MORTGAGE BANKERS ASSOCIATION

Investing in communities

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Before the

House Financial Services Committee

United States House of Representatives

Meeting on

"FHA Oversight of Loan Originators"

January 9, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for asking the Mortgage Bankers Association (MBA)[1] to testify on the Federal Housing Administration (FHA) and the risks and rewards that come with the agency's recent spike in loan volume. I am John Courson, President and CEO of MBA. I was engaged in the mortgage banking industry, and an FHA approved lender, for over 40 year and was MBA Chairman in 2003.

A strong and vibrant FHA has always been a top priority for MBA's members. That is why even before the housing market steeply declined and foreclosure rates rose, MBA advocated for modernizing FHA so as to increase its relevance and encourage more borrowers to use programs known to be safe, sound and effective. MBA has pushed for important reforms and stricter controls, including increased regulation and more funding for advanced technology to help monitor originations and lenders. Since the collapse of the subprime market, MBA has been advocating for the safe expansion of affordable homeownership programs that offer responsible lending options to borrowers. FHA offers the types of responsible programs that we support.

I also want to thank this Committee for the priority it gave to reinvigorating FHA, which ultimately led to the passage of a strong FHA modernization bill as part of last summer's Housing and Economic Recovery Act (HERA). Many of the provisions in that legislation were ones MBA had supported throughout the years – these reforms will allow FHA to play an expanded role in the current housing crisis and beyond.

FHA's future is especially important to groups who traditionally have needed help achieving the dream of homeownership. More than any other nationally available program, FHA has traditionally focused on the needs of first-time, minority, and/or low- and moderate-income borrowers. In 1990, 64 percent of FHA borrowers using FHA to purchase a home were first-time homebuyers. Today that rate has climbed to approximately 77 percent. In 1992, about one in five FHA-insured purchase loans went to minority homebuyers. That number in recent years has grown to more than one in three. Minorities make up a greater percentage of FHA borrowers than they do conventional market borrowers.

FHA is particularly important to those minority populations experiencing the largest homeownership gaps. According to recent data provided by HUD, both first-time

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

homebuyers and minorities continue to make up a significant portion of FHA's customer base. In FY 2008, FHA insured 225,586 purchase mortgages and 174,139, or 77 percent, went to first-time homebuyers. Minorities received 54,951 FHA-insured mortgages in 2008, or 24 percent.

As we have seen over the last year and a half, FHA has become increasingly more vital to the nation's housing market. FHA's percentage of all originations grew from three percent in 2006 to over 20 percent by the end of 2008. There are several reasons for this dramatic growth:

1. FHA loans typically require lower downpayments than those purchased by the GSEs. Generally, the maximum loan to value ratio for FHA loans is 96.5 percent, compared to 95 percent for the GSEs.
2. GSE loans typically have higher credit score requirements than FHA loans. Buyers who do not qualify under the GSE requirements may still be able to qualify for an FHA loan.
3. The Economic Stimulus Act of 2008 temporarily raised the FHA and GSE loan limits for most of the country, which made FHA an option for more homebuyers in 2008. Although those temporary loan limits have since expired, the new loan limits included in HERA are leading to more loan originations than the years before the stimulus.

Because of MBA's strong support of FHA and its mission to help provide affordable homeownership, we applaud the increased use of its programs. The increase in FHA volume, however, is a double-edged sword and requires FHA and FHA-approved lenders to be more vigilant than ever about who is allowed to originate FHA loans.

MBA is pleased that homebuyers are finally appreciating and taking advantage of the benefits of FHA and the prudent lending opportunity it provides. However, MBA is concerned that since the once lucrative subprime market has evaporated, some of the less scrupulous lenders who specialized in that business are now turning their attention to FHA lending. In particular, many are concerned about mortgage brokers, who are less regulated than mortgage bankers, but can be approved as FHA correspondents.[2] While most are honest originators who have simply changed their business model to reflect a changing market, there are likely to be some mortgage bankers and brokers who want to exploit that market and take advantage of borrowers who may think their choices are limited. To be clear, MBA strongly opposes mortgage practices that jeopardize consumers and damage the reputation of the mortgage industry.

