Prepared Testimony

of

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on

"The FHA Reform Act of 2010"

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Good afternoon Chairwoman Waters, Ranking Member Capito, and members of the Committee. I am Mike Anderson, Vice Chairman of Government Affairs for the National Association of Mortgage Brokers ("NAMB"). I am a Certified Residential Mortgage Specialist ("CRMS") and an FHA-Approved Loan Correspondent with over 31 years of experience as a mortgage professional in the State of Louisiana. Thank you for inviting me to testify today on "The FHA Reform Act of 2010."

I. Introduction

The National Association of Mortgage Brokers is the voice of the mortgage broker industry, representing the interests of mortgage professionals and homebuyers nationwide. Established in 1973 and headquartered in McLean, Virginia, NAMB is the oldest and largest national trade association representing the mortgage broker industry.

Today, NAMB advocates on behalf of more than 70,000 small business mortgage professionals located in all 50 states and the District of Columbia. NAMB also represents the interests of homebuyers, and advocates for public policies that serve mortgage consumers by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to enhancing consumer protection and promoting the highest degree of professionalism and ethical standards for its members. NAMB requires its members to adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. NAMB also provides its members with access to professional education opportunities and offers rigorous certification programs, including the CRMS, to recognize members with the highest levels of industry knowledge and education.

Additionally, NAMB serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

NAMB members are typically small business owners, employing between three and fifty employees. They serve both urban and rural communities of every size, and operate in all 50 states and the District of Columbia. NAMB members work with consumers as they make their way through the complex mortgage origination process, and add value to that process for both consumers and lenders by serving many areas that are typically underserved by banks and other financial institutions. Because many NAMB members establish and operate their businesses exclusively within the communities they serve, these individuals also add value to the origination process by providing goods, facilities, and services with quantifiable value, including a loyal customer base and goodwill.

NAMB members, together with the rest of the mortgage broker industry, bring greater competition to the market for origination services and typically provide consumers with a local alternative to using a large national bank or lender.

II. Background

Last year, the Department of Housing & Urban Development ("HUD") began announcing a series of significant changes to the Federal Housing Administration ("FHA") loan program designed to strengthen FHA's capital reserves and better manage its exposure to risk. In addressing the changes, FHA Commissioner David Stevens commented that risk management and credit policy changes at FHA are needed in today's market to strengthen the insurance fund and help ensure that lenders have proper and sufficient protections.

Many of these changes have already been implemented through administrative measures such as the issuance of Mortgagee Letters, or are currently being finalized as part of the notice and comment rulemaking process. However, other FHA policy changes sought by HUD require specific legislative action, which is the subject of today's hearing.

In this written testimony, NAMB will discuss the specific legislative changes proposed in the FHA Reform Act of 2010 ("Reform Act"), as well as the administrative policy changes that have already been implemented by HUD or will soon take effect. NAMB supports many of the changes that have been made or are currently being pursued by HUD, and NAMB applauds Commissioner Stevens for his dedicated efforts to strengthen and protect the FHA loan program and the FHA insurance fund. Nevertheless, NAMB does have a number of serious concerns about certain aspects of the policy changes taking effect at FHA, and we would like to work with HUD and this Committee to resolve some of these issues.

III. FHA Reform Act of 2010

The FHA Reform Act of 2010 ("FHA Reform Act") contains three specific changes to current FHA policy, which were sought by HUD in its January 20, 2010 announcement of additional administrative policy changes. Specifically, the FHA Reform Act would grant FHA the authority to increase annual mortgage insurance premiums ("MIP") charged to borrowers beyond their current statutory cap; ensure that lenders are required to indemnify the Secretary for any losses on loans they originate or underwrite; and give the Secretary an enhanced ability to review mortgagee performance and terminate FHA-approval if necessary.

a. Authorization to Increase Annual Mortgage Insurance Premium

Section 203(c)(2)(B) of the National Housing Act (12 U.S.C. 1709(c)(2)(B)) currently requires the Secretary to establish and collect annual MIP payments in an amount not exceeding 0.50 percent of an FHA borrower's insured principal balance on a loan, for loan amounts less than 90 percent of the appraised value of the property. This Section also requires the Secretary to collect annual MIP payments in an amount not exceeding 0.55 percent on loan amounts greater than 95 percent of the appraised property value.

