Statement of
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Committee on Financial Services
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"Sustainable Housing Finance:
Perspectives on Reforming FHA"

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Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, thank you for the opportunity to testify today on behalf of the Mortgage Bankers Association (MBA). My name is David H. Stevens, and I am the President and CEO of MBA. From 2009 to 2011, I served as Assistant Secretary for Housing and FHA Commissioner at the U.S. Department of Housing and Urban Development (HUD). I have over 30 years experience in real estate finance. On a personal note, FHA allowed me to achieve the American dream of homeownership; I bought my first home in the early 1980's with an FHA-insured loan.

FHA made headlines at the end of 2012 following the revelation that its Mutual Mortgage Insurance (MMI) Fund, which holds the accounts for the single-family programs, had a negative capital ratio. Conversely, accounts for FHA's multifamily rental and healthcare programs, which are supported by HUD's General and Special Risk Insurance (GI/SRI) Fund, are fiscally sound. The Actuarial Review of the FHA MMI Fund Forward Loans for Fiscal Year (FY) 2012, released by HUD on November 16, 2012, confirmed that FHA, like most participants in the mortgage market, is still dealing with fallout from the recent housing crisis.

MBA firmly believes that FHA has a vital role in the United States' housing finance system and its mission of serving first-time homebuyers and underserved populations and playing a countercyclical role should continue. Since its inception in 1934, FHA has enabled more than 40 million families to become homeowners.[1] In FY 2012, 77 percent of FHA purchase endorsements were to first-time homebuyers and 33 percent were to minority homebuyers. According to Home Mortgage Disclosure Act (HMDA) data, in 2011, 56 percent of African American homebuyers, and almost 59 percent of Hispanic homebuyers financed their purchases with FHA loans.[2] In 2012, applications for government refinance loans (primarily FHA) were almost 15 percent of all refinance applications, while applications for government loans to purchase a home were 37 percent of all purchase applications.[3] Thus, recent data confirm that FHA continues to play an especially critical role in providing homeownership opportunities.

Given the negative financial position for FHA's single-family program, a reexamination of U.S. housing policy is warranted. The policy decisions made today will help determine FHA's financial solvency, and whether it can continue to fulfill its traditional mission without taxpayer support. Congress, the Obama administration, and other stakeholders will need to consider requisite trade-offs that seek to balance FHA's financial stability against the maintenance of a program that facilitates homeownership for slightly higher risk consumers who might not otherwise be able to qualify for a loan. It is within this context that MBA provides this statement evaluating various policy options that FHA could undertake to ensure the long-term viability of its single-family and multifamily programs.

FHA and its Role in the Housing Market

FHA has played an important countercyclical role in the mortgage markets, both historically and in the most recent housing downturn. As private market credit risk appetites grew during the pre-crisis years, FHA began to lose market share. FHA's market share significantly declined during the early 2000s, a period when the private market was experiencing significant growth

[1] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 11. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.
[2] MBA analysis of 2011 HMDA data.
[3] Data compiled from MBA Weekly Applications Surveys.

due to alternative mortgage products and a rise in demand for private label mortgage-backed securities.

Many of FHA's traditional borrowers – low-wealth families with minimal funds for a downpayment – left FHA during the housing boom for subprime and other loans that provided lower initial monthly payments and more lenient credit requirements such as limited or no documentation. As the housing markets heated up, FHA's fully documented underwriting was perceived as overly onerous and bureaucratic. From 2003 until 2007, FHA's share of the mortgage market hovered between two and seven percent.[4] Its flagship 30-year fixed-rate mortgage was shunned by many borrowers looking for lower initial mortgage payments. In addition to FHA's more stringent underwriting standards, there was a general belief by many market participants, lenders and borrowers alike, that FHA-insured loans were too time-consuming, expensive, and complicated compared to conventional or subprime loans. As a result, FHA was not the first choice for many real estate borrowers, brokers and lenders.

During this explosion of subprime lending, FHA was further weighed down by seller-funded downpayment assistance programs, which proved to be extremely costly to the MMI Fund. These programs often resulted in inflated property values and real loan-to-values (LTVs) in excess of 100 percent. These seller-funded downpayment assistance program loans have performed two to three times worse than typical FHA-insured loans, and still represent an expected drain on the Fund of about $15 billion in the years ahead.[5] The Actuary estimates that if seller-funded downpayment loans were not in FHA's portfolio, the net economic value of the MMI Fund would be positive $1.77 billion.[6]

As the housing market began to tumble in 2007, the private label market contracted precipitously and lenders began to shift as much production as possible to FHA, Fannie Mae, and Freddie Mac. The Economic Stimulus Act of 2008 increased both conventional and FHA loan limits throughout the country, especially in high-cost areas. Approximately 75 of the highest cost counties in the nation saw the FHA loan limits more than double from $362,790 to $729,750. Another 500 counties had new loan limits set between $280,000 and $729,750. The remaining 2,500 counties had new loan limits of $280,000, up from $200,000. The once dormant FHA experienced high demand from coast to coast.[7] At the height of the housing crisis in 2009, government loans accounted for over 40 percent of the purchase market compared to 34 percent today.[8] Most of these loans were FHA-insured. Importantly, unlike the private sector and the government sponsored enterprises (GSEs), FHA moved slowly to tighten its credit standards, even though the agency was partly shielded by lenders making their own decisions to put credit overlays on FHA-insured loans to mitigate risk. Even with these actions, in performing this countercyclical role, FHA's post-crisis books-of-business - 2008 and 2009 vintage loans- continue to show very significant losses, as reflected in the FY 2012 Actuarial Review.

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[4] U.S. Dept. of Housing and Urban Development, FHA Single Family Activity in the Home-Purchase Market Through June 2012. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=fhamkt0612.pdf.

[5] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 7. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

[6] *Ibid* at p. 25.

[7] Mortgage Bankers Association, The Future of the Federal Housing Administration and the Government National Mortgage Association (September 2010) at p. 26. Can be accessed at: http://www.mortgagebankers.org/files/ResourceCenter/FHA/TheFutureofFHAandGinnieMae.pdf.

[8] Data compiled from MBA Weekly Applications Surveys.

FY 2012 Actuarial Review

The Actuarial Review provides an annual assessment of the fiscal health of the FHA and its financial outlook at a particular point in time. The FY 2012 Review showed that the capital ratio of the MMI Fund had fallen to negative 1.44 percent, well below its statutory 2 percent requirement. In the FY 2011 Review, the ratio was 0.24 percent, and the ratio for the prior two years had been below the statutory 2 percent minimum as well. The news that the capital ratio had turned negative prompted immediate concerns that FHA might require a draw from the U.S. Treasury (Treasury) - the first in the agency's history - and called into sharp focus whether FHA's policies need to be adjusted.

Highlights of the Actuarial Review include:

- The negative 1.44 percent ratio represents a negative economic value of $16.3 billion. This is the first time the Fund has been negative since the early 1990s.
- The *economic value* indicates the amount of resources the fund has over and above the reserve held for expected losses over the full life of the mortgage portfolio.
- The Actuarial Review cites several important reasons for the decline in the capital reserve ratio, including:

    - A less optimistic House Price Appreciation (HPA) forecast since last year ($10.5 billion reduction).
    - Lower historic and projected path for interest rates ($8 billion reduction). More borrowers are projected to pay off their mortgages, which reduces future revenues to the current portfolio.
    - Refinements to the forecasting model. Following recommendations by the GAO, HUD's Inspector General, and others, the actuary changed the way it calculates losses on defaulted loans. This change in methodology resulted in an estimated $13 billion ($10 billion on the forward mortgage portfolio; $3 billion on reverse mortgage loans) in reduced economic value compared to last year's projections. Previous models did not adequately model the differential loss severities of pre-foreclosure sales (short sales) versus conveyances (REO sales). In particular, last year's model did not apply large enough loss severities for very high LTV loans. This year's Review takes a more comprehensive approach towards the modeling of previously modified loans.