[2] For purposes of this testimony, MBA is using the terms "FHA-approved lender" and "mortgagee" synonymously, and "FHA-approved broker" and "correspondent" synonymously.

At its base, the mortgage industry does good work. Mortgage lenders help homebuyers realize their dreams of homeownership through prudent lending. It is because of our strong belief in the system that MBA supports the following key ways to protect FHA and help restore faith in the entire mortgage industry:

1. Improve the quality of FHA originations.

With less liquidity in the housing market, borrowers with less-than-perfect credit histories or no credit histories are increasingly relying on FHA-insured products. The most effective way to maintain the quality of FHA originations is to initiate quality control at the beginning of the process. MBA believes several steps should be taken to maintain the quality of FHA loans and ensure their strong performance:

1) Standards and qualifications for becoming an FHA correspondent should be raised.
2) FHA should have more aggressive, streamlined and timely processes to expel "bad actors." These participants include FHA-approved mortgagees and correspondents, real estate brokers and appraisers.
3) Net worth for FHA-approved mortgagees and correspondents should be increased to help ensure that consumers are conducting business with well capitalized companies. Net worth requirements assure that brokers and bankers cannot enter the market if they are underfinanced.
4) Fraud prevention tools should be made available to and used consistently by approved lenders. FHA should have mechanisms and resources to update guidance regularly to keep up with current trends.

2. Provide FHA with staff resources and technology to expose and eliminate lenders that do not uphold ethical standards.

The demand for FHA insurance has risen rapidly over the last year and a half. This dramatic increase in demand has put a strain on the staff at both FHA and Ginnie Mae. MBA has long supported an increase in staff and technology resources to enable FHA and Ginnie Mae to be adequately equipped to serve the housing market. MBA is grateful for Congress' authorization of funding in HERA of $25 million for each fiscal year from 2009 through 2013. We now would like to work with Congress to ensure the funds are appropriated.

FHA faces severe challenges in managing its resources and programs in a quickly changing mortgage market. FHA needs greater flexibility and increased resources to recruit, manage, and compensate employees if it is to keep pace with this changing financial landscape. Lenders and correspondents that commit unscrupulous activities have become increasingly sophisticated in their tactics. It is unfair to expect FHA to combat these attempts without appropriate tools and human resources.

Moreover, MBA believes FHA cannot keep pace with an industry that is becoming increasingly technologically driven as long as it lacks the authority to use its revenues to invest in new technology. Improvements to FHA's systems will allow it to more effectively manage its portfolio, thus increasing efficiencies and lowering operational costs, and to monitor its operations and partners more closely to mitigate losses. MBA believes that such an investment would yield savings to FHA operations far in excess of the initial cost.

Ginnie Mae also needs additional resources to keep up with the demand created by the dramatic growth in FHA loans. Specifically, Ginnie Mae urgently needs the following resources, at a minimum, and will probably require more as FHA's market share increases:

- Salaries appropriation of $11 million from revenues earned.
- An increase in staff size from 69 to 78 people.
- Operating expenses to remain non-appropriated and apportionments of $175 million to fund multiyear contract obligations and pay for automated risk solutions.
- Increased commitment authority.

Without at least these additional resources, Ginnie Mae will struggle to keep pace with FHA, thus reducing liquidity at a critical moment for the housing market.

3. Strengthen regulation of mortgage brokers.

MBA believes that an integral part of protecting the future soundness of FHA is ensuring that FHA-approved mortgagees and correspondents (including mortgage brokers) that participate in the program and originate FHA-insured mortgages have the competence and wherewithal to protect consumers and taxpayers from undue loss.

We strongly believe that rigorous licensing and registration requirements, as well as net worth and minimum bonding requirements, are essential components of any protective framework.

MBA supported the Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act, enacted as part Title V of HERA, which encourages states to enact strong licensing and registration laws for mortgagees and correspondents, and in the event they fail to do so, HUD would establish and enforce licensing and registration rules. These new laws will include educational, testing and character requirements as well as bonding and/or net worth requirements.

