

GAO

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FEDERAL HOUSING ADMINISTRATION

Risks to the Mutual Mortgage Insurance Fund and the Agency's Operations

Statement of Mathew J. Scirè, Director
Financial Markets and Community Investment

U.S. Government Accountability Office

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Highlights of [GAO-12-277T](#), a testimony before the Committee on Financial Services, House of Representatives

Why GAO Did This Study

The Federal Housing Administration (FHA) has helped millions purchase homes by insuring private lenders against losses from defaults on single-family mortgages. In recent years, FHA has experienced a dramatic increase in its market role due, in part, to the contraction of other mortgage market segments. The increased reliance on FHA mortgage insurance highlights the need for FHA to ensure that it has the proper controls in place to minimize financial risks while meeting the housing needs of borrowers.

This statement discusses (1) changes in the financial condition of FHA's fund used to insure mortgages—the Mutual Mortgage Insurance Fund (Fund)—and the budgetary implications of these changes; (2) how FHA evaluates the financial condition of the Fund; and (3) steps FHA has taken to assess and manage risks.

This statement is drawn from a recent report on FHA's oversight capacity (GAO-12-15) as well as a report issued in September 2010 on the financial condition of the Fund (GAO-10-827R). GAO also obtained updated information on the status of the Fund from the recently issued actuarial report on the Fund.

What GAO Recommends

GAO previously made recommendations on modeling the Fund's financial condition, risk assessments, and human capital. FHA agreed with these recommendations and told GAO they have efforts underway to implement them.

View [GAO-12-277T](#). For more information, contact Mathew J. Scire at (202) 512-8678 or sciremj@gao.gov.

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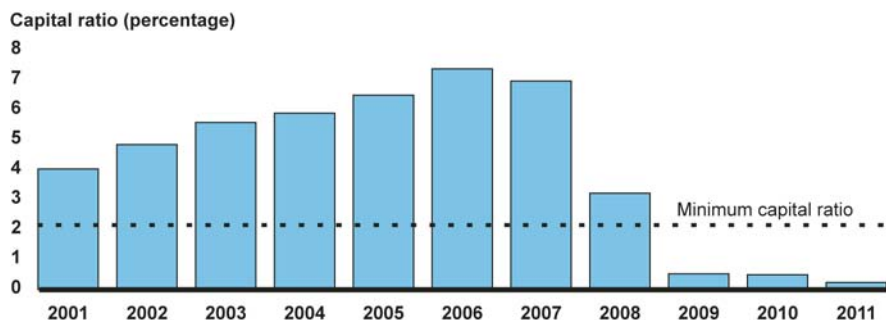
What GAO Found

For the third consecutive year, FHA reported that the Fund's capital ratio (the ratio of economic value to insurance-in-force) has not met the 2 percent statutory minimum (see below). FHA cites declines in the Fund's economic value due to higher-than-expected defaults, claims, and losses. At the same time, the other component of the ratio, FHA's insurance-in-force, has grown rapidly. The Fund's condition also worsened from a budgetary perspective, with balances in the Fund's capital reserve account reaching new lows. If the account were depleted, FHA would require more funds to help cover costs on insurance issued to date.

FHA enhanced methods for assessing the Fund's financial condition but has not yet addressed GAO's 2010 recommendation for improving the reliability of its estimates. It relies on a single economic forecast, which does not fully account for variability in future house prices and interest rates. An approach that would simulate hundreds of economic paths for house prices and interest rates would improve the reliability of its capital ratio estimates.

FHA has taken or plans a number of steps to better assess and manage risk. It created a risk office in 2010 and hired a consultant to recommend best practices. FHA plans to charter committees to evaluate risks at enterprise-wide and programmatic levels. It began a quality control initiative in the Office of Single Family Housing, in which program and field offices assess and report on risks. FHA also enhanced lender and appraiser reviews. While FHA's consultant recommended integrating risk assessments, the quality control and risk office activities currently remain separate efforts. Also, the Office of Single Family Housing has not annually updated assessments since 2009 as required. Without integrated and updated risk assessments that identify emerging risks, FHA lacks assurance it has identified all its risks. Further, human capital presents challenges. FHA has not created a systematic workforce plan to identify critical skills and skill gaps. Such a plan will be needed because high percentages of staff are eligible to retire soon. Without a workforce planning process that includes succession planning, FHA's ability to systematically identify workforce needs is limited.

Estimate of the Fund's Capital Ratio, 2001-2011



Source: GAO analysis of FHA data.

