

GAO Highlights

Highlights of [GAO-18-92](#), a report to congressional requesters

Why GAO Did This Study

FHA insures private lenders against losses from defaults on single-family mortgages. According to independent actuarial reviews, in fiscal years 2009–2014, FHA's MMI Fund (which insures \$1.2 trillion in single-family traditional and reverse mortgages) did not meet its statutory 2 percent capital requirement. Also, a budgetary review determined that the fund required \$1.69 billion in supplemental funds in fiscal year 2013.

GAO was asked to examine issues concerning the MMI Fund's capital requirement and actuarial reviews. This report examines the types of information provided by assessments of the fund's financial condition, FHA's capital requirement and stress testing practices, and trade-offs associated with including reverse mortgages in the fund's capital assessment.

GAO analyzed actuarial and budgetary assessments of the MMI Fund. GAO reviewed financial institution and regulatory capital and stress testing principles to develop an evaluative framework and applied it to FHA. GAO also interviewed federal and mortgage industry officials.

What GAO Recommends

Congress should consider specifying the economic conditions the MMI Fund would be expected to withstand without supplemental funds, and FHA should conduct stress tests on a fund-wide basis and specify the objectives of its stress tests. GAO also continues to maintain that Congress should incorporate accountability mechanisms into FHA's capital requirement (as stated in [GAO-13-722](#)). FHA agreed with GAO's recommendations.

View [GAO-18-92](#). For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov.

November 2017

FEDERAL HOUSING ADMINISTRATION

Capital Requirements and Stress Testing Practices Need Strengthening

What GAO Found

The Federal Housing Administration's (FHA) budgetary reviews of the Mutual Mortgage Insurance Fund (MMI Fund) assess whether it needs more budget authority to cover expected future costs, and independent actuarial reviews provide complementary information on the fund's finances. FHA uses the actuarial reviews to assess whether the MMI Fund's capital ratio (economic value divided by insurance obligations) meets the 2 percent requirement and how fund components would perform under alternative economic scenarios. While the actuarial assessment does not directly determine the need for additional budget authority, it evaluates the fund's ability to absorb unexpected losses and may prompt changes in FHA policies and insurance premiums.

Capital requirements and stress testing practices—tools for managing financial risks—for the MMI Fund are not consistent with all elements of a framework GAO developed to help assess these tools in the context of FHA's single-family mortgage insurance programs. In accordance with the framework, FHA's capital assessments and stress tests are transparent and incorporate a number of relevant risk factors. However, areas of inconsistency include the following:

- **Scenario-based requirement.** The statutory capital requirement is intended to help ensure the fund can absorb unexpected losses but is not based on a specified risk threshold, such as an adverse economic scenario the fund would be expected to withstand without requiring supplemental funds.
- **Accountability mechanisms.** The capital requirement also does not include accountability mechanisms, such as a set of steps FHA would have to take if the capital ratio again fell below the 2 percent minimum.
- **Fund-wide stress tests.** FHA has conducted separate stress tests—projections of financial condition under adverse scenarios—of its forward (traditional) and reverse mortgage (loans against home equity available to seniors) portfolios, but has not performed tests on a fund-wide basis.
- **Stress test objectives.** FHA has not defined specific objectives for its stress tests such as determining the amount of additional capital, if any, that would be needed to withstand conditions similar to the last housing crisis.

Strengthening FHA's capital requirement and stress testing practices could help ensure that the MMI Fund is able to withstand economic downturns and that stress test results are as relevant and useful as possible for risk management.

Including reverse mortgages in the fund's capital assessment has advantages and disadvantages. Unlike for stress tests, FHA jointly assesses forward and reverse mortgages to calculate a combined capital ratio. Subjecting the reverse mortgage portfolio to capital assessment has made its financial condition more transparent. But, the portfolio's sensitivity to changes in economic assumptions makes the combined ratio more unpredictable. Alternative approaches also pose trade-offs. For example, a separate reverse mortgage capital requirement may help ensure the financial transparency of both portfolios, but requiring FHA to hold more capital to account for the volatility of the reverse mortgage portfolio could compel FHA to raise insurance premiums or lower borrowing limits.