predictions. Also, model structure changes removed an artificial cap on the effect of declining home prices on REO loss rates.

It should be noted that while the shift in value from what was projected last year to what was calculated in this year's review is substantial, the 2011 actuarial report did indicate that should house price appreciation or interest rates deviate from the base case scenario used for the actuary's projections, such deviations would impact the Fund's value in FY 2012. Furthermore, the FY 2011 report stated explicitly that there was an approximately 50 percent chance that if economic forecasts in FY 2012 differed materially from those used in the prior year's report, the Fund would have a negative value. These findings were the result of stress testing requested by HUD. While stress tests are not required by statute, FHA directs the actuary to perform them annually to provide greater insight into what may be expected if conditions deviate from those established in the base case scenario. For the FY 2012 report, FHA asked the Actuary to estimate the value of the Fund based upon those economic paths that yield the 10th best, 25th best, 25th worst, 10th worst and the singular worst projected economic values. Additionally, the Actuary was also asked to evaluate two additional scenarios which represent singular, deterministic economic paths with no random fluctuations. First was the Moody's Protracted Slump Scenario, the most stressful alternative scenario forecasted by Moody's Analytics in July 2012. Second was a Low Interest Rate Scenario, representing a continuation of the historically low interest rate environment prevailing at the end of FY 2012.

The significant shift in dollar value this year from what was expected in last year's report highlights the volatility associated with thirty year projections of economic conditions. Additionally, they are indicative of what occurs when underlying factors change for a portfolio the size of FHA's. The $23 billion difference between the estimated value of the Fund in this year's actuarial review versus that projected in last year's represents only a 2 percent shift in value.

D. Actions Taken to Date to Protect the Fund

Throughout the tenure of this Administration, FHA has taken aggressive and decisive actions to improve the health and trajectory of the MMI Fund, while ensuring continued access to mortgage credit for American families. The changes made to FHA policy since 2009 are projected to have improved the economic value of the Fund by at least $20 billion. That FHA's capital ratio has

remained positive until this year is primarily due to the reforms to risk management, credit policy, lender enforcement, and consumer protections made over the past four years – the most sweeping changes to policy in FHA's nearly 80 year history. Our efforts to date to strengthen FHA have been focused on eliminating unnecessary risks and ensuring sufficient revenue generation from new endorsements while continuing to learn from what is working in our efforts to improve FHA's asset management and loss mitigation approaches. As Secretary Donovan said before the Senate Banking Committee in December, that work is not over. To that end, in January and February of 2013, we issued additional guidance implementing policy changes to benefit the Fund.

1. Counterparty Risk Management and Lender Enforcement

One of the first things this Administration did upon taking office was to take strong actions to improve FHA's monitoring and oversight of lenders. This has included substantial improvements to risk analysis systems and procedures, and policy changes to focus resources on the areas of FHA's business which pose the greatest potential risk to the MMI Fund. These efforts have resulted in record numbers of lenders being withdrawn from FHA programs, substantial improvements in lender compliance with FHA requirements, and a number of settlements with lenders and servicers for violations of FHA origination or servicing requirements.

Additionally, we have been concerned of late with a number of web-based and print advertisements that proclaim the supposed ease of obtaining an FHA-insured loan following a foreclosure. While FHA has taken a number of proactive steps in the past few years to clarify its requirements regarding lender advertising and to enforce those requirements aggressively, we determined in recent months that it was necessary to address the issue of post-foreclosure advertising specifically. Therefore, on January 25, 2013 FHA issued a reminder to its industry partners that advertisements that imply that little or no qualification criteria are necessary to obtain an FHA loan are unacceptable and that FHA will not hesitate to take action within its authority to enforce its requirements related to lender advertising, including sanctions by HUD's Mortgagee Review Board and/or referral to the HUD Inspector General or the Consumer Financial Protection Bureau (CFPB).

2. Credit Policy

We have also worked to strengthen our credit policies for FHA borrowers. First and foremost, FHA implemented Congress's elimination of seller-funded down payment assistance programs which cost the MMI Fund more than $15 billion in economic value. Further, we enacted increased down payment requirements for borrowers with credit scores below 580. The long-term positive impact of these two credit policy changes cannot be overstated. The 2005 – 2008 vintages, accounting for less than 15% of total originations over the last 30 years, are projected by the Actuary to contribute more than one-third of total credit losses of the Fund. Loans with credit scores below 580 and/or seller-funded down payment assistance will have accounted for 44% of those losses. Additionally, we have proposed regulations to reduce the amount of allowable seller concessions that increase risks to FHA arising from inflated appraisals.

In late 2012, FHA announced several additional policy changes that continue its work to strengthen credit policy while balancing the need to avoid negatively impacting the ongoing recovery and maintaining access to mortgage financing for credit worthy borrowers while also taking steps to recede FHA's total market share. These steps – requiring manual underwriting

for borrowers with credit scores below 620 and debt to income (DTI) ratios over 43 percent, enhancements to FHA's TOTAL Scorecard, and a proposed increase in the required down payment for borrowers seeking loans in excess of $625,500 – will, together with all the other measures outlined above as well as those detailed in Appendix A of FHA's Annual Report to Congress, will better ensure that home buyers using FHA-insured financing are capable of meeting their mortgage obligations and won't put undue stress on the Fund.

3. Increased Revenue

In addition to the improvements made to the quality of new endorsements, we have also made the difficult choice to increase mortgage insurance premiums for FHA-insured loans multiple times in the past four years. Since 2009, FHA has increased premiums five times – the most recent increase coming in response to the FY 2012 actuarial review, and which will add an additional $150 or more in annual mortgage premium costs for the average FHA borrower. Combined, the premium increases made since 2009 have, to date, yielded more than $10 billion in additional economic value for the Fund. These increases have not been undertaken lightly, and FHA has been careful to balance changes to pricing to improve the outlook of the Fund with its countercyclical role of providing liquidity and access to credit in the midst of the recent crisis and ongoing recovery.

4. Loss Mitigation and Asset Management

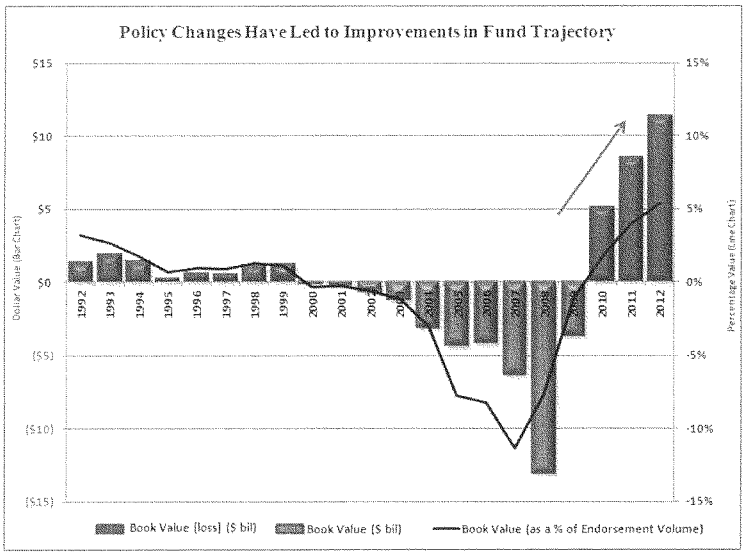
FHA has not just addressed issues associated with the origination of new loans, but has also taken decisive steps to control costs and limit losses on the back end of its business through improvements to its REO disposition processes and loss mitigation strategies. First, we changed our strategy and approach with regard to the REO management and marketing contracts through which FHA's REO property inventory is managed and sold. Enhancements to the oversight of contractors and better monitoring of their compliance with FHA guidelines, as well as measures which promote competition and continuity within specific markets, have resulted in notable improvements to FHA's REO processes. As a result of the changes HUD has made, the gap between appraised values of REO properties and their sales prices has decreased by 62% and the time in inventory for FHA properties has reduced by 45%, decreasing losses on the REO portfolio and improving recoveries for the Fund.