The FHA Reform Act amends Section 203(c)(2)(B) of the National Housing Act (12 U.S.C. 1709(c)(2)(B)) to permit, but not require, the Secretary to establish and collect annual MIP payments from FHA borrowers in an amount not exceeding 1.50 percent of the insured principal balance on a loan for loan amounts less than 90 percent of the appraised value of the property, and 1.55 percent on loan amounts greater than 95 percent.

NAMB is concerned this policy change will cause an increase in costs for FHA borrowers, particularly at a time when so many families are struggling financially and our mortgage and housing markets remain in crisis. While we understand the adverse effect that the housing market collapse and subsequent foreclosure crisis have had on FHA's capital reserves, we do not believe that such a significant increase in the annual MIP charged to borrowers is the answer.

Each time mortgage costs are increased for consumers, whether in the conventional or FHA market, a segment of the potential home buying population is eliminated from that market. For example, a borrower today with an annual income of $75,000 and monthly debts totaling $600 could make the minimum downpayment of 3.5 percent, receive an interest rate of 4.75 percent, and qualify through FHA to purchase a $205,000 home. However, if the proposed increase in annual MIP is implemented, this same borrower would only qualify to purchase a $185,000 home. This is the cost equivalent of a 1.25 percent interest rate increase. What is worse, when interest rates rise, the maximum purchase price this same borrower could qualify for through FHA decreases even more dramatically. With an interest rate of just 6.25 percent, the borrower in this example would only qualify to purchase a $165,000 home.

Additionally, the proposed across-the-board increase in annual MIP is effectively a mandate requiring borrowers in States with low default rates to subsidize the unusually high rate of claims in certain geographic areas. NAMB does not believe that FHA should be instituting changes that will price otherwise qualified and eligible borrowers out of the market or require high-performing States to pay the price for those actually responsible for FHA's depleted capital reserves.

For these reasons, NAMB respectfully urges this Committee to amend the proposed legislation we are discussing today and reject the increase in annual MIP that FHA is seeking authority to implement. However, if the Committee feels it is necessary and appropriate to grant FHA this authority, NAMB

encourages the Committee to direct FHA to properly account for default rates, credit risk, or both when implementing the change in annual MIP charged to borrowers.

b. *Indemnification by Mortgagees*

The FHA Reform Act amends Section 202 of the National Housing Act (12 U.S.C. 1708) by adding a new section that would ensure all direct endorsement mortgage lenders are liable to indemnify the Secretary for any loss on loans they originate or underwrite. This Section would allow the Secretary to require indemnification if a mortgage approved by the Secretary under the direct endorsement program or insured by a mortgagee pursuant to a delegation of authority under section 256 was not originated or underwritten in accordance with requirements established by the Secretary, and the Secretary pays an insurance claim within a reasonable period of time, which is specified by the Secretary. The Secretary would also be entitled to indemnification if fraud or misrepresentation was involved in connection with the origination or underwriting of the loan, regardless of when an insurance claim is paid.

NAMB supports requiring FHA-approved Mortgagees to indemnify the Secretary for losses incurred by the agency on insured loans that are originated and/or underwritten outside of FHA guidelines and requirements. It is critical to the future health and prosperity of the FHA loan program that participants adhere to the established guidelines and are held accountable if and when they fail to do so. However, informed professionals often interpret FHA's guidelines differently. Indemnification requests should have due process and be appealable. NAMB understands that the process should not be so complex as to totally impair indemnification nor should it be an arbitrary action by HUD merely as a tool to recover losses.

c. *Review of Mortgagee Performance*

Section 4 of the FHA Reform Act amends section 533 of the National Housing Act (12 U.S.C. 1735f-11) to give the Secretary an enhanced ability to review mortgagee performance and, if a mortgagee is found to have an excessive rate of early defaults or claims, to terminate the mortgagee's approval to originate or underwrite single family mortgages in a specified area or areas, or on a nationwide basis.