- The total *capital resources* of the Fund at the end of FY 2012 were estimated to be $30.4 billion.
- The Actuarial Review finds that there is a five percent chance over the next few years that *capital resources* will go negative.
- Focusing on the forward portfolio, as of the end of FY 2012, the Fund is projected to have an estimated economic value of negative $13.48 billion, an unamortized Insurance-in-Force (IIF) of $1,126.27 billion and amortized IIF of $1,053.33 billion.
- The economic value of the 2007-2009 books of business is negative seven percent while the economic value of the 2010-2012 books of business is positive three percent.
- The FY 2012 book of business is projected to contribute an estimated $11.92 billion in present value to the economic value of the Fund.

- The economic value is projected to increase over the next seven years to reach $54.25 billion by the end of FY 2019. However, this estimate is subject to assumptions regarding the volume and composition of future books of business.
- HUD also reports that the Home Equity Conversion Mortgage (HECM), FHA's reverse mortgage program, portfolio has a negative economic value, negative 3.5 percent. Adding the economic value of the forward mortgage and HECM program produces a total economic value of negative $16.3 billion.

Importantly, these findings do not mean that FHA has insufficient cash to pay insurance claims, a current operating deficit, or will need to immediately draw funds from Treasury. Indeed, the Actuarial Review itself does not determine if FHA needs a draw from Treasury; that need is determined by the economic assumptions used in the President's FY 2014 budget proposal. The final determination on a potential draw will be made in September 2013.

Given that the country just went through a severe recession from which it is still recovering, it is not surprising that FHA is experiencing significant losses on loans made during the crisis, as well as losses on the large volume of new business. High unemployment, steep home price declines and the seller-funded downpayment assistance program loans weighed heavily on the MMI Fund. The Actuarial Review estimates that the forward loan portfolio in MMI Fund may not be positive until 2014, and will reach the statutory two percent threshold some time in FY 2017; the HECM portfolio is not projected to be positive within the timeframe of the Actuarial Review.[9]

MBA has reviewed the audits of the MMI Fund. These audits used a wealth of data and sophisticated modeling techniques. MBA believes that minor specification changes in the default model, or subtle differences in the treatment of the data, would not have yielded significantly different results. Uncertainty regarding the economy is a more important factor.

With regard to economic uncertainty, MBA wishes to underscore that the soundness of FHA's financial position is intricately tied to whether the assumptions and predictions that were used as the basis for the Actuarial Review hold true. While the industry is cautiously optimistic about FHA's recent programmatic changes, MBA recognizes the severity of the losses stemming from the 2007-2009 books of business are so great, and the uncertainty in forecasting economic trends is so high, that the possibility of a further decline in the capital ratio must be acknowledged.

Moreover, assumptions regarding certain key variables, including the future paths of home prices and interest rates, can significantly sway the estimate of Fund value in either direction.

Importantly, FHA's capital adequacy requirements are designed to be analogous to those for private institutions – they minimize the likelihood that taxpayers would need to provide funds to FHA. For a private sector financial institution, regulatory capital measures are a key indicator of financial health. Banks and other financial institutions set aside reserves to cover expected losses on lending, but also hold capital to cover unexpected losses that may arise from changes in economic or financial market conditions or loan performance. Regulators require financial institutions to hold sufficient capital to minimize the likelihood that they would become insolvent during a crisis. FHA's requirements are modeled after these sound and proven practices,

[9] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 46. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

although, clearly the recent crisis has taken a severe toll on the FHA's financial stability which may require additional programmatic changes.

National Delinquency Survey Recap from Fourth Quarter 2012

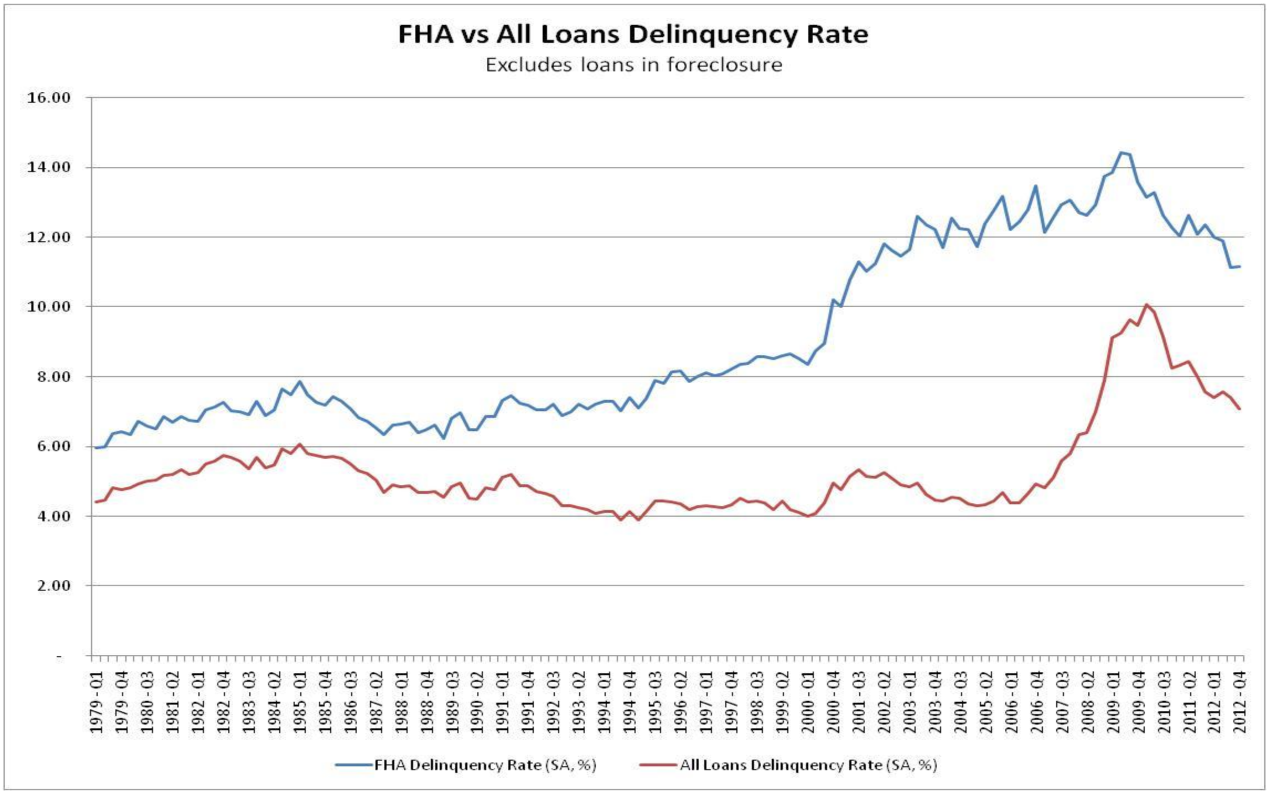
On February 21, 2013, MBA released its fourth quarter 2012 National Delinquency Survey (NDS) results. There were large improvements in mortgage performance nationally and in almost every state. The 30-day delinquency rate decreased 21 basis points to its lowest level since mid-2007. With fewer new delinquencies, the foreclosure start rate and foreclosure inventory rates continued to fall and are at their lowest levels since 2007 and 2008, respectively. Overall, we believe that these improvements in market conditions bode well for FHA as it works to improve its financial situation.

