Increase Certainty for Lenders Participating in the FHA Program

The legal and reputational risks associated with originating Federal Housing Administration (FHA)-insured loans have increased markedly in recent years. MBA supports efforts to develop clearer standards and expectations for lenders doing business with FHA. Such improvements will incentivize greater lender participation and increase the availability of affordable mortgage credit, particularly for low- to moderate-income and first-time homebuyers.

OVERVIEW

- For each individual loan for which insurance is obtained through FHA, lenders must certify many processes and data elements regarding the loan terms, borrower information, loan approval conditions, and numerous other factors.
- Lenders must also make annual certifications to attest to the institution’s compliance with FHA program requirements, including net worth and quality control requirements. Lenders unable to certify on their FHA annual renewal must supply the Department of Housing and Urban Development (HUD) with a written explanation of the reasons for their inability to certify compliance.
- Separately, in June 2015, HUD released its final Single Family Housing Loan Quality Assessment Methodology (Defect Taxonomy). The Defect Taxonomy is FHA’s plan to increase the efficacy of its own quality assurance efforts. It serves as a common language for classifying loan-level defects and addresses FHA’s strategy to identify and capture information about defects and severities revealed through an individual loan-level review.
- In May 2017, FHA implemented its Loan Review System (LRS), which operationalized the Defect Taxonomy. The LRS reviews provide defect categories and severity tiers to lenders. However, full implementation of the Defect Taxonomy remain incomplete, awaiting additional work to align defect severities with the appropriate remedies.

IMPACT

- In recent years, the Department of Justice (DOJ) has relied upon the loan-level and annual certifications to pursue lenders for treble damages under the False Claims Act.
- These certifications hold lenders to an unreasonable standard of perfection that results in a threat of False Claims Act liability for minor loan defects, which has in turn caused many lenders to retreat from the FHA program.

For more information, visit mba.org or call (202) 557-2700.
Because the final Defect Taxonomy failed to address the concerns repeatedly raised by MBA, including the lack of specific remedies for each defect severity tier, it has not fully achieved its potential to serve as a precise, transparent quality assurance mechanism for lenders.

Similarly, the LRS has provided little additional enforcement clarity, which makes it difficult for lenders to accurately assess their potential liability. This outcome has also contributed to the pullback in FHA participation by many lenders.

MBA’S POSITION / NEXT STEPS

- MBA strongly believes that lender participation in the FHA program will not show substantial or sustained improvement unless lenders are provided with greater clarity regarding their responsibilities and potential liability when originating FHA-insured loans. Creating well-defined standards and expectations for lenders is therefore critical to expanding access to credit.

- MBA firmly supports HUD’s stated intent to only hold lenders liable for mistakes that would have altered the decision to approve and insure the loan. However, MBA continues to believe that an official clarification of HUD’s original intent through revisions to the loan-level certification is vital to restoring legal certainty and expanding participation in the program.

- MBA also appreciates HUD’s attention to process and operational improvements related to the annual certification. However, MBA maintains that HUD should streamline its certification clearance process through reliance on the lender’s certification statement, or on lender information disclosed through normal reporting. This will alleviate burdens for both HUD and lenders throughout the certification process.

- MBA believes that a clear and fair quality assurance program will provide the transparency and consistency lenders need to do business with FHA and provide affordable mortgage credit to low- to moderate-income and first-time homebuyers.

- MBA continues to advocate for the LRS to include a Defect Taxonomy that assigns specific—and appropriately proportioned—remedies to each defect tier. Until it can provide lenders with a clear understanding of the consequences associated with certain defects, the Defect Taxonomy will not have a meaningful impact on increasing access to credit.

- MBA will also continue working with FHA to develop clear, reasonable and consistent standards that focus on errors affecting insurability and seek to improve the overall manufacturing quality of FHA-insured lending.

- MBA continues to support the need for legislation, such as that which was introduced in 2018 during the prior Congress by Reps. Josh Gottheimer (D-NJ) and Lee Zeldin (R-NY), to encourage HUD and DOJ to pursue these needed False Claims Act liability changes.