IMPLEMENTATION OF HIGHER FHA LOAN FEES AND PENDING LEGISLATIVE PROPOSALS TO STRENGTHEN THE FHA MMIF FUND AND IMPROVE LENDER OVERSIGHT

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

SEPTEMBER 22, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–156

U.S. GOVERNMENT PRINTING OFFICE

62–681 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIÉRREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

IMPLEMENTATION OF HIGHER FHA LOAN FEES AND PENDING LEGISLATIVE PROPOSALS TO STRENGTHEN THE FHA MMIF FUND AND IMPROVE LENDER OVERSIGHT

Wednesday, September 22, 2010

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. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Sherman, Moore of Kansas, Scott, Green, Klein, Carson, Adler; Bachus, Royce, Capito, Hensarling, Garrett, Posey, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order. I want to apologize to the absent members. We originally scheduled this hearing at the request of the gentlewoman from West Virginia, Mrs. Capito, when the House acted, and the Senate followed our lead and accommodated some requests from the Administration to give them some of the tools. And I am pleased that those things have happened. There is a better and broader set of provisions still over there.

The gentlewoman from West Virginia at the time asked quite appropriately for there to be a hearing. Obviously, when we set the hearing, we did not—we thought it was going to be on a day when there had been votes the night before. So I apologize for the fact that we are scheduling this at a time when there aren't a lot of members around.

I said, I apologize to the members. I was going to apologize to Mr. Stevens, but let's be honest, very few witnesses testifying miss members. I was once out in Hollywood at a tour they give you at the studios, and they were making some movie with panthers. I think Nastassja Kinski was in it. And when we got to this one place, they apologized to me because the panthers were at lunch. And I said, you never have to apologize to me for the absence of panthers. I have never missed them. And I suspect that may be somewhat the way the witness feels.

But it is an important subject.

Mr. BACHUS. Some of the panthers are filing in.

The CHAIRMAN. Okay. We will proceed with this.

Let me just say—and I am not going to take a lot of time—that I have found the Commissioner to be responsive and effective. The

FHA plays a very important role. I think we all agree, including the Commissioner, and I know Secretary Donovan, that it is playing a bigger role now than we would like it to be. The percentage that the FHA has right now is not what it ought to be for the longer term. It is good that it is there for now.

Examining how housing finance should be structured, what happens after the demise of the GSEs, what is the role of the FHA and the home loan banks and the private entities that will deal with this are the number one set of topics for this committee. We will be dealing with the question of what does the world look like after the GSEs next week. But the FHA's role is a part of it. So this is a very important hearing from that standpoint, and I welcome the Commissioner.

The gentleman from Alabama is now recognized for how long?

Mr. BACHUS. Does anyone else wish to speak on our side? And how much time do we have?

The CHAIRMAN. Ten minutes.

Mr. BACHUS. Ten minutes. I will take 3 minutes.

The CHAIRMAN. The gentleman from Alabama is recognized for 3 minutes. Well, just talk as long as you want.

Mr. BACHUS. Thank you, Chairman Frank, and thank, you Commissioner Stevens, for appearing before us this morning to provide us an update on the fiscal and management performance of the FHA.

I also want to thank Mrs. Capito for her leadership on FHA issues and for requesting this hearing.

The release of last year's annual independent audit of the FHA Insurance Fund and continued weakness in the housing market have sparked a lot of anxiety on Capitol Hill and in the financial markets as to whether the FHA program is viable, and whether it can meet the many management and market challenges that lie ahead. Last November's annual independent audit indicated that the FHA fund had dropped to less than—to a less-than-expected .53 percent capital ratio substantially below the statutory 2 percent requirement.

The report also stated that the economic value of the fund declined over 75 percent from the previous year to approximately $2.73 billion. A new audit of the fund is expected in less than 2 months, and given the many statutory and regulatory changes that have been implemented over the past year, it should serve as a useful barometer of whether the policies are working.

Beyond the health of the fund, however, there are other policy questions this committee needs to address. For example, there are current estimates that the Federal Government is responsible for more than 95 percent of all new mortgages, with FHA carrying a 30 percent market share. This undeniably strong presence in the market coupled with government guarantees for loans up to $729,750 raises serious questions regarding the impact of Federal policies and how we can assure that the private sector reenters the market to decrease taxpayers' exposure.

In assisting struggling homeowners, FHA has implemented several new programs to assist families facing foreclosures and borrowers whose mortgage principal exceeds the value of their home. My understanding is that TARP and Neighborhood Stabilization

Program funds have been used; however, I am not clear how these initiatives have helped a substantial number of families and whether the assistance offered was cost-effective to the taxpayer or fair to the homeowner.

And regarding efforts to dispose of real estate owned by the FHA, there are concerns the agency is marketing programs that encourage the same types of fraud, abuse and poor underwriting standards that led to the current housing crisis, which also increased taxpayer exposure. And I add to that the fact that there are literally millions of homes on the market, many millions owned by banks, those being in foreclosure or facing foreclosure, which is an additional challenge.

In closing, I commend Ranking Member Capito again for her work on the preservation and reform of the FHA program. Her legislation, H.R. 4811, the FHA Safety and Soundness and Taxpayer Protection Act of 2010, includes important enforcement, fiscal, and risk assessment tools necessary to adequately administer the program, detect fraud and abuse, strengthen underwriting standards, and protect the taxpayer. We believe these are worthy reforms that deserve the Administration's support.

Commissioner Stevens, thank you again for being here. We look forward to your testimony.

The CHAIRMAN. The gentlewoman from West Virginia, the ranking member of the subcommittee, is recognized.

Mrs. CAPITO. Thank you, Mr. Chairman. I would like to thank you and the ranking member for—well, first of all, thank Chairman Frank for the debate that we had in July, and for honoring my request that we have this meeting here with Commissioner Stevens today. So thank you, Commissioner, for coming.

Without repeating a lot of what we already know, almost a year ago, the FHA presented to Congress an independent actuarial report on the health of the Mutual Mortgage Insurance Fund. I think we were all a little stunned. We were surprised to learn that the reserves had fallen well below the mandated 2 percent. But since that hearing, we have worked in good faith, I think, together to present commonsense ideas to help reform the FHA.

As we know, the result of this was the introduction of H.R. 4811, the FHA Safety and Soundness and Taxpayer Protection Act of 2010, which includes a lot of the reforms, much-needed reforms: enforcement, fiscal, and risk assessment tools; detection of fraud and abuse; and strengthening underwriting standards. A majority of these reforms were included in H.R. 5072, which passed overwhelmingly in the House. One of the centerpieces of this was the ability for FHA to increase the annual premium, which was then signed into law, taken out separately and signed into law in July. But I would urge my colleagues in the Senate to move forward with further consideration of the reforms that we have.

I look forward to hearing from Commissioner Stevens today about the progress of the changes FHA has already implemented to shore up the fund and to begin reducing FHA's market share. Some estimates show that the Federal Government accounts for over 95 percent of the mortgage market, with FHA making up 30 percent of that on its own. We must find solutions to restore a healthy and vibrant private market if our economy is going to function properly. FHA does have a role to play in the mortgage market, but its presence should not be this large.

What steps should we take to encourage private capital back into the market? FHA is currently able to insure loans up to $729,000; $750,000 in high-cost areas. The limits for conforming loans are similar. Are higher loan limits an impediment to private market participation? I hope that is a question we can get into today.

Finally, as Ranking Member Bachus mentioned in his statement, FHA has implemented several new programs designed to assist homeowners facing foreclosure and borrowers whose mortgage principal exceeds the value of their homes, and to reduce the number of foreclosed properties in the FHA portfolio. These use TARP funds in neighborhood stabilization programs. Concerns have been raised. I have raised concerns as well. But these new programs will invite the same types of fraud, abuse, and poor underwriting practices that led to the current housing crisis, while also increasing taxpayer exposure. It would be interesting to hear your thoughts on these new programs, specifically on the concerns that have been raised.

Additionally, I would like to say that one of the reasons I felt this hearing was so important is because in July when we moved forward with the reforms on the premium—on how to—FHA to assess the premiums, I had the feeling that our backs were up against the wall. We were in a situation where we needed to act in July, because waiting until September or October was going to put FHA in a bit of a precarious position. And that raised a major red flag for me, because if in 2 months, we are going to reach that level of, I don't want to say crisis, but concern, that concerns me as to what the status of this is and where we are moving forward.

So I appreciate you coming today, and I again thank the chairman for calling this meeting. Thank you.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Commissioner, it is good to see you. Again, today, as I recall, this is your fourth time up to testify before either the full Financial Services Committee or my subcommittee since you were appointed last year. We appreciate all the hard work you have undertaken at FHA to root out the bad actors and improve the financial health of the agency during the most devastating economic housing crisis in a generation.

As you know, the House passed my bill, the FHA Reform Act of 2010, H.R. 5072, in June of this year. That bill contained many important reforms, including providing FHA with the ability to adjust their premium structure and giving new powers to FHA to crack down on lenders that use fraud or misrepresentation, don't originate or don't underwrite loans according to FHA requirements. In addition, my bill would give FHA the ability to withdraw originating and underwriting approval for a lender nationwide based on the performance of one or more of its regional branches, and would improve the reporting tools available to FHA to monitor risks.

Unfortunately, the Senate did not take action on that bill, so many critical aspects of the reform we proposed have not been made law. However, I was pleased that both the House and Senate took action shortly before the August recess to pass a pared-down bill to simply give FHA the authority to increase the annual mortgage insurance premium.

I am eager to hear from the Commissioner today on the continued need for the other provisions in the FHA Reform Act. Additionally, I am interested in hearing from the Commissioner about the implementation of the annual mortgage insurance premium increase which will become effective on October 4th and how FHA's new proposed premium structure change will impact the size of the agency's capital reserves.

Finally, while I know that the new FHA actuarial study is not yet available, I would like to hear more from the Commissioner about his take on the state of the housing market and how that is impacting current FHA borrowers, individuals looking to purchase FHA-insured homes and the health of the Mutual Mortgage Insurance Fund. So, Mr. Commissioner, I look forward to your testimony.

Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

As you noted, Mr. Chairman, the private sector lenders have really scaled back their activities during the last 2 years, and the FHA has significantly stepped in and gone from probably less than 5 percent to more than 30 percent of the mortgage market. And if you include Fannie Mae and Freddie Mac in that, it is now over 90 percent of new mortgages in the United States.

It would be misguided, however, I think, to claim that this amount of government involvement in the mortgage market following a crisis would be proof that the market would not be able to function without the government going forward into the future. It was largely through these government entities that we saw the erosion of lending standards, the elimination of downpayment requirements, and the proliferation of subprime and Alt-A loans. Since the government was complicit in inflating the housing bubble and causing many of the problems we are dealing with today, to turn around and to say then, see, you need us forevermore, would be nonsensical.

So there is broad agreement that this much government support is unsustainable. At least at the margin, it appears the private market is ready and willing to step in, but in many ways is being priced out of the market by the FHA.

The government has been and remains ill-equipped to evaluate and price mortgage default risk. If we hope to build a more resilient, less bubble-prone mortgage market, I would say now is the time to at least begin to look at scaling back the level of government support. Mr. Stevens, I look forward to hearing from you on these topics and questioning you.

And I yield back, Mr. Chairman.

The CHAIRMAN. And with that, Mr. Stevens, we will take your statement. Any material you want to submit in addition—I am sorry, Mr. Hensarling is recognized.

