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

Written Testimony of Secretary Shaun Donovan
Hearing before the House Committee on Financial Services
Status of the FHA Mutual Mortgage Insurance Fund and the FY 2011 Actuarial Report

Thursday, December 1, 2011

Chairman Bachus, Ranking Member Frank, and Members of the Committee, thank you for the opportunity to testify regarding the status of the Federal Housing Administration's (FHA) Mutual Mortgage Insurance Fund (MMI Fund or Fund).

As the Members of this panel are aware, FHA continues to perform a vital role in the ongoing recovery of our housing market and broader economy. Not only is FHA permitting families to realize the dream of home ownership, but through partnership with thousands of mortgage brokers and lenders nationwide, FHA is contributing to the stabilization of the nation's housing finance system as it recovers from the recent recession. These activities are central to the realization of FHA's mission of more than 75 years to support adequate flows of mortgage capital in good times and bad, and to act as a countercyclical force during downturns in the nation's mortgage markets.

On November 15, 2011, HUD delivered its fiscal year (FY) 2011 Report to Congress on FHA's financial status. The *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2011* summarizes the results of the independent actuarial report prepared by Integrated Financial Engineering (IFE) and provides a status report on the fiscal health of the MMI Fund. As the report makes clear, FHA remains resilient and continues to play a critically important role in our housing markets. Just as important, the report demonstrates that over the last two and a half years, even as the country's housing markets have continued to face serious challenges, FHA's new books of business have been of extremely high quality. Indeed, the independent actuary projects that the MMI Fund capital reserve ratio will return to a level above the required 2 percent in 2014.

Today, I would like to discuss with you the status of FHA's activities and finances, as well as the steps that this Administration is taking to ensure the rapid restoration of the MMI Fund capital reserve ratio and the ongoing sustainability of FHA's single family programs.

FHA's Role in the Nation's Housing Market

Throughout its history, FHA has helped to ensure adequate flows of mortgage capital for low- to moderate-income, minority and first-time homebuyers. This has been especially true during periods of difficulty or disruption in the mortgage markets when the flow of private capital is reduced. Again in FY 2011, FHA provided much needed assistance to these underserved communities while acting as a countercyclical force to a housing industry faced with the most severe economic conditions since the Great Depression.

FHA insured $236 billion in mortgages in FY 2011, providing access to credit for over 770,000 homebuyers – over 585,000, or 75%, of whom were first-time buyers. FHA also enabled more than 440,000 homeowners to save an average of $160 per month on their mortgage payments through refinancing at today's historically low interest rates. All told, over the past three years FHA has made homeownership possible for 2.27 million first-time buyers. According to annual surveys performed by the National Association of Realtors, FHA supported 56 percent of all first-time buyers in 2009 and 2010.[1]

Additionally, FHA provided significant support in FY 2011 for minority homebuyers and minority homeowners seeking to refinance their properties to lower monthly housing costs. Among those borrowers who disclosed their race, 30 percent of FHA home-purchase endorsements and over 15 percent of refinance loans were for members of minority communities. According to the 2010 Home Mortgage Disclosure Act (HMDA) lender activity report data, FHA continues to lead the market in support for minority homeownership. While FHA insurance was used for 37 percent of all (owner-occupant) home-purchase borrowers, its share of minority borrowers was 46 percent.[2] Indeed, 60 percent of African Americans and 59 percent of Hispanics and Latinos used FHA insurance to buy a home.

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[1] Survey results are published in the National Association of Realtors *Profile of Home Buyers and Sellers 2010*., and *Profile of Home Buyers and Sellers 2009* reports. The FHA share of first-time buyers is highlighted in press releases that accompanied publication of those reports:
http://www.realtor.org/press_room/news_releases/2009/11/survey_record ;
http://www.realtor.org/press_room/news_releases/2010/11/survey .

[2] The FHA share when loans with white borrowers but minority co-borrowers are included as minorities is 45 percent. FHA shares are slightly lower when investor loans are included in the totals. However, FHA does not currently insure investor/rental or vacation-home loans.

While FHA continues to play an elevated role in the nation's mortgage finance system, we remain committed to shrinking the government footprint in the market. And there are encouraging signs that private capital is starting to return. Indeed, in FY 2011, FHA loan volume decreased by 34% from its peak in FY 2009, and total market share declined for the first time since 2006.

As FHA offers access to homeownership for borrowers, this Administration has made substantial efforts to ensure that it is extending credit to qualified borrowers who will have the ability to sustain this opportunity over time. Those efforts are bearing fruit. For all of FY 2011, the credit quality of borrowers utilizing FHA insurance set a new record high, with the average score across all borrowers breaking 700 for the first time ever. FHA saw a three-year rise in credit quality of new FHA-insured borrowers, and throughout all four quarters of FY 2011, more than one-third of FHA borrowers possessed credit scores at or above 720. By contrast, in the second quarter of 2008, the share of such A-grade borrowers was under 10 percent.