Finally, in FY 2012, FHA implemented a significant expansion of its note sales program whereby non-performing loans are sold in pools at a market-determined price via auction to investors, who are then able to explore options for homeowners to either remain in their homes or obtain a viable non-retention solution. This initiative, known as the Distressed Asset Stabilization Program (DASP), exponentially expands the number of loans sold in each sale while introducing innovations designed to promote stability in hard hit geographies. In addition to the sale of pools comprised of properties located throughout the nation, FHA also created Neighborhood Stabilization Pools of loans concentrated in specific Metropolitan Statistical Areas (MSAs). For the first sale in this expanded program, the MSAs of Newark, Tampa, Chicago and Phoenix were selected for inclusion in the program. These pools included additional requirements targeted at reducing the inventory of vacant foreclosed properties in these communities and providing enhanced options for homeowners and community members to benefit from these properties that would otherwise end up in FHA's REO inventory. The initial results from the first DASP sale were positive, resulting in the Actuary's estimate of improved economic value for the Fund from

this initiative of more than $1 billion over the next two years. The next DASP sale is scheduled for March 2013.

The effectiveness of these changes can be seen in the stark contrast between books of business insured prior to 2010 and those insured since that time, which is clear in the graph below.

Economic Net Worth by Book-of-Business



Source: FY 2012 Actuarial Reviews of the MMI Fund; analysis by U.S. Department of HUD/FHA.

B. Additional Actions to Be Taken in FY 2013

While FHA has enacted substantial reforms under the current Administration, this year's actuarial review makes clear that loans made prior to and at the outset of the recent crisis continue to weigh heavily on the health of the MMI Fund. Therefore, building upon the significant efforts already undertaken to protect and preserve the MMI Fund, FHA is implementing a series of additional actions to continue improving the Fund's trajectory over both the short and long term. Using the Actuary's model, collectively, these changes are projected to provide billions of economic value for the MMI Fund in FY 2013.

1. Reduce Losses from Legacy Books of Business

The changes made since 2009 to FHA's lender oversight, credit policies, and premium pricing have yielded substantial improvements in the quality of new loans endorsed by FHA. But significant opportunity remains to reduce the impact on the Fund of poorly performing legacy

loans severely impacted by the recession, and to provide greater assistance for distressed borrowers as they seek to recover and find meaningful assistance in dealing with their delinquent loans. With a majority of FHA's projected losses attributable to loans insured from 2007-2009, FHA will take several additional steps to maximize recovery in the areas of loss mitigation and asset management.

The Actuary projects nearly $60 billion in claims costs for FHA from seriously delinquent loans that will go to claim by the end of FY 2014, largely arising from loans insured between 2007 and 2009. As a result, reducing the severity of losses derived from these loans will exert a demonstrable positive impact to Fund performance over the next few years. Throughout the past fiscal year, FHA has been executing on an overall asset management strategy aimed at ramping up REO alternatives. REO alternatives (primarily short sales) comprised about 15%-20% of total dispositions since 2010, yielding average loss severities about 20% lower than REO. In recent months, as noted, FHA also unveiled its Distressed Asset Stabilization Program (DASP), another REO alternative that improves Fund performance. These and other actions have had a measurable effect, as loss severities have already fallen by 9% in the last year A reduction in loss severities will further improve fund performance..

- **Re-design of FHA Modification Treatments to Better Assist Delinquent Homeowners**
  FHA issued a Mortgagee Letter on November 16, 2012 that established revised standards for repayment plans, standard modifications, and FHA-HAMP loss mitigation products, which are expected better assist distressed borrowers and reduce losses to the Fund from foreclosures. FHA loss mitigation policies will be geared towards greater payment relief for borrowers, targeting payment reductions of at least 20% for FHA-HAMP modifications, which will result in more sustainable payment outcomes for borrowers over the long term. This approach is intended to yield lower claim costs for FHA while also reducing prepayment speeds for insured loans, both of which will positively impact the MMI Fund.

- **Streamlining of the FHA Short-sale Policy**
  Although FHA is deeply committed to providing loss mitigation alternatives to borrowers which permit them to retain their homes, home retention is simply not an option for some borrowers. For these borrowers, pre-foreclosure sales (short-sales) offer an opportunity to transition out of their homes. This enables both FHA and the borrowers to avoid the costs and damages of the foreclosure process. FHA will introduce a streamlined pre-foreclosure sale policy which removes certain barriers for borrowers in obtaining a short sale on their FHA-insured mortgage. This change is expected to increase the number of defaulted loans that end in short sales rather than foreclosures. Because losses from short-sales are substantially lower than from the traditional FHA REO process, the shift of greater numbers of distressed homeowners to short-sale dispositions rather than foreclosures are anticipated to yield better results for the MMI Fund while allowing distressed borrowers to start anew without having to go through the difficult and costly foreclosure process.

- **Claim without Conveyance Pilot Program**
  FHA plans to expand a pilot whereby properties secured by non-performing FHA-insured loans are offered for sale by the lender who has completed the foreclosure process. At a reserve price slightly below the outstanding unpaid principal balance of the loan, the properties are sold to third party purchasers without ever being conveyed to FHA. This

method of disposing of these properties is expected to yield lower losses for the MMI Fund than selling them through FHA's normal REO disposition process, as carrying costs associated with preserving, managing, and marketing an REO property were eliminated.

- **Proactive Strategies to Further Improve Recoveries**
  In addition to the policy and programmatic changes outlined above, FHA will also take several innovative and proactive steps to increase utilization of loss mitigation options and reduce unnecessary asset disposition losses. First, beginning in 2013, FHA will launch a large-scale proactive marketing campaign to promote modification and short-sale strategies for delinquent borrowers. This effort is expected to increase utilization of these programs, which will permit more borrowers to become aware of and take advantage of these opportunities, while reducing foreclosures and decreasing associated losses for FHA. In addition, FHA will also pursue more creative strategies to dispose of REO properties in geographies where traditional asset disposition methods yield net negative recoveries for FHA. This approach is anticipated to both save money for FHA on unnecessary losses as well as contribute to community stabilization initiatives in cities hit hard by the recession.

2. Further Strengthen the Quality and Impact of New Endorsements

While much has been done under the current Administration to improve the performance and revenue of new FHA endorsements, we believe it is vital to take additional steps to strengthen new books to ensure the long term health of the MMI Fund. Accordingly, in the second quarter of FY 2013, FHA will implement the following policies for new originations.

- **Revised Premium Cancellation Policy**
  Under a policy change made in 2001, FHA has been cancelling required mortgage insurance premiums (MIPs) on loans for which the outstanding principal balance reaches less than 78% of the original principal balance. However, FHA remains responsible for insuring 100% of the unpaid principal balance of a loan for the entire life of the loan, such loan life often extending far beyond the cessation of MIP payments. As written, the timing of MIP cancellation is directly tied to the contract mortgage rate, not to the actual loan LTV. That policy, which was reversed in a Mortgagee Letter published on January 31, 2013, was put in place at a time when it was assumed that home price values would not decline, but today we know that LTV measured by appraised value in a declining market can mean that actual LTVs are far lower than amortized mortgage LTV, resulting in higher losses for FHA on defaulted loans. Analyses conducted by FHA's Office of Risk Management projects lost revenue of approximately $10 billion in the 2010-2012 vintages as a result of the current cancellation policy. The same analyses also suggest that 10%-12% of all claims losses will occur after MIP cancellation. Therefore, beginning with new loans endorsed after June 6, 2013, FHA plans to once again collect premiums based upon the unpaid principal balance of FHA loans for the entire period during which they are insured, permitting FHA to retain significant revenue that is currently being forfeited prematurely.

