

111TH CONGRESS }  
*1st Session*

COMMITTEE PRINT

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MEETING ON  
**FHA OVERSIGHT OF LOAN ORIGINATORS**

COMMITTEE ON FINANCIAL SERVICES  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED ELEVENTH CONGRESS  
FIRST SESSION



JANUARY 9, 2009



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## FHA OVERSIGHT OF LOAN ORIGINATORS

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Friday, January 9, 2009

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Ackerman, Meeks, Moore of Kansas, Hinojosa, Clay, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Hodes, Ellison, Klein, Wilson, Perlmutter, Donnelly, Foster, Speier, Minnick, Adler, Kilroy, Driehaus, Kosmas, Grayson, Himes, Peters, Maffei; Bachus, Castle, Manzullo, Capito, Hensarling, Neugebauer, Campbell, Posey, Lee, Paulsen, and Lance.

The CHAIRMAN. This gathering will begin. As was noted last week, we are not yet formally constituted as a committee, but we do have the full complement of Members on both sides. So while we have not yet been formally constituted by a vote of the House as a committee, the membership is now complete. We are still operating somewhat informally. The ranking member informed me he has requests for 15 minutes of time, so we will do 15 and 15. I hope we can move very quickly. Members on the Democratic side who wish to say something should notify the staff. I will begin first of all by taking note of the disastrous job numbers we have today that is within the jurisdiction of this committee. The collapse of the leave-the-market alone with capital do it for us system is now stunning in its impact.

We have lost over a million jobs in 2 months, really a very extraordinary negative impact that we have haven't seen in a very long time and it makes it all the more important for us to do sensible interventions. I do want to announce that the committee will be releasing today the draft of a bill to impose conditions on anything that would—on any expenditure of the second \$750 billion of the TARP. I am going to talk about that briefly. When we passed that bill, there were some who scoffed at what we said were safeguards. There were predictions that the entire \$700 billion would be spent without any input.

We put in there significant oversight, which has now begun to come forward, and more importantly, a requirement that after the first half was spent, there be a period of notification for Congress before the second half could be spent and the resolution disapproval. That has worked maybe even better than some people

had thought it might so that we have frozen the second \$350 billion.

It is now clear that the incoming Administration understands that. And by the way, we are beyond the point where the current Administration could spend it. There is a 15-day period after the triggering that would now get you into the Obama Administration. There will have to be very strict rules. Many of us have a great deal of confidence in the Obama Administration, but I am prepared here to draw on the wisdom of a previous Republican President, "We will trust but verify." The verification will be a bill that will be mandating attention to foreclosure to money being re-lent when it is given to the banks for other things. A draft of that will be released today.

We will have another one of these non-hearing-hearings on it on Tuesday. The bill will probably come to the Floor next week. Members will see it. We are not constituted so that we can have a formal markup yet, but we will have the bill out there. Members will see it. And we will be in conversations about it. And as I said, I think it will go to the Floor.

The Bush Administration has not yet requested the second \$350 billion, so this might be academic. But we thought it was important to make it clear what our conditions would be so that if there is a request for the second \$350 billion, even from the incoming Administration or whether the new one does want to have the ability to deploy it, they will know when it meets the House of Representatives requires for them to go forward.

Finally, on today's hearing, we hope if we are able to work out appropriate conditions to get the second \$350 billion freed up. If that is the case, it will increase, we believe, the role of the FHA in dealing with this. We passed a bill, HOPE for Homeowners, which was part of it last year in which we tried to put the FHA in a position to help as a resource in diminishing foreclosures. And it turns out it was drafted so restrictively that it hasn't been used. We were concerned about being excessively generous.

I think we erred on the other side. We have been talking to a variety of groups, including the Chairman of the Federal Reserve and others, about making it more workable. Making that more workable will be something we hope will be done in the second half of the \$350 billion. But it involves a greater role for the FHA. In an article in Business Week on December 31st of this past year and in The New York Times article on December 10th, both of which I ask—although we don't really need unanimous consent. We should put them in the record. If anybody wants to put it in the record, it is open. We will do that. Saying that there is a danger of the FHA not being able sufficiently to screen the applications. We will be directing more people, including some people who have been in trouble to the FHA if the program works.

It is essential therefore—we are not here to talk about that program. We are here to talk about the FHA because we want to make sure that whatever increased role the FHA has, it is able to deal with it, whether it has enough staff, whether it is doing its job right, that whole range of questions. So the focus today is on the allegations that have been published in respectable publications, Business Week and The New York Times, that there was too much

laxity in the FHA. We want to see if that is the case, and if so, more importantly, what we can do to make sure it doesn't happen going forward. Because having an FHA that is available to work with low-income people is an essential part of having an alternative to the subprime mortgage schemes that got us in trouble.

And clearly there were people who got subprime mortgages who should not have gotten mortgages. And there were other people who got bad subprime mortgages who if they were given appropriate mortgages would not be in trouble. That is in part the role of the FHA. So this hearing is about the capacity of the FHA going forward to be an entity we can rely on. And for that to be the case, we have to know what is behind these allegations, whether they were accurate, and more importantly, if they were—what is being done and what can be done to diminish them. The gentleman from Alabama.

Mr. BACHUS. Thank you, Chairman Frank, for holding today's hearing on the FHA's insurance program and the procedures for monitoring lender and mortgage broker participation in the program and combating fraud. With the credit and foreclosure crisis, FHA has played an increasing role in assisting homeowners and is attempting to fill the void left by the contraction of the conventional market. Over the past year, FHA has seen its business as a share of home sales increase from 4 percent in 2006 to 21 percent in 2008. That 21 percent represents a new peak. The last peak was 18 percent in 1990. FHA's share of total mortgage volumes has gone from 2 percent in 2006 to 26 percent in 2008. And this new level has not been seen since prior to 1970. According to the Department of Housing and Urban Development, a steady flow of homeowners continue to use FHA to refinance out of subprime mortgages and FHA anticipates that it will likely insure over 1.6 million mortgages in Fiscal Year 2009, representing close to \$300 billion.

Recent media reports indicate that HUD's Federal Housing Administration, FHA, significantly increased market share in 2008, raising concerns that the agency is ill-equipped to adequately oversee FHA-approved lenders and licensees, to employ appropriate technology and to manage human capital to protect the taxpayer from exposure to significant financial losses. The December 1, 2008, article in *Business Week* that the chairman mentioned quoted *Inside Mortgage Finance*, a research and newsletter firm, and an estimate they gave that over the next 5 years, new loans backed by FHA insurance will fail and perhaps cost the taxpayers as much as \$100 billion and as the chairman said, that is sort of the driving force behind this hearing, that report and others.

According to the article, former Federal housing officials say FHA is ill-equipped to deal with the onslaught of new lenders seeking to participate in the program. The HUD IG, Ken Donohue, mentioned in the article and he was quoted as saying that FHA "faces a tsunami in the form of subprime lenders that favor aggressive sales tactics and engage in fraud." In that same article, Mr. Donohue noted that he is very concerned that fraudulent subprime lenders are reconstituting themselves and could potentially bring bad loans to the FHA portfolio, and that is what all of us want to

avoid and get assurances that there are procedures in place to stop that.

The Business Week article further states, “FHA staffing has remained roughly level over the past 5 years at just under 1,000 employees. Even as the tsunami has been building that Donohue points out, the FHA unit that approves new lenders recertifies existing ones and oversees quality assurance has only five slots, two of those were vacant this fall according to HUD’s Web site.”

And I continue to quote here: “Former housing officials say lender evaluations sometimes amount to little more than a brief phone call which helps explain why questionable—ex-subprime operations can reinvent themselves and gain approval,” and they close with another quote from the IG saying, “they are absolutely understaffed and they need a much better IT system in place. That is one of their great vulnerabilities.”

This hearing, I hope, will give FHA an opportunity to address the concerns raised in Business Week and other articles. And explain what steps the agency is taking to ensure that the program is being run in a safe and sound manner. I hope today’s hearing can help provide the committee with some answers on how we can ensure that the FHA continues to operate in a safe and sound manner and help worthy borrowers achieve homeownership. Thank you.

The CHAIRMAN. Let me go to a couple of others on this side. The gentleman from Delaware for 2 minutes.

Mr. CASTLE. Thank you very much, Mr. Chairman. I share the concerns of both the opening statements by the chairman and the ranking member. I think we should be concerned. I have also read this Business Week article and a few others and I would concur that there may be some laxity in the circumstance. I do not know, for example, Mr. Murray, if the FHA has sufficient employees to carry out its responsibilities. But my greatest concern is that there is no doubt that for the last half dozen years, perhaps before this, we had a group of individuals, not everybody obviously, a lot of individuals particularly in the subprime areas and the Alt-A areas who had gotten involved in mortgage lending and perhaps didn’t have the background for that. Some got involved in it feloniously and intentionally.

And if you read these stories—they may be highlights, but even if they are highlights, it is a problem. You have a lot of these same individuals being approved as approved lenders under FHA. And I don’t know what the vetting process is for the loan correspondents and firms that are granted the authority to act as direct loan endorsement agents. But my sense is that is something that needs to be watched very carefully.

There is a huge shift right now as loans go to the FHA. And I don’t have a problem with that. And our obligation, your obligation, in my judgment, is to protect the borrowers as best we can and we are not doing that if indeed we have lenders out there who are able to violate the rules. And we are condoning that if we approve some of these lenders, particularly those with rather questionable backgrounds from before. And I just wonder if our enforcement mechanisms are sufficient. Those are the kinds of answers that I will be looking for today. How does the FHA involve itself in these situa-

tions, are these companies all endorsed by the FHA, are they able to advertise they have FHA backing therefore some sense of security to the borrowers out there that perhaps is unjustified. These are issues I think that we need to make sure that we are looking into to protect consumers from fraudulent practices.

So I look forward to the testimony, and hopefully we will get answers that are satisfactory and start down a path of making sure that these problems are being addressed. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Green, for 3 minutes.

Mr. GREEN. Thank you, Mr. Chairman. And I thank you for your comments on the "trust and verify." I absolutely concur with you. I would like to, if I may, repeat some of what has been said, because there are times when things are so important that they bear repeating. It is important for us to note that FHA does not lend money directly. FHA is sort of like having your uncle co-sign for you and work with you to the extent that your uncle has co-signed a note. In this case, the co-signer is Uncle Sam because FHA is a part of the Federal Government. I think that it is exceedingly important that we make all efforts possible to assure people that those lenders who are now coming into FHA will not bring with them the same habits that they had when they were dealing in the subprime market, many of them doing business in less than an honorable fashion.

I do not want to paint everyone with the same brush. There were many persons who were honorable and who were doing credible business and doing an outstanding job. But we do note that we are in the circumstance that we are in because there were many who were not and because we had many who were not and because we have so many who are now moving into FHA, it is anticipated that—actually FHA has grown from 16,000 to 36,000 brokers according to this Business Week article, the number of approved lenders and broker, approved to participate in FHA grew from 16,000 to—in 2007 to 36,000 today. That is a lot and I think that it is appropriate for us to take all productive, constructive measures to make sure that we do not allow what has created a problem to continue to be a problem. I thank you, Mr. Chairman, and I yield back the balance of my time.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling, for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. As we know, FHA is one of the few government agencies that is entirely fee based and does not receive taxpayer subsidies. As we are looking at the single largest deficit in our Nation's history since World War II, \$7 trillion to \$8 trillion of taxpayer exposure through sundry bailout plans and a promised stimulus plan that may top out at over a trillion dollars. I, for one, want to ensure that FHA remains a fee-based institution. With the onslaught of loan demand, though, I think it is entirely appropriate that we examine whether or not FHA has the budget, the resources, and the expertise to handle the challenge. A significant part of the challenge will be presented by a multitude of fraudulent players who may try to qualify as FHA loan originators and borrowers.

We know it just wasn't lax underwriting standards that brought us to where we find ourselves; it was out-and-out fraud. According to FSN, mortgage fraud is up 1,400 percent in this decade alone. And for every predatory lender—and there were many—there were also many predatory borrowers. And tragically, a lot of this fraud went undetected, and when detected, usually went unprosecuted. It is also a reminder for those who advocate more regulation; it is not always a matter of more regulation. Quite often the solution is enforcing the regulations that we already have on the books. As the ranking member indicated, FHA, by some expert estimates, may be looking at \$100 billion in losses over the next 5 years. This simply cannot be allowed to happen.

As important as it is for this committee to examine loan originators, it is also even more important that we look at loan criteria. No greater correlation between default and the lack of significant downpayment and I hope, Mr. Chairman, that this committee will look at increasing the downpayment requirement in lowering the conforming loans. With that, I appreciate you holding this hearing and I yield back the balance of my time.

The CHAIRMAN. All members who have requested time who have spoken who are here, so we will now turn to our witnesses. We have and we appreciate his attending, Mr. Phillip Murray, who is the Deputy Assistant Secretary for Single Family Housing Programs at HUD, and James Heist, who is the Assistant Inspector General for Audit, office of inspector general of the Department of Housing and Urban Development. Mr. Murray, we will begin with you.

**STATEMENT OF PHILLIP MURRAY, DEPUTY ASSISTANT SECRETARY FOR SINGLE FAMILY HOUSING PROGRAMS, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

Mr. MURRAY. Thank you, and good morning. Chairman Frank, Ranking Member Bachus, and members of the committee, I appear before you today on behalf of the Federal Housing Administration. My name is Phillip Murray, and I am the Deputy Assistant Secretary for Single Family Housing at FHA. I am responsible for managing all the single family business for FHA, and I have been at HUD for 29 years, with the past 17 at FHA. Let me begin by saying that prior to my current position, I was the Director of the Office of Lender Activities and Program Compliance responsible for administering the various risk management activities of FHA-approved lenders, which included sanctioning lenders and other related parties who failed to comply with HUD and FHA requirements.

As HUD's former top cop, I personally take issue with recent press accounts suggesting that FHA is vulnerable to the same type of unsavory business practices as we have seen in the subprime market. These stories misrepresent a well respected Federal program that has provided untold benefits to millions of Americans, as well as the efforts of hundreds of HUD employees who administer it. FHA-insured loans are neither high cost nor high risk to home buyers; rather, FHA is a vehicle for borrowers to access prime rate loans. FHA has never, never allowed the loose underwriting or expensive loan terms that were characteristic of subprime lending.

FHA borrowers must provide evidence of income and employment to validate their capacity to make their mortgage payments and FHA products never carry teaser rates or prepayment penalties. Turning now to the specific topic of today's meeting, the Department's efforts to protect FHA insurance funds and serve the public are best demonstrated by the thoroughness of its approval and monitoring standards.

Lenders applying for participation in FHA insurance programs are subject to rigorous initial approval requirements. FHA scrutinizes lenders based on: one, the company's financial capacity and resources; two, the possession of appropriate State licensing; three, the eligibility of the company, its principals and officers to participate in government programs; and four, the company's quality control plans and compliance procedures.

Additionally, lenders must renew their approval annually to ensure ongoing adherence to FHA lender approval requirements. Lenders that fail to meet these renewed requirements are terminated and thus cannot originate FHA loans. Please note that despite the extensive pressures to do so, FHA has not and will not lessen its stance. Newly approved lenders must meet eligibility requirements and programmatic requirements and are held to the same standards as existing lenders. FHA is constantly monitoring low-level compliance, lender performance, and portfolio performance through a variety of risk management tools.

In addition to the rigorous approval standards FHA imposes, the agency has nationwide quality assurance divisions. That comprehensively monitors lenders performance and compliance through remote and onsite monitoring reviews as well as through electronic surveillance. Furthermore, FHA conducts an annual actuarial review, and it also maintains credit subsidy models that annually review FHA's book of business for risk factors to identify any necessary forward adjustments. As a matter of fact, it was these procedures that identified the unacceptable and high default rates when loans close with seller downpayment funding. FHA's last two audits have been clean, with no material weaknesses identified. And FHA is no longer on GAO's troubled agency watchlist. FHA is proud of these accomplishments.

While I can assure you that FHA is fully committed to continuing aggressive oversight of its program, I must restate FHA's long-standing need for additional resources to further bolster the agency's monitoring and oversight capacities. A critical area is information technology. We need to replace the 35 legacy systems FHA uses in its operations. In spite of the fact that these systems are based on technology and computer programming languages that are decades old, FHA has made these systems work. But this cannot continue and the IT infrastructure at FHA needs to be replaced now.

Finally, I want to address a topic pertinent to today's discussion of FHA's continued strength and vitality, the proposed "cram-down" bill. FHA and Ginnie Mae do not have the legal authority to reimburse servicers for the cram-down amounts not received from borrowers but paid through to investors. This could create a powerful disincentive from doing business with FHA and Ginnie Mae, while costing taxpayers additional dollars. FHA urges careful consider-

ation as Congress contemplates this matter so we can continue to help more Americans realize the benefits of prime rate FHA-insured mortgages. Again, I want to thank you for the opportunity to explain FHA's comprehensive lender oversight and monitoring efforts. I would be happy to answer any questions. Thank you.

[The prepared statement of Mr. Murray can be found on page 89 of the appendix.]

Ms. WATERS. [presiding]. Thank you very much. Mr. James, is that "Heist" or "Heist?"

Mr. HEIST. "Heist."

Ms. WATERS. "Heist."

**STATEMENT OF JAMES A. HEIST, ASSISTANT INSPECTOR GENERAL FOR AUDIT, OFFICE OF INSPECTOR GENERAL, UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**

Mr. HEIST. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for inviting me to testify today. I very much appreciate the opportunity to testify on behalf of the Inspector General on the important issue of FHA oversight of loan originators. Over the years, we have had concerns with FHA systems and infrastructure to adequately perform its current requirements and services. This was expressed by the OIG prior to the current influx of loans. We continue to remain keenly interested in FHA's ability and capacity to oversee the newly generated business.

The past year-and-a-half has certainly produced a lot of changes. With the collapse of the subprime market, FHA has seen a dramatic increase in new business. In September 2007, HUD began to provide assistance through the FHA Secure Program to refinance existing subprime mortgages. The Housing and Economic Recovery Act passed last summer created a new HOPE for Homeowners Program to enable FHA to refinance the mortgages of at-risk borrowers. It also authorized changes to the FHA's reverse mortgage program that will enable more seniors to tap into their homes' equity. The volume of single-family loans, FHA loans, has tripled from \$59 billion in Fiscal Year 2007 to over \$180 billion in Fiscal Year 2008. Market comparisons show that FHA's share of insured mortgage endorsements have increased from 21 to 76 percent. And this is based on the latest monthly data available compared to last year.

And that includes all endorsements, including refinances. We continue to believe there is a critical need for more resources at FHA: one, to enhance its IT systems; two, to increase its personnel to deal with the volume; three, to maintain a workforce with the necessary skills; four, to oversee numerous contractors; and five, to increase oversight in all critical front-end processes, including appraisals and underwriting. We are gratified that a new penalty provision was inserted into the Housing and Economic Recovery Act. The statute now creates an increased criminal penalty for committing fraud against FHA programs and will be a useful tool for prosecutors. The results of the latest actuarial study show that HUD has sustained significant losses in the single family program. As of September 30, 2008, the fund's economic value was an estimated

\$12.9 billion, an almost 40 percent drop from over \$21 billion in 2007.

The current value represents 3 percent of the mortgages insured by FHA. Although above the 2 percent ratio required by law, it is well below the 6.4 percent ratio from the prior year. If more pessimistic assumptions are factored in, the ratio could dip below 2 percent in succeeding years, requiring an increase in premiums or appropriations to make up the shortfall. Among our many audits, we have found that FHA needs to improve its internal control structure by formalizing risk assessments of its program and administrative functions.

In another area, our audit of the FHA appraiser roster identified weaknesses in the quality control and monitoring of their roster. Results from a number of other audits at FHA lenders have noticed significant underwriting deficiencies, inadequate quality controls, and other operational irregularities. We have also recently initiated an inspection of the mortgagee review board enforcement actions and its efficiency effectiveness and impact in resolving cases of serious noncompliance with FHA regulations. We note that the FHA lender approval process is largely manual. FHA will be challenged within current resource constraints to keep up with the increasing volume of entities doing FHA business. We believe that the oversight of these lenders could be improved with monitoring loan prescreening systems. The tightening credit market has increased FHA's position as a loan insurer and with that is coming an increase in lenders and brokers seeking to do business with FHA and a concern with some of those loan originators.

For example, we are currently investigating several FHA lenders who were also lenders in the subprime market. The movement toward FHA is already underway and is reflected in recent statistics. FHA lender approvals increased five-fold in a 2-year period. Previous investigation of an FHA lender in New York led to the debarment of its owner for a period of 5 years. After the debarment was served, the lender resumed operations using the same fraudulent practices. Another area of concern is the growing reverse mortgage program. The larger loan limits can be attractive to exploiters of the elderly whether by third parties or even family members who seek to strip equity from seniors. The Office of Inspector General stands ready to assist in whatever way is deemed necessary and will be vigilant in its efforts to protect the funds of the American taxpayer. We thank you for the opportunity to relay our views and greatly appreciate the activities of the Congress to protect FHA's funds from predatory and improper practices and to ensure effective oversight of the lending community at this critical time.

[The prepared statement of Mr. Heist can be found on page 81 of the appendix.]

The CHAIRMAN. Thank you.

Mr. Heist, let me ask you on the one last point you made: We have found a very enthusiastic response with regard to the home equity mortgages, that has been—when done right, that has been very helpful. The AARP, for instance, has been very enthusiastic.

The problem we have found is one you touched on, namely that there has not been any significant set of problems in the execution of the program itself, but once an individual gets the proceeds from

that—in some cases, older people who are not as sophisticated, may not be at the top of their game—they have been vulnerable to bad advice about what to do with the money.

Now, one of the reforms we put into the bill that became law was to say that you cannot be the same entity promoting that and then investing the funds for people. That is helpful. But you very carefully referred to abuse by third parties or family members.

I would urge you, if you have any ideas about how we can further protect the recipients from abuse, to share them with us, because we think this is an important program. And whether now or later as we go forward, if there are further safeguards that we could put in there to prevent victimization of the people who got that money, please work with us.

Mr. HEIST. We will be happy to do that. And while I am not at liberty to talk about ongoing investigations, our investigators are seeing schemes where the elderly are being steered into annuity products, for example, with unreasonable terms and—

The CHAIRMAN. Now, these are being steered by—is there collusion between—I don't want to impinge on the investigation—between the entities that are selling these and then the entities that are doing the annuities?

Mr. HEIST. We have seen where they have had identity of interests.

The CHAIRMAN. All right. Let us do this because I don't want to in any way interfere with the ability to break that up.

Please work with our staffs, as I think this is clearly a bipartisan interest we have, in whatever you think—whatever recommendations you want to make to minimize that, because I don't want to see a program that can be beneficial and has been beneficial dealt with that way.

Mr. HEIST. The other thing we are doing is partnering with organizations such as AARP to get the word out regarding education and fraud awareness.

The CHAIRMAN. One of the things we can do on that is to say that, for instance, we can make sure that these are done through the FHA, that the FHA takes on a major role in warning people against this.

So we did take the one step of saying—I think Senator McCaskill has been very interested in that. My colleague from Missouri and others, we have taken one step, but we are ready to do more to protect this program.

Mr. Murray—and I apologize; I had to go out and deal with another matter—but we have heard some of the criticisms. Have you specific responses to some of them?

I guess the question is, are there inaccuracies or are these things that can be cured going forward? And in particular, are you staffed adequately and do you have sufficient authority to find people who ought to be rejected from participation and reject them?

Mr. MURRAY. First, I rather appreciate having the article because it causes us to be here to discuss this. Let me assure you, first of all, the sky is not falling.

The CHAIRMAN. You are a very tolerant man, Mr. Murray.

Mr. MURRAY. Yes, but the sky is not falling.

But, yes, we have a real need to upgrade our technology. We have an absolute need to hire more staff. Although we hired 142 people last year who—with retirement and moving elsewhere, we only netted 60 individuals. And we are in dire need of additional contracting money, so we can procure some more fraud detection tools, more people to work on our front-end detections.

The CHAIRMAN. I assume if we are successful in fixing HOPE for Homeowners, which we passed in a form in which the intentions outpace the capacity to deliver, if we are able to fix that and send you even more business, then these needs would be obviously exacerbated?

Mr. MURRAY. Yes, sir.

But in terms of the story, although it may in most places appear to be factual, what we did was we allowed Business Week access to our public site on our Neighborhood Watch system where you or any other citizen can look at the performance of my lenders. They chose a few lenders and decided to explore them further.

The problem that I think we had with this, that may misrepresent, is that they look at these individuals and their performance in the subprime market, and then in the next sentence they refer to FHA. These two do not—it is not a nexus.

The CHAIRMAN. In other words, you are suggesting that some of the abuses that they alluded to were a non-FHA product?

Mr. MURRAY. Absolutely, sir.

And what the article also failed to say in its five—five lenders, without talking about any specifics, two of the lenders, one only made one loan, the other made 63 loans, which is the very minimal loan for any of our lenders.

The other three, they were already on our radar screen. There have been actions taken either by my compliance enforcement people and/or the IG, and we have made referrals. So—

The CHAIRMAN. I think it would be interesting—I don't see any reason why you could not send us a document that would identify those individuals. If there is a confidentiality problem with one or two, you can cover that up.