Additionally, FHA continues to see improvement in its mortgage delinquency rates. The overall delinquency rate for FHA-insured loans was relatively stable throughout FY 2011. FHA has experienced a dramatic decline in the rate of early payment defaults (EPD) over the past three years, indicating that new loans originated in the past few years are of significantly higher quality than those originated prior to this Administration. This decline can be attributed to both the policy changes that have been made to improve the quality of loans insured by FHA, as well as better underwriting by lenders working to align with FHA's strengthened monitoring and evaluation of lender compliance with FHA requirements. EPDs are defined by three consecutive missed payments within the first six payment cycles. Among home purchase loans, the incidence of such EPDs for loans originated in early 2011 was less than one-sixth the rate seen in early 2008. For fully-underwritten (non-streamline) refinance loans, the EPD rate in early 2011 was just one-ninth of its peak in mid 2008. For streamline refinance loans, the improvement has been most dramatic, with the early 2011 rate being only one-twelfth of what it was at the peak in mid 2008.

For those borrowers who face difficulties in meeting their mortgage obligations, FHA has continued to provide much needed assistance through its loss mitigation programs. In FY 2011, FHA loss mitigation tools were used to cure 362,000 defaults, and yielded the lowest re-default rates of the past five years. An additional 142,000 distressed homeowners had their monthly payments reduced through loan modifications. Since the start of this Administration, FHA has provided over 1 million loss mitigation and early delinquency interventions for borrowers. In addition to helping responsible borrowers weather difficult times, these loss mitigation efforts also help minimize losses to the MMI Fund.

The FY 2011 Actuarial Review of FHA's MMI Fund

The condition of the Mutual Mortgage Fund and an analysis of its short- and long-term health are explained in the FHA's report to Congress. The independent actuarial studies use statistical models to predict 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.

The MMI Fund operates with two primary sets of financial accounts.[3] First, all business transactions related to insurance operations are maintained in a series of Financing Accounts at the U.S. Treasury.[4] Then, secondary reserves for unexpected claim expenses are maintained in a separate Capital Reserve Account, which is also held at the U.S. Treasury.

FHA's MMI Fund programs, like all federal government direct-loan and loan-guarantee programs are subject to the Federal Credit Reform Act, which provides "permanent indefinite authority" to cover increases in costs for outstanding loans and loan guarantees. For example, if there is an extraordinary increase in actual or expected claims the authority under FCRA provides access to funds to cover the increase in cost. Thus, FHA programs always have access to sufficient funds with which to pay insurance claims. That would be true even in the absence of a Capital Reserve Account.

At the end of FY 2011, the MMI Fund had $33.7 billion in account balances with the U.S. Treasury. Of that total, $29.0 billion was in the Financing Accounts and $4.7 billion in the Capital Reserve Account. Total capital resources at the end of FY 2011 were $400 million higher than at the end of FY 2010, and $1.9 billion higher than at the end of FY 2009. They were also $7.7 billion higher than was predicted last year by the independent actuaries.

[3] 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.

[4] There are individual Financing Accounts maintained for each annual book of business, or what are called budget cohorts. There are also separate accounts for forward loans and for HECM.

The actuarial review weighs these balances against the accrued liabilities of FHA insurance currently in force. The review estimates these liabilities at $30.8 billion. So on net, the independent actuarial assessments find that the MMI Fund estimated economic net worth stands at $2.6 billion, representing a capital reserve ratio of 0.24 percent. Last year, the estimated capital ratio was 0.50 percent and the estimated economic net worth was $4.7 billion.

Some major reasons for the year-over-year decline in estimated capital position include the following. First, according to the forecast by Moody's Analytics, which was used by the actuaries for their analysis, home prices are estimated to have fallen 5.6 percent in 2011, which would further impair the value of books already underwater. Second, more loans, particularly from the years of the housing bubble from 2006-2008, are currently in serious delinquency, and a significant percentage have been there for more than one year. For extended delinquency loans, many of which are in foreclosure processing, eventual claim becomes the most likely outcome. Third, more active loans have had a previous serious delinquency (3 months or more), and their (elevated) re-default potential is now built into the actuarial calculations. The independent actuaries made a decision to treat foreclosure actions likely affected by so called robo-signing problems as expected claims in 2012.

By incorporating these projections into this year's actuarial analysis, the independent actuary is accounting for further negative events in the course of the nation's continued economic recovery.