The foreclosure starts rate decreased by the largest amount ever in the MBA survey and now stands at half of its peak in 2009. Similarly, the 33 basis point drop in the foreclosure inventory rate is also the largest in the history of the survey. One cautionary note is that the 90-day+ delinquency rate increased by eight basis points, reversing a fairly steady pattern of decline and the largest increase in this rate in three years. While we normally see an increase in this rate in individual states when they change their foreclosure laws, 38 states had increases in the percentage of loans three payments or more past due, indicating that we could see a modest increase in foreclosure starts in subsequent quarters.

The two biggest factors impacting the number of loans in the foreclosure process still are the magnitude of the problem in Florida and the judicial foreclosure systems in some states. Twelve percent of the mortgages in Florida are in the process of foreclosure, down from a peak of 14.5 percent last year but still an extraordinarily high rate that is impacting the national rate. Florida accounts for almost 24 percent of all loans in foreclosure in the nation, but only 7.4 percent of loans serviced. In addition, while the percentages of loans in foreclosure dropped in almost all states, the average rate for judicial states was 6.2 percent – triple the average rate of 2.1 percent for non-judicial states. In those cases, the ultimate reduction in the number of loans in foreclosure will have less to do with the recovery of the economy and the housing market than with the return to reasonable foreclosure timelines.

The performance of FHA loans was mixed. While the foreclosure starts and foreclosure inventory percentages both fell, the delinquency percentages generally remained flat or increased slightly, particularly the percentage of loans 90 days or more past due. The other loan types generally saw declines in delinquency rates in the fourth quarter. However, 44 percent of FHA loans that are seriously delinquent were made in the years 2008 and 2009, while loans made in those years represent a smaller share of FHA's overall book of business.

After large third quarter increases in the foreclosure starts and inventory rates for FHA loans due to actions by some large servicers to re-start foreclosure processes that had been temporarily halted, these rates fell in the fourth quarter. The percent of loans in foreclosure for FHA loans decreased to 3.85 percent, and FHA foreclosure starts decreased to 0.86 percent. The percent of FHA loans in foreclosure was almost 40 basis points lower than the record high of Q2 2012, but remained well above historical averages.


FHA vs All Loans Delinquency Rate
Excludes loans in foreclosure
16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
-
1979 - Q1
1979 - Q4
1980 - Q3
1981 - Q2
1982 - Q1
1982 - Q4
1983 - Q3
1984 - Q2
1985 - Q1
1985 - Q4
1986 - Q3
1987 - Q2
1988 - Q1
1988 - Q4
1989 - Q3
1990 - Q2
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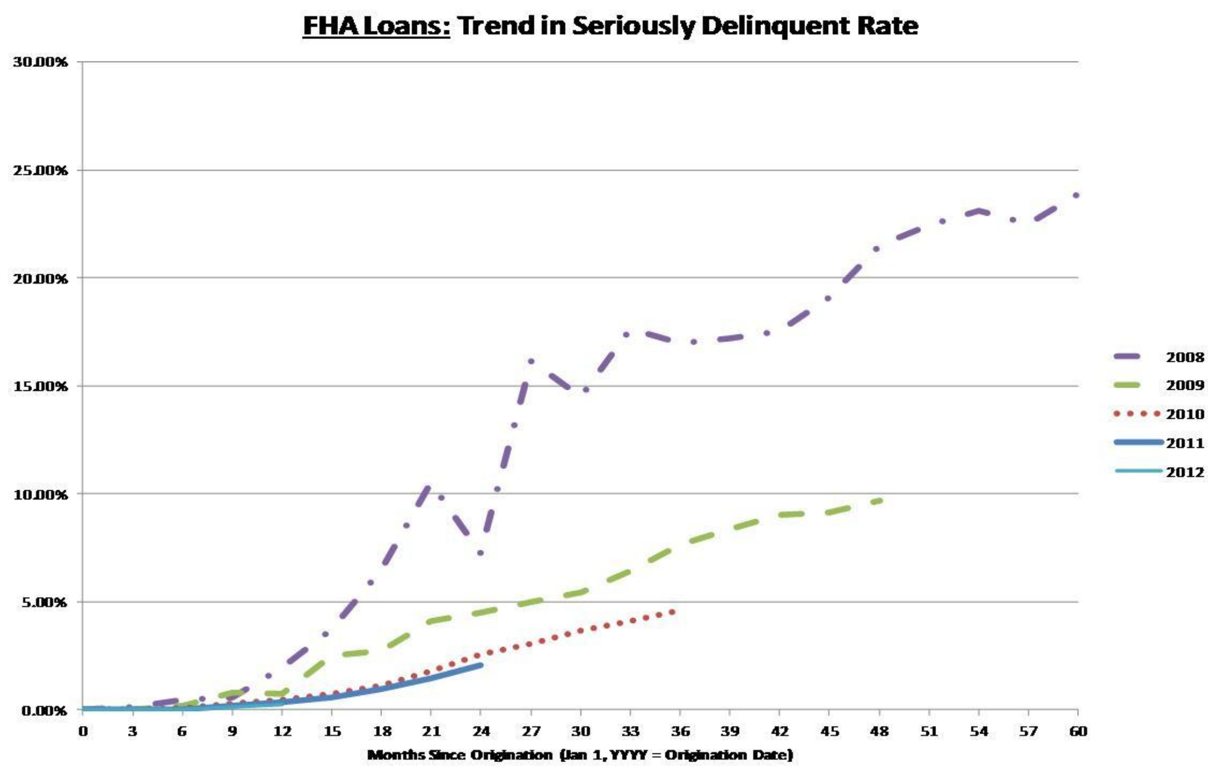
1998 - Q3
1999 - Q2
2000 - Q1
2000 - Q4
2001 - Q3
2002 - Q2
2003 - Q1
2003 - Q4
2004 - Q3
2005 - Q2
2006 - Q1
2006 - Q4
2007 - Q3
2008 - Q2
2009 - Q1
2009 - Q4
2010 - Q3
2011 - Q2
2012 - Q1
2012 - Q4
FHA Delinquency Rate (SA, %)
All Loans Delinquency Rate (SA, %)


FHA Loans: Trend in Seriously Delinquent Rate
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
0
3
6
9
12
15
18
21
24
27
30
33
36
39
42
45
48
51
54
57
60
Months Since Origination (Jan 1, YYYY = Origination Date)
2008
2009
2010
2011
2012

Recent FHA Policy Changes

FHA has made a series of single-family risk management and lender oversight and enforcement changes over the last two years, such as raising the annual mortgage insurance premium several times, increasing downpayment requirements from 3.5 percent to 10 percent for borrowers with credit scores below 580, eliminating FHA's approval of loan correspondents, raising lender net worth requirements in all programs, re-examining HECM policies, and establishing the Office of Risk Management. By making these changes, FHA has taken substantive steps over a short period of time to protect the Fund. The credit profile and performance of the FY 2010 to 2012 portfolios are testaments to these changes: the average FHA credit score for FY 2011 was 696[10] and the delinquency rate was 2.07 percent in the fourth quarter of 2012.[11] Significant performance improvement in the Fund is especially notable in the 2010, 2011, and 2012 books of business.