Mr. HENSARLING. Thank you, Mr. Chairman.

I do not believe that we will ultimately have a housing recovery until we have a job recovery. I think one thing that many members heard over the August recess was that there was too much uncertainty in this economy. And we know that the Federal Reserve has reported that there is at least $2 trillion, roughly $2 trillion, of capital that public companies are sitting on that are on the sidelines that have not come into this market to create jobs.

Over and over you hear questions about the cost and uncertainty of health care. Unfortunately, people don't even know what their effective tax rate is going to be beginning January 1st. After two over $1 trillion deficits in a row, businesses don't know how they are going to be called upon to pay for that. Under the Dodd-Frank bill with, I believe, 342 rulemakings, more uncertainty in this economy, all of this has an impact ultimately on the FHA.

I do want to thank the Commissioner. I think a number of solid steps have been taken under his stewardship. I want to thank the ranking member from West Virginia and the chairwoman from California for the legislation that they proffered that we passed in the House. Solid steps have been made. But people still are concerned, and rightfully so, about whether the FHA prove to be the next great American taxpayer bailout.

I look forward to hearing the Commissioner's testimony, and not unlike the gentleman from California, once you have the government dominate 95 percent of the market, I do not believe that to be a good thing, a sustainable thing. I do not think it is something that the taxpayers of America want. And until we see a program that will allow the competitive market to once again come back into place, I fear for the future of the FHA's fund.

Mr. Chairman, I thank you for calling this hearing. I yield back.

The CHAIRMAN. The Commissioner is now recognized for such time as he needs.

STATEMENT OF THE HONORABLE DAVID H. STEVENS, ASSISTANT SECRETARY FOR HOUSING/FHA COMMISSIONER U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. STEVENS. Thank you, Mr. Chairman.

Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for the opportunity to testify on the financial condition of the Federal Housing Administration.

With Congress' help over the last year, FHA has made significant reforms that have put the agency on stronger financial footing. I would like to discuss those reforms today and explain why our ability to protect the taxpayer for the future depends on Congress enacting a broader, more comprehensive set of reforms that we have proposed.

As you know, last year we informed Congress of the independent actuary's findings that FHA's secondary reserves had fallen below—had fallen to .53 percent of the total insurance in force below the required 2 percent level. I told you then that Secretary Donovan and I would do everything in our power to ensure that the taxpayer was protected. And today, while we are by no means out of the woods, we have made significant headway toward stabilizing that portfolio.

In fact, according to our third quarter report to Congress, instead of losing $2.6 billion in funds as the actuary predicted, FHA has generated an additional $1.3 billion in capital resources through the third fiscal quarter and continues to earn more funds for the taxpayer. Furthermore, actual foreclosures of FHA-insured homes have been 20 percent less than predicted, which is why we have paid $3.7 billion less in claims than projected. This was only possible because the Administration had already begun implementing the most sweeping set of reforms to FHA credit policy, risk management, lender enforcement, and consumer protections in the agency's history.

Mr. Chairman, we said last year that we would hire the first Chief Risk Officer in the organization's history, and with congressional approval we have formally established a permanent risk management office within FHA, headed by a Deputy Assistant Secretary, allowing us to assess and annualize risk more actively and more proactively.

We also said that FHA would strengthen its lender enforcement policies, and we have, eliminating FHA approval for loan correspondents and increasing net worth requirements for lenders. We have also suspended some well-known FHA-approved lenders and withdrawn FHA approval for over 1,500 other lenders, and have imposed over $4¼ million in civil penalties and administrative payments to noncompliant institutions. We are sending a very clear message that if you don't operate ethically and transparently, we will not do business with you.

We said that we would restructure our mortgage insurance premiums, and we have. In April, we raised our premiums from 175 basis points to 225 basis points across all product types. In early October, thanks to legislation passed by Congress, FHA reduced that premium up front to 100 basis points, offset by an increase in the annual premium from 85 to 90 basis points depending on the loan's loan-to-value ratio. On behalf of Secretary Donovan and myself, I want to thank the House, particularly you, Chairman Frank, and Ranking Member Bachus for your leadership in passing that important legislation. I also want to thank Chairwoman Waters and Ranking Member Capito as well.

In addition, we also said that we would improve the quality of loans we were making, and we have. We are strengthening credit, risk controls, and we have implemented a two-step FICO floor for FHA purchase borrowers. Purchase borrowers with credit scores below 580 are now required to make a minimum of 10 percent downpayment. Only those with stronger credit scores can make a minimum of 3½ percent downpayment.

We also promised to reduce seller concessions, which often create incentives to inflate appraised value and are significantly more likely to go into default. That is why we have proposed a rule to reduce the maximum seller concessions from 6 percent to 3 percent.

Lastly, we said we would modernize technology within the FHA, and with your help we have made great strides towards improving technical capacity to handle increased volume, delivering our first comprehensive technology transformation plan to Congress and modernizing FHA's technology infrastructure.

We have also awarded contracts to upgrade our risk and fraud tools and are building staff capacity through hiring and training.

The early results of these efforts are encouraging. I mentioned earlier that our capital reserves are growing faster than projected, and that claim payments are less than forecasted. Loan quality is improving as well. Our third-quarter report shows that loan performance, as measured by serious delinquencies and early payment delinquency rates, has improved significantly with the first year-over-year decline in new 90-day delinquencies in years. The average credit score on current insurance endorsements has risen from 634 in 2007 to 700 today. Going forward, the President's budget projects these actions will produce an additional $4.1 billion in FHA receipts in Fiscal Year 2011, funds that FHA earns for the taxpayer.

Of course, despite the progress we have made, Mr. Chairman, the job is far from over. Secretary Donovan and I remain committed to comprehensive FHA reform legislation. And I would like to thank the House of Representatives for recognizing the urgency of this issue by passing the FHA Reform Act. Here again, I want to thank this committee, and particularly the leaders from both parties, for bringing this bill to passage in the House. Tomorrow when I testify on the same set of issues in front of the Senate Banking Committee, I will be urging the panel members to follow the House's lead in passing comprehensive FHA legislation before the end of the year.

In addition to strengthening FHA's lender enforcement ability, the bill will allow for third-party loan originators to close FHA-insured loans in their name and extend FHA's ability to hold all lenders to the same standard by permitting us to recoup losses through required indemnification for loans that were improperly eliminated or in which fraud or misrepresentation was involved. Building a stronger foundation for the future requires us to pass this legislation, and I hope the Senate will follow your lead and pass it by the end of the year.

Mr. Chairman, these reforms are important not only because we still have a long way to go, because home prices may still decline further, and conditions may get worse before they get better; they are also important because we know the critical role FHA is playing in our housing market right now. Mr. Chairman, this makes it even more important that we continue to deliver on the commitments to strengthen the FHA and assist responsible borrowers who need a helping hand, while working to facilitate the return of private capital to the housing market. We look forward to working with Congress closely on all these issues as we further reduce risk to the American taxpayer and ensure FHA can continue to provide stability in the housing market at the moment we need it most.

So thank you again for the opportunity to testify, and with that, I would be happy to answer any of your questions.

[The prepared statement of Commissioner Stevens can be found on page 36 of the appendix.]

The CHAIRMAN. Thank you, Commissioner Stevens.

Let me say first, I am going to say to my Republican colleagues, I know if we have a lame duck session, there will be questions about what should and shouldn't be done, but I would hope that this FHA bill, which went through the House with virtual unanimity, would be considered sufficiently noncontroversial and bipartisan so that we would join those of us here with the Administration in asking the Senate to pass the rest of the bill. We got them to pass some pieces of it which you said were particularly important. But especially after what you said, I would hope that would be something, and I would think it would be, that we could jointly approach the Senate and say, whatever the fights are, set them aside.

I know there are some people who argue that in a lame duck session, you don't do anything that is terribly controversial, although by Republican standards, apparently impeaching the President of the United States doesn't count as controversial, since the Republicans did that in the lame duck session of 1998. That would seem to be a pretty high bar under which we could get other legislation. But leaving that aside, we, I think, could get some agreement on this.

The other thing I just wanted to say is to thank you, Commissioner. But I want to take some credit on a bipartisan basis for this committee. You mentioned the debarment and the failure. We had during the transition between the Obama and Bush Administrations, the outgoing Bush Administration officials came and testified and mentioned—in fact, it was not even the Presidential appointees, they were the civil servants who ran the place—and told us—this would have been late 2008 early 2009—that they did not have these powers of debarment; that the FHA would know there were bad actors, but would still have to give those bad actors a fifth, sixth, seventh, eighth bite at the apple, and maybe they would succeed in getting some things through. And this committee on a bipartisan basis initiated that grant after listening to the people running it in the last day's of the Bush Administration, and then the Obama Administration came in and we worked with them.

And so, again, I think we will have our disagreements, and we will have the criticisms that people make, but I take some pride in that, and I was very pleased to have you tell us that, and we agree, the role that the public sector entities are now playing in the mortgage market is greater than it should be. But I take some comfort from the fact that while it is there, we have given you the tools to deal with it in an effective way. So I appreciate that. And that is really all I wanted to say, but I am through.

Mr. BACHUS. Mr. Chairman, I agree with a lot of what you said and would like Mrs. Capito, the chairman of the subcommittee, to respond further.

The CHAIRMAN. I will yield to the gentlewoman.

Mr. BACHUS. If she would.

Mrs. CAPITO. Well—

The CHAIRMAN. I am through.

Mrs. CAPITO. Oh, okay. Could I ask a question?

The CHAIRMAN. Yes.

Mrs. CAPITO. Okay. Great. Thank you.

Commissioner Stevens, am I correct in assuming that the next independent review will be then coming out in November like the previous one?

Mr. STEVENS. Yes.

Mrs. CAPITO. Do you have a sense of where you are there? I did miss the very beginning of your statement, so I apologize for that.

Mr. STEVENS. The actuary is done at the end of the fiscal year by an independent firm, I think as we all know, and the fiscal year obviously ends at the end of September. So at the end of the year, the actuarial firm will take the full year's data and produce a report. We intend to have that report in early November.

Mrs. CAPITO. So you don't have a real—I am sure you have your month-to-months and those kind of things.

Mr. STEVENS. Here is what I would say. As we have said in our third-quarter report that we released to Congress, there are so many performance indicators that show that the strength of the portfolio is much stronger than it was a year ago. The variables, obviously, are what is the home price forecast. And that is the single biggest impact of putting out an actuarial forecast that could ultimately be the determinant of where the capital reserve will end up. And so that is one of the big variants. There are a variety of other things that we can talk through, but I would not want to assume what this independent firm will come out with when they release the actuarial study.

Mrs. CAPITO. I raised an issue in my opening statement about the loan limits and the conforming limits. How many loans is the FHA making in that larger—say, over a half million up to whatever, the 700-and-some thousand? And do you see this a place where FHA should be playing, or is it time to pull back on that? Your comments?

Mr. STEVENS. I think you ask an important question, and I know it is one that you all are going to take up in debate here in the near term.

There is absolutely no doubt that FHA should not be playing as large a role as it is playing in the market. It also was a sign of unhealthiness in the market when it was only 5 percent of the market. Traditionally over time, in my 3 decades in this industry, FHA has always played a role on sort of average terms in the low teens as a percent of the overall market, that being said as it relates specifically to loan limits.

The thing that I think we all need to understand clearly about the FHA loan limits as it stands is that it is not about the cap. Less than 3 percent of FHA's loans are over $417,000, less than 3 percent.

