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Good morning Chairman Arrington, Ranking Member O'Rourke, and other Members of the Subcommittee. Thank you for the opportunity to appear before you today to discuss the Department of Veterans Affairs (VA) Home Loan Guaranty Service, certain lenders' home loan churning practices, and the effects of those practices on Servicemembers and Veterans. I am accompanied by Mr. John Bell, Deputy Director, Loan Guaranty Service.

Overview

The mission of VA's Home Loan Guaranty Service is to maximize opportunities for Servicemembers and Veterans to obtain, retain, and adapt their homes by providing viable and fiscally responsible benefits in recognition of their service to our country.

We empower Servicemembers and Veterans with information and access to innovative, high-quality products and services, and we engage industry partners to make loans in an efficient and effective manner. Through our focus on Servicemembers and Veterans, the partnerships we have developed, and our continuous drive to innovate in areas of operations and performance, we have built a high-performing program that has provided guaranties for more than 23 million loans totaling in excess of $2 trillion over the last 70-plus years. Last fiscal year alone, VA guaranteed an all-time record of over 740,000 loans, totaling more than $189 billion. Of those loans, over 380,000 were purchase loans (an annual record for purchase loans), nearly 191,000 were interest rate reduction refinancing loans (IRRRL), and about 167,000 were cash-out refinancing loans. Over the past four fiscal years, the vast majority of VA-guaranteed loans have been purchase and cash-out refinance loans; not IRRRLs. VA's purchase loan volume has ranged from about 62 percent of all guaranteed loans in Fiscal Year (FY) 2014 to just over 51 percent last fiscal year. Cash-out loans have ranged from roughly 16 percent of guaranteed loans in FY 2014 to just shy of 23 percent last fiscal year. IRRRLs were roughly 21 percent of guaranteed loan volume in FY 2014 and roughly 26 percent last fiscal year. VA has provided more loan guaranties over the past 5 fiscal years (approximately 3.1 million) than it did in the 10 years prior (approximately 2.9 million).

The overwhelming majority of VA-guaranteed loans (upwards of 98 percent) are sold in the secondary mortgage market with a full faith and credit guaranty from the Government National Mortgage Association (GNMA or Ginnie Mae). GNMA's role in the secondary market provides the necessary liquidity of capital so that lenders can then fund additional mortgage loans (e.g., additional VA-guaranteed loans to Servicemembers and Veterans).

Program Success

The VA-guaranteed home loan benefit helps provide Servicemembers and Veterans with access to a low-cost mortgage option. VA-guaranteed loans require low or no down payment, require no private mortgage insurance, and often have lower interest rates than other products. According to industry data, interest rates for VA-guaranteed loans have been the lowest in the marketplace for over 2 years.

VA loans perform very well compared to other government loan programs and conventional loans. During the worst housing-market crash since the Great Depression, VA helped almost 700,000 Servicemembers, Veterans, and their families retain their homes or otherwise avoid foreclosure. Cumulatively, for the period between fiscal years 2009 and 2017, VA worked with private sector loan servicers to avoid foreclosure for over 80 percent of Servicemembers and/or Veteran borrowers who defaulted on their home loans. This equates to the government avoiding over $22 billion in foreclosure claim payments. Further, VA's foreclosure inventory rate (the percentage of loans in foreclosure) outperformed that of even prime loans during, and immediately following, the market crash.

VA's portfolio of about 2.9 million active home loans outperforms or is on-par with other loan types. According to the most recently available Mortgage Bankers Association National Delinquency Survey data (Q3 2017), VA's overall delinquency rate of 4.24 percent is just slightly higher than the 3.97 rate for Conventional loans. This compares favorably to the 9.4 percent delinquency rate for the Federal Housing Authority's (FHA) loan program. In terms of serious delinquencies and foreclosure inventory, VA outperforms all other loan types. According to the most recently available Mortgage Bankers Association National Delinquency Survey data (2017 third quarter), VA has the lowest foreclosure inventory rate in the industry: 0.95 percent compared to 1.15 percent for Conventional loans and 1.76 percent for FHA loans. VA also has the lowest seriously delinquent rate: 2.08 percent compared to 2.28 percent for Conventional loans and 3.86 percent for FHA loans. This means that of the over 2.9 million active VA loans, only 2.08 percent are 90-days or more past-due and less than one percent are in foreclosure.

