

**WRITTEN STATEMENT OF THE U.S. DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT  
Hearing before the Committee on Financial Services  
Subcommittee on Oversight and Investigations**

Chairman Moore, Ranking Member Biggert, and members of the Subcommittee, Secretary Donovan thanks you for the opportunity to submit this written statement regarding the Federal Housing Administration's (FHA) efforts to strengthen program oversight and prevent fraud in its programs.

For the past 75 years, FHA has served as the bedrock of the nation's mortgage finance industry. Through good times and bad, FHA financing has been available to those seeking safe and affordable mortgages, focusing on the fundamentals of prudent underwriting, sound credit policies and a long held commitment to strong program oversight and risk management – practices that were all but forgotten during the subprime boom.

The turmoil in the housing market over the last few years has had a devastating effect on the nation's economy. Today, FHA is playing its traditional role by providing stability and liquidity to the housing market and access to credit for families seeking affordable financing options. This has resulted in dramatic changes in FHA's business. By some industry estimates, FHA has gone from less than 3% market share, just a few short years ago, to approximately 30% of the single family mortgage market today. In addition, FHA has managed a staggering surge of lenders seeking approval to participate in its programs. Over the last two years, FHA has seen a dramatic increase in lender applications.

FHA remains committed to the guiding principles that have protected FHA's programs and insurance funds and the public from undue risk. As you may recall, FHA provided detailed testimony to the House Financial Services Committee on January 9, 2009, that outlined our risk management activities as they relate to lender approval, oversight, and program enforcement. While these compliance and risk management practices have been effective, FHA continues to strengthen its risk management and fraud prevention framework to ensure that its programs are protected from fraud and abusive lending practices.

As part of the 2010 Budget, HUD is launching an expanded initiative designed to improve its ability to combat mortgage fraud, teach consumers how to avoid predatory practices and enhance oversight of FHA approved lenders. In addition, Congress's recent passage of the Helping Homeowners Save Their Homes Act of 2009 has provided much needed support to this end. This legislation provides FHA with expanded authority to ensure that those who are proven to be engaged in predatory lending practices are not allowed to participate in the FHA programs, as well as to take actions against those who violate program requirements.

Additionally, the Fraud Enforcement and Recovery Act of 2009 provides HUD's Office of Inspector General (OIG) with significant funding to target mortgage fraud. We hope to leverage the OIG's funding with our program knowledge and referral protocols to target those unscrupulous lenders that violate program requirements and seek to commit fraud.

## **Agency Wide Initiative to Combat Mortgage Fraud and Predatory Practices**

As part of the agency's continuing efforts to improve oversight and protection of the FHA insurance funds, HUD has requested \$37 million for an agency wide initiative to Combat Mortgage Fraud and Predatory Practices.

HUD recognizes that the current market environment increases the potential for mortgage fraud and predatory practices on multiple fronts. On one level, the significant expansion in the volume of FHA insured loans exposes the insurance funds to increased risk of abuses within the program. With increased volume and market share, the number of new participating lenders has increased 230 percent in the past years, from 997 to 3300 lenders. At the same time, new forms of predatory practices are on the rise. According to the FBI, the decline in the housing market has created an ideal climate for predators in the form of mortgage rescue scams. Almost half of the budget request will be used to boost fraud detection by training industry partners and giving FHA access to state-of-the art fraud detection tools, including automated valuation tools for verifying appraisals, and income verification mechanisms. These tools would be applied to all phases of the mortgage insurance process and give FHA the ability to more efficiently identify misrepresentations at the consumer, application, and property levels through the automated check and analysis of multiple data sources.

This effort is a part of the HUD's broader Transformation Initiative which is intended to revive, transform and reform the way the Department does business. HUD is seeking authority to set aside 1% of its total budget for an agency wide Transformation Initiative that would build transparency and accountability in the agency through the use of metrics to gauge performance, research to evaluate programs and assess the broader impact of federal interventions, technical assistance to identify and diffuse innovation and technology to track spending, inform decisions and curb fraud, waste and abuse.

## **Consumer Outreach and Education Campaign**

HUD firmly believes that the first line of protection against predatory lending is an informed consumer. We will build on existing efforts to launch a comprehensive campaign, designed to inform homebuyers and homeowners about fraudulent and predatory lending practices. HUD will partner with multiple entities and jurisdictions – such as OIG, State Attorneys General, consumer advocacy groups, housing counseling agencies – for this grass roots campaign, which will include a series of local and regional roundtables and media opportunities to increase consumer awareness about mortgage fraud and loan modification scams.

## **Expanded Loan Modification Efforts**

Traditionally, HUD has had an aggressive program to help delinquent FHA borrowers remain in their homes and mitigate FHA losses on FHA insured loans. In FY 2008, FHA's home retention efforts helped 96,000 families retain their homes. We are on target to assist even more families this year. As of May 31, we have helped 79,000 families retain their homes.

HUD intends to expand its loss mitigation efforts, by extending the benefits of Making Home Affordable to FHA borrowers in the near future. The program design ensures that borrowers are able to obtain sustainable mortgage payments through refinancing or loan modification.

FHA's National Servicing Center makes certain that families who are experiencing difficulty in making their mortgage payments are placed in the loss mitigation program that is most suitable for them and their circumstances. Lenders who fail to engage in loss mitigation activities prior to foreclosure are subject to both sanctions and civil money penalties. In addition, we intend to develop a tool that monitors a servicer's compliance with FHA's loss mitigation guidelines, preventing them from undermining the Department's efforts towards ensuring sustainable homeownership and protecting FHA from future losses.