Mrs. CAPITO. So that would be the 3 percent of the actual numbers of the loans. But then what does that account—do you have a different figure that accounts for how much that is?

Mr. STEVENS. How much volume?

Mrs. CAPITO. Yes.

Mr. STEVENS. I don't have a number I could give you, but since they are larger loans, it would be a slightly, but not significant difference between the numbers themselves.

Mrs. CAPITO. So only 3 percent of those are in the category I am talking about?

Mr. STEVENS. Right.

And if I could, I just want to clarify, for those of you who understand how FHA is set, and I know you do, it is based on median sales price, median home value, across the entire Nation. And the way that temporary limits provide for today is it provides for the FHA loan amount to be 125 percent of median home price in every MSA across the country. So it is a very detailed schedule.

Very few MSAs—the majority of MSAs actually would never go anywhere near the cap based on the 125 percent. The concern we have is if that was not extended for another year, that would drop to 115 percent as was passed under HERA. So it is 115 percent of median sales price, but the median sales prices will also be adjusted to current median sales prices, which are also going to be dropping. So there would be, in essence, a double hit to communities across the country that are really nowhere near these high loan limits. But it is the formula itself that is at the core of the necessity for the availability of FHA financing in communities across districts across the country.

Mrs. CAPITO. And the other thing I raised, and I have one quick other question, was the Neighborhood Stabilization Program. As you know, we have put billions of dollars into this program, and it sort of morphed into a little bit different program through the FHA, or through HUD. How do you respond to accountability, transparency, and all the issues that I think are raised in a program such as this?

Mr. STEVENS. I think the key question that has been raised around FHA's role in the Neighborhood Stabilization Program has been around something called First Look, which provides an opportunity through the Stabilization Trust and their grantees to in many cases have a 14-day prelook period at FHA foreclosure in inventory before it goes to the open market.

Now, the reason for that, and the reason why the Secretary has been so supportive of that and we supported that policy, is twofold. One, it actually—I think it protects FHA ultimately from a financial standpoint, and I will explain that. But first and foremost, it also protects communities. If by allowing in select communities, with the grantees' participation, to identify homes in those communities that would be best served by letting the grantee be involved and get a first look and potentially buy that home for potentially a homeowner, or potentially just to return that home back to the community that could be converted into other use, it allows for broader community stabilization.

That is what Secretary Donovan has been so focused on is the broader impacts. But more importantly, please keep in mind that the 14-day period that the trust gets a look at these properties is preforeclosure, before we take control of that property for resale. And what we find is on the properties that ultimately are sold, they go much faster off our portfolio than they would otherwise, and so we actually reduce our carrying costs in FHA's REO space.

So we don't—the overall impact of the First Look program in terms of the total REO portfolio will not be a significant number, but we do believe it will have value to the strength of the FHA while also stabilizing communities.

The CHAIRMAN. Thank you.

If I could get agreement, I gave up most of my time, but I had 1 minute of questions, if there is no objection. And that is there has been a lot of concern about the foreclosure process. You called it to mind when you talked about foreclosure. Now, I understand you have a pilot project with Wells Fargo where you and Wells were partnered in terms of third-party notification to try and diminish foreclosures, and I am told that worked well. And if that is the case, could we get it expanded? I do think we have learned one of the problems is inadequate notice, people weren't used to all this, and we are trying to improve this in a number of ways. You had some concerns about how Fannie Mae and Freddie Mac are doing. Is it correct that your experiment with Wells worked well, and if so, is that a basis for expanding it?

Mr. STEVENS. It is correct, Mr. Chairman, that Wells Fargo was experimenting with a third-party firm that would actually go door knocking in an attempt to try to mitigate, problem solve at-risk properties in the foreclosure process and make sure that those homeowners were aware of any option available. It had some success. We support any effort that would help mitigate that process.

Please do keep in mind with FHA, we are a little different than other portfolios in the country that we require, mandate for all our servicers that they engage in loss mitigation in the early period of default, which these third-party firms could help. But our process is far more extensive than many other processes.

The CHAIRMAN. But does it include some requirement that there be contact before foreclosure?

Mr. STEVENS. It does include, absolutely, a requirement that they contact the borrower pre-foreclosure, and that is mandated. And we are now at a point we are much more robust in our tracking of servicers and engaging with them much more—

The CHAIRMAN. Could you, because we have heard a lot of complaints from members, it has been written about in the press, and there are some concerns in Florida about it that hit the New York Times, if you could respond in writing and tell us what you are doing and maybe some basis on which we might improve it, I thank you.

Mr. STEVENS. Absolutely.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

There are a number of issues here that I would like to spend just a little bit of time on. It is not going to be possible to go through all of these. But the loss mitigation process that he is talking about is, I guess, similar to what we are attempting to do in our legislation in mandating loss mitigation prior to foreclosure. So I would be interested also, as the chairman is, in seeing exactly the way that you are handling this.

Let me just say on NSP, Mrs. Capito just asked some questions. I think it is about time that we hold hearings, and I think we had planned on holding some hearings, on NSP to see exactly what is happening. In some of the areas, they were a little slow getting started, and we need to find out whether or not we have provided the technical assistance to some of those entities to make sure they have NSP programs operating in the way that we intended them to operate.

You also mentioned something about the 14-day period that you give to the grantees in order to access the REOs. And we have been holding some meetings out in my area about REOs, all of the REOs from everywhere. And we have discovered that FHA just didn't have that many that they were dealing with. But I want to make sure that in whatever way we dispose of them, that the local Realtors and realtists have an opportunity to do business. So when the

14-day period—if a grantee is interested in the REO, does that cut out the Realtor or the realtist? How does that work; do you know?

Mr. STEVENS. They would get a look through the contractors that are managing REO inventory for us. But you have made very clear to me in separate conversations about the need to utilize local Realtors in the markets where that REO exists. And you are absolutely right, Ms. Waters, that in California, obviously, we don't have a lot of loans in your State, so it is not as big a volume of numbers.

I will tell you it is something that the Secretary is also interested in, and in the First Look rollout that we just announced, FHA was ahead of the curve, we announced it first. We then, both Assistant Secretary Mercedes Marquez and I, called every bank in the Nation, including Freddie Mac and Fannie Mae, every major servicer, and asked them to participate in First Look as well.

So I do believe, to your concern, particularly in California, there is an opportunity to more broadly engage. And we could take that back also as a discussion item to follow up on to make sure, now that we have all the banks signed on with Freddie Mac and Fannie Mae and First Look, that obviously will cover every market in the Nation. And we can go through that dialogue also about making sure that local service providers are given the opportunity to participate in this process, if that is the core to your concern.

Ms. WATERS. Yes, that is part of my concern, not only the Realtors. But one of the things I want to take a closer look at is the management of these properties, because one of the complaints are—ongoing complaints we have is that you have a national management service, and the way that they work, you may end up with people providing services from one State to the other State, which cuts out the locals in some way. So I do want to talk about that more. Not today.

Mr. STEVENS. I understand.

Ms. WATERS. But in the future to see how we make sure that the local service providers, whatever services they are providing, have an opportunity to really participate, because this goes to the whole question of jobs in the communities, etc.

Now, having said all that, what about the PTFA? This is, as I am told, the program protecting tenants in foreclosed properties. The Protecting Tenants in Foreclosed Property Act passed as part of the Helping Families Save Their Homes Act of 2009. Under PTFA, in the event of a foreclosure, bona fide tenants have the right to stay in their property for 90 days or the remainder of their lease, whichever is longer. According to advocates working on this issue, they are not sure about what FHA is doing at this time. Are you familiar with this at all?

Mr. STEVENS. I am briefly familiar of it, and I went through a briefing on this yesterday.

We are in complete compliance with the Protecting Families/Save Their Homes Act, and I would be glad to follow up with more detailed information on that for you.

Ms. WATERS. Okay. Thank you. I would be interested to see how that is working.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from Alabama.

Mr. BACHUS. Commissioner, in my opening statement, I commented that certain estimates are that the government, the Federal Government, is responsible for 95 percent of new mortgages. I am not sure that is—you may have a little different figure. But the FHA is carrying more than 30 percent of the market. I have heard both you and Secretary Donovan express concern that the FHA's current market share is unsustainable, and I would like your comment on that. And also, what steps should Congress take to encourage private capital back into the market?

Mr. STEVENS. Thank you for that question, and it is something that we spend a significant amount of time concerned with.

As I said earlier, I have been in this industry for 3 decades, and I started at a time when private banks and savings and loans did much of the mortgage finance in America, and the GSEs were just a small part of the market. Clearly, that has changed as our markets have become more sophisticated over the past decades.

There is also no doubt that there is a significant absence of capital. And I do not believe that there would be an avenue for private capital to emerge right now, given concerns about home price futures and volatility in terms of available capital, regulatory oversight, and the risk experience that many of the banks have from their previous years.

As you can appreciate, many of the more interesting products that emerged over the last decade, many of those were bank portfolios, as well as the private sector that engaged in things like option ARMs, the home equity—HELOC—market, those kinds of things, which ultimately had performance rates that may cause some resistance to reemerging. That being said, we know markets are cyclical, and as the housing market recovers, which it will, albeit perhaps slowly, there will be interest for private capital to reemerge.

Now, the way FHA needs to shrink its market share back and create an opportunity for private capital to reemerge is being undertaken right now in what I think are significant steps. We have made two mortgage insurance premium changes to price our credit risk in a way that is more safe and sound, and by doing so it is creating an entree for the private mortgage insurance industry combined with private capital on the first mortgage to reemerge. And I am sure your staff, if not you yourselves, have heard the mortgage insurance industry applaud at many of our recent changes, because we are clearly creating an opportunity for private capital to reengage.

The changing of seller concessions—FHA has rules that are just frankly more lenient than the private markets allow and more lenient than should have been allowed at FHA, and we are trying to change those things as well. Requiring bigger downpayments for lower FICO scores, which we have just implemented, prior to my coming here, there was no FICO floor at all, prior to my being sworn in in July of last year. And now, we are saying for scores of 580 and below, you have to have a 10 percent downpayment. That is the biggest single change in downpayments in FHA's history in terms of requiring sort of more skin in the game to create a more level playing field.

I think as we go forward, as financial stability begins to take hold, the future of the housing finance system decisions that need to be made, the White Paper that will be submitted to Congress in January on that subject, that will begin to create the rules of the road that I believe will create an environment for private capital to reengage. But without question, FHA needs to shrink its share of the market, but it needs to do so in a balanced way so that we are not just creating a vacuum where still no capital would come in regardless of our participation or the lack thereof.

Mr. BACHUS. And I agree that it has to be done in a reasonable manner. I think the housing market is really addicted to the government assistance now in this subsidy.

How can we reduce the government's involvement and limit taxpayer exposure? You mentioned downpayments is one important thing and also requiring a sound credit history. Are there others?

Mr. STEVENS. And I think the way—perhaps a healthy way to look at this is to begin to reflect back on the environment we are in. Obviously, we are still very much in the thick of the worst housing crisis in our Nation's history. It was brought on by an excessive amount of speculation in terms of too many products that created an enthusiasm for homebuying that was far from rational. And one thing we have learned is clearly not everybody should own a home in the go-forward market, and this Administration understands that clearly as well.