Considering the importance of FHA, MBA continues to support increased net worth and bonding requirements for mortgage correspondents and bankers to participate in the program. Net worth requirements serve to assure that a vendor has a stake in the industry and they also provide some resources for a borrower to seek in the event of misfeasance.

MBA strongly objected last year when some consideration was given to lowering FHA's requirements for correspondents. Congress rightly rejected this proposal and MBA sincerely hopes that the Committee does not reconsider it.

Currently, FHA requires that for mortgagees to be qualified to underwrite FHA loans they must have a net worth of $250,000 and correspondents must have a net worth of $63,000. While MBA believes that differences in net worth and bonding requirements for mortgagees and for correspondents are appropriate considering the greater responsibilities to the public and investors that mortgagees have, MBA believes both standards should be increased to ensure that underfinanced actors do not harm the market.

In particular, MBA believes that for correspondents the corporate net worth requirements should be at least $150,000, plus $25,000 for each branch office up to the requirement for a mortgagee. MBA would also support a reasonable increase in corporate net worth for mortgagees.

4. Support efforts to reduce mortgage fraud.

One significant concern about the management of FHA with its increased volume that has gone mostly unmentioned is mortgage fraud against lenders, which could severely impact the Mutual Mortgage Insurance Fund (MMIF). As FHA endorses more and more mortgages, its insurance fund runs the risk of being exposed to a greater proportion of mortgage fraud than when it held a smaller share of the mortgage market. According to the Mortgage Asset Research Institute (MARI), incident reports of mortgage fraud increased 45 percent in the second quarter of 2008 from the same period in 2007.[3] As any lender's market share increases, it is reasonable to assume that its exposure to mortgage fraud increases proportionately to that increase.

[3] Quarterly Fraud Report, 2Q 2008, Mortgage Asset Research Institute, December 2, 2008 (http://www.marisolutions.com/pdfs/mba/mortgage-fraud-report-2008Q2.pdf).

Mortgage fraud impacts FHA by pulling funds away from the MMIF intended for ensuring regular installment payments to the mortgage investor, even in the instance where a borrower skips a payment or even defaults on the loan due to job loss, health care costs or other life challenges, rather than intent to commit mortgage fraud. It may be years before the fraud committed results in an insurance claim with FHA. Whether a property associated with an FHA-insured loan is quickly resold after closing for a much higher price, or a borrower commits fraud through overstating his or her income on the mortgage application, or the seller manipulates the appraisal to overvalue the property so the collateral is unsupportive to recoup any losses, the payout from the MMIF adds to the strain on the insurance fund and thereby potentially on the American taxpayer.

In general, MBA strongly encourages lenders to consider any steps necessary to defend themselves from fraudulent mortgage schemes, such as integrating the Mortgage Fraud Warning Notice from the Federal Bureau of Investigation (FBI) into their loan processes. MBA also supports additional, dedicated funding for the FBI's efforts in tracking down and prosecuting mortgage fraud. The funding should provide for new FBI field investigators, dedicated prosecutors and support for the operations of FBI Interagency Task Forces in the areas with the highest concentrations of mortgage fraud.

In addition, MBA has taken the lead to establish a Mortgage Fraud Prevention Database that would allow all lenders to report incidents, which would further empower lenders to make informed decisions about the parties with whom they do business. The database will be established this year.

Thank you for the opportunity to testify. Strengthening FHA is just one of MBA's priorities this year and we look forward to continuing our partnership with the Committee on other important issues throughout 2009. Stabilizing the markets, helping keep families in their homes and strengthening regulation of our industry to prevent future relapses are other issues we consider priorities. Addressing these issues together will help homebuyers regain their faith in the mortgage industry.

The importance of FHA at this time in our country's financial history cannot be over emphasized. The agency's programs and integrity must be maintained. On behalf of the Mortgage Bankers Association, we stand ready to work with you to strengthen FHA and Ginnie Mae and protect their programs.