Chairman Bachus, Ranking Member Frank, and Members of the Committee:

I am pleased to be here to participate in today's hearing on the financial condition of the Federal Housing Administration's (FHA) Mutual Mortgage Insurance Fund (Fund). As you know, FHA has helped millions of families purchase homes through its single-family mortgage insurance programs and insures almost all of its single-family mortgages under the Fund.

FHA reported in November 2011 that for the third consecutive year, the Fund was not meeting the statutory 2 percent capital reserve requirement, as measured by the Fund's estimated capital ratio—that is, the Fund's economic value divided by the insurance-in-force. Although the Fund historically has produced budgetary receipts for the federal government, a weakening in the performance of FHA-insured loans has heightened the possibility that FHA could require additional funds to help cover its costs on insurance issued to date. The increased reliance on FHA mortgage insurance highlights the need for FHA to ensure that it has the proper controls in place to minimize financial risks while meeting the housing needs of borrowers.

My statement today is based on a September 2010 report about FHA's financial condition and a report issued in November of this year about the agency's risk assessment and human capital management.¹ Specifically, I will discuss (1) how estimates of the Fund's capital ratio changed in recent years and the budgetary implications of changes in the Fund's financial condition, (2) how FHA and its actuarial review contractor evaluate the financial condition of the Fund, and (3) steps FHA has taken to manage and assess risks. I also will briefly discuss our report on the risks faced by the Government National Mortgage Association (Ginnie Mae), which was released today.²

To do this work, we analyzed actuarial reviews of the Fund and federal budget documents, and interviewed FHA officials, staff from FHA's

¹See GAO, *Mortgage Financing: Opportunities to Enhance Management and Oversight of FHA's Financial Condition*, [GAO-10-827R](#) (Washington, D.C.: Sept. 14, 2010) and GAO, *Federal Housing Administration: Improvements Needed in Risk Assessment and Human Capital Management*, [GAO-12-15](#) (Washington, D.C.: Nov. 7, 2011).

²GAO, *Ginnie Mae: Risk Management and Cost Modeling Require Continuing Attention*, [GAO-12-49](#) (Washington, D.C.: Nov. 14, 2011).

actuarial review contractor, and selected housing market researchers. We also analyzed data on FHA's business volume, market share, workload, and staff and contractor resources. We reviewed documentation on the proposed structure and functions of FHA's Office of Risk Management and Regulatory Affairs and the Office of Single Family Housing's internal quality control initiative. Finally, we reviewed changes to FHA guidance that address risks associated with lenders and appraisers and documentation related to workforce and succession planning. Our study of Ginnie Mae assessed operational risks and financial exposure. We reported on Ginnie Mae volume and market share, reviewed guidance and Ginnie Mae's credit subsidy calculations and estimation model, and interviewed agency officials and others. The reports include a detailed description of our scope and methodology.

The work on which this statement was based was performed from September 2009 to November 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Under the Federal Credit Reform Act of 1990 (FCRA), FHA and other federal agencies must estimate the net lifetime costs—known as credit subsidy costs—of their loan insurance or guarantee programs and include the costs to the government in their annual budgets. Credit subsidy costs represent the net present value of expected lifetime cash flows, excluding administrative costs.³ When estimated cash inflows exceed expected cash outflows, a program is said to have a negative credit subsidy rate and generates offsetting receipts that reduce the federal budget deficit. When the opposite is true, the program is said to have a positive credit subsidy rate—and therefore requires appropriations. Generally, agencies must produce annual updates of their subsidy estimates—reestimates—on the basis of information about actual performance and estimated changes in future loan performance. FCRA recognized the difficulty of

³For a mortgage insurance program, cash inflows consist primarily of fees and premiums charged to insured borrowers and proceeds from sales of foreclosed properties, and cash outflows consist mostly of payments to lenders to cover the cost of claims.

making credit subsidy estimates that mirrored actual loan performance and provides permanent and indefinite budget authority for reestimates that reflect increased program costs. Upward reestimates increase the federal budget deficit unless accompanied by reductions in other government spending or an increase in receipts.

The Omnibus Budget Reconciliation Act of 1990 required the Secretary of the Department of Housing and Urban Development (HUD) to take steps to ensure that the Fund attained a capital ratio of at least 2 percent by November 2000 and maintained at least a 2 percent ratio at all times thereafter.⁴ It also required an annual independent actuarial review of the economic net worth and soundness of the Fund. The annual actuarial review is now a requirement in the Housing and Economic Recovery Act of 2008, which also requires that the Secretary of HUD annually report to Congress on the results of the review.