NAMB is very supportive of measures to enhance the accountability of participants in the FHA program. However, we are concerned that in our current economic environment, otherwise responsible lenders, particularly in some of the hardest hit geographic areas, will show uncharacteristically high rates of defaults and claims that could threaten their approval as a mortgagee.

Protections should be put into place to ensure that FHA's enhanced ability to review mortgagee performance takes into consideration the longer-term performance history of loans originated and/or underwritten by the mortgagee, along with market forces and factors outside of the mortgagee's control, which may have contributed to uncharacteristically high default rates or claims in certain geographic areas or over a specific period of time.

FHA should consider whether a mortgagee is making loans to underserved borrowers resulting in a higher than average default rate. Since this is a primary mission of FHA, mortgagees should be able to offer this defense before any action is taken by HUD. Termination should have warnings, notice, and appeal rights.

Additionally, if and when FHA deems it necessary to terminate a mortgagee's approval, NAMB believes it is imperative that guidelines be put into place to help retrieve FHA loans already in the pipeline, so as to avoid any repeat of the situation that transpired in the wake of FHA's termination of Taylor, Bean & Whitaker last year. A model exists in many State Banking Divisions already, and NAMB believes that

FHA should devise and implement a similar model that would help protect consumers as FHA seeks to expand its enforcement authority and its ability to terminate mortgagees' approval.

IV. Regulatory & Administrative Changes Proposed by FHA on January 20, 2010

a. Increased Upfront Mortgage Insurance Premium

Effective April 5, 2010, FHA will increase its upfront MIP charged to borrowers by 50 basis points to 2.25 percent. According to FHA, the upfront MIP increase is designed to build up capital reserves and help bring back private lending. FHA believes that the first step is to raise the upfront MIP, and then seek legislative authority to increase the maximum annual MIP, with the idea that some of the consumer cost burden from the upfront MIP may then be shifted to the annual MIP. This, FHA contends, will allow for capital reserves to increase with less impact to the consumer, because the annual MIP is paid over the life of the loan instead of at the time of closing.

NAMB is concerned about the proposed change in upfront borrower MIP costs for a number of reasons, particularly when it is coupled with the proposed increase in annual MIP. First, as we discussed above with regard to increasing the annual MIP, NAMB does not believe this is the right economic environment to be raising consumer costs and likely pricing qualified borrowers out of the market. Second, high-cost rules in various states place caps on the total allowable points and fees in a mortgage transaction, and these rules often do not exclude FHA's upfront MIP from the high-cost calculation. The proposed increase in upfront MIP will bring FHA loans under the high-cost rules in number of states and under Truth-In-Lending regulations, and therefore will basically destroy the FHA market in those states.

Finally, raising the upfront MIP may increase FHA's capital reserves, but it also increases FHA's exposure to risk. Because the upfront MIP may be financed by borrowers and rolled into the principal balance of the loan, borrowers will have less equity in their property and FHA will be insuring higher loan-to-value mortgages.

b. Increased Credit Score & Downpayment Requirements

FHA has proposed updating its credit score and downpayment requirements for new borrowers, effective as early as this summer. Borrowers who possess a credit score of 580 or above would be required to make the current 3.5 percent minimum downpayment, while borrowers with a credit score below 580 would be required to make a minimum 10 percent downpayment to be eligible for FHA. FHA believes that this allows the agency to better balance its risk and continue to provide access to the program to those borrowers who have historically performed well.

NAMB is concerned that these new credit score and downpayment requirements may be too restrictive, and could ultimately have a significant negative impact on FHA's origination volume. Traditionally, borrowers with high credit scores have not chosen to utilize FHA. However, in today's market, because GSE fees tied to borrowers' credit scores have increased dramatically, many of these borrowers are moving away from conventional loans and opting instead for FHA products. This trend may not continue after the conventional mortgage market recovers, and FHA could risk losing significant market share back to the GSEs if only the very best borrows are eligible for participation in the loan program.