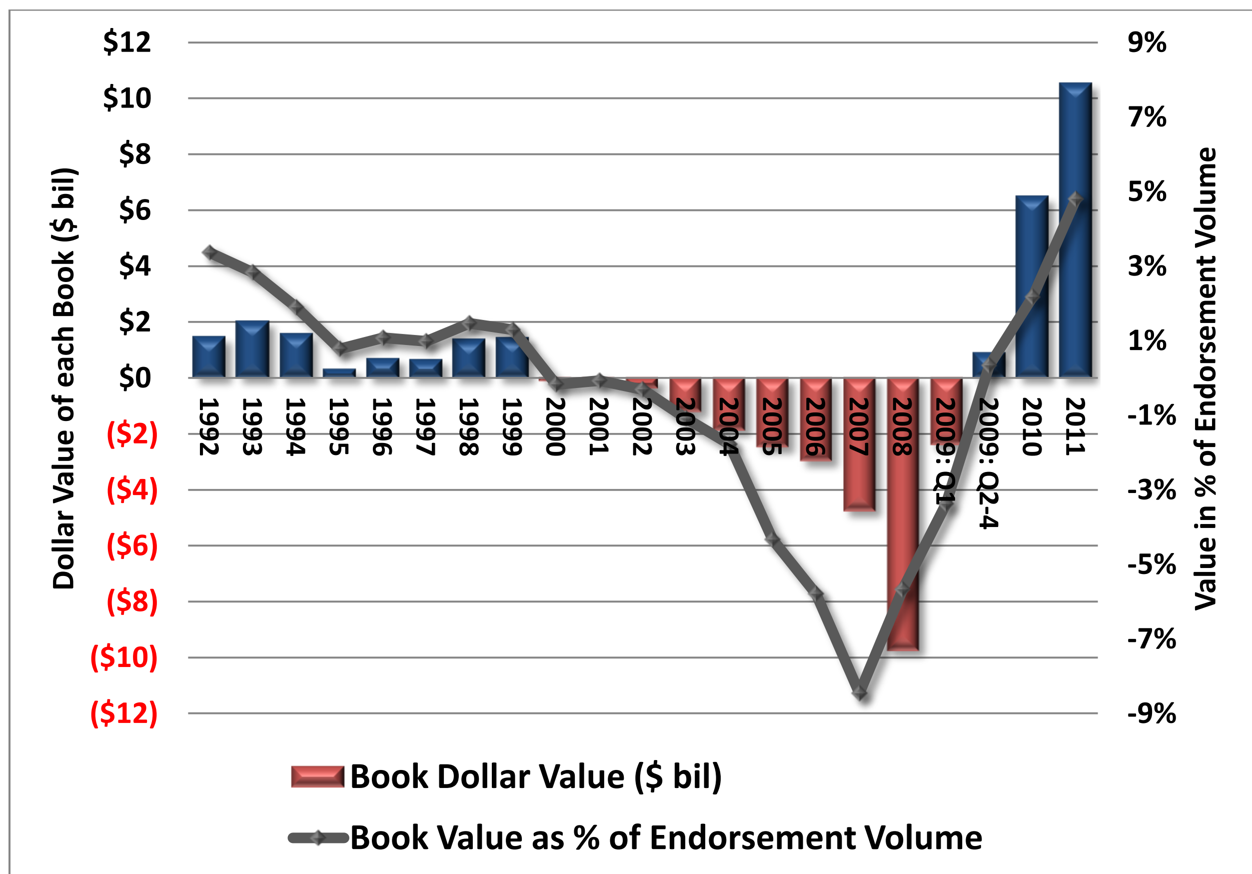
Despite these projections, the review also made clear that under base-case economics the Fund will remain positive, and its prospects for the future are good. The actuaries found that FHA's current underwriting and premium structure have created an actuarially sound basis for growing capital at a rapid rate once the economy and housing markets experience steady and sustained growth. And base-case projections estimate that the capital ratio will reach 2 percent again in 2014, sooner than was projected in last year's report.

The actuaries' review also shows that the stress on FHA's resources is primarily caused by the poor quality of loans insured prior to 2009. By contrast, those loans insured from 2009 onward are performing well. Indeed, final losses on the 2000-2009 Q1 books are expected to exceed $26 billion, and 2008 alone could have a net final cost of close to $10 billion. The actuaries predict that claim rates on the 2006 – 2008 books could each surpass 20 percent.

In addition to being originated near the peak of the housing bubble, the 2007 and 2008 books were also heavily affected by seller-funded downpayment loans. Those loans were eliminated by Congress as of October 2008, so they disappear from new endorsements starting in January 2009. However, their ongoing effect on the financial status of the MMI Fund is still measurable.[5] The independent actuaries estimate that economic net worth would be higher by over $14 billion had such loans never been insured.[6]

In contrast, single family books of business insured under this Administration are expected to provide significant negative subsidy receipts to offset losses on earlier endorsements. Net income generated by the 2009 Q2 – 2011 books is expected to be $18 billion. The stark contrast in the quality of FHA business under this Administration compared to that insured prior to 2009 is clearly visible in Figure 1 below.