- **MIP Increase**
  We are very grateful for the flexibility Congress granted us in 2010 to adjust FHA's premium pricing. And we have utilized that flexibility five times, with the most recent increase in annual MIP released in a mortgagee letter on January 31, 2013. Consistent with FHA's continued efforts to balance its countercyclical role in the nation's mortgage market with its

responsibility to manage the Fund, FHA will increase annual mortgage insurance premiums by an additional 10 basis points. While the new loans being made today are profitable to FHA and we do not want to over-burden or constrict access to credit as the housing market continues to mend, we also must ensure that we are 1) rebuilding adequate reserves for the future and 2) phasing out of our counter-cyclical role by reducing FHA's footprint in the marketplace and helping to facilitate the return of private capital. FHA has played a vital part in ensuring access to credit for borrowers and liquidity in the market, yet its current outsized role should and will decrease. Indeed, its market share has declined yearly since a peak in 2009. This premium increase, $13 per month for the average FHA borrower, which FHA plans to implement in 2013 will add significant revenue to the Fund and ensure that FHA does not take on additional market share, while at the same time being modest enough that it doesn't impact borrower access to credit or threaten our emerging housing recovery.

- **Future Credit Policy and Pricing Changes**
  While much has already been done to improve the quality of new FHA endorsements, the effectiveness of which are clear in the performance and projected value of loan cohorts insured since 2010, FHA is continually evaluating its portfolio to identify and mitigate risks, and to provide enhancements that benefit both consumers and the Fund. And we welcome additional proposals which will further assist in strengthening the MMI Fund.

- **Housing Counseling Incentive Policy**
  Significant evidence has shown that housing counseling improves the success of home buyers – particularly first time homebuyers.[3] FHA intends to develop new policies which incentivize, or in some cases require, borrowers to complete a pre-purchase housing counseling program prior to the purchase of a home using FHA-insured financing. We will work during this fiscal year to craft and receive feedback on the precise contours of this initiative. This endeavor is expected to ultimately improve outcomes for both borrowers and FHA, reducing losses to the Fund as higher numbers of new borrowers attain successful home purchases.

3. Stabilize and Strengthen the HECM Program

Changes in borrower utilization of the HECM program and the modeling changes employed by the actuary for the FY 2012 review show substantial stress in the HECM program. In order to mitigate the negative impact of the 2013 and future HECM books on the MMI Fund, FHA is taking aggressive actions in both the near and long terms to ensure that consumers are better protected and able to sustain their reverse mortgage, while also protecting the Fund.

- **Immediate Steps to Reduce Losses in the Near Term**
  Given current regulatory authority, FHA has limited ability to address root cause issues and will, therefore, be forced to make blunt changes to the program on an interim basis. FHA

[3] HUD conducted a review of pre-purchase counseling that was published in 2012, which also found that the program was serving its intended population. The study tracked 573 participants at 12 to 18 months after receiving pre-purchase counseling services. Only one of the purchasers had fallen at least 30 days behind on his or her mortgage payments and none had a major derogatory event on a mortgage account. A report on the study's findings can be found at:
http://www.huduser.org/portal/publications/hsgfin/pre_purchase_counseling.html

will take immediate action to better align the program with its objective of enabling seniors to age-in-place. These changes will protect FHA from losses and reduce the likelihood of borrower defaults due to nonpayment of property taxes and insurance.

In administrative guidance dated January 30, 2013, FHA consolidated the Fixed Rate Standard program with the Fixed Rate HECM Saver product, which will result in a reduction of the maximum amount of funds available to a HECM borrower.

Additionally, in an effort to reduce losses associated with the conveyance and disposition of properties mortgaged with a HECM, FHA will issue new incentives for estate executors of HECM borrowers to dispose of properties themselves rather than conveying them to HUD. Executors are permitted to either sell such properties or convey them to HUD. Reversing the historical trend, over the past few years, larger numbers of executors have been choosing to convey these properties to FHA rather than sell them, adding costs and reducing recoveries for FHA. By incentivizing the sale of properties by executors, FHA is able to avoid property management, maintenance, and marketing costs associated with the REO disposition process, thereby reducing losses to the Fund on these properties.

- **Longer-term Changes to Permanently Strengthen the Program**
  Over a longer term, either through the granting of the legislative authority described below or via the much longer rule making process, FHA will also pursue other material changes to ensure the long-term viability of the HECM program. These measures include:
  - Limiting the draw at origination to mandatory obligations (i.e. closing costs, mortgage liens and federal debt), providing greater flexibility in addressing the individual needs of borrowers than the across-the-board reductions to principal limit factors described above, while still protecting the Fund from losses on loans where the maximum loan amount is drawn up-front;
  - Performing a financial assessment of borrowers as a basis for loan approval and determining the suitability of various HECM products to protect consumers from acquiring loans not fit for their situation; and
  - Establishing a tax and insurance set-aside to ensure sufficient equity or an annuity is available to pay taxes and insurance on the mortgaged property so that defaults resulting from nonpayment of taxes and insurance can be avoided.

E. Legislative Requests to Further Strengthen the Fund

Over the past several years, Congress has moved in important ways to strengthen and protect FHA, and for that we are very grateful. Indeed, were it not for the flexibility granted by Congress to FHA in 2010 in setting premium pricing, the current economic value of the MMI Fund would be more than $10 billion lower than it is today. And the work this body has done to establish FHA's first ever Office of Risk Management has been instrumental to our improved ability to identify risks in FHA programs and take action to mitigate them. So thank you for your commitment to making FHA stronger and more secure over the long term.

But today, we are asking for your help once again so that FHA is better able to protect the Fund while continuing to execute its mission. The proposals outlined below will enhance FHA's ability to hold lenders accountable for non-compliance with FHA policy and provide greater flexibility for FHA

to make changes to policies and procedures as emerging needs and trends are identified. As a result, FHA will better be able to avoid unnecessary losses before they occur.

1. **Indemnification Authority for Direct Endorsement Lenders:** This provision, which FHA has been seeking since 2010, would allow FHA to seek indemnification from Direct Endorsement lenders, which represent 70% of all FHA approved lenders. Currently FHA only has authority to require indemnification for lenders with Lender Insurance (LI) approval. In granting this authority, FHA will be able to obtain indemnification from all of its approved lenders for loans that do not comply with its guidelines.

2. **Revised Indemnification Authority**: This change would eliminate the "knew or should have known" standard with regard to fraud or misrepresentation. While the Government-Sponsored Enterprises require lenders to retain all fraud related risk, FHA only holds lenders accountable for fraudulent activity if they "knew or should have known" of its occurrence. Providing proof to meet this standard limits FHA's ability to require lenders to be accountable for fraud in FHA-insured loans, and its removal would significantly improve FHA's ability to avoid unnecessary losses arising from fraudulent activity.

3. **Authority to Terminate Origination and Underwriting Approval:** This legislation would give FHA enhanced ability to review lender performance and, if a lender is found to have an excessive rate of early defaults or claims, would provide greater flexibility in terminating the approval of the lender to originate or underwrite single family mortgages for FHA insurance. FHA has been seeking this authority since 2010.

4. **Revised Compare Ratio Requirement:** This provision would revise the statute governing the Credit Watch Termination Initiative to provide greater flexibility in establishing the metric by which FHA compares lender performance so that it more effectively captures the true performance of a lender during all market conditions, minimizing further poor performance by FHA lenders while reducing uncertainty for them. Specifically, this legislation would allow the Secretary to compare the rate of early defaults and claims for insured single family mortgage loans originated or underwritten by a lender with those same rates for other lenders on any basis the Secretary determines appropriate, such as geographic area, varying underwriting standards, or populations served. Further, the provision would permit the Secretary to implement such comparisons via regulations, notice, or Mortgagee Letter. This will allow FHA to tailor the compare ratio such that it provides meaningful comparisons of lenders in varying market conditions, providing greater clarity for lenders and a more refined understanding of their performance for FHA.

5. **Authority to Transfer Servicing:** In order to facilitate more effective loss mitigation, this change would give FHA the authority to require poorly performing servicers to transfer individual loans to another servicer with better performance results. Such authority would permit FHA to better avoid losses arising from poor servicing of FHA-insured loans, yielding better results for both borrowers and FHA.

V. Conclusion

Mr. Chairman, there are real signs of recovery in the nation's housing market. Given the progress we've seen—and FHA's central role in that progress—it's clear that FHA has done precisely what it was

designed to do. It has allowed millions of American families to benefit from homeownership and affordable rental options. It has provided vital liquidity in the nation's mortgage finance markets. And it has acted as a vital stabilizing force when an economic crisis precipitated by the housing market could have led to a second Great Depression. FHA must continue to be a reliable steward of taxpayer dollars and also remain a key source of access to homeownership for the families of today and for future generations. We are committed to that goal, and we look forward to collaborating with Members of this committee in that effort.