Federal agencies face a number of risks. In the case of agencies with loan guarantee or insurance programs, they can face credit risks that include borrower default risk, which arises as borrowers become unable to make payments on insured mortgages. Agencies with these programs also face counterparty risk. That is, an agency may suffer losses due to weaknesses or uncertainties in the work of its counterparties—in this example, lenders and appraisers. And all agencies face operational risks, the risk of loss resulting from inadequate or failed internal processes or people (in terms of staff numbers, training, and skills), or external events. For this statement, we focus on operational risks related to FHA's staffing and contractor capacity to process increasing workloads.

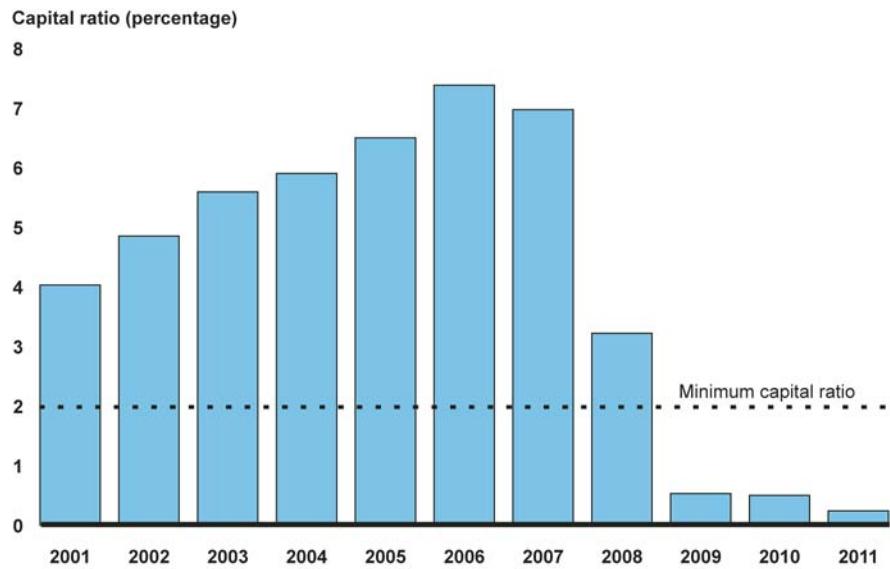
The Fund's Financial Condition Continues to Worsen, Increasing the Possibility That FHA Will Require Additional Funds

The Fund's capital ratio dropped sharply in 2008 and fell below the statutory minimum in 2009, when economic and market developments created conditions that simultaneously reduced the Fund's economic value (the numerator of the ratio) and increased the insurance-in-force (the denominator of the ratio).⁵ According to annual actuarial reviews of the Fund, the capital ratio fell from about 7 percent in 2006 to 3 percent in 2008 and 0.5 percent in 2009 (see fig. 1). For 2010 and 2011, the ratios were 0.5 and 0.24 percent, respectively.

⁴Pub. L. No. 101-508.

⁵Unless otherwise stated, the years shown in this testimony are fiscal years.

Figure 1: Estimates of the Fund's Capital Ratio, 2001–2011



Source: GAO analysis of FHA data.

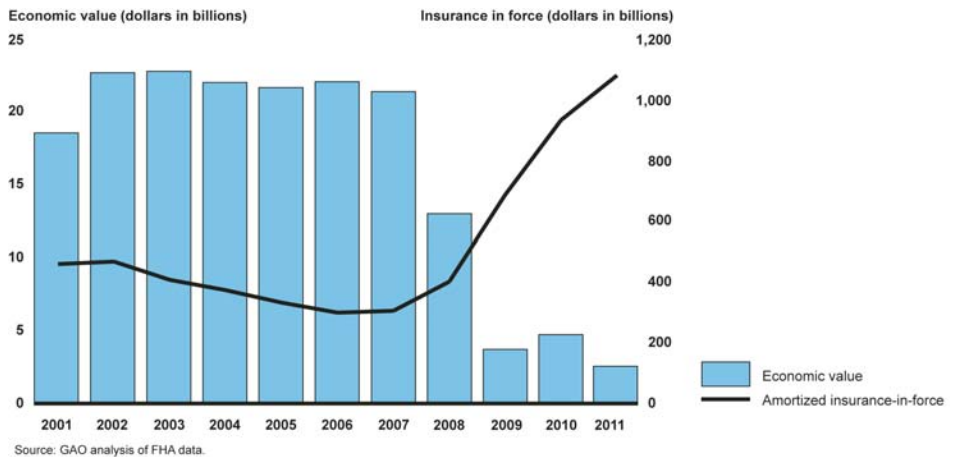
In its recent report to Congress, HUD cited several reasons for the declines from 2010 to 2011. These included

- Continuing declines in home prices. Forecasts for the 2010 actuarial study predicted house price declines of 2.8 percent before bottoming in the middle of 2011. This year's forecasts—dated July 2011—predicted negative growth of 5.6 percent for FHA's single-family portfolio in 2011. Higher-than-expected declines in house values contributed to both higher defaults and claims and higher loss-on-claim than anticipated last year.
- More loans, particularly from the housing bubble years of 2006-2008 were in serious delinquency, and a significant percentage had been there for more than one year. Claims become the most likely outcome for extended delinquency loans, many of which are in foreclosure.
- For the first time, the actuarial calculations built in factors recognizing the elevated re-default potential from the increased number of active loans with a previous serious delinquency (3 months or more).