Figure 1. Estimated Lifetime Value of Each Single-Family Book of Business, 1992-2001



Source: U.S. Department of HUD/FHA.

[5] Their on-going effect is not only in remaining home purchase loans that could still result in an insurance claim, but also through streamline refinancing that brought many of the 2005-2008 loans into the 2009 and even 2010 books.
[6] The net expected cost of those loans, as projected by the independent actuaries, grew by $1.8 billion over the past year to $14.1 billion.

In spite of the actuaries' determination that the MMI Fund will remain positive under base-case economic scenarios, potential risks to the fund remain. While the actuaries predict that recovery of MMI capital will occur quickly as a result of the historically-high premium rates charged today, as well as by controls put in place over the past two years to avoid the possibility of a repeat of the adverse selection that affected FHA prior to 2009, the principal unknown for the future remains how and when housing markets will consistently and fully recover. Significant further declines in home prices could create a situation in which the current portfolio would require additional support.

The base-case economic forecast used by the independent actuaries is the median expected path of the economy over the next five-to-ten years, as determined by Moody's Analytics.[7] Moody's Analytics provides four alternative short-run economic scenarios in addition to the base-case. One is an optimistic case, in which home prices start to rise immediately. The other three represent successively worse housing market conditions over the 2012-2013 period. Specifically, the scenarios presented are: a stronger near-term rebound (S1), a mild second recession (S2), a deeper second recession (S3), and a protracted slump (S4). Moody's defines the chance of each alternative in terms of percentiles in an overall distribution of potential economic outcomes. Those percentiles for each of these four scenarios are the 10th (S1), 75th (S2), 90th (S3), and 96th (S4). Each represents a position within the total range of economic environments that Moody's predicts are possible over the next several years.

The base-case scenario indicates price declines in 2011 of 5.6% and predicts a small amount of growth in prices in 2012 (1.3%), followed by more steady growth starting in 2013. Nevertheless, negative house price growth, rather than stable or growing prices as reflected in the base-case forecast, could create a situation in which future net losses on the current, outstanding portfolio could exceed current capital resources. For the long-term, even a period of stagnant house prices would adversely affect the FHA fund.

It should be noted, however, that the "Mild Second Recession" scenario utilized by the actuaries poses an additional 9 percent decline in home prices beyond the 5.6 percent base-case decline, for a total two-year decline of 14.6 percent. In contrast, the worst 2-year period recorded by the FHFA was from Q2 2007 to Q2 2009, when prices fell just under 13 percent. Thus, even the Moody's "Mild Second Recession" scenario is worse than the worst declines experienced since the start of the recent economic crisis. Figure 2 shows the various scenarios utilized by the actuaries for their projections. All these scenarios assume steady and significant house price growth after finding various low points in 2012. Should price declines continue beyond 2012, however, the condition of the FHA fund would worsen.

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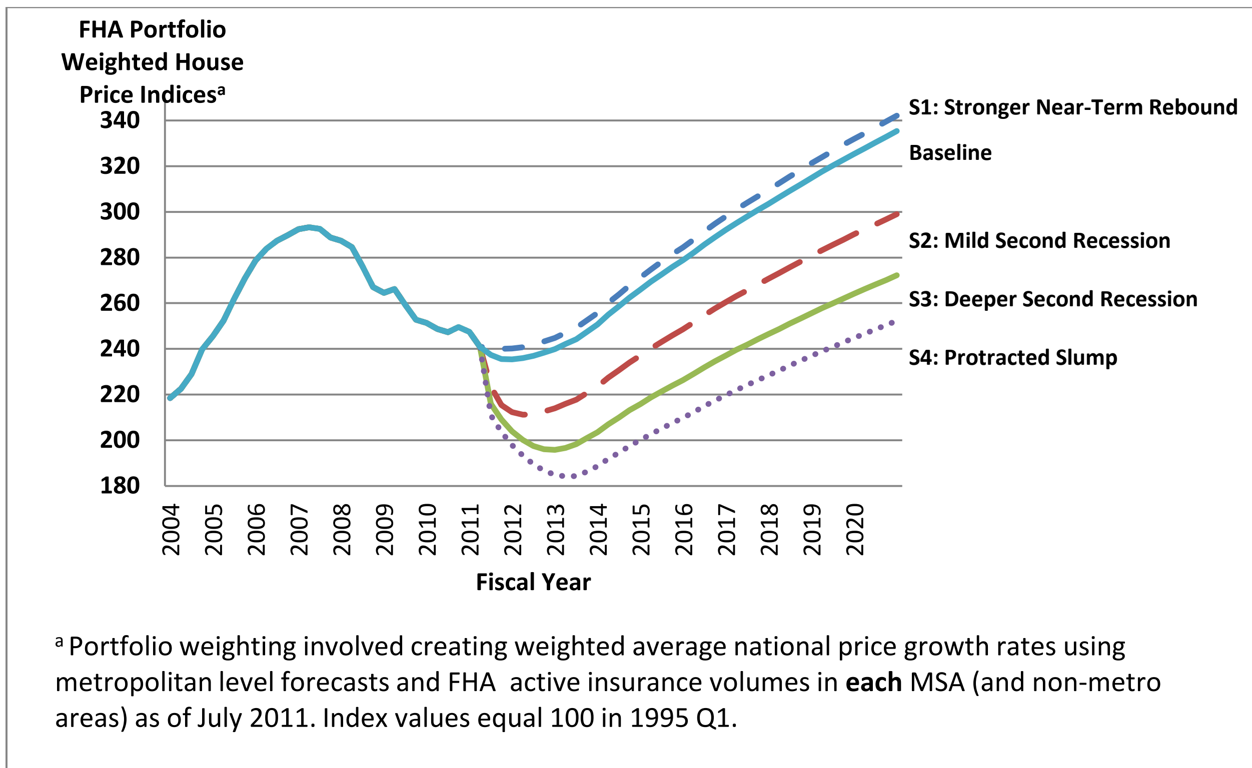
[7] The FY 2011 independent actuarial studies used Moody's July 2011forecasts of house prices, interest rates, and mortgage originations, along with age-group population growth projections of the U.S. Bureau of the Census.