Talking Points on Amendments to HR 5072, the FHA Reform Act of 2010

Amendment	Talking Points
Garrett – 084 Downpayment requirement of 5% and prohibition of financing of closing costs	- FHA analysis has shown that downpayment alone is not indicative of loan performance but rather that performance is due to a combination of factors including credit score. An across the board 5% minimum down payment does not go far enough in current market conditions for the riskiest borrowers and is too stringent for safer borrowers. FHA is proposing to in the process of implementing regulations that will increase the minimum down payment to 10% for borrowers with credit scores below 580, while keeping the minimum down payment at 3.5% for borrowers with credit scores of 580 and above to reflect analysis of FHA loan performance data. - FHA has regulatory authority to adjust downpayment requirements, in response to market conditions or other factors, in conjunction with data analysis. FHA is appropriately using this authority to make credit policy changes, as described above, and it would be counterproductive to put in place restrictions that remove that flexible authority. - Increasing FHA's statutory down payment from 3.5% to 5% would potentially reduce the volume of loans endorsed by FHA – loans that are fully underwritten and the vast majority of which would perform – by more than 40%. This would have a negative impact on the broader housing market by significantly reducing demand and could potentially lead to a double dip in housing prices, threatening the positive signs of stabilization in the housing market. - Raising the downpayment would effectively exclude more than 300,000 potential responsible borrowers who could otherwise perform in an FHA-insured loan. This would especially impact the underserved borrowers which FHA is intended to serve. - An increase in FHA's minimum downpayment from 3.5% to 5% would have relatively little impact on restoring the FHA capital reserves to the Congressionally mandated level of 2 percent. Increasing the minimum downpayment to 5% for all loans would add $500 million in receipts to FHA's baseline 2011 budget. In contrast, the policy changes that FHA has put in place, in combination with the restructuring of mortgage insurance premiums which has been proposed through the FHA Reform Act , would contribute $4.1 billion in receipts to the FHA.

Garrett – 085 Risk-sharing requirement – 5% retention of loan by originator	- Risk sharing requirements should be considered more broadly in the context of pending regulatory reform legislation. - The proposed structure would potentially have a negative impact on the pricing and operations of Ginnie Mae securities. The amendment would create two owners of loans, effectively obligating Ginnie Mae to service for the other owner (of the 5%) without adequate protections to Ginnie Mae. Additionally, investors could raise interest rates depending on who held the 5%. Loans originated by larger institutions may price better than a community bank simply due to the larger balance sheet of the larger institution and not related to loan quality. - A risk-sharing requirement will require that banks hold capital against their FHA-insured loans. This proposal will limit the ability of small lenders to participate in the FHA program, concentrating participation on the hands of the largest banks.
Garrett – 086 Prohibition on financing upfront mortgage insurance premium	- The FHA Reform Act of 2010 will permit FHA to restructure upfront and annual mortgage insurance premiums and enable FHA to reduce the upfront mortgage insurance premium to 1%, which will significantly reduce risk. - FHA retains authority to adjust upfront mortgage insurance premiums in the future through regulation and it would be counterproductive to put in place restrictions that remove that flexible authority. Requiring borrowers to pay their upfront MIP in cash would create another hurdle to homeownership without necessarily leading to a commensurate increase in loan performance.
Garrett – 087 Downpayment requirement for higher-risk borrowers	- FHA analysis has shown that downpayment alone is not indicative of loan performance but rather that performance is due to a combination of factors including credit score. An across the board 5% minimum down payment does not go far enough in current market conditions for the riskiest borrowers and is too stringent for safer borrowers. FHA is proposing to in the process of implementing regulations that will increase the minimum down payment to 10% for borrowers with credit scores below 580, while keeping the minimum down payment at 3.5% for borrowers with credit scores of 580 and above to reflect analysis of FHA loan performance data. - FHA has regulatory authority to adjust downpayment requirements, in response to market conditions or other factors, in conjunction with data analysis. FHA is appropriately using this authority to make credit policy changes, as described above, and it would be

	counterproductive to put in place restrictions that remove that flexible authority.
Garrett – 089 Downpayment required during periods when MMIF does not comply with capital ratio requirement	- The National Housing Act requires the HUD Secretary to make changes to return the MMIF capital reserve above the mandated 2%. These changes can include a variety of reforms, including but not limited to minimum downpayment. FHA has instituted a series of reforms within the past year to strengthen the safety and soundness of the fund and return the capital ratio above 2%. - A mandatory increase in the minimum downpayment for all loans to 5%, irrespective of future loan performance, would significantly lengthen the timeframe within which the MMIF capital ratio could return to 2%. This requirement would reduce expected future mortgage insurance premiums to the MMIF by preventing responsible borrowers from obtaining lower downpayment loans that would perform and contribute premiums that are used to rebuild the capital reserves. - An increase in FHA's minimum downpayment from 3.5% to 5% would have relatively little impact on restoring the FHA capital reserves to the Congressionally mandated level of 2 percent. Increasing the minimum downpayment to 5% for all loans would add $500 million in receipts to FHA's baseline 2011 budget. In contrast, the policy changes that FHA has put in place, in combination with the restructuring of mortgage insurance premiums which has been proposed through the FHA Reform Act , would contribute $4.1 billion in receipts to the FHA.
Hensarling – 164 Moratorium on FHA insurance until MMIF meets capital ratio requirements	- The National Housing Act requires the HUD Secretary to make changes to return the MMIF capital reserve above the mandated 2%. These changes can include a variety of reforms, including but not limited to minimum downpayment. FHA has instituted a series of reforms within the past year to strengthen the safety and soundness of the fund and return the capital ratio above 2%. - Prohibiting FHA insurance on new loans, irrespective of future loan performance, would significantly lengthen the timeframe within which the MMIF capital ratio could return to 2%. This requirement would reduce expected future mortgage insurance premiums to the MMIF by preventing responsible borrowers from obtaining FHA-insured loans that would perform and contribute premiums that are used to rebuild the capital reserves. - FHA has been mandated by Congress to serve as a countercyclical force in the housing finance system, to ensure liquidity to

	responsible borrowers during times of financial stress in the private sector. During such times of financial stress, the broader downturn in the economy and falling housing prices may lead to a decline in FHA's capital ratio. This amendment would prohibit FHA from fulfilling its countercyclical role at precisely the time that it would be most needed. The FHA traditionally has a market share of 10-15%, which has increased to approximately 30% during this economic crisis. - The capital ratio is highly dependent upon prospective housing price, interest rate, and other economic forecasts over the next thirty years. These forecasts can change significantly over a short period of time, especially during volatile periods of economic recovery. The ability to precisely predict the capital ratio during such periods is difficult. This amendment would require withdrawal of liquidity from the housing market, which could lead to dramatic impacts on the broader economy, based on imperfect information that is subject to change. - The official capital ratio is calculated once per year, during the annual actuarial review. While FHA provides quarterly updates to Congress on the status of the MMIF, the official capital ratio is only calculated once per year. This amendment would effectively require FHA to exit the housing market for a minimum of a year if the capital ratio were to fall below 2%. - This amendment would introduce considerable uncertainty to the housing market, as FHA's presence in the market would be uncertain. This would translate to higher costs to the consumer as the market would have to price this new risk into the mortgage finance system. These costs would not contribute any benefit to the taxpayer or help to return the MMIF capital ratio above 2%. - Significant negative impact to pricing and operations of Ginnie Mae securities as supply of FHA loans for its securities would become more unpredictable.

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February 5, 2013

The Honorable Jeb Hensarling
Chairman
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

Re: ***The Role of the Federal Housing Administration in Housing Finance***

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I write in conjunction with tomorrow's Full Committee hearing, "*The Role of the Federal Housing Administration (FHA) in Housing Finance*." Given the increase in FHA guaranteed mortgages in recent years, and questions surrounding the stability of the Mutual Mortgage Insurance Fund, NAFCU appreciates the Committee holding this important hearing. During consideration of the *FHA Emergency Fiscal Solvency Act of 2012* (H.R. 4264) last Congress, NAFCU strongly supported provisions of the legislation that would have given the FHA necessary tools to better manage financial risk.