- The independent actuaries also made a decision to treat foreclosure actions likely affected by so called robo signing problems as expected claims in 2012.⁶

In reviewing the components of the capital ratio, the combination of a relatively stable economic value (numerator of the ratio) and a declining insurance-in-force (denominator) over much of the decade increased the capital ratio. However, since 2008, the economic value has fallen as the insurance-in-force has risen, dramatically lowering the capital ratio (see fig. 2).

Figure 2: Estimates of the Fund’s Economic Value and Insurance-in-force, 2001–2011



At the same time, the Fund’s condition has worsened from a budgetary perspective. Historically, FHA has estimated that its loan insurance program was a negative subsidy program (that is, estimated cash inflows exceeded expected cash outflows). On the basis of these estimates, FHA accumulated substantial balances in a budgetary account known as the capital reserve account, which holds reserves in excess of those needed for estimated credit subsidy costs and helps cover unanticipated

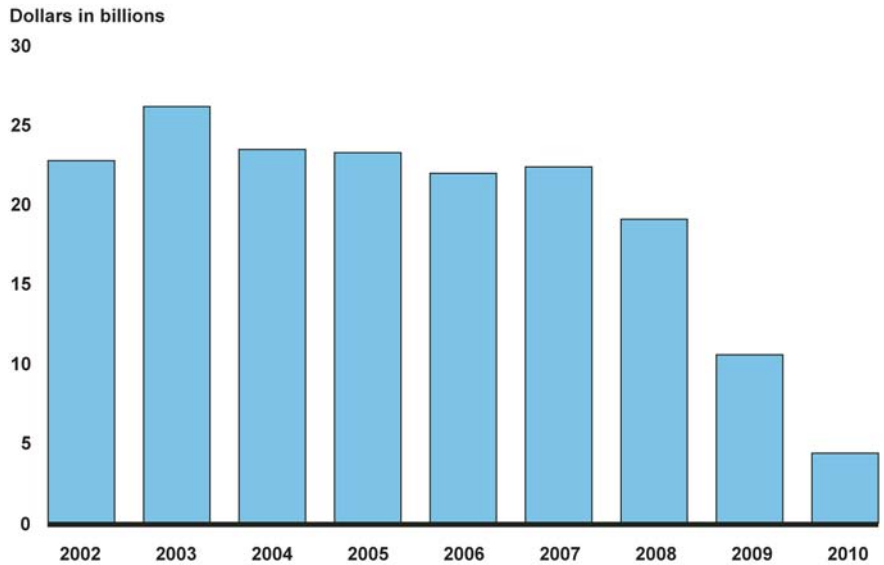
⁶Robosigning refers to mortgage servicers’ practice of having a small number of employees sign a large number of affidavits and other legal documents that mortgage companies subsequently submitted to courts and other public authorities to execute foreclosures. For more information, see GAO, *Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight*, [GAO-11-433](#) (Washington, D.C.: May 2, 2011).

increases in those costs such as higher-than-expected claims. Reserves needed to cover estimated subsidy costs are held in the Fund's financing account.⁷

However, in recent years the capital reserve account has covered large upward reestimates of FHA's credit subsidy costs through transfers to the financing account. As a result, balances in the capital reserve account fell dramatically—from \$22 billion at the end of 2007 to \$4.4 billion by the end of 2010 (see fig. 3). If the reserve account were to be depleted, FHA would need to draw on permanent and indefinite budget authority to cover additional increases in estimated credit subsidy costs. FHA's latest annual report to Congress raises the possibility that if house prices decline in 2012, the expected future losses on the current, outstanding portfolio could exceed current capital resources. These would be offset by the expected net receipts from the new 2012 cohort of loans. But, according to HUD, if house prices were to decline in 2012 by an amount rivaling that of 2011, these new loans would not be expected to generate sufficient net receipts to offset any potential decline in value of the current outstanding portfolio, which could necessitate assistance from the Department of the Treasury (Treasury). Under one stress scenario in which house prices decline by 13.7 percent in 2011, rather than the 5.6 percent assumed in the baseline scenario, and house prices decline another 1.3 percent in 2012, HUD estimates that it may require \$13 billion in assistance from Treasury to ensure the financing account had sufficient loss reserves.