By all estimates by independents, the homeownership rate will begin to decline. The big void here at this point is to make certain that we don't create an additional tipping point by an aberrant action in the absence of any other capital provider in the market. And so having gone through market cycles, I believe that private capital will emerge as markets stabilize, and as we move into that scenario, the necessity for FHA to play this size of a role, I believe, will shrink. And I believe it will be the same for both—obviously for whatever the future of the financial system is—for Freddie Mac and Fannie Mae. Collectively, there is a commitment that private capital needs to emerge, and I believe it will emerge as markets begin to stabilize over time.

Mr. BACHUS. Thank you.

The CHAIRMAN. The gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

My questions will build to some extent on those of Mrs. Capito. One way to get a—perhaps the most likely way we are going to get a double-dip recession is to see another sudden decline in housing prices, particularly in the 12 largest metropolitan areas, high-cost areas, in this country. Representing one of those areas, home sales are going forward, and every single home sale other than Malibu is Fannie, Freddie or FHA. And it is critical that we maintain the $729,000 limit, or we are going to see a sudden crash in home prices. Not only will the $800,000 home not be able to get financed and perhaps sell for $500,000, but the $500,000 then crashes commensurately.

If we don't act soon, then how do you open escrow on November 1st, knowing that if the escrow doesn't get to close in January, you can't get financing, and it all falls through? The private sector, therefore, needs to know before November that we are going to maintain this limit at least for the foreseeable future. But it is also the public sector that needs to know you are running one of these agencies.

It is my understanding that FHA will soon begin recalculating its loan limits to prepare for the scheduled December 31st expiration of the temporary higher limit that has been in place since 2008. I understand that it takes some time to recalibrate the underwriting programs after the loan limit changes. So if Congress decides to extend these higher levels, and I hope they will, we should act sooner, I believe, rather than later, or else there may be some lag time in implementation of the loan agreements.

When will the FHA begin the process of recalculating loan limits? That is to say, what is the deadline for Congress to act to avoid any dislocation in the mortgage market and to ensure continued access to affordable markets in important places like Los Angeles?

Mr. STEVENS. I would support your statement that extending the loan limits for another year is important. The Administration does support extending the loan limits both for Freddie Mac, Fannie Mae, and FHA for an additional year for the reasons you describe.

I also do want to as well reemphasize the point that for FHA, it is less about the high loan limit, since a very small number of loans actually go to that level. It is more how reverting back to the permanent policies from the temporary policies would affect every market area, every city in America by collapsing the formula of how the limits are calculated in every single market. So to that extent, the Administration is behind both the extension of the FHA and GSE loan limits.

And beyond that, to your point, you are absolutely right as well, is that lenders are going to begin committing people at lower loan limits much sooner than in previous years because the processing times are longer, and portfolios and backlogs and mortgage applications are high in their operation. So getting that done quickly is going to be even more important in order to avoid people from not being able to get the high loan limits in the near term.

We are in the process right now of looking at the median sales price data, and I don't have a specific timeline of when we would have the new policy. I would be glad to get that information back to this committee as to when we would announce our policy change, but it would be effective as of January 1st.

Mr. SHERMAN. And would your life be a lot easier if we told you by the end of September what the rules were for January?

Mr. STEVENS. Clearly, getting this done sooner rather than later is important. And it is not about—with the FHA, this is really about how everybody associated with homeownership in America in every community across America will be impacted.

Mr. SHERMAN. Let me sneak in one more question. When you and Secretary Donovan appeared before the committee last December, I asked whether you could quantify the benefits that accrue to the FHA reserves from the larger loan limits since they appear to perform better. The Secretary testified that it was too early to make such an estimate. We are a little later now. To what extent is the ability to ensure those somewhat larger home values in higher or—larger loans in high-cost areas benefiting your reserves?

Mr. STEVENS. The simple way to look at this is those higher loans, generally speaking, are a very small percentage of our portfolio, less than 3 percent. They perform no worse than any other loan in the portfolio; in some cases, they perform perhaps a little better on the recent portfolio. But it is not a huge income generator in that context for FHA. It is more about providing that level of opportunity for people to have access to the mortgage finance system, again, across the country.

Mr. SHERMAN. Thank you.

Ms. WATERS. [presiding] Thank you.

Mr. Royce?

Mr. ROYCE. Thank you, Madam Chairwoman.

I was going to ask you, Commissioner Stevens, we had an opportunity every couple of weeks, due to the work of Mr. Garrett and Mr. Kanjorski, to sit down in a private setting with Secretary Geithner, Paul Volcker, our former Federal Reserve Chairman Greenspan, Comptroller John Dugan of the OCC, and to listen to them give us their analysis of some of the actions that have been taken that put us into the crisis, as well as some of the recommendations going forward. And one of the comments that Paul Volcker made, and subsequently was reiterated in meetings when this was brought up, was just the real problem with overleverage in the system, that it was a great failing, and in particular, as explained, the overleveraging combined with some of the moral hazard that we had created with these quasi public-private entities that had an implied public backstop. And as a consequence they said that Fannie Mae and Freddie Mac, for example, were overleveraged 100 to 1, involved in arbitri.

Last year, we went through some of the numbers that were presented, which, if I understand it, meant that your capital reserve ratio had fallen to .53 percent, which would be a lot less than the 2 percent mandated. The 2 percent mandated itself would be a 50-to-1 ratio. So that would mean that the overleveraging was somewhere in the area—something less than 200 to 1.

Now, I remember in 2004, the arguments—those of us who were critics of Fannie and Freddie—the arguments we were making about the extent of the overleveraging. And, of course, we were told at the time that they would not need a taxpayer bailout. And I guess in essence, since it is all off balance sheet, we have losses of $145 billion now, but eventually, that is going to be on the books. That loss is going to be something that we are going to have to absorb, that the taxpayers will directly absorb.

So the question I have for you is, can you say with any level of certainty, and I know the President—I read your remarks. We know that we have to see the actuarial study this year. We know it is—in a couple of months it will be prepared, but last year's number was very, very troubling. You had less than a fourth of the minimum capital requirements which you are required to hold. Is the capital level now going to take us out of the woods, and can you say with any level of certainty that FHA will not need to be bailed out? Let me just ask you that question.

Mr. STEVENS. This requires a little precision, but let me just try to explain this as succinctly as possible.

I was sworn into this job in July of last year. When I testified in April, I was running a large company as president and COO, and I came in during testimony and said FHA was taking on risks it should not be taking, and the 2006, 2007, and 2008 portfolios that were originated with very little control and very little scrutiny over the institutions that originated them are going to cost FHA a significant amount of money, and that is literally the—it is those book years that had the greatest impact on the portfolio. As a result, the capital reserve did drop below the 2 percent but it isn't the total capital.

Mr. ROYCE. That is secondary capital?

Mr. STEVENS. That is secondary capital. What happened is we reduced what is in the capital reserve and shifted into what is called the financing account, because the financing account has to hold all reserves required to pay all forecasted losses.

Mr. ROYCE. That is the 4.5 percent today?

Mr. STEVENS. That is correct. And so to just give you an example, last year when I reported the capital reserves, the combined accounts were $31.8 billion. In the third quarter report, we are at $33.1 billion. So we are $1.3 billion higher than we were.

Mr. ROYCE. I understand. But the part that was extrapolated off of the poor position then was that it could be a loss of $1.6 billion in 2012, right? So what you are saying is that when the new analysis comes in, that projection is going to probably be significantly lower; or do you know?

Mr. STEVENS. Here is what I would strongly caution for any of us who have been in financial forecasting on financial institutional balance sheets. The most significant driver in the forecast is ultimately going to be the projected forecast of home prices, forecasted projection of interest rates. Those are going to be two significant drivers on the performance of the balance sheet.

I am not going to answer with any certainty where I think the capital reserve will finish at the end of the year. Again, this is an independent actuarial firm that is reviewing our portfolio and running their models on the portfolio. I will tell you this: that if the fund has not gone negative and continues to remain positive, it will be thanks to the quick actions of this committee and Congress giving us more authority and actions of this Administration taking it—

Mr. ROYCE. And you did imply that private capital was currently being priced out of the market by FHA as well? I think you implied that.

Ms. WATERS. Mr. Moore.

Mr. MOORE OF KANSAS. Thank you. Mr. Stevens, in June of 2009, the Oversight Subcommittee I chair held a hearing on the need to strengthen fraud prevention efforts in FHA and other HUD programs. HUD's Inspector General Kenneth Donohue listed several traditional fraud schemes—namely, appraisal fraud, identity theft, and loan origination fraud—that remained a concern with respect to FHA as well as other kinds of fraud, such as foreclosure fraud, bankruptcy fraud, and reverse mortgage fraud that he was concerned about.

It has been more than a year since that hearing. What steps has FHA taken to combat both the traditional and new forms of fraud, and is there a particular kind of fraud that is of most concern?

Mr. STEVENS. Well, thanks to observers like the Inspector General and others that have looked at fraud in the FHA, and with the help of Congress and the budget that was provided to FHA, we have taken a variety of significant actions, and I will try to outline a few of them very briefly.

Mr. MOORE OF KANSAS. Thank you.

Mr. STEVENS. First, we went after institutions that were behaving improperly, and we established a much more frequent regimen of mortgagee review board meetings which, in the last year alone, we have eliminated 1,500 institutions that we believe were acting improperly in the FHA portfolio, some of which became very visible stories in the media—such as Lend America and Taylor, Bean & Whitaker and others—where those announcements culminated even further legal action. That is our first line of defense.

The second is we submitted a technology plan, and we have already to date awarded three contracts for fraud tools that are going to be developed within the FHA portfolio. We just announced our last contract a couple of days ago through appropriations to fight fraud and misrepresentation in the market at the loan level.

There is institutional fraud that has existed in our industry, and it typically involves some form of collusion between multiple participants in the market. An appraiser, a loan officer, a title agent, perhaps a real estate agent, will work together to try to commit fraud. And we believe while there will always be these risks in the market, the implementation of the SAFE Act, our technology enhancements that we are making at FHA have significantly increased scrutiny on lenders. The additional authority we received from Congress and the additional authority we are asking for in the FHA Reform Act will help ensure that gets reduced to as small a number as possible on a going-forward basis.

Mr. MOORE OF KANSAS. Thank you, sir.

And, Mr. Stevens, on page 4 of your testimony, you noted that last October you hired the organization's first Chief Risk Officer. Reflecting on the recent financial crisis, it was clear that many financial firms, Lehman Brothers and others, may have had risk officers in their organization, but they were often overruled for other priorities. Obviously, the government doesn't have the same profit motive as Lehman Brothers, but I believe that taxpayer resources should be carefully managed to minimize waste, fraud, and abuse.

Since establishing this new risk management position, has this officer been influential in better managing FHA's risk profile, and going forward, how do you make sure the Chief Risk Officer's recommendations are fully considered and not disregarded for other FHA priorities?

Mr. STEVENS. The question you ask was one that was actually expressed by both parties here in the committee, and it is one that is a significant concern to me.

In the entire history of FHA, there has never been a risk officer, a risk office; and quite frankly, when I walked into my position, there wasn't a risk report of information being provided. The risk officer now is an independent office reporting directly to the Commissioner as a Deputy Assistant Secretary on par with the heads of the multifamily business, the single family business, and the health care business.

We are right now working on a regimen to change policies and procedures so that any recommended change to policy will actually go through the risk officer, where they can agree or disagree with that policy; and if they disagree, it will stop the process at that point, ultimately could result in things having to be escalated to a Secretary in the event of disagreement, but at least to the Commissioner for decision-making.

So I agree strongly with the concerns that you expressed and others have expressed here in the room, that at a bare minimum on a go-for-the-long-term, we need to make sure that that risk officer and that risk office has the procedures in place to support them regardless of who may be in the leadership chairs within the organization down the road.

