



October 15, 2014

Kathleen Zadareky
Deputy Assistant Secretary for Single Family Housing
U.S. Department of Housing and Urban Development
451 7th Street, S.W.
Washington, D.C. 20410

Re: FHA's Single Family Housing Loan Quality Assessment Methodology (Defect Taxonomy)

Dear Deputy Assistant Secretary Zadareky:

The Mortgage Bankers Association (MBA) appreciates the Department of Housing and Urban Development's (HUD) efforts to develop a new quality assurance framework and to seek input from stakeholders to ensure the process is well-designed, comprehensive, and implementable. MBA shares HUD's goals in the proposed "FHA's Single Family Housing Loan Quality Assessment Methodology (Defect Taxonomy)" and believes a new quality assurance framework should:

- communicate a clear policy message;
- encourage lending to FHA targeted populations; and
- provide timely feedback on the effectiveness of HUD's underwriting policies and procedures.

Once the proposal is refined and finalized, the Taxonomy has the potential to provide lenders with clearer and more timely feedback that will benefit both lenders and HUD by ensuring that all parties have a mutual understanding of expectations and consequences. MBA is encouraged that a Taxonomy that is truly transparent will facilitate lenders and HUD working together to ensure the origination of quality FHA-insured loans and eliminate a "gotcha" environment where lenders fear that minor errors will lead to indemnification requests. Greater certainty regarding indemnification risk can benefit consumers by providing lenders comfort to expand the credit box and increase access to affordable mortgage credit.

Feedback and Recommendations

Over the previous month, MBA has worked closely with its members to develop a list of issues and clarifications which HUD should address before proceeding with the development and implementation of the Taxonomy. The members who provided input represent a wide range of mortgage bankers, from large national banks to small, independent mortgage bankers. MBA and its members have identified over 100 issues, most of which are requests for clarifications which would strengthen the communication and understanding of the taxonomy for lenders and promote the understanding of HUD's intent of the Taxonomy. In general, MBA commends HUD for its conscientious delineation of its defect tiers. As instructed, MBA has submitted its detailed, page-by-page feedback to HUD and has highlighted particular instances where we

believe HUD should conduct additional outreach with lenders. For example, MBA believes significant work still needs to occur in the Lender Operations category. MBA would be pleased to facilitate input from a diverse group of lenders.

In addition to the detailed feedback, MBA also has several high-level recommendations regarding the Taxonomy and the implementation plan, which are discussed below.

Clarify Remedies Associated with Each Tier and Defect

Currently, the draft proposal does not assign remedies to any of the four tiers or to specific defects within them. HUD has indicated that the only statutory remedy available to the agency is indemnification. Based on lenders' analysis of the example criteria, Tiers 3 and 4 should not include defects that require indemnification. Further, depending on the individual case, defects in Tiers 1 and 2 can be cured by a lender or may require indemnification. MBA requests that HUD provide specific confirmation that loans in Tiers 1 and 2 may be cured through the existing processes, and that loans in Tiers 3 and 4 will never be the subject of indemnification demands.

Providing lenders with specific remedies for each tier would further support HUD's stated goal of increased transparency and clearer communication with lenders. Without explicit statements that Tiers 3 and 4 defects do not require indemnification, HUD's intended outcome of the Taxonomy encouraging lending to FHA targeted populations is nullified, as it does not significantly change the current lending environment.

MBA strongly recommends that HUD explicitly state that defects associated with Tiers 3 and 4 are not indemnifiable and that Tiers 1 and 2 defects may be curable. A clear statement from HUD on whether a tier includes potential indemnifiable defects removes any ambiguity and better ensures that lenders have clear expectations of the consequences associated with specific defects. *This is the most critical change needed to the proposal— if it is not made none of the other proposed changes will have a meaningful impact on increasing access to credit.*

Revise Lender Certifications to Provide Certainty

As previously stated, MBA applauds HUD's effort to clarify its quality assurance processes. The quality assurance process is a critical part of lenders' risk assessment; however, it is not the only one. Lenders consider other factors, such as the impact of FHA's servicing rules, the compare ratio, and, increasingly, legal action by the Department of Justice (DOJ). MBA cautions HUD that its goal of encouraging lending within FHA's mission of serving low and moderate income borrowers is seriously jeopardized if HUD does not revise its current lender certifications. Amending HUD certifications to reflect realistic lender assertions is key to providing lenders with the comfort that they will not be subject to lawsuits triggered by minor errors. MBA strongly recommends that HUD use its authority to create clear legal expectations for lenders.