Thank you. My time has expired and I appreciate that. And I obviously will encourage—do you stay on or do you leave in a week? Or what is happening?

Mr. MURRAY. No, sir, I am a career person.

The CHAIRMAN. You are career. Good.

Then what we would like is—someone will have to change it. Make sure and tell them that we are specifically requesting—I know there are problems with OMB. Please let them know that the committee of jurisdiction will be specifically requesting what you think you need to staff up both in terms of technology and individuals to deal with this, because we want to make you more of a player than you are.

So we need to know what we need to put into your hands in terms of resources so you can do that job.

Mr. MURRAY. We stand poised and ready to serve, and we need the assistance.

The CHAIRMAN. And that is a direct request from us.

The gentleman from Alabama.

Mr. BACHUS. Thank you.

Mr. Murray, Mr. Heist in his written testimony talked about your process for selecting lenders or monitoring the quality of their loans is a post endorsement process, it is not a prescreening process. Is that correct? And does that bother you?

Mr. MURRAY. There is an approval process for new lenders coming in. That is one separate set. Once they are in, lenders, full-eagle lenders submit loans to us. During that process, there are front-end analyses of that process, of those loans.

Mr. BACHUS. That is just random and not all of them—

Mr. MURRAY. Absolutely, it is random. There is an algorithm done, a significant statistical sampling of our loans done through an algorithm, and so currently we do a random sampling of 5 percent.

Mr. BACHUS. Mr. Heist, you are recommending actually a prescreening, just a program that large lenders use? Would that be—

Mr. HEIST. One of the concerns we have about the review in the post-screening is—

Mr. BACHUS. Pull the microphone a little closer.

Mr. HEIST. I am sorry. I forgot to push the button.

One of the concerns we have with the monitoring that is done is it oftentimes can take a period of time for the default statistics to show up to provide for some intervention.

FHA has done a lot to enhance its early warning and targeting; and, in fact, we work with FHA when we target lenders for our audit work. With advances in technologies, there are opportunities to do more on a prescreening basis where you can actually—and actually insist on the lenders doing more prescreening to identify red flags, if you will, anomalies in appraisal information, whether the individual owns multiple properties and is disguising himself as an owner-occupant, those sorts of things.

But FHA needs the resources to be able to do those sorts of things.

Mr. BACHUS. So you just don't have the resources; is that what—or have you thought about doing that?

Mr. MURRAY. Actually, we agree with the IG: but for funding resources, we would have that. But bear in mind, we have many, many tools. There is not one tool that is a panacea for anything.

So when the new lenders come in, we do test cases. We run them through test cases. They actually have to pass a test.

Mr. BACHUS. Once the loans are made, you are reviewing only about 1 out of 20; is that right?

Mr. MURRAY. I think that refers to our post-tech endorsement at the front end. Once they come through the door, we do a thorough analysis on 5 percent of the cases, based on the properties and the underwriting criteria.

Mr. BACHUS. For every loan?

Mr. MURRAY. Five percent of all the loans that come through.

Mr. BACHUS. Five percent?

Mr. MURRAY. Five percent. Our evaluation tells us that is an adequate statistical sampling to do that with. However, we would be more than happy to do a larger amount. But again it all comes back to staffing and funding.

Mr. BACHUS. Yes, if you required a prescreening, that would obviously cut down on your losses, would it not?

Mr. MURRAY. All of our tools help us in assisting. So as long—as you go along the way where there are checkpoints that we stop. When you are first approved, we make sure that you actually know how to do FHA business through test cases. If you don't pass our test cases, you don't get approved to do further work.

Once that happens, once the loans are made, we have a variety of tools to monitor—

Mr. BACHUS. But that is all manual, and it is random, right?

Mr. MURRAY. Okay. I understand. What you are talking about is the very front end when they first submit the loans in.

It is a manual screening as well as an electronic screening. Seventy percent of our loans are done through lender insurance, which is an electronic self-insuring process; the other 30 percent is manual. And I can say despite a lot of objections with us introducing lender insurance some years ago, I can tell you today that the reason why we are still standing and are able to handle this workload is because we went to lender insurance where 70 percent of our loans are being done, which relieves the burden from our staff.

Mr. BACHUS. Let me ask you really quickly, you mentioned that this new legislation on the bankruptcy cram-down presents some unique problems for FHA and VA. Would you just give me what you see as those problems?

You mentioned that—

Mr. MURRAY. Yes, I did. My job was to just sort of make you aware of that. I will give you one example.

We pay partial claims, and if we—and if every borrower who we have in partial claims decided to file bankruptcy, that would cost us \$640 million of lost revenue. That is just one example.

Mr. BACHUS. It would be significant losses if you weren't carved out of that?

Mr. MURRAY. Yes, sir. Because we don't have the authority to do that, nor do we have the funding to pay for it. Because the investors have to be paid.

The CHAIRMAN. We do have the authority. You appropriate it through the funding. Don't hesitate to ask us regarding both.

The gentlewoman from California, the chairwoman of the Housing Subcommittee.

Ms. WATERS. Thank you very much, Mr. Chairman. I am very pleased.

The CHAIRMAN. The once and future chairwoman of the Subcommittee on Housing.

Ms. WATERS. Mr. Chairman, I thank you for holding this hearing. This is very important. We all worked very hard to strengthen FHA and to make sure that it was equipped to be back in business doing what it was intended to do when it was originated here in the Congress of the United States. And it looks as if it is doing pretty well; it appears that FHA is now in business.

We recognize that FHA was practically killed off by the subprime market that was offering all kind of exotic loans, which basically made FHA relevant; but now we are moving in another direction.

But, Mr. Chairman, and members, I want you to hear this and hear it well. We don't intend for FHA to do business with some of

the bad subprime lenders that got us in trouble in the first place. Now, there is a scathing article in Business Week about the fact that FHA is allowing some of the worst actors and perpetrators of fraud to come in and be FHA approved, and putting them back out into the market again.

We have a lot of work to do here with regulatory agencies to clean up the mess that has created this economic crisis that we are in. Can you tell me why you cannot vet and determine the bad subprime actors, some of whom have been indicted, some of whom have gone to prison, and some of whom have just changed the name on the door; they are still the same players.

Why can't you know the difference between legitimate lenders and these mortgage companies that we are reading about, Mr. Murray?

Mr. MURRAY. Yes. That is a very good question, and we do—we do a thorough vetting process to approve lenders.

The article is sort of misleading because it is guilt by association. Because your father did this, your brother did this or your sister did this, you therefore are somehow guilty. Any lender who comes in for approval, they are afforded due process.

We take actions against lenders through the Administrative Procedure Act. We are very diligent in pursuing individuals. You may not have been in when, in my opening remarks, when I was saying that prior to this job, I was housing's top cop; and I think in the 75 years of FHA, this is probably the first time we have ever had an enforcement compliance person running the show. So let me assure you that we are very, very aggressive in going after individuals and very diligent in doing this.

Now, do we need additional authorities? Absolutely. Do we need additional resources to help us get to where we need to be? Absolutely. I do believe in the new loan officer registry program that would help us even further for local authorities who sanction individuals who can then feed back to us the actions that they have taken in the more—a quicker way.

Ms. WATERS. If I may just take back my time for a moment. Are you familiar with Premier and Paramount Mortgage Companies?

Mr. MURRAY. Yes, ma'am.

Ms. WATERS. Are you telling me that Premier and Paramount, given their background of subprime lending and problems, that you deem them to be all right to be approved by FHA to do business with?

Mr. MURRAY. As I recall, with those lenders, we have no evidence that they have been convicted or indicted of some wrongdoing. We have many lenders who engage in subprime and are perfectly—and even their own subprime bases may be fine.

Ms. WATERS. What about Lend America in Melville? Mr. Ashley, who pleaded guilty in 1996 in Federal court to two counts of wire fraud, on and on and on; and then opened Liberty Market, was on 5 years' probation, \$30,000 fine, father spent 4 years in prison.

Is it okay to do business with them?

Mr. MURRAY. According to our attorneys, there is a—I forget the term—there is a period of time. I guess the question: When did this happen, what was the offense, is there a nexus to the business?

For example—I give you a case I can recall—we had a lender who was convicted 30 years ago when he was in college, and we found that the conviction was that while he was in college, he got in trouble with drugs. That did not have a nexus 30-year forward to his—

Ms. WATERS. Excuse me if I may. Obviously, we are not talking about those kinds of cases. What we are talking about is this:

Based on what I am reading, I see the bad actors moving over to FHA because the money has dried up, and they can get these guarantees. We are going to have a large amount of defaults and we are going to have to pay.

Now, we really want—I would like to hear from FHA how you are going to stop this. If you need some help from Congress, you need to come and ask us what, and tell us what you think we can do to help us to make sure that we don't—you have one company, that is doing Alt-A loans. Why would you authorize FHA backing for a company that is doing Alt-A when Alt-A loans are at the epicenter of the crisis on these subprime loans?

Mr. MURRAY. I don't have a legal basis for stopping someone from doing some other business with FHA. The practices that they may or may not be doing have no bearing on FHA's business, because we don't allow that. They cannot put that square peg into our round hole. It does not happen.

We have many of our best, top, most-respected lenders who also do subprime lending. That doesn't necessarily mean they are bad.

Ms. WATERS. The argument has been made here, there is some good subprime lending and bad subprime lending. Obviously, I am talking about the subprime lending that created the subprime meltdown in this country and the economic crisis that resulted from that.

We really do believe that—I believe that FHA does not have to deal with people who have a record and a history of fraud and creating problems.

What are you going to do about it?

Mr. MURRAY. I agree with you wholeheartedly and I share your concerns with that. As a matter of fact, we are in the throes of proposing new rules to help us deny these—

The CHAIRMAN. Mr. Murray, we are over time. These are very important questions. We will ask you to respond in writing to the questions of the gentlewoman, and we may be back to you on that.

The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Heist, I don't know if you can answer this question or not, but Mr. Murray indicated there is a thorough vetting process to approve lenders. That may or may not be true. My question is, is this vetting process a complete enough process or should we be doing something more?

I think everybody up here is vitally concerned about rather questionable lenders. We are hoping that FHA can stop the bleeding of subprime lending and—etc. And the reports that I have read and seen indicate to me that failure prediction under FHA loans is pretty high as well. And I am very concerned about these lenders, a lot of whom by their previous practices are pretty marginal.

So do we have the right vetting processes in place? I am not sure if that falls in your role as Inspector General or not.

Mr. HEIST. I can't comment fully on the vetting process except to say that regardless of whether FHA is constrained on its ability to keep people out, we advocate that they—and we have talked about that in answer to other questions—that they take advantage of the technologies that are available to be able to prescreen the loans on a more comprehensive basis through advances in technology to overcome the—

Mr. CASTLE. My question pertains to who is being approved as a lender, who is being approved as somebody they are dealing with, not to the actual people borrowing in this circumstance. And maybe you are not qualified to answer that.

Mr. HEIST. There are limitations. We have an investigative case, for example, where at the time the case didn't meet the dollar thresholds to prosecute criminally, but nevertheless we pursued a debarment case against the individual. The debarment is for a period of 5 years; 5 years ran, and the person was back in business doing the same thing. We took the steps to have—working with the Justice Department to file an injunction to prevent that individual.

There are limitations to the vetting process. You have an example of somebody who was debarred, the individual served their time, and FHA has to let them back into the program. But there are things they can do to increase the oversight.

Mr. CASTLE. Let me jump to Mr. Murray. Do you think we should enhance or update or make stronger the vetting process, or do you feel the vetting process is presently successful?

Mr. MURRAY. No, sir. I fully agree. We need additional tools to help us to, further, to not allow folks in. There are many individuals that I will take a look at—

Mr. CASTLE. When you say you need “additional tools,” I understand the technology and those kinds of things, but do the additional tools—is this something we should be doing as a Congress or something that FHA can be doing?

Mr. MURRAY. That is something we ourselves can do through additional rulemaking, because as time goes on, there are different practices, people get engaged in different schemes and the like. We need to constantly reinvent ourselves and to move forward.

There are many folks I see as—

Mr. CASTLE. Why aren't you doing this now? I say this because we are going from the subprime problem and the continuing problems with loans in this country, the huge numbers which you have indicated here today. So if we do need to enhance the vetting process or the lending process for insurance purposes, why don't we?

Mr. MURRAY. No. We are currently—we have a committee in FHA single family across the board, putting together new rules and procedures that—to address this subprime issue, to address the new frauds and the things that we see coming down the road.

Mr. CASTLE. Let me ask you another question. What is the FHA doing to review and update its net worth requirements for FHA originators? Is that part of this?

Mr. MURRAY. Yes.

Mr. CASTLE. Part of it is that the lender should be able to cover potential losses, whatever it may be. And if their net worth is not higher, that is an issue.

Mr. MURRAY. To cover losses is not the purpose of the net worth. But to answer your question, that is one of the issues we have on the table. We have a litany of things that we are putting together, drafting, and we are going to propose for rulemaking.

Mr. CASTLE. Can you give me a rough time estimate as to when you think this work will be completed in terms of things we talked about?

Mr. MURRAY. We can't do anything until the next Administration comes on board, and that is my intent, the first thing when we are asked what we are working on is to present all these rules that we have.

Mr. CASTLE. Are you thinking spring or early summer?

Mr. MURRAY. I am hoping this spring I will have the chance to present it, once we get an okay to do it. Rulemaking normally takes 18 months. That is outside of our control, but that is what it normally takes. But to the extent we can do things through a mortgage letter, I fully expect to do it that way.

Believe me, as a compliance person, I am very aggressive in handling any potential fraud and people who are hell bent on doing mischief. That is certainly something that I simply do not tolerate.

Mr. CASTLE. Thank you. I yield back, Mr. Chairman.

The CHAIRMAN. Since we are not in regular order, I am going to use some discretion here. The gentlewoman from California, Ms. Speier, has been a very diligent member of the committee and spends long hours at the bottom, although the good news for her is that she has now gained several members to whom she is senior on this committee. She had a question that was directly relevant as a follow-up to her colleague from California. In the absence of what I am sure will not be strenuous objection, I call on the gentlewoman from California.

Ms. SPEIER. Thank you, Mr. Chairman.

Mr. Murray, you just said that you are very keen on compliance and the gentlewoman from California went through a list of problem lenders, and you suggested that they were lenders who had very few loans or lenders who had violations that did not have a nexus. Have you have an opportunity to read the Inspector General's presentation to the committee?

Mr. MURRAY. Yes, ma'am.

Ms. SPEIER. So you are aware then of his reference to problem lenders. As he highlighted in their audit, he references a lender who had a number of serious issues related to RESPA violations, such as paying marketing fees, noncompetition fees, and quality incentives to real estate companies in exchange for more than \$57 million in FHA mortgage business. The corporation's license was suspended by the State of Arizona and has filed for bankruptcy. One of the principal owners and principal managers reconstituted under a different name, but operates from the same location. In 2008, HUD approved the new entity to originate and process FHA loans despite its principal's prior convictions for RESPA violations. How do you respond to that?

Mr. MURRAY. I am glad you mentioned that, because that is an issue that is very near and dear to my heart. The issue here is the problems are with the lending entity. The individual was not subject to that. If that individual had been debarred, indicted, convicted, fine. I would have some legal authority to not let them in. Absent that, I have no authority to stop them from coming in.

Now having said that, that is part of one of the new rules that we are putting together to allow us to say if you were a principal of a company, we get a chance to ask you what was your role, and we can then decide whether or not we will allow you to come into FHA.

Even without the authority, I have attempted to do that, but through our own attorneys, they caution me that legally I cannot do that.

Ms. SPEIER. Are you saying that you have no discretion to determine whether or not to allow someone to be a lender?

Mr. MURRAY. I have no discretion to say because you were a part of this company, and this company did bad acts, that I can infer those bad acts to you and not allow you to come in.

Ms. SPEIER. This is a principal of that company.

Mr. MURRAY. Yes, ma'am.

The CHAIRMAN. Would the gentlewoman yield?

Ms. SPEIER. I do.

The CHAIRMAN. Thank you. That has been very useful. You say it takes 18 months to do this by rule?

Mr. MURRAY. For ruling.

The CHAIRMAN. But if we were to do it by statute, specifically give you that authority, it would take a lot less time, wouldn't it?

Mr. MURRAY. Yes, sir.

The CHAIRMAN. I'm sure the gentlewomen, my two colleagues from California would want to work on that. Thank you.

Mr. MURRAY. I will be glad to work with you.

The CHAIRMAN. The gentleman from—they gave me the list and I lost the list. The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

Gentlemen, back in April of last year when this committee marked up the FHA modernization bill, I offered an amendment that was accepted by the chairman—it doesn't happen often around here, but it happened on that particular day—that required borrowers to agree in writing to be liable to repay the FHA any direct financial benefit achieved from the reduction of indebtedness on the existing mortgage that was derived from any purposeful misrepresentation that was made in their certifications and documentation.

I had offered another amendment, which was not accepted, that required that the mortgagor would actually provide documentation to the originator of the mortgage that certified that the data was complete and accurate, including statements regarding income assets, debt, occupancy, and matters of identification.

The Chair didn't accept that. There was a legitimate debate and discussion. I think the Chair concluded he felt that was too onerous. I didn't conclude that, he did, his opinion was relevant. But as most of the questioning from the panel has centered upon fraud

on the lender part, I want to focus somewhat on potential fraud on the part of the borrower.

The first question I would have with respect to the language that was included in the statute is, how is it being implemented? How are applicants being notified of the process? Is there a form that they now sign, acknowledging that they will be liable for the indebtedness for purposeful misrepresentations? Mr. Murray, what can you tell me about the matter?

Mr. MURRAY. I am sorry, are you referring to HOPE for Homeowners?

Mr. HENSARLING. Yes.

Mr. MURRAY. Yes. We propose to have the borrowers sign a certification and to provide counseling to them that they are signing the certification that they will be liable for any fraudulent statements that they make.

Mr. HENSARLING. I'm sorry, I didn't hear the first part of the statement. This is currently being done? I know the program has had scant demand.

Mr. MURRAY. Yes. The HOPE for Homeowners committee, they have developed a form for the express purpose of notifying a borrower that they will be held liable for any fraudulent statements that they make.

Mr. HENSARLING. But I am still unclear. Is it currently in use or is it not currently in use?

Mr. MURRAY. Yes, it is.

Mr. HENSARLING. Okay, thank you. Thank you.

The CHAIRMAN. It is called the Hensarling oath.

Mr. HENSARLING. I like the name, Mr. Chairman.

Can you enlighten me, Mr. Murray, then just on the general vetting process? We have talked about the vetting process for the borrowers. I would like to be enlightened more on the details of the vetting process for borrowers.

Mr. MURRAY. Borrowers?

Mr. HENSARLING. Borrowers. Again, according to FinCEN, we had the majority of the mortgage fraud over the last decade that arose from borrowers misrepresenting their income and misrepresenting their assets, misrepresenting their occupancy. So again there is much predatory lending that took place in the market. I would also offer the opinion there was much predatory borrowing, according to the Inspector General's observations. Already the single family program has sustained significant losses. We have had a 40 percent drop in value. So I am concerned about, again as I mentioned in my opening statement, sustaining the fee-based program that we have here, and I am concerned about what is the vetting process that is being used on the borrower's side, not just the lender's side to protect the taxpayer.

Mr. MURRAY. Yes, thank you, I understand.

We have introduced a Social Security check that we and the lenders can use to go in to ensure that the person who is representing themselves is not dead or that they are truly in fact they themselves who are there.

We validate their employment and we also validate and verify their income. And we also do Federal checks.

Mr. HENSARLING. Now, how are you validating and how are you verifying? Can you get more specific?

Mr. MURRAY. Yes, that is part of the loan underwriting process where you actually go out, using the—

Mr. HENSARLING. Clearly, it hasn't been done well in the past, so I am somewhat concerned as to how are you using it now.

Mr. MURRAY. I have no indication that it has not been done well in the past.

I think it is important to say that the little snippets of the examples of wrongdoing and fraud by everyone, and I—as an enforcement person, I can tell you many, many stories. But when you get down to it, it is less than 2 percent of people who tend to do wrong things. FHA is no different; it is a macrocosm of the society as a whole. There will always be someone there trying to circumvent the system. Having said that, we are very diligent in making certain we go after those folks, try to stop them in any way, fashion or form that we can do that. But historically we have always done verifications of the borrower's income, to identify who they are, make sure they don't owe other Federal debt and verify that they are in fact employed. That is totally unlike in the subprime.

Mr. HENSARLING. My time has expired.

The CHAIRMAN. Thank you. The gentleman from New York.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Murray, let me ask you this, one of the big problems I have had with a number of mortgage brokers is that they are able to charge what I think is basically almost a kickback. I know they do it on FHA loan originations also, yield spread premiums, and these yield spread premiums seems to give the lenders an advantage for steering borrowers into higher mortgages than what they actually qualify for. And this has a devastating affect on poor people and folks who are just aspiring for a better life, having to pay these yield spread premiums.

So I would like to know whether or not the FHA, you believe the FHA loans, which are supposed to be low cost as it is, should ban the use of yield spread premiums?

Mr. MURRAY. That is a good question, and I share your concern. FHA has absolutely no authority over yield spread premiums. If Congress would like to provide us with that, I would certainly find it useful.

Mr. MEEKS. So you are saying that if we do something statutorily with reference to that, it would be something that you would see helpful?

Mr. MURRAY. Yes.

Mr. MEEKS. I agree. Would you work with us on developing that legislation?

Mr. MURRAY. I would gladly work with you on any and every possible thing that we can do to safeguard the Federal funds and the American public.

Mr. MEEKS. We will be in touch with you to make sure we work on that. Thank you.

Maybe you be help me with something else, because I am having this huge difficulty in my district also in regards to foreclosures and I have found that when I was able—I have people coming into my office every day, counselors and lawyers, trying to help the

number of individuals who are going into foreclosures, and when we are able to get to the banks, etc., we have been able to help some people stay in their homes.

When I look at the voluntary program, on its face, it seems like it should be good. When I look at the HOPE for Homeowners Program, it doesn't seem to be as successful. I was wondering if you could give us any insight as to why, for example, it looks—I think the statistics say 2.2 million subprime foreclosures through the end of next year. We have to stop this hemorrhaging—whether you can give us insight why HOPE is not working or how HOPE can improve because it seemed like these voluntary programs are not doing what they are supposed to be doing.

Mr. MURRAY. We have been concerned with that, that the eligibility criteria is candidly a little too restrictive. Recently, there have been some changes to make it a little bit more workable and we are now seeing more loans being done. I think we are now at 380-something applications have been filed and there are actually 15 loans that have gone to closing. And so hopefully some of the relief we have given, but candidly we would love to see further relief and some refinements to that program.

Mr. MEEKS. We then agree that something needs to be done. I think that is something again that we need to work on very closely because every day, somebody is being put on the street. And until we get to the bottom of stopping this problem, we are going to continually have the economic problems, the problems of the value of homes continuing to depreciate, as people leave, neighborhoods are being destroyed, because you homes are being boarded up. And I am starting to feel that maybe just voluntary participation in the program is not working. We have to do something more than that.

The CHAIRMAN. Would the gentleman yield? In fairness to the people from HUD, part of the problem is we drafted it for homeowners, which we wrote. We did it at a time when there was a lot of concern that we were being too lavish, too open-handed and to respond to that we toughened it up some. We may have toughened it up beyond what current circumstances require.

We have requested, in consultation with HUD and others, changes in the plan to meet some of those problems, and we are hoping it will be in the stimulus or maybe in the TARP bill. So part of that has been offered and we have been working. Some changes have been made administratively, but we acknowledge that we were tougher than was workable and we are trying, without being excessive, to open it up some.

Mr. MEEKS. My last question is to Mr. Heist. Again, I am trying to work my way through this because we are trying to make the market move again. And it seems as though now the only one who can buy a house or get involved in a house, I still believe that the best investment that one can make is in real estate or into owning their own home if they can afford it, but now, you have to have a 750 or better score in order to get a house, which then keeps the market stagnant and we can't get out of these crises.

I was just wondering and trying to figure out with your FICO scores of 750 or better being the only way that you can get a mortgage nowadays, liquidity, thereby shutting down people who have decent credit can't get a house. Do you have any ideas or solutions?

I would like to hear your thoughts on how we can deal with this dilemma that keeps spiraling; it seems like we can't get out of this circle.

Mr. HEIST. As someone who is responsible for auditing these programs, I can only deal with the requirements that are in place right now. The reality, as you suggested, is a dilemma and there is a correlation between credit scores and the likelihood of that loan to default. That is a reality that FHA has to deal with and factor in when it makes its rules and sets standards for lenders when they underwrite loans.

The CHAIRMAN. One last comment, because I took some of the gentleman's time.

Mr. MEEKS. I yield back.

The CHAIRMAN. Thank you. The gentleman from Florida, Mr. Posey.

Mr. POSEY. I thank you very much, Mr. Chairman.

Gentlemen, in last year's Housing and Economic Recovery Act, a provision was inserted to prevent the FHA from implementing a risk-based premium pricing structure for the riskier loans. Under the proposed initiative, in exchange for a significantly lower interest rate, those with a higher risk of default would have paid a slightly higher insurance premium.