⁷The financing account records lifetime cash flows for loans insured in 1992 and thereafter. It appears in the budget for informational and analytical purposes but is not included in the budget totals or budget authority or outlays.

Figure 3: End-of-Year Balances in the Fund's Capital Reserve Account, 2002–2010



Source: GAO analysis of federal budget data.

FHA's Current Methodology for Assessing the Fund's Condition Does Not Fully Account for Future Economic Volatility

As we reported in September 2010, FHA and its actuarial review contractor enhanced their methods for assessing the Fund's financial condition but still were addressing other methodological issues that could affect the reliability of estimates of the capital ratio. Annual actuarial reviews of the Fund use statistical models to estimate the probability that loans will prepay or result in insurance claims on the basis of certain loan and borrower characteristics (such as loan-to-value ratios and borrower credit scores) and key economic variables (such as house prices and interest rates).⁸ FHA and its contractor have enhanced these models in recent years, by incorporating additional variables related to loan performance and developed an additional model to predict loss rates on insurance claims. Also, consistent with recommendations we made in a prior report, in 2003 the actuarial reviews began to analyze the impact of

⁸The loan-to-value ratio is the ratio of the amount of the mortgage loan to the value of the home.

more pessimistic economic scenarios—for example, nationwide declines in home prices—than they did previously.⁹

However, the current methodology is significantly limited by its reliance on a single economic forecast to produce the estimate of the capital ratio that is used to determine if the Fund is meeting the 2 percent capital reserve requirement. This approach does not fully account for the variability in future house prices and interest rates that the Fund may face. As a result, baseline estimates of the capital ratio may tend to underestimate insurance claims and mortgage prepayments and therefore may tend to overestimate the Fund's economic value. In a November 2003 report, the Congressional Budget Office concluded that FHA could project the Fund's cash flows more accurately by using an approach (stochastic modeling) that involves running simulations of hundreds of different economic paths to produce a distribution of capital ratio estimates.¹⁰

Given the uncertainty that always surrounds estimates of future economic activity, the report we issued last year recommended that HUD require the actuarial review contractor to use stochastic simulation of future economic conditions, including house prices and interest rates, to estimate the Fund's capital ratio and include the results of this analysis in FHA's annual report to Congress on the financial status of the Fund. However, the most recent annual report does not include an estimate of the Fund's capital ratio using this technique. In response to our 2010 report, FHA officials told us that they were planning to require the actuarial review contractor to use a stochastic simulation model for the 2011 actuarial review. But, these officials said that the model would be used to examine the implications of extreme economic scenarios on the Fund and decisions about using the model to estimate the Fund's capital ratio had not been made.

⁹GAO, *Mortgage Financing: FHA's Fund Has Grown, but Options for Drawing on the Fund Have Uncertain Outcomes*, [GAO-01-460](#) (Washington, D.C.: Feb. 28, 2001).

¹⁰Congressional Budget Office, *Subsidy Estimates for FHA Mortgage Guarantees*, a CBO paper (Washington, D.C.: November 2003).

FHA Has Taken Steps to Address Risks, but Has Yet to Implement a Comprehensive Risk-Assessment Strategy

FHA faces risks resulting from its operations. FHA's loan volume grew significantly from 2006 to 2010. In 2006, FHA insured almost half a million loans, totaling \$70 billion in mortgage insurance. By 2010, it insured 1.7 million loans, or about \$319 billion in mortgage insurance. During the same time period, FHA's single-family staff increased 8 percent, from 932 employees in 2006 to 1,011 employees in 2010, while increases in key workload areas often surpassed 100 percent:

- Staff in the homeownership centers' Processing and Underwriting Division grew at a slower rate (22 percent) than key workload items, particularly volume-driven loan reviews (which increased by more than 100 percent).
- Increases in contractor staff and workload related to management of foreclosed or real estate-owned properties were substantial, but noncontractor staff levels increased at more modest levels.
- Loss mitigation actions more than doubled from 2006 to 2010, while loss mitigation staff levels remained relatively constant.¹¹

Although FHA Worked to Address Credit and Operational Risk, It Has Not Yet Put a Comprehensive Strategy in Place