### **Strengthen the Lender Approval and Recertification Process**

Efforts are also underway to strengthen lender approval and recertification requirements. The Helping Homeowners Save Their Homes Act gives FHA the authority to deny approval to lenders that have unresolved findings from a field review by HUD or have been convicted of a felony related to participation in the real estate or mortgage industry. This provision also incorporates S.A.F.E. Act registration as a condition of approval. FHA will now have the ability to electronically evaluate new applicants and lenders seeking recertification against a nationwide database to ensure that those originating FHA loans are properly licensed in the states in which they operate. FHA is also pursuing contract services to acquire access to criminal background and credit reporting that will be used to enhance the applicant screening process. This service will also allow FHA to check the status of principals, agents, owners, and officers during a lender's annual recertification for continued participation in FHA programs. Additionally, HUD's General Counsel is working on language that will strengthen lender certification language, providing FHA with another avenue to pursue sanctions against those who violate FHA requirements.

The Act also prohibits anyone not approved by FHA from playing a role in the origination of an FHA loan. This practice has long been problematic, leading to excessive fees being charged to the borrower and introducing a party to the transaction that FHA has no enforcement authority over. The Act also provides clear enforcement authority to prohibit such third parties from playing a role in the origination of FHA-insured loans by allowing FHA to pursue civil money penalties against those that violate this provision.

The Act also expands current requirements for reporting a change in business status. Currently, lenders are required to notify FHA if the lender is denied or has lost a license to operate within a State. This new reporting provision requires that the lender must now also notify FHA if individual employees of the lender lose a State license. Additionally, this provision requires that the lender notify FHA if there is a revocation of a State-issued mortgage loan originator license issued pursuant to the S.A.F. E. Act. From our experience, lenders that have a material change in business seldom notify FHA. FHA has entered into discussions with the Conference of State Bank Supervisors to get direct feeds from the National Mortgage Licensing System. This will allow FHA to take timely action against those that fail to uphold their responsibility.

Finally, FHA is conducting a thorough evaluation of its existing lender approval requirements to determine if there are any additional controls that should be put into place.

### **Expanded Risk-Based Monitoring**

FHA's nationwide risk-based monitoring program works to prevent and detect mortgage fraud and abusive lending practices. Monitoring reviews are conducted in order to discover findings of deficiencies related to the origination or servicing of loans. Functional areas (retail, wholesale, servicing, direct lending, quality control/compliance, etc.) are also carefully reviewed to determine how the lender monitors its activities and decreases risk throughout its FHA portfolio. FHA's targeting methodology is continually refined to incorporate various changes in mortgage industry business practices as well as advances in its targeting tools. Given the significant increase in new lenders and the significant increase in loan originations, FHA expanded its risk-based lender monitoring effort to proactively address the risks associated with an influx in new lenders. FHA also recently reactivated its Special Work Assessment Teams (SWAT) to conduct single-focus on-site reviews of lenders whose originations are exhibiting signs of distress. This additional oversight is critical to ensuring that emerging risks are effectively managed and mitigated. FHA will continue to forward all instances of potential mortgage fraud to HUD's Office of Inspector General for review. In fact, for FY 2009, as of May 31, we have referred 534 cases of suspected fraud to the OIG.

Furthermore, FHA's Credit Watch Termination Initiative identifies originators with excessive default rates relative to other lenders. Credit Watch Termination protects the integrity of the FHA insurance funds and sanctions those lenders who demonstrate imprudent or potentially abusive lending practices. This unique enforcement tool provides for a systematic review of a lender's early default and claim rate for loans originated during the initial 24 months from endorsement; and a comparison to the default and claim rate for all lenders in a specific HUD jurisdiction. Lender's with a compare ratio that exceeds a 200% threshold and national average are subject to proposed termination.

FHA is extending the Credit Watch Termination Initiative to include not only the originator of the loan but also the lender that made the underwriting decision. This extension will provide additional scrutiny on lenders that generate a majority of FHA production.

Finally, FHA is collaborating with industry trade groups, lenders and agencies that monitor fraud initiatives to ensure that FHA stays abreast of the ever changing methods used by those that seek to commit mortgage fraud.

### **System Enhancements to Better Detect Fraud and Abusive Lending**

The ever increasing need for FHA to intensify its anti-fraud product arsenal requires early-warning detection tools and system enhancements to automate what are today, manual functions. The lack of critical early-warning detection tools was cited in a Government Accountability Office (GAO) audit in January 2004, as a high risk finding. FHA is currently evaluating several different fraud detection tools that may improve our ability to detect fraudulent loans prior to endorsement, uncover future potential fraud, and highlight other performance weaknesses. This effort has been on FHA's radar for several years but has been hindered by the unavailability of funding.

Aside from fraud detection tools, several system enhancements are underway that are material to combating mortgage fraud. FHA is working to automate its review of a lender's principals, agents, owners, officers, and others against various databases to determine eligibility to

participate in FHA programs. These changes will increase process efficiency, data reliability, and will allow FHA to better focus on those lenders that attempt to circumvent procedures.

FHA is also working on a comprehensive strategy to improve risk metrics, benchmarking, and reporting across the various functions of FHA. FHA is exploring Business Intelligence (BI) applications that will allow FHA to decrease development costs at the system level and leverage the mountains of data that are already collected and stored. Improved analytics and transparent reporting will allow FHA to improve its targeting decisions, develop new mechanisms to detect fraud, and help FHA properly align its risk appetite.

FHA will continue to improve its ability to monitor and ensure compliance of its partners. As its business grows, FHA is evolving to meet the challenges presented by such growth, making great strides in its hiring practices, investments in improved information technology systems, and regulatory and programmatic reforms. Insuring mortgages inherently involves a degree of risk. For decades, FHA has successfully taken measured steps to help more Americans enjoy and sustain the opportunities of homeownership, while consistently evolving its programs to better protect taxpayers and ensure the integrity of its insurance funds.