We have seen a significant expansion of the FHA loans over the past year. We have seen the balance in the insurance fund drop by approximately 50 percent. We have seen FHA take on riskier loans, and we have seen the Congress pass a law that prevents the FHA from managing risk. It looks to me that the Congress may have put in place policies that increased the risk of FHA going into default like it did the conventional market.

Do you think that by eliminating the ability of FHA to adjust for risk in this manner to fund is less solvent and thus the taxpayers are put at a potentially greater risk? I would like a response from both of you. Yes or no would be perfect.

Mr. MURRAY. First, I would like to say that we don't believe that FHA has riskier loans, but we would also be very desirous of having risk-based pricing.

Mr. POSEY. Is that a yes or a no?

The CHAIRMAN. That was a Senate provision, so don't feel inhibited in answering fully.

Mr. BACHUS. We actually passed a bill and there was bipartisan agreement in the House to put risk-based pricing in. It did move to the Senate and a Member there added that amendment, that amendment prohibiting risk-based premiums.

Mr. HEIST. My only observation at the time was implementing a risk-based pricing and the ability of FHA again to deal with the increased complexities and the resources in the systems to be able to do it effectively, as far as a concept we were neutral on that. Just concerned as far as the capacity to implement it.

Mr. POSEY. Thank you for following up, Mr. Chairman. But do you have an opinion whether the ability to do that would make the taxpayer safer from risk?

Mr. HEIST. No, I don't.

Mr. POSEY. You really don't, no?

Mr. HEIST. No.

Mr. POSEY. Do you know who in the world might be able to give us an answer on that?

Mr. MURRAY. For us, it reduces the burden of premiums and the like on the less riskier borrowers. In other words, the cost for an FHA loan would be slightly less. So in other words, the risk goes to those who are—need to be the more riskier borrowers.

Mr. POSEY. Thank you, Mr. Chairman. I didn't want to even take up this much time, but I think it is just a fundamentally good question.

The CHAIRMAN. No, I appreciate it. I think this is a case of Congress doling out authority to the FHA, so maybe it will change.

The gentleman from Kansas.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. To both of the witnesses, I think we all would agree that there is a foreclosure crisis going on in our country right now. FDIC Chairman Sheila Bair has a plan which I believe is reasonable to address this problem. I believe we all appreciate the lenders who are working with homeowners who are refinancing, modifying loans to keep people in their homes. As Congress considers how to allocate remaining TARP funds, would it be appropriate to utilize a substantial amount, perhaps \$100 billion, for foreclosure mitigation to keep people in their homes and address this foreclosure crisis.

I am addressing this question to both of our witnesses.

Mr. HEIST. I would defer to Mr. Murray on that one.

Mr. MURRAY. I am sorry. I really can't answer that. I don't have an answer for that.

Mr. MOORE OF KANSAS. Do you have any thoughts as to what we might do to address the foreclosure crisis then if we don't use TARP funds?

Mr. MURRAY. I would be more than happy to send you a written response to that.

Mr. MOORE OF KANSAS. I would appreciate that.

The CHAIRMAN. Mr. Campbell from California.

Mr. CAMPBELL. Thank you, Mr. Chairman.

I wanted to ask Mr. Murray, during Mr. Heist's testimony he talked about the reserve requirement being 2 percent and how it has fallen from 6 to 3, and we all know about the conditions in the marketplace and so forth. Since FHA is making—the volume is up so much, and since there is such a much greater percentage of the market is now FHA that is going out there, shouldn't we be making loans now that should be adding to that reserve requirement and not having it fall quite so much given all this increased volume? Am I wrong? What is happening?

Mr. MURRAY. I would initially tend to agree with you that with the uptick in volume, that does add to the reserve, but that whole calculation is a highly, highly technical thing with people who are far brighter than I at HUD who deal with that, and I would be more than happy to have any questions answered for you if you would like.

Mr. CAMPBELL. Mr. Heist, I don't know if you are one of those far brighter people, but take a stab at it.

Mr. HEIST. Absolutely not. But I do know that those estimates are profoundly sensitive to changes in overall macroeconomic conditions, how much house prices are going up and down. When you

foreclose on a property, given the market conditions in that particular community, how much are you going to get on that property? FHA's loss rates, for example, have been going up from what was in the 30s percentage range up through the 40s over the past couple of years. So those sorts of factors really drive how much FHA is going to expect to lose.

Mr. CAMPBELL. I guess for both of you—and here is where I am going and I think you can tell that and what I am worried about, is that we all know no matter how good your underwriting was, you are going to have losses on things that have happened because of the drop in house prices and the unemployment that has continued to increase, etc. So we all know that is going to happen. But now we have the benefit of knowing that has all happened as we are making new loans and that presumably the new loans we are making should be on more solid footing and thereby should be adding to that reserve.

I guess I am just concerned about this thing, as the volume gets bigger and the reserve numbers keep dropping, that is a concern. Is there something wrong with the underwriting that is going on now? Everybody has touched on this to some degree, because the underwriting we are doing now is not as good as it ought to be, and we are putting new loans on the books that are actually damaging the reserve requirement as we are putting them on?

Mr. MURRAY. I think—again, I don't want to step out here. As a room full of Ph.D.s sort of articulate to us, it is more of an accounting process that the reserve is small because of the increase in volume that we took dollars from the reserve to cover potential losses associated with the new huge book of business. So it is an accounting function, but that is totally outside of my ability to even comment on. So I don't want to mislead anyone.

Mr. CAMPBELL. Mr. Heist, anything more you want to add?

Mr. HEIST. Not at this point, no.

Mr. CAMPBELL. Madam Chairwoman, I hopefully—I am not sure we got a good response to that, but I do think it is something we need to be concerned about. Clearly, there will be more volume going through here as we move forward. And that volume should be helping the reserve balance, not hurting it, I would think.

Ms. WATERS. [presiding]. Absolutely.

Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Madam Chairwoman. Before I ask my questions of the witnesses, I want to say thank you to you and Chairman Frank for having this hearing to discuss FHA oversight of loan originators. I ask unanimous consent to include in today's record two documents, a CRS report entitled "Housing and Economic Recovery Act of 2008," and, secondly, an Overview of the Conference of State Bank Supervisors, Supervision of the Mortgage Industry Through Collaboration and Technology.

Mr. Chairman, I ask for unanimous consent.

The CHAIRMAN. Oh, I am sorry. As I said earlier, not everybody was here, since it is not a formal committee we announced that anything anybody wants to be put into the record will be put into the record. I can't guarantee anybody will read it, but it will be in the record.

Mr. HINOJOSA. Thank you for that clarification. By the end of the year, CSBS reportedly will have 33 States on the mortgage origination system. Only 2 States have not committed to be on the system, but they likely will join us in 2010 at the latest. If not, it is my understanding that HUD will be doing the licensing in those States.

Mr. Murray, I would like to ask you my first question. Would you like to comment on the performance of CSBS, considering what is required of the supervisors?

Mr. MURRAY. Sir, unfortunately I can't answer that. That issue is not in my office. That is done in our Office of Consumer Regulatory Affairs.

Mr. HINOJOSA. Mr. Heist?

Mr. HEIST. Is that the licensing of lenders and brokers?

Mr. HINOJOSA. Yes.

Mr. HEIST. Only just to say that the States control the licensing, and we have noted, again given in light of FHA's resources, there is minimal staff assigned to oversee that process. And it is a concern of ours that FHA's oversight of that and ensuring that the States are equipped to do the licensing that they need to do is adequate.

Mr. HINOJOSA. In listening to some of the questions that some of my colleagues have asked before me, I question why you have not requested an increase in funding for administrative staff.

Mr. HEIST. I can say that the Office of Inspector General has asked for additional resources. We, like FHA, are strained in our ability to audit and investigate single family fraud cases.

Mr. HINOJOSA. Mr. Murray, you said that you all were only examining 5 percent of the loan applications and you thought that if given the resources you might be able to increase that to at least 10 percent of applications. How much money would it take in resources to be able to do that?

Mr. MURRAY. I am sorry, I couldn't answer that just right here.

Mr. HINOJOSA. I have been informed that there are a lot of claims and foreclosures to come before Federal Housing Administration. So Mr. Murray, in light of this, why has the FHA not taken the actions to adjust the underwriting requirements to reflect a changing environment?

Mr. MURRAY. I think HUD's underwriting requirements are very sufficient, they are well tested. I think most of the foreclosures are due to economic conditions. It has nothing to do with the quality of the loan. It is more like personal circumstances.

Mr. HINOJOSA. The reason I ask that question is that the area that I represent in south Texas, deep south Texas, 80 percent of my constituents are Hispanic. And I find that the highest hurdle for Hispanics seeking to purchase loans is the downpayment. And that of course is getting worse under the present changing environment that I am talking about. So I think that FHA is the best path to homeownership for Hispanics because they seem to be a little bit more lenient on that downpayment. So I find that there needs to be some changes considered and, if not, I think that you just don't have a good pulse as to how difficult it is in regions of the country like the one that I represent.

Mr. MURRAY. And I am quite certain that is correct what you are saying, and it may be so in the conventional market, but what we find, our—Federal fund rates are relatively low. The fund rate for 2007 was 6.56 percent, and in 2008, it was 6.9 percent. But that is default, because people go in and out of default. But the claim rate, which is what costs money, was 1.42 percent in 2007 and 1.3 percent in 2008. So that is a very, very low rate.

I think that there is evidence that we pretty much have our underwriting criteria pretty tightly triggered, but we can always, always look at more. As I said earlier, we have an internal task force to look across our business front end, back end, REO and the like, and we are looking at what can we tweak or fix given today's economic environment so we are not sitting still. So we will make sure we take a look in Texas.

Mr. HINOJOSA. My time has run out, and I have to yield back.

The CHAIRMAN. The gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you, Mr. Chairman. Mr. Murray, on page 2 of your testimony, the middle paragraph, "FHA-insured loans are neither high cost nor high risk for homeowners." Do you see that? It is actually the first page of your testimony.

Mr. MURRAY. Yes, sir.

Mr. MANZULLO. Has FHA always required written verification of a borrower's employment?

Mr. MURRAY. Absolutely.

Mr. MANZULLO. Is that standard?

Mr. MURRAY. Absolutely, sir.

Mr. MANZULLO. That obviously goes to the borrower's capacity to meet the monthly mortgage obligation.

Mr. MURRAY. Right.

Mr. MANZULLO. I guess what perplexes me, what bothers me is July 17th, I believe, we had a hearing here with Fed Chairman Bernanke who said that the Fed had done a top to bottom review of all mortgage applications, etc. And they are now going to require written verification that somebody actually does make that amount of money once it is put into the application. However, I believe that requirement does not go into effect until October 2009. There was a gasp in the room when I asked Mr. Bernanke why he waited 13 months. He said, "because we don't expect the housing market to recover until then." I thought that was pretty cavalier on his part because these are opinion makers. What I don't understand is why the FHA has apparently always adopted very common-sense requirements for a loan; i.e., you have to be able to repay it before you can sign the note to get the property. I know you can't speak on behalf of the Fed, but what happened here? You are the good guy.

Mr. MURRAY. I don't know. I think since 1934, which was when someone decided that you needed a mortgage that lasted more than 5 years, underwriting standards were put into place and they have been continually refined. It is my understanding—

Mr. MANZULLO. What year, 1994?

Mr. MURRAY. I said 1934. And no, sir, I was not there.

Mr. MANZULLO. 1934, okay.

Mr. MURRAY. The new Federal rules will mimic the FHA's long-standing underwriting requirements. It is just good basic business sense.

Mr. MANZULLO. You just answered an inquiry as to the default rate, FHA being 1.5, something like that, under 1.5.

Mr. MURRAY. The claim rate this past fiscal year was 1.3 percent.

Mr. MANZULLO. Is that dollar volume or actual numbers of mortgages?

Mr. MURRAY. That is a percentage of loans.

Mr. MANZULLO. Pardon?

Mr. MURRAY. A percentage of loans.

Mr. MANZULLO. Okay. So that would be—

Mr. MURRAY. 1.3 percent of the loans went to claim.

Mr. MANZULLO. Meaning that the FHA insurance had to be used?

Mr. MURRAY. Yes, sir.

Mr. MANZULLO. Okay. That is pretty low, isn't it?

Mr. MURRAY. Absolutely.

Mr. MANZULLO. Do you have any problems with the—it was FHA Secure that allowed people who had loans that they could not afford, not because of employment problems, but because of balloons and teasers, and were allowed to bring those into the FHA umbrella. It was about 350,000. The program ended at the end of last year.

Do you have any problem that any of those loans could exceed the normal rate of default to which you just testified?

Mr. MURRAY. Absolutely not, sir. We subject those loans to the same underwriting requirements. And if they don't match, they don't come in.

Mr. MANZULLO. The HOPE for Homeowners Program has been less than successful. I never liked it in the first place because it is called a common law composition, which lenders could do at any time with their borrowers, especially in light of fact that this Congress at least did something wise where we said that any forgiveness of principal—as to your principal residence would not be considered to be imputed income under the income tax.

Let me ask you an open-ended question. Aside from asking for more manpower, etc., what do you think FHA can do to even further improve your performance?

Mr. MURRAY. I think I answered earlier to the gentleman over here that what we can do is put together some thoughts on that. I am not prepared off the top of my head.

Mr. MANZULLO. Okay.

Mr. MURRAY. I think that is a very deep subject and there is an array of things that we could consider, and that is also a part of our task force that we are working on now.

Mr. MANZULLO. I appreciate that, because we always like to look at models, government programs that have worked, and it is apparent that there is a model going here, especially helping out people who don't have the full amount downpayment that could qualify under conventional mortgage.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

This is a critical time. It is important that we prevent a precipitous decline of home prices in all neighborhoods, including those of us who represent the high-cost areas. The FHA loan limit in the Fannie and Freddie limits as well have declined with the new year. It is my understanding that FHA actually makes a profit on its larger conforming loans, as does Fannie and Freddie; and I hope that Congress passes soon legislation so that the limits for Fannie and Freddie and essentially FHA are no lower in 2009 in each area.

The CHAIRMAN. Will the gentleman yield?

Mr. SHERMAN. Yes, I will.

The CHAIRMAN. That will be in the economic recovery package as a result of the conversations yesterday. We got the approval from the Obama Administration. Obviously, it is something near and dear to the heart of the Speaker; and keeping the loan limits at last year's level for this year so we can then think about what we will do going forward will be in the economic recovery program for FHA, Fannie Mae, and Freddie Mac. Because the gentleman is accurate that they are moneymakers.

Mr. SHERMAN. I thank the chairman, not just for those comments but for his work in achieving a legislative result that is so important to so many areas of the country and the country as a whole.

Now, shifting to FHA operations, every mortgage broker is required to submit an audit financial statement showing a net worth of a quarter million dollars for some and for the nonsupervised loan correspondents a \$63,000 net worth. The thing is that net worths of that level can evaporate very, very quickly. They are not very large. We have seen 313 mortgage bankers, lenders, and Wall Street firms go out of business. Their net worth of much, much larger amounts evaporated very quickly. And so we see that the thousands of dollars spent on audit fees every year are not available for consumers. Instead, they go to my old home boys in the accounting profession.

So I would hope that the FHA would take seriously effort proposals to require a surety bond in lieu of an audit financial statement or the creation of a recovery fund so those thousands of dollars that are going to audit fees are instead going to a fund that will be available for consumers.

I hope to be able to ask a formal question on that issue, but I want to shift Mr. Murray to another issue.

The National Association of Realtors has expressed serious concerns about the shortcomings of FHA technology. As they note in their statement submitted for the record, currently, FHA operates technology which is an average age of 18 years old; and Brian Montgomery, FHA Commissioner, has stated that the software programs are often older than the staff maintaining them. You still have a COBOL system that is 30 years old.

It is estimated that \$65 million is required to upgrade FHA systems, according to the National Association of Realtors; and that would not only upgrade the system but provide for appropriate staffing. What is the status of your current technology initiatives? When and at what cost do you expect to bring the agency into the 21st Century?

Mr. MURRAY. The status is, as I said in my opening statement, we are managing it. We are using it. We have managed to do tweaks here and there through maintenance.

Candidly, in one of our 35 systems, for less than the cost of maintenance, 1 year's worth of maintenance, we can turn it into a Web-based system that would work fantastically for us. We can't do it because we don't have working capital funds to do it.

Our systems are adequate at this juncture, but it will not sustain itself as our business continues to increase. So we absolutely need additional funding. Our technology people estimate somewhere between \$20 million a year for us to segment these certified systems into—

Mr. SHERMAN. So you feel you need \$20 million a year over a period of how many years?

Mr. MURRAY. Five years.

Mr. SHERMAN. \$20 million in order to upgrade your technology.

I don't know whether—all we can do is work with the Appropriations Committee on that or whether there is a way to change legislation through this committee that would achieve that goal. But I can't imagine a better use of funds, given the new mission or expanded mission of the FHA.

Actually, I believe my time has expired.

The CHAIRMAN. The gentlewoman from West Virginia.

Mrs. CAPITO. I would like to thank the witnesses for sharing information.

First of all, I would like to ask unanimous consent to submit my opening statement into the record. I think that was already going to be done, but I wanted to make sure that was all right.

In 2008, Congress shut down the avenue of the seller-funded or the downpayment assistance avenue for FHA borrowers; and I would like to know what percentage of your portfolio that you have right now still has those seller-funded downpayment assistance and what effect you think that might have on your future portfolio moving forward and what you are finding now that particular avenue has been shut down?

Mr. MURRAY. We don't—I don't have those numbers of what they have, but I would guess that there is a pipeline of loans that are there. We do know that 30 percent of those would generally go to default.

Mrs. CAPITO. Let me just clarify that. Thirty percent of the seller-funded downpayment assistance loans go to default?

Mr. MURRAY. Yes, that is correct. Yes. And we do know we have significant amounts of new volume coming in, so, hopefully, that would tend to offset that.

Mrs. CAPITO. Okay. So, hopefully, that will have the intended effect to steady that downpayment issue.

We also raised the downpayment requirements from 3 percent to 3.5 percent. What effect does that have? If we are having more volume of FHA loans, where do you speculate or how do you document where people are getting their downpayment and are able to meet that requirement?

Mr. MURRAY. My staff is confirming what I was thinking. What we are seeing is going back to where it was before, before the

downpayment assistance program came into being, and that is from family and relatives and the like.

Mrs. CAPITO. Thank you.

I would like to say, as the volume of FHA loans has increased, I know a lot of financial institutions that have put in applications to become loan originators, I share the concern of my colleagues of those who have been in maybe the subprime and less than maybe aboveboard practices can then migrate into becoming a large vendor, so to speak, for FHA loans. But I would say I think we want to be careful not to cast a broad brush here. Because, having been in one of my lending institutions, a community bank in my own community, they have an application before the FHA right now to become a lender. They are a terrific institution that has, I think, a wonderful reputation for providing great community services, financial services to our local communities.

I would hate to see a situation where, as we cast a brush to try to cast out the bad actors, that we then unintentionally begin to harm the folks who are there doing the right thing, have their applications in order, and intend to fulfill that dream of helping folks achieve homeownership. So I would just throw that cautionary flag before you, having been in several of these institutions in my State of West Virginia and knowing they are doing it the right way and want to be able to offer FHA as a possibility for home buyers.

Mr. MURRAY. As part of our vetting process, to the extent that we have the legal authority to prevent someone, a so-called bad actor, however that may be defined, both from a personal perspective and a legal perspective, if there are bad actors, our process is not to allow you to come in. But, having said that, absent us having that, then we approve them.

Now, if they are so inclined to engage in mischief, we have so many checks and balances and electronic surveillance in our operation they could not prevail for a long period of time, because you will be caught very quickly.

Mrs. CAPITO. And the taxpayer will be on the hook once again for the unscrupulous actions of certain folks, whether it was the subprime lenders or it is somebody moving to FHA and putting forward unscrupulous practices. It will be not only that individual homeowner hurt in some form or fashion but all of us as a general constituency will be hurt as well.

Mr. MURRAY. Right. Invariably, you have that, no matter what.

Across the country I would argue—and I think the IG would even agree with me—there is less than 2 percent of people probably who stretch out to engage in mischief or wrong activities. The vast, vast majority of lenders are very good. They have exercised with extreme integrity.

I do want to point out that we have a process called Credit Watch that no one else in the industry has that will do electronic surveillance on a quarterly basis. At a press of a button, we can examine the default and claim rate of every approved branch of every approved FHA lender, that's 44,000 views, and the combinations of places they can do business across the country. Every quarter, any lender who exceeds the default and claim rate by 200 percent for the local jurisdiction in comparison with others doing business, we will send them a proposed termination notice of their

branch and in a 9-day period, we will send the notices, have a hearing and make a determination whether or not to terminate them or have them make some corrections and stay in place.

Mrs. CAPITO. Could I just make one clarification? On the seller-funded downpayment assistance programs, you mentioned that 30 percent of those were in default. Would that mean 30 percent of the mortgages in default are seller funded or that, of the seller-funded programs, 30 percent of those are in default?

Mr. MURRAY. Compared to our standard book of business, seller-funded downpayment assistance as an entity is 30 percent—I am sorry, their loans perform 2 to 3 times worse.

Mrs. CAPITO. Thank you.

Mr. MURRAY. Okay.

The CHAIRMAN. The gentlewoman from New York, Mrs. McCarthy.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

Mr. Murray, you just talked about Credit Watch. Is that in place now or has that been in place for a while?

Mr. MURRAY. Yes, ma'am we launched it in May, 1999.

Mrs. MCCARTHY OF NEW YORK. So if you could clarify it for me, the way you were explaining it, why didn't we see all the subprime loaners during these years being picked up a little bit faster?

Mr. MURRAY. Because we don't have subprime lenders in FHA.

Mrs. MCCARTHY OF NEW YORK. So you are only looking at the loaners that you have?

Mr. MURRAY. Yes, we only do FHA. So even if those folks, the bad actors, were doing subprime and they now come to FHA, they couldn't fit their square peg in our round hole. They would be caught.

Mrs. MCCARTHY OF NEW YORK. Maybe it is something we should be looking at to expand then, being that we will not be able to do that much.

One of the things I wanted to ask you, with your FHA loans—I work a lot with the Long Island Housing Partnership in Long Island, New York. We basically—or I should say they basically work with low-income families, obviously trying to allow them to buy their first home. Financial literacy has been a big thing on my part here on this committee. I know we worked on helping these different groups on educating people on how to buy a home, to see if they could buy a home.

With your loans, even with your loans, even though they are lower, do you educate them that it is not just the mortgage, it is the insurance, it is the electric bill, it is the taxes in the area that they live? Because, obviously, a lot of people could buy a home. That doesn't mean they can keep up with what it costs to keep that home going. To me, that is something that I personally believe should be mandatory on every single housing loan.

Mr. MURRAY. Yes. We have 2,300 housing counselors that we fund; and their services are free or at very low cost. Part of their pre-purchase counseling, that is exactly what they do, to help them establish budgets and help them understand they have to make a payment. You can't put that off. You put something else off.

In terms of mandatory counseling, that may be somewhat problematic. There has been tests of that back in the 1990's and the

like. There are just not enough housing counselors to go around. If you have it mandatory, you may have a segment of the population who is not served regularly or soon enough to enter into a real estate deal.

Mrs. MCCARTHY OF NEW YORK. The thing of it is, the housing authority on Long Island has no defaults.

Mr. MURRAY. Right.

Mrs. MCCARTHY OF NEW YORK. So if you are looking at a cost basis, who is coming out ahead? Even though—I know it is not mandatory. Nobody on this committee likes the word “mandatory.” I often wonder if we wouldn’t be in the problem that we are in today if things had been done differently that we have been fighting for, for years on this committee.

With obviously your increased responsibility, and we have heard constantly over and over again that you need more staff and higher technology to work into to do what you are doing, could you give me an idea on the flow of work that you have had in the last 10 years and what has the growth been on having staff, keeping staff? We heard you talk about the computers and what kind of money you need for that. Obviously, that will be a tough sell on every issue. Because, basically, every branch is saying they need more help in that particular organization. So if you could give me an idea of how much more work you are doing over the last couple of years with maybe the same amount of staff coming back from the 1990’s.

Mr. MURRAY. Our environment has pretty much tripled. The first 2 weeks in December, we have seen the largest volume we have ever had in the history of FHA.

Our staffing levels have been pretty much the same over the last 4 or 5 years, which is slightly less than 900 employees. But also during that process, we have been embracing technology to the extent that we can. For example, we had a contractor and some staff doing the annual financial audit. We completely automated that process and—where a system will run through the audits to find deficiencies, and we maximize our staff resources by just hiring five accountants to help look for the deficiencies.

So we have been embracing technologies to the extent we can and have the monies available to do that. Not only do we want to fix the technology that we have, we want to embrace new technologies. There are a lot of things we want to do that would be state-of-the-art, that we want to embrace.

Mrs. MCCARTHY OF NEW YORK. I can’t see—my time is up.

The CHAIRMAN. The gentleman from New Jersey, Mr. Lance.

Mr. LANCE. Thank you very much, Mr. Chairman.