Although FHA has taken steps to assess credit and operational risks facing its single-family insurance programs, its current risk-assessment strategy is not comprehensive because it is not integrated across the agency and lacks annual assessments and mechanisms to anticipate changing conditions. To address credit risk and help improve the financial condition of the Fund (which is supported by borrower premiums), FHA raised premiums and made or proposed policy or underwriting changes. For example, in April 2011 FHA increased its annual insurance premiums from 0.85 percent to 1.10 percent for borrowers with 30-year loans with initial loan-to-value ratios of 95 percent or less and from 0.90 percent to 1.15 percent for borrowers with 30-year loans with initial loan-to-value ratios greater than 95 percent. Additionally, FHA increased down-payment requirements for borrowers with lower credit scores. FHA also has proposed reducing allowable seller contributions at closing, thereby helping to ensure that buyers put more of their own funds into the home purchase. In addition, FHA is in the process of revising its mortgage scorecard algorithm, to recognize the effect of various risk elements not

¹¹Loss mitigation actions seek to minimize losses from potential foreclosures by finding alternatives to foreclosure and helping homeowners retain their homes, if possible.

currently discerned by the scorecard and determine what cases warrant manual underwriting.¹² According to FHA, these revisions are in the early stages, and no completion date has been set.

To address operational risks and improve its risk-assessment strategy, in 2010 FHA received congressional approval to establish the Office of Risk Management and Regulatory Affairs and create the position of Deputy Assistant Secretary for Risk Management and Regulatory Affairs, which reports directly to the Assistant Secretary for Housing-FHA Commissioner. To provide assistance to the Office of Risk Management (one of the offices within the Office of Risk Management and Regulatory Affairs) in developing a risk-management strategy and organizational structure and establishing risk-management policies and processes, FHA hired a consultant to produce a comprehensive report and recommend best practices for its operation.¹³ According to FHA officials, FHA plans to adopt the consultant's recommendation to establish an enterprise risk committee to address overall risk to the organization and a second tier of committees to address program and operational risks. In addition, in 2009 the Office of Single Family Housing implemented an internal quality control initiative at headquarters and the four homeownership centers. For the areas identified as high-risk, headquarters and the homeownership center divisions developed plans to document control objectives and established a monitoring strategy in which each homeownership center submits quarterly reports to headquarters on the effectiveness of the controls, including the status of any mitigation efforts.

However, FHA's risk-assessment strategy raises several issues. First, FHA's current risk-assessment strategy is not comprehensive because it is not integrated throughout the organization. While the consultant recommended that FHA integrate risk assessment and reporting throughout the organization, currently Single Family Housing's quality control activities and the Office of Risk Management's activities remain separate efforts. FHA officials noted that until the Office of Risk Management set up a governance process, the integration suggested by

¹²The purpose of the algorithm is to objectively measure the borrower's risk of default quickly and efficiently by examining the data the borrower provides on the loan application and the borrower's credit score.

¹³McKinsey & Company, *Building the ORM Organization, Close-out Materials*, a report prepared at the request of the Department of Housing and Urban Development, December 2010.

the consultant would not be possible. In the meantime, they stated that every effort was being made to help ensure that the Office of Risk Management's activities complemented program office activities. Second, contrary to HUD guidance, Single Family Housing has not conducted an annual, systematic review of risks to its program and administrative functions. According to an official in the Office of Single Family Housing, although management intended to conduct an annual assessment, the dates slipped because of changes in senior leadership in Single Family Housing and few staff were available to perform assessments (because of attrition and increased workload). Finally, Single Family Housing's current risk-assessment efforts do not include procedures for anticipating potential risks presented by changing conditions. The consultant's report proposes a reporting process and templates for identifying emerging risks and provides specific examples. Office of Risk Management officials told us that once they are operational the risk committees eventually would determine the exact design and content of the reports and templates.

Moreover, implementation and integration of the new risk-assessment strategy and planned tools has been slow because of delays in defining the Office of Risk Management's authority, difficulty filling new staff positions in the Office of Risk Management, and changes in FHA leadership.

All these factors limit FHA's effectiveness in identifying, planning for, and addressing risk. More specifically, without an integrated risk-assessment strategy, certain risks may not be fully addressed at the operational level in a way that minimizes risk to the insurance programs; without annual reassessments of its risks, Single Family Housing lacks assurance that its quality control efforts address all its risks; and without ongoing mechanisms in place to anticipate and address new or emerging risks, FHA lacks a systematic approach to help the agency identify, analyze, and formulate timely plans to respond most effectively to changed conditions and risks. Therefore, we recommended that FHA (1) integrate the internal quality control initiative of the Office of Single Family Housing into the operational risk processes of the Office of Risk Management, (2) conduct an annual risk assessment, and (3) establish ongoing mechanisms—such as use of the report templates from the 2010 consultant's report—to anticipate and address risks that might be caused by changing conditions. FHA agreed with the recommendations and stated that it either was working toward achieving the recommendations or had plans to do so in the very near future. For example, FHA said it would leverage or integrate existing risk management efforts as soon as the Office of Risk Management's final governance structure and risk

management strategies were in place. The agency also stated that the Office of Risk Management would conduct an annual risk assessment as a component of its overall risk management strategy. It stressed that ongoing mechanisms to anticipate and address risks related to changing conditions would be part of the office's strategy.