My risk officer is here with me today, Bob Ryan, who is behind me, and he has a strong, significant reputation in the industry for being thoughtful and focused on risk management. And I can assure you, under this Administration, no one will override the risk officer to be more lenient. As a matter of fact, we are clearly by our actions, if anything, going the other way.

Mr. MOORE. Thank you so very much. I yield back.

Ms. WATERS. Mr. Hensarling.

Mr. HENSARLING. Thank you, Madam Chairwoman.

Commissioner Stevens, under the FHA, this first look sales program, the neighborhood stabilization groups, this can be both individual 501(c)(3)s and municipalities, is that correct, ultimately can qualify for the first loan program?

Mr. STEVENS. Yes.

Mr. HENSARLING. And as I understand it, you will sell these properties, I think is it within a 14-day window of putting it on the market?

Mr. STEVENS. That is correct.

Mr. HENSARLING. At a 10 percent discount to their appraised value, correct?

Mr. STEVENS. That is incorrect.

Mr. HENSARLING. That is incorrect?

Mr. STEVENS. Yes.

Mr. HENSARLING. FHA properties at a discount of 10 percent below their appraised value. Okay. What do you offer them at if this information is incorrect?

Mr. STEVENS. The minimum discount required for NSP through the trust is a 1 percent discount, and part of that is the grantee also must pay a fee. They must pay some of the fees that are incurred in the settlement of that transaction.

Mr. HENSARLING. Okay. They do receive a discount, and now we are debating perhaps what that discount is.

Mr. STEVENS. I have gone through extensive discussions on that particular issue, both in the development of the program and as recently as this morning, talking about the process that NSP grantees go through and what, if any, price advantage may be given. They get a bid process.

Mr. HENSARLING. Let me see if I am hearing what I think I am hearing. You are saying that the price advantage is 1 percent?

Mr. STEVENS. The price advantage as guaranteed is 1 percent.

Mr. HENSARLING. Guaranteed at 1 percent. So you can make it larger? And your interpretation—

Mr. STEVENS. That is correct.

Mr. HENSARLING. —of the statute—and just how large can you make the discount? What is your interpretation?

Mr. STEVENS. We have programs in FHA that have existed for years that allow discounts to communities for as high as 50 percent, depending on the condition of the property and what it does for the community. They are done as a very small percentage over time. I have actually not found that many that have been done.

Mr. HENSARLING. Commissioner Stevens, let me ask this question.

Again, we know that in the last 2 years, our Nation has experienced deficits, over $1 trillion, and we have the single largest debt we have ever had in America's history. Debt held by the public is going to double in 5 years under the President's budget, triple over 10. It is an unsustainable path that even the Administration has admitted, and so I am concerned with any discount with these properties that are provided.

I guess my question here is this: If a municipality receives a property at some discount, it is my understanding that there is nothing that prevents them from turning around and perhaps flipping that at a profit, so that ultimately the Federal taxpayer who is going broke may subsidize a municipal taxpayer who may or may not also be going broke.

Can you disabuse me of this notion, or is it possible under the program that the properties can be flipped?

Mr. STEVENS. First of all, there are restrictions on the resale through the Neighborhood Stabilization Program, but I want to emphasize your primary point. I hope it is your primary point. FHA is estimated by the President's budget to produce over $5 billion in net positive receipts to the taxpayer in the next year. This Administration—

Mr. HENSARLING. Again, that is a good thing, but it was not responsive to the question.

Mr. STEVENS. Well, excuse me, I apologize. I thought it was the beginning of the point that was being made.

There are restrictions on the resale of properties, and from our perspective, we view actually this program on the REO sales where virtually all REO that is sold in America by us and virtually everybody else, ultimately is sold at whatever the market will bear.

Mr. HENSARLING. So the grantees conceivably can flip it at a profit, correct?

Mr. STEVENS. It is limited. It is capped in terms of the profit.

Mr. HENSARLING. My time is running out here, Mr. Stevens. Let me try to get in another question.

As I look at the kind of the broad swath of the Administration's foreclosure mitigation plans that haven't seemed terribly successful to me, and that according to MVA stats that I think with the exception of one quarter, delinquencies have continued to climb.

I am particularly concerned about certain aspects of the HEMP program. I think this summer I saw a report that the average back-end ratio and the debt-to-income for HEMP modifications is 63½ percent, which I believe most people would not believe to be a sustainable debt burden on American households. So I am curious. Of the FHA HEMP modifications, what assumption are you making on default rates going forward, and explain to me why risky borrowers are not being allowed to refinance into an already fiscally precarious insurance—

Mr. STEVENS. So the FHA HEMP refinance program takes an existing FHA loan and refinances them into another FHA loan at the same balance. So from a risk standpoint to the taxpayer and to the portfolio, it doesn't add any incremental increased risk. We already own the risk on that mortgage when we do the HEMP modification, where there is absolutely no incremental risk on that program.

There is absolutely no doubt that back-end ratios are going to be a driver of performance on any of the HEMP programs. And that is why as an example in our FHA short refinance program, which will cause actual principal write-down, we have capped the back-end ratio for people to be eligible for that program. But I want to restate that there is no incremental risk.

Mr. HENSARLING. Incremental being the operative term?

Mr. STEVENS. Well, the risk is already on the loan, right?

Ms. WATERS. Thank you very much. Mr. Carson?

Mr. CARSON. Thank you, Madam Chairwoman.

When you testified before the Subcommittee on Housing and Community Opportunity in March of this year, you proposed that the Secretary be allowed to hold all investment lenders to the same standard of accountability. Provisions in the FHA Reform Act of 2010 permit the Secretary to require indemnity to all such lenders.

Do you believe that there is a need for more oversight or stricter qualifications as to which lenders are approved as direct endorsement lenders?

Mr. STEVENS. I do, and we did ask for that; and I appreciate the question.

In the FHA reform bill that the House passed and this committee put forth, it allowed us to expand our indemnification capabilities from what is called LI lenders to direct endorsement lenders. That bill has not been through the Senate, and so at this point we still operate in a world where we have stronger indemnification rights with LI lenders than we do direct endorsement lenders. So that being said, I will tell you a couple of things we are doing.

We increased the minimum capital standards required of all lenders, direct endorsement or otherwise, so that we are making sure that there at least is enough capital for these institutions to bear their obligations in the event of fraud or misrepresentation, which they all bear regardless of whether they are DE or LI.

In addition to that, our mortgagee review board has stepped up our enforcement activities on all lenders where we are scrutinizing institutions with high compare ratios that are outside of the norm and taking them under a closer look than past organizations within FHA have done previously. But without question, the ability to get the remaining terms that were in the FHA Reform Act through the

Senate and into law will give us the broader enforcement capabilities that we clearly need.

Mr. CARSON. One last question. Protecting the mortgage insurance fund and capital reserves and, in turn, the American taxpayers are major reasons for congressional support of FHA reform. Do you agree that the legislation appropriately addresses the concerns for current and future states of these funds?

Mr. STEVENS. Yes, I do.

Mr. CARSON. Thank you. I yield back my time.

Ms. WATERS. Mr. Posey?

Mr. POSEY. Thank you, Madam Chairwoman.

Mr. Stevens, do you think the housing market has hit bottom? I notice you indicate that equities are up in your written testimony. Do you think the market has bottomed out?

Mr. STEVENS. I am not an economist. I do believe that the market is clearly in a better place than it was a year ago.

Mr. POSEY. Just give me a yes or no. Do you think the market has bottomed out?

Mr. STEVENS. I honestly—and I am not trying to be evasive—don't have a yes or no answer. I think we are near bottom. Whether there is a few percentage points further down—

Mr. POSEY. So that is no, you don't think it has bottomed out yet; you think we are near bottom?

Mr. STEVENS. I wouldn't be surprised—

Mr. POSEY. That has to be in your vocabulary. Gut reaction. Do you think we hit bottom yet or not? You are the second top guy. You ought to know this.

Mr. STEVENS. And I am not trying to be evasive. I am just going to tell you I think we are, at minimum, near bottom and we may be at bottom. To be honest—

Mr. POSEY. I can't believe you just can't say yes or no.

Mr. STEVENS. I review the same data that you have.

Mr. POSEY. I can't believe you are giving me a song and dance. I just want to know, do you think we have hit bottom yet? You say we are near bottom. That means we are past bottom and on the way down? Just tell me this straight: Do you think we have hit bottom yet?

Mr. STEVENS. I apologize if you are assuming I am trying to give you a song and dance. I am trying to give a statement that doesn't indicate that I have an absolute answer to—

Mr. POSEY. I don't want your absolute answer. I want your personal opinion. Do you think we have hit bottom yet?

Mr. STEVENS. I think we are, at minimum, near bottom.

Mr. POSEY. How many loans does FHA insure?

Mr. STEVENS. We are going to do about 1.7 million loans this year.

Mr. POSEY. No, how many total do you have insured?

Mr. STEVENS. Six million.

Mr. POSEY. How many of those are current?

Mr. STEVENS. If you give me just a moment, I will tell you the exact numbers, but about 91 percent are current.

Mr. POSEY. Okay. Of the 90 percent that aren't current, how many are 30 days, 60 days, 90 days or worse?

Mr. STEVENS. If you give me just one moment I want to pull—

Mr. POSEY. You can be looking at those while I ask you some more questions.

Mr. STEVENS. Okay.

Mr. POSEY. Original estimates for the HOPE for Homeowners Program would be that it would assist up to 400,000 troubled homeowners, and to date, there have only been 1,355 applications when these notes were taken. What do you think the reason is for people not to participate?

Mr. STEVENS. I apologize; which specific program was this?

Mr. POSEY. HOPE for Homeowners.

Mr. STEVENS. The challenge with the HOPE for Homeowners, I think it was a program built on good intent, but the processes in place, as we have heard with a lot of these programs, the paperwork required, the fact that there is still not a clear liquid take-up, there is not a securitization market for that on the back end, puts some natural limitations into the program.

Mr. POSEY. Okay. Under the HEMP program, what do you think the status of that is? In other words, there was $14 billion provided for incentives to support write-downs and second liens. What percentage of that has been spent and what percentage is still unspent?

Mr. STEVENS. Well, HEMP has a variety of types of the program. One is obviously the modification of the first mortgage. There is a 2MP program which provides for second lien write-down which was just rolled out midyear this year, and I don't have the specific data for that. I would have to get that from Treasury, but it is a very minimum number that has utilized the second lien write-down.

Mr. POSEY. I would like you to get that for us in writing if you would.

Mr. STEVENS. Yes.

Mr. POSEY. I guess from TARP, that was $14 billion. I just wonder what portion has been utilized, and for what purpose, and what portion has still been unutilized. I hear from an awful lot of constituents who are in trouble, and you have quite a good Representative in central Florida, by the way, who does quite an effective job of helping people out; but there is still such a large amount of paperwork. They have such a difficulty, FHA and non-FHA loans, and being able to talk to anybody who is in a position of making the decisions, and not FHA-specific problem, but I think a problem that could largely mostly help turn this economy around.

And just to re-ask another question that has already been asked, to what extent, if any, do you think FHA would be looking for a bailout in the future?

Mr. STEVENS. At this point, based on the reserves of FHA, it is running on its own. It is financially sound. It is below the minimum capital requirements. We need to increase that capital, but it is requiring a bailout. We will know more when the actuarial study is complete.