To Mr. Heist, about a year ago, an audit was conducted of HUD’s Quality Assurance Division, and the audit determined that it did not consistently require FHA-approved lenders to indemnify loans with similar material deficiencies and did not always resolve material deficient or potentially fraudulent loans in a consistent fashion. Sir, could you update the committee as to what has occurred in the last year and what steps the Department has taken to ensure that uniform resolutions to loan underwriting deficiencies are handled in an appropriate fashion?

Mr. HEIST. I believe our recommendations spoke to among the various homeownership centers ensuring that they are referring things on an equal footing, making decisions about whether a particular case was so egregious that it should be indemnified by the lender. And we spoke to headquarters improving their oversight of the field just to make sure things are being done consistently and that when they do have fraudulent loans, they are referred to the IG.

Mr. LANCE. Mr. Murray, would you like to comment on that, sir?

Mr. MURRAY. Yes, we both strive for consistency.

With respect to looking at asking someone to indemnify a loan, it must be material. These things are not one-size-fits-all. You can have two lenders, in two different parts of the country, perhaps having the same violations, but there are also mitigating circumstances and factors that led to that. That is a discussion in resolving those issues. So you will not have it 100 percent from homeownership center to homeownership center or even within a homeownership center. Because you cannot just say, you did this; therefore, you pay that. You just cannot do that. It is not that absolute.

Mr. LANCE. And, Mr. Murray, would it depend based upon the region of the country and the cost of housing in the country or would there be other factors?

Mr. MURRAY. No, it would be mitigating factors, what led to that or did you subsequently find support documentation that would allow us to say, okay, we will do something differently.

Mr. LANCE. As a follow-up to the question from the gentlelady from West Virginia, Mr. Murray, what percentage of the FHA portfolio is in the now-banned seller-funded downpayment programs? I am not sure I heard the—

Mr. MURRAY. FHA does not allow seller funding downpayment.

Mr. LANCE. Yes, sir, I know that has been banned since October of 2008. What percentage is in the portfolio now?

Mr. MURRAY. Before the ban, it constituted 30 percent.

Mr. LANCE. Thirty percent.

Mr. MURRAY. So I would assume it is decreasing—not decreasing, but with the influx of new loans—

Mr. LANCE. Presumably, it is decreasing because of the influx of new loans. But it was 30 percent when it was banned on October 1, 2008.

And what effect will these types of loans have on the capital reserve ratio?

Mr. MURRAY. That is one of those questions I have to defer to my office of evaluation for that, but we are glad to get an answer for you.

Mr. LANCE. Thank you very much. I would appreciate that through the Chair.

Thank you, Mr. Chairman. I yield the balance of my time.

The CHAIRMAN. The gentleman from California, Mr. Baca.

Mr. BACA. Thank you very much, Mr. Chairman.

Mr. Murray, many of the foreclosure consultants work in the best interests of the clients to modify troubled mortgages so homeowners may avoid foreclosure. However, as the foreclosure rate has gone up, communities across the country, including my district,

have seen a rise in fraudulent actors to provide legitimate foreclosure prevention services. Many of these predatory actors have taken money in advance while not performing any service at all, leaving many homeowners on the streets with home foreclosures on them. You probably have seen false flyers on cars and on homes and on TVs.

Just as with any real estate transaction, those assisting with loan modifications should only receive payment once a transaction is complete. In California, a foreclosure consultant must be certified—and I state—must be certified under the new real estate laws or pay penalty. Is this something that FHA might be willing to consider?

Mr. MURRAY. I think in FHA, there is not that problem. Part of our process is we require loss mitigation of our lenders. That is early on in the process, from the first time they become 45 days behind, the pamphlet goes out. So at least FHA borrowers are informed or should be informed that these are resources here to assist you in that.

And let me just add that in the last year, we did over 100,000 loan modifications, and 65 percent of those folks retained their homeownership as a result of that.

Now the broader picture about these individuals who are—there are many, many schemes. As we go to conferences, we try to warn people. But that is totally beyond the purview of HUD. We certainly cannot do what Justice and the FBI themselves cannot do. Poor little FHA certainly can't do anything about that. But to the extent that we might find our own servicers, FHA-approved servicers, not offering loss mitigation, yes, we will take immediate action against those guys.

Mr. BACA. You talked earlier too as well about new rules that are needed. And as we look at new rules, we can come up with all of the new rules, but we need the enforcement, which goes back to what the chairman indicated at the beginning: having the appropriate staff to make sure that the enforcement is done there, because all the regulations, the oversight, the accountability, can be there, but if you don't enforce those laws, then we have these same predators continuing to do what they are doing right now. I know you talked a little bit about that Credit Watch, a little bit, but that is something that is not in place.

Mr. MURRAY. It is in place.

Mr. BACA. It is in place. Then my question would be: What legal authority would you need, because that is one thing you said earlier; you need legal authority. So what do you need—what do we need to do to make sure you have the legal authority that we can go after some of these individuals?

Mr. MURRAY. We are going to propose rules. I don't know—perhaps with respect to the Mortgage Review Board, we may need some statutory changes, making some statutory changes. But I think for the most part, just through rulemaking we can enhance and tighten our requirements.

As Ms. Waters was saying, I too am bothered by principals of an entity who got into trouble, dissolved themselves, and recreated themselves again. I do not have the authority, absent these people being debarred or convicted, from stopping that individual from

forming another company. We have that on the table right now to do that.

What we are trying to do is to say that if you have unfinished business, unresolved issues, and we are looking that if you have received a letter from either my monitoring staff or from the Inspector General's Office, and if you shut down business once receiving that letter, that we can then hold the individuals accountable. Because we often, my monitors, as well as Mr. Heist's folks, when they go out, oftentimes by the time you send the finding letters to the lenders, they are gone. We want to be able to hold the principals accountable. That is rulemaking for us.

Mr. BACA. Did you want to answer, Mr. Heist?

Mr. HEIST. On one front, the Congress has acted. Part of the Housing and Economic Recovery Act provided for increased penalties, making a criminal offense against FHA equivalent to that against a financial institution. So we are hopeful that will give some more motivation for prosecutors to go after some of these cases. We also agree that going after the principals is an excellent idea because it prevents being able to set up shop as another company.

Mr. BACA. My final question—and I know my time has run out—but in reference to the regulations that were not in place, when did this actually start occurring? Because I know that the chairman over the last 2 years has tried to put in regulations and enforcement, but the regulations were lacking, and that was part of the problem. When did all of this occur in the regulations of the enforcement aspect, because apparently there have been statements that say, we are overregulated, we don't want government intervention; and yet, government needs to intervene and needs to have those kind of regulations to have the kind of accountability and oversights in the enforcement.

When did this all start happening?

Mr. MURRAY. People and miscreants engaged in wrongdoing have always existed. I think what happens is as situations evolve, we need to evolve with them. There is always the next mortgage fraud scheme. So I think what we are finding, and we all agree, is that we are in a particularly difficult situation now. There may be more and more people who have been engaged in wrongdoing maybe looking to come to HUD, not knowing that they probably cannot get away with what they were doing, but nonetheless we still need to be able to hold folks accountable.

Believe me, my staff, we have 120 monitors who actually go out on site and get into your books and your business. They are very, very aggressive individuals. What we need to have as well, as Mr. Heist is saying, is the authority to hold people accountable to do the things that we really need to do to make an example.

Mr. BACA. Let us know how we can help you there.

The CHAIRMAN. I will also note that starting in 2002, there was a precipitous drop in FHA guarantees. It dropped very significantly. It has gone back up again. I think what has happened is the staffing hasn't tracked the increase in activity. It went down in the 200,000 range. It is back up to where it should be. It dropped by about two-thirds. I think part of the problem is the lag there in staffing up as there was an increase.

The gentleman from Texas. I keep ignoring him.

Mr. NEUGEBAUER. I thank the chairman.

Mr. Heist, I think it has been alluded to a couple of times that there is a model that determines what the current reserve requirement is, based on actuarially and the portfolio condition, and I heard you say maybe economic conditions that are being projected, I guess, forward. Is there third-party validation on that formula and how it is being calculated? Because some companies got in trouble coming up with their own models and leading someone to believe that in fact the reserves were sufficient, when in turn they were not. So is there third-party validation?

Mr. HEIST. The actuarial study itself is by law required to be conducted by an independent actuarial firm. That is actually beyond the auditing realm that I deal with. So there is some degree of third party, at least with respect to the assumptions used. Again, this isn't under my purview, but in addition to coming up with a bottom-line best estimate, they report what would happen if certain things happened. If you were more pessimistic in your assumptions, here is what the impact would be. This is a concern because if things turn out worse than it was projected back in September, the value of the fund will be determined to be less.

Mr. NEUGEBAUER. Which brings me to the question that legislation has been introduced that would allow bankruptcy judges to cram down lenders, and obviously FHA would fall under that. Has anybody done any—or thought about doing some calculations of what impact that legislation might have on the condition of the fund? Because one of the things that could happen here, we could actually pass this into law, and the impacts of that on the fund could in fact cause the actuarial number to go down; and, in fact, the fund could then be not meeting the statutory requirement. I think that is important information for this committee to have.

Mr. HEIST. I am not aware of any study.

Mr. NEUGEBAUER. Mr. Murray, who would we request some evaluation of what impact this legislation would have on the fund?

Mr. MURRAY. I will take that back to my principals.

Mr. NEUGEBAUER. Could you put that on somebody's ASAP list, because I have a feeling that legislation is moving rather quickly. I think that is important, because the fund has lost half of its value in just 1 year. So the trend is not good. Additional legislation in the form of a cram-down could in fact accelerate that. And I think if that is, in fact, going to happen, I think this committee needs to know that.

Mr. Murray, the other question I have is, you feel like you are doing a good job in vetting the people who are direct endorsers and people who are able to participate in the FHA program. But while you don't have risk-based pricing authority, do you feel like you have the latitude on terms and conditions? For example, have you thought about or is there a policy in some areas where you have experienced high losses and you have seen major devaluation in real estate values? Do you have the authority or are you able to increase the downpayment requirement on some of those loans?

Mr. MURRAY. No. FHA has never done this pricing regionally. It has always been a national—

Mr. NEUGEBAUER. In other words, if somebody applies for a loan, and they apply for a 3½ percent downpayment, you don't have any latitude—or, say, this is an area or a borrower where we don't feel that it is in the best interest to make a loan with a 96.5 percent loan?

Mr. MURRAY. I think the only two requirements are that clearly if it is in a declining market, we now require two appraisals. If the individual has a credit score of less than 500, we would require at least 10 percent down. That is a new procedure we now have. But otherwise, our underwriting criteria is consistent nationwide.

Mr. NEUGEBAUER. So the credit score drives the downpayment. Anything below 500 has to be a 10 percent loan?

Mr. MURRAY. That is the only credit score requirement we have.

Mr. NEUGEBAUER. What is your minimum credit score?

Mr. MURRAY. We don't use credit scores at all. The industry may impose credit scores on our borrowers, but FHA, as a policy, that is not part of our underwriting.

Mr. NEUGEBAUER. But you do require additional downpayment for a below 500 credit score; is that what you said?

Mr. MURRAY. That is correct.

Mr. NEUGEBAUER. So that is really the only time that you would look at a lesser downpayment, a credit-score threshold?

Mr. MURRAY. If we do cash-out refinances, that also requires a higher so-called downpayment.

Mr. NEUGEBAUER. I will look forward to hearing back from you on the impact of the cram-down on the reserve fund.

Mr. HINOJOSA. [presiding]. I would like to call on Congressman Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. I want to thank the witnesses for their patience today.

Mr. Murray, a long, long time ago in your opening statement, you said that in your opinion, the sky is not falling. While that should be reassuring to the committee, over the previous months we have had a parade of stellar witnesses who have given us the same expression. I call to mind Secretary Paulson and Chairman Bernanke who sat in that very same chair, at that very same table, and said that, first of all, they said, we had no problem. Secondly, they said, we have it contained. We heard from Fannie Mae and Freddie Mac that they were fine, in good shape going forward. So please forgive me for my skepticism.

While the sky is not falling, the balance in the FHA Mutual Mortgage Insurance Fund certainly is; would you agree?

Mr. MURRAY. No, sir, not necessarily so.

Mr. LYNCH. I have numbers here that said that last year we had a balance of \$21.2 billion, and today we have a balance of \$12 billion, a drop of 40 percent. That would constitute a falling balance. Are we cool with that?

Mr. MURRAY. No, sir. It is in the unencumbered reserve account. It is an accounting exercise.

Mr. LYNCH. I understand how you calculate it. You calculate a total. You calculated a total last year and you calculated a total this year. I know you are projecting losses in the future. But last year you projected—let's see, 40 percent higher—let's say you pro-

jected a 40 percent greater drop this year than you projected last year, using your own numbers.

Mr. MURRAY. I would have to say what I stated earlier, that the actuarial and those sort of things are done out of our Office of Evaluation. That is well beyond my purview.

Mr. LYNCH. Let's go to Mr. Heist. You are the Inspector General, correct?

Mr. HEIST. Yes.

Mr. LYNCH. You are familiar with this accounting?

Mr. HEIST. Yes. In some limited way, yes.

Mr. LYNCH. By statute, the Mutual Mortgage Insurance Fund has to maintain at least a minimum 2 percent ratio between the balance in the fund—the projected balance in the fund and the amount of FHA loans out there. They were at 6.4 percent last year; and they are at 3 percent this year, after a 40 percent drop. Correct?

Mr. HEIST. That is correct.

Mr. LYNCH. The data forecast that was used to project that is based on June 2008. Is that correct, Mr. Heist?

Mr. HEIST. That is correct.

Mr. LYNCH. I just want to say, June 2008 is a significant date for the following reasons: it was before IndyMac, that failure, which was mortgage-related; it was before the government takeover of Fannie and Freddie; before Lehman went under, the largest single bankruptcy in the country, in our history; it was before the failure of AIG as a private entity; it was before Washington Mutual went under, which was the biggest thrift failure ever in this country; it was before the Citigroup bailout; it was before Morgan Stanley and Goldman Sachs went out of the investment bank business; it was before Merrill Lynch collapsed, and also the collapse of Wachovia; and it was before the unemployment rate went to 6.5 percent.

Now, all that considered, with all that data in front of us, Mr. Heist, based on all the available data, I am concerned about this. I think they are going to drop below 2 percent. And I think they are going to need a bailout from Congress. And you are somebody who has looked at these numbers. Could you give me your opinion on this?

Mr. HEIST. In fact, the independent auditors who work for us, who did FHA's financial statements which were published in the middle of November, said the same thing and expressed the same concern; that the assumptions that were used may be optimistic, and expressed a concern that the capital ratio may indeed decline, at least towards 2 percent. And that is a concern.

Mr. LYNCH. Mr. Murray, anything to add to that? I understand it is a different department within FHA, and a different team, but the numbers are what they are. Can you persuade me that we are not going to approach that 2 percent?

Mr. MURRAY. No, sir. I am sorry; I couldn't do that.

Mr. LYNCH. All right.

Mr. Chairman, I yield back. Thank you.

Mr. HINOJOSA. I would like to call on the gentleman from Texas, Congressman Green.

Mr. GREEN. I thank you, Mr. Chairman, and I thank the witnesses for appearing.

Mr. Heist, because time is of the essence, I may not have an opportunity to ask you questions. I do want to assure you that this does not mean that I do not love you. I will have to show you some love on another occasion, possibly.

Mr. Murray, I do have questions for you. Without getting into statistical analysis or differential equations or vector analysis, let's talk for just a moment about this default rate that you referenced a while ago. And I am talking about now with seller-assisted downpayment.

Do you agree, sir, that if the buyer provides his or her own downpayment, the success rate for those loans with HUD is 97 percent?

Mr. MURRAY. I am not aware of the statistics, but I guess from a general theory—

Mr. GREEN. I believe it is correct. If you need to confer with one of your colleagues with you, I will honor that.

Mr. MURRAY. They are not are from the Office of Evaluation.

Mr. GREEN. Ninety-seven percent. The success rate for buyers who receive downpayment assistance from relatives, from various programs, perhaps a program that a municipality is affording buyers, is 95 percent. The success rate with seller-assisted downpayment is 94 percent. If we subtract 94 from 97, we have a difference of 3 percent. That is 3 times the default rate that HUD has been referencing.

If this is incorrect, provide me with your statistical information so that I may have some degree of clarity with reference to what I have called to your attention.

Mr. MURRAY. Yes. Again, I really cannot speak to that. That is an issue I have to get back with the Office of Evaluation.

Mr. GREEN. Mr. Murray, God bless you. You spoke to it earlier. That is the reason I am back here. I had other business to attend to, but I monitor these hearings. You spoke to it earlier when you indicated that it was 3 times, I believe, the default rate. Did you not make that comment earlier?

Mr. MURRAY. Yes. HUD has long been on record saying the—

Mr. GREEN. Mr. Murray, you need to look into this statistical information because it is entirely misleading if what I have said is correct. Because what it causes one to conclude is that the 3 times is some large number, some large difference between the seller-assisted and the case wherein the buyer actually pays his or her own downpayment, because 94 from 97 gives us 3, and that is the 3 times that HUD has been referencing.

Again, if you have specific information to the contrary, I beg that you give me the specific information to the contrary.

Mr. MURRAY. Absolutely.

Mr. GREEN. When you provide this, if you would, sir, I would like to, for our purposes, have some timeline. How long do you think it will take you to provide me with this information?

Mr. MURRAY. My staff tells me we can possibly have our office do it today.

Mr. GREEN. I understand. Staff tells me most things too. So I appreciate what you are saying. It is exceedingly important that we deal with this, because the seller-assisted downpayment program is

one that I support, Mr. Murray. I want to make my position very clear, transparently so.

I support it, Mr. Murray, because we have many persons who can make mortgage payments but don't have a downpayment. I support it, Mr. Murray, because many persons who receive downpayments from relatives are still having that benefit with HUD, but the persons who get the downpayments from the seller do not. And for those who would contend that this may create some sort of collusion, we can move to what is known as a blind-pool appraisal process, something used by the VA. The VA utilizes a blind-pool appraisal process such that you don't have collusion between the appraiser and any of the parties associated with the loan itself.

I am honored to visit with you on any occasion to talk to you about this, because I will be moving in this next session of Congress, along with colleagues—by the way, I don't like using the personal pronoun "I." Most things are done with other people. It is just that in this environment if you don't say "I," sometimes you lose the opportunity to let people know that you are doing things. So I only use it for the purpose of letting people know that I am involved. But I would like to talk to you more about it.

I thank you for your testimony today, and I yield back the balance of my time.

Mr. HINOJOSA. Thank you. I would like to now call on Congresswoman Melissa Bean from Illinois.

Ms. BEAN. Thank you, Mr. Chairman. Thank you both for your testimony today.

I want to go back to something that Congresswoman Speier mentioned earlier. She had talked about some of these past convictions of individuals and firms who are now applying for FHA involvement and participation in their applications.

You have talked about lack of resources and an extensive increase in the number of applications you are receiving, which makes it even harder to go through. In the Business Week article that mentioned some disturbing examples of those who are now participating in the FHA programs but had been contributors to the subprime crisis that we are now all suffering through, in their past practices there was an example of one individual who didn't include their criminal record in their applications. In many cases, there are many firms and individuals being investigated who have not yet been convicted.

Is it my understanding—and you can correct me if I am wrong—that it is only those who have been convicted that you have to consider. And if that is the case, do you have suggestions on what you prefer to see as the criteria so that you can better weed out those individuals and firms who are contributing those types of practices as bad actors?

In other words, should they have to report investigations or associations with or past employment with firms who have been under investigations or convicted?

Mr. MURRAY. We have requirements where we do look at past criminal activities and behavior and the like. The article is kind of difficult to follow because there is a theory of present responsibility. So when was one convicted, what did they do when they were convicted, how does that play into the action?

Yes, there are a lots of things that we want to do to try to tighten up the requirements that will give us the ability to say no, we don't want you to participate in FHA. Right now we don't have that authority. We are very limited in what we can and cannot do. And I mentioned earlier, clearly if we have an entity that has been sanctioned, we can act on that. Because the entity has been sanctioned and its principals chose to reestablish itself, I don't necessarily have a basis for going after that person unless someone took an action against that individual, like a debarment or a conviction, or those sort of things.

So, yes, there are things we want to do. But let me just clarify one thing though. Even though we have tripled the number of lenders trying to come back in, we have not lessened our requirements at all. It will take as long as it takes to go through a thorough investigation and review of an individual before we approve them to come into our program.

So that is why it does take longer, and people complain about that, but so be it. We are very, very mindful with our gatekeeping, and not anyone will come into our program. If, as I said earlier, if people would come in and choose to make mischief, we have so many systems in place that you will get caught sooner as opposed to later.

If I might, we have a process that no one else in the industry has, whereas a lender—or let's say broker for example—I don't want to pick them out, but if they wanted to do bad paper in the conventional market, they would send it to several different sponsors, and that sponsor would notice, hey, this guy is sending me bad paper.

When you come to FHA, you can do the same thing, but I track the performance of your loans by you. I don't care where you send them, it is being tracked. So they all start going up, I know that, and I can terminate your participation at least for a 6-month period until you fix the problem. So we have that and no one else has that.

Ms. BEAN. Was that the Credit Watch that you were talking about?

Mr. MURRAY. That is the Credit Watch.

Ms. BEAN. I am only going to interrupt you because my time is running out. Just to clarify, you are open to further suggestions and further restrictions from this body?

Mr. MURRAY. Yes, absolutely. But whenever we put too many restrictions on things, it just will not work.

Ms. BEAN. Just eliminating bad actors.

Thank you. I yield back.

Mr. MURRAY. Thank you.

Mr. HINOJOSA. I now call on Congressman Bill Foster from Illinois.

Mr. FOSTER. Thank you.

This is for Mr. Murray. If the current trends continue, have you done an analysis of how your rates would have to change to preserve the 2 percent reserve fund? Are you in a situation where you can make a relatively modest change in your rates and have the reserve fund stay healthy?

Mr. MURRAY. I would not be in a position to speak to that. That is all done through the Office of Evaluations, and they are constantly doing these models.

Mr. FOSTER. I guess maybe this is a similar question, but are you aware of any analysis where if there is, as many people expect, a further 15 percent or 25 percent drop in real estate prices, what that would do to the reserve fund?

Mr. MURRAY. I am not personally aware.

Mr. FOSTER. Would you be able to get that information to us?

Mr. MURRAY. Yes. We can get it from the Office of Evaluation.

Mr. FOSTER. In regards to the Credit Watch Termination Initiative, you say that the lenders with a relative compare ratio greater than 200 percent are subject to proposed termination. First off, is the 200 percent 200 percent of the nationwide average, or some sort of local average?

Mr. MURRAY. We do this at the branch level because we are concerned about the effect on neighborhoods. So we do it at the branch level. So if a particular branch of a lender, if his relative default and claim rate is higher than that of the national rate, and is also 200 percent or more of the local rate, there—

Mr. FOSTER. They make allowance for neighborhood conditions and so on.

Mr. MURRAY. Yes, because we are comparing them with other lenders who are doing business in the same jurisdiction.

Mr. FOSTER. Which is sensible.

What fraction of these are actually terminated of the ones proposed for termination?

Mr. MURRAY. We have not put a number on that. I can tell you at one time it was like 80 percent we sustained termination on. Eighty percent. That was at one point in time, maybe 3 years ago. That is not something we track deliberately because we don't want the industry to believe that we have a quota and that we are trying to get the folks. We want them to understand it is a fully administrative proceeding. You can make your case, mitigating factors, and we will review the facts.

Mr. FOSTER. When an originator starts originating a large number of mortgages that default promptly, are there any other financial penalties that they suffer immediately?

Mr. MURRAY. First of all, we believe from a monitoring standpoint that any loan that goes in default within the first 2 years, they are subject to monitoring. Those are the ones we target. Clearly, any loan that goes into default within the first 6 months, we assume it is more of a problem with the loan as opposed to borrower circumstance.

Mr. FOSTER. My question is: Does the originator suffer promptly when he starts shoveling out a bunch of things?

Mr. MURRAY. Credit Watch is the quickest thing that one can do. But at 6 months, they are required to go back and to reassess why that loan went bad. Now, through our monitoring, as we go out to the field and we look at fact base to see what caused that, we then will request an indemnification if we find there is a material violation.

Mr. FOSTER. What I am fishing for is, there was some sort of deferred payment or penalty that would kick in so they wouldn't get paid the full amount—or something like that.

Mr. MURRAY. That is what indemnification would do.

Mr. FOSTER. That is sort of a retroactive thing. I was thinking if it was automatic, if they knew for sure that if this thing defaulted for any reason that they simply wouldn't get their last payment. Something like that.

Mr. MURRAY. We don't have the same authority that is done in the private sector where when you bring bad paper, they make you buy it back. We cannot do that.

Mr. FOSTER. Okay.

My last question: What is the role of tax records in verification of income, and is there a useful legislative or technological initiative that might make them more useful or more immediately useful?

Mr. MURRAY. For borrowers or for lenders?

Mr. FOSTER. For borrowers.

Mr. MURRAY. That is what we use them for.

Mr. FOSTER. So you take the Social Security number and ask the IRS, hey, is this income real?

Mr. MURRAY. We don't currently do that today, but that is one of the things we have in our proposal.