FHA Has Taken Steps to Address Counterparty Risks, but Continues to Face Human Capital Challenges

With growth in loan volume, the number of lenders and appraisers (or counterparties) participating in FHA's single-family programs also has grown. The total number of FHA-approved lenders increased 24 percent, from 10,370 in 2006 to 12,844 in 2010. The number of FHA-approved appraisers increased approximately 67 percent from 33,553 in 2006 to 56,192 in 2010.

However, FHA has made recent changes to address risks posed by its lenders and appraisers. For example, on May 20, 2010, FHA stopped approving new loan correspondents.¹⁴ As of January 1, 2011, existing loan correspondents could no longer participate in FHA programs. Former loan correspondents now can participate only as third-party originators through sponsorship by FHA-approved lenders. As a result, as of September 2011, FHA had almost 3,700 approved lenders. Furthermore, the agency has increased the net worth requirement for approved lenders. On May 20, 2011, FHA increased the requirement for existing lenders to \$1 million, except for lenders classified as small under the Small Business Administration's size standards (their requirement increased to \$500,000). As of May 20, 2013, FHA will require a net worth of \$1 million for all lenders, plus 1 percent of the total loan volume in excess of \$25 million, to a maximum required net worth of \$2.5 million.¹⁵ To help ensure that lenders and appraisers follow its policies and procedures, FHA also has enhanced the criteria used to select loans for technical reviews. Specifically, since May 3, 2010, the agency has considered high-risk loan or borrower characteristics, such as certain

¹⁴Loan correspondents were lenders that originated FHA-insured loans—meaning that they could accept mortgage applications, obtain employment verifications and credit histories on applicants, order appraisals, and perform other tasks that precede the loan underwriting process—but did not have direct endorsement authority. Direct endorsement authority is the authority to underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review.

¹⁵Loan volume is defined as FHA single-family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year.

types of refinanced loans and loans to borrowers with low credit scores. Additionally, FHA increased the number of risk factors used to target lenders for review. FHA also has revised its approach for overseeing appraisers.

FHA has addressed staffing and training needs and succession planning to some extent, but it lacks plans that strategically address future workforce needs, including replacing retiring staff. Although workforce planning practices used by leading organizations include defining critical skills and skill gaps, FHA's current approach does not have mechanisms for doing so. FHA previously had a multiyear workforce plan that identified the critical competencies; analyzed skills and competencies, including gaps; and proposed comprehensive strategies to address these gaps, but has not created another such plan.¹⁶ Instead, FHA has relied on occasional Resource Estimation and Allocation Process studies and annual managerial assessments of staffing and training needs.¹⁷

FHA also currently does not have a succession plan, although a HUD plan for 2006–2009 identified mission-critical positions, analyzed existing staff competencies, assessed the number of retirement-eligible employees, and determined the probability of near-term retirements.¹⁸ Succession planning is particularly important because almost 50 percent of Single Family Housing headquarters staff are eligible to retire in the next 3 years. The percentage of staff eligible to retire at the homeownership centers is even higher—63 percent.

While FHA has taken some steps to address succession planning, they have been limited. FHA implemented two initiatives focused on succession planning. The first, begun in 2010, was intended to help ensure that, at any given time, at least two additional supervisors, managers, or executives could perform the work of each supervisor, manager, or executive. However, this does not apply to staff positions

¹⁶Department of Housing and Urban Development, *Strategic Workforce Plan, FY04 to FY08, Office of Housing*, (Washington, D.C.: July 2004).

¹⁷Resource Estimation and Allocation Process studies establish a staffing baseline for budget formulation and execution, strategic planning, organizational and management analyses, and ongoing management of staff resources.

¹⁸Department of Housing and Urban Development, *Succession Management Plan, Fiscal Year 2006-2009*, (Washington, D.C.: September 2006).

beyond management. The second initiative also began in 2010. Its goal is to train and develop staff. Neither initiative assesses the number of retirement-eligible employees in critical positions as required by HUD guidance. According to FHA officials, as resources have dwindled, they have considered all their positions to be critical.