Given the Committee's concerns about the solvency of the FHA, NAFCU would also like to once again bring to the Committee's attention an ongoing trend whereby homeowners who have the capacity to make their mortgage payments instead choose to default. This concept of "strategic default" is troubling to community-based financial institutions like credit unions. Simply put, policy makers should ensure that policies do not unintentionally create an incentive for borrowers to walk away from their mortgages.

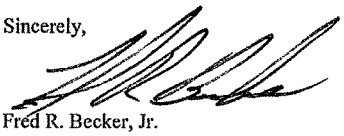
As you may know, the FHA's current policy with respect to strategic default is barring such borrowers from obtaining another FHA loan for a minimum of three years. Comparatively, Fannie Mae has instituted a policy that would prohibit such borrowers for seven years.

The FHA recently pledged to enforce additional enforcement for those bad actors soliciting borrowers with the false pretense that they can "automatically" qualify for an FHA loan after three years without meeting a host of other requirements. Still, NAFCU remains concerned about the FHA's general policy on this issue and encourages Congress to exercise additional oversight in this area. Lawmakers should actively debunk the idea that the FHA is a safe haven for those who strategically defaulted on previous mortgages. This risk to the taxpayer, encouraged by current FHA policy, is a critical part of the safety and soundness conversation that must be reviewed.

As you know, NAFCU has long supported the important role the FHA plays in our nation's housing market. The FHA's viability is crucial, especially in providing an option for those who would otherwise be unable to obtain a mortgage in the conventional mortgage market. As community-based financial service providers, credit unions take great pride in responsibly assisting their member-owners attain homeownership. To that end, NAFCU looks forward to working with the Committee on FHA and related housing finance reform issues during this session of Congress.

Again, thank you for holding this important hearing today. If my colleagues or I can be of assistance to you or if you have any questions regarding this issue, please feel free to contact myself or NAFCU's Senior Associate Director of Legislative Affairs, Jillian Pevo, at 703-963-7082.

Sincerely,



Fred R. Becker, Jr.
President and CEO
NAFCU

cc: Members of the House Financial Services Committee

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November 9, 2012

The Honorable Shaun Donovan
Secretary
U.S. Department of Housing and Urban Development
451 7th Street SW
Washington, DC 20410

Dear Secretary Donovan,

I have read several press reports over the last week concerning the health of the Mutual Mortgage Insurance Fund (MMI Fund) which included projections that the FHA may need to draw down funds from the Department of Treasury to cover expected claims over the next 30 years. Accordingly, I am writing to request information concerning the FHA's ability to cover expected losses based on the MMI Fund's current levels.

The foreclosure crisis of the last four years has put enormous stress on the housing market and its ability to recover from the losses we experienced starting in 2007. I understand that losses from loans originated between 2005 and 2008 will likely continue to be a drag on the Fund. However, the FHA insures a much larger share of the market than it did before the crisis and, as a result, several steps have been taken since 2009 to help sure up the Fund. These include increases in insurance premiums, new rules requiring higher risk borrowers to make higher down payments and efforts to mitigate losses on delinquent loans. The FHA has also reportedly recovered approximately $900 million as part of the mortgage servicing settlement. These actions will likely bolster the agency's reserves, however, I believe it is important to know whether they will ward off the need for temporary support from the U.S. Treasury.

I am hoping you can provide my office information about the capital reserves in the MMI Fund which are dangerously low and only slightly above the 2% level that is required by law. Specifically, to what extent are you concerned that the Fund is operating so close to the 2% level? In addition, what is the likelihood that FHA will need to access funds from the U.S. Treasury and what additional steps will the FHA take to ensure it does not need to access those funds? Finally, please advise my office as to the efforts by the FHA to enforce the rules that are designed to stem foreclosures and decrease further losses.

Thank you for your assistance with this request. I look forward to working with you to address the housing crisis that has been holding back economic growth in our country.

Sincerely,

Carolyn B. Maloney

CAROLYN B. MALONEY
Member of Congress

PRINTED ON RECYCLED PAPER

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-1000

ASSISTANT SECRETARY FOR CONGRESSIONAL
AND INTERGOVERNMENTAL RELATIONS

FEB 11 2013

The Honorable Carolyn B. Maloney
U.S. House of Representatives
Washington, DC 20515-3214

Dear Representative Maloney:

I am writing in further response to your letter to Housing and Urban Development (HUD) Secretary Shaun Donovan of November 9, 2012 concerning the Federal Housing Administration (FHA) Mutual Mortgage Insurance (MMI) Fund.

As you know, HUD delivered to Congress on November 16, 2012 its fiscal year 2012 Report to Congress on the Financial Status of the MMI Fund. The report indicated that although FHA has over $30 billion dollars in cash reserves on hand, the Fund's capital reserve ratio fell to negative 1.44 percent, and the Fund's economic value, the estimated amount needed for the FHA to meet expected claims over the next 30 years, is negative $16.3 billion. As Secretary Donovan has testified before the Senate Banking Committee and as FHA Commissioner Carol Galante will testify before the House Financial Service Committee on February 13, earlier FHA books of business continue to be the prime source of stress to the Fund, with fully $70 billion in estimated claims attributable to the 2007-2009 books of business alone. In contrast, the independent actuary attested once again to the high quality and profitability of books insured since 2010, which are the strongest in agency history.

Secretary Donovan and Commissioner Galante remain very concerned about the actuary's estimate of the level of capital reserves in the MMI Fund based on expected claims and economic projections over the next 30 years. Throughout the tenure of this Administration, FHA has taken and will continue to take aggressive and decisive actions to improve the health and the trajectory of the MMI Fund, while ensuring continued access to mortgage credit for American families. The changes made to FHA policy since 2009 are projected to have improved the economic value of the Fund by at least $20 billion. That FHA's capital ratio has remained positive until this year, despite the severe economic downturn, is primarily due to the reforms to risk management, credit policy, lender enforcement, and consumer protections made over the past four years – the most sweeping changes to policy in FHA's nearly 80 year history. A complete list of these FHA actions taken under this Administration is enclosed with this letter.

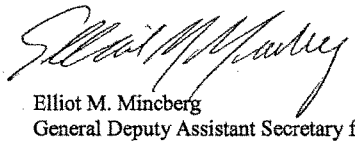
With respect to your question about the possibility of FHA accessing funds from the U.S. Treasury, the President's budget, which is currently under development, will reflect an estimate of whether FHA may require use of permanent indefinite budget authority to satisfy the projected budget re-estimate. The actual amount needed, if any, would be determined in September before the end of the current fiscal year. Under the Federal Credit Reform Act of 1990, FHA, like other government direct loan and loan guarantee programs, is required to hold sufficient capital to pay expected losses for the duration of the terms of the loans it insures. Therefore, if such a transfer were necessary, it would reflect that under the economic assumptions common to the President's

budget, FHA lacked sufficient funds in its Financing Account to pay expected claims over the next 30 years. This internal governmental accounting transaction would not reflect that FHA was carrying a negative cash balance at the end of the fiscal year.

As you are aware, our country's housing market is experiencing a still fragile recovery from the serious problems we experienced only too recently. Much of the progress that we are seeing in the housing sector has been possible because of the FHA, which has provided access to homeownership for millions of American families and without which the crisis would have been much worse. In fact, Moody's analytics estimates that were it not for FHA's presence during the crisis, house prices would have fallen an additional 25 percent. We look forward to working with you and other Members of Congress on additional legislation that will help ensure that the FHA continues to fulfill its vital role of providing access to homeownership for underserved, low-wealth populations while strengthening the MMI Fund.

I hope that this information will be helpful. Please do not hesitate to contact me if you would like any further information. Thank you again for your inquiry and your continuing interest in the Department's programs and activities.