Mr. FOSTER. It is on your technological roadmap. But you do access tax records by asking the IRS?

Mr. MURRAY. The lenders do that.

Mr. FOSTER. The lenders get tax records.

Mr. MURRAY. It is up to the lenders to verify income and employment and the like, and they do verify the tax records.

Mr. FOSTER. By going to the IRS, or does the mortgage applicant provide them something?

Mr. MURRAY. There is an electronic process that they use.

Mr. FOSTER. So it doesn't represent a hole that fraud is leaking through.

Mr. HEIST. It would take a legislative change, but OIG has advocated making those sorts of income verification mechanisms available. There is a whole host of privacy questions that have to be debated as part of that. Right now, the lender has to verify the income through the borrower and through the employer that the borrower says he is employed with. That wouldn't necessarily catch all income, and it might not be the most administratively efficient way to do it.

Mr. HINOJOSA. Thank you. I would like to advise everyone that in approximately 15 minutes or so, we expect that there will be some votes. I have visited with the chairman, and if any member here would like to come back and ask questions, you may do so. So let me move forward and get as many as we possibly can, and work with me and we will give everybody an opportunity to ask their questions.

I would like to ask Congressman Walt Minnick from Idaho if he has any questions.

Mr. MINNICK. Thank you, Mr. Chairman.

Mr. Murray, I gather from your opening statement that you think CitiBank is mistaken as a matter of public policy in now ap-

proving of the restoring of a bankruptcy court's authority to modify mortgages?

Mr. MURRAY. No, sir. I am only speaking about FHA.

Mr. MINNICK. You think that would be appropriate policy.

Mr. MURRAY. I am only speaking in terms of how that affects FHA and Ginnie Mae. We don't have the authority or the financial wherewithal to pay the investors.

Mr. MINNICK. I know you don't. But as a matter of public policy—in your opening statement, you said you opposed any kind of cram-down authority to a bankruptcy judge.

Mr. MURRAY. I was just talking FHA. It was not a broad statement. Only FHA. I just wanted to bring that to this body's attention.

Mr. MINNICK. Even with respect to FHA, wouldn't giving a bankruptcy judge that authority keep more people in their homes and reduce the number of foreclosures and ultimately the cost to FHA lenders?

Mr. MURRAY. I was not prepared to offer a personal opinion. That would be a personal opinion of mine.

Mr. MINNICK. So you have no view on the topic.

Mr. MURRAY. No, sir.

Mr. MINNICK. I would hope that your Administration would see the wisdom of giving a bankruptcy judge that authority. And perhaps you could convey a message back that there are members of this committee who believe that if we are going to keep people in their homes, if we are going to make purchasers of credit-backed mortgage securities do a better job of due diligence, that we need to have that authority in the system.

Thank you very much, Mr. Chairman. I yield back the balance of my time.

Mr. HINOJOSA. At this time, I would like to call on Congresswoman Suzanne Kosmas from Florida.

Ms. KOSMAS. Thank you. I appreciate the opportunity to be here. Frankly, most of the questions that I had in mind during the course of the conversation have already been asked. But referencing back to those questions asked by Congresswoman Bean and to the Credit Watch, I too—we have been full circle, starting with the Business Week article and the difficulties described there, and then your very healthy confidence in FHA and its ability to control and maintain the processes as well as the requirements.

At the same time, it seems that the article that does refer specifically to one specific lender that had 9.2 percent—I think was the number of its loans in default—and I heard you talk about a suspension or termination for some period of time.

I guess I am more curious what enforcement measures that you have beyond that for lenders who obviously are way outside the realm of normal in the numbers of loans that they are producing that go into default. That is significantly higher than your 1.3 percent you described as the FHA number.

Mr. MURRAY. For that article we have to put that 9.2 percent in context. And I think that was a national number. I think where we would look at where they performed their business, there were only like 218 percent.

What I can say, two of those lenders we have absolutely zero problems with that we have done an array of look-sees at. We have had absolutely no problems. There are another three, I believe, we have looked at prior to this article, and they were already on our radar. We have reviewed them, we have taken certain actions, we have made certain recommendations and referrals to the Office of Inspector General by law, as we are required to do. That just helps to support that even if you come in, you will get caught if you continue your practices.

But Credit Watch is just the tool to do that. We have no other authority to deal with people. It is not a violation to have a high default claim rate. That is not a violation of our program. But Credit Watch is a tool that we use to put you in check; that if you do, we will give you a time-out.

Ms. KOSMAS. I certainly appreciate that. Although it appears minimal, as you can understand the reason for the hearing and the reason that we are here is the fear that the explosive number of FHA applications and mortgages that have occurred during this time when the public, our taxpayers, have lost their confidence in the processes in the financial sector applies also to FHA.

While, as I said, I respect your confidence in what you do and your ability to defend FHA's programs, and I certainly, having been in the real estate business for 30 years, I think much of what you say is entirely accurate, but we are in a new ball game, so to speak.

My question to you would be specifically: If there were greater opportunity for you to enforce some stricter standards, if there are consistent situations in which the numbers higher than what you deem to be an acceptable amount for any company—and I am not trying to single out any company, just trying to put you in a position where you have the opportunity—we have talked about ways in which you can prevent; now I am talking about ways in which you can stop the hemorrhaging if you do have bad actors who are causing this problem to be exacerbated.

Mr. MURRAY. Absolutely. I have never been accused of being shy about going after people. We are standing at the doorway very diligently. We are very interested in any additional tools that we can use. As a matter of fact, in Credit Watch, we are expanding that and we are actually going to monitor the performance of the underwriting lenders as well. Currently, we do the origination, but now we are going to do the underwriting. So we are tightening it up.

Ms. KOSMAS. I guess what we are all saying is, tell us what you need in order to fill your toolbox so that we cannot wake up one day and say, we saw it coming but we didn't do anything to prevent it. So we would appreciate being partners with you in making that happen. Thank you.

Thank you, Mr. Chairman.

Mr. HINOJOSA. Thank you. I want to give ample time to the Congressman from Florida, Alan Grayson, to have his questions heard.

Mr. GRAYSON. Thank you very much, Mr. Chairman.

Mr. Heist, how many FHA mortgages are outstanding today?

Mr. HEIST. I don't have that information. I would have to get it for you.

Mr. GRAYSON. Mr. Murray?

Mr. MURRAY. Possibly 4.5 million.

Mr. GRAYSON. Any idea how many Fannie Mae and Freddie Mac loans are outstanding today?

Mr. MURRAY. No, sir.

Mr. GRAYSON. Since the housing crisis began 2 years ago, how many of those 4.5 million loans have gone to foreclosures claims?

Mr. MURRAY. Our claim rate in 2007 is 1.42; in 2008, 1.3. The claim rate.

Mr. GRAYSON. So if there were 4 million, can you help me with the math?

Mr. MURRAY. One percent of 4 million. Let me look from this standpoint. We have approximately 38,000 homes in our inventory. Typically, in the last 2 years—sorry; we have about 50,000 homes in our inventory. We sell about 38,000 a year, for the last 2 years. Those are the ones that have gone to claim.

Mr. GRAYSON. So, cumulatively, somewhere approaching 100,000 homes since the housing crisis began; is that correct?

Mr. MURRAY. I guess.

Mr. GRAYSON. That is the number that have gone into foreclosure during that time that are FHA-loan houses, correct?

Mr. MURRAY. Yes.

Mr. GRAYSON. Now, how many people have actually been convicted of mortgage fraud since the housing crisis began 2 years ago?

Mr. MURRAY. I have no idea. That is probably something in the Office of Inspector General. Now if you are talking very specifically to FHA, any instances of fraud—because we make hundreds of referrals to them each year, and we are required by law to do so. I think we did 700 last year. So any incidences of fraud we refer to the IG's Office of Investigation for further review. They have to tell you from there.

Mr. GRAYSON. Right. But my question is, how many people have actually been convicted of mortgage fraud since the housing crisis began?

Mr. MURRAY. I don't know. That moves beyond the realm of what we do.

Mr. GRAYSON. Let's explore that a little bit. You said you have made 700 referrals. Of those 700 referrals, I think you said, each year, how many of those resulted in a criminal conviction?

Mr. MURRAY. Once it leaves us—because of our agreement with the Office of Inspector General, once we make a referral, that is their domain. We are no longer involved. Our hands are off. So I do not track that data. I have no knowledge of that data.

Mr. GRAYSON. Mr. Murray, aren't you a little bit curious to know what happens after you make a referral like that? You are accusing people of criminal fraud, and you seem to lose track of them.

Mr. MURRAY. Not the ones that we take action against. I know fully well what happens to those. We refer those to the Office of Inspector General. They have their own reports and audits.

Mr. GRAYSON. Mr. Heist, would you like to try to answer my question?

Mr. HEIST. I have the statistics right here, but that is for the entire Department. We would have to break that out for you and submit it to you for the record.

Mr. GRAYSON. All right. My question specifically is: How many people have been convicted of criminal fraud since the housing crisis began? I am talking mortgage criminal fraud. How many?

Mr. HEIST. That is the number we would have to get for you. I would be happy to do that.

Mr. GRAYSON. Any idea? Is it a thousand?

Mr. HEIST. One thing to keep in mind, criminal cases take a period of time to get to us. So I would suspect that the number would appear fairly small, because we are seeing cases now that were in the pipeline when FHA's volume was low. As the volume increases, we will expect more cases to come in. Very few of those would likely have been criminally convicted at this stage.

Mr. GRAYSON. The statute of limitations is 5 years, Mr. Heist. How many people have been convicted of mortgage fraud in the past 5 years? How many?

Mr. HEIST. I don't have that information. I would be happy to provide it.

Mr. GRAYSON. A rough order of magnitude, please?

Mr. HEIST. We don't know at this point.

Mr. GRAYSON. Will you please provide the information? I think the American people would like to know.

You provided information that said that 6.5 percent of FHA loans are in default, and you said that you use Credit Watch and Appraisal Watch to try to keep that amount in check and to keep the foreclosure claims in check. How many lenders actually have been terminated from the FHA program since the mortgage crisis began? I am not talking about branches, I am talking about lenders. How many?

Mr. MURRAY. I may have that here.

Mr. GRAYSON. I see my time is up, so maybe you can provide that separately. I will point out to you that given the increase in approved lenders in the past 2 years from 692 to over 3,300, it seems that this would be a good time to do some culling. Maybe you could make sure that lenders who have 3 times the default rate are excluded from the program because, after all, inclusion in the program is not a right, it is a privilege.

Thank you.

Mr. HINOJOSA. Thank you, Congressman Grayson.

At this time, I want to thank the two witnesses for taking the time to testify before our committee. We all appreciate your appearance. This panel is now dismissed.

The chairman will bring up the second panel following the last three votes we are now in the House, that is taking place now.

I declare this portion in recess.

[recess]

The CHAIRMAN. I am sorry, guys. When we scheduled this, I didn't anticipate votes today. So I thought we would have been able to have fewer members around. This committee, we were hoping to shrink it, but instead it got bigger.

I would, just as a courtesy to people, tell people that in the future I am probably going to have to try to do more hearings through subcommittees. It is unwieldy, and it is nice to have people who want to be members, but we will have to deal with it.

So I appreciate your staying around for this is directly relevant. And I am here and, more importantly, the staff members are here who will be listening.

So let us go ahead.

Mr. Courson, let us begin with you.

**STATEMENT OF JOHN A. COURSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MORTGAGE BANKERS ASSOCIATION (MBA)**

Mr. COURSON. Thank you very much, Mr. Chairman. Good afternoon, Chairman Frank, Ranking Member Bachus, and members of the committee. Thank you for inviting the Mortgage Bankers Association to testify this afternoon on the Federal Housing Administration and the risk and rewards that come with the Agency's recent growth in market share.

As someone who has been an FHA-approved lender for 40 years, I have special appreciation for the important role FHA plays in our Nation's housing mission. When FHA began to lose market share to subprime, MBA was one of the first to advocate for legislation to modernize FHA. While some argued that FHA had outlived its usefulness and should be allowed to wither on the vine, we at MBA felt that more borrowers, not less, should be encouraged to utilize its programs, programs we knew to be safe, sound, and affordable. And so, with so much credit drying up, it has become a lifeline to borrowers and a key component to our Nation's economic recovery.

I would like to take a moment, Mr. Chairman, to acknowledge the priority this committee has given on a truly bipartisan basis to reinvigorating FHA. Working together, we passed a strong FHA modernization bill as part of last year's Housing and Economic Recovery Act. Many of the provisions of that legislation were ones MBA had advocated even back in the years when I was its chairman, reforms that will allow FHA to play an expanded role in the current housing crisis for years to come.

Now, here is the good news: These efforts have worked and FHA is back. It has gone from a mere 3 percent of the market share 18 months ago to a healthy 20 percent today. That is quite a rebound, and it is where we believe FHA should be.

But as we applaud FHA's turnaround, that increase in volume is a double-edged sword that requires FHA and FHA-approved lenders to be more vigilant than ever about who is allowed to originate FHA loans. Much like you, we are concerned that some unscrupulous lenders may now be turning their attention to FHA and its programs. To be clear, MBA strongly opposes mortgage practices that jeopardize consumers and damage the reputation of the mortgage industry.

In the next few weeks, Mr. Chairman, MBA will be unveiling its FHA agenda for the new Congress. Let me touch briefly on the issues that will be at the heart of this agenda.

First, we need to provide FHA with greater resources, both staff and technology, to expose and eliminate lenders that do not uphold ethical standards. MBA has long supported an increase in staff and newer technology to enable FHA and Ginnie Mae to better serve the housing market. We are grateful Congress has authorized fund-

ing for this purpose under HERA, and now we want to work with you to ensure these funds are appropriated.

FHA faces enormous challenges in managing its programs in an ever-changing world, and it would be unfair to expect FHA to respond to the housing crisis with anything less than our full support. Moreover, MBA believes that FHA cannot keep pace with an industry that is becoming increasingly technologically driven as long as it lacks the authority to use its revenues to invest in technology. Improvements in the FHA system will allow it more effectively to manage its portfolio, thus increase efficiencies and lower operational costs. Such an investment would yield savings far in excess of any initial cost.

Second, we need to approve the quality of FHA originations. MBA believes that an integral part of protecting the soundness of FHA is ensuring the mortgage lenders and mortgage brokers that participate in the program and originate FHA-insured mortgages have the confidence and the wherewithal to protect consumers and taxpayers from undue loss. MBA supports a bonding requirement for mortgage brokers to participate in the program, just as there is such a requirement in place now for mortgage lenders.

We all support net worth requirements to assure that every lender has a stake in the industry. We believe this committee and Congress were right to reject proposals over the last 3 years to lower FHA's financial requirements.

And, finally, we continue to push for ways to reduce mortgage fraud. As FHA endorses more and more mortgages, its insurance fund runs the risk of being exposed to higher levels of mortgage fraud. According to the Mortgage Asset Research Institute, reports of mortgage fraud increased 45 percent in the second quarter of 2008 from the same period of the previous year.

Mr. Chairman, on behalf of MBA, we look forward to working with the committee on our shared priorities: stabilizing the markets; helping keep families in their homes; and strengthening regulation of our industry to prevent future relapses. I know it may be a little difficult for some people to believe, but I am here today as the president and CEO of MBA to say that we need more and better regulation in this field. Thank you for the opportunity to testify.

[The prepared statement of Mr. Courson can be found on page 60 of the appendix.]

The CHAIRMAN. Thank you.

Mr. Hanzimanolis?

**STATEMENT OF GEORGE HANZIMANOLIS, CRMS, FOUNDER,  
BANKERS FIRST MORTGAGE INC., AND PAST PRESIDENT,  
NATIONAL ASSOCIATION OF MORTGAGE BROKERS (NAMB)**

Mr. HANZIMANOLIS. Good afternoon, Chairman Frank, Ranking Member Bachus, and members of the committee. My name is George Hanzimanolis, and I am the past president of the National Association of Mortgage Brokers and the founder of Bankers First Mortgage. Thank you for inviting NAMB to testify today on FHA oversight of loan originators.

The FHA program has helped insure over 34 million properties since its inception in 1934. The program was created to help home

buyers who may have had some financial problems in the past or didn't have a lot of money saved.

Since subprime products have slowly dissipated and conventional loans are very difficult to obtain for some borrowers, the FHA program has become a viable alternative. As such, the FHA has experienced an increase in interest among loan originators and borrowers.

There are significant differences between subprime and FHA-originated loans. The FHA has some controls in place to prevent losses similar to those seen in the subprime market. If HUD is able to identify problematic individuals, properly monitor its mortgagees, and is empowered to disbar them in a reasonable timeframe, losses should be minimal; however, even conservative mortgage lending is expected to have some losses. In times of economic instability, FHA premiums may need to be adjusted to cover added risk.

In order to provide stronger protection to the FHA insurance pool, NAMB believes Congress should allow risk-based pricing for FHA premiums and repeal the 1-year moratorium or implement a complete government subsidy of FHA loans.

There are three types of FHA loan originators: supervised mortgagees, which are depositories; nonsupervised mortgagees, such as mortgage lenders who are not depositories; and finally, nonsupervised loan correspondents who are often mortgage brokers who originate for one or more sponsors. A loan correspondent must be sponsored by a fully approved supervised or nonsupervised direct endorsement mortgagee who agrees to underwrite and fund the FHA loan.

Mortgage brokers never underwrite the FHA loan. A sponsoring lender always underwrites the FHA loan and makes the final lending decision. There are eligibility requirements, including HUD policy and regulatory criteria a mortgage broker must adhere to in order to become an approved FHA loan originator regarding operations, employees, credit checks, licensing, auditing, and more.

To become more effective in compliance and enforcement, NAMB suggests the following: remove the \$250,000 and \$63,000 net worth; require FHA originator applicants to be on an individual basis and subject to registry requirements of the SAFE Act; update the Neighborhood Watch early warning system; and increase the efficiency and speed of reviews performed by the Mortgagee Review Board.

Net worth is a false predictor of honesty, integrity, and performance; and a minimum net worth does not indicate the competency of the originators within the company. Current market reality as witnessed by hundreds of mortgage bankers, lenders, and Wall Street firms that have gone out of business proves that net worth can disappear quickly and without notice. Net worth is not available when a borrower seeks redress.

Instead of the mandate for a net worth, NAMB suggests the implementation of a recovery fund whereby every FHA loan originator must contribute to such a fund in order to originate an FHA loan. Similar requirements are standard for any person who wants to become licensed in the State pursuant to the SAFE Act.

Since 2002, NAMB has called for the licensure and registration of all mortgage originators through background investigations, test-

ing and continuing education. I would like to point out that this committee was the first to respond to the need to track individuals. NAMB is very proud to have been part of this process and to finally see the bill become law.

The SAFE Act should help to keep track of all FHA loan originators as they now have to be part of the loan registry. Since the tracking system created by the registry applies to each individual and not each company, NAMB recommends that the FHA application for loan originators apply to the individual and not just the company. If the application process was set up this way, it would be easier and more efficient for HUD to track bad FHA actors.

In order to monitor compliance, HUD instituted the Neighborhood Watch early warning system to identify mortgagees who have unacceptable default rates. However, 24 months must elapse to achieve a true average. NAMB recommends that HUD update the Neighborhood Watch early warning system and expedite the recognition of high default rates.

NAMB also suggests that HUD put more resources towards improving the Mortgagee Review Board process, including computerization.

Finally, the temporary increase in FHA and GSA loan limits in the Economic Stimulus Act of 2008 is having a significant impact in the high-cost areas, particularly in the California housing market. For example, in October 2007, FHA insured only 688 mortgage loans in the State. A year later, the FHA insured over 14,000 home loans in California. Under the proposed new limits by FHFA and FHA, most areas in California and other high-cost areas are scheduled to experience significant reductions due to the transition for the terms of last year's stimulus bill to permanent loan limit provisions in the Housing and Economic Recovery Act.

We look forward to working with you and HUD to help sustain the FHA program and all it has to offer consumers. Thank you.

[The prepared statement of Mr. Hanzimanolis can be found on page 67 of the appendix.]

The CHAIRMAN. Thank you, Mr. Hanzimanolis.

Let me begin by saying that is striking. I have been a big advocate, as you know, of keeping the loan limit. I just want to be clear on all of it. The single most variant price in America, based on geography, is housing price because of the immobility. Virtually every other price, given the mobility of things these days, is either uniform or varies very slightly. House prices, housing not being mobile, vary greatly. For the Federal Government to maintain one single house price, it has to be either too high somewhere, too low elsewhere and skewed.

I am pleased to be able to report to you—you probably heard this as you patiently sat through this longer hearing this morning—that in the economic recovery plan, there will be legislation that will keep the loan limits up for this year. And then, because it is not healthy to do it year by year, I am hoping that this year we will set a higher limit indefinitely.

What we have also done is—standard metropolitan statistical areas were not geared to be a predictor of the relevant house price because you can have an SMSA with widely variant housing markets even within one area. So we have given the administrators the

authority to set subareas for the purpose of assessing the appropriate median.

But as much as I was for that—those figures you gave us, something like 600 to 14,000—it is one of the best demonstrations of the success of an action that I can see. So I thank you for that.

Let me just do a couple of things. As I understand it—because in order to be honest, there was some concern before—the ranking member had been a strong advocate of mortgage licensing, and that wasn't always one of the most popular ideas he put forward. But I take it that there is now general agreement that is an important thing to do; is that correct?

Mr. COURSON. From the mortgage banker's standpoint, that is correct. And I will admit—being the new CEO, I will admit that we were opposed to individual license fees, as the ranking member knows, for a number of years. But, look, we are in a situation now where we need to restore faith in the mortgage industry, and there are a number of bold and aggressive actions we need to take.

So we are in support.

The CHAIRMAN. I appreciate that. And you were very lucky that the ranking member is far more gracious than I. So he will accept your acknowledgement in that spirit.

But I appreciate the point you made about regulation, and that if that is done right, regulation is promarket. The absence of regulation can be very bad for the market because confidence is an important part of a well-functioning market. And when people don't have confidence, you get a resistance to participating. So having people know, okay, I am going to be dealing with this individual, and he or she is licensed by a competent authority, that is one step—not the only step—towards giving people some assurance.

Let me just ask one more question and turn it over to—Mr. Hanzimanolis, you gave a list of things you thought could be done to improve things. Could you tell me which of those could be done by regulation, which would require a statutory change? If you don't have that—if you don't have it now off the top of your head, let us know because we do want to make these—yes, sir.

Mr. HANZIMANOLIS. We will have a list and we are going to release it next week.

The CHAIRMAN. Let us know we can do—which ones are statutory and which ones are not.

Let me ask one other thing. It has been—on risk-based pricing, by the way—you follow as well, that came from the United States Senate; and I think it had its motivations in some people who were in some competitive situations. I have this one concern about risk-based pricing and that is, I don't want a hardworking man or woman making \$50,000 a year who takes a loan and makes the payments ultimately to have to pay a lot more than I would pay. And I would like to work out a way so that the risk-based pricing, that the burden falls on those people who are risks, but not unduly on everybody. And I will ask your help on that. I would like to return the right to do risk-based pricing, but in a way that does not unduly damage people in lower incomes.

But let me ask you about the only other controversial one, seller-financed downpayments. Do either of you have any views on that?

Mr. HANZIMANOLIS. Our position has been to support the seller downpayment assistance in the past. We are evaluating that now, and especially given the numbers that we hear—

The CHAIRMAN. Let me make this—Mr. Courson, let me ask what your sense—

Mr. COURSON. We are opposed to that, the seller-financed.

I was—I just resigned as chairman of the California Housing Finance Agency, and those housing financing and many other downpayment assistance programs are available to borrowers for FHA loans that are not seller—

The CHAIRMAN. Let me put it this way.

I think there is—and many of my colleagues who represent minority communities have been interested in this. I think there is a burden that exists on those who think seller-financed has a role to play to show us how we can do that to minimize the risk. And we would be willing to entertain that, but I think that is what is going to be have to be done. So I invite you to work with others to see if we can find ways to minimize the risk.

We had proposals for a minimum credit score and some other things. Mr. Olson, behind me, did very good work in trying to make that less of a problem without throwing out the whole thing. So we will need a consensus if we are to go forward.

The gentleman from Alabama.

Mr. BACHUS. Thank you. Let me ask Mr. Hanzimanolis, you and Mr. Courson, what are you all doing to encourage lenders to defend themselves from fraudulent mortgage schemes? Are there any programs that you have found helpful or that you believe that Congress could benefit from knowing about?

Mr. COURSON. We are very concerned. Obviously, it is a strain on us and our members and our industry. So what we are doing are a couple of things.

We have developed a model mortgage fraud bill, and we are taking that to the States—to each of the States and introducing a model fraud bill that really puts—in many States mortgage fraud is not even in the same category as other fraud. So this would create a statutory basis in each State to prosecute on a criminal basis mortgage fraud.

The second is that a group of our members—and we are working—we are doing the work for them—are putting together a mortgage fraud database. This will be—it is a very expensive, very big project. All of our large members are in it, and they will be able to submit—and this will have mortgage insurers, lenders as well—data on fraud that they see either by their employees who have been terminated or by borrowers into a database. They are going to make no judgment as to whether it is or is not guilty—not guilty and so on. But the data is going to go in and be able to be shared by a broad base.