Figure 2. House Price Paths used by Independent Actuaries for Sensitivity Analysis



[a] Portfolio weighting involved creating weighted average national price growth rates using metropolitan level forecasts and FHA active insurance volumes in **each** MSA (and non-metro areas) as of July 2011. Index values equal 100 in 1995 Q1.

Source: Analysis by the U.S. Department of HUD/FHA using historical and Moody's Analytics' forecasts of the FHFA all-transactions house price index at the metropolitan level, as adjusted by IFE Group.

For the near term, any worsening of economic conditions in 2012 that creates a diminished value on the current, outstanding portfolio in excess of approximately $7 billion would put the MMI Fund in a position where additional support would be required. Should it be necessary, the first place where additional support for the current portfolio would come from is net receipts on new endorsements. FHA could also implement policy changes, such as insurance premium increases, to provide further support to the Fund.

Only if conditions worsened substantially would the losses exceed amounts available in the MMI Fund next year. In this case, the Federal Credit Reform Act of 1990 provides for permanent and indefinite budget authority for any increase in the cost of outstanding direct loans and loan guarantees, including FHA MMI guarantees.

Managing Risk to the Fund

Program Policy Changes

While the Fund has remained positive, we are keenly aware of the importance of remaining vigilant to the risks the agency faces and will continue to take the actions necessary to protect the Fund and taxpayers. Indeed, such vigilance has been the hallmark of the current Administration. Having taken office in the midst of the greatest recession since the Great Depression and faced with a housing market in crisis, this Administration acted immediately to strengthen FHA and protect its insurance Funds by instituting the most sweeping reforms to credit policy, risk management, lender enforcement, and consumer protection in FHA history.

First, beginning in 2010, FHA raised its mortgage insurance premiums three times, actions that were made possible in part as a result of legislation passed by Congress. As we have frequently said, FHA greatly appreciates the key role that was played by this committee in that effort. Thanks to those actions, FHA's current premium levels are the highest they have ever been in the agency's history. The new annual mortgage insurance premium structure alone led to an increase in the FY 2011 economic value of the MMI Fund of $1.37 billion. It should also be noted that due to today's historically low interest rates, FHA has been able to strengthen the MMI Fund through its premium increases without jeopardizing housing affordability.

Continuing our progress, last year FHA implemented a "two-step" credit score policy for FHA borrowers. Those with credit scores below 580 are now required to contribute a minimum down payment of 10 percent. Only those with stronger credit scores are eligible for FHA-insured mortgages with the minimum 3.5 percent down payment.

In addition, a final rule will soon be published that outlines changes to FHA's requirements regarding seller concessions. Allowable seller concessions will be reduced and are never to exceed actual closing costs. These changes will accord with industry norms regarding seller concessions and better protect the MMI Fund from risks associated with inflated appraisal values.

FHA has also made significant changes to the HECM program. In September of 2010, FHA introduced the HECM Saver product as a second option for reverse mortgage borrowers. The HECM Saver offers significantly reduced upfront loan closing costs for mortgagors who wish to borrow less than the

maximum amount available under a standard HECM loan. In addition, FHA adjusted the principal limit factors used to determine the maximum claim amount for HECM loans to assure that HECM Standard could be self-supporting. Finally, FHA provided guidance for lenders regarding the treatment of tax-and-insurance defaults by HECM borrowers. These policy measures have significantly strengthened the HECM program so that it can continue to provide important financial options for seniors without posing unnecessary risks to the MMI Fund.