More recently, in response to the FY 2012 Actuarial Review, FHA announced a series of program changes aimed at increasing revenue, reducing credit risk, and improving the management of the existing portfolio. MBA believes that these recent changes are fiscally prudent and warranted given the financial realities described in the Actuarial Review.
In late January 2013, FHA announced the following administrative changes directly aimed at either increasing revenue or reducing credit risk:

1. Increase in the annual mortgage insurance premium (MIP) of 10 basis points for all forward loans, except streamline refinances effective for case number assigned on or after April 1, 2013.
2. Change in the MIP cancellation policy to require that most loans charge the MIP for the life of the loan, or 11 years, effective June 3, 2013 for loans with case number assigned on or after that date.
3. Change in credit policy to require that borrowers with credit scores under 620 must be manually underwritten, effective April1, 2013.
4. Consolidation of the HECM Fixed Rate Standard Program and HECM Saver Program, to allow borrowers to have the predictability of a fixed-rate, but with a lower upfront fee, effective April 1, 2013.

In addition, MBA supports FHA's recent proposal to lower the maximum LTV on FHA-insured loans above $625,500 from 96.5 percent to 95 percent, which effectively raises the minimum downpayment on these loans from 3.5 percent to 5 percent.

Looking forward, there is shared concern among industry, consumer groups, policymakers, and Congress that additional steps may be needed to ensure that FHA is financially secure for the long term. At the same time, some are concerned that recent decisions and potential upcoming programmatic changes may be too costly in terms of homeownership opportunities and potentially cutting off credit to vital sections of the market. Both sentiments are valid and deserve serious, thoughtful, and balanced consideration.

[10] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 18. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.
[11] *See* Chart on page 7.

Policy Considerations

From MBA's perspective, further programmatic changes at FHA must balance three priorities:

1. Restoring financial solvency to the MMI Fund;
2. Preserving FHA's housing mission; and
3. Maintaining FHA's countercyclical role.

Congress and this Administration face the challenge of striking a balance among these three goals. Moreover, policymakers must decide whether FHA requires marginal changes to its current program to meet these goals or whether substantial changes to the program are required.

Any decision regarding substantial, systemic changes, however cannot be done in a vacuum. Changes that shift the role of FHA within the housing finance system must be done with consideration of the current debate of the future of the GSEs. Adjustments in how the FHA, Ginnie Mae, Fannie Mae or Freddie Mac function within the system could greatly impact the operations, policies, or market share of the others. Prudent action is necessary in order to limit unintended consequences that could be detrimental to the entire U.S. economy.

MBA is currently working with a member advisory group that will make policy recommendations for FHA. MBA will release those recommendations as a resource for this subcommittee and other policymakers. The items below reflect some of the considerations that the group is examining.

<u>FHA and Private Capital: Risk-Sharing and Guarantee Reduction</u>

One of the most fundamental questions that has been asked since the revelation of FHA's negative capital ratio is whether the private sector should have a role in sharing risk with the FHA and if so what should that role be. Some policymakers and industry participants, such as private mortgage insurers, have suggested that the FHA should incorporate risk-sharing options in its business model as a way of offsetting some of the agency's current risk, reducing the size of the government's footprint, and thus mitigating the threat to the MMI Fund and better protecting taxpayers. MBA agrees that the option of third-party risk-sharing should be explored.

Congress and FHA should consider scenarios where first-loss private capital is ahead of the FHA government guarantee. The risk-sharing could be at the individual loan level, such as by including private mortgage insurance, or instead, at the level of the mortgage-backed security (MBS). MBA notes that any risk-sharing at the MBS level would probably have to be conducted in conjunction with Ginnie Mae. Proponents suggest that risk-sharing not only protects the taxpayer, but also increases the quality of underwriting either by the private mortgage insurers or by lenders who will have an increased incentive to make sure that the borrower can afford the loan. On the other hand, others are concerned that private insurers would be able to adversely select FHA, providing insurance only on lower risk loans, while leaving the government to fully insure higher risk loans.

Beyond the concerns about adverse selection, the specific details of any risk-sharing proposal would be critical and it would be imperative that any structure not advantage lenders with certain business models over other constructs. For example, MBA would be wary of any risk-sharing proposal that was not viable economically for diverse lender business models, particularly community banks and independent mortgage bankers.

Another option for mitigating taxpayer risk would be to reduce FHA's guarantee to less than 100 percent. Since the November 2012 release of the Actuarial Review, some industry stakeholders have suggested that the FHA should lower the guarantee on FHA-insured loans from 100 percent to something similar to the U.S. Department of Veterans Affairs (VA) home loan guarantee which ranges from 25 percent to 50 percent. Proponents contend that such a change would be beneficial because it would reduce FHA's potential liability on the loans it insures, thus protecting the taxpayer. Moreover, similar to risk-sharing, a reduction in FHA's guarantee would incentivize lenders to improve origination quality as private capital exposed to credit risk would demand more careful lending thereby reducing exposure to losses resulting from borrower default.

MBA has begun to evaluate the significant implications of such a policy. Among other consequences, a change such as this would impact Ginnie Mae pricing, FHA mortgage insurance premiums, the ability of independent mortgage bankers and other smaller lenders to retain risk, and affect VA loan pricing.

For example, putting risk back to lenders/servicers would necessitate that Ginnie Mae, which now relies upon a full credit guarantee from FHA, to spend additional resources (and likely raise the Ginnie Mae guarantee fee) to monitor and manage this new counterparty risk. It is possible that reducing the 100 percent guarantee would simply move risk from one government entity to another. It is unclear whether Ginnie Mae currently has the resources to manage additional counterparty risk. Additionally, smaller mortgage lenders are accustomed to managing representation and warrant risk, but are not structured to take on large amounts of credit risk, potentially causing them to restrict credit or leave this business. Conversely, larger lenders with a national reach and large balance sheets might be able and willing to taking on additional risk if it meant a larger market share. This could lead to further consolidation in the mortgage banking industry and fewer credit options for consumers. Moreover, because of the 100 percent guarantee, FHA-insured loans held in lenders' portfolios receive a zero percent risk weight. Reducing the FHA guarantee could lead to different accounting and bank capital treatment of holding or servicing FHA-insured loans. The issue is complex, as the change in guarantee would impact lenders differently based on their business model, thus possibly impacting the cost and availability of credit to American homebuyers.

<u>Risk Management Resources</u>

MBA has long advocated for FHA and Ginnie Mae receiving the necessary resources to hire new staff with current mortgage market skills to appropriately manage the single-family and multifamily portfolios. MBA supports the recent efforts that FHA has taken to improve its risk management and protect the safety and soundness of the agency, but these efforts cannot be sustained without ample, highly-qualified, professional staff and modern, state-of-the art technology. FHA and Ginnie Mae should be given the ability to recruit and pay staff at a higher federal pay scale, on par with other "professional-grade" cabinet, regulatory, and independent agencies that require specialized expertise, such as the Federal Deposit Insurance Corporation (FDIC) or the U.S. Securities and Exchange Commission (SEC). Although FHA's market share is likely to decrease in the future as more private capital returns to the mortgage market, we recognize that FHA will still need the resources to manage endorsements for the lifespan of these loans and we support giving FHA the funds and flexibility to do so. Moreover, MBA recommends both agencies also have the ability to more broadly utilize retention allowances, recruitment bonuses, and superior qualifications appointments.