We need transparency. We need to have transparency between lenders on fraud that is taking place one against the other.

Mr. BACHUS. Sure. How about the mortgage brokers?

Mr. HANZIMANOLIS. The National Association of Mortgage Brokers developed the Lending Integrity Seal of Approval. We rolled that out this past year, and it holds mortgage brokers to a higher

standard in addition to all the things that you see in the SAFE Act, which is the equivalent background check.

Before it was ever required, we required a criminal background check, education, ethics, and then also adhering to our code of ethics and best business practices. And anyone who is found not to comply with that would be thrown out of the association and reported to the State associations and also possibly the regulators, depending on what the situation was.

Secondly, as mortgage brokers, we are always working with our lenders, our large lenders, and we have a number of them that are industry partners within our organization. So we meet with them regularly to try to determine what issues there might be in the marketplace and how we can better make corrections within the industry to prevent fraud.

I think we are making some great steps in that direction.

Mr. BACHUS. Thank you.

Let me ask both of you: You have heard a lot about bankruptcy cram-down, and it is back again. I will tell you that I am uneasy about that provision because I—it sounds wonderful, and it actually—since it applies to other properties, it almost seems like a fair thing to do. But I am concerned that it could cause maybe even almost an immediate increase in the cost of a mortgage or in the interest rate that is going to be factored in and everybody is going to pay it.

Do your associations have concern about these proposals?

Mr. COURSON. I think the mortgage bankers' concern is probably pretty well-known by this time about the cram-down, and we are concerned. And we are concerned not only for the immediate effects; it is the long-term effects on the markets and the security holders.

And, frankly, thinking about where we are at FHA, I will tell you that Mr. Murray this morning talked about the fact that if there is a cram-down, FHA will not pay the lender the amount of the cram-down as part of the claim. That means that lender, therefore, has to pay that and has to, more importantly, advance that cash through to the Ginnie Mae security holder.

Even for big lenders, that is an issue. But for your smaller and medium-sized servicers, it could get to the point, Congressman, where they frankly just don't have the cash or capital. And now what have we done?

Ginnie Mae takes the responsibility of making good on their guaranteeing passing back. So there is—I won't take your time, but there are many issues that have to be addressed despite an agreement that we heard about yesterday. I wouldn't say that was a real agreement in terms of really addressing all of the issues that need to be addressed, particularly the FHA—

Mr. BACHUS. My concern has been an increase in the interest rate. But I think what you are saying is that another concern is not only just the availability of mortgages, but what you are saying is, a shift or the private market won't be able to come back as quickly, I guess, is that—

Mr. COURSON. Congressman, I know that history tends to repeat itself. And once you statutorily change a contract by allowing a cram-down, the market looks and the investor and the worldwide

markets look and say, can it happen again? And the fear is, if an FHA who doesn't have the authority to pay those claims—if you are an FHA lender and you fear that coming back, what you might do is raise the downpayment requirement despite the fact that FHA will take this 96.5 percent loan, you—to protect yourself and your customer. So it has a lot of ramifications.

Mr. BACHUS. All right. I agree. And if you all would like to submit a letter concerning that I would invite you to do so. Or—

Mr. HANZIMANOLIS. It certainly is not an easy topic, and our board of directors has met several times to discuss it because while we definitely see there are concerns in the marketplace and how it could be affected, we also look at the other side of that from a consumer standpoint on how many foreclosures could be out there. So it took several board meetings to discuss this in great detail.

At this time, we support the cram-down because we feel that if there are people with second or third homes that can easily have their mortgages crammed down, why shouldn't a first-time home buyer or someone with a primary home have that same right?

With the Citi announcement yesterday, we are evaluating that to see if we agree with that completely, with that position. But at this time, it is something that we are taking the position that we support the cram-down, which some people may find strange that someone on the lending side of the business would do that, but we feel is a more responsible road to take.

Mr. BACHUS. Is that just a blanket "we support it" or is it let us maybe—it is going to be hard to abrogate contracts in the past, so I am not sure you can support it except for going forward. I think there are some real constitutional problems.

But let us just assume that we are talking about mortgages that are made tomorrow or the next day, because after the law is enacted, I see tremendous problems. I don't think you are ever going to get something that the courts are going to ever give a green light on. I think you are going to see injunctions and all sorts of legal action.

But let us just say that you were to agree to something going forward. Don't you have some unease about making that permanent as opposed to just say they were reacting to an emergency and we are going to do this for 6 months and see if it works?

Mr. HANZIMANOLIS. I think when I say it not an easy decision to make, it is not clear to say I am going to take this one side completely. I think—I know our association feels that is some merit in the cram-down. But the details are very, very important.

So I agree with you, Congressman, it is not something that should just be, yes, it is an absolute endorsement of it. We need to make sure the details are right. That is why we are evaluating Citi's position that was announced yesterday and how it can be instituted to help the consumers and at the same time not affect the lending side of the business.

Mr. BACHUS. Yes. I think even a short term—a shorter term to it and an expiration date if you are going to do it, I think that only makes sense because I think there are—there had been pretty much bipartisan agreement before the last 2 or 3 months that this is not a good thing, particularly not long term. Thank you.

Mr. Courson?

Mr. COURSON. I was just going to respond to that. I agree. And when you look at what was discussed yesterday, despite their opposition to it, if, in fact, there is going to be an agreement, we need to make sure that all the elements of the agreement are considered—FHA, VA loans perhaps being exempted.

If it is crafted because of the subprime issue, then let us include subprime loans. Let us have a sunset period. And maybe there should be a waterfall that says no Congressman, and no Senator wants to put people into bankruptcy. Maybe there ought to be a waterfall that says, you go through these steps with your servicer, and if you don't qualify for A, B or C, then move into the cram-down with these strictures in it.

Mr. BACHUS. I think those would all be moves in the right direction and I think would minimize, at least short term, some of the effect. You agree to these things and they are with you for the rest of your life. And so I would caution you about responding to an emergency with a permanent fix. Thank you.

Mr. KANJORSKI. [presiding]. I am not going to take very much time because it is getting late. I just wanted to welcome to the committee my good friend, George Hanzimanolis. He is not only a constituent of mine, but a friend of mine. And he is a very progressive individual in the real estate community.

Mr. BACHUS. Mr. Courson is, too.

Mr. COURSON. Thank you.

Mr. KANJORSKI. The question I have, just to sum this up is, all day today I have been sitting in meetings that give some pessimistic views of what we can expect and where we are going.

Could you tell us your opinions of where we are vis-a-vis real estate, the deflation that is occurring in real estate? And if you anticipate a turnaround in real estate and the economy, when and under what circumstances? It gives us an opportunity for some of the viewers of this meeting to get an optimistic view before we bring this hearing to a close.

Mr. COURSON. Mr. Chairman, as the new president and CEO, I am sure that my research and economic department will shudder when I respond to your question, but I will.

I think our view is—and we have said clearly that this not going to be a quick turnaround. This is going to be a slow process, and I think the market in terms of real estate values and so on—remember—I must say that we have to remember that there are few States impacting a large amount of the numbers that we are seeing. And being from California, being one of those States, there are many parts of the country where, in fact, we have seen the diminution of value the way we have others. So it is a very uneven—when you look at it globally, it is a big number. But it is very uneven regionally.

But having said that, I think that the greatest concern now is we were seeing real estate obviously decline. Now we have the jobs issue. People have to have jobs. We are now moving into delinquencies and loans coming into default that are prime loans because of the lack of economic activity and the lack of jobs. So we are into another set of borrowers. So we think that until you solve the jobs issue, until the economy can start moving forward, we are not going to see a substantial improvement in prices.

Mr. KANJORSKI. George?

Mr. HANZIMANOLIS. I agree with Mr. Courson. It is not something that turns quickly, but I think there are things we can do, especially with regards to FHA, that may be able to help us move this along. Certainly, the more mortgage programs that are available to the consumer, the quicker the inventory dries up; and I think we all agree if inventory—if more people out there are able to buy homes and the inventory dries up, then we will start to see things move in the right direction again.

That is one of the reasons in my testimony I mention the idea of eliminating net worth from mortgage brokers when it comes to offering FHA and, instead, putting in a recovery fund. It is more responsible and it allows mortgage brokers to be able to offer the FHA product to more people. Those people who deal with mortgage brokers throughout the country would have access to homes, easier access to credit and I think that would help.

We also—the \$7,500 tax credit that was passed and is in effect until July 1st; personally, as a mortgage broker dealing with customers every single day—it is a wonderful program and very, very well received by the consumers. I would love to see if that is something that can continue on because a lot of people are coming out and buying homes now because of that.

So certainly jobs are an issue and these others are issue, but what we have control over here is helping the real estate market; and I think including mortgage brokers more, by allowing them to offer more products, would certainly help the consumers and help the economy.

Mr. KANJORSKI. Thank you, George.

We are now at that time where the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the meeting record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

The meeting is adjourned.

[Whereupon, at 2:16 p.m., the meeting was adjourned.]



# **A P P E N D I X**

January 9, 2009



**Testimony of John A. Courson  
President and Chief Executive Officer  
Mortgage Bankers Association  
Before the  
House Financial Services Committee  
United States House of Representatives  
Meeting on  
“FHA Oversight of Loan Originators”  
January 9, 2009**

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for asking the Mortgage Bankers Association (MBA)<sup>1</sup> to testify on the Federal Housing Administration (FHA) and the risks and rewards that come with the agency's recent spike in loan volume. I am John Courson, President and CEO of MBA. I was engaged in the mortgage banking industry, and an FHA approved lender, for over 40 year and was MBA Chairman in 2003.

A strong and vibrant FHA has always been a top priority for MBA's members. That is why even before the housing market steeply declined and foreclosure rates rose, MBA advocated for modernizing FHA so as to increase its relevance and encourage more borrowers to use programs known to be safe, sound and effective. MBA has pushed for important reforms and stricter controls, including increased regulation and more funding for advanced technology to help monitor originations and lenders. Since the collapse of the subprime market, MBA has been advocating for the safe expansion of affordable homeownership programs that offer responsible lending options to borrowers. FHA offers the types of responsible programs that we support.

I also want to thank this Committee for the priority it gave to reinvigorating FHA, which ultimately led to the passage of a strong FHA modernization bill as part of last summer's Housing and Economic Recovery Act (HERA). Many of the provisions in that legislation were ones MBA had supported throughout the years – these reforms will allow FHA to play an expanded role in the current housing crisis and beyond.

FHA's future is especially important to groups who traditionally have needed help achieving the dream of homeownership. More than any other nationally available program, FHA has traditionally focused on the needs of first-time, minority, and/or low- and moderate-income borrowers. In 1990, 64 percent of FHA borrowers using FHA to purchase a home were first-time homebuyers. Today that rate has climbed to approximately 77 percent. In 1992, about one in five FHA-insured purchase loans went to minority homebuyers. That number in recent years has grown to more than one in three. Minorities make up a greater percentage of FHA borrowers than they do conventional market borrowers.

FHA is particularly important to those minority populations experiencing the largest homeownership gaps. According to recent data provided by HUD, both first-time

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<sup>1</sup> The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 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](http://www.mortgagebankers.org).

homebuyers and minorities continue to make up a significant portion of FHA's customer base. In FY 2008, FHA insured 225,586 purchase mortgages and 174,139, or 77 percent, went to first-time homebuyers. Minorities received 54,951 FHA-insured mortgages in 2008, or 24 percent.

As we have seen over the last year and a half, FHA has become increasingly more vital to the nation's housing market. FHA's percentage of all originations grew from three percent in 2006 to over 20 percent by the end of 2008. There are several reasons for this dramatic growth:

1. FHA loans typically require lower downpayments than those purchased by the GSEs. Generally, the maximum loan to value ratio for FHA loans is 96.5 percent, compared to 95 percent for the GSEs.
2. GSE loans typically have higher credit score requirements than FHA loans. Buyers who do not qualify under the GSE requirements may still be able to qualify for an FHA loan.
3. The Economic Stimulus Act of 2008 temporarily raised the FHA and GSE loan limits for most of the country, which made FHA an option for more homebuyers in 2008. Although those temporary loan limits have since expired, the new loan limits included in HERA are leading to more loan originations than the years before the stimulus.

Because of MBA's strong support of FHA and its mission to help provide affordable homeownership, we applaud the increased use of its programs. The increase in FHA volume, however, is a double-edged sword and requires FHA and FHA-approved lenders to be more vigilant than ever about who is allowed to originate FHA loans.

MBA is pleased that homebuyers are finally appreciating and taking advantage of the benefits of FHA and the prudent lending opportunity it provides. However, MBA is concerned that since the once lucrative subprime market has evaporated, some of the less scrupulous lenders who specialized in that business are now turning their attention to FHA lending. In particular, many are concerned about mortgage brokers, who are less regulated than mortgage bankers, but can be approved as FHA correspondents.<sup>2</sup> While most are honest originators who have simply changed their business model to reflect a changing market, there are likely to be some mortgage bankers and brokers who want to exploit that market and take advantage of borrowers who may think their choices are limited. To be clear, MBA strongly opposes mortgage practices that jeopardize consumers and damage the reputation of the mortgage industry.

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<sup>2</sup> For purposes of this testimony, MBA is using the terms "FHA-approved lender" and "mortgagee" synonymously, and "FHA-approved broker" and "correspondent" synonymously.

At its base, the mortgage industry does good work. Mortgage lenders help homebuyers realize their dreams of homeownership through prudent lending. It is because of our strong belief in the system that MBA supports the following key ways to protect FHA and help restore faith in the entire mortgage industry:

**1. Improve the quality of FHA originations.**

With less liquidity in the housing market, borrowers with less-than-perfect credit histories or no credit histories are increasingly relying on FHA-insured products. The most effective way to maintain the quality of FHA originations is to initiate quality control at the beginning of the process. MBA believes several steps should be taken to maintain the quality of FHA loans and ensure their strong performance:

- 1) Standards and qualifications for becoming an FHA correspondent should be raised.
- 2) FHA should have more aggressive, streamlined and timely processes to expel "bad actors." These participants include FHA-approved mortgagees and correspondents, real estate brokers and appraisers.
- 3) Net worth for FHA-approved mortgagees and correspondents should be increased to help ensure that consumers are conducting business with well capitalized companies. Net worth requirements assure that brokers and bankers cannot enter the market if they are underfinanced.
- 4) Fraud prevention tools should be made available to and used consistently by approved lenders. FHA should have mechanisms and resources to update guidance regularly to keep up with current trends.

**2. Provide FHA with staff resources and technology to expose and eliminate lenders that do not uphold ethical standards.**

The demand for FHA insurance has risen rapidly over the last year and a half. This dramatic increase in demand has put a strain on the staff at both FHA and Ginnie Mae. MBA has long supported an increase in staff and technology resources to enable FHA and Ginnie Mae to be adequately equipped to serve the housing market. MBA is grateful for Congress' authorization of funding in HERA of \$25 million for each fiscal year from 2009 through 2013. We now would like to work with Congress to ensure the funds are appropriated.

FHA faces severe challenges in managing its resources and programs in a quickly changing mortgage market. FHA needs greater flexibility and increased resources to recruit, manage, and compensate employees if it is to keep pace with this changing financial landscape. Lenders and correspondents that commit unscrupulous activities

have become increasingly sophisticated in their tactics. It is unfair to expect FHA to combat these attempts without appropriate tools and human resources.

Moreover, MBA believes FHA cannot keep pace with an industry that is becoming increasingly technologically driven as long as it lacks the authority to use its revenues to invest in new technology. Improvements to FHA's systems will allow it to more effectively manage its portfolio, thus increasing efficiencies and lowering operational costs, and to monitor its operations and partners more closely to mitigate losses. MBA believes that such an investment would yield savings to FHA operations far in excess of the initial cost.

Ginnie Mae also needs additional resources to keep up with the demand created by the dramatic growth in FHA loans. Specifically, Ginnie Mae urgently needs the following resources, at a minimum, and will probably require more as FHA's market share increases:

- Salaries appropriation of \$11 million from revenues earned.
- An increase in staff size from 69 to 78 people.
- Operating expenses to remain non-appropriated and apportionments of \$175 million to fund multiyear contract obligations and pay for automated risk solutions.
- Increased commitment authority.

Without at least these additional resources, Ginnie Mae will struggle to keep pace with FHA, thus reducing liquidity at a critical moment for the housing market.

### **3. Strengthen regulation of mortgage brokers.**

MBA believes that an integral part of protecting the future soundness of FHA is ensuring that FHA-approved mortgagees and correspondents (including mortgage brokers) that participate in the program and originate FHA-insured mortgages have the competence and wherewithal to protect consumers and taxpayers from undue loss.

We strongly believe that rigorous licensing and registration requirements, as well as net worth and minimum bonding requirements, are essential components of any protective framework.

MBA supported the Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act, enacted as part Title V of HERA, which encourages states to enact strong licensing and registration laws for mortgagees and correspondents, and in the event they fail to do so, HUD would establish and enforce licensing and registration rules. These new laws will

include educational, testing and character requirements as well as bonding and/or net worth requirements.

Considering the importance of FHA, MBA continues to support increased net worth and bonding requirements for mortgage correspondents and bankers to participate in the program. Net worth requirements serve to assure that a vendor has a stake in the industry and they also provide some resources for a borrower to seek in the event of misfeasance.

MBA strongly objected last year when some consideration was given to lowering FHA's requirements for correspondents. Congress rightly rejected this proposal and MBA sincerely hopes that the Committee does not reconsider it.

Currently, FHA requires that for mortgagees to be qualified to underwrite FHA loans they must have a net worth of \$250,000 and correspondents must have a net worth of \$63,000. While MBA believes that differences in net worth and bonding requirements for mortgagees and for correspondents are appropriate considering the greater responsibilities to the public and investors that mortgagees have, MBA believes both standards should be increased to ensure that underfinanced actors do not harm the market.

In particular, MBA believes that for correspondents the corporate net worth requirements should be at least \$150,000, plus \$25,000 for each branch office up to the requirement for a mortgagee. MBA would also support a reasonable increase in corporate net worth for mortgagees.

#### **4. Support efforts to reduce mortgage fraud.**

One significant concern about the management of FHA with its increased volume that has gone mostly unmentioned is mortgage fraud against lenders, which could severely impact the Mutual Mortgage Insurance Fund (MMIF). As FHA endorses more and more mortgages, its insurance fund runs the risk of being exposed to a greater proportion of mortgage fraud than when it held a smaller share of the mortgage market. According to the Mortgage Asset Research Institute (MARI), incident reports of mortgage fraud increased 45 percent in the second quarter of 2008 from the same period in 2007.<sup>3</sup> As any lender's market share increases, it is reasonable to assume that its exposure to mortgage fraud increases proportionately to that increase.

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<sup>3</sup> Quarterly Fraud Report, 2Q 2008, Mortgage Asset Research Institute, December 2, 2008 (<http://www.marisolutions.com/pdfs/mba/mortgage-fraud-report-2008Q2.pdf>).

Mortgage fraud impacts FHA by pulling funds away from the MMIF intended for ensuring regular installment payments to the mortgage investor, even in the instance where a borrower skips a payment or even defaults on the loan due to job loss, health care costs or other life challenges, rather than intent to commit mortgage fraud. It may be years before the fraud committed results in an insurance claim with FHA. Whether a property associated with an FHA-insured loan is quickly resold after closing for a much higher price, or a borrower commits fraud through overstating his or her income on the mortgage application, or the seller manipulates the appraisal to overvalue the property so the collateral is unresponsive to recoup any losses, the payout from the MMIF adds to the strain on the insurance fund and thereby potentially on the American taxpayer.

In general, MBA strongly encourages lenders to consider any steps necessary to defend themselves from fraudulent mortgage schemes, such as integrating the Mortgage Fraud Warning Notice from the Federal Bureau of Investigation (FBI) into their loan processes. MBA also supports additional, dedicated funding for the FBI's efforts in tracking down and prosecuting mortgage fraud. The funding should provide for new FBI field investigators, dedicated prosecutors and support for the operations of FBI Interagency Task Forces in the areas with the highest concentrations of mortgage fraud.

In addition, MBA has taken the lead to establish a Mortgage Fraud Prevention Database that would allow all lenders to report incidents, which would further empower lenders to make informed decisions about the parties with whom they do business. The database will be established this year.

Thank you for the opportunity to testify. Strengthening FHA is just one of MBA's priorities this year and we look forward to continuing our partnership with the Committee on other important issues throughout 2009. Stabilizing the markets, helping keep families in their homes and strengthening regulation of our industry to prevent future relapses are other issues we consider priorities. Addressing these issues together will help homebuyers regain their faith in the mortgage industry.

The importance of FHA at this time in our country's financial history cannot be over emphasized. The agency's programs and integrity must be maintained. On behalf of the Mortgage Bankers Association, we stand ready to work with you to strengthen FHA and Ginnie Mae and protect their programs.



Testimony of  
George Hanzimanolis, CRMS, Past-President

National Association of Mortgage Brokers

on

“FHA Oversight of Loan Originators”

before the

U.S. House Financial Services Committee

United States House of Representatives

Friday, January 9, 2009

Chairman Frank, Ranking Member Bachus and members of the Committee, thank you for inviting NAMB to testify today on ways that the Department of Housing and Urban Development (HUD) and the Federal Housing Administration (FHA) may improve oversight of loan originators. In particular, we appreciate the opportunity to address the implications of the increasing role of FHA, methods by which FHA could more effectively monitor compliance of FHA originators, and the need for increased funding and staffing for FHA.

NAMB is the only national trade association exclusively devoted to representing the mortgage brokerage industry, and as the voice of the mortgage brokers, NAMB speaks on behalf of members in all 50 states and the District of Columbia. NAMB members are typically small business men and women with four to seven employees, who adhere to a strict code of ethics and best lending practices when presenting consumers with an array of mortgage financing options from which they can choose. Mortgage brokers typically maintain business relationships with various lenders so they can offer a variety of loan

products for their customers to choose from. Our members play a critical role in helping the American economy and in making the dream of homeownership a reality for American families.

#### **I. The Risk to the FHA Program**

FHA mortgage insurance was created to help provide lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. The insurance pool is paid for by premiums that homeowners pay when they utilize the program.

Although there is now some concern regarding the subprime industry entering the FHA market, existing rules and policies to some extent prevent this from happening. There are some significant differences between subprime and FHA originated loans. Borrowers that utilize the FHA program have to adhere to higher standards than they would in the subprime market, have down payments and are expected to meet strict loan-to-value ratios. Subprime and other high risk loans often had prepayment penalties and/or negative amortization. FHA loans do not permit these actions. Also, FHA loans are required to be made on owner-occupied primary residences, cannot be made on second homes or be non-owner occupied, and cannot be no-income or stated-income loans. Additionally, a large number of subprime loans that were made were on investment properties, second homes, or were no-income or stated-income loans

Although the controls in place in the FHA program will help to prevent losses similar to those seen in the subprime market, one must realize that FHA was created to absorb risk to lenders. If HUD is able to identify problematic individuals, properly monitor its mortgagees and is empowered to disbar them in a reasonable time frame, losses from that source should be minimal. However, even conservative mortgage lending is expected to have some losses. For decades, FHA has been able to absorb its losses from premiums collected. FHA was designed to promote homeownership in good markets and difficult markets. In times of economic instability, FHA premiums may need to be adjusted to cover added risk. In order to provide stronger protection to the FHA insurance pool, NAMB believes Congress should allow risk-based pricing for FHA premiums or implement a complete government subsidy of FHA loans. Even if Congress decides a subsidy is required, it would be considerably less expensive than many other stimulus programs already being implemented.

On October 1, 2008, the U.S. Department of Housing and Urban Development (HUD) implemented a one-year moratorium on the Federal Housing Administration's (FHA) Risk-Based Premium structure pursuant to the Housing and Economic Recovery Act of 2008 (HERA). NAMB supports lifting the moratorium so that the risk to the FHA fund is balanced by the premiums paid by borrowers.

The ability to match borrower characteristics with an appropriate mortgage insurance premium has been recognized as essential by every private mortgage insurer (PMI). PMI

companies have established levels of credit quality, loan-to-value, and protection coverage to aid in this matching process. These companies also offer various programs that allow for upfront mortgage insurance premiums, monthly premiums, or combinations of both. This flexibility has enabled lenders to make conventional loans that are either not allowable under FHA or present a risk level that is currently unacceptable to FHA.

FHA is essentially a government mortgage insurance provider. Where FHA mortgage insurance is not available, PMI companies are free to increase premiums without fear of losing market share to a more competitively priced FHA loan product. FHA should be permitted to balance risk with premiums charged in order to increase competition and ultimately drive down costs for consumers. Since FHA is not required to make a suitable profit or demonstrate market growth to shareholders, it is likely that FHA can afford to assume greater risk levels than PMI companies can currently absorb. This increased capacity to assume and manage risk will allow FHA to not only serve borrowers who presently do not have PMI available as a choice, but also those borrowers whose premiums will be reduced because of the increased competition in the market.

## **II. Mortgage Brokers & FHA Loans**

A mortgage broker is a real estate financing professional or entity that works with both borrowers and lenders, while representing neither, to obtain a mortgage loan. A mortgage broker works with consumers throughout the complex mortgage origination process. Accordingly, a mortgage broker's role may include taking an application; performing a financial and credit evaluation; producing documents; satisfying underwriting conditions; working with realtors; ordering title searches, appraisals, and pay off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings.