Sincerely,



Elliot M. Mincberg
General Deputy Assistant Secretary for
Congressional and Intergovernmental Relations

I. Appendix A: Summary of FHA Policy Changes under the Current Administration

1. **Changes implemented via mortgagee letter with an implementation date of January 1, 2010:**
    a. Modifications to streamline refinance documentation requirements
    b. New appraisal standards
    c. Submission of audited financial statements required for supervised lenders

2. **Mortgage insurance premium (MIP) increase and adjustments to upfront/annual MIP relationship**
    a. 1/12/2010 – Increased Upfront MIP to 2.25%
    b. 10/4/2010 –
        i. Lowered up front MIP to 1%
        ii. Raised annual MIP to 85 to 90 basis points
    c. 4/18/2011 – Increased annual MIP by 25 basis points
    d. 4/9/2012 –
        i. Increased upfront MIP from 1% to 1.75%
        ii. Increased annual MIP by 10 basis points
    e. 6/11/2012 – Increased annual MIP for loans in excess of $625,500 by 25 basis points
    f. 4/1/2013 – Increased annual MIP by 5-10 basis points, depending on loan amount and LTV.

3. **New downpayment requirements**
    a. Mortgagee Letter effective October 4, 2010
        i. Loans to borrowers with a FICO of 579 or lower require a minimum 10% downpayment
        ii. Loans to borrowers with a FICO of 580 or above require current minimum 3.5% downpayment
        iii. Minimum FICO of 500
    b. Federal Register Notice published February 6, 2013
        i. Loans to borrowers seeking loans above $625,500 require a 5% downpayment

4. **Enhanced underwriting requirements**
    a. Mortgagee Letter effective April 1, 2012
        i. Updated documentation requirements for self-employed borrowers
        ii. Offered new guidance on disputed accounts
        iii. Expanded the definition of family members for identity of interest transactions
    b. Mortgagee Letter published January 31, 2013
        i. Borrowers with credit scores below 620 and debt to income ratios over 43% subject to manual underwriting

5. **Changes to the HECM Program**
    a. Mortgagee Letter effective October 4, 2010
        i. Introduced HECM Saver, which provides a lower upfront premium (.01%) and a lower max principal limit
        ii. Increased annual MIP to 1.25%
        iii. Adjusted the HECM Principal Limit Factors, resulting in lower maximum principal limits
    b. Mortgagee Letter published January 3, 2011
        i. Provided detailed guidance regarding the property charge loss mitigation requirements for HECM loans
    c. Mortgagee Letter published January 30, 2012
        i. Consolidated Fixed Rate Standard and Fixed Rate Saver programs

6. **Increased enforcement for FHA-approved lenders**
    a. Enforcement actions taken against lenders
        i. Heightened enforcement of HUD requirements for FHA-approved lenders has yielded over:
            1. 1,780 lenders withdrawn from FHA's program as a result of violations of FHA approval, origination, or servicing requirements.
            2. Imposition of more than $14.26 million dollars in civil money penalties and administrative payments for FHA-approved lenders
        ii. Issued notice to lending community that FHA will pursue directly or through Federal partners those who advertise access to FHA, particularly after foreclosure or other credit impacting event, does not require satisfaction of all FHA loan origination and underwriting criteria
    b. Mortgagee Letter effective January 21, 2010
        i. Enhanced monitoring of lender performance and compliance with FHA guidelines and standards.
        ii. Expanded the Credit Watch Termination Initiative to include evaluation of lender underwriting performance in addition to origination performance
    c. Implementation of statutory authority through regulation of section 256 of the National Housing Act to enforce indemnification provisions for lender's using delegated insuring process
        i. Final rule published January 25, 2012, with an effective date of February 24, 2012
        ii. A Mortgagee letter and Lender Insurance guide will soon be issued to implement this new rule.
    d. Additional authority sought by FHA through legislation:
        i. Amendment of section 256 of the National Housing Act to apply indemnification provisions to all Direct Endorsement lenders. This would require all approved underwriting mortgagees to assume liability for all of the loans that they underwrite

ii. Legislative authority permitting HUD maximum flexibility to establish separate "areas" for purposes of review and termination under the Credit Watch initiative. This would provide authority to withdraw originating and underwriting approval for a lender nationwide or in a specific area on the basis of the performance of its regional branches

7. **Changes to FHA lender approval requirements**
   a. Final rule published week of April 20, 2010
      i. Increased net worth requirements for approved mortgagees. All new lender applicants for FHA programs must possess a minimum net worth of $1 million. Effective one year from enactment of the rule, current FHA approved lenders, with the exception of small businesses, must possess a minimum net worth of $1 million. Current FHA-approved small business lenders must possess a minimum net worth of $500,000. Effective three years after enactment of the rule, approved lenders and applicants to FHA single-family programs, regardless of size, must have a net worth of $1 million plus 1% of total loan volume in excess of $25 million
      ii. Eliminated independent FHA approval of mortgage brokers who originate but do not underwrite loans. FHA-approved mortgagees who underwrite loans retain strict liability for all loans, regardless of origination via their retail operations or through their sponsored mortgage brokers
      iii. Codified requirements for submission of audited financial statements by supervised mortgagees
   b. Mortgagee Letter published on January 5, 2011
      i. Required mortgagees that possess NMLS IDs to provide those to FHA for both lender approval and loan origination processes
   c. Mortgagee Letter effective July 28, 2011, provided alternative financial reporting requirements for small supervised lenders to decrease burdens associated with FHA's lender approval and renewal processes

8. **Updated Quality Control Requirements for Direct Endorsement Lenders**
   a. Mortgagee Letter effective January 5, 2011
      i. Updated FHA's quality control requirements to include new requirements related to Sponsored Third Party Originators, reporting of fraud and material deficiencies, and recording of sales or transfers of FHA mortgages

9. **Refinance Program Policy**
   a. Mortgagee Letter published February 14, 2011
      i. Extensive guidance regarding requirements and changes for FHA Standard and Streamlined refinance programs
   b. Mortgagee Letter published March 6, 2012
      i. For borrowers who are current on their loans, FHA reduced the upfront and annual MIPs for Streamline refinances of FHA-insured loans

endorsed on or before May 31, 2009 to permit these borrowers to take advantage of historically low interest rates, reducing their payments and decreasing risk to FHA

10. Consolidated and updated FHA condominium policy

a. Mortgagee Letter issued June 30, 2011, and effective August 29, 2011
   i. Consolidate guidelines published in 2009;
   ii. Provide a single source of information for the Condominium Approval and Recertification Process;
   iii. Update, consolidate and clarify existing condominium policy guidance; and
   iv. Expand FHA's flexibility to consider exceptions at the individual project level
b. Mortgagee Letter issued in summer 2012 to revise updated guidance

11. Reduction in allowable seller concessions

a. Proposed policy change published in June of 2010
   i. Received over 1,000 comments, prompting extensive additional analysis which led to substantial revisions to the rule
   ii. New proposed rule published February 23, 2012
   iii. Final Rule Expected in 2013

12. Enhanced and expanded loan sale program

a. Effective with the quarterly sale that took place in September 2012, FHA expanded the 601 Note Sales Program, now known as the Distressed Asset Stabilization Program, providing the opportunity for better outcomes for borrowers, communities and FHA on non-performing loans.

Questions for the Record

February 13, 2013 Hearing on "A Look at the FY 2012 FHA Actuarial Report"

HUD Responses

Questions from Representative Foster:

Question 1:

As the FHA sells discounted, delinquent loans to investors, what specific efforts are being pursued to keep underwater borrowers in their homes? Are there further steps that can be taken to ensure that borrowers are afforded every opportunity to stay in their homes and combat blighted communities?

HUD has been active in helping borrowers having trouble making their mortgage payments. Traditionally, FHA has offered a Streamlined Refinance option to all borrowers with FHA-insured loans, allowing homeowners an opportunity to refinance their home to take advantage of lower interest rates without an appraisal. In 2011, FHA announced that borrowers whose loans were endorsed for insurance before June 1, 2010 could refinance their loans at the same mortgage insurance premium that FHA charged at the time of origination. This program has greatly benefited underwater borrowers by permitting them to reduce their mortgage payments and at the same time reduced risk to FHA.