MBA also strongly supports funding to upgrade technology to improve operational efficiencies. New and updated technology would enable FHA to be better equipped to handle the challenges of a modern marketplace. An example of how FHA could modernize its technology for the betterment of consumers and lenders is by permitting the use of electronic signatures (e-signatures) for all mortgage origination forms required by FHA. E-signatures, acceptable under federal law and by FHA on certain documents, would help reduce processing issues that impair the homebuying process. E-signatures could reduce the volume of lost paperwork, reduce the time required to close a loan, lower borrower costs, and reduce signature fraud. MBA has requested that FHA implement a revised policy accepting the use of e-signatures on all of its loan documents. MBA has also advocated that FHA adopt the Mortgage Industry Standards Maintenance Organization (MISMO) single-family data standards, as Ginnie Mae, Fannie Mae, and Freddie Mac have done. Data standardization would help FHA improve efficiencies and lower costs.

Risk-Based Underwriting

In underwriting borrowers, individual risk factors can sometimes be mitigated by compensating factors. FHA's traditional underwriting philosophy takes this approach. Attempting to further improve the credit quality of the portfolio through excessive risk tightening could delay or prevent homeownership for responsible borrowers and is counter to FHA's mission. Congress and the administration need to recognize that while the losses in the 2008 and 2009 books can be reduced and managed through better default management execution at FHA, changing credit standards on future books will not reduce embedded losses, and may actually harm the housing market recovery.

Risk-based underwriting, or specifying particular underwriting criteria within certain credit boundaries, could be structured in various ways to reduce FHA's credit risk. As indicated below, the social consequences could be significant if FHA employs overly stringent credit controls. Thus, finding the right balance is critical.

Downpayment Requirement

Increasing FHA's minimum downpayment requirement would immediately improve FHA's risk profile on new business, but possibly at an unacceptable social cost.

An increase of the minimum downpayment from 3.5 percent to 5 percent for FHA-insured loans would reduce expected losses to the MMI Fund through lower default rates and lower loss severity in the event of default. This step would increase the economic value of future books of business, but obviously would do nothing to reduce losses already on the books. Moreover, the performance of the 2010 – 2012 books clearly indicates that higher downpayments are not a necessary condition for a strong performing book. It should be noted that the enterprises GSEs, Fannie Mae and Freddie Mac, price differently based on LTVs. For example, Fannie Mae charges an additional loan level price adjustment of 50 basis points for loans with LTVs between 95 and 97 percent.

FHA has made similar policy changes that increase minimum downpayments for certain borrowers. A borrower with a credit score below 580 is required to have a 10 percent downpayment. Additionally, HUD has proposed raising the minimum downpayment for borrowers with loans above $625,500 to five percent.

FHA could continue this trend by designing a tiered downpayment structure based on credit scores where borrowers with the greatest risk of defaulting would be required to pay higher downpayments than borrowers with better credit scores. A borrower's credit score is a predictor of probability of default. FHA could consider a structure similar to the following: 3.5 percent minimum downpayment for borrowers with credit scores 620 and greater; 10 percent minimum downpayment for borrowers with credit scores between 580 and 620; 15 percent downpayment for borrowers with credit scores less than 580.

Changing the singular downpayment structure in a way that is contrary to the average pricing/cross-subsidization model that currently exists, however, could makes mortgages less affordable for borrowers on the margins. Furthermore, it is not clear whether a borrower who could accumulate a 10 percent downpayment would still choose a FHA loan, which could lead to the loss of some higher quality borrowers.

In short, the social consequences of increasing the minimum downpayment requirement could be dramatic. An increase would unnecessarily delay home purchase for many Americans who might be successful homeowners, with the greatest impact falling on the underserved. In particular, a tiered downpayment structure would place a greater financial burden on borrowers who may have the least amount of savings.

Credit Score Floor

In response to the FY 2012 Actuarial Review, FHA is requiring borrowers with credit scores below 620 to have a maximum debt-to-income ratio no greater than 43 percent in order for their loan applications to be approved through FHA's TOTAL Scorecard, an automated system used by FHA-approved lenders to score the quality of an FHA loan application.[12] Borrowers with credit scores and DTI ratios that do not meet these requirements may still obtain an FHA-insured loan, but their loan application must be manually underwritten by the lender to ensure adequate compensating factors.

Raising the minimum credit score to 620 for all borrowers would reflect the current market standard of private lenders, making FHA less subject to adverse selection based on its credit policy. As the most recent Actuarial Review indicates, there is a strong correlation between the credit score and loan performance. As the average FHA credit score has risen, performance of the corresponding books of business has greatly improved. Borrowers with extremely weak credit may be better served by credit counseling and a slower path to homeownership, rather than a costlier loan today.

A downside risk is that raising the minimum credit score to 620 could reduce affordable credit options for many borrowers, some of whom may have qualified for a loan had it not been for a one-time life event, such as job loss or medical expenses. FHA has been one of the few fully-underwritten and documented lending options for borrowers with impaired credit. Increasing

[12] Letter from Acting Assistant Secretary for Housing, FHA Commissioner Carol Galante to Sen. Robert Corker, December 18, 2012. Can be accessed at: http://www.corker.senate.gov/public/_cache/files/940b16a2-a401-418f-b409-5dca6e176c42/12-18-12_Letter%20from_Carol_Galante.pdf.

FHA eligibility standards may provide fertile ground for the growth of a new subprime market and/or predatory lending.

Reserve and Debt-to-Income Requirements

Similar to the downpayment option, structuring reserves and DTI requirements on a tiered basis could promote even stronger performance than that seen in recent books. Reserves and DTI requirements would better enable higher risk borrowers to absorb major expenses, such as replacing a heating system or paying for a car repair without risking delinquency. These changes would positively impact FHA's default rate and should reduce future claims. This would be another means of ensuring borrowers are truly prepared for the cost of homeownership.

Conversely, these changes would also delay homebuying for borrowers who would potentially need to accumulate additional cash for a downpayment.

High-Cost Loan Limits

In 2011, Congress extended the high-cost loan limits first enacted in the Economic Stimulus Act of 2008, thereby maintaining the FHA high-cost loan limit of $729,750 until December 31, 2013. Importantly, this loan limit was only extended for FHA-insured loans; the GSE loan limit was lowered to $625,500. According to MBA data, less than one percent of FHA-insured loans are between $625,500 and $729,750. FHA lending above $625,500 is most prevalent in the following areas: Washington D.C. (12.9 percent); California (3.4 percent); Virginia (3.2 percent); and New York (3.1 percent).[13]

There is evidence that the demand for large loans is growing and that these borrowers will be adequately served by the private sector. According to MBA's Weekly Application Survey Data, there was a 22 percent increase in the number of loans between $625,000 and $729,000 from 2011 and 2012. As the demand for this market grows, the private sector will readily expand its offerings to qualified borrowers.

Allowing the current high-cost area loan limits to expire in 2013, and reducing them to the GSE loan limits, would help sharpen FHA's focus on serving low-to-moderate income and first-time homebuyers. The expiration would not greatly affect national FHA lending and would expand the opportunity for private lenders to serve higher income borrowers.