There are eligibility requirements, including HUD policy and regulatory criteria, a mortgage broker must adhere to in order to become an approved FHA loan originator regarding operations, employees, credit checks and other issues.

FHA classifies approved mortgage originators based on the functions they will perform and type of organization.

A mortgagee may become FHA approved upon meeting HUD's requirements, and submitting an acceptable HUD form 11701, Application for Approval, the appropriate non-refundable application fee, and other materials which are described in HUD's Mortgagee Approval Handbook.

There are three basic types of FHA approved originating mortgagees including a supervised mortgagee who are members of the Federal Reserve and whose accounts are insured by either the Federal Deposit Insurance Corporation (FDIC), or the National Credit Union Administration (NCUA); non-supervised mortgagees (i.e., mortgage lenders) who are not depositories; and finally, non-supervised loan correspondents who are often mortgage brokers that have as their principal activity the origination of FHA-

insured mortgages for sale or transfer to one or more sponsors who underwrite the mortgages. A loan correspondent must be sponsored by a fully approved supervised or non-supervised direct endorsement mortgagee, who agrees to underwrite and fund the FHA loan. The loan correspondent can either close the loan in its own name or in the name of the underwriting sponsor. Traditionally, mortgage brokers close in the name of the underwriting sponsor. Mortgage brokers *NEVER* underwrite the FHA loan. An additional level of approval is called direct endorsement, or "DE" which is available to supervised and non-supervised mortgagees. The DE status enables mortgagees to underwrite and close an FHA loan before submitting the loan to HUD for insurance endorsement.

It is important to point out the specific role a mortgage broker plays in originating an FHA loan. The mortgage broker is responsible for taking the consumer loan application, obtaining merged credit reports and importing loan application data. The mortgage broker then enters his/her FHA correspondent ID and the sponsoring wholesaler FHA lender ID. The second step involves sending the borrower's information through Freddie Mac's Loan Prospector or Fannie Mae's Desktop Underwriter system which is programmed with the FHA Total Scorecard underwriting parameters. At this point, the mortgage broker receives a full "FHA Total Scorecard Feedback Certificate." The third step involves the mortgage broker processing the information he/she has collected from the consumer and then sending the full file to the sponsoring lender. Finally, the sponsoring lender reviews the "FHA Total Scorecard Feedback Certificate" and underwrites the loan per FHA requirements and makes the final lending decision.

### **III. Monitoring of FHA Loan Originators**

Each FHA approved mortgagee must renew its approval status annually. HUD reviews information on each mortgagee to determine if continued approval is appropriate. All mortgagees submit an annual verification report. Most pay an annual renewal fee and non-supervised mortgagees and non-supervised loan correspondents must also submit audited financial statements and supplementary reports.

Due to its increased activity, FHA must improve its methods of monitoring the compliance of its mortgagees. NAMB has identified four areas requiring change in order for the FHA to become more effective in compliance and enforcement: (1) removal of the \$250,000/\$63,000 net worth; (2) identifying originators who are able to operate outside of the requirements of the SAFE Act as established by HERA and requiring them to comply; (3) updating the Neighborhood Watch Early Warning System and expediting the recognition of high default rates; and (4) increasing the efficiency and speed of reviews performed by the Mortgagee Review Board.

#### **A. Net Worth**

In order to be FHA approved and remain FHA approved, lender applicants must maintain a net worth of \$250,000. Non-supervised loan correspondents must have a minimum net

worth of \$63,000 plus \$25,000 per branch, often creating a net worth requirement similar to lenders. However, net worth is a false predictor of honesty and integrity and a minimum net worth does not indicate the competency of the originators within the company. Current market reality, as witnessed by the 313<sup>1</sup> mortgage bankers, lenders and Wall Street firms that have gone out of business, proves that net worth can disappear quickly and without notice. In addition, there are very large companies who have little or no net worth, some of them without enough to even meet the FHA requirements.

Net worth is not available when a borrower seeks redress. Owners and employees of these large companies can create new companies or sub-companies in an effort to originate FHA loans. When this happens, HUD has no ability to properly identify the offending parties, causing a lack of compliance to perpetuate. There is no evidence to demonstrate that loans originated by high net worth originators perform better than those with a lower net worth.

Instead of the mandate for a net worth requirement, NAMB suggests the implementation of a recovery fund whereby every FHA loan originator must contribute to such fund in order to originate an FHA loan. Similar requirements are standard for any person that wants to become licensed in a state pursuant to the SAFE Act. NAMB suggests that the FHA establish an FHA Recovery Fund to be paid for by FHA loan originators as well.

#### **B. SAFE Act**

Currently, HUD does not have an adequate system in place to identify improper prior mortgage practices on the part of the applicant. There are a few eligibility requirements for applicants such as a good credit history, no sanctions, submission of resumes, and minimum staffing; however, in recent years, some individuals have found a way to operate outside of the standards set forth by the FHA.

A recent issue has come to our attention regarding “Non-Approved Counselors” who essentially originate FHA loans and receive a fee for providing this service to consumers. This fee is not paid by the FHA mortgagee, but rather by the consumer from his or her own available funds. The “counselors” do not have to adhere to any of the FHA origination requirements and are not employees or affiliated with the mortgagee, effectively circumventing the process that exists today. They are not even required to be licensed as they are being paid for “counseling” services and cannot take a loan application, verify data or give disclosures; yet they often collect one to two percent of the loan amount which is often thousands of dollars. This loophole essentially allows unlicensed individuals with no credentials or checks to advertise they can provide FHA loans. HUD has banned such consultants or counselors for HECM mortgages but has not done so for forward mortgages.

A key requirement within the SAFE Act is that all originators must undergo a background check and be licensed as part of the National Mortgage Licensing System &

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<sup>1</sup> A full list of companies that have filed for bankruptcy as of January 6, 2009 is attached (Attachment A). This list was provided by The Mortgage Lender Implode-O-Meter, <http://ml-implode.com/>.

Registry (NMLS & R). Since 2002, NAMB has called for the licensure and registration of all mortgage originators through background investigations, testing, and continuing education. These requests were realized through the establishment of NMLS & R. The SAFE Act should help to keep track of all FHA loan originators as they now have to be part of the loan registry created by the Act (which includes fingerprinting and background checks). Since the tracking system created by the registry applies to each individual and not each company, NAMB recommends that the FHA application for loan originators apply to the individual and not just the company. If the application process was set up this way, it would be easier and more efficient for HUD to track bad FHA actors.

### **C. Neighborhood Watch Early Warning System**

In order to monitor compliance, HUD instituted the Neighborhood Watch Early Warning System to identify mortgagees who have an unacceptable default rate. The Neighborhood Watch Early Warning System is triggered when a mortgagee's default rate exceeds mortgages originated within the preceding 24 months, exceeds 200 percent of the default and claim rate within the geographic area served by a HUD field office, and also exceeds the national default and claim rate. The name implies prompt recognition of high default rates. However, 24 months must elapse to achieve a true average. The mortgagee must be notified and has appeal rights. This process is often very slow, and the affected individuals move on to another mortgagee leaving the issue unsolved and the mortgagees unnamed. NAMB recommends that HUD update the Neighborhood Watch Early Warning System and expedite the recognition of high default rates.

### **D. Mortgagee Review Board**

Default is only one indicator of mortgagee problems. Fraud, failure to comply with FHA guidelines and poor practices can create undetected problems, as well. HUD is slow in identifying problems and the Mortgagee Review Board is slow to respond to them. Finally, the courts make it difficult for HUD to recover any losses and it can take years to complete the process. NAMB suggests that HUD put more resources toward improving the Mortgagee Review Board process and insuring its actions and judgments come to fruition.

## **IV. FHA Resources**

In order to increase efficiency and productivity, funding for HUD and the FHA program must increase. The FHA has too few employees reviewing new applicants. It can take up to 6 months to receive an answer back from the FHA as to the status of a mortgage broker's application. With the increase in volume of FHA loans, there is a clear need to increase funding for all areas relating to FHA, particularly including computerization, lender assessment, approval and enforcement. In addition, there is a need for better coordination between HUD and law enforcement, as well as increased enforcement of the Truth in Lending Act and the Real Estate Settlement Procedures Act.

#### V. FHA Loan Limits

FHA volume has increased in part due to the recently enacted increase in FHA loan limits. As intended by the Economic Stimulus Act of 2008, the temporary increase in loan limits for the FHA (and the Government Sponsored Enterprises [GSEs]) are having a significant impact in high cost areas, particularly in the California housing market. For example, in October of 2007, FHA insured only 688 mortgage loans in the State. In October of this year, after the enactment of the Economic Stimulus Act, FHA insured over 14,000 home loans in California. Clearly, FHA is playing a critical role in providing affordable single family mortgage loans throughout the State.

In November, the Federal Housing Finance Agency (FHFA) announced the 2009 GSE loan limits, and FHA announced their 2009 loan limits, for areas nationwide using the Department of Housing and Urban Development's recalculated home prices. Under these proposed new limits, most areas in California are scheduled to experience significant reductions due to the transition from the terms of last year's stimulus bill to permanent loan limit provisions adopted in P.L. 110-289.

In California specifically, due to the decrease in the loan limits and HUD's resetting of county median home prices, 38 counties will have their GSE loan limit decrease on January 1, 2009, by an average of over \$85,000. In addition, 55 counties in California will experience an FHA loan limit decrease on January 1, 2009, by an average of over \$104,000. Decreasing the GSE and FHA loan limits will increase the cost of buying a home in California and across the country, exacerbating problems in the housing markets.

To make the situation worse, recent announcements that have been made by the Private Mortgage Insurance companies that they will no longer allow mortgage insurance coverage on loan amounts over \$417,000 in the states of: Arizona, California, Florida, or Nevada. Condos have already been dropped by PMIs.

We need to keep affordable mortgage finance available at a time when the housing markets are facing their greatest challenge in 70 years. Any stimulus package that the Congress considers should include a provision to extend these limits, since the housing market is the core issue affecting our economy.

#### VI. Conclusion

Congress has the opportunity to work with HUD to establish a system that will promote oversight, protect the consumer and revitalize the FHA program by ensuring that individuals across the country are protected both as homebuyers and taxpayers. We look forward to working with Congress to achieve this objective. NAMB appreciates this opportunity to offer our perspective on FHA oversight of loan originators. I am happy to answer any questions.

**Attachment A****FAILED LENDER LIST**

List provided by "The Mortgage Lender Implode-O-Meter"  
<http://ml-implode.com>

- 313. Ivanhoe Mortgage/Central Pacific Mortgage
- 312. Frontier Investment Co.
- 311. BankUnited - Wholesale
- 310. Solstice Capital Group - HSBC
- 309. MortgageIT
- 308. HCL Finance Inc. - Wholesale
- 307. LIME Financial Svcs. - Wholesale
- 306. Mortgage Network Inc. - Wholesale
- 305. Fortes Financial - Wholesale
- 304. HSBC Mortgage Corp. - Wholesale
- 303. CBRE Realty Finance
- 302. Franklin Bank, SSB
- 301. Mortgage Lion, Inc. - Wholesale
- 300. HMS Capital, Inc.
- 299. American Sterling Bank - Wholesale
- 298. CTX Mortgage Co. - Retail
- 297. Equity One Commercial
- 296. Coldstream Financial Svcs.
- 295. Banco Popular North America - Wholesale
- 294. Ace Mortgage Funding, LLC
- 293. E-Loan
- 292. Gateway Bank, F.S.B. - Wholesale
- 291. First Call Mortgage Co.
- 290. Downey Savings and Loan - Wholesale
- 289. Prospect's Metrocities Mortgage - Wholesale
- 288. ComCor Mortgage - Wholesale
- 287. Chevy Chase Bank - Wholesale
- 286. Washington Mutual - Retail and Warehouse
- 285. Hometown Commercial Capital
- 284. Mid Atlantic Capital LLC
- 283. Kemper Mortgage, Inc.
- 282. Liberty Mortgage Funding Co.
- 281. Freddie Mac
- 280. Fannie Mae
- 279. Pacific Community Mortgage, Inc. - Gold Reverse, Inc.
- 278. Homecomings Financial, LLC
- 277. Thornburg Mortgage
- 276. CSB Mortgage
- 275. Carteret Mortgage Corporation
- 274. Accredited Home Lenders, Lone Star Funds - Wholesale
- 273. Western Residential Mortgage
- 272. Liberty Home Lending
- 271. Equipoint Financial Network, Inc.
- 270. Ideal Mortgage Bankers, Ltd. - Wholesale

269. Silver State Bank - Wholesale
268. Irwin Union Bank & Trust Co. - Wholesale
267. SunTrust Bank Equity Wholesale
266. Wachovia Mortgage, FSB - Wholesale
265. Lehman Brothers SBF
264. IndyMac Bancorp
263. Mortgages Ltd.
262. Wilmington Finance - Wholesale
261. Accredited Home Lenders, Home Funds Direct
260. Assured Lending Corp. - Wholesale
259. Homewide Lending Corporation
258. Vanguard Mortgage & Title, Inc.
257. Chase Home Equity - Wholesale
256. Chase Subprime - Wholesale
255. Evergreen Investment & Carnation Banc
254. Casa Blanca Mortgage/Shearson - Wholesale
253. Guaranty Bank - Correspondent
252. Citi Residential Lending
251. Montgomery Mortgage Capital Company
250. E\*Trade Wholesale Lending
249. Shearson Financial Network, Inc.
248. American Bank Mortgage Group - Wholesale
247. AmeriBanc Corp.
246. Washington Mutual - Wholesale
245. Century Bank, F.S.B. - Wholesale
244. Diversified Mortgage, Inc.
243. National Wholesale Funding
242. Centennial Mortgage and Funding, Inc./Award Mortgage
241. Fidelity Home Mortgage Corp.
240. LMI Funding, Inc.
239. Millennium Mortgage - Wholesale
238. Origen Financial, Inc. (Correspondent)
237. CitiMortgage - Home Equity Wholesale
236. Bear Stearns Residential Mortgage
235. East West Mortgage Co. of VA
234. New Vision Residential Lending
233. Washington Savings Bank, F.S.B. - Wholesale
232. Macquarie Mortgages USA Inc.
231. Global Mortgage, Inc.
230. Unique Mortgage Solutions (UMS, LLC)
229. First Franklin - Merrill Lynch
228. First National Mortgage Sources
227. Resource Mortgage (Wholesale)
226. KH Financial
225. Lydian Mortgage
224. OMG Wholesale Lending
223. Saxon Mortgage (Wholesale)
222. Beazer Mortgage Corp.
221. Allpointe Mortgage (Broker Program)
220. Popular Warehouse Lending
219. Allied Lending Corp. (Wholesale)

218. BF Saul Wholesale Lending  
217. Community Resource Mortgage  
216. Lehman/Aurora Loan Services  
215. Residential Mortgage Capital  
214. Maverick Residential Mortgage  
213. Countrywide Financial Corp.  
212. First NLC Financial Services  
211. First American Bank (Wholesale)  
210. Soma Financial  
209. National City Corp. (Wholesale)  
208. Heartland Wholesale Funding  
207. Homefront Mortgage Inc.  
206. PNC Bank H.E.  
205. Family First Mortgage Corp.  
204. First Fidelity Financial  
203. BSM Financial  
202. 1st Choice Mortgage  
201. Wescom Credit Union  
200. Coast Financial Holdings/Coast Bank  
199. WaMu (Subprime)  
198. First Madison Mortgage  
197. Southern Star Mortgage  
196. TransLand Financial  
195. Secured Bankers Mortgage Company (SBMC)  
194. ComUnity Lending  
193. Delta Financial Corp  
192. BayRock Mortgage  
191. Empire Bancorp  
190. Option One - H&R Block  
189. Citigroup - FCS Warehouse  
188. Charter One (Wholesale)  
187. Wells Fargo - Home Equity  
186. Paul Financial, LLC  
185. Webster Bank (Wholesale)  
184. Fieldstone Mortgage Company  
183. Tribeca Lending Corp. (Wholesale)  
182. WAMU Comm. Correspondent  
181. Marlin Mortgage Company  
180. Countrywide Specialty Lending  
179. UBS Home Finance  
178. MortgageIT-DB (Retail)  
177. Edgewater Lending Group  
176. ResMAE Mortgage Corp.  
175. Citimortgage Correspondent (2nds)  
174. AMC Lending  
173. Liberty American Mortgage  
172. Exchange Financial (Wholesale)  
171. FirstBank Mortgage  
170. Bank of America (Wholesale)  
169. Diablo Funding Group Inc.  
168. Honor State Bank

167. Spectrum Financial Group
166. Priority Funding Mortgage Bankers
165. BrooksAmerica Mortgage Corp.
164. Valley Vista Mortgage
163. New State Mortgage Company
162. Summit Mortgage Company
161. WMC
160. Paragon Home Lending
159. First Mariner Wholesale
158. The Lending Connection
157. Foxtons, Inc.
156. SCME Mortgage Bankers
155. Aapex Mortgage (Apex Financial Group)
154. Wells Fargo (various Correspondent and Non-prime divisions)
153. Nationstar Mortgage
152. Decision One (HSBC)
151. Impac Lending Group
150. Long Beach (WaMu Warehouse/Correspondent)
149. Expanded Mortgage Credit Wholesale
148. The Mortgage Store Financial
147. C & G Financial
146. CFIC Home Mortgage
145. All Fund Mortgage
144. LownHome Financial
143. Sea Breeze Financial Services
142. Castle Point Mortgage
141. Premium Funding Corp
140. Group One Lending
139. Allstate Home Loans / Allstate Funding
138. Home Loan Specialists (HLS)
137. Transnational Finance Wholesale
136. CIT Home Lending
135. Capital Six Funding
134. Mortgage Investors Group (MIG) - Wholesale
133. Amstar Mortgage Corp
132. Quality Home Loans
131. BNC Mortgage (Lehman)
130. First National Bank of Arizona
129. Chevy Chase Bank Correspondent
128. GreenPoint Mortgage - Capital One Wholesale
127. NovaStar, Homeview Lending
126. Quick Loan Funding
125. Calusa Investments
124. Mercantile Mortgage
123. First Magnus
122. First Indiana Wholesale
121. GEM Loans / Pacific American Mortgage (PAMCO)
120. Kirkwood Financial Corporation
119. Lexington Lending
118. Express Capital Lending
117. Deutsche Bank Correspondent Lending Group (CLG)

116. MLSG  
115. Trump Mortgage  
114. HomeBanc Mortgage Corporation  
113. Mylor Financial  
112. Aegis  
111. Alternative Financing Corp (AFC) Wholesale  
110. Winstar Mortgage  
109. American Home Mortgage / American Brokers Conduit  
108. Optima Funding  
107. Equity Funding Group  
106. Sunset Mortgage  
105. Nations Home Lending  
104. Entrust Mortgage  
103. Alera Financial (Wholesale)  
102. Flick Mortgage/Mortgage Simple  
101. Dollar Mortgage Corporation  
100. Alliance Bancorp  
99. Choice Capital Funding  
98. Premier Mortgage Funding  
97. Stone Creek Funding  
96. FlexPoint Funding (Wholesale & Retail)  
95. Starpointe Mortgage  
94. Unlimited Loan Resources (ULR)  
93. Freestand Financial  
92. Steward Financial  
91. Bridge Capital Corporation  
90. Altivus Financial  
89. ACT Mortgage  
88. Alliance Mortgage Banking Corp (AMBC)  
87. Concord Mortgage Wholesale  
86. Heartwell Mortgage  
85. Oak Street Mortgage  
84. The Mortgage Warehouse  
83. First Street Financial  
82. Right-Away Mortgage  
81. Heritage Plaza Mortgage  
80. Horizon Bank Wholesale Lending Group  
79. Lancaster Mortgage Bank (LMB)  
78. Bryco (Wholesale)  
77. No Red Tape Mortgage  
76. The Lending Group (TLG)  
75. Pro 30 Funding  
74. NetBank Funding, Market Street Mortgage  
73. Columbia Home Loans, LLC  
72. Mortgage Tree Lending  
71. Homeland Capital Group  
70. Nation One Mortgage  
69. Dana Capital Group  
68. Millenium Funding Group  
67. MILA  
66. Home Equity of America

65. Opteum (Wholesale, Conduit)
64. Innovative Mortgage Capital
63. Home Capital, Inc.
62. Home 123 Mortgage
61. Homefield Financial
60. First Horizon Subprime, Equity Lending
59. Platinum Capital Group (Wholesale)
58. First Source Funding Group (FSFG)
57. Alterna Mortgage
56. Solutions Funding
55. People's Mortgage
54. LowerMyPayment.com
53. Zone Funding
52. First Consolidated (Subprime Wholesale)
51. EquiFirst
50. SouthStar Funding
49. Warehouse USA
48. H&R Block Mortgage
47. Madison Equity Loans
46. HSBC Mortgage Services (correspondent div.)
45. Sunset Direct Lending
44. Kellner Mortgage Investments
43. LoanCity
42. CoreStar Financial Group
41. Ameriquest, ACC Wholesale
40. Investaid Corp.
39. People's Choice Financial Corp.
38. Master Financial
37. Maribella Mortgage
36. FMF Capital LLC
35. New Century Financial Corp.
34. Wachovia Mortgage (Correspondent div.)
33. Ameritrust Mortgage Company (Subprime Wholesale)
32. Trojan Lending (Wholesale)
31. Fremont General Corporation
30. DomesticBank (Wholesale Lending Division)
29. Liberty One Lending
28. Eagle First Mortgage
27. Coastal Capital
26. Silver State Mortgage
25. ECC Capital/Encore Credit
24. Lender's Direct Capital Corporation (wholesale division)
23. Concorde Acceptance
22. DeepGreen Financial
21. American Freedom Mortgage, Inc.
20. Millenium Bankshares (Mortgage Subsidiaries)
19. Summit Mortgage
18. Mandalay Mortgage
17. Rose Mortgage
16. EquiBanc
15. FundingAmerica

14. Popular Financial Holdings
13. Clear Choice Financial/Bay Capital
12. Origen Wholesale Lending
11. SecuredFunding
10. Preferred Advantage
9. MLN
8. Sovereign Bancorp (Wholesale Ops)
7. Harbourton Mortgage Investment Corporation
6. OwnIt Mortgage
5. Sebring Capital Partners
4. Axis Mortgage & Investments
3. Meritage Mortgage
2. Acoustic Home Loans
1. Merit Financial



**STATEMENT OF JAMES A. HEIST  
ASSISTANT INSPECTOR GENERAL FOR AUDIT  
DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**BEFORE THE  
COMMITTEE ON FINANCIAL SERVICES  
UNITED STATES HOUSE OF REPRESENTATIVES  
JANUARY 9, 2009**

Chairman Frank, Ranking Member Bachus, and members of the Committee, thank you for inviting me to testify today. I very much appreciate the opportunity to testify on behalf of the Inspector General on the important issue of FHA oversight of loan originators.

### **Background**

The U.S. Department of Housing and Urban Development (HUD) Inspector General is one of the original 12 Inspectors General authorized under the Inspector General Act of 1978. The OIG strives to make a difference in HUD's performance and accountability. The OIG is committed to its statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations. While organizationally located within the Department, the OIG operates independently with separate budget authority. This independence allows for clear and objective reporting to the Secretary and to the Congress.

The Department's primary challenge is to find ways to improve housing and to expand opportunities for families seeking to improve their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans nationwide obtain affordable housing. These programs, which include Federal Housing Administration (FHA) mortgage insurance for Single-Family and Multifamily properties are funded through a \$30+ billion annual budget and, in the case of FHA, through mortgage insurance premiums.

The Committee asked that we provide an overview of recent changes to the FHA program, an assessment of FHA requirements and needs, identify any issues of importance, and detail any ongoing or planned OIG work in the area. We have recently stated in correspondence to the Congress that, through the multitude of our work in auditing and investigating many facets of the FHA programs over the course of many years, we have had, and continue to have, concerns regarding FHA's systems and infrastructure to adequately perform its current requirements and services. This was expressed by the OIG to the FHA through audits and reports regarding a spectrum of areas prior to the current influx of loans coming into the program and prior to the consideration of the numerous proposals that expanded its reach. We continue to remain keenly interested in FHA's ability and capacity to oversee the newly generated business.

### **The Landscape**

The past year and a half have certainly produced a lot of changes and initiatives. In response to increasing delinquencies and foreclosures brought about by the collapsing subprime mortgage market, in September 2007, HUD acted administratively to provide mortgage assistance through the FHA Secure program to refinance existing subprime mortgages. The program was expanded in May 2008 to provide lenders the added flexibility to refinance and insure more mortgages, including those for borrowers who were late on a few payments and/or received a voluntary

mortgage principal write-down from their lenders. The FHA recently issued a formal letter terminating the program stating that “maintaining the program past the original termination date would have a negative financial impact on the MMI Fund.”

The Housing and Economic Recovery Act passed last summer, created a new Hope for Homeowners program to enable FHA to refinance the mortgages of at-risk borrowers. While activity to date has been limited, the FHA was authorized to guarantee \$300 billion in new loans to help prevent an estimated 400,000 homeowners from foreclosure. It also authorized changes to the FHA’s Home Equity Conversion Mortgage (reverse) program that will enable more seniors to tap into their home’s equity.