While NAMB supports FHA's desire to ensure that only quality loans are insured by the agency, NAMB has concerns about FHA's proposed changes to the downpayment and credit score requirements for borrowers. NAMB strongly believes that FHA should not seek to establish such restrictive requirements that only the very best borrowers can qualify for the program.

c. *Reduction in Allowable Seller Contributions*

FHA has also proposed limiting the total amount of seller concessions that an FHA borrower is eligible to receive, in an effort to conform to industry standards and reduce the risk to FHA posed by potential value inflation.

NAMB opposes any reduction in the amount of allowable seller concessions. Throughout the country, there is a surplus of homes on the market and there are qualified buyers seeking to enter the market. However, in these economic times, many borrowers lack the cash necessary to cover all of the upfront costs associated with obtaining a mortgage and purchasing a home. Although it is true that FHA currently allows nearly double what the conventional market will accept as allowable seller concessions, such concessions are critical to countless buyers who would otherwise not be able to afford the purchase of their home.

V. Regulatory & Administrative Changes Proposed Prior to January 20, 2010

HUD announced its first in this series of policy changes on September 18, 2009. Among the changes announced were new appraisal standards, modified procedures for streamlined refinance transactions, and new approval and participation requirements for mortgagees and loan correspondents.

NAMB believes that these new policies will have a profound effect on the FHA program. As with many of the new policies which we have already discussed, NAMB is supportive of some of the Commissioner's efforts to improve the FHA program, and we would like to specifically thank Commissioner Stevens for proposing removal of the burdensome and unnecessary audit requirement for loan correspondents.

At the same time however, NAMB believes that there are flaws in some of the new FHA policies, particularly with regard to appraisals, that must be worked out to ensure that the program continues to run efficiently and effectively into the future.

a. *Appraiser Independence*

New FHA appraisal ordering took effect February 15, 2010. FHA believes that these new guidelines will enhance appraiser independence and geographic competence. The new guidelines prohibit mortgage brokers and commission-based lender loan officers from ordering appraisals, much like the Home Valuation Code of Conduct ("HVCC"), which was implemented by Fannie Mae and Freddie Mac (together, "the GSEs") in May 2009.

The HVCC is a highly controversial shift in appraisal policy that resulted from a joint agreement reached between the GSEs, the Federal Housing Finance Agency ("FHFA"), and New York Attorney General, Andrew Cuomo. The HVCC purports to enhance the independence and accuracy of the appraisal process. However, what the HVCC truly accomplishes is an increase in consumer costs, a decline in appraisal quality, the extension of closing deadlines, and the virtual extinction of independent appraisers.

Although FHA has varied the provisions of the HVCC slightly in Mortgagee Letter 2009-28, these variations are unlikely to allow FHA to escape any of the serious issues currently facing consumers and originators in the conventional mortgage market as a result of the HVCC.

NAMB believes it is important to strengthen the integrity and independence of the home appraisal process, as appraiser independence is essential to protecting consumers and the FHA insurance fund from fraud and unnecessary risk. However, NAMB does not believe the HVCC, or the new FHA appraisal guidelines, will effectively achieve these goals.

The impetus behind these new appraisal policies – the HVCC and the new FHA guidelines – is the perception that appraisers were being pressured or improperly influenced by mortgage originators. However, the HVCC is failing to provide any greater protection for appraisers. Appraisers are still subjected to significant pressure and undue influence, but instead of coming from mortgage originators it is now coming from the Appraisal Management Companies ("AMCs") that were granted a virtual monopoly over the appraisal process by the HVCC.

In fact, a growing number of appraisers are reporting that the pressure and attempts to improperly influence their professional judgment is far worse under the AMC-dominated regime prescribed by the HVCC than it ever was when appraisers were permitted to work directly with originators. Specifically, appraisers are reporting that AMCs are requiring them to prepare appraisals in violation of the Uniform Standards of Professional Appraisal Practice ("USPAP") and generally accepted appraisal guidelines.