Additionally, FHA helps underwater borrowers avoid foreclosure through the FHA-Home Affordable Modification Program (HAMP), a component of HUD's loss mitigation program. Borrowers who experience a loss of income or an increase of living expenses due to certain verifiable causes can, through the FHA HAMP, reduce their mortgage payments to no more than 31 percent of the homeowner's verified gross income, allowing them to keep their home. In November 2012, FHA outlined changes to its loss mitigation waterfall, moving HAMP up so borrowers could more quickly be offered deeper payment relief.

FHA also assists underwater borrowers through its short refinance program. This program started in 2010 and allows some underwater non-FHA borrowers the opportunity to qualify for a new FHA-insured mortgage if they are current on their existing mortgage and if their lender agrees to write off at least ten percent of the UPB (unpaid balance) of the first mortgage. This helped responsible borrowers who were current on their mortgages but were experiencing financial hardships because property values in their community had declined. Finally, HUD's Office of Housing Counseling continues to assist underwater borrowers. In 2012, 2,410 HUD-approved housing counseling agencies assisted over 1.9 million renters and owners.

Question 2:

My understanding is that low value loans are generally of little interest to large purchasers of mortgage securities. Are you aware of any efforts at FHA to separate out and sell specialized portfolios consisting of low-value, non-performing loans in the $100,000 and below range?

HUD cannot speak to the interest in low-value loans among other issuers of securities; however Ginnie Mae, which securitizes 98 percent of FHA insured loans, does not allow non-performing loans to remain in its securities. Modified loans can be securitized through Ginnie Mae, but they must go through a 3-month trial modification and demonstrate re-performance before being securitized.

Questions for the Record

February 13, 2013 Hearing on "A Look at the FY 2012 FHA Actuarial Report"

HUD Responses

FHA has sold a large number of low-value, nonperforming loans over the past year as a result of the Distressed Asset Stabilization Program, but there has been no separate effort other than through that process to sell specialized portfolios of these types of loans.

Question from Rep. Hinojosa

Some of my colleagues have argued that the Federal Housing Administration represents an overreach of the federal government into the private home loan sector. We continue to hear the refrain, "the F.H.A. footprint is too Large, bring in more private industry." I don't believe anyone in this room will argue against increasing the market share of private industry in the home loan business. However, the role of the F.H.A. is to stabilize the supply of credit during times of contraction, and to make sure that working-class families are not cut out from the American Dream.

We had an extreme period of contraction recently, and the F.H.A. stepped in. Housing prices hadn't fallen so quickly since the Great Depression, and as the agency whose role it is to provide stabilization, you can expect that its finances will take a hit. Up until this point, from its conception in 1934, the FHA has not cost the taxpayer a dime. Now we will have to address its fiscal soundness, while still acknowledging the important role it plays in American communities.

I would like to ask you, Ms. Galante: Can you discuss the role the F.H.A. played during the recession providing housing credit, and how its existence may have altered how the recession played out?

During and after the worst recession since the Great Depression, FHA played a crucial role in the recovery of the housing market, preserving access to credit and, according to Mark Zandi, preventing a 25 percent steeper decline in housing prices across the country. FHA's fundamental role in the housing finance system is to provide access to credit for those not adequately served by the private market, and when the private market significantly decreased its lending activity during the housing crisis, FHA played its traditional countercyclical role to provide credit to borrowers.

Since its creation in 1934, FHA has played a vital role in our nation's housing market—serving as a stabilizing force during national or regional market constrictions and ensuring that underserved borrowers are able to access mortgage credit. In the last five years alone, FHA has helped nearly 7 million families become homeowners or refinance into a more affordable home loan—ultimately aiding in the recovery of the housing market.

Questions from Rep. Luetkemeyer

Question 1:

Generally speaking, banks and other lenders are being required to tighten lending standards in an effort to protect borrowers, customers and, more generally, the American public. Is FHA

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HUD Responses

tightening lending standards? Is FHA fully complying with or adopting the rules promulgated by the federal government the last several years? If not, why?

Before and in the aftermath of the Great Recession, FHA continued to require full documentation in originating FHA-insured loans and, since 2009, has taken significant steps to tighten its lender oversight and credit policies to ensure that newly insured loans are strong and appropriately priced.

Since 2009, FHA has increased down payment requirements for borrowers with credit scores below 580, and regulations are being finalized to reduce the amount of available seller concessions. Furthermore, FHA has taken steps to require manual underwriting for borrowers with credit scores below 620 and debt-to-income ratios over 43 percent. FHA has enhanced FHA's TOTAL Scorecard, and is proposing an increase in the required down payment for borrowers seeking loans that are greater than $625,500.

Under the Dodd-Frank Act, HUD has created an Office of Housing Counseling within the Office of Housing, served as a rulemaker for the Qualified Residential Mortgage rule, and issued a proposed rule on qualified mortgages.

Question 2:

As I understand it, when a buyer purchases a FHA and HUD-owned property, that buyer is provided with a select list of settlement service providers and title agents with whom they may work. Many argue that this type of action, should it occur in the private market, would be a clear violation of RESPA. Do HUD and FHA have plans to open its title and settlement service providers list in such a way that the agencies are not picking providers (contrary to RESPA) but rather, like all other home sale transactions, the buyer can freely choose his or her service providers?

When a buyer purchases a FHA real estate owned (REO) property, the buyer is free to select any closing agent and/or title company in which they chose to do business. HUD does not maintain nor provide a list of closing entities. There is currently no difference in how HUD closes its sales transaction under Buyer Select than what occurs as normal course of business in the private market.

Questions from Rep. Ross

Question 1:

Commissioner Galante — I asked this question of the experts last week and now I'm glad I'm able to ask you this as well. I appreciate that FHA and committee members are looking at the long-term stability of the MMIF, but my immediate concern is over these non-performing loans you mentioned that make up a large part of the notes FHA currently holds. Transferring some of that current risk load back to the private market first—where it should be—should be one of the first steps the agency takes. In fact, right now, FHA currently insures over 20,000 homes right now in my district, and my understanding is that FHA had actually sold off a bulk

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HUD Responses

of their insured notes in the Tampa area last year and is planning to do the same in Orlando next year. I believe this is part of the Distressed Asset Stabilization Program you mentioned. Could you talk a little bit about that process? Did it go well, and what is the interest for more of these kinds of sales in the future? Is there the capacity, right now, to purchase those notes and relieve the FHA of more of your inventory?

Begun in 2012, DASP disposes of severely delinquent loans by selling them before they go through the foreclosure process and become HUD-held REO properties. This enables FHA to avoid carrying and maintenance costs associated with REO disposition while achieving material reductions in FHA's delinquent loan portfolio. Purchasers are required to pursue a course of loss mitigation and can initiate foreclosure only if this process fails. Since purchasers acquire these notes at prices often less than the balance of the loan, they have financial flexibility to realize a return on their purchase investments while providing expanded loss mitigation options to current borrowers who have exhausted FHA's loss mitigation tools—creating an additional opportunity to avoid foreclosure. The use of a competitive bid mechanism for these sales maximizes returns to the FHA fund while providing this enhanced foreclosure prevention to borrowers.

After delinquent FHA-insured loans are pooled and sold competitively through an auction, the original servicer submits insurance claims to FHA for all the eligible loans. FHA processes the claims, removes the FHA insurance, and transfers the loan to the new servicer. Once the note is purchased, foreclosure is delayed for a minimum of six additional months, giving the new servicer an opportunity to find a solution to allow the loan to re-perform, or find an alternative to foreclosure that best meets the need of both the borrower and the servicer.

The first three sales were a success. The program sold more than 45,000 total notes, and there is strong investor appetite for continued sales through this program. FHA has the capacity to process the sales, and the private market has shown the ability to take on these notes. Because the notes are generally sold for less than the outstanding principal balance, the purchaser has the ability to grant principal reductions or modify the loan terms while still making a return on the initial investment.

Question 2:

Additionally, I appreciate the guidance you've given lenders, warning against excessive advertising for "cheap, FHA rates," and some other deceptive practices. In your testimony you claim that you believe the private market should be the primary provider of mortgage insurance, and the FHA be there to fill in, yet your website boasts that you're currently the largest mortgage insurance provider in the world. Therefore, I'd like you to explain what steps you see the FHA taking that would encourage lenders to steer homebuyers to other non-FHA options when it comes to mortgage insurance? What kind of direction are you giving lenders to ensure FHA is the mortgage insurer of last resort, not the first?

