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FHA ANNOUNCES CREDIT POLICY CHANGES, ADDING CHIEF RISK OFFICER

Policy Changes Will Reduce Risk As Officials Anticipate Annual Actuarial Study to Show Capital Reserve Ratio Dropping Below Congressionally-Mandated 2 percent

WASHINGTON, DC - Federal Housing Administration (FHA) Commissioner David H. Stevens today announced plans to implement a set of credit policy changes that will enhance the agency's risk management functions. Stevens also announced his intention to hire a Chief Risk Officer for the first time in the FHA's 75-year history.

Both actions come as the agency's annual independent actuarial study is being completed. The study will be sent to Congress in November and is expected to show the capital reserve ratio dropping below the congressionally-mandated threshold of two percent. The changes announced today will strengthen the FHA's reserves and better manage risk.

"To be clear, the fund's reserves are sufficient to cover our future losses, so the FHA will not require taxpayer assistance or new Congressional action," said Commissioner Stevens. "That said, given the size and scope of the FHA and its importance to today's market, these risk management and credit policy changes are important steps in strengthening the FHA fund, by ensuring that lenders have proper and sufficient protections."

"By keeping affordable loans flowing, particularly to the growing ranks of first-time homebuyers, the FHA has been critical to our nation's economic and housing market recovery," said U.S. Department of Housing and Urban Development Secretary Shaun Donovan. "As we begin to move from recession to recovery, these changes will not only ensure FHA's financial strength but they will also help to further strengthen our nation's economy."

FHA's congressionally mandated capital reserve ratio, which is determined by the independent actuarial study, measures excess reserves above and beyond projected losses over the next 30 years. FHA continues to hold more than $30 billion in its total reserves today, or more than 4.4% of its insurance in force. Additionally, FHA's full faith and credit insurance means that there is no risk to homeowners or bondholders, even in the event that the capital reserve ratio drops below the two percent threshold mandated by Congress. With the FHA's higher average credit scores and tighter credit policies announced today, the FHA fund is expected to produce revenue for the U.S. Treasury.

The FHA's risk management functions are currently dispersed across a number of offices. The Chief Risk Officer will oversee the coordination of FHA's efforts to concentrate risk management in a single division devoted solely to managing and mitigating risk to the FHA's insurance fund - across all FHA programs.

In addition to adding a Chief Risk Officer, the FHA is proposing specific credit policy changes that are largely focused on ensuring responsible lending and risk management for FHA-approved lenders. These changes build on lessons learned in the credit crisis and seek to align the FHA with the Administration's goal of regulatory reform. As the FHA's stable of lenders grows, these lenders must have "skin in the game." These credit changes will do that by ensuring they have long-term interest in the performance of the loans they originate.

Changes Being Pursued by Mortgagee Letter, Effective January 1

Require Submission of Audited Financial Statements by Supervised Mortgagees

Requires supervised mortgagees to submit audited annual financial statements to FHA. This new requirement is a prudent safeguard that permits FHA to ensure that those entities with which it does business are adequately capitalized to meet potential needs. FHA is aware that the majority of supervised and non-supervised mortgagees are already required to prepare audited financial statements for various regulatory bodies, Government Sponsored Enterprises (GSEs), and investors. Given these existing requirements, FHA's new policy will help to reduce risk at limited new costs for approved mortgagees.

Modify Procedures for Streamline Refinance Transactions

Revises current 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 to cap maximum LTV at 125 percent. An appraisal will be required in all cases where a borrower wants to add closing costs to the transaction. These revisions bring documentation standards for streamline refinance transactions in line with other FHA loan origination guidelines, ensures the borrower's capacity to repay the new mortgage, and prohibits the dangerous practice of loan churning, where borrowers raise cash through successive cash-out refinancings that put them further in debt.

Require Appraiser Independence In Loan Origination

Provides new guidelines on ordering appraisals for FHA-insured mortgages and reaffirms existing policy on FHA requirements regarding appraiser independence and geographic competence. Mortgage brokers and commission based lender staff are prohibited from ordering appraisals. FHA does not require the use of Appraisal Management Companies or other third party providers, but does require that lenders take responsibility to assure appraiser independence. While FHA's existing policies regarding appraiser independence are consistent with the Home Valuation Code of Conduct (HVCC), FHA will adopt language from the Code to ensure full alignment of FHA and GSE standards.

Modify Appraisal Validity Period

FHA's appraisal validity period will be reduced to four months for all properties including existing,

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proposed and new construction. Previous validity periods were six months for existing properties and up to twelve months for proposed and under construction properties. This provides for more accurate home values used for underwriting FHA-insured mortgages during volatile housing market conditions.

Appraisal Portability

Provides new guidelines that 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. This will prevent delays in closing that often occur when a loan is transferred to a new lender.

Changes Being Pursued by Rule Making Process

Modify Mortgagee Approval and Participation in FHA Loan Origination

Lenders seeking approval to originate, underwrite, or service an FHA loan must meet the eligibility criteria for a supervised or non-supervised mortgagee. Mortgagees with this approval status must assume liability for all the loans they originate and/or underwrite. Loan Correspondents (mortgage brokers) will continue to be able to originate FHA-insured loans through their relationships with approved mortgagees; however they will no longer receive independent FHA approval for origination eligibility. These policy changes will require the FHA approved mortgagee to assume responsibility and liability for the FHA insured loan underwritten and closed by the approved mortgagee. These changes align FHA with the GSEs and will potentially increase the number of loan correspondents (mortgage brokers) who are eligible to originate FHA-insured loans while providing for more effective oversight of loan correspondents through the FHA approved mortgagees.

Increase Net-Worth Requirements for Mortgagees

The FHA plans to propose to increase the net worth requirement for approved mortgagees to meet industry standards. The requirement is currently at $250,000 and has not been increased since 1993. HUD is proposing an initial increase of approximately $1,000,000 that would be in place within one year of the enactment of this rule. To maintain consistency with industry standards, HUD may propose that the net worth requirements be increased further in future years to a level comparable to those required by GSEs and other market institutions. These changes will help to ensure that FHA lenders are sufficiently capitalized to meet potential needs, thereby permitting HUD to mitigate losses and decrease risks to the FHA insurance fund.

All mortgagee letters will be available at noon today on HUD's website. The proposed rule provisions will be subject to a notice and comment period, after which the final rule will take effect.

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*HUD is the nation's housing agency committed to sustaining homeownership; creating affordable housing opportunities for low-income Americans; and supporting the homeless, elderly, people with disabilities and people living with AIDS. The Department also promotes economic and community development ad enforces the nation's fair housing laws. More information about HUD and its programs is available on the Internet at **www.hud.gov** and **espanol.hud.gov**.*

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