Today, unlike when an appraiser had multiple mortgage broker and/or loan officer clients, the HVCC has restricted their work to be on behalf of only one or possibly two AMCs. Under this construct, if an appraiser fails to comply with any AMC "request," they will no longer receive appraisal assignments from possibly their only client. With many knowledgeable and skilled appraisers unwilling to work under such conditions and consequently leaving the profession, the appraisers that remain willing to work for the AMCs are generally far less qualified and experienced. This has resulted in a rapid decline in appraisal quality since the implementation of the HVCC, which directly contradicts the widely purported view of HVCC proponents that turning over virtually exclusive authority for appraisal ordering to third-party AMCs would produce more accurate appraisals.

Although it can be fairly said that conducting appraisals is both a science and an art form, there is evidence showing that multiple appraisals ordered on the same property under the HVCC can vary by more than 20%. While it is unrealistic to expect multiple appraisals to come in with values that fall within a tight tolerance window, the extremely large variances we are seeing on multiple appraisals under the HVCC are cause for great concern. As the quality of appraisals goes down, there is a high likelihood that these poorly conducted home valuations will further deteriorate the already weak housing market.

Moreover, with the virtual elimination of all competition in the market for home appraisals, AMCs have reduced appraisers' fees by as much as 50%, while at the same time increasing consumer costs for appraisals by more than 50%. NAMB members are reporting an increase in consumer costs between $50 and $150 per appraisal. HUD believes it has solved this problem by making the AMCs pay rates that are "customary and reasonable" for the area where a property is located. However, with AMCs dominating the market and most AMCs underpaying appraisers for their work, it will likely prove to be extremely difficult to establish what "customary and reasonable" really means.

NAMB strongly opposes FHA's decision to follow in the footsteps of the HVCC, given its glaring weaknesses and failures in the short time since it has taken effect. Moreover, NAMB believes FHA already has a more effective mechanism in place for assuring appraiser independence, as every FHA appraisal is reviewed by the sponsoring direct endorsement lender's underwriter prior to loan approval. This system of checks has served FHA well for years and we believe would continue to do so in the absence of the proposed new appraisal guidelines. Finally, NAMB believes that adequate additional safeguards were put in place by the amendments to Regulation Z of the Truth-in-Lending Act, which took effect October 1, 2009.

Prior to the effective date of these new appraisal guidelines, FHA was the only remaining segment of the market where independent appraisers could receive a fair wage and operate without unreasonable pressure, scrutiny, or restraints. NAMB strongly encourages HUD to consider withdrawing Mortgagee Letter 2009-28 and engage representatives from both the mortgage and appraisal industries in meaningful discussions of alternative approaches prior to implementing the proposed guidelines or any other significant changes to the appraisal ordering process for FHA.

b. Appraisal Portability

Mortgagee Letter 2009-29 specifically addresses the issue of appraisal portability, which is another tremendous problem created by the HVCC. FHA's new guidelines would allow a second appraisal to be ordered under a limited set of circumstances when a borrower switches from one lender to another and restates the requirement that the first lender must transfer the appraisal to the second lender at the request of the borrower. These new guidelines are designed to prevent delays in closing that often occur when a loan is transferred from one lender to another.

NAMB strongly supports FHA's effort to increase appraisal portability. However, we are concerned that this new FHA policy, as written, will fail to achieve its intended goal. As long as mortgage brokers are prohibited from ordering appraisals for their customers, they cannot be identified as the "client," and the appraisal will not truly be portable.

Appraisals are addressed to the "client" who orders the appraisal. USPAP prohibits the "readdressing" of appraisals. When mortgage brokers order an appraisal, the broker is the "client" and that appraisal may be freely transferred to any FHA-approved sponsoring lender with whom the broker maintains a relationship. However, if lenders are required to order the appraisal and are identified as the "client," not even HUD's mandate that an appraisal must be transferred from one lender to another upon a borrower's request will permit readdressing the appraisal to the second lender. Moreover, even if a transfer of the appraisal was lawful, the time that would almost certainly be lost in that process would prove to be severely damaging to the borrower.

c. Modified Procedures for Streamlined Refinance Transactions

On January 1, 2010, FHA implemented changes to certain procedures for streamline refinance transactions to: establish new requirements for seasoning, payment history, income verification, and demonstration of net tangible benefit to the borrower; provide for collection of credit score information when available; and cap the maximum loan-to-value ratio at 125%. An appraisal is required in all cases where a borrower wants to add even minimal closing costs to the transaction.

