



Testimony of John A. Courson
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Before the
House Financial Services Subcommittee on
Housing and Community Opportunity
Hearing on
“The FHA Reform Act of 2010”
March 11, 2010

Chairwoman Waters, Ranking Member Capito and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)¹ on the proposed FHA Reform Act of 2010. I am John Courson, President and Chief Executive Officer of MBA. I was engaged in the mortgage banking industry, and an FHA approved lender, for over 40 years and was MBA Chairman in 2003.

The Federal Housing Administration (FHA) is especially important to segments of the population who need a little extra help to achieve the American dream of homeownership. More than any other nationally available program, FHA focuses on the needs of first-time, minority, and low- and moderate- income borrowers. According to recent data provided by the Department of Housing and Urban Development (HUD), both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. As of January 2010, approximately 81 percent of FHA-insured home purchase loans were made to first-time homebuyers, and 32 percent of these first-time loans were made to minorities. Minorities also comprise a higher percentage of the FHA market than the conventional mortgage market.

MBA has always been a proponent for a strong and vibrant FHA. We called for updates and enhancements to FHA's risk management, scope and operations well before the current market disruptions reestablished FHA's prominence as a catalyst for bringing liquidity to the housing finance system. MBA believes FHA's dramatic growth and corresponding need to keep the Mutual Mortgage Insurance Fund ("MMI Fund") solvent make it imperative that we act swift and appropriate measures to preserve the agency's strength and viability now and over the longer term. Protecting and improving FHA requires a multifaceted approach: ensuring that FHA has the right resources; requiring appropriate eligibility standards for lenders; creating credit policies that are both prudent and aligned with FHA's mission; and ensuring that FHA is providing market liquidity during times of crisis.

When MBA last testified before the House Financial Services Committee, FHA had recently released its Actuarial Report. The report showed that the capital reserve account of the MMI Fund had fallen well below the statutory target of two percent. In fact, it had fallen dramatically from three percent in 2008 to just 0.53 percent in 2009. The announced shortfall in the capital reserve account was a major wake-up call for FHA and the lending community but not a reason to panic. The two percent target was established by Congress to ensure that FHA could withstand the stress of a major housing and mortgage market downturn, an event like the one experienced by the

¹The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 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.

industry over the past two years. In response to the decrease in the reserve account, HUD and FHA leadership have been taking proactive measures in order to ensure that a taxpayer “bailout” will not be necessary.

These measures include a series of policy changes that address risk management – changes designed to strengthen FHA’s capital reserves. Announced by FHA on January 20, 2010, these policy changes fall into three categories: 1) legislative; 2) regulatory; and 3) operational.

The legislative changes, which require congressional action, include:

- Increasing the statutory cap on the annual mortgage insurance premium (MIP). In concert with the increase, the upfront and annual premium structure will be adjusted, with some of the upfront premium being shifted to the annual premium.
- Amending the National Housing Act to apply indemnification provisions to all Direct Endorsement (DE) lenders.
- Granting HUD the flexibility to establish separate “areas” for review and termination under the Credit Watch initiative. With this authority, FHA could withdraw a lender’s nationwide approval on the basis of the performance of one or more of its regional branches.

The regulatory changes, which would be implemented through a notice and comment rulemaking, include:

- Requiring a 10 percent downpayment for loans to borrowers with a credit score of 579 or lower.
- Reducing allowable seller concessions from six percent to three percent.
- Implementing statutory authority to enforce indemnification provisions for lenders using delegated insuring process.

The operational changes, which FHA can implement on its own or through Mortgagee Letters, include:

- Raising the upfront mortgage insurance premium by 50 basis points to 2.25 percent – this change goes into effect April 5, 2010.
- Enhancing the monitoring of lender performance and compliance with FHA guidelines and standards – FHA has begun implementation.
- Publicly reporting lender performance rankings – FHA has begun implementation.

MBA supports many of these regulatory and operational changes, such as increasing the downpayment requirement for borrowers with credit scores below 580, raising the upfront MIP, and enhancing the monitoring of lender performance and compliance with FHA guidelines and standards. We also support increasing the annual premiums, to be implemented with a reduction of the upfront premium.

We have concerns, however, about some of FHA's other proposed changes, such as expanding indemnification to include all DE lenders, the authority to withdraw approval for a lender's nationwide operations on the basis of the lender's performance at a regional branch, and reducing allowable seller concessions.

MBA offers the following remarks with respect to the policy changes this subcommittee requested that we specifically address.