Changes have also been made to the condominium program, including the introduction of a project re-approval and recertification process for FHA-approved condominium projects, as well as a comprehensive revision of FHA's Condominium Project Approval and Processing Guide. These changes ensure the compliance of condominium projects with FHA requirements while updating those policies to better accord with industry trends and norms.

HUD also made changes to its loss mitigation requirements to increase the use of trial payment periods prior to a mortgagee executing a Loan Modification or Partial Claim action to cure a default. Trial payment plans are expected to reduce re-default rates on loan modifications and partial claims, and thereby reduce costs to the FHA Insurance Fund.

Lender Oversight and Enforcement

Just as significant as the changes made to FHA's loan programs has been the strengthening of its oversight and enforcement for FHA-approved lenders. Starting with heightened approval requirements for lenders, FHA is ensuring that it partners with stable and responsible lenders, and that HUD's limited oversight resources are focused appropriately on the entities that pose the greatest potential threat to FHA's insurance funds. Indeed, as a result of FHA's heightened oversight of lenders, over the past three fiscal years HUD has withdrawn the approval of over 1,600 lenders to participate in FHA programs, while protecting the fund through indemnifications and required repayments of improperly originated loans, and the imposition of more than $10 million in civil money penalties and administrative payments..

Additionally, FHA has made substantial changes to its targeting and execution of loan file reviews. Utilizing risk-based targeting that employs a wider array of potential risk factors than has been used previously, FHA has enhanced its ability to identify the lenders and loans that most warrant closer inspection by HUD. In so doing, FHA is better able to prevent unwarranted risks to the MMI Fund.

Risk Management at FHA

Integral to the long-term sustainability of the MMI Fund is a culture of decision making at HUD that emphasizes the importance of risk management. An effort that began with this Administration is the development of the Office of Risk Management and Regulatory Affairs (ORMRA) within the Office of Housing. This new Office provides for a central focus on risk tolerance, risk exposure, and risk management for each of the various FHA program areas. The complete establishment and integration of the Office within FHA are top priorities for HUD. While there is still work to be done to fully establish a comprehensive risk-management framework, significant progress has already been made.

Over the past fiscal year, ORMRA has hired over 15 new employees. These hires bring with them a diverse background in risk management, covering all of FHA's core lines of insurance business. Following the transition of the first Deputy Assistant Secretary for ORMRA, Bob Ryan, to a new role as special advisor to the HUD Secretary, a Senior Advisor for Risk has recently joined FHA to provide continued leadership and expertise in risk management.

The risk management office has become a significant part of the business operations within FHA. As partners to each business line and program area, the risk managers are involved in a wide array of policy and operational decision making processes. On a monthly basis, formal meetings are held between ORMRA and each of the business lines to discuss emerging risks, recent trends, and policy updates. In addition, ORMRA provides substantial capacity for risk monitoring and reporting, and for general portfolio analysis. Over the next fiscal year, ORMRA has plans to further enhance its analytical capabilities with a variety of new tools.

It should also be noted that the GAO conducted an audit entitled, "Federal Housing Administration: Improvements Needed in Risk Assessment and Human Capital Management," that examined the integration of ORMRA activities with FHA operations, as well as FHA's broader workforce planning mechanisms. The GAO Report found that in general HUD was making significant progress in its incorporation of risk management activities and the assessment and development of its human capital. HUD agreed with the audit's recommendations to continue these activities and felt that the audit provided helpful analysis of the current state with regard to risk management and human capital development within FHA. FHA was already at work to implement many of the GAO's recommendations prior to the start of the audit and will utilize the audit in its continued efforts to manage risk and human capital.

Leveraging Technology to Manage Risk and Protect the Fund

In addition to the steps HUD has taken to strengthen the MMI Fund via policy, process, and organizational changes, the Department is also engaged in a large-scale effort to acquire and employ a modern financial services information technology environment to better manage and mitigate counterparty risk across all of FHA's insurance programs. The FHA Transformation Initiative will enable risk detection and fraud prevention by capturing critical data points at the front-end of the loan lifecycle, and leveraging risk and fraud tools, rules based technology, and transactional controls to minimize exposure to FHA's insurance Funds.

These tools will enable FHA to leverage 21st century information technology systems to manage risk at all points of the loan lifecycle. For example, the FHA Transformation Initiative will automate the application process for FHA lender approval, and will provide enhanced data validation capabilities for the evaluation of lender applications. In addition, the initiative will also provide risk analytics mechanisms to identify and manage risk-based exceptions for inbound endorsements and appraisals, permitting FHA to address these concerns at the loan level. Finally, the initiative will provide FHA with comprehensive portfolio analysis tools by which it can identify and evaluate current and emerging risk trends in order to more effectively take appropriate action to avoid or mitigate risks to the MMI Fund.

