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DECISION

THE COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FILE: B-203904 **DATE:** March 30, 1982

MATTER OF: Insurance Reserve-Insured Loan Program of National Housing Act

DIGEST:

1. Regulation in 24 C.F.R. § 201.12(c) which provides that annual downward adjustments in a lender's loss reserve account, out of which all insured loan claims are paid, should begin 5 years after an insurance contract is issued to the lender is based on assumption that during initial 5-year period the lender will be actively engaged in making title I insured loans. Since the insurance reserve does not even come into existence until the insured lender actually begins to make loans and report them to HUD for insurance, HUD should not interpret the regulations as requiring adjustments in the reserve of a lender to commence until 5 years after the lender begins to make insured loans.

2. Even if regulation in 24 C.F.R. § 201.12(c) is interpreted as requiring the annual adjustments in a lender's loss reserve account to commence 5 years after the contract of insurance is approved, whether or not the lender has actually been making insured loans during that period, HUD is authorized under 12 U.S.C. § 1703(e) to waive that regulatory provision where, as here, such an interpretation would be unfair to a lender that has substantially complied with the regulations in good faith.

This decision is in response to a request from the Assistant Secretary for Housing, Department of Housing and Urban Development (HUD), for our legal opinion on the proper interpretation of a provision in HUD's Title I insured loan regulations. If the regulations are read to require an annual adjustment to be made in a lending institution's total insurance reserve 5 years from the date it entered into a contract of insurance with HUD rather than 5 years from the date it began to make insured loans, it would result in an injustice to one of the major participants in the Title I insured loan program, the General Electric Credit Corporation (GECC). As explained below, GAO has no objection to the latter interpretation which would give GECC a grace period of 5 years from the time it began to make insured loans before the annual reductions to its insurance reserve commence.

Under section 2(a) of the National Housing Act, 12 U.S.C. § 1703, the Secretary of HUD is authorized to insure property improvement and mobile home loans made by participating lending institutions. The statute limits HUD's liability on a particular loan to a maximum of 90 percent of the loss suffered by the lender. The statute also provides as follows:

> "* * *In no case shall the insurance granted by the Secretary under this section to any such financial institution on loans, advances of credit, and purchases made by such financial institution for such purposes on and after July 1, 1939, exceed 10 per centum of the total amount of such loans, advances of credit, and purchases * * *."

The effect of this statutory provision is to limit the Government's liability to a particular lender to a maximum of 10 percent of the total outstanding balance of all loans made by that lender which qualified for Federal insurance under the program.

In order to implement this 10 percent statutory limitation, HUD has adopted a regulation set forth at 24 C.F.R. § 201.12 which provides as follows:

> "(a) Legal limit. Subject to the limitation on the Commissioner's authority to insure as stipulated in section 2 of Title I of the Act, the Commissioner, pursuant to the provisions of § 201.11, will reimburse any insured for losses sustained by it in accordance with the general insurance reserve provisions of paragraph (b) of this section.
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> "(b) There shall be maintained for each insured a general insurance reserve which shall equal 10 percent of the aggregate amount advanced on all eligible loans originated by such insured pursuant to the provisions of the regulations * * * less the amount of all claims approved for payment in connection with such loans and less the amount of any adjustment made pursuant to paragraph (c) of this section.
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> "(c) Adjustment of general reserve. The amount of the general insurance reserve to the credit of each insured shall be adjusted on October 1 of each year by deducting therefrom an amount equivalent to 10 percent of the amount of such insurance reserve

> on the records of the Commissioner as of the date of such adjustment: Provided, That no such adjustment shall reduce the insurance reserve of any insured to an amount less that $15,000: However, no such adjustment shall be made in the insurance reserve of any financial institution until the first day of October next following the expiration of a period of 60 months after the issuance of a contract of insurance to such institution by the Commissioner. * * *" (Emphasis added.)

This regulation is designed to maintain each lender's insurance reserve, known as a "loss reserve account", out of which all claims are paid, at 10 percent of its outstanding insured loan balance, less claims approved for payment. See 55 Comp. Gen. 658 (1976), as modified by 56 Comp. Gen. 279 (1977). The 10 percent annual adjustment mandated by subsection (c) of the regulations is necessary because the insurance reserve is not reduced as individual loans are paid off, either in accordance with the loan schedule or as a result of prepayment by the borrower. As the Assistant Secretary points out, without some type of mechanism such as the annual adjustment procedure, "a lender's reserve could grow out of proportion", resulting in claims being paid by HUD in excess of the 10 percent statutory limitation. The regulations also provide that the first 10 percent annual adjustment to the insurance reserve shall not be made until 5 years "after the issuance of a conract of insurance to such institution."

As explained in the submission, in 1972 the GECC entered into a contract of insurance with HUD, authorizing it to make insured loans. However, for various reasons, GECC did not elect to begin its active participation in the program until 1977. Consequently, GECC's reserve account was adjusted downward by 10 percent in its first year of actual participation in the insured loan program and in every year since then. The total of all of these annual adjustments during the 5-year period from 1977 through 1982 will amount to several million dollars.

The specific question raised by the Assistant Secretary in his letter to us is whether the waiver authority granted HUD in section 2(b) of the National Housing Act, 12 U.S.C. § 1703(e) might give HUD a basis for relieving GECC from the "injustice" that would otherwise be imposed on it by a literal interpretation of the regulation. Presumably, such a waiver, if granted would restore to GECC's loss reserve account the total of all of the annual downward adjustments made since 1977 and would further provide that future adjustments in its reserve account should not be made until 1982—5 years after GECC actually began to make insured loans.

For the reasons set forth below, we would have no objection if HUD restores the monies in question to GECC's loss reserve account, waiting until 1982 before initiating the annual adjustment process.

