This Final Rule will be published soon in the Federal Register. The date of publication in the Federal Register determines the effective date of this Final Rule, as well as other dates as identified in the Final Rule.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 202

[Docket No. FR 5356-F-02]
RIN 2502-AI81

Federal Housing Administration: Continuation of FHA Reform— Strengthening Risk Management through Responsible FHA-Approved Lenders

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Final rule.

SUMMARY: This final rule adopts changes pertaining to the approval of mortgage lenders by the Federal Housing Administration (FHA), as proposed in a November 30, 2009 rule, that are designed to strengthen FHA by improving its management of risk. As proposed in the November 30, 2009, rule, this final rule increases the net worth requirement for FHA-approved mortgagees. The increase, the first since 1993, is adopted to ensure that FHA-approved mortgagees are sufficiently capitalized for the financial transactions occurring, and concomitant risks present, in today's economy. As also proposed in the November 30, 2009, rule, this final rule provides for elimination of the FHA approval process for loan correspondents. Loan correspondents will no longer be approved participants in FHA programs. Loan correspondents, however, will continue to have the opportunity to participate in FHA programs as third-party originators (TPOs) through sponsorship by FHA-approved mortgagees, as is currently the case, or through application to be approved as an FHA-approved mortgagee. In eliminating FHA's approval of loan correspondents, FHA-approved mortgagees assume full responsibility to ensure that a sponsored loan correspondent adheres to FHA's loan origination and processing requirements. Finally, this final rule updates FHA's regulations to incorporate criteria specified in the Helping Families Save Their Homes Act of 2009 (HFSH Act) designed to ensure that

only entities of integrity are involved in the origination of FHA-insured loans.

This final rule takes into consideration the public comments received on the November 30, 2009, proposed rule and, as discussed in the Supplementary Information section of this rule, changes have been made at this final rule stage in response to public comment and further consideration by HUD of the proposals made in the November 30, 2009, rule.

DATES: Effective Date: [**Insert date 30 days from the date of publication in the Federal Register**].

FOR FURTHER INFORMATION CONTACT: Office of Lender Activities and Program Compliance, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410-8000; telephone number 202-708-1515 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION

I. Background – The Proposed Rule

In September 2009, FHA announced plans to implement a set of policy changes designed to enhance FHA's risk management functions. The announcement preceded completion of an independent actuarial study to be submitted to Congress and which was expected to show FHA's capital reserve ratio dropping below the congressionally mandated threshold of 2 percent.[1] The changes announced in September 2009 were prompted by recognition of the need to put in place measures that would immediately commence strengthening FHA's reserves and, for the long term,

[1] HUD released its independent actuarial study on November 13, 2009. The study reported that FHA sustained significant losses from loans insured prior to 2009, and that FHA's capital reserve ratio had fallen below the congressionally mandated level of 2 percent. The capital reserve ratio generally reflects the reserves available (after paying expected claims and expenses) as a percentage of the current portfolio, to address unexpected losses. The report can be found at: http://www.hud.gov/offices/hsg/fhafy09annualmanagementreport.pdf.

better manage risk. The changes that FHA announced in September 2009 included the policy changes submitted for public comment in HUD's proposed rule published in the Federal Register on November 30, 2009 (74 FR 62521).

HUD proposed the following policy changes in its November 30, 2009, proposed rule:

1. Increasing the Net Worth Requirements for FHA-Approved Mortgagees. HUD proposed to increase the net worth requirements for current FHA-approved mortgagees, including investing mortgagees, and applicants seeking FHA approval as mortgagees from $250,000 to $2.5 million over a period of 3 years. The proposed rule provided that within one year of the effective date of the final rule, which would follow the November 30, 2009, proposed rule, supervised and nonsupervised mortgagees and investing mortgagees would be required to have a minimum net worth of $1 million, of which at least 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.[2] Mortgagees would be required to comply with the minimum net worth requirement of $2.5 million within 3 years of the effective date of the final rule, with at least 20 percent of such net worth consisting of liquid assets.

In proposing to increase the net worth requirements of approved mortgagees, the November 30, 2009, proposed rule noted that the net worth requirements of FHA-approved mortgagees had not been increased since 1993. HUD advised that the increases were not only necessary adjustments for inflation, but would help ensure that FHA-approved mortgage lenders, including investing mortgagees, are sufficiently capitalized to meet the potential needs associated with the financial services they provide.

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[2] Supervised mortgagees are financial institutions that are members of the Federal Reserve System, and financial institutions whose accounts are insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA). Examples of supervised mortgagees are banks, savings associations, and credit unions. Nonsupervised mortgagees are non-depository financial entities that have as their principal activity the lending or investment of funds in real estate mortgages. Investing mortgagees are organizations, including charitable or not-for-profit institutions or pension funds, which are not approved as another type of institution and that invest funds under their own control. (See definitions of these terms at 24 CFR 202.6(a), 202.7(a), and 202.9(a), respectively.)

2. Limiting Approval to Mortgagees. In the November 30, 2009, rule, HUD proposed to limit FHA's approval only to mortgagees that underwrite loans and can perform any origination and/or servicing function and can also own FHA-insured loans. Loan correspondents, in contrast to mortgagees, perform any origination function except underwriting, and cannot service or own FHA-insured mortgage loans. HUD did not propose to alter the approval process of investing mortgagees and governmental institutions, as addressed in 24 CFR 202.9 and 202.10.

In proposing to limit FHA's approval to the mortgagee charged with underwriting, servicing, or owning a loan, HUD advised that it is the mortgage lender with the greatest control over the mortgage loan that should be subject to FHA's rigorous lender approval and oversight processes, and bear the greatest degree of responsibility and liability for the mortgage loan obtained by the mortgage borrower and insured by FHA. In the November 30, 2009, proposed rule, HUD advised that loan correspondents would continue to have the opportunity to participate in the origination of FHA mortgage loans as third-party originators (TPOs) through association with an FHA-approved mortgagee, as is currently the arrangement, but TPOs would no longer be subject to the FHA lender approval process. HUD also advised that since HUD would no longer be approving loan correspondents, and in acknowledgement and anticipation that loan correspondents would continue to be involved in the origination of FHA-insured mortgage loans through sponsorship, FHA-approved mortgagees would assume full responsibility to ensure that their sponsored TPOs adhere to FHA origination and processing requirements.

Responsibility for actions of TPOs is not a new responsibility for FHA-approved mortgagees. HUD's current regulations in 24 CFR 202.8(b)(7) provide that: "Each sponsor shall be responsible to the Secretary for the actions of its loan correspondent lenders or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to

be held responsible." The present regulations in 24 CFR 202.8(b)(6) provide that: "Each sponsor must obtain approval of its loan correspondent lenders or mortgagees from the Secretary." It is the obligation to obtain approval of loan correspondents/TPOs from FHA that, under this final rule, mortgagees will no longer have to meet. However, in being relieved of the responsibility to obtain prior approval from FHA of the TPOs that it would like to sponsor, the mortgagee assumes responsibility that sponsored TPOs meet FHA's requirements regarding loan origination and processing as found in relevant statutes, regulations, HUD handbooks, and mortgagee letters. Failure of the TPO to comply with these requirements may result in FHA seeking sanctions against the sponsoring FHA-approved mortgagee.

The proposed rule provided that, upon promulgation of the final rule, entities that are already approved by FHA as loan correspondents would not be permitted to renew their loan correspondent status or automatically convert their approval to mortgagee, and only FHA-approved mortgagees would be allowed to request FHA case numbers. However, a loan correspondent would be eligible to apply to FHA to obtain approval as a mortgagee.

3. Ineligibility to Participate in Origination of FHA-Insured Loans. The November 30, 2009, rule proposed to codify criteria specified in section 203 of the HFSH Act that precludes any lending entity not approved or authorized by the Secretary from participating in FHA programs, and also prohibits participation by an entity if the entity is currently: suspended, debarred, or under limited denial of participation; under indictment for, or has been convicted of, an offense that reflects adversely upon the applicant's integrity, competence, or fitness to meet the responsibilities of an approved mortgagee; subject to unresolved findings of a HUD investigation, or engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility; convicted of, or has pled guilty or nolo contendere to, a felony related to

participation in the real estate or mortgage loan industry; in violation of the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act (Title V of Division A of Public Law 110-289, approved July 30, 2008) (SAFE Act); or in violation of any other requirement established by the Secretary.

Implementation of the criteria in section 203 of the HFSH Act did not require rulemaking, and the November 30, 2009, proposed rule noted that the statutory restrictions were in effect upon enactment of the HFSH Act.[3]

4. Use of HUD Registered Business Name and Business Changes. The November 30, 2009, rule also proposed to codify the statutory requirement presented in section 203 of the HFSH Act that directs FHA-approved mortgagees to use their HUD-registered business names in all advertisements and promotional materials related to FHA programs. HUD-registered business names include any alias or "doing business as" (DBA) on file with FHA. In addition to codifying this statutory requirement, the November 30, 2009, rule also proposed to codify the requirements specified in FHA's Strengthening Counterparty Risk Management Mortgagee Letter, issued September 18, 2009, and found at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/index.cfm. This Mortgagee Letter directed FHA-approved mortgagees to maintain copies of all advertisements and promotional materials for a period of 2 years from the date that the materials are circulated or used for advertisement purposes.

The November 30, 2009, rule also proposed to codify the requirement in section 203 of the HFSH Act that requires mortgagees to notify FHA if individual employees of the lender are subject to any sanction or other administrative action. In incorporating this requirement, the November 30,

[3] These criteria were announced by the Mortgagee Letter entitled "Strengthening Counterparty Risk Management," issued September 18, 2009, and can be found as document number 09-31 at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/index.cfm.

2009, rule noted that HUD was also proposing to codify its existing requirements pertaining to notification to FHA of business changes, such as changes in legal structure, which are currently found in HUD Handbook 4060.1, REV-2, Chapters 2 and 6.

The amendments proposed by the November 30, 2009, proposed rule are discussed in more detail in the November 30, 2009, Federal Register at 74 FR 62522 through 62528.

II. This Final Rule – Policies Adopted

In consideration of issues raised by the commenters and HUD's own further consideration of issues related to this final rule, HUD is making the following changes at the final rule stage:

Net Worth Requirements for Applicants for Approval to Participate in FHA Single Family or Multifamily Programs and for FHA-Approved Mortgagees: 2010 to 2011

The following net worth requirements are effective on **[insert effective date of final rule]**, for new applicants for FHA approval to participate in FHA single-family or multifamily programs, and effective on [**insert date one year from effective date of final rule**], for all approved supervised and nonsupervised lenders and mortgagees, and all approved investing lenders and mortgagees with FHA approval as of [**insert effective date of final rule**]:

- Applicants for FHA Approval and Existing Non-Small Business Approved Lenders and Mortgagees. An applicant for FHA approval or an approved lender or mortgagee that exceeds the size standards for its industry classification as established by the Small Business Administration (SBA) at 13 CFR 121.201, Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities) shall have a net worth of not less than $1,000,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.
- Existing Small Business Approved Lenders and Mortgagees. An approved lender or mortgagee

that meets the SBA size standards for its industry classification shall have a net worth of not less than $500,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary. The net worth requirements for small business lenders and mortgagees remain applicable as long as the mortgagee continues to meet the SBA size standard for a small business. If, based on the audited financial statement prepared at the end of its fiscal year and provided to HUD at the commencement of the new fiscal year, a small business lender or mortgagee no longer meets the SBA size standard of a small business, the mortgagee shall meet the net worth requirements for a non-small business mortgagee by the last day of the fiscal year in which the audited financial statements were submitted.

Net Worth Requirements for Applicants for Approval to Participate in FHA Single Family or Multifamily Programs and FHA-Approved Mortgagees: 2013 and After

The following net worth requirements are effective on [**insert date three years from effective date of final rule**], for new applicants for FHA approval to participate in FHA single-family or multifamily programs, for all approved supervised and nonsupervised lenders and mortgagees, and for all FHA-approved investing lenders and mortgagees:

- Single Family Mortgagees. Irrespective of size, all FHA-approved mortgagees and applicants for approval to participate in FHA single family programs shall have a net worth of $1 million, plus an additional net worth of one percent of the total volume in excess of $25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million. No less than 20 percent of the mortgagee's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.
- Multifamily Mortgagees. Irrespective of size, all existing FHA-approved mortgagees and

applicants for approval to participate in FHA multifamily programs shall have a minimum net worth of $1 million. For those multifamily mortgagees that also engage in multifamily mortgage servicing, an additional net worth of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. For multifamily mortgagees that do not perform multifamily mortgage servicing, an additional net worth of one half of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. No less than 20 percent of the mortgagee's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

- Single Family and Multifamily Mortgagees. Irrespective of size, all existing FHA-approved mortgagees and applicants for approval to participate in both FHA single family and multifamily programs must meet the net worth requirements for a single family mortgagee. Therefore, if a mortgagee is a participant in both the multifamily *and* single family programs, it is required to meet the greater net worth requirements for single family mortgagees.

Elimination of FHA Approval of Loan Correspondents

The final rule limits the FHA approval process to mortgagees, but provides that all loan correspondents approved as of the date of the effective date of this final rule will maintain their approval through December 31, 2010. Commencing 30 days following publication of this rule, FHA will no longer approve new applicants for approval as loan correspondents.

Processing and Closing a Loan

The final rule clarifies that, as a result of HUD's elimination of the FHA approval process for loan correspondents, the requirements regarding Principal-Authorized Agent relationships will also

change. Mortgage loans originated through Principal-Authorized Agent relationships will be permitted to close in either party's name. However, to participate in such relationships, both the Principal and Authorized Agent must be approved as Direct Endorsement lenders under 24 CFR 203.3. Further, for mortgage loans originated under the relationship, the Principal must originate and the Authorized Agent must underwrite, and their actions must be recorded as such in FHA Connection (FHA's Computer Home Underwriting Mortgage System).

Nonsubstantive Technical Changes

In addition, HUD has taken the opportunity afforded by this final rule to make several nonsubstantive changes to the proposed rule for purposes of clarity. For example, HUD has removed paragraph (c) of the definition of "Lender or title I lender" at § 202.2 to remove a reference to loan correspondents.

III. Two Issues under Consideration

As discussed in more detail later in this preamble, HUD is reviewing two issues for further consideration, and taking public comment on one of the issues.

First, HUD will further consider the prohibition on a TPO closing a loan in its own name. This final rule provides, as did the proposed rule, that a TPO may not close a loan in its name, and HUD is not considering withdrawing this prohibition in this final rule. However, HUD will further examine this issue. Until and unless HUD announces a change to this prohibition, the prohibition for currently FHA-approved loan correspondents (that subsequently will come become TPOs) closing any FHA-insured mortgages in their own names will be applicable commencing January 1, 2011. Currently FHA-approved loan correspondents may continue to close FHA-insured mortgages in their own name through December 31, 2010.

Second, HUD is considering requiring FHA-approved mortgagees that originate multifamily

mortgages of $25 million or more to retain as additional net worth 50 basis points (0.5%) of the fee income resulting from such loans, in addition to their required net worth as set forth in this rule, up to a maximum of $5 million. This provision is intended to ensure sufficient mortgagee capitalization to compensate for the increased risk posed by such high cost projects. HUD is specifically taking public comment on this issue for a period of 30 days, and asks commenters to follow the public comment instructions in Section V of this preamble. This is the only issue for which HUD solicits comment.

IV. Discussion of Public Comments

By the close of the public comment period on the November 30, 2009, proposed rule, on December 30, 2009, HUD had received 207 public comments. Comments were received from a variety of industry participants, including large direct endorsement FHA lenders, FHA loan correspondents, trade associations representing participants in the mortgage industry, and other interested parties such as law firms, certified public accountants, and individuals. In addition, the Office of Advocacy, of SBA, commented on the discussion of its impact on small businesses. All public comments can be found in the preamble to the rule, at www.regulations.gov.

A. The Comments, Generally

The majority of the comments supported the goals of the November 30, 2009, rule, but differed with or opposed HUD's proposed methods of implementation of the rule. For instance, many commenters supported the elimination of loan correspondent approval but expressed concerns about the proposed means of implementing this provision and its possible impact on loan origination activities, including concerns that borrowers would be affected by the absence of FHA approval and oversight of loan correspondents. Similarly, commenters generally supported FHA's intention to increase net worth requirements for mortgagees, but were not in agreement with the level to which HUD proposed to increase these requirements, or the timing of the increase. Other commenters sought

postponement of any changes to lender/loan correspondent requirements until the housing market recovered. They stated this was not the time for HUD to make such "sweeping" changes to its relationships with the industry. Other commenters requested changes to policies that were not proposed in the November 30, 2009, proposed rule, such as changes to downpayment requirements, yield spread premiums, and the Home Valuation Code of Conduct. These changes were not addressed in the November 30, 2009, proposed rule and are therefore outside the scope of this rulemaking.

B. Specific Issues Raised by Commenters

The following presents the key issues raised by the public comments and HUD's response to these issues.

Timing of FHA's Policy Changes

Comment: Commenters stated that this rule, combined with the new Real Estate Settlement Procedures Act (RESPA) disclosures, will result in the demise of the mortgage lending industry, other than big banks, and, by favoring large financial institutions, will limit the recovery of the housing market through the growth engine of small business. Commenters stated that changes to the current FHA system will further burden the weak housing market by adding more people to the ranks of the unemployed and risking foreclosure of their homes. Commenters stated that the current market is becoming stable and such sweeping action is unnecessary.

HUD Response: HUD recognizes that the housing market remains in stress and that the FHA programs are a key element in sustaining economic recovery. However, the downturn in the housing market has not been without consequences to FHA. Consistent with its proactive role in previous economic crises, FHA once again positioned itself in this current crisis to quickly respond to the needs of homeowners in distress and qualified homebuyers without access to credit. As a result, the volume of FHA insurance increased as private sources of mortgage finance retreated from the market. The pace

of growth in FHA's portfolio over such a short period of time, combined with continued housing price declines, defaults by homeowners, and home foreclosures has had an adverse impact on FHA, as evidenced by the reduction in FHA's capital reserve ratio reported in the independent actuarial study recently submitted to Congress.[4] FHA cannot continue to be a stabilizing force in the mortgage market if FHA's own condition is not stable and strong. Although the timing of implementation of these measures may not be ideal, they cannot and should not be delayed. Replenishing FHA's capital reserves as quickly as possible is essential to ensuring that FHA remains available to respond to needs in the housing market. Additionally, as discussed below in HUD's response to specific comments raised about net worth requirements and the elimination of loan correspondents, the changes adopted by this final rule are not as sweeping as some commenters declare.

FHA's Role in the Housing Market

Comment: Commenters stated that the changes proposed to be implemented represent a major redefinition of the way FHA monitors and sources its business. Commenters stated that the policy changes would reduce the competency and selectivity of FHA originators precisely at such a time when it is necessary to improve the quality of loan originators. Commenters stated that FHA's proposals are at odds with other of the Administration's proposals pertaining to the financial/housing markets, which would increase, not decrease, regulatory oversight. Commenters stated that a reduction of regulatory oversight will make FHA-insured loans vulnerable to involvement by entities that do not have the experience and competency that is traditionally found in FHA-insured mortgage loan participants, experience and competency required by FHA regulations, which will create more problems for FHA and borrowers of FHA-insured loans. Commenters stated that by favoring the larger mortgage lenders, FHA's changes in policies will result in less competition, less choice, and harm to consumers.

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[4] See footnote 1.

HUD Response: Through the policy changes adopted in this final rule, FHA is not abandoning its traditional role in the housing market. The changes adopted are designed to ensure that FHA remains financially stable and strong, and that, as a result of the availability of FHA insurance, mortgage lenders are able to offer more affordable mortgage loan terms as they always have through FHA mortgage insurance programs.

FHA is not retreating from regulatory oversight. As further discussed below, the focus of FHA-approval on mortgage lenders that underwrite and own mortgage loans reflects recognition that these are the entities that control the decision to extend a mortgage loan to a borrower, including the assessment of the mortgage borrower's ability to repay the mortgage loan, and therefore, should be the entities subject to FHA's regulatory oversight and requirements for sufficient capitalization. It is HUD's position that the policy changes implemented by this rule promote better regulatory oversight by focusing FHA's resources on oversight of the entities with the greatest degree of control over an FHA-insured mortgage loan. Furthermore, the SAFE Act and other recent initiatives have provided a uniform and reliable method of tracking loan originator licensing and compliance. As noted earlier in this preamble and further discussed below, FHA-approved mortgagees now have, and have always had, responsibility and liability for the performance of sponsored loan correspondents. The final rule merely shifts to a sponsoring mortgagee the threshold assessment of a loan correspondent's qualifications to participate in FHA-insured loan transactions as a component part of the eligibility of the mortgage loan for FHA insurance.

Increase in Net Worth Requirements

Comment: The majority of those commenting on the proposed net worth increase expressed the view that $1 million was an acceptable level of required net worth for lenders, although some commenters requested a delay in the effective date of the increase beyond the one-year period

proposed by HUD and until such time as it could be said that the economy had sufficiently recovered. Among those commenters supporting the increase to $1 million, the majority of them, however, stated that the total increase in required net worth, to a level of $2.5 million, was excessive. Commenters stated that a net worth of $2.5 million would favor only the largest financial institutions, and eliminate the possibility of smaller mortgage lenders being able to obtain approval as FHA-approved mortgagees. Commenters stated that the increase in net worth would only be passed on to the borrowers by mortgage lenders charging higher fees.

Some commenters suggested that net worth requirements be increased by different amounts, ranging from $500,000 to tiered requirements based on origination or lending volume, or by a Consumer Price Index (CPI) indicator. Other commenters suggested that the proposed time frame of 3 years in which to comply with this new requirement was unrealistic. Other commenters stated that there should be no need to align FHA with Fannie Mae and Freddie Mac, particularly given the serious financial problems of those government-sponsored enterprises. A few commenters noted that the net worth requirements imposed by Ginnie Mae have not been raised for some time, and that Ginnie Mae was allegedly in better financial condition than either Fannie Mae or Freddie Mac.

Some commenters submitted that an increase in the net worth was not the appropriate solution to enhance mortgage lender responsibility and performance. Commenters stated that no correlation had been shown between higher net worth and mortgage lender performance. Other commenters advised that net worth for FHA-approved mortgagees is actually higher than the $250,000 cited by HUD, because HUD also requires lenders to maintain net worth of one percent of funded loans. Other commenters suggested alternatives to increasing net worth such as establishing borrower FICO® requirements (a credit scoring system developed by the Fair Isaac Corporation), instituting required mortgagