

## FHA ANNOUNCES POLICY CHANGES INCLUDING INCREASED ENFORCEMENT ON FHA LENDERS

The Federal Housing Administration (FHA) and its parent agency, the US Department of Housing and Urban Development (HUD), have recently initiated certain policy changes designed to improve the ability of the FHA to manage its risks while continuing to fulfill its mission of providing access to homeownership. The new policy changes, announced by FHA Commissioner David Stevens on January 20, 2010, include:

- Increasing enforcement efforts with respect to FHA lenders;
- Increasing the FHA's mortgage insurance premiums;
- Establishing a new minimum FICO score for new borrowers to qualify for the FHA's 3.5% down payment program; and
- Reducing allowable seller concessions from 6% to 3%.

In furtherance of this announcement, the FHA issued Mortgagee Letters 2010-02 (ML 2010-02) and 2010-03 (ML 2010-03) on January 21, 2010, which implement the enforcement and mortgage insurance premium policy changes. The remaining policy changes will be implemented during the early summer after a notice and comment period.

In addition, HUD Secretary Shaun Donovan requested legislative authority in December 2009 to require all FHA-approved lenders to assume liability for all the loans they originate and directly endorse, in lieu of submitting initial paperwork on the borrower to HUD.

All of these developments are designed to increase the FHA's enforcement authority against lenders who may have fraudulently marketed and sold FHA-backed loans to consumers, while also reducing the riskiest consumers' access to FHA-backed loans. The developments are further summarized below.

### I. INCREASED ENFORCEMENT ON FHA LENDERS

#### A. HUD's Authority to Terminate FHA Lenders

ML 2010-03 advises lenders that HUD will be using its regulatory authority to terminate a lender's authorization to underwrite single family loans in geographic areas where the lender has a high rate of early defaults and claims. It states that under HUD's regulations the agency is permitted to terminate the underwriting

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authority of any lender having default and claim rates that exceed 200% of the rates within a HUD geographic region, and also exceed the national default and claim rates. This HUD termination authority applies to loans with an amortization period that commenced within the preceding 24 months. To implement its authority, ML 2010-03 states that HUD intends to systematically review all Direct Endorsement (DE) underwriting lenders' default and claim rates on loans with an amortization date commencing within the preceding 24 months. The current DE program streamlines the lending process by enabling FHA-approved lenders to consider single-family mortgage applications without first submitting paperwork to HUD.

ML 2010-03 further provides that HUD will review the rate of defaults and claims on all FHA-insured single family loans every three months and may terminate a DE underwriting lender's approval to underwrite FHA-insured loans in an area where the lender's default and claim rates exceed the established Credit Watch Termination threshold. HUD will reduce the Credit Watch Termination threshold over time in accordance with the following timetable:

24 Month Period Ending Date	Termination Threshold
December 31, 2009	300%
June 30, 2010	250%
December 31, 2010	200%

HUD may revise the termination threshold for any of these dates provided that it issues a notice in advance of the effective date of the change. Although HUD will establish a minimum number of defaults and claims below which it will not perform analyses, if HUD determines that a lender underwriting only a few loans experiences default and claim rates exceeding the above termination threshold, HUD may, in its discretion, terminate the lender nevertheless.

### **B. Recent FHA Enforcement Actions**

The FHA has already permanently withdrawn FHA approval of three mortgage lenders and suspended a fourth for a minimum of six months. Underlying these

actions, the FHA cited the following types of alleged violations:

- failing to comply with employment requirements for borrowers;
- charging borrowers impermissible or excessive fees;
- failure to disclose all fees on the Good Faith Estimates; and
- failure to perform a quality control review of loans that went into default within six month after closing.

In addition, the HUD Inspector General served subpoenas on fifteen DE mortgage companies with high rates of FHA default claims. The subpoenas requested comprehensive information related to loan defaults that led to FHA mortgage insurance fund payouts. These increased enforcement efforts should put lenders on notice that the FHA plans to take a more aggressive approach to monitoring lender activity and ensuring compliance with existing and/or new FHA rules and regulations.

### **C. Effect of Termination**

The termination of a lender's underwriting authority precludes the lender from underwriting FHA-insured single family loans within the area of the HUD field office(s) listed in the notice. If however, a terminated lender is authorized to purchase, hold, or service FHA-backed loans, it may continue to do so.

### **D. Appeal and Reinstatement Process**

ML 2010-03 and existing HUD regulations set forth an appeal and reinstatement process. They provide that within 30 calendar days of the date of receipt of a proposed termination notice, a lender is permitted to request, in writing, an informal conference with the Deputy Assistant Secretary or his or her designee for Single Family Housing to appeal the proposed termination. If the lender does not request an informal conference within 30 days of receiving the proposed termination notice, the right to appeal will be deemed to be waived and the lender's authority will be terminated 60 days from the date of the proposed termination notice.

Under existing HUD regulations, a terminated lender may request to have its authority reinstated six months after the effective date of the termination. To support a request for reinstatement, the lender must demonstrate that the underlying causes for the termination have been corrected through an independent review conducted by an independent Certified Public Accountant qualified to perform public audits under the Government Accounting Office's Government Auditing Standards. The lender must also submit a written corrective plan addressing issues raised by the CPA and evidence that it has implemented the plan addressing such issues. HUD reserves the right to impose additional requirements on the lender.

## II. MORTGAGE INSURANCE PREMIUM INCREASE

ML 2010-02 addresses the FHA's proposal to increase mortgage insurance premiums, effective on or after April 5, 2010. Under this proposal, the FHA expects to raise its upfront mortgage insurance premium (MIP) by 50 basis points to 2.25% for purchase money and refinance transactions. The FHA also announced its plan to request legislative authority to increase the maximum annual MIP that the FHA can charge. If the FHA receives this legislative authority, the FHA may shift some of the premium increase from the upfront MIP to the annual MIP, which would allow for a lower up-front cost to the consumer.

The upfront and annual premiums will apply to all mortgages insured under the FHA's Single Family Insurance Programs, except for mortgages under certain programs, such as Home for Homeowners, and programs targeted to certain areas and neighborhoods.

## III. NEW MINIMUM FICO SCORE FOR BORROWERS TO QUALIFY FOR LOWER DOWN PAYMENTS

The FHA also has announced that it expects to establish a minimum FICO score of 580 for new borrowers to qualify for the FHA's 3.5% down payment program. New borrowers with less than a 580 FICO score will be required to make a down payment of at least 10% of the principal

amount of the loan. This policy change will allow the FHA to reduce the lending risks of blemished credit borrowers. The FHA has not specified when this new policy will become effective.

## IV. REDUCTION OF ALLOWABLE SELLER CONCESSIONS

Finally, the FHA will reduce allowable seller concessions from six percent to three percent to conform to industry standards. This change is expected to reduce the risk of inflated appraised values. A proposed rule will be published in the Federal Register for notice and comment rulemaking in February 2010, with the rule expected to go into effect in early summer.

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*Arnold & Porter LLP is available to respond to questions raised by the FHA policy changes. We can assist in determining how the current and proposed changes may affect your business and industry. For further information, please contact your Arnold & Porter attorney or:*

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