As previously noted, FHA played a crucial role in preventing further damage to the housing market during this worst economic downturn since the Great Depression. FHA plays a countercyclical role, expanding activity to ensure access to credit. Without the FHA, it would have been much more difficult for middle-class families to get a home loan, home prices would

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HUD Responses

have fallen even further, and more families would have lost their homes to foreclosure. FHA has been critical to promoting stability in the housing market.

As a consequence of playing this role and constructions of credit in the overall mortgage market, FHA market share did increase, reaching its peak in 2009. However, since that time, and while FHA took critical steps to strengthen the health of the MMI fund and revise credit and asset management policies, that market share has declined. In addition, since 2009, FHA has adjusted premiums five times and, in June 2013, reversed a policy whereby borrowers with FHA-insured loans did not pay mortgage insurance premiums once the loan reached a 78 percent loan-to-value ratio, even though the loan itself remained FHA-insured. These changes have enabled FHA to ensure it is properly pricing for risk, protecting the Fund while also preserving access to credit for families underserved in the mortgage finance market which FHA was designed to serve.

Questions from Rep. Royce

Question 1:

Commissioner Galante, in late January, the FHA announced that you intend to raise the minimum down payment requirement on loans above $625,500 from 3.5 percent to 5 percent and charge the maximum annual premium allowed of 1.55 percent. In this announcement, you stated that "this change...will help protect FHA and further facilitate its efforts to encourage higher levels of private market participation in the housing market." If this is true, why shouldn't the FHA implement similar increases for all loans to increase private market participation in the housing market? Also, FHA still allows seller concessions of up to 6 percent of the purchase price towards closing costs—while the industry standard is closer to 3 percent. So even in the case of a 3.5 percent down payment or 5 percent down, the addition of a seller concession of up to 6 percent could lead to the FHA insuring an underwater loan from the get-go. This would happen in cases when a seller concession is merely tacked onto the final sale price of the house—the FHA recognized this as a possible outcome in your own proposal (in January 2010) to reduce the allowable seller concession from 6 percent to 3 percent stating that the current policy "creates incentives to inflate appraised value." This was proposed in early 2010 but over three years later has still not been implemented.

Don't you agree we need to move quicker and more boldly in order to return the FHA to a sound fiscal footing? Please answer this question both as it relates to minimum down payments and seller concessions.

FHA has consistently proven that low down payment lending can be done successfully because loan performance is a function of a number of factors, not just the loan-to-value ratio at origination. Through fully documented, holistic underwriting, FHA has served millions of borrowers—including, according to HMDA, approximately 49 percent of African American and 48 percent of Hispanic borrowers, through FHA. Further, 70 percent of FHA loans serve first-time homebuyers who may find it difficult to accumulate a down payment but who have the resources to sustain a monthly mortgage payment.

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FHA agrees that reducing allowable seller contributions to 3 percent would reduce risk to the Fund and borrowers. Since the initial 2010 proposal, due to significant comments, FHA re-proposed its rule and is in the process of finalizing a regulation to accomplish this goal. FHA is committed to working expeditiously on all regulatory actions and has demonstrated its ability to work quickly and boldly on many policy issues. As a government agency, FHA also must allow for public participation and an open exchange of ideas. It must promote predictability and reduce uncertainty, and it must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. It also must take into account benefits and costs, both quantitative and qualitative. These general regulatory principles help ensure FHA implements sound regulations and account for the views of affected private sector stakeholders, State, local, and tribal officials, and the public as a whole.

We look forward to working with the committee to accomplish the shared goal of working more swiftly and effectively to respond to emerging risks and protect the Fund. Despite many policy and organizational changes undertaken by FHA over the years, there are a number of constraints which FHA strongly feels limit our ability to manage risk appropriately and are having a negative impact on FHA's fiscal health. These constraints include an increasingly complex mortgage market, aging FHA systems and infrastructure, a need for additional skills and expertise, and difficulty responding quickly to major risk issues as a result of contractual and statutory limitations. For FHA to manage risk and maintain operations as a 21st century mortgage insurer, these constraints must be dealt with appropriately. For that reason, we would like to continue to explore with the Committee tools which can be leveraged to allow FHA to minimize risk to the Fund and taxpayers while continuing to serve consumers.

Question 2:

Has the FHA ever used appraisals panels in the past, where members of a panel were selected based on experience and geographical competence similar to the practice of the VA? Please give some historical background on their use. If so, why was this system abandoned? Do you think a system based on rotation (VA) rather than lender selection (FHA) would improve appraiser independence and quality? What quality control is conducted on appraisal work now? Does FHA have a standard similar to the VA where a minimum of 10% of the work is field reviewed?

In the past, FHA managed a roster of appraisers. Appraisers applied to FHA to be added to the panel, provided a list of areas in which they were competent to practice, and were then assigned on a rotational basis. At that time, each state had appraisal review managers on staff who played a very active part in the process. However, with the transition to the Homeownership Center (HOC) structure and due to problems with this practice related to timeliness to appraisals—when the market was very active it could take a few weeks to get an appraiser to respond and even a month or six weeks to get the appraisal back to the lender—and at the urging of the lending industry, it was ended in the late 1980s. This is when "lender select" was created.

While it is possible to create a system to manage FHA appraisers in a manner similar to VA, there are some difficulties. At present, FHA has approximately 51,000 appraisers on the Roster and in the past few years has received at least one appraisal report for approximately 38,000 of

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them. Assigning all of these appraisers in rotation would in no way guarantee higher quality or better independence. The best way to improve that is to continue with our program to receive the appraisal reports electronically and build out the quality control processes we have planned. FHA has been processing 900,000 to 1,200,000 loans in the past few years (significantly more than VA), so while we appreciate the advantages of the VA panel we believe we can provide effective independence and quality improvement by following the program we have begun to build.

Question 3:
It is my understanding that the FHA maintains capital reserves both as secondary capital and in the financing account—which together make up the total reserves. How do these two accounts interact? What has been the recent history of transfers between the two accounts?

Unique to FHA, unlike other federal direct loan and loan guarantee programs, is the maintenance of two accounts—a Financing Account and a Capital Reserve Account. Under the Federal Credit Reform Act (FCRA), as with other direct loan or loan guarantee programs, FHA must maintain sufficient reserves in the Financing Account to pay expected losses. In addition, the Capital Reserve Account holds amounts in excess of those needed to pay all anticipated claims. When the Financing Account balance falls below the mandated level, funds can be transferred from the capital reserve account in order to ensure the Financing Account contains enough to satisfy expected losses over the life of the loans.

Like other federal credit agencies, FHA estimates and re-estimates the net lifetime costs—known as credit subsidy costs—of the mortgages it insures. When the present value of estimated cash inflows (such as borrower insurance premiums) exceed the present value of expected cash outflows (such as insurance claims), negative subsidies are generated. As each loan is endorsed, negative subsidy is generated. The negative subsidy is disbursed from the MMI financing account and collected in the MMI Capital Reserve. Additionally, downward re-estimates are disbursed from the Financing Account and collected in MMI Capital Reserve account. A downward re-estimate indicates that not enough subsidy has been paid from the financing account to the Capital Reserve account.

When it is estimated the Financing Account has disbursed too much subsidy, an upward re-estimate is needed. Upward re-estimates are transferred from the Capital Reserve account to the Financing account.

The following chart shows the recent history of transfers between the two accounts.

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	Fiscal Year				
Activity (in millions)	2013	2012	2011	2010	2009
Negative Subsidy (Financing to Capital Reserve)	(16,753)	(5,582)	(6,739)	(2,651)	(566)
Downward Re-estimates (Financing to Capital Reserve)	(5,241)	(5,655)	(847)	(26)	(469)
Upward Re-estimates (Capital Reserve to Program to Financing)	27,672	13,868	7,601	9,868	10,384

FY 13 Upward and Downward re-estimates will be recorded in September 2013