FHA Proposed Legislative Changes

Increase in the Annual Mortgage Insurance Premiums

MBA supports a reasonable increase in the annual mortgage insurance premiums. On April 5, 2010, the upfront MIP will increase from 1.75 percent of the loan amount to 2.25 percent – the statutory maximum – for most FHA mortgages (the Home Equity Conversion Mortgages and HOPE for Homeowners programs are notable exceptions). HUD is asking Congress to increase by statute the maximum annual premium FHA is authorized to charge from 0.55 percent to 1.55 percent. If this legislative change is enacted, FHA plans to lower the upfront premium and increase the annual premium. This shift will allow for an increase to the capital reserve with a lower up-front cost to the consumer. MBA supports this request and its plan for implementation.

Indemnification Changes for Direct Endorsement Lenders

MBA supports high standards for all lenders that participate in the FHA programs in order to protect the viability of FHA, the lender's reputation, and the reputation of the industry. HUD is proposing to extend the Secretary's authority to require indemnification by lenders to include all Direct Endorsement lenders, not just those that participate in the Lender Insurance (LI) program.

FHA-insured single family mortgages are originated and underwritten through the DE process, which allows an FHA-approved DE lender to underwrite mortgage loans, determine their eligibility for insurance, and submit them directly for insurance endorsement without FHA's prior review. High-performing DE lenders with acceptable default and claim rates may apply to be approved to participate in the LI program, which enables these lenders to endorse FHA mortgage loans for insurance without a pre-endorsement review by FHA.

From February 1, 2009, through February 1, 2010, there were approximately 2,024 active DE lenders; 596 of these lenders were also approved for participation in the LI Program. As of January 2010, approximately 71 percent of FHA loan volume was endorsed through the LI process. Expanding this section of the National Housing Act to include DE lenders would impact approximately 1,428 lenders.

Under the statutory authority of section 256(c) of the National Housing Act, the HUD Secretary can require indemnification (the lender agreeing to assume the risk of what may be an anticipated loss by FHA) of a loan through the LI program if the loan was not originated or underwritten in accordance with requirements established by HUD. If fraud or misrepresentation was involved in connection with the origination or underwriting, HUD may require these lenders to indemnify HUD for the loss regardless of when an insurance claim is paid. This existing authority only applies to indemnification by LI lenders and currently does not include DE lenders that are not participants in the LI program. For loans not originated under the LI program, HUD may request, but not require, indemnification by the mortgagee. It is important to note that all FHA loans are subject to indemnification by any DE lender – participating in the LI program or not – in the event of lender fraud or material misrepresentation.

Lenders participating in the LI program are able to endorse FHA mortgage loans without a pre-endorsement review by FHA. These lenders are willing to accept the additional risk of indemnification in the event they fail to originate or underwrite a loan in accordance with HUD's requirements. In contrast, all of the FHA loans originated by DE lenders not in the LI program undergo a pre-endorsement review by FHA prior to the issuance of the insurance certificate.

Indemnification is a very serious issue. Lenders incorporate sophisticated quality control systems to minimize their exposure to these liabilities. By extending this additional responsibility onto DE lenders, FHA will cause responsible lenders to become even more cautious in underwriting loans. FHA's action would run counter to its mission by reducing the availability of affordable housing credit. MBA members recognize and accept accountability for instances of fraud and negligence within their control. They are concerned, however, about the layering of additional risk management requirements that significantly increase compliance costs and lead to fewer responsible borrowers qualifying for FHA loans.

Establishing "areas" for purposes of Review under the Credit Watch Initiative

FHA is also seeking a legislative change that would give the agency maximum flexibility to establish separate "areas" for purposes of review and termination under the Credit Watch initiative. This change would provide authority to withdraw originating and underwriting approval for a lender nationwide on the basis of the performance of its regional branches.

FHA should be fully empowered to enforce its guidelines, including taking swift action to sanction remediation against violations commensurate with their level of severity. Moreover, we understand that particularly egregious abuses may merit sanctions against a lender beyond the regional level.

MBA wants to work with FHA to develop fair and transparent processes and procedures for determining the grounds for triggering a nationwide action against a lender. We urge

Congress to require that the policy include well-defined and incremental enforcement standards so that lenders have ample opportunity to rectify any regional concerns within their field office before FHA imposes a national sanction. National lenders should be afforded the ability to demonstrate the actions they implemented before HUD takes more drastic action.

Other Comments

Reducing Seller Concessions

FHA is proposing to reduce the current maximum seller concession from six percent to three percent. This change will make FHA's standards consistent with Fannie Mae and Freddie Mac's seller concession policies. MBA plans to comment on this proposed regulatory change thoroughly during the public comment period.