Refinance Loan Program Overview

There are two types of VA refinance loans. The first, an IRRRL, is generally used by Servicemembers or Veterans to obtain a lower interest rate than the current rate the Servicemember or Veteran is paying on his or her existing home loan. IRRRLs are sometimes called streamlined refinances because they have fewer underwriting requirements than other types of refinance loans. The purpose of an IRRRL is to place a Servicemember or Veteran in a better financial position than he or she is in on an existing mortgage, typically by reducing the interest rate on the existing loan, which lowers the monthly mortgage payments. An IRRRL may also be used in order to (i) reduce the term of the loan, thereby reducing the total of payments on the loan, (ii) to convert an adjustable rate mortgage to a loan with a fixed interest rate, or (iii) to make energy efficient improvements to the home. A Servicemember or Veteran may not use an IRRRL to obtain cash for the equity he or she may have in the property securing the loan.

A second type of VA refinance loan is one in which a Servicemember or Veteran may also use the home loan benefit to refinance an existing loan or other lien (not necessarily a VA-guaranteed loan) and borrow against the value of the property that is the security for the existing loan. In other words, a Veteran may "pull cash" out of the home's equity using a "regular," non-IRRRL, refinancing loan.

Refinance Loan Challenges

While the overwhelming majority of lenders (more than 1,500) who originate IRRRLs are conducting business with Servicemembers and Veterans in a responsible manner, we have in recent months identified a very small number of lenders (arguably less than 10) that appear to regularly close loans in a manner inconsistent with the program's intent. Instead of offering loan products that provide a tangible benefit to borrowers, these lenders appear to be targeting Servicemembers and Veterans who have made less than six payments on their original loan.

The practice of refinancing a mortgage multiple times within short timeframes is called "serial refinancing" or "loan churning," and it may cause Servicemembers and Veterans to prolong debt repayment by adding more payments and interest to the new loan. Serial refinancing of VA-guaranteed loans may also strip equity, increase the principal balance, and increase the loan-to-value ratio, which potentially raises the risk of loan default. In addition, the unpredictability of when and how often these refinances take place is causing investors to be pessimistic about purchasing GNMA-backed loan pools, due to the perceived risk associated with buying debt that will be paid off in a shorter time frame than the investors anticipated at the time of pricing. This risk of prepayment affects pricing, which could cause lenders to offset the difference by charging higher interest rates for VA-guaranteed loans.

In order to entice Veterans to refinance their mortgages, a small number of lenders have also implemented aggressive and often misleading marketing practices, such as phone solicitations or frequently mailed print materials. It is concerning that such loans can have terms that may not be in the Servicemember's or Veteran's best financial interest.

Our colleagues at GNMA have frequently espoused in recent months that the impacts felt by investors in the secondary markets have been acute. Lenders who systematically engage in serial refinancing, or "churning," VA loans have focused almost exclusively on IRRRLs, which, unlike VA origination and cash-out loans, do not require underwriting or valuation determinations. These lenders have focused their efforts on targeting Servicemembers and Veterans who have VA-guaranteed loans precisely because IRRRLs are relatively inexpensive and quickly completed. It is important to note that although VA's overall loan volume has been historically high over the past four fiscal years, on average, IRRRLs have represented about only a third of VA's overall volume for FY 2015 and FY 2016. VA notes, however, that only a small number of lenders are systematically engaging in churning practices, and a relatively small number of Veterans have been affected. VA estimates that approximately 8,000 Veterans obtained two or more IRRRLs (or about 4 percent of the IRRRL volume) in FY 2016. That number declined significantly in FY 2017 to approximately 1,600 Veterans who obtained two or more IRRRLs (or about 0.8 percent of the IRRRL volume). .

VA Focus on Serial Refinancing

Even though the serial refinancing issue is not systemic to our overall portfolio, VA has over the past several years been very concerned about serial refinancing or "churning," in the IRRRL program. In fact, when VA published an Interim Final Rule (IFR) on May 9, 2014, implementing provisions of the Dodd-Frank Act, VA defined the types of VA loans that are "qualified mortgages," and addressed this very issue. Pursuant to the Ability-to-Repay provisions of the Truth in Lending Act, qualified mortgages have either safe harbor protection or the presumption that the borrower is able to repay a loan. In the IFR, VA established that in order for an IRRRL to be considered a safe harbor qualified mortgage, the loan being refinanced must meet certain seasoning and recoupment requirements to prevent serial refinancing and equity skimming.

