

June 28, 2019

Brian Montgomery
Acting Deputy Secretary and Assistant Secretary for Housing
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

RE: Comments on FHA's Proposed Changes to Loan-Level Certification and Defect Taxonomy

Dear Mr. Montgomery:

Thank you for providing the opportunity to offer feedback on the proposed revisions to the FHA loan-level certification and Defect Taxonomy. We continue to believe that getting the loan-level certification requirements right is of enormous consequence to consumers, lenders, and the well-being of the FHA program. It will enable more borrowers to have access to safe and affordable mortgage credit, assist FHA to operate a safe and sustainable mortgage insurance program with effective quality control, and provide lenders with the clarity they need about enforcement standards to expand access to FHA-insured mortgage credit. Providing greater clarity to lenders on how FHA will address potential loan defects will encourage more lenders, particularly larger depository institutions, to participate in the FHA program. We also hope that increased clarity will reduce the number of lender overlays on FHA loans, such as higher credit score requirements. Greater lender participation has the potential to expand homeownership opportunities for the borrowers FHA serves, which can help working families gain access to affordable mortgage credit.

Maintaining the integrity of and ensuring competition within the FHA market is extremely important. FHA makes up a considerable portion of the loans originated to communities of color. In 2017, 42.43% of home purchase loans to African Americans and 40.81% of home purchase loans to Latinx consumers were FHA-insured mortgages. Given the challenges that communities of color have faced in the aftermath of the foreclosure and financial crises, improving the viability of the FHA program is of national importance. The situation is most dire for African American consumers who are facing a crisis in homeownership. According to the U.S. Census, the homeownership rate for African Americans has dropped to record lows. At 41.1% the rate is now lower than it was when the Fair Housing Act was passed in 1968.

While FHA has thoroughly and helpfully streamlined the certification language and filled in the details of the Defect Taxonomy on the origination side, we believe that the revisions will not fix the issue and further changes are essential. As written, a lender who signs the loan-level certification may still be subject to strict liability for ordinary and inconsequential errors in the loan manufacturing process. Without substantial clarification of the type outlined below, FHA's well-intentioned effort will not render meaningful results.

Recommendations for the Loan-Level Certification

The certification as proposed provides a strict liability standard — either the FHA Handbook has been followed precisely and entirely, or the certification is allegedly false, and a False Claims Act case could be brought for minor errors. A lender with the most robust underwriting processes and quality control systems in place still cannot ensure perfection. Even if FHA's practice is not to interpret the Handbook to require absolute adherence to each discrete requirement, the proposed certification sets out an unintentional standard of perfection that has become the basis for the Department of Justice to bring False Claims Act cases against lenders. We strongly believe that fraud and bad conduct should always be addressed and pursued aggressively. The False Claims Act remains a critical tool. However, the loan-level certification should not be used to create False Claims Act liability for insignificant errors. Furthermore, FHA has a wealth of administrative remedies, penalties, and sanctions it can impose on a lender to address misconduct, including indemnification and debarment.

Option #1

Thus, to account for the issues inherent in certifying perfect compliance with the Handbook, we recommend the following changes:

- 1) Include language that the lender has reviewed and is aware of the requirements applicable to the information submitted, as well as to FHA's administrative remedies and penalties for any failures to comply.
- 2) Include language to make clear that the certification is based on the judgement of an underwriter making a good faith determination.

We recommend the certification state as follows:

I certify that:

The mortgage was rated as an "accept" or "approve" by FHA's TOTAL Mortgage Scorecard;

I reviewed and am aware of the requirements applicable to the information submitted to TOTAL in accordance with Single Family Housing Policy Handbook 4000.1 (SF Handbook) and the requirements under SF Handbook 4000.1 Section II.A.4.e Final Underwriting Decision (TOTAL), and FHA's administrative remedies and penalties for any failures to comply with these requirements; and

This mortgage is submitted for insurance based on the judgment of an underwriter making a good faith determination.

Option #2

Alternatively, if FHA requires explicit certification to the Handbook, the certification could include language stating that if there is a failure to comply with FHA requirements, such failures will be remedied in accordance with the Defect Taxonomy.

I certify that:

- This mortgage was rated as an “accept” or “approve” by FHA's TOTAL Mortgage Scorecard;
- The final information submitted to TOTAL on which the rating was obtained was documented in accordance with Single Family Housing Policy Handbook 4000.1 (SF Handbook) Section II.A.4 and accurately represents the final information obtained by the mortgagee, and this mortgage complies with SF Handbook 4000.1 Section II.A.4.e Final Underwriting Decision (TOTAL), except where any failure to document, accurately represent, or comply, individually or collectively, with these requirements does not result in the ineligibility of the mortgage for FHA insurance;
- This mortgage is submitted for insurance based on the judgment of an underwriter making a good faith determination; and
- In the event there is any failure in compliance with the above requirements, I will remedy such failure in accordance with the provisions and procedures applicable to the Defect Taxonomy in effect at the time of the insurance of this mortgage by HUD.

However, we understand the challenges with explicitly integrating the Defect Taxonomy — a guidance document that is not required by statute or regulation and can be changed without public notice — with the certification. Thus, we strongly urge HUD to consider option #1.

Recommendations for the Defect Taxonomy

We are pleased that FHA has provided greater detail in the Defect Taxonomy and connects defects of varying severity to remedies. However, we offer a few recommendations to bolster consistency and clarity.

First, as an overarching matter, we urge HUD to apply administrative remedies and penalties consistently. As stated on page 3 of the Defect Taxonomy, numerous offices within HUD may become involved in an administrative matter. HUD should ensure the principles stated in the Defect Taxonomy are integrated into different divisions at the agency.

Furthermore, the distinction between tiers 1 and 2 versus tiers 3 and 4 appears to be whether the loan is eligible for insurance. We suggest FHA make that distinction explicit. Tiers 3 and 4

defects which do not require a response in the Loan Review System should be explicitly tagged as defects which do not make the loan ineligible for FHA insurance.

Lastly, tiers 1 and 4 include: evidence of fraudulent or materially misrepresented information about which the lender knew or should have known *or* did not know and could not have known. For tier 4 defects, we suggest adding “**reasonably** did not know and could not have known” to clarify that the standard is based on what a lender could have reasonably known through a good faith underwriting and quality control process.

Conclusion

These complex issues have an enormous impact on borrower access to FHA mortgage credit. We urge FHA to consider our recommendations, particularly option #1 with respect to the loan-level certification, as we believe they will encourage depository institutions to return to FHA lending and will maximize compliance with FHA requirements. Thank you for your consideration.

Sincerely,

Center for Responsible Lending
Consumer Federation of America
The Leadership Conference on Civil and Human Rights
NAACP
National Association of Hispanic Real Estate Professionals
National Association of Real Estate Brokers
National Coalition for Asian Pacific American Community Development (National CAPACD)
National Community Reinvestment Coalition
National Fair Housing Alliance
National Urban League