Managing Risk at Ginnie Mae

I also appreciate the Committee's request for information on the steps Ginnie Mae is taking to improve risk management. Created more than 40 years ago to facilitate a secondary market for government-insured products, Ginnie Mae has performed extremely well throughout its history, Nearly every year of its existence, it has generated profits for U.S. taxpayers. In Fiscal Year (FY) 2011, Ginnie Mae earned $1.2 billion; it was Ginnie Mae's best earnings year ever. Net income in FY 2011 exceeded FY 2010's net income of $541 million and topped the previous high of $908 million set in 2008. This equates to a negative subsidy of $991 million in 2010 and $841 million in 2011. In addition to reporting substantial income for FY 2011, Ginnie Mae has accumulated retained earnings, or capital, of approximately $15.7 billion, which will serve to cushion it against further economic upheaval. These financial results are based on conservative accounting standards and certified by an external auditor.

Ginnie Mae has achieved this strong performance in the midst of the worst housing crisis the nation has experienced since the Great Depression. Over the last three years, it has managed a large increase in business volume; its share of the market rose from approximately 5 percent to approximately 40

percent in some months following the start of the crisis. Ginnie Mae's market share now stands at approximately 26 percent.   Further, the crisis not only brought large increases in business volume; but also brought an influx of new lenders seeking to join Ginnie Mae's MBS program, and an increasingly complex set of risks resulting from the difficult economic environment.

The possible failure of a large counterparty is the primary risk that exposes Ginnie Mae and taxpayers to a negative financial impact. At Ginnie Mae, counterparty risk is managed by tightly controlling entry into the program and by closely watching the performance of counterparties after approval. In an effort to enhance its front-end risk management practices, during the last two years Ginnie Mae has increased net worth requirements across all of its business lines and has implemented new liquid asset and enterprise-wide capital standards. Specifically, Ginnie Mae has raised the net worth requirement for participating in its Single Family program from $1 million to $2.5 million; for participating in its Multifamily program from $500,000 to $1 million; and in the program in which MBS are backed by reverse mortgages from $1 million to $5 million. For participating in its new Manufactured Housing program, Ginnie Mae established a net worth requirement of $10 million. In addition to these new net worth requirements, all Ginnie Mae Issuers are required to maintain least of 20 percent of their net worth in liquid assets.

Of course, the primary risk management objective *after* an Issuer meets the eligibility requirements and is approved to join the program is to ensure that it has the financial capacity to meet its obligations to investors. To accomplish this, Ginnie Mae regularly evaluates the financial statements of each Issuer to confirm its net worth, liquid assets, and capital; conducts field reviews to assess compliance with program requirements; verifies the insurance status of its collateral; and monitors the delinquency levels of its Issuers' portfolios.

Risk management practices and cost modeling procedures have been improved by increasing the staffing resources devoted to Issuer oversight, relationship management, and econometric modeling.

Ginnie Mae continues to enhance its risk management practices and cost modeling procedures. Cutting-edge technology tools – a corporate-watch program and an issuer scorecard – aimed at better tracking, analyzing, and scoring counter-party risk are near implementation. The corporate-watch program will allow Ginnie Mae to aggregate financial exposure, risk ratings, and financial data across all Issuers and their affiliates. The issuer scorecard will enable to Ginnie Mae to evaluate and compare Issuers with one another, scoring their performance relative to their peers and to established benchmarks. The increase in personnel funds included in the recently enacted 2012 appropriations bill will support these enhancements.

More comprehensive data on FHA loans and customized economic scenarios have been added to Ginnie Mae's cost modeling methods. It has also incorporated additional loan-level detail such as streamline-refinance status on loans through data-sharing agreements with the FHA. Ginnie Mae plans to further enhance its risk management practices and cost modeling to ensure the most accurate results. Planned enhancements in risk management practices include developing options to better manage and dispose of the assets of defaulted Issuers, designing new methodologies for assessing the risk of mortgage banks and non-regulated entities, and improving operational risk by strengthening the oversight of external vendors. With respect to cost modeling Ginnie Mae is implementing a plan to develop econometric models which more accurately forecast issuer default risks and their associated costs through different economic environments. Ginnie Mae plans to incorporate sensitivity analysis to identify which cash flow assumptions will have the greatest impact on its cost modeling, and to add more sophisticated economic scenarios that test multiple variables simultaneously.

The effectiveness of Ginnie Mae's efforts was affirmed when Ginnie Mae recently engaged McKinsey & Company to assess its risk management practices. McKinsey & Company concluded that Ginnie Mae's risk management practices and infrastructure should, in all but the most extreme circumstances, protect it from significant financial and operational events. Indeed, given Ginnie Mae's positive performance during the current crisis, while we will pursue additional improvements as described above, I am confident that Ginnie Mae has the risk management practices and cost modeling procedures in place to adequately protect tax payers.