VA believed that the IFR would eliminate the demand for loans that did not receive the safe harbor protections. In other words, VA intended for the market to use pricing differentials to deter churning practices. However, this did not occur. Despite VA's intention to prevent serial refinancing, some lenders ignored the seasoning and recoupment guidelines because VA would still guarantee the loan if other requirements were met. In response, VA has been evaluating program and industry data related to IRRRLs to ascertain the overall impact on the VA Home Loan Guaranty Program and to determine what policy changes could be made to curb serial refinancing.

While VA's focus has been on serial refinancing of IRRRLs, we realize that some lenders may be shifting their business models in response to current market conditions. Although credit underwriting and appraisal requirements provide guard against affordability and valuation concerns, VA has been examining VA and other industry data to ensure that our Regular/Cash-out refinance programs are also serving their intended purpose as loans that benefit our Veteran borrowers. There are multiple factors that VA believes will contribute to the reduction of serial refinancing practices. In addition to longer-term measures like regulatory action, VA has also focused attention on policy changes that can be implemented rather quickly. For example, VA has worked closely with GNMA to curb some serial refinancing practices. This effort resulted in the issuance of an October 2016 GNMA All Participants Memorandum (APM). The APM established a 6-month seasoning requirement for streamlined refinance loans, which includes IRRRLs, to be eligible for certain GNMA issuer pools. Since the GNMA policy became effective in February 2017, VA's overall IRRRL volume has declined from over 35,000 loans per month to approximately 8,000 loans per month. VA also saw a decline in the number of potential serial refinance actions between FY 2016 and FY 2017. As mentioned previously, VA estimates that the number of Veterans affected by serial refinances is much smaller than the overall IRRRL portfolio, declining from approximately 8,000 in fiscal year 2016 to approximately 1,600 in fiscal year 2017. In short, there was a significant decline in the number of multiple loans by the same Servicemember or Veteran for the same property in a given year.

In October 2017, VA and GNMA established a "Joint Ginnie Mae – VA Refinance Loan Task Force." As stated in the press release announcing the partnership, "The task force will focus on examining critical issues, important data and lender behaviors related to refinancing loans, and will determine what program and policy changes should be made by the agencies to ensure these loans do not pose an undue risk or burden to Veterans or the American taxpayer." On December 7, 2017, the taskforce issued a GNMA APM, which established a 6-month seasoning requirement for streamlined and cash-out refinancing loans to be eligible for certain GNMA securities.

In addition to VA's work with GNMA, VA has worked with the Consumer Financial Protection Bureau (CFPB) over the last several years to address complaints from Servicemembers and Veterans about misleading solicitations to refinance VA-guaranteed loans. VA and CFPB's Office of Military Affairs have monthly meetings to discuss issues and establish plans to educate the Servicemember and Veteran communities about issues regarding VA-guaranteed loans. In November 2017, VA and CFPB issued our first Warning Order to Servicemembers and Veterans who currently have a VA-guaranteed loan. The Warning Order provided information on what to consider when receiving advertisements and when thinking about refinancing an existing VA-guaranteed loan. Specifically, the Warning Order advised Servicemembers and Veterans of the dangers associated with solicitations that promise extremely low interest rates, thousands of dollars in cash back, and skipped mortgage payments.

While the collaboration with GNMA and CFPB has helped to address the serial refinancing problem, VA plans to further address churning practices by issuing a proposed rulemaking. In determining what policy actions to take, VA is evaluating a range of possible measures – such as net tangible benefit tests, seasoning requirements, recoupment requirements, and others – and the effects that the measures might have on Servicemembers' or Veterans' access to their earned benefits, as well as, the impact on lenders, servicers, and mortgage investors.

Conclusion

Mr. Chairman, with the continued high volume of loans in the VA Home Loan Guaranty Program, the coming months at VA will continue to be busy and challenging, but I know we will continue to provide our country's Servicemembers and Veterans with a safe and viable loan guaranty option. Thank you for your continued support of our programs and for this opportunity to speak today.

This concludes my testimony, and I welcome any questions that you or other Members of the Subcommittee may have.