Mr. POSEY. Can I take that as a tentative no?

Ms. WATERS. Thank you. Mr. Klein?

Mr. KLEIN. Thank you, Madam Chairwoman.

I just want to pick up on, Mr. Stevens, what Chairman Frank brought up before. We passed an FHA reform bill earlier in the House, and the Senate sort of stalled on it. One of the things that

I had worked on was this pilot program which—an outreach in terms of dealing with foreclosures and things like that. Wells Fargo, I think, had partnered in doing face-to-face outreach with troubled borrowers and it seems to have worked fairly well. This whole issue of informed borrowers, understand what their choices are, not just getting a foreclosure notice, and sort of face-to-face approach for more information.

Since the bill didn't pass, I worked on this with Mr. Marchant, but this is something that you have the authority to consider and push it out there a little bit in terms of more information and working with these organizations or some third-party professionals that do this. The more information borrowers can have about their choices, the better off we will be.

A lot of it is they just don't know. People leave, they come, they go. The posting doesn't always work. The issue here is making more information available. So I want to encourage you, is that something you have the authority to do without the full legislation?

Mr. STEVENS. We are looking at precisely what our authority is for third-party outreach. We completely agree with you that it can be impactful. We have spoken to Wells Fargo in terms of the responsiveness of their pilot program they have been utilizing. They pay anywhere from $70 to $100 per door-knocker to go out. But we agree that early contact is critical and we completely support any effort that would be successful and we are looking to see how much authority we have and, more importantly, if we have the funds to deploy the door-knockers.

I do want to restate, and Chairman Frank asked this question earlier, that FHA is a little different, that we require contact—loss mitigation actions within that early period of delinquency in all loans within the FHA portfolio as a part of our services. So we already have a broad set of interventions that are required of all services. We already have a broad set of interventions that are required, but if the door-knocking, third-party intervention would add value in improving performance and helping these homeowners who are so desperately in need, we would absolutely support that.

Mr. KLEIN. If I can, just to continue on this, I think what we found is the face-to-face contact is very meaningful. People are stressed. They don't know where to turn. They don't know what their choices are. They hear about this program and that program, that some local not-for-profit in the community or city is doing something. It is a matter of getting good information to them, having someone they can look in the eye and say, "Hey, here is what the choices are."

Again, the goal here is if someone can stay—and one of the points, we help them, we want them to stay. It is good for the community. It is good for that person. Sometimes it is deferring some of the principal to the back. There are a lot of things that can be done. It is a disconnect that sometimes makes people just lose it all.

So I think it is a good investment. If you can get back to me and let me know what your position is on whether you have the authority, and if you do, what you are going to do. Certainly, I would just suggest Florida as a good case study for as much of this that can be done as possible. We would appreciate it.

Mr. STEVENS. We will do so.

Mr. KLEIN. Thank you.

Ms. WATERS. Thank you very much. Mr. Garrett.

Mr. GARRETT. Thank you. And in 5 minutes, you are done and you can go home.

Just to follow up on the gentleman from Texas, one question. The reason why I guess there was, I felt, confusion there as far as whether it is 1 point or 10 points with regard to the first loan program was because—and he didn't have that right then, but I do now—is that it is in the Department's press release, and I will just read the sentence.

It says: "Furthermore, first look would provide NSE purchasers with the opportunity to purchase FHA property at a discount of 10 percent below their appraised value. It is better." So he was going by your press release, so let's just clarify.

This is an error, then; is that what you are saying?

Mr. STEVENS. If it would be permissible, I would like to respond in writing and make sure that we clarify what was stated in the press release versus our specific policy.

Mr. GARRETT. Okay. That would be very helpful. Thank you.

I appreciate the fact the opening comment was that you have about what, 20 or 30 years in the industry, and coming to hear it was actually in private industry, and that is good in my book. Some people say that is what we are sort of lacking here in Washington in the Administration. So I appreciate your background in this.

So I am going to put you on the spot in that respect. I know you don't want to give a specific number with regard to Ed's question to the capital levels, where we were before, at one quarter. I know your answer is we do not want to go below zero. That is a yes, right?

Mr. STEVENS. Correct.

Mr. GARRETT. But can you give me this answer? When the report comes out, will we be higher or lower than—I don't want a firm number from you—but can you give us your best estimate, with all your years of experience, of whether we will be higher or lower than that number?

Mr. STEVENS. A little of that is also trying to predict what home prices will be.

Mr. GARRETT. I understand that.

Mr. STEVENS. And to relate that to the previous question, let me just—and I want to be clear in the answer. I can't give you that answer. And the reason is that the firm that does the actuarial study will incorporate a home-price forecast that is a new model that is being used which takes local markets and looks at the exact rating of the FHA portfolio. It is much improved. We don't have the data of all the specific markets, so I just don't want to predict when the capital reserve that is such a small number ultimately will be in the actual study itself. So I do not have—

Mr. GARRETT. Is that something that you as the new guy in charge, new guy in town, sort of would want to have in your position that you would be able to—maybe not today, maybe not tomorrow, to quote a line from Casablanca—but is that not a line today that you would want to be able to do that yourself? Because that seems to be an important number you need to know so you can gauge the rest of your activities, right?

Mr. STEVENS. We would like to have the ability to do that and we are—

Mr. GARRETT. So you can't do it now; is what you are saying?

Mr. STEVENS. The resources required to be able to bring in third parties to be able to do the analytics—

Mr. GARRETT. Internally you can't do it?

Mr. STEVENS. The FHA Reform Act that you all voted and pushed through has that ability in there. So here is what we do do, and you have it in your third quarterly report to Congress which we just submitted. We give you a lot of data about the portfolio, which is clearly a lot stronger than anybody predicted.

Mr. GARRETT. So the short answer is you can't do it now; you want to do it; in the future you may be able to do it?

Mr. STEVENS. That is correct.

Mr. GARRETT. On the home loan prices, so your notes or notes I took was, okay, the larger loans are around—under 3 percent of your portfolio, right? They are not a significant income generator for the FHA, right?

Mr. STEVENS. Right.

Mr. GARRETT. So here is the issue. Right now, we are in town very quickly trying to decide whether we should pass a tax cut for people—not tax cut—extend the tax breaks for those people making over $250,000. Should we be subsidizing those people on the revenue side, right? That is what the issue is in town right now.

Here, over here at the FHA, though, we are basically subsidizing those people who are the high-income people in their home purchases of people making $200,000 to $250,000.

Is that consistent that, on the one hand, the Administration does not want to subsidize them, but on the other hand, your agency says, no, we should be subsidizing, even though it is such a small percentage of the portfolio and it is not generating much money?

Mr. STEVENS. To be clear, the Administration supports the broad extension of the loan limits for the next year, and as I stated earlier, Mr. Garrett, is that the FHA high loan limit wouldn't be the most significant impact if they were not extended. The big impact would be to even the lower end of communities across the country which depend on this formula of whether it is 125 percent of median sales price or or 115—

Mr. GARRETT. So if we could just fix the formula, maybe then we can address this issue and the Administration could be consistent then in how we handle this?

Mr. STEVENS. That would clearly be an alternative if we went down the path. The challenge is we have such a short timeline for the industry to adopt any changes taking place, is that we would be impacting MSAs across the country if we do not extend.

Mr. GARRETT. Mr. Chairman, I just have one more question.

The CHAIRMAN. Go ahead.

Mr. GARRETT. Other than the GSEs—I know we haven't fixed that problem yet, but that is coming. But right now, they have something over there called the adverse market fees and loan level price adjustments. Okay?

Mr. STEVENS. Yes.

Mr. GARRETT. And they charge these fees, and I understand when they were here, they explained why they do them. It helps the book, that sort of thing.

But from your perspective, do you see them as actually driving away business from the GSEs because that raises the cost of going through the GSEs, right? And so if it drives business away from the GSEs, that is sort of pushing it into where? The only other market that is available and to you folks.

Mr. STEVENS. There are three markets, and we have seen them growing. We are seeing some of the larger financial institutions come into the market with jumbo financing, high loan balance financing, which usually has taken the form of adjustable rate mortgages, but we are seeing a growing volume occurring right now over recent weeks.

The other two areas are clearly the loan level price adjustments—what consumers and participants in the industry are ultimately going to make a choice based on the cost of the loan.

GSEs risk base price so they charge less for the top credit tier, and they charge more as the risk increases. FHA has always been a flat-priced market over time, and we have talked about this before in terms of this. But the one change we put into place so far, obviously, is if you are below 580 we are now adding additional expense to it. But generally speaking, there is no question that the cost of the loan is going to reflect consumer behavior in one direction or the other.

Mr. GARRETT. Say that last line again?

Mr. STEVENS. There is no question that the price of the loan is going to affect the decision the home buyer or borrower makes ultimately and which loan product they select.

Mr. GARRETT. So, at the end of the day, I will say all other things being equal, as far as the price risk and the pricing for that element of concern, if they add the price of the adverse fees into it, it is going to be—and as a consumer, that is that going to be higher cost for me, so I am going to do the GSE. I know I might go into the private market, but right now that really isn't there, so I am going to end up with you folks.

Mr. STEVENS. And I just say factually that we have had, with our recent price change, we have actually made the GSE review mortgage insurance and the loan level price adjustment is actually a better option for some home buyers, and so our adjustments have actually helped perhaps create a shift back. However, we would describe sort of the private capital entre, but without question, they will make a decision based on the price of their mortgage.

Mr. GARRETT. Just one follow-up on the beginning question, Mr. Chairman—where the gentleman from Texas is going.

I understand I would think that the policy issue rationale behind the—what do you call it—the first loan—first look programs. I understand the theory behind that and I understand also where the gentleman from Texas is coming. I sort of lean that way, that at the end of the day, you want your book to be good; you want a situation that you are not coming back here with the capital level below 2 percent, or even below zero, and looking for any bailouts or what have you.

The problem is, I wonder with the default rates that we currently see—maybe you can give me the number on that on the default rates. I forget what it is right now for the houses that go into it.

Mr. STEVENS. We have 8½ percent above 90 days late.

Mr. GARRETT. Okay. I thought it was higher than that.

The CHAIRMAN. We do want to wind it up.

Mr. GARRETT. So the question is, don't you really just sort of kick the proverbial can down the road on these; so good for the first 6 months or 30 days or what have you on these things. But at the end of the day, if I am going to still default, the risk was on the book before and after; all you did was push it down the road and you didn't really benefit your bottom line at the end of the day anyway. Actually it may be worse because those people have just taken advantage of the house for 30 days or 60 days or 90 days and haven't paid on it.

Mr. STEVENS. Well, actually the performance rate on the FHA portfolio is significantly higher than any other portfolio. People actually will go into default, but they will recover at a rate that is significantly higher than what I experienced in the private sector or at the GSEs over time. A lot of it has to do with our aggressive loss mitigation and programs we can put in place to get people back on track.

And I will just tell you, remember, all our loans are owner-occupied, primary residence, and our average loan balance is much lower than most other portfolios in the market. So I don't believe there is an alternative lifestyle option for many people if we can help them get back into the home.

The CHAIRMAN. The time has expired. I don't want to get into too much more of a discussion of alternative lifestyle options. That would take us along a different path.

I will say that any members, either those who are here or those who couldn't be here because we understand the schedule had been changed for votes, who have additional questions can submit them.

We can expect the Commissioner, as he always has, to be responsive. And I would ask unanimous consent to insert into the record the statement submitted to us by our colleague Mr. Towns, the chairman of the Government Reform Committee, on his bill which deals with red lining, H.R. 5941, and without objection, that will be made a part of the record.