Evaluate Loans Based on Documents Lenders Used to Originally Underwrite the Loans

The criteria by which HUD will review a loan to determine its Basis of Ratings code is unclear. To provide a fair assessment, MBA recommends that HUD evaluate loans based only on evidence available to the lender at the time of origination. This policy is key to HUD ensuring that lenders are held to a fair and reasonable standard.

Two simple examples prove this point. In some cases, information available at the time of origination clearly indicates that the borrower intends to occupy the subject property as their primary residence, and the lender has satisfied all FHA requirements. However, if conflicting documentation emerges after closing, the lender should not be required to indemnify the loan. Similarly, a loan should not be subject to indemnification when the lender underwrites a loan based on supported and verified income documentation in the original loan file, but new information comes to light years after the closing that may contradict that verified data, such as representations in a borrower's subsequent bankruptcy filing.

MBA urges HUD to clarify that the agency will only use information available to the lender at the time of origination to evaluate loans.

Partner with Industry to Provide Additional Clarity in the “Valuation Process” Category

As previously stated, MBA highlights specific sections in the Taxonomy where we recommend HUD and the industry collaborate to improve the communication of the quality assessment methodology. A significant category that warrants particular attention are the issues related to appraisal and property eligibility. Additional specificity and the inclusion of tolerances in this category are necessary to ensure that lenders will not be held accountable for information that is not in their control or for retrospective information that is based on new data. For example, per the appraisal independence requirements, lenders are not responsible for the comparables (“comps”) that appraisers use to determine the value of a property. HUD, therefore, should not expect lenders to indemnify loans because HUD believes the values of homes were calculated incorrectly based on poor comp choices by appraisers. These types of distinctions within the description of the category are essential for lenders in order to provide the comfort they need to expand their credit boxes and provide greater consumer access to credit.

MBA recommends that HUD work with industry to develop reasonable, fair, and well-communicated valuation standards.

Provide a Sunset on Indemnifications

MBA strongly recommends that HUD implement a sunset period on lender indemnification, similar to the policy of the Government Sponsored Enterprises (GSEs). The GSEs offer a sunset from loan put-backs from lenders if certain conditions are met, such as if a loan reaches 36 months with no more than two 30-day delinquencies. Well-defined sunsets provide certainty and are good ways to encourage lenders to expand the credit box. MBA would like to work with HUD to develop appropriate sunset guidelines for the FHA program.

Provide an Independent Arbitration Method to Reconcile Taxonomy Disputes between HUD and Lenders

While the Taxonomy strives to provide an objective methodology, HUD and lenders still may encounter situations where they cannot reach agreement on a defect or the remedy. This situation would be especially problematic if the conflict is related to a possible indemnification. If the parties are at an impasse on a loan or loans, MBA believes that independent arbitration should be available to provide unbiased dispute resolution. MBA would like to work with HUD to develop an appropriate independent dispute resolution process that would be fair, expeditious, and transparent.

Provide Details on Taxonomy Implementation, Maintenance, and Review

MBA has unanswered questions about how the Taxonomy will be implemented; its maintenance, including how criteria will be updated; and the review process for ensuring that it is meeting its intended purposes. We request that HUD outline its plans to stakeholders as it develops the Taxonomy. MBA strongly recommends that HUD not implement the Taxonomy until after it addresses significant issues outlined in this letter and in the detailed form. Moreover, we also encourage HUD to maintain communication with industry throughout the development process and after the Taxonomy is finalized.

Conclusion

MBA greatly appreciates HUD's work to develop a loan quality assessment methodology and HUD's effort to seek needed input. MBA looks forward to continued dialogue with HUD as this process advances.

Should you have any questions or wish to discuss and aspect of these comments further, please contact Tamara King, Associate Vice President of Loan Production and Member Engagement at 202-557-2758 or tking@mba.org.

Sincerely,

Pete Mills
Senior Vice President, Residential Policy and Member Services
Mortgage Bankers Association