On the other hand, according to FHA data, larger loans tend to perform better compared with smaller loans in the same geographical area. Also, borrowers are already charged an additional 25 basis points for these loans.[14] Thus, these high-cost loans actually improve the performance of the MMI Fund and provide additional revenue. Given that loans above $625,000 comprise a small percentage of FHA's portfolio, but have a significant number of positive attributes, policymakers might consider extending the limits until the MMI Fund is financially stable.

While it would be rational to lower the high-cost FHA limits to focus the program on lower-income and lower-wealth borrowers, the question is when to make this change. It is also

[13] Data compiled from MBA Weekly Applications Surveys.
[14] Integrated Financial Engineering, Inc., Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2012 (November 2012) at p. 48. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=ar2012_forward_loans.pdf.

important to recognize that making this change is unlikely to contribute positively to the financial health of the Fund, but would primarily serve to focus FHA on serving these borrowers.

Lender Enforcement

In recent years, FHA has greatly increased its enforcement of agency-approved lenders. FHA has:

- Enhanced monitoring of lender performance and compliance with FHA guidelines and standards (Effective January 21, 2010).[15]
- Expanded the Credit Watch Termination Initiative to include evaluation of lender underwriting performance in addition to origination performance (Effective January 21, 2010).[16]
- Implemented its statutory authority through regulation of section 256 of the National Housing Act to enforce indemnification provisions for lender's using delegated insuring process (Effective February 24, 2012).[17]

Post crisis, lenders have typically been more conservative in their origination standards than FHA would permit. In fact, this is one of the reasons that FHA's financial position, while troubling, is not as dire as that of the GSEs: lenders acted to control the risk profile of FHA lending because even though the loans were guaranteed, enforcement actions against lenders in the event of default are extremely costly.

According to HUD, since early 2009, heightened enforcement of its requirements for FHA-approved lenders has resulted in over 1,600 lenders being withdrawn from FHA's program as a result of violations of FHA approval, origination, or servicing requirements and the imposition of more than $13.8 million in civil money penalties and administrative payments for FHA-approved lenders.[18]

Additionally, the U.S. Department of Justice (DOJ) has recently begun filing court actions against lenders under the False Claims Act (FCA). The FCA is a federal law that imposes liability on any person who knowingly presents a false or fraudulent claim for payment or approval to the U.S. government. These court actions are based on allegedly false loan-level certifications and annual certifications by lenders. The penalties are severe – lenders can be liable for three times the damages sustained by HUD, plus civil penalties of up to $11,000 per transaction. Since May 2011, HUD and the DOJ have filed and/or settled five cases against lenders, with settlement amounts ranging in four cases being $132.8 million, $158.3 million, $202.3 and $1 billion.[19]

The prospect of tough administrative and legal enforcement actions provides strong incentives for lenders to carefully follow FHA program guidelines. These enforcement actions also increase revenue for the MMI Fund.

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[15] Mortgagee Letter 2010-02.
[16] Mortgagee Letter 2010-03.
[17] 24 CFR Part 203.
[18] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 61. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf
[19] Schulman, P.L., Baugher, K. M. (2012). Triple Trouble. Mortgage Banking, 72 (10), pp. 61-62.

There is a point, however, where harsh enforcement actions can have negative consequences for the FHA and eligible borrowers. While some in Congress and other policymakers may believe that additional FHA lender enforcement tools and legal actions were necessary to contend with some of the real and alleged lending abuses that occurred in the past by companies, it is undeniable that the increase in intensity of lender enforcement has contributed to a constriction of credit. Blunt tools, such as "zero-tolerance" lender enforcement, only serve to cause lenders to restrict lending to qualified borrowers for fear that minor, unintentional, and immaterial mistakes will serve as reasons for requiring indemnifications, or worse, as the basis for a False Claims lawsuit. Indemnifications or FCA lawsuits present problems for lenders, but they can be catastrophic for smaller independent mortgage bankers and community banks.

When lenders must operate their businesses within standards that permit virtually no errors of any sort or otherwise face substantial financial penalties, they will naturally restrict their underwriting to be well within the boundaries of permissible lending. Thus, overlays that include higher credit scores, lower debt-to-income ratios, and reserve requirements – all above and beyond the official FHA program guidelines – become logical outcomes to mitigate lender risk. This response from lenders directly impacts consumers by eliminating borrowers who could possibly be responsible homeowners, but have a few risk factors. Given the high stakes of indemnification or lawsuits, it is difficult for lenders to justify taking a chance on marginal borrowers – much of FHA's targeted population.

Let me be clear: as FHA commissioner, I initiated tighter controls and enforcement procedures that shut down irresponsible FHA lenders. When warranted, this is the right thing to do for the Fund and the market. Dishonest or sloppy lenders have no place within the FHA program. However, FHA must take a balanced approach to enforcement; otherwise FHA's practices risk a curtailment of sustainable credit at a time when credit is needed to support the housing market recovery.

MBA unquestionably supports high standards for all lenders that participate in FHA programs in order to protect the agency's viability, the lender's reputation, and the reputation of the industry. MBA members recognize and accept accountability for instances of fraud and negligence within their control. Moreover, lenders take full responsibility for underwriting mistakes that lead to loan delinquencies and incorporate sophisticated quality control systems to minimize the possibility of indemnifications. There must, however, be a reasonable allowance for human error, certainly when the error is not the cause of the delinquency or default. MBA would staunchly oppose efforts that allow FHA to go beyond reasonable standards of lender enforcement.

<u>Servicing Loss Mitigation</u>

FHA has taken proactive, appropriate, and aggressive steps to manage its 2000 to 2009 books-of-business, which include the agency's most costly loans. MBA commends these efforts, given that FHA already holds the risk on the loans. MBA also recognizes that additional steps may be necessary to further minimize losses. Below are MBA's thoughts on various means FHA is employing or considering to further reduce losses.

Launch large-scale proactive modification and partial claim campaigns for delinquent borrowers

During recent years, HUD has promoted several programs to assist borrowers retain homeownership, including FHA's Home Affordable Modification Program (HAMP), which help homeowners experiencing financial hardship make their homes more affordable by reducing the mortgage payment. Recently, HUD made revisions to its loss mitigation home retention options making it easier for borrowers to qualify for FHA HAMP partial claims[20] and modifications.

Enhancing loan modifications and partial claims have the potential to achieve FHA's objective of helping more delinquent borrowers return to performing on their mortgages and ultimately reducing losses from foreclosures. MBA is encouraged that this effort will yield positive results and truly make a difference for many borrowers.

MBA does recognize, however, that increasing the number of partial claims in the short-term will require more cash outlays from the MMI Fund. Unsuccessful partial claims are costly to the MMI Fund because they prolong non-performing loans and increase claim obligations, deterioration of property and other liabilities. However, MBA anticipates that the increase in partial claims and other loss mitigation solutions will result in long-term savings for HUD.

Encourage Pre-foreclosure Sales

A pre-foreclosure sale (PFS) is a "short sale" - a sale of the property in satisfaction of a defaulted mortgage even though the proceeds are less than the amount owed on the mortgage.

HUD has acknowledged that pre-foreclosure sales are beneficial in the economic recovery, and result in cost-savings for HUD. For these reasons, HUD plans to take steps to encourage more pre-foreclosure sales as an alternative to foreclosure.