And the committee will adjourn, to reconvene at 2 p.m. for a hearing with the Secretary of the Treasury.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

A P P E N D I X

September 22, 2010

Testimony of the Honorable Edolphus Towns
United States Representative
10th District of New York
Before the
Committee on Financial Services
US House of Representatives

September 22, 2010

Mr. Chairman, ranking member Bachus, and distinguished members of the Financial Services Committee: on July 29, I introduced H.R. 5941, the Anti-Redlining and Anti-Mortgage Fraud Act of 2010. It has been referred to your committee for consideration. Knowing of your Committee's valuable work fighting redlining and mortgage fraud, I am suggesting that this bill would help to solve them.

We all know what redlining is: banks and financial institutions won't make loans in certain areas or to certain communities, because there is a perception that loans in those areas or to individuals in certain minority communities are somehow considered to be riskier than other loans. It is illegal. It is morally wrong.

But what is less well known about redlining is that it is a practice encouraged by statistical analysis. It can seem like common sense – when a high percentage of loans go bad that are made in certain geographical areas, or to members of some minority communities, any statistical predictor is going to suggest that other loans in that geographical area, or to other members of those minority communities, are extraordinarily risky. It is unsound analysis based on statistical artifacts, to be sure. Individual performance is what counts. Each loan applicant has the right to be evaluated on individual characteristics, and must not be denied a loan based primarily on membership in a minority community, nor on where they live.

We also know that mortgage fraud is an insider's game. The FBI estimates that 80% of mortgage fraud is for profit, not property. That is, more than $20 billion a year is stolen by criminals familiar with the system, who know how to avoid the alarms and tripwires built into our financial infrastructure. But long after the money is gone, it is clear how the theft was made. There are many methods, such as straw buyers, phantom properties, and "chunking", when an applicant with good credit gives all of her information to a crook, who then signs her up as a co-borrower on many other loans. By the time anyone realizes there has even been a crime, hundreds of thousands of dollars has vanished, several banks have been eroded, and someone's credit has been ruined. In this digital age, an astonishing amount of financial crime is still being committed with fax machines and White-Out.

That is why I have introduced H.R. 5941. It is a simple technological innovation - each mortgage ***application*** would be recorded with a unique identifier. There are many proposals to attach an identification number to mortgages, but they all occur later in the process and involve only some loans.

H.R. 5941 would record every single application for a mortgage, including re-financing, home equity loans and so on, with minimal information from every applicant: the name and Social Security Number of the applicant, the lender, and the property. That's it. All of this information is already taken currently in the process - but it is not recorded in a manner that is available to other parts of the process, for example, the underwriter who actually approves the loan has no way of seeing that applicant's name as a co-borrower on multiple applications. The applicant herself does not know she is being scammed in a chunking scheme. There is no way to know in time.

What we propose is that each application be treated like footprints in fresh, quick drying concrete, so that the very first footprints are visible as a unique set to everyone who follows. The institutions that receive later applications will know about earlier ones. The system mandated by H.R. 5941 will provide information in real time. The beauty of recording this minimal information from every application is that this information does not change --

It is important to know that this legislation will not interfere with commerce in any way. It will promote the sound lending practices that encourage home ownership. Loan applicants will be encouraged to shop for sensible and favorable terms, and those whose predatory practices exploit and discriminate will be exposed. No one knows more than the members of this Committee that mortgage fraud and redlining hurt most the hardworking low-income family that is qualified for a home loan.

An underwriter who approves a loan will be able to require that prior applications be closed. No more issuing a dozen mortgages to the same borrower on the same property – the straw buyer trick that we have seen is a significant form of mortgage fraud.

Our distinguished colleague Congresswoman Judy Biggert described the technological innovation necessary to fight this sort of trickery as "a ticker tape". That may seem like a 19th century solution to a 21st century problem, but she is exactly right: this is the best way to use technology. Recording minimal information on every application with a unique identifier through a kind of clearinghouse is precisely the way telecommunications companies crushed fraud in long-distance calls. The universe of potential fraud can be cross-referenced in real time. The kind of practices that are costing Americans tens of billions every year will be exposed – and we all know that sunlight is the best disinfectant.

Perhaps best of all, this is not a tool for statistical prediction. It will be used to fight redlining, because it records the acts of individuals, rather than unfair and illegal predictions of group behavior based on neighborhoods or minority groups.

I hope that this Committee will give H.R. 5941 favorable consideration as it considers further measures for FHA reform. In the interim, I also suggest that the Committee lend its support to a pilot project to test this innovative way to use technology to fight redlining and mortgage fraud by starting at Ginnie Mae, which plays such a crucial role in restoring the essential role of homeownership to the American Dream.

Thank you for your consideration.

Written Testimony of David H. Stevens
Assistant Secretary of Housing – Federal Housing Administration Commissioner
U.S. Department of Housing and Urban Development

"Implementation of Higher FHA Loan Fees and Pending Legislative Proposals to Strengthen the FHA MMIF Fund and Improve Lender Oversight"

Hearing before the House of Representatives Committee on Financial Services
Wednesday, September 22, 2010

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for the opportunity to testify today on the progress the Federal Housing Administration has made towards strengthening its financial condition.

As you know, last year we informed Congress of the independent actuary's findings that FHA's secondary reserves had fallen below the required level. Ten months later, while there is still much work to be done, FHA is on a predicted path that will put the agency in a stronger financial position for the future.

Mr. Chairman, last year at this time the independent actuaries predicted that we would draw down $2.6 billion of capital resources over the first three quarters of this year to pay for rising claim expenses. As noted in our third quarter MMI Fund report to Congress, instead of decreasing by $2.6 billion, net income increased by $450 million. Once we add interest earnings to core insurance income, our capital resources grew by $1.3 billion in the first three quarters of this fiscal year. While our actual performance to date has been significantly better than predicted by the actuary, the net budgetary actuals are in-line with projections in the President's Budget that was provided to the Congress in February.

While economic conditions evolve and significant risk and short-term house price volatility remain present, current trends indicate that as a result of the actions taken by the Administration and Congress, we are making progress in strengthening the FHA portfolio and rebuilding our capital reserves.

The positive signs we are seeing are due, in large part, to the numerous reforms put in place and actions the FHA has taken over the last year, including an increase to insurance premiums in April and the suspension or withdrawal of approval for 1,500 lenders from doing business with FHA. This does not yet account for the additional authority to change our annual premium structure passed by Congress that will add an estimated $300 million per month to the FHA fund.

Of course, we remain cautious, and the job is not yet done. With home prices uncertain, our continued vigilance in strengthening both loan quality and performance for future loans is particularly important. To that end, it is important to note that the early performance data of loans insured in FY 2009 and 2010 are much stronger than previous years. While FHA is currently playing an important and temporarily elevated role in providing liquidity to the housing market, it is doing so responsibly.

With the remainder of my testimony, I will explain our efforts in greater detail. In particular, I will describe the role FHA is playing in the market, the reforms FHA and the Congress have put in place, the early results these reforms are producing, and why our ability to protect the taxpayer for the future requires Congress to enact the broader, more comprehensive set of reforms we have proposed.

FHA's Current Role in the Housing Market

I'd like to take a moment to outline the important countercyclical role FHA has played in our housing market during these difficult economic times. Created by President Franklin Roosevelt in 1934 at a time when housing prices had collapsed, the FHA was designed to provide affordable homeownership options that would keep our mortgage markets afloat during tough times.

Indeed, when the market began its slow collapse three years ago, FHA comprised only about two-to-three percent of the housing market. But when private capital vanished at the end of 2008, it was the FHA that stepped in – insuring approximately 30 percent of purchases and 20 percent of refinances in the housing market. Since January 2009, the agency has helped nearly 3 million Americans either purchase a home, or refinance into more stable, affordable mortgages. At the same time FHA has also helped more than a half million families at risk of foreclosure through 760,000 loss mitigation actions.

The results of these extraordinary but necessary actions, combined with many others across the Administration, are clear. Home prices began to stabilize. And homeowner equity started growing again in the second quarter of 2009 – to date, increasing over a trillion dollars, or close to $14,000 on average for the nation's nearly 78 million homeowners.

FHA's Current Financial Condition

Still, this heightened role comes at a cost. Last November, upon the final completion of FHA's independent actuarial review of fiscal year 2009, we reported to Congress that FHA's secondary reserves had fallen below the required two percent level – to 0.53 percent of the total insurance-in-force. Combined with reserves held in the Financing Account, FHA reported that it held more than 4.5 percent of total insurance-in-force in reserves – $31 billion set aside specifically to cover losses over the next 30 years.

The Administration has taken very seriously its responsibility to ensure that FHA is operating on sound financial footing while minimizing risk to taxpayers. Since I took office as FHA Commissioner in July 2009, we have implemented a broad range of actions demonstrating steadfast stewardship of the fund, while carefully ensuring that we continue to serve communities nationwide.

Specifically, over the past year, this Administration has announced and implemented the most sweeping combination of reforms to FHA credit policy, risk management, lender enforcement, and consumer protections in its history. These reforms have strengthened our financial condition and minimized risk to taxpayers as we continue to fulfill our mission.

On behalf of Secretary Donovan and myself, I want to thank both chambers of Congress, and particularly the leadership of you, Chairman Frank, Ranking Member Bachus, Subcommittee Chairwoman Waters and Ranking Member Capito, for the partnership and cooperation exhibited in passing H.R. 5981, which provides FHA the authority to modernize its premium structure. As you know, this authority was granted through unanimous consent in the Senate and passed by voice vote in the House before being signed into law by President Obama on August 11, 2010. FHA has moved quickly to implement a new premium structure, which will take effect on October 4. Similar authority was included in H.R. 5072, the broader FHA reform measure, which this Committee passed in May and which passed the full House of Representatives in June. While the swift work of Congress has allowed us to implement the premium change, which is important for FHA's ability to generate greater revenues for taxpayers in line with the President's Fiscal Year 2011 Budget proposal, we at HUD remain committed to comprehensive FHA reform which will provide the tools we need to continue our efforts.

As you know, on January 20th of this year, FHA proposed taking a series of administrative steps to mitigate risk and augment the Mutual Mortgage Insurance (MMI) Fund's capital reserves. These proposals included: increasing the mortgage insurance premium (MIP); imposing a firm floor on allowable credit scores; requiring a higher down payment for borrowers with lower credit scores; further tightening the minimum credit score required for borrowers with low down payments; reducing the maximum permissible seller concession to match the industry norm; and implementing a series of significant measures aimed at increasing lender responsibility and enforcement. We have followed through with each of these reforms, which I will discuss in this testimony.

In conjunction with updated down payment and credit score guidelines published on September 3, the changes to FHA's premium structure are projected to result in an additional $4.1 billion in FHA receipts in Fiscal Year 2011.

With the 2010 fiscal year coming to a close, the independent actuary is in the process of completing its annual study and projections of the capital reserve ratio of the FHA MMI Fund. We expect to deliver the finding of this independent study to Congress in November, which will include the official measure of the capital reserve ratio.

In the interim, I am pleased to inform you that tangible, measureable progress is being made to improve loan quality and performance compared to past years. The independent actuary projected that more than 71 percent of FHA's losses over the next 5 years will come not from newly insured loans, but loans already on our existing books when this Administration took office.