The Way Forward

Mr. Chairman and Ranking Member Frank, as is clear from the review by the independent actuaries of FHA's Mutual Mortgage Insurance Fund, FHA is at a critical juncture. It continues to play a crucial role in our housing markets – perhaps more so than at any point in its history. But having played such an outsized role in a distressed economy, and without appropriate risk management and policy controls at the outset of the housing crisis, FHA has been forced to deal with unprecedented stresses to its insurance Fund.

We must continue to take actions that vigorously protect the Fund while assisting the market to fully recover. The way forward is clear. First, FHA must continue to extend credit to responsible borrowers who are capable of meeting their obligations while carefully stepping back its market share, a process that has begun already. Second, borrowers facing difficulties in meeting their obligations need to be provided with a range of potential solutions, and afforded appropriate assistance by their servicers. And

FHA must possess robust and comprehensive lender oversight and counterparty risk management capabilities commensurate with the insurance services it provides.

The actuarial report demonstrates that the sweeping changes made since the Administration took office in 2009 have dramatically improved the prospects for the long-term health of the MMI Fund, despite the virtually unprecedented challenges facing the FHA as a result of the housing crisis. And the vigilance and attention this Administration has shown to protecting taxpayers through the effective management of FHA will continue aggressively.

FHA continues to evaluate the policy options we have available so that we can implement appropriate measures to ensure even better performance of the Fund going forward. These potential policy options would build off of the foundation of reforms FHA has already put in place and some will require Congressional support. The five primary areas of focus for our actions are:

1. Premium increases: FHA is constantly evaluating the appropriate level of premiums given the potential risks to the MMI Fund, and any action regarding premiums will be considered in the context of balancing access to credit in today's economic environment with the need for added revenue generation to protect the Fund. This is a delicate balance, but we know we must first and foremost protect the Fund's resources so that its programs remain continually available.

2. Lender enforcement: A final rule to be published in the very near future outlines requirements related to indemnification by lenders participating in the Lender Insurance (LI) Program for loans that were improperly originated, or for which fraud or misrepresentation were involved. This final rule will permit FHA to improve its oversight of LI lenders and better protect its insurance Funds from the adverse effects of non-compliant loans. FHA has also sought via legislation expanded indemnification capabilities that would permit the Department to require indemnification by all lenders for loans that were improperly originated, not just those participating in the Lender Insurance Program. This authority would hold all FHA-approved standards to the same level of accountability and ensure that HUD has the ability to avoid or recover losses for non-compliant loans. Additionally, FHA has sought and would benefit from broader lender termination authority to more effectively target lender terminations based upon the risks presented by individual lenders. Such authorities would significantly enhance FHA's ability to hold lenders accountable for their underwriting of FHA loans and compliance with FHA requirements.

3. Loss mitigation: FHA is assessing further loss mitigation strategies, including potential changes to our partial payment of claim process as well as ensuring that the streamline refinance tool is being used as widely as appropriate.

4. Requirements for borrowers: While FHA will look carefully at any potential problem areas with regard to borrower credit quality and corresponding loan performance the Department

generally believes that existing requirements maintain appropriate standards to adequately protect the Fund. FHA is keenly aware of the need to balance its role in helping to facilitate the recovery of the housing market with appropriate management of risk to the MMI Fund. Moreover, further tightening of credit and down-payment requirements for future borrowers will not significantly impact FHA's financial resources and could deny access to mortgage financing for responsible borrowers, contrary to FHA's mission. FHA has already made substantial changes with regard to borrower qualification requirements under this Administration. Indeed, a final rule will soon be published that outlines changes to FHA's requirements regarding seller concessions. Allowable seller concessions will be reduced and allowed never to exceed actual closing costs. These changes will accord with industry norms regarding seller concessions and better protect the MMI Fund from risks associated with inflated appraisal values.

5. REO and pre-REO recovery: Through the Mortgage Acquisition and Disposition Initiative (601 Notes Sales) and various pilot opportunities resulting from the RFI process initiated in conjunction with FHFA and Treasury, FHA hopes to implement successful strategies to increase REO recovery rates, thereby limiting losses to the MMI Fund associated with HUD's REO property inventory.

Mr. Chairman, as the annual report to Congress shows, FHA's financial condition, while still facing risks that must be addressed, is remarkably resilient in the wake of the extraordinary turmoil in the housing market. Amid nearly unprecedented economic conditions that have devastated other institutions, FHA continues to provide a critical source of mortgage capital to responsible families who are ready for homeownership, in addition to bolstering a still-fragile housing market. And thanks to this Administration's reforms, combined with the important steps that lie ahead to further strengthen the status of the MMI Fund and reduce the footprint of FHA, we are working to ensure that FHA will continue to perform its historic mission while maintaining its responsibility to the American taxpayer.

Thank you for inviting me here today and I'd be happy to respond to any questions you may have.