Pre-foreclosure sales allow homeowners a quick resolution of a mortgage loan in default without experiencing the foreclosure process. HUD benefits by avoiding extended foreclosure and eviction periods during which debenture interest and claim expenses accumulate and when property damage can occur.

Modifying the rules on pre-foreclosure sales will allow borrowers who cannot and do not want to retain their homes dispose of them more quickly. However, modifying the rules also may increase strategic defaults by borrowers who are capable of repaying their debts. Such a result would increase overall losses for FHA. With proper controls, however, this risk can be minimized.

Enhance servicer performance management and oversight

HUD is in the process of implementing an enhanced servicer performance scorecard that we understand will include the following four core areas: i) foreclosure prevention; ii) loss mitigation engagement; iii) single-family default monitoring system (SFDMS) reporting; and iv) re-defaults. It is expected that the new scorecard will become the vehicle to determine loss mitigation incentives and treble damages for failing to engage in loss mitigation. Changes to the scorecard will require rulemaking and *Federal Register* notice and comment before they become effective. In addition, HUD will issue a Mortgagee Letter with further details.

[20] Under the Partial Claim Option, the Lender will advance funds on behalf of the Borrower in an amount necessary to reinstate the delinquent loan. The Borrower will execute a Promissory Note and Subordinate Mortgage payable to HUD. Currently, these Promissory or "Partial Claim" Notes assess no interest and are not due and payable until the Borrower either pays off the first mortgage or no longer owns the property.

The new scorecard changes how performance is measured, and will likely reduce HUD outlays of loss mitigation incentive payments and could increase the imposition of treble damages. Servicers depend on loss mitigation incentives to cover the enhanced servicing obligations imposed on them to administer delinquent FHA borrowers. Also, the new scorecard will provide a vehicle to impose treble damages for reporting issues and issues outside of the servicer's control (such as re-defaults) rather than on servicers' efforts to offer loss mitigation. We do not believe treble damages are the appropriate remedy in these cases. The changes, in turn, will result in additional overlays in origination to reduce the risk of default, which in turn will lessen the number of borrowers to FHA.

Accelerate Note Sales

As part of the effort to address the housing market's "shadow inventory" and to target relief to communities with high foreclosure activity, HUD has accelerated the use of note sales through the Distressed Asset Stabilization Program (DASP). This program enables HUD to sell severely delinquent loans insured by the FHA through a competitive bidding process in which loans are sold to the highest bidder, including non-profit and community-based organizations. HUD benefits from the program because it does not have the expense of an extended foreclosure process, saving considerable money for FHA's insurance fund. Borrowers benefit because note holders have additional flexibilities to modify loans that FHA servicers do not have.

<u>Home Equity Conversion Mortgage (HECM) Program</u>

The independent actuary projects the economic value of the HECM ("reverse mortgage") portfolio to be negative $2.8 billion, compared to $1.4 billion in FY 2011.The major reasons for this steep decline are:

- Updated mortality and termination speeds. Expected termination rates are slower than projected last year, thereby reducing the economic value by $1.9 billion. Survivorship beyond 10 years results in a greater chance of loan balances exceeding property values and HUD realizing a loss.
- Higher rate of property conveyance at termination. Presently, about 70 percent of non-refinance loan terminations result in the conveyance of properties to HUD compared to about 70 percent of property sales being handled directly by owners or real estate executers historically. The new actuarial estimates use updated projection model rates based on this new reality. This change reduces the value of the Fund by $1.9 billion.
- Less optimistic baseline house appreciation rates. As discussed in the FY MMI Actuarial section, home price appreciations have been revised since the FY2011 Actuarial Review.[21]

In response to the actuarial findings, HUD has announced significant changes to the HECM program. MBA continues to support the HECM program and the association applauds FHA for devising a solution to immediately address problems with the HECM program but still allow seniors to continue to have viable reverse mortgage options. Effective April 1, 2013, FHA consolidated the Fixed Rate Standard program with the HECM Saver product, thus reducing the

[21] U.S. Dept. of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund (November 2012) at p. 50. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf

maximum amount of funds available to the borrower.[22] The HECM Saver allows the borrower to continue to have the predictability of a fixed-rate loan with lower upfront costs, but the borrower is not able to draw as much funds as the Fixed Rate Standard. Although only a few years old, the HECM Saver is proving to be cost effective for borrowers and financially prudent for FHA.

A key challenge HUD has faced in managing the HECM program has been its inability to move swiftly in making programmatic changes that could enhance the security and financial performance of the Mutual Mortgage Insurance Fund.

MBA strongly supports the changes recently proposed in the "HECM Stabilization Act of 2013" (S. 469) which would amend the National Housing Act to give HUD the authority it needs to quickly and thoughtfully make changes to the HECM program as market conditions warrant. MBA is concerned that if HUD is not granted this authority in a timely manner through the HECM Stabilization Act of 2013, or another similar mechanism, the agency will be forced to take drastic measures to severely curtail the program, thereby eliminating an important financial tool for American seniors. The HECM program is an important option for helping seniors to age gracefully and with respect; it should be preserved.

While MBA fully supports granting HUD the authority to make changes to the HECM program to guarantee its continued vitality, it strongly urges Congress to be mindful of the implications of how changes are implemented and asks that Congress set a two year review period for the proposed law to review its effectiveness. An over-correction in the administration of this vital program could drastically impact the availability of credit to this important and growing segment of the population.

Support FHA Multifamily and Healthcare Loan Programs

FHA is an essential source of the long-term, fixed-rate debt needed to build and refinance multifamily rental units for working families, seniors, and underserved populations as well as for affordable, good quality healthcare facilities. Not only do multifamily and healthcare loans perform well with low default rates, but the programs generate funds for the federal government in the form of negative credit subsidy. In recent years, FHA has restructured the business operations for multifamily and healthcare lending making them more efficient. Additionally, according to the FHA Annual Management Report for FY 2012 released by HUD on November 15, 2012, refinances accounted for 73 percent of the FY 2012 FHA multifamily originations, thus stabilizing multifamily housing resources.[23] When an FHA loan is refinanced, it further protects the HUD's GI/SRI Fund.

Recently, FHA notified Congress that it had exceeded 75 percent of its commitment authority available to insure mortgages under the GI/SRI Fund under the first Continuing Resolution. It expects to run out of commitment authority again, perhaps as soon as July. MBA supports the authorization of an additional $5 billion in FY 2013 commitment authority to FHA for multifamily and healthcare programs. Without the additional $5 billion in commitment authority, it is possible that these important programs will experience disruptions. The variety of loans in this program, originated by 89 active FHA lenders, with funding from investors, insured by FHA and securitized by Ginnie Mae, represent a significant, stable source of capital for properties that

[22] Mortgagee Letter 2013-01.
[23] Federal Housing Administration, FHA Annual Management Report, Fiscal Year 2012 (November 2012) at p. 29. Can be accessed at: http://portal.hud.gov/hudportal/documents/huddoc?id=FHAFY12AnnualMgmntRpt.pdf.

might not be served by other capital market sources.[24] FHA multifamily loans serve properties with Low Income Housing Tax Credits, properties receiving project based rental assistance contracts as well as housing for households earning 60 to 80 percent of average median income. FHA's longer term mortgages, unlike the 7 to 12 year terms available in the conventional market, are crucial for affordable multifamily housing properties. HUD's own economic analysis of its healthcare programs states that they provide significant economic stimulus during construction and afterwards with new healthcare jobs.