In our view, it is not even necessary for the Secretary to exercise his waiver authority under 17 U.S.C. § 1703(e) in order to achieve the result HUD desires. Although the literal language in 24 C.F.R. § 201.12(c) might be subject to a different interpretation, we believe that this regulation was clearly intended to grant a participating lender a 5-year grace period from the date on which it actually begins to make insured loans before the annual downward adjustments of the insurance reserve must commence. Until that time, no insurance reserve can possibly exist, since subsection (b) of section 201.12 of the regulations defines "general insurance reserve" as "10 percent of the aggregate amount advanced on all eligible loans originated by such insured * * *." It is not logical to require the downward adjustment process to begin whether or not there are any funds in the reserve to adjust. Accordingly, we believe that under the circumstances involved here, the regulation in question can and should be interpreted so as not to require the 10 percent annual adjustment to be made in a lender's loss reserve account until 5 years after the lender actually begins to make insured loans and report them to HUD.

Consideration of the underlying rationale behind the annual adjustment process and the 5-year grace period provided for in the regulations further supports our interpretation. The apparent justification of providing for a 5-year grace period before beginning the annual downward adjustments is the fact that in any long term loan interest payments are heavily front loaded with relatively little reduction of the principal in the initial years of loan repayment. Therefore, since the purpose of the regulatory provision providing for a 10 percent annual reduction in a lender's insurance reserve is to maintain the reserve at 10 percent of the lender's outstanding insured loan balance as loans are paid off, in accordance with the 10 percent limitation on HUD's maximum liability imposed by 12 U.S.C. § 1703, HUD adopted this delay in beginning the annual adjustment process so that a lender's insurance reserve could not decline at a faster rate than the lender's outstanding loan balance. In this respect, we note that in 1972 when the grace period was increased from 3 to 5 years and the amount of the annual adjustment was lowered from 15 to 10 percent, HUD explained that the changes were necessary because of the longer maturity of new Title I loans. See 37 Fed. Reg. 10665, May 26, 1972.

It is clear that the establishment of a 5-year grace period before the annual 10 percent downward adjustments commence is premised on the assumption that during that period, the lender will be actively engaged in making Title I insured loans. As a result, during this initial 5-year period, the insurance reserve of the lender will continue to increase in magnitude and no downward adjustments will be made. However, that did not happen in this case. Although GECC entered into a contract of insurance with HUD in 1972, it did not report any loans to HUD for insurance until 1977 when it began to actively participate in the program. Until that time, its insurance reserve was nonexistent. Interpreting the regulations so as to require the 5-year grace period to begin to run once the contract of insurance is issued would, in our view, frustrate the intended purpose of the regulation where, as here, no insured loans were made by a lender during that period.

In analogous situations involving questions of statutory interpretation, our Office and the courts have recognized that when giving effect to the plain meaning of the words in the statute leads to an absurd or unreasonable result, clearly at variance with the policy of the legislation as a whole, the purpose of the statute rather than its literal words will be followed. See 50 Comp. Gen. 604, 605 (1971) and cases cited therein. In light of the even greater discretion generally accorded agencies in the interpretation of their own regulations, a strong argument can be made to support HUD's interpretation of 24 C.F.R. § 201.12(c) in a manner that would allow the 5-year grace period to begin from the date on which a lender actually began to make insured loans and report them to HUD. We believe that this interpretation would accomplish the inherent purpose of the regulation and would be consistent with the 10 percent statutory limitation.

Even if we concluded that the regulation in question was not amenable to the foregoing interpretation, it is our view that the same result could be reached pursuant to the waiver authority granted the Secretary of HUD in the National Housing Act. In this regard, 12 U.S.C. § 1703(e), provides as follows:

> "The Secretary is authorized to waive compliance with regulations heretofore or hereafter prescribed by him with respect to the interest and maturity of and the terms, conditions, and restrictions under which loans, advances of credit, and purchases may be insured under this section * * *, if in his judgment the enforcement of such regulations would impose an injustice upon an insured institution which has

> substantially complied with such regulations in good faith and refunded or credited any excess charge made, and where such waiver does not involve an increase of the obligation of the Secretary beyond the obligation which would have been involved if the regulations had been fully complied with."

As noted by HUD in its submission, historically, this authority has only been used when a particular claim involving a regulatory violation was submitted for insurance benefits. However, the statutory language granting the Secretary of HUD authority to waive its regulations is quite broad. We do not believe it would be unreasonable to conclude that the Secretary's authority to waive any regulation in connection with the "terms, conditions, and restrictions under which loans * * * may be insured under this section * * *" includes the provision in 24 C.F.R. § 201.12 which governs the basic question of how much money is available to pay claims on any insured loan.

The other necessary statutory requirements that must be satisfied before a waiver can be granted appear to be present here as well. As stated in the submission, GECC's record as an insured lender has been excellent. In its first 3 years of loan activity GECC has been paid only $337.957 in insurance benefits for a loan loss ratio of .2 percent compared to an average of 1.8 percent of all other Title I mobile home lenders. Considering GECC's loan record, we believe that failure to relieve it from the effects of an overly restrictive interpretation of the regulations would "impose an injustice upon an insured institution which has substantially complied with such regulations in good faith." Moreover, a waiver would not increase HUD's liability beyond that which it would have had if the regulations had been fully complied with since the waiver would merely allow the lender to receive the full benefits of the 5-year grace period enjoyed by all other lenders under the regulations.

In accordance with the foregoing, we would have no objection if HUD restores the monies already deducted from GECC's loss reserve account and, before commencing the annual adjustment process, grants GECC a grace period of 5 years from the date on which it actually began to participate in the program by making Title I loans and reporting them to HUD for insurance.

for Milton J. Socolar

Comptroller General
of the United States