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December 30, 2009

The Honorable David Stevens
Assistant Secretary for Single-Family and FHA Commissioner
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Docket No. FR 5356-P-01
Federal Housing Administration (FHA): Continuation of FHA Reform –
Strengthening Risk Management Through Responsible FHA-Approved
Lenders

Dear Sir:

American Bankers Association appreciates the opportunity to comment on the Department of Housing and Urban Development's (HUD) proposal to modernize and reform risk management of the Federal Housing Administration program (FHA).

ABA understands and encourages the Department's objectives of increasing risk management and ensuring financial soundness of the FHA program. We are concerned, however, about the impact of the Department's proposal to remove approval requirements for loan correspondents. Our comments will focus on this aspect of the proposal.

Proposal:

In the issuance published on November 30, 2009, FHA proposes to no longer approve loan correspondents as approved participants in FHA programs. Mortgagees would be required to ensure that their loan correspondents meet applicable requirements. The FHA-approved mortgagee will, in turn, act as sponsor as it has in the past. However, in using a sponsor/correspondent relationship, the sponsoring mortgagee must agree to assume responsibility for any loan correspondent that works with the mortgagee in the FHA insured loan, and assume liability for the FHA-insured loan underwritten and closed in the name of the FHA-approved mortgagee.

The intended effect of this proposal is to greatly increase the responsibility and liability of an FHA-approved mortgagee over its loan correspondents. The proposed changes will result in an abrupt shift of liability that would effectively render a sponsor legally responsible for all acts, errors, and omissions of any non-approved loan correspondent, regardless of fault or any knowledge on the part of the mortgagee.

ABA Position:

ABA is in general agreement that increasing the FHA-approved mortgagee's responsibilities over loan correspondents will lead to diminished risks for the FHA insurance fund, as well as a likely increase in the quality of FHA loan origination practices. We are in accord with these principles, and want to ensure that HUD's objectives of strengthening this mortgage insurance program are fully achieved. We are, however, concerned about the boundless liability that this proposal will impose on lenders, and therefore present recommendations on confining such risk to manageable levels.

ABA's overall worry regarding this proposal stems from the fact that this vast governmental surrender of oversight will cause profound changes in FHA lending across all states. The proposed rule would subject mortgagees to penalties for any and all violations of HUD requirements in connection with an FHA-insured loan.

ABA Recommendation:

ABA believes that the transfer of program oversight set forth in this proposed rule would be more acceptable, and financial institutions would be more willing to continue operating in FHA, if there are appropriate assurances regarding the compliance and legal risks associated with this program. Risk management controls required by lenders could be achieved by drawing proper limits around that liability, and in clarifying the criteria that FHA-approved mortgagees must use to analyze the correspondent's character and institutional soundness.

ABA proposes that the Department adopt a set of specific steps that can serve as a "safe harbor" for the mortgagee. We note that there are various precedents for such an approach, including an Interagency Guidance on Nontraditional Mortgage Product Risks, issued in October 2006, which specifies criteria for strong systems and controls for establishing and maintaining relationships with third parties. *See* 71 FR 58609. In addition, banking agencies have numerous guidelines and compliance bulletins that establish proper management for risks that arise from all types of third party arrangements. These banking agency guidelines are currently in full effect, and have proven successful in managing third-party risks for depository institutions.

ABA strongly recommends that HUD use these existing regulatory provisions as a guide in the current FHA context, to ensure that mortgagees are provided with appropriate clarity over their correspondent relationships. We encourage HUD to carefully review these regulatory precedents. ABA respectfully submits the following list, which could be used in

any final FHA rule, as a recommendation of the types of factors that could serve as “safe harbor” protections against FHA sanctions emanating from acts or omissions of third parties—

- Institutions should have “strong systems and controls” in place for establishing and maintaining relationships with third parties;
- Institutions should have procedures for performing due diligence;
- Mortgagees should have monitoring procedures to track loan quality from each third-party source;
- Institutions should maintain clearly identified steps to address instances of documentation problems, credit lapses, or consumer complaints;
- Institutions should establish clearly delineated steps to take remedial actions involving lapses in third-party operations;
- Mortgagees should have to obtain MARI reports on all correspondents;
- Mortgagees should maintain broker-originator recertification programs, including annual validation that brokers meet established integrity requirements or training;
- Institutions should be able to demonstrate quality control policies and procedures.

ABA understands that any “safe harbor” protection should not be so all-encompassing as to rid lenders of all liability. Under ABA’s safe harbor suggestion, mortgagees would be responsible for monitoring the quality and performance of loans received from third party originators. In addition, FHA-approved entities that accept loans from correspondents should still remain liable to the consumer for any loan-level defects. These safe harbor provisions would, however, provide reasonable protections for mortgagees in Mortgagee Review Board proceeding and investigations to debar and/or sanction lenders for the omissions of correspondents.

ABA believes that, if adopted, these recommendations would go a long way in mitigating potential harm to all parties involved in FHA transactions as unintended effects of the proposal. Changes of the type suggested here would encourage the desired behavior and oversight in a manner that benefits the consumer, the lender, the correspondent, as well as the FHA fund itself.

Summary:

ABA appreciates the opportunity to offer views on the important matter of modernizing FHA. We believe, however, that before HUD finalizes any FHA rule, it must ensure that it contains clear guidance as to how mortgagees can avoid the unbounded liability risks imposed by a proposed system that transfers all third-party risk to the sponsor. Rational steps to avoid unbounded liability is essential to prevent needless disruptions in FHA lending, and to ensure that banks can continue to safely contribute to the success of the FHA program.

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For any questions on the above, please contact ABA's Rod J. Alba, at ralba@aba.com, or 202-663-5592.

Sincerely,

A handwritten signature in black ink, appearing to read "Rod J. Alba". The signature is stylized and cursive, with the first name "Rod" being the most prominent.

Rod J. Alba