According to FHA officials, plans to update their workforce and succession plans were suspended. In 2007–2009, FHA had a workforce planning process designed to identify critical skill gaps and a strategy for addressing these gaps. According to the officials, HUD told FHA to stop this initiative in 2009 because HUD was going to implement a workforce planning process for the entire department. However, the effort never came to fruition because of funding shortages. Without a more comprehensive workforce planning process that includes succession planning, FHA's ability to systematically identify the workforce needed for the future and plan for upcoming retirements is limited. Therefore, we recommended that FHA develop workforce and succession plans for the Office of Single Family Housing. FHA agreed, stating that it would develop a formal workforce plan and had efforts underway to develop a succession plan.

Ginnie Mae's Risk Management and Cost Modeling Require Continuing Attention

We released a report today about Ginnie Mae, which has experienced a substantial increase in the volume of its business since 2007 as the volume of federally insured or guaranteed mortgages increased. Ginnie Mae is a wholly owned government corporation in HUD, which guarantees the timely payment of principal and interest on mortgage-backed securities (MBS) backed by pools of federally insured or guaranteed mortgage loans, such as FHA loans. As of 2010, Ginnie Mae guaranteed more than \$1 trillion in outstanding MBS composed primarily of FHA-insured mortgages. The growth in outstanding Ginnie Mae-guaranteed MBS resulted in an increased financial exposure for the federal government. Nonetheless, Ginnie Mae's revenues exceeded its costs, and it has accumulated a capital reserve of about \$14.6 billion.

Ginnie Mae has taken steps to better manage operational and counterparty risks and has several initiatives planned or underway. The operational risks the agency may face include limited staff, substantial reliance on contractors, and the need for modernized information systems. Ginnie Mae plans to increase its staff levels, complete a reorganization, and implement recommendations related to contracting. For Ginnie Mae, counterparty risk is the risk that issuers of Ginnie Mae MBS fail to provide investors with monthly principal and interest

payments. To manage its counterparty risk, Ginnie Mae has processes in place to oversee MBS issuers that include approval, monitoring, and enforcement and has revised its approval and monitoring procedures. For example, in 2010 Ginnie Mae increased the minimum net worth requirement for issuers of Ginnie Mae-guaranteed MBS to \$2.5 million. But, planned initiatives to enhance its risk-management processes for issuers, including its tracking and reporting systems, have not been fully implemented. It will be important for Ginnie Mae to complete its initiatives related to operational and counterparty risk as soon as practicable.

In developing inputs and procedures for the model used to forecast costs and revenues, Ginnie Mae did not consider certain practices identified in Federal Accounting Standards Advisory Board (FASAB) guidance for preparing cost estimates of federal credit programs. Ginnie Mae has not developed estimates based on the best available data, performed sensitivity analyses to determine which assumptions have the greatest impact on the model, or documented why it used management assumptions rather than available data. By not fully implementing practices in FASAB guidance that GAO believes represent sound internal controls for models, Ginnie Mae's model may not use critical data that could affect the agency's ability to provide well-informed budgetary cost estimates and financial statements. This may limit Ginnie Mae's ability to accurately report to Congress the extent to which its programs represent a financial exposure to the government.

We recommended that the Secretary of Housing and Urban Development direct Ginnie Mae to take steps to ensure its model more closely follows certain practices identified in Federal Accounting Standards Advisory Board guidance for estimating subsidy costs of credit programs. More specifically, Ginnie Mae should (1) assess and document that it is using the best available data in its model and most appropriate modeling approach, (2) conduct and document sensitivity analyses to determine which cash flow assumptions have the greatest impact on the model, (3) document how management assumptions are determined, such as those for issuer defaults and mortgage buyout rates, and (4) assess the extent to which management assumptions, such as those for issuer defaults and mortgage buyout rates, can be replaced with quantitative estimates. The President of Ginnie Mae wrote that Ginnie Mae is working towards implementing our recommendation for conducting sensitivity analyses relating to issuer risk and behavior, but neither agreed nor disagreed with our other specific recommendations. In addition, Ginnie Mae agreed with our observation about the importance of completing

ongoing and planned initiatives for enhancing its risk-management processes, as soon as practicable, to improve operations.

Mr. Chairman, Ranking Member Frank, and Members of the Committee, this concludes my prepared statement. I would be happy to respond to any questions that you may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this testimony, please contact Mathew J. Scire` Director, at 202-512-8678 or sciremj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Paige Smith (Assistant Director), Andy Pauline (Assistant Director), Steve Westley (Assistant Director), Dan Alspaugh, Nadine Garrick Raidbard, John McGrail, Marc Molino, Jos R. Pea, Beth Reed Fritts, Paul G. Revesz, and Barbara Roesmann.

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