NAMB understands HUD's rationale that these revisions were to bring documentation standards for streamline refinance transactions in line with other FHA loan origination guidelines, ensure a borrower's capacity to repay the new mortgage, and prohibit the dangerous practice of loan churning, where borrowers raise cash through successive cash-out refinancings that put them further in debt. However, NAMB is concerned that many borrowers will not be able to refinance to a lower rate, which could possibly increase the default rate rather than provide an equity cushion. Borrowers who are demonstrating financial responsibility despite hardship are being prevented from a deserved lower interest rate. When a borrower shows they have both the desire and ability to maintain his/her payments without traditional proofs of income, he/she should be allowed to refinance to a lower rate and payment.

d. *Elimination of FHA Approval Requirements for Loan Correspondents*

In a Proposed Rule published November 30, 2009, HUD sought to change the eligibility criteria for FHA lender approval. Under the Proposed Rule, loan correspondents would no longer be eligible to receive independent FHA-approved status. Rather, FHA lender approval would be limited to mortgagees.

According to HUD, this limitation reflects recognition that the mortgagee, by underwriting, servicing or owning a loan, is the most critical lending party to a mortgage transaction, and as such should be the party that is subject to FHA's rigorous lender approval and oversight processes.

Under the Proposed Rule, loan correspondents would continue to be authorized to participate in the origination of FHA loans through association with a FHA-approved mortgagee, but these entities would no longer be subject to the FHA lender approval process. Some who commented on the proposed rule have pointed out that the new rule would prevent anyone from originating a HECM (reverse mortgage) unless they were an employee of the largest lenders. This is a serious consequence of eliminating correspondent status for smaller companies' altogether.

NAMB has long advocated for changes to the FHA approval process that would help a greater number of third-party originators become eligible to originate FHA loans. Therefore NAMB is very supportive of HUD's decision to eliminate the independent approval requirement for loan correspondents. By removing the overly burdensome financial audit and net worth requirements that are currently in place for third-party originators, HUD is creating an opportunity for a greater number of third-party originators to participate in the FHA loan program and is allowing third-party originators to operate in a fashion similar to that which exists under current Fannie Mae & Freddie Mac guidelines.

Nevertheless, NAMB is concerned that disconnecting loan correspondents from the FHA system fails to adequately account for the widely varied participants in today's mortgage market. In its comment letter, NAMB strongly urged HUD to modify the Proposed Rule and grant loan correspondents full access to the FHA Connection, as well as the authority to obtain FHA case numbers and assign FHA-approved appraisers.

FHA loan correspondents take on various forms, including small banks that lack the staff to perform all FHA functions, independent mortgage bankers who do not desire to service FHA loans and mortgage brokers who possess the requisite expertise but need a funding partner. This is why NAMB believes it is important for loan correspondents to maintain some status with HUD and the FHA, and retain access to the FHA system. Specifically, NAMB believes loan correspondents must be able to obtain case numbers for FHA loans and communicate directly with the FHA. The inability to communicate with FHA or access FHA websites will pose serious issues for loan correspondents attempting to determine whether a borrower is eligible for FHA financing.

e. *Requirement for Sponsoring Mortgagees to Supervise Loan Correspondents*

In the same November 30, 2009 Proposed Rule, HUD also sought to require FHA-approved mortgagees to assume responsibility for ensuring that any loan correspondent sponsored by the mortgagee meets all applicable requirements.

The FHA-approved mortgagee would continue to act as a sponsor, as it has in the past. However, in establishing a sponsor-correspondent relationship, the mortgagee would be required to assume responsibility for the actions of any loan correspondent working with the mortgagee on a FHA loan transaction, for activities related to loan origination.