Finally, MBA recommends that Congress ask HUD for transparency in FHA data for multifamily and healthcare loans so that Congress and the public can readily access specific performance data on multifamily and healthcare loans in the GI/SRI fund. The result should be a better understanding of the financial success or risks in FHA multifamily and healthcare programs.

Potential Impact on FHA from other Regulatory Initiatives

Potential changes to FHA cannot be viewed in isolation. Over the last five years, following the mortgage crisis, a host of major rules are in the process of changing the face of mortgage finance. Many of these changes are welcome and overdue, while others are concerning. All will permeate the financial system and FHA. And as these changes come on line, their impacts must be carefully assessed through the prism of how they will serve consumers and the nation. Two major rules deserve particular attention.

<u>FHA Qualified Mortgage</u>

The Dodd-Frank Wall Street Reform and Consumer Protection Act required the Consumer Financial Protection Bureau (CFPB) to issue rules implementing the law's "Ability to Repay" provisions and to define a class of "qualified mortgages" (QM) that would receive some degree of legal protection in the event of undue litigation concerning the origination of the loan. The law further authorizes HUD, the U.S. Department of Veterans Affairs, and the U.S. Department of Agriculture, in consultation with the CFPB, to prescribe rules defining types of loans they insure, guarantee or administer that are QM loans, which may revise, add to, or subtract from the CFPB's definition. FHA loans comprise approximately 30 percent of today's mortgage market. For several reasons, MBA has strongly urged the CFPB to eliminate the distinction between FHA QM safe harbor and FHA QM rebuttable presumption loans or at least raise the APR threshold to more realistically define FHA QM safe harbor loans considering the inclusion of the MIP in the APR for FHA loans.

The CFPB's final rule makes clear that the bifurcation between QM safe harbor loans and QM rebuttable presumption loans is intended to provide greater recourse to subprime borrowers. FHA loans, however, are not "subprime." They are subject to government oversight and significant regulation. FHA loans are generally fixed-rate and adjustable loans are subject to extremely tight adjustment limits to protect borrowers. All loans must be fully-documented, meet minimum downpayment and other requirements, and loans with credit scores under 620 now must also meet DTI requirements. Given the parameters of the FHA program and its regulation of all aspects of the process, MBA believes its borrowers are already well protected. Establishing a cutoff for FHA safe harbor loans will only add regulatory burden without providing any offsetting benefit.

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[24] *Ibid* at p. 27.

MBA strongly believes that for the foreseeable future lenders will be extremely wary of originating loans that fall outside of the QM safe harbor. Consequently, if the APR threshold is not at least expanded, the availability of FHA credit for underserved populations – first-time, minority, and low- and moderate-income borrowers – may be unduly limited, jeopardizing FHA's ability to fulfill its important role.

Qualified Residential Mortgage

Another outstanding issue that will have a profound impact on FHA is the proposed risk retention rule. The Dodd-Frank Wall Street Reform and Consumer Protection Act require mortgage securitizers to retain five percent of the credit risk unless the mortgage is a Qualified Residential Mortgage (QRM). The proposed rule issued by six federal regulators nearly 20 months ago would require families to make a 20 percent downpayment and meet relatively low DTI and other stringent requirements. It is not at all clear from the proposal whether the regulators reflected on the relationship between the proposed QRM definition and the FHA's eligibility requirements in light of FHA's statutory exemption from risk retention. The proposed QRM definition appears to conflict directly with the Administration's plan for reforming the housing finance system because it would make it far more difficult for private capital to re-enter the housing finance market. In its white paper, the administration made clear that it intends to shrink FHA from its current role of financing one-third of all mortgages, and one-half of all purchase mortgages.

MBA supports FHA's role as a source of financing for first-time homebuyers and other underserved groups. However, because of the wide disparity between FHA's downpayment requirement of 3.5 percent and the QRM requirement of 20 percent, MBA believes the proposed risk retention rule would force over-utilization of FHA and other government programs. While FHA should continue to play a critical role in our housing finance system, MBA firmly believes that it is not in the public interest for a government insurance program like FHA to dominate the market, especially if private capital is ready and willing to provide reasonable financing for the same borrowers.

Ginnie Mae

Ginnie Mae has played a significant role in helping to stabilize the housing market. Since the 2008 crisis, Ginnie Mae has provided $1.7 trillion in liquidity, directly providing housing opportunities for 7.1 million households.[25] Ginnie Mae's full faith and credit guarantee attracts capital from all around the world, lowering interest rates for borrowers using government loan products.

During the last three years, Ginnie Mae has nearly doubled its staff, specifically enhancing its risk monitoring and customer management functions. Additionally, Ginnie Mae has taken many steps toward modernizing its technology and infrastructure and hired a senior manager in 2012 to lead these efforts. The new technology completely replaces legacy systems used for issuing, administering and disclosing on its securities.

[25] Government National Mortgage Association, Annual Report 2012 (November 2012) at pg. v. Can be accessed at: http://www.ginniemae.gov/inside_gnma/company_overview/budget_performance/Annual_Reports/annual_report12.pdf.

Despite these advancements, Ginnie Mae needs to make improvements that allow the agency to be as agile and responsive as private sector entities. Improving Ginnie Mae's ability to respond to an increasingly complex market and risk environment should be a top priority. To that end, MBA has long advocated that in order for Ginnie Mae to operate in its most efficient and effective manner, it must have greater ability to act as a private corporation.

Ginnie Mae faces challenges driven by the budget and appropriations process, where the timeline from request to action can be as long as two years. This timeframe makes it difficult for Ginnie Mae to appropriately respond to unanticipated market needs, and imposes operational difficulties on the organization.

Ginnie Mae should be given the flexibility and financial resources to hire the appropriate number of qualified staff for its current and future needs. Furthermore, Ginnie Mae should be given the ability to recruit and pay staff at a higher federal pay scale, on par with other "professional-grade" cabinet, regulatory, and independent agencies that require specialized expertise, such as the Federal Deposit Insurance Corporation (FDIC) or the U.S. Securities and Exchange Commission (SEC). Additionally, MBA recommends that Ginnie Mae have the ability to more broadly utilize retention allowances, recruitment bonuses, and superior qualifications appointments.

Finally, the strength of Ginnie Mae's guarantee is based on its ability to make timely payment of principal and interest to global investors. The requirements involved with the government procurement process inhibit Ginnie Mae's ability to rapidly and effectively respond to market changes such as the default of a large lender. Providing Ginnie Mae with flexibility regarding hiring and procurement would allow the agency to be more effective in responding to potentially significant risk events.

Conclusion

MBA believes that FHA plays a vital role in the nation's housing finance system, and that its mission of serving underserved populations should continue. It is the MBA's position that the recent changes announced by FHA are fiscally prudent and warranted given the financial realities described in the Actuarial Review of FHA's MMI Fund for Fiscal Year 2012. As Congress examines the need for further FHA reform, its goal should be to balance FHA's risk mitigation with appropriate policies that allow responsible borrowers to have access to credit. If the pendulum swings too far in certain areas, such as lender enforcement, sustainable credit will be curtailed at a time when it is needed to support the housing market recovery.

MBA urges a balanced approach that will help FHA maintain its mission focus and remain fiscally sound over the long term. As that process continues, MBA looks forward to working with this subcommittee, others within the Congress, and the administration to help achieve this objective.