As we turn to today’s environment, the volume of Single-Family FHA-insured loans has enlarged in Fiscal Year 2008 by tripling from \$59 billion in Fiscal Year 2007 to over \$180 billion in Fiscal Year 2008. The latest figures from Single-Family market comparisons from October 2008, show that FHA’s total endorsements have increased from 21% of the market the year before to 76% of the market which includes both home sales and refinances. FHA’s home sales’ market share has increased from 6.4% to 23%. Many potential homeowner loans may not have come to the agency yet as some of the new initiatives are still taking hold and the industry is flushing out its options and possibly posturing for more favorable terms. FHA may not be able to handle its expanded workload or new programs that require the agency to take on riskier loans than it historically has had in its portfolio.

#### **FHA Resources**

It is our understanding from the Department that funding for 22 staff positions and approximately \$20 million for system improvements have been made available for the Hope for Homeowners program. They further tell us that they have limited resources for other newly-instituted modernization initiatives and that while they did receive a modest amount to be used for the administration (by the Office of Community Planning and Development) of the Neighborhood Stabilization Program, that funding must also be used for other disaster assistance needs. As you are aware, the Department as a whole has had significant new responsibilities over the last seven years in rebuilding communities devastated by disasters (i.e., lower Manhattan post-September 11<sup>th</sup>; the Gulf Coast region after hurricanes Katrina, Rita and Wilma; the Galveston area after recent hurricanes; California fires; and Midwest flooding) that have added approximately \$30 billion in new program funds that require quick distribution and important oversight.

FHA tells us that they are reprogramming other funds to try to address modernization requirements. Yet, it remains very tight particularly as it relates to oversight. For example, the mortgage licensing provisions contained in the new legislation set minimum standards for nationwide licensing and a registration system for mortgage broker and loan officers. We have

recently been told that there is one FHA person in the RESPA (Real Estate Settlements Procedure Act) unit who is assigned to work with the States in complying with this new regulatory requirement.

We continue to believe there is a critical need for more resources for FHA: 1) to enhance its IT systems; 2) to increase its personnel in a way to deal with an escalation in processing requirements; 3) to increase its training of personnel to maintain a workforce with the necessary skills to deal with the responsibility of this new portfolio; 4) to oversee the numerous contractors it maintains; and 5) to increase its oversight in all critical front end issues including such important areas as the appraisal and underwriting processes.

While not the focus of this hearing, we are also concerned that increases in demand to the FHA program are having collateral implications for the integrity of the Government National Mortgage Association (Ginnie Mae) mortgage-backed securities program including the potential for increases in fraud in that program. HUD too needs to consider the downstream risks to investors and financial institutions of Ginnie Mae's eventual securitization of a large proportion of the Hope for Homeowners and Home Equity Conversion Mortgage (HECM) Single-Family loans. Like FHA, Ginnie Mae has seen an augmentation in its market share (it had a 39% market share for the month of October 2008 surpassing both Fannie Mae and Freddie Mac and increased \$150 billion in outstanding mortgage-backed securities and commitments during a one year period from FY 2007 to FY 2008) and it too has stretched and limited resources to adequately address this increase.

Despite all these enumerated issues, we are gratified that a new penalty provision was inserted into the Housing and Economic Recovery Act. When we corresponded during consideration of that legislation, we stated our belief that a new penalty enunciated specifically for the FHA program would be beneficial from an oversight and enforcement perspective. We assisted in its development and were very pleased that it was included in the final passage. The statute now creates a penalty for committing fraud against FHA programs, similar to the predicates established in the Financial Institutions Reform, Recovery and Enforcement Act legislation, and will be a useful tool for prosecutors and the law enforcement community to employ in order to address those who would seek to harm the program.

#### **OIG Observations**

The results of the latest actuarial study show that HUD has sustained significant losses in its Single-Family program making a once fairly robust program's reserves smaller. The study shows that FHA's fund to cover losses on the mortgages it insures are contracting. As of September 30, the fund's economic value was an estimated \$12.9 billion, an almost 40 percent drop from over \$21 billion a year ago. The current \$12.9 billion economic value represents 3 percent of the mortgages insured by the FHA. Although above the 2 percent ratio required by

law, it is well below the 6.4 percent ratio from the same time last year. Moreover, these latest projections used macroeconomic forecast data as of June 2008 and are profoundly sensitive to the accuracy of those forecasts. If more pessimistic assumptions are factored in, the ratio could dip below 2 percent in succeeding years requiring an increase in premiums or Congressional appropriation intervention to make up the shortfall. Since its inception in 1934, FHA has been self-sustaining and it has paid premiums to the fund, which has covered its fluctuating defaults and foreclosures.

The largest problem facing FHA, and the lenders it works with, is the fallout from decreasing home values. About 6.5 percent of FHA loans are currently in default. This reinforces the importance for FHA approved lenders to maintain solid underwriting standards and quality control processes in order to withstand severe adverse economic conditions. Another extensive problem confronting FHA has been its inability to upgrade and replace legacy (developed in the 1970s and 1980s) application systems that had been previously scheduled to be integrated. The FHA systems environment remains at risk and must evolve to keep up with its new demands. Add to that an escalation in the properties owned and managed by FHA and the overall picture becomes more complicated.

#### **Continuing OIG Audit and Inspection Concerns**

We continue to focus our audit and inspection resources on the Single-Family program and point out where weaknesses or deficiencies need to be addressed. Among many different areas that we have reviewed, we have found that FHA needs to improve its internal control structure by formalizing risk assessments of its programs and its administrative functions and by conducting ongoing management control reviews. It also needs to establish a comprehensive strategy regarding its risk-based monitoring of program activities and participants and identify corrective actions required to improve its management controls in a timely manner. In another area, our audit of the FHA appraiser roster identified weaknesses in the quality control review and monitoring of the roster. The roster contained unreliable data including the listing of 3,480 appraisers with expired licenses and 199 appraisers that had been state sanctioned. In a further review, we found that HUD's appraiser review process was not adequate to reliably and consistently identify and remedy deficiencies associated with appraisers. Moreover, results from a number of other key audits have noted significant lender underwriting deficiencies, inadequate quality controls, and other operational irregularities.

Additionally, we note that FHA's lender approval process is largely manual. FHA will be challenged within current resource constraints to keep up with the increasing volume of entities doing business. FHA controls currently rely upon random, and again, manual processes by contractors to select for review about one in every 20 loans or approximately 5 percent. FHA then relies upon post-endorsement automated lender or service performance information, such as high delinquency or early default rates, to target these entities for examining a limited number of

loans for quality assurance reviews. We believe FHA needs the resources to take advantage of commercial off-the-shelf pre-screening loan software or to require at least the larger lenders use such tools as part of their underwriting process.

Further, we have recently initiated an inspection of the Mortgagee Review Board (MRB) enforcement actions and its efficiency, effectiveness and impact in resolving cases of serious non-compliance with FHA regulations particularly during this period of significant changes in the housing market. The MRB is a statutorily created board within the Department that has responsibility to sanction FHA-approved lending institutions that violate applicable housing laws and HUD regulations and policies. The Departmental Enforcement Center is responsible for case preparation and referral to the MRB for final decision on sanctions.

Specifically, our review will determine the timeliness of decisions; evaluate controls over the mortgagee referral and enforcement processes; summarize data gathered on settlement agreements and collections; and provide an objective basis to comment on the effectiveness of the MRB as a regulatory body. We are looking into issues such as the types of penalties assessed; whether the penalties were mitigated to administrative payments; the sizes of the mortgagees brought before the board; the elapsed time from referral to board action; whether indemnification was required; and whether the mortgagees were repeat offenders or their principals were under limited denial of participations or debarred. We anticipate completion of this review in a few months.

Our audit work also highlights how problem lenders may regain admission into the FHA program even when previous transgressions were apparent. For example, we looked at an Arizona corporation that was approved as an FHA mortgage lender by HUD in 1996. This particular lender had 13 active branch offices and sponsored close to 2,000 FHA-approved loan correspondents nationwide. As highlighted in our audit, this lender had a number of serious issues related to RESPA violations such as paying marketing fees, non-competition fees and quality incentives to real estate companies in exchange for more than \$57 million in FHA mortgage business. The corporation's license was suspended by the State and it filed for bankruptcy. One of the principal owners and principal managers reconstituted under a different name but operates from the same location. In 2008, HUD approved the new entity to originate and process FHA loans despite its principals' prior citations for RESPA violations.

#### **Continuing OIG Investigative Concerns**

Until recently, FHA's market share remained quite low as conventional subprime loans were heavily marketed by lenders. The tightening credit market has increased FHA's position as a loan insurer and, with that, is coming an increase in lender/brokers seeking to do business with the federal program and an overall concern regarding some of these loan originators. For example, we currently have under investigation for alleged inappropriate activities several FHA

lenders who were also lenders in the subprime market. The movement towards HUD is already underway as reflected in recent statistics. FHA lender approvals increased 525% in a two year period. For example, as of the end of Fiscal Year 2008, FHA had over 3300 approved lenders as compared to 997 at the end of Fiscal Year 2007 for an increase of 330%. If you compare the FY 2008 totals (over 3300) to the FY 2006 totals (692) it is a 525% increase. Open applications received so far for FY 2009 total 1007 of which 827 have already been approved. The integrity and reliability of this crop of program loan originators, in our view, is unproven and, in light of the aggressive recent history of this industry, may pose a risk to the program.

In addition, FHA is now, due to loan limit increases, serving new metropolitan areas with which it previously has had little interaction. With such entry, come new players and unknown hazards. Simultaneous to this confluence of events, is an increase in the reported incidents of mortgage fraud. Mortgage fraud incidents reports, as compiled by the Mortgage Asset Research Institute, have increased by 45 percent in the second quarter compared to a year-ago period.

Like the Arizona example cited above in our audit concerns, we also have seen on the investigative side lenders reacquiring FHA approval despite past abuses. A previous investigation on an FHA lender in New York led to the debarment of its owner for a period of five years from originating FHA insured loans. After the debarment was served, the lender, under the same owner, resumed operations using the same fraudulent practices. We again reviewed some of the loans and determined that the originations were fraudulent similar to the loans investigated in the first case. The OIG, in conjunction with the U.S. Attorney's Office, sought and received an injunction against them in order to stop the business from operating. Following the injunction, FHA withdrew their lender approval.

In the area of foreclosure recovery, recent trends show that certain individuals in the industry are preying on desperate and vulnerable homeowners who are facing foreclosure. Some improper activities include equity skimming [whereby the homeowner is approached and offered an opportunity to get out of financial trouble by the promise to pay off the mortgage or to receive a sum of money when the property is sold -- the property is then deeded to the unscrupulous individual who may charge the homeowner rent and then fails to make the mortgage payment thereby causing the property to go into foreclosure] and lease/buy-back plans [wherein the homeowner is deceived into signing over title with the belief that they can remain in the house as a renter and eventually buy back -- the terms are so unrealistic that buy-back is impossible and the homeowner loses possession with the new title holder walking away with most or all of the equity].

Another area of concern is the growing Home Equity Conversion Mortgage program. As an internal matter, in 2007, FHA's independent auditors identified a significant deficiency in the financial statement audit that showed the program being supported by a combination of servicer-provided applications, vendor databases, modification of existing FHA legacy systems and

manually performed input to the FHA's general ledger. From an external standpoint, we are aware that the larger loan limits can be attractive to exploiters of the elderly, whether it is by third parties or by even family members, who seek to strip equity from senior homeowners. Due to the vulnerability of the population this program serves, we are also concerned about evasions of statutory counseling requirements or even fraud by counseling entities. We are working with the Chairman and members of the Senate Committee on Aging to address some of their concerns regarding these issues.

Some HECM-related fraud activities involve flipping where an investor sells the property to an elderly straw buyer and enters into a quit claim deed with the straw buyer. The buyer applies for the HECM loan within a short time frame and the appraisal used to originate the HECM loan is then fraudulently inflated. This allows the investor to illegally divert the proceeds of the loan. Straw buyers are "recruited" in residential areas with a high rate of renters. The buyers are often unaware that they must pay property taxes and some are unaware that the cash due to them at closing has been diverted. A current investigation involves recruiting elderly homeless to live in properties victimizing these seniors who often have desperate needs. Another activity that we currently have under investigation involves financial professionals convincing HECM borrowers to invest HECM proceeds in a financial product such as an annuity. The financial professionals receive increased fees and, in the case of annuities, the victims are unable to get access to their savings for many years or even past their projected life expectancy. We have been partnering with the AARP and other groups to foster consumer protection education awareness. We are also a key participant in the mortgage fraud task forces nationwide coordinated by the Department of Justice.

The Office of the Inspector General stands ready to assist in whatever way is deemed necessary and will be vigilant in its efforts to protect the funds of the American taxpayer. We thank you for the opportunity to relay our impressions based on the body of our work and greatly appreciate the activities of the Congress to protect FHA's funds from predatory and improper practices and to ensure an effective response on oversight of the lender community at this critical time.

**Prepared Statement of Phillip Murray**

Deputy Assistant Secretary for Single Family Housing Programs  
U.S. Department of Housing and Urban Development

Meeting of the Committee on Financial Services  
United States House of Representatives



“FHA Oversight of Loan Originators”

January 9, 2009

On behalf of the Federal Housing Administration (FHA), I'd like to thank you for the opportunity to speak about FHA's comprehensive lender oversight and monitoring practices. I am Phillip Murray, the Deputy Assistant Secretary for Single Family Housing and I am responsible for managing all single family business for FHA. I have been with the U.S. Department of Housing and Urban Development (HUD) for 29 years, 17 of those with FHA, and am pleased to appear before you today.

Let me begin by stating that prior to my current position, I was the Director of the Office of Lender Activities and Program Compliance, responsible for administering various risk management activities of FHA approved lenders, which included sanctioning lenders and related parties who failed to comply with HUD and FHA requirements. Therefore, I take issue with recent press accounts suggesting that FHA is vulnerable to the same type of unsavory business practices as we've seen in the subprime mortgage market. These stories misrepresent a well-respected federal program that has provided untold benefits to millions of Americans, as well as the efforts of hundreds of HUD employees who administer it. The comparison of a safe, affordable FHA-insured mortgage to a subprime loan and the insinuation that such unsavory practices as were seen in the subprime market would be tolerated in FHA programs reveals a deep lack of understanding regarding the fundamental differences in the products and practices of these two segments of the market.

FHA-insured loans are neither high-cost nor high-risk for homeowners. Rather, they are stable products designed to provide homeownership opportunities to Americans prepared for such responsibility. Before FHA insures any mortgage, a lender must verify a borrower's employment, fully documenting their income as evidence of the borrower's capacity to meet their monthly mortgage obligation. Further, FHA prohibits underwriting based on "teaser" rates, requires that lenders escrow for taxes and insurance, and will not tolerate any prepayment penalties or balloon mortgages. In addition to these types of consumer safeguards, FHA-approved lenders are required to work with borrowers to resolve any delinquencies and avoid foreclosure at the first sign of difficulty. It is the combination of all of these protective features that makes FHA products safe and give homebuyers confidence in these products and in FHA.

Turning now to the specific topic of today's meeting, since its inception in 1934, FHA's single-family insurance program has been able to meet the costs of claims through up-front and annual insurance premiums paid by borrowers obtaining FHA mortgage loans, and earnings on insurance fund assets. To safeguard its ability to extend homeownership opportunities to Americans, the Department takes an aggressive stance to ensure that its FHA insurance funds are financially sound and adequately protected. The Mutual Mortgage Insurance Fund, the largest FHA insurance fund, is subject to an annual actuarial review and is required to meet a statutory minimum 2 percent capital reserve ratio. This ratio has been exceeded by the Department every year since its establishment.

FHA also conducts an annual actuarial review and maintains credit subsidy models that annually review each book of business and its underlying policy parameters and risk factors. These procedures assist FHA in estimating the cost to the government of insured loans and in making any necessary forward adjustments to credit subsidy models. Such analysis identified "seller-funded down payments" as an unacceptable risk to FHA and Congress subsequently prohibited FHA from

accepting future loans with a seller-funded down payment. FHA has also implemented Credit Watch and Appraiser Watch processes that monitor lenders and appraisers associated with unacceptably high default and claim rates for the purpose of terminating their FHA program participation. Between Fiscal Year (FY) 2004 and 2008, 455 appraisers and 354 FHA lender branches of 333 FHA approved lenders were terminated from FHA program participation by these processes.

The Department's efforts to protect FHA insurance funds and serve homebuyers and homeowners are best demonstrated by the thoroughness of its approval and monitoring standards. Lenders applying for participation in FHA's insurance programs are subject to rigorous initial approval requirements in addition to those standards imposed by the states in which they operate. Lender applications for FHA approval undergo an evaluation of: 1) the company's financial capacity and resources; 2) its possession of appropriate state licensing; 3) the eligibility of the company, and its principals, owners and officers to participate in government programs; and, 4) the company's quality control and compliance plans and procedures.

Additionally, lenders renew their approval annually to ensure ongoing adherence to FHA lender approval requirements. The renewal process requires lenders to certify their continued compliance with FHA guidelines, and to submit audited financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) and in compliance with the U.S. Government Accountability Office (GAO) Audit Guide. HUD has established the HUD Inspector General's (OIG) Consolidated Audit Guide as a supplement to the GAO Audit Guide, which contains specific requirements for audits on various types of HUD programs participants. Audit statements are evaluated to ensure compliance with FHA net worth and liquidity requirements and to discover potential prohibited business arrangements or practices. The audit submission also includes a report by the CPA regarding the company's internal financial controls and its compliance with applicable laws and HUD regulations. Lenders that fail to meet the annual renewal requirements are not recertified. The FHA lender approval and recertification processes provide great assurance that HUD partners with entities that are financially and professionally sound.

FHA is constantly monitoring loan level compliance, lender performance, and portfolio performance. While all loans are required to pass a number of verification checks prior to insurance endorsement, FHA staff routinely perform rigorous reviews on a sample of the insured portfolio. For example, FHA staff conducts Post Endorsement Technical Reviews (PETR) of loans with an emphasis on compliance with FHA requirements to ensure that loans do not pose a risk to the FHA insurance funds. For the period of FY 2004 through FY 2008, FHA staff conducted such reviews on 322,000 loans. These case level reviews resulted in 1,448 indemnification agreements.

FHA also has a nationwide Quality Assurance Division that comprehensively monitors lenders for performance and compliance, complementing other FHA risk management strategies. All FHA approved lenders are eligible for monitoring by HUD's Single Family Quality Assurance Division, which continually refines its targeting methodology to incorporate various changes in mortgage industry business practices as well as advances in its targeting tools. Since FY 2000, FHA has made significant changes to reduce risk in its insurance operations in the areas of lender approval and recertification, loan origination, and servicing. Similarly, the Quality Assurance Division has changed its targeting approach and how it executes lender monitoring. Prior to the start of each

fiscal year, an annual Lender Targeting Plan is prepared. The Plan is risk-based and is prepared using a combination of data from HUD's systems. A list of lenders for review is generated by analyzing and evaluating data regarding default and claim rate levels, lender insurance processing, product types, and origination and servicing volumes.

Quality Assurance Division offices located in the field conduct HUD Lender Monitoring Reviews that include on-site loan level review of lender files as well as a review of lenders' compliance with FHA program requirements. These reviews are conducted in order to discover findings of deficiencies related to the origination or servicing of loans. Functional areas (retail, wholesale, servicing, direct lending, quality control/compliance, etc.) are also carefully reviewed to determine how the lender monitors its activities and decreases risk throughout its FHA portfolio. This methodology requires the review of a reasonable number of loans in each of the lender's operational areas and interviews with senior management to understand the policies and procedures the lender uses to minimize risk, to both HUD and the lender. Common deficiencies include missing or fraudulent documentation utilized in originations; inappropriate or prohibited business practices on the part of a lender; or insufficient or inadequate loss mitigation. From FY 2004 through FY 2008, this group conducted 2,988 monitoring reviews, evaluating 64,468 loans. These case level reviews resulted in 4,446 indemnification agreements. It should be noted that HUD staff also identifies potential evidence of fraud and refers such findings to the HUD OIG and during the period FY 2004 through FY 2008, FHA referred 2,257 loans to the OIG.

Further, the HUD Headquarters Quality Assurance Division conducts the highly effective Credit Watch Termination Initiative, which identifies underwriting lenders and originators with excessive default rates relative to other lenders. FHA currently performs a quarterly analysis of the default and claim rate for each lender branch (approximately 25,000 branches), comparing it with average rates for all lenders located in each HUD field office jurisdiction. Those lenders with a relative compare ratio of greater than 200 percent are subject to proposed termination. Credit Watch protects the integrity of the FHA insurance funds and sanctions those lenders who demonstrate imprudent or possible abusive lending practices. The list of lender branches terminated as a result of the Credit Watch Termination Initiative is published quarterly in the *Federal Register* and is also available on the Internet at <http://www.hud.gov/offices/hsg/sfh/lender/lendterm.cfm>. The default rates of all FHA lenders are displayed on the Internet at <https://entp.hud.gov/sfnw/public> to serve as a source of information by which other lenders and interested parties can judge a lender's performance.

Evidence of program violations is referred to the Department's Enforcement Center and/or the Mortgagee Review Board (MRB) for possible administrative action. The mission of the MRB is to protect the FHA and its mortgage insurance funds from fraud and program abuse, and encourage compliance by FHA approved lenders. When there is adequate evidence of serious violations, the Board hears cases against FHA approved single family and multifamily mortgagees relating to loan origination and servicing activity. The Board can impose civil money penalties and administrative sanctions against Title I and Title II FHA approved lenders and mortgagees who knowingly and materially violate FHA program statutes, regulations and handbook requirements. A lender is afforded due process in that they are given a notice of violation and an opportunity to respond and rebut. Given that MRB action is subject to the Administrative Procedures Act (APA), HUD's Office of General Counsel thoroughly reviews MRB cases for legal sufficiency. Challenges to

MRB actions are subject to APA, which requires an on the record evidentiary hearing before an Administrative Law Judge.

The Board responds to referrals from HUD field and program offices, the Office of Inspector General, and Ginnie Mae. While the MRB is not a court of law and operates under certain statutory constraints, the Board uses a variety of tools to ensure that mortgagees originate and service FHA-insured mortgages in compliance with the Department's requirements. Mortgagees that violate statutes, regulations, and policies governing HUD/FHA programs are subject to administrative sanctions by the MRB. The sanctions include reprimand, probation, suspension, and withdrawal of approval. As mentioned above, the MRB may issue cease-and-desist orders and impose civil money penalties against mortgagees. Also, the MRB may enter into Settlement Agreements, which protect the Department while avoiding litigation against a mortgagee. The Mortgagee Review Board took action against 219 lenders between FY 2004 and FY 2008.

The extensive and continual efforts of FHA to monitor and ensure the compliance of its partners are unparalleled in the industry. As its business grows, FHA is evolving to meet the challenge, improving its programs through hiring, technological, regulatory and programmatic reforms, as well as constant improvements to monitoring and enforcement efforts. Insuring mortgages inherently involves a degree of risk. For decades, FHA has successfully taken measured steps to help more Americans enjoy the opportunities of homeownership, while consistently modernizing its programs to protect taxpayers and ensure the integrity of its insurance funds.

While I can assure you that FHA is fully committed to continuing aggressive oversight of its programs, I restate FHA's long-standing need for investments to further bolster the agency's monitoring and oversight capabilities. The issue became urgent once the subprime mortgage crisis began to grow larger and Congressional actions to expand FHA's role were legislated. HUD has been vocal in recent years about its needs for FHA, particularly in the area of information technology (IT) systems. This is a critical need—FHA data is stored on 35 separate legacy systems, **which have been obsolete for nearly two decades.**

Finally, I want to address a topic I feel is pertinent to today's discussion of FHA's continued strength and vitality in the current market, which is the possible provision of authority to bankruptcy judges to "cram-down" or otherwise modify mortgages. It has been the longstanding policy of this Administration to oppose any such legislation. Providing authority to bankruptcy judges to modify mortgages will add uncertainty for investors and the mortgage markets, which will lead to higher interest rates for borrowers. Specifically, however, HUD feels it important that the Congress consider the implications of any legislation granting such authority to bankruptcy courts on the operations of both FHA and Ginnie Mae.

FHA and Ginnie Mae do not have the legal authority to reimburse lenders for the "cram-down" amounts that are forgiven through the bankruptcy process but still must be paid to the investors under the terms of the securities. Therefore, any legislation in this area would likely create a powerful disincentive to doing business with FHA and Ginnie Mae. Loss of guarantee and premium fees and impairment of mission capability would occur at FHA and Ginnie Mae. If issuers are unable to make up the difference on "cram-down" terms, Ginnie Mae could be forced to take over portfolios and incur the costs of additional "cram-downs" as well as the costs of servicing those

portfolios. As the Congress contemplates this matter, I strongly urge careful consideration of the points I am raising today so that FHA and Ginnie Mae can continue to play a leading and stabilizing role both during the current market distress and in the future.

Again, I want to thank you for the opportunity to explain FHA's comprehensive lender oversight and monitoring efforts.