Indeed, the early-period delinquency rates for FY 2009 and FY 2010 loans are much lower than the early-period delinquency rates for loans insured in FY 2007 and FY 2008. This improvement suggests that ultimate claim rates on loans endorsed in FY 2009 and FY 2010 should be markedly better than the ultimate claim rates of loans endorsed in FY 2007 and FY 2008.

As detailed in FHA's third quarter report to Congress, it was clear that FHA's loan characteristics and financial performance are better than had been forecast in the FY 2009 actuarial review.

Highlights of FY 2010 Q3 Report to Congress

On August 2, FHA delivered its third quarter report to Congress highlighting the status of the single family MMI Fund programs (enclosed in appendix). As mentioned above, FHA has conducted rigorous analytical reviews, established new reporting protocols and procedures, and announced some of the most extensive policy changes in its history. Under the supervision of our new Chief Risk Officer, these changes have been made to better protect the safety and soundness of the MMI Fund while continuing to serve our mission and support the stabilization of the housing market.

As part of our commitment to increased transparency and to provide Congress with better information and data on the performance and operations of the MMI Fund, we enhanced our quarterly report to include the financial status of MMI Fund cash flows, early payment delinquencies and serious delinquency rates.

As I noted earlier, the third quarter report shows that many aspects of the fund are in better shape. Specifically, the amount of cash reserves in the fund is nearly $3 billion higher than forecasted in last year's actuarial report.

There are other positive signs as well. FHA's portfolio shows the average credit score on current insurance endorsements has risen from 634 in 2007 to nearly 700 today. Loan performance, as measured by serious delinquency and early period delinquency rates, has improved significantly, with the first year-over-year decline in new 90-day delinquencies in years. And actual claim payments to date are $3.7 billion lower than had been projected by the independent actuary although this is somewhat offset by lower than projected property recoveries.

Additional Reforms – Progress to Date

The two key ways in which we have strengthened FHA fund solvency have been to increase revenues and engage in better risk management. Therefore, we have been focused on restructuring our mortgage insurance premiums and putting in place mechanisms and policies to protect the FHA for the future.

In October of 2009, we hired the first Chief Risk Officer in the organization's history. On July 28, 2010 we received Congressional approval to formally establish this position and create a permanent risk management office within FHA, for which the Risk Officer is now Deputy Assistant Secretary. With this new office and additional staffing, we have begun to expand our capacity to assess financial and operational risk, perform more sophisticated data analysis, and respond to market developments.

Additionally, FHA introduced policy changes and improved lender oversight and enforcement to increase the quality of FHA insured loans. From my first day as FHA Commissioner, I began a thorough review of our loan practices and organizational capacity and gaps. Over the past 12 months we have introduced a number of new policies and taken several steps within our existing authority, all aimed at strengthening the quality of FHA-insured loans while focusing on ways to improve our operations.

In April, we published Final Rule (FR5356-F-02) "Federal Housing Administration: Continuation of FHA Reform – Strengthening Risk Management Through Responsible FHA-Approved Lenders." Most significantly, this rule eliminated FHA approval for loan correspondents and increased net worth requirements for lenders, thereby strengthening FHA's counterparty risk management capabilities.

On April 5 of this year, FHA raised its upfront mortgage insurance premium from 175 basis points to 225 basis points across all FHA product types (purchase, conventional to FHA refinances, and FHA to FHA refinances).

Subsequently, passage of H.R. 5981 granted us the authority to adjust the FHA annual premium. As stated in previous testimony and noted in the proposed budget, once this authority to adjust FHA's annual premium was granted, we would move to lower the upfront premium simultaneously with an increase to the annual premium.

Effective October 4, 2010, FHA will reduce upfront premiums from 225 basis points to 100 basis points and increase the annual premium to 85 basis points from 50 basis points for loans with loan-to-value ratios (LTV) up to and including 95% and to 90 basis points from 55 basis points for LTVs above 95%.

We are confident this new premium structure is sound policy, more in line with private mortgage insurers' pricing, and will facilitate the return of private capital to the mortgage market. In addition, the estimated value of this change is approximately $300 million per month of additional income to the MMI Fund.

Our Mortgagee Review Board, which I chair, meets monthly and has uncovered numerous violations of FHA origination and underwriting requirements. We have found false certifications and omissions, such as failures to verify the borrower's income and creditworthiness increased mortgagee review board actions. We've suspended some well-known FHA-approved lenders and withdrawn FHA-approval for over 1,500 others. In addition, we imposed over $4.27 million in civil money penalties and administrative payments to non-compliant lenders.

Beyond steeply increasing lender enforcement, we've strengthened credit and risk controls – toughening requirements on our Streamlined Refinance program, making several improvements to the appraisal process and to condominium policies, and publishing a final rule in the Federal Register outlining new down payment and credit score requirements.

Specifically, FHA implemented a "two-step" FICO floor for FHA purchase borrowers, which will reduce both the claim rate on new insurance as well as the loss rate experienced on those claims. A minimum down payment of 10% is now required of purchase borrowers with FICO scores below 579, and a minimum down payment of 3.5% is required for those with FICO scores at 580 and above. In addition, applicants with credit scores below 500 are no longer eligible for FHA insurance.

Currently, we have a proposed rule in the Federal Register which is in the comment period to reduce the maximum permissible seller concession from its current 6 percent level to 3 percent, which is in line with industry norms. The current level exposes the FHA to excess risk by creating incentives to inflate appraised value. FHA's experience shows that loans with high levels of seller concessions are significantly more likely to go to claim. Experience to date on loans insured from FY 2003 to FY 2008 suggests that claim rates on high-concession loans are 50 percent higher or more than those on low-concession loans. We anticipate the final rule to be published before the end of this calendar year.

Within our Single Family operations, we have made significant progress in our post-endorsement review process. This year we implemented a new algorithm for selecting recently insured loan files for post-endorsement technical reviews. This enhancement gives us a more precise way to conduct quality control reviews. Today, loans are selected for review based on a cascade of loan level characteristics that target risk, making our efforts much more effective and efficient.

To address system and staff constraints, we have been working with Congress to increase staff and technical capacity to handle the increased volume and market dynamics we currently face. We are focused on technology modernization and have teams in place working to upgrade our technology systems. We have a long way to go, but we successfully delivered FHA's first comprehensive technology transformation plan to Congress last September, which we have been implementing throughout this year. In addition, we recently awarded contracts to begin upgrading our risk and fraud tools. We are well underway to awarding additional contracts, and we continue to make progress modernizing FHA's technology infrastructure.

Finally, Mr. Chairman, since I arrived in July 2009, we have added 118 net new hires to Housing's payroll, and I have implemented an aggressive training and human capital development plan that includes managerial and technical skill building training as well as on-the-job mentoring.

Commitment to Comprehensive FHA Reform

Of course, the job is far from over. As important as the new premium authority established under H.R. 5891 is, Secretary Donovan and I remain committed to comprehensive FHA reform legislation that enhances FHA's lender enforcement capabilities and risk management efforts critical to our ability to monitor lender performance and ensure compliance. As already mentioned, we hope Congress will pass comprehensive FHA legislation before the end of the year.

Let me take this opportunity to once again thank this Committee for its work on H.R. 5072. Your efforts not only led to passage of comprehensive FHA reform by a substantial margin in the House but also laid the ground work for a companion Senate FHA reform bill, introduced by Senators Mark Begich and Sherrod Brown.

FHA remains committed to working with Congress to enact the full breadth of reforms introduced in H.R. 5072 and S. 3704, sponsored by Senators Begich and Brown. In addition to provisions strengthening FHA's lender enforcement ability, the legislation also includes technical clarifications that will allow for third party loan originators to close FHA insured loans in their name. This third party provision is particularly important to ensuring that several hundred community banks are able to continue originating FHA loans.

Additionally, HUD is seeking Congressional authority to extend FHA's ability to hold all lenders to the same standard and permit FHA to recoup losses through required indemnification for loans that were improperly originated and for which the error may have impacted the original loan decision, or in which fraud or misrepresentation were involved. FHA currently has this authority for loans originated through the Lender Insured (LI) process, which accounts for 70 percent of FHA loan volume, but only 29 percent of FHA-approved lenders. FHA is asking that Congress grant explicit authority to require indemnification for loans that were improperly originated for the remaining 71 percent of FHA-approved lenders. FHA is simply requesting that Congress permit FHA to hold all lenders to the same standard; FHA is not asking for expansion of authorities beyond those already granted to FHA to oversee lenders participating in the LI program. Moreover, this legislation will enable FHA to prevent lenders who have demonstrated poor performance in one area of the country from engaging in FHA lending nationwide, because it is often only a matter of time before a lender that has shown it is unable or unwilling to engage in prudent lending in one geographic region exhibits the same recklessness and irresponsibility somewhere else.

Facilitating our Recovery and Protecting the Taxpayer

Chairman Frank and Ranking Member Bachus, as you can see, we have proposed a comprehensive set of reforms to improve loan performance, hold lenders accountable, and increase revenues to the FHA fund, while also ensuring that FHA continues to support the overall recovery of the housing market and fulfill its mission of providing homeownership opportunities for responsible borrowers.

However, shoring up the FHA won't solve all our housing challenges, which is why the Administration is working to produce a more balanced, comprehensive national housing policy that supports homeownership and rental housing alike, providing people with the options they need to make good choices for their families.

Further, as important as the FHA is at this moment, I want to emphasize that the elevated role it is playing is temporary – a bridge to economic recovery helping to ensure that mortgage financing remains available until private capital returns. Thus, while we must remain mindful that qualified, responsible families need the continued ability to purchase a home, the changes and legislative requests that we have announced are crafted to ensure that FHA steps back to facilitate the return of the private sector as soon as possible.

So, Mr. Chairman, while FHA must remain a key source of safe mortgage financing at a critical moment in our country's history, we recognize the risks that we face and the challenges of this temporary expanded role that we play in today's market. The bottom line is this: the loans FHA insures must be safe and self-sustaining over the long-term. With these reforms the Administration is committed to ensuring that they are today – and into the future. We look forward to working with Congress closely on all these issues and hope to gain your support for our legislative requests to further reduce risks to the American taxpayer.

Thank you again for this opportunity to testify. I would be glad to respond to any questions.

HUD Questions for the Record
House Financial Services Committee
Hearing on FHA Stability – September 22, 2010

- **What new and innovative sources of funding are being considered by FHA to add liquidity to the housing market?**
  - FHA is currently serving its countercyclical role to support housing market recovery by providing mortgage insurance, which facilitates liquidity in the housing market. In addition to facilitating market stability, recent actions taken by FHA including the restructuring of FHA mortgage insurance premiums, have begun to support liquidity in the housing market by encouraging more competition from private mortgage insurers.
- **What do you think about the use of private sector capital as a means to complement existing FHA mortgage lending activities?**
  - FHA is open to considering proposals for the use of private sector participation to complement existing FHA mortgage lending activities that fall within its statutory guidelines and do not add risk to the Fund while protecting consumers. As it stands, the FHA insures mortgages that are funded with private capital.
- **Having reviewed my proposal before, what do you think of Shared Equity Homeownership as a means of reducing risk in the FHA portfolio and expanding access to homeownership?**
  - A well structured shared equity homeownership program may have the potential to expand access to homeownership. However, there are numerous programmatic details and consumer safeguards that must be put in place in order to ensure that the program would be viable for the Fund and consumer. As part of the Dodd-Frank Wall Street Reform bill, HUD will be issuing a report on Shared Equity Homeownership in the near future, which will provide further details on the viability of shared equity homeownership programs.