For the purposes of this hearing, we would like to point out that the reduction in seller concessions will primarily impact low-to-moderate, first-time, and minority homebuyers. Seller concessions are usually used to pay for borrowers' closing costs and make buying a home more affordable. We are concerned that this could be another policy change that would have an adverse effect on the population that traditionally has sought FHA's assistance to purchase a home. We believe it is important to carefully balance FHA's risk management obligations with its duty to pursue its affordable housing mission and support the housing recovery.

Changing FHA Downpayment Requirements

There has been much discussion among policymakers and the industry about whether FHA should increase its minimum 3.5 percent downpayment requirement. One of the changes FHA recently proposed is to raise the minimum downpayment to ten percent for borrowers whose credit scores are lower than 580. MBA supports that change. We do not, however, believe that the minimum downpayment should be raised for all FHA borrowers. Although well intentioned, there are better ways to reduce risks to FHA.

With lenders requiring higher downpayments and private mortgage insurance being unavailable in many cases, FHA is more important to the market today than ever. Increasing the downpayment requirement will greatly reduce the availability of credit at a time when we are just beginning to see signs of economic recovery.

Other actions, such as a updating of the TOTAL Scorecard and changes to premium levels, are alternative ways to manage risk. We should allow ample time to test those policy changes before enacting an across-the-board downpayment increase.

TOTAL Scorecard

As FHA is assessing all of its risk management tools and polices, we strongly encourage the agency to examine the FHA TOTAL Scorecard in order to improve its reliability, and functionality. MBA believes the time is right to reevaluate whether the current scorecard is the right technology for promoting sustainable homeownership. In particular, such an evaluation should review the thoroughness of the scorecard's borrower risk assessment capabilities.

Resources Necessary for Improved FHA Operations

MBA believes a critical requirement for achieving, sustaining and protecting the housing market's long-term vigor is ensuring that FHA has the resources it needs to operate in a modern, high-tech real estate finance industry. FHA's staff levels have remained virtually unchanged in recent years, even though its market share has risen from three percent to over 30 percent. This ratio of activity to resources is unsustainable, because it stretches FHA beyond its capacity. MBA strongly supports H.R. 3146, the 21st Century FHA Housing Act, which would provide FHA with up to \$72 million in funding to hire additional staff and upgrade its compensation levels so they would be commensurate with those at other federal financial regulators. The bill also permits funding to upgrade technology. Modern technology would enable FHA to better monitor lenders, protect against fraud, and generally be better equipped to handle the challenges of a modern marketplace.

MBA is grateful that, under the Housing and Economic Recovery Act of 2008 (HERA), Congress authorized \$25 million to be allocated each year from FY 2009 through 2013 to provide FHA with improved technology and processes and to help reduce mortgage fraud. The Omnibus Appropriations Act of 2009² made \$4 million available for FY 2009 and FY 2010 to be used "for planning, modernizing, improving and maintaining information technology applications and infrastructure supporting FHA." While this funding is appreciated, it is not nearly enough to address FHA's growing needs. We urge Congress to provide the full \$25 million each fiscal year through 2013, as authorized under HERA. Furthermore, as in H.R. 3146, FHA should be given the statutory authority to use its future revenues to make technology upgrades as needed. Ensuring these resources are available to FHA not only helps support the viability of its products and services, but it also helps protect the MMI Fund and the American taxpayer.

FHA Multifamily Programs

MBA would like to commend the House for passing H.R. 3527, the FHA Multifamily Loan Limit Adjustment Act, in September 2009. While FHA's multifamily loan limits are

² Pub. L. 111-8 (March 10, 2009).

sufficiently high in most markets, in some areas of the country they are severely restricting the ability to use FHA insurance programs to finance rental housing. H.R. 3527 will increase the loan limits for elevator buildings and provide the HUD Secretary with additional discretion in extremely high cost areas (similar to that provided in Alaska and Hawaii today).

MBA is also working closely with FHA on underwriting changes for new and rehabilitated rental properties. As is the case on the residential side, FHA's multifamily programs are experiencing heightened demand during the economic downturn. Until other sources of capital return, FHA will continue to see record growth in its share of the multifamily market. We believe the alignment of interest between FHA and the MBA on these issues is very strong, and we look forward to continuing to work with FHA to promote prudent lending decisions that will preserve the MF Insurance Fund.

Conclusion

MBA appreciates that FHA is performing the countercyclical role for which it was created by ensuring a stable, liquid and affordable source of housing finance during this difficult time in the housing market. We look forward to working with FHA and Congress to strike a balance between prudent risk management practices and providing assistance to qualified borrowers. Thank you again for the opportunity to share MBA's views.