Specifically, FHA-approved mortgagees would be required to ensure that their sponsored loan correspondents comply with all requirements that make loans eligible for FHA insurance. Mortgagees must also ensure that loan correspondents meet established standards for demonstrating integrity and financial soundness, including those standards emphasized in the Helping Families Save Their Homes Act. Additionally, mortgagees would be responsible for ensuring that all parties to an FHA transaction comply with FHA's requirements regarding loan origination, processing, underwriting, and servicing found in relevant statutes, regulations, HUD handbooks, and mortgagee letters. Finally, the FHA-approved mortgagee would be required to assume liability for any FHA-insured loan underwritten and closed in the name of the mortgagee.

In its comment letter, NAMB expressed concern that the Proposed Rule goes too far in transferring all supervisory authority over loan correspondents from HUD to sponsoring FHA-approved mortgagees. NAMB believes that it is proper for HUD to establish some standards for loan correspondents that may be reasonably supervised by sponsoring mortgagees. However, some tracking and control functions are better performed by a government agency. For this reason, NAMB strongly believes the oversight of loan correspondents should be shared between HUD and the sponsoring FHA-approved mortgagees. For these reasons, NAMB encouraged HUD to revise the Proposed Rule and provide for more balanced, dual oversight of loan correspondents.

f. <u>Requirement that Loans be Underwritten and Closed in the name of the FHA-Approved Mortgagee</u>

HUD has also proposed a requirement that all FHA-insured mortgages be underwritten and closed in the name of the FHA-approved mortgagee. NAMB does not support the requirement that all loans must be underwritten and closed in the name of the FHA-approved mortgagee. Such a requirement is inconsistent with current practices under GSE and VA loan programs, conflicts with various state and federal laws, and will create issues in numerous states where loan correspondents function as lenders or table-funding entities.

It is a common misperception that the term loan correspondent is synonymous with mortgage broker. In reality, FHA loan correspondents take various forms, including small banks that lack the staff to perform all FHA functions, independent mortgage bankers who do not desire to service FHA loans, and mortgage brokers who possess the requisite expertise but need a funding partner. The requirement in the Proposed Rule that all FHA-insured loans be underwritten and closed in the name of the approved mortgagee effectively declares any entity that is not a FHA-approved mortgagee is a mortgage broker, irrespective of the entity's net worth, typical market function, or classification under different state laws and regulations.

By effectively changing the classification of such entities, the Proposed Rule could impose a number of unintended economic burdens on formerly FHA-approved loan correspondents. For example, these entities may need to obtain further licensing under state laws with regard to mortgage brokering (as opposed to mortgage lending) activities. Additionally, state law may impose limitations on the fees these entities are permitted to charge when acting in a mortgage broker capacity. Finally, these entities will be required to provide different disclosures to consumers under the Real Estate Settlement Procedures Act ("RESPA") and various state laws when acting as a mortgage broker, as opposed to a lender.

g. <u>Increased Net Worth Requirements for FHA-Approved Mortgagees</u>

Finally, HUD included provisions in the November 30, 2009 Proposed Rule that would increase the net worth requirement for FHA-approved mortgagees in an effort to comport with current industry standards. The current net worth requirement for mortgagees approved by FHA is $250,000. This figure has not increased since 1993.

The Proposed Rule would initially increase the minimum net worth requirement to $1 million, with at least twenty percent of that figure being liquid assets consisting of cash or its equivalent. Within three years after enactment of this rule, the minimum net worth required for mortgagees would be increased to $2.5 million, with at least twenty percent of that amount consisting of liquid assets.

The Proposed Rule cites the recent rise in net worth requirements by Fannie Mae and Ginnie Mae as evidence supporting the increase for FHA-approved mortgagees. However, this comparison is flawed because FHA is more akin to a Private Mortgage Insurance ("PMI") company than to Ginnie Mae or the GSEs. While it is reasonable for Ginnie Mae to establish and maintain criteria similar to that set by the GSEs, since these entities perform similar functions, it is unreasonable and excessive for FHA to impose such requirements when its contemporaries – the PMI companies – require no similar net worth.

NAMB is concerned about an increased net worth requirement for two primary reasons. First, it would tend to concentrate power and control in the hands of only the largest lenders. Under such a scenario, when a large entity fails, the resulting losses could severely destabilize the FHA insurance fund. Also, there is a real risk that providing the largest lenders with a virtual monopoly will result in higher costs and other adverse consequences for consumers and small businesses. For example, the increased net worth requirement is likely to force many smaller entities to surrender their FHA-approved mortgagee status.

However, because the Proposed Rule will require the few remaining FHA-approved mortgagees to assume responsibility for their sponsored loan correspondents, it is fair to assume the supply of correspondents will greatly exceed the demand and risk tolerance of mortgagees for sponsoring these correspondents. The net result will be fewer entities originating FHA loans, as many highly qualified originators will be forced out of the FHA market altogether, due to lack of sponsorship and insufficient capital to obtain independent approval.

Second, net worth has been shown to evaporate in mere days, meaning the satisfaction of a net worth requirement, no matter how large, can create a false sense of security. To date, there has been no link made between loan quality or performance and net worth. Eliminating high-quality mortgagees simply on the basis of net worth could have an inverse effect and actually harm the quality of FHA loan production.

Instead of establishing an unreasonably high net worth requirement, NAMB urged HUD to explore implementation of a recovery fund, whereby every FHA-approved mortgagee must contribute to the fund in order to originate, fund or service an FHA loan. Such an alternative would be similar to the current standard requirements for any person that wants to become licensed in a state pursuant to the SAFE Act.

Additionally, NAMB encouraged HUD to explore other alternatives to increasing the net worth requirements as proposed, including establishing tiered net worth requirements based on volume.

VI. FHA is Not the New Subprime

With the collapse of the subprime market, there is some concern that the problems leading to that collapse will begin to creep into the FHA market and expose the FHA insurance fund to greater risk. NAMB strongly believes that the FHA rules and guidelines currently in place, together with the strong and positive FHA policy changes and larger reforms affecting the entire mortgage industry, will be sufficient to prevent this from happening.

The SAFE Act has significantly increased professional standards and accountability for all mortgage originators. Today, as opposed to during the peak of the subprime lending boom, it is extremely difficult

for bad actors to enter, remain, or move within the mortgage industry to prey on consumers. Additionally, FHA imposes its own requirements for mortgagees and loan correspondents, which further vets the individuals and entities that may be approved to participate in the program. Finally, much like originators, borrowers using FHA must adhere to higher standards than the ones which existed in the subprime market. Some of these higher standards include income verification, mandatory downpayment requirements and strict loan-to-value ratios. FHA also does not permit many of the loan product features, such as prepayment penalties, huge payment spikes, and negative amortization, which exposed borrowers and lenders to greater risk and were prevalent in so many loans made in the subprime market, and FHA requires borrowers to occupy the home they are purchasing as their primary residence, which was never a requirement in the subprime market.

There has almost certainly been some migration of mortgage originators from the subprime market over to FHA, since a significant majority of the mortgage industry was involved in some way with subprime lending. However, with the safeguards in place at FHA and throughout the mortgage industry, this migration should not be viewed as a threat to the FHA program, but rather as a tremendous opportunity for growth. Now, perhaps more than ever, highly qualified and well-established mortgage originators are again looking to FHA as a means of offering an affordable loan product to their customers. This renewed interest in the FHA program, coupled with heightened standards for every mortgage originator who wishes to remain in the industry, should position FHA to recapture much of the market share that was lost to the subprime market over the past decade.

VII. Conclusion

NAMB and the mortgage professionals we represent are very interested in maintaining a strong, healthy and relevant FHA loan program. FHA has been an innovator as well as an engine driving the housing market in this country. Not since the Great Depression has FHA's role been so vital.

Thank you for inviting NAMB to testify today and offer our perspective on "The FHA Reform Act of 2010," as well as the many administrative and regulatory changes to FHA proposed and implemented by HUD in recent months. We are grateful for the opportunities we have had to work with HUD and this Committee on a variety of issues, and we look forward to building and strengthening these relationships as we continue to work together to improve the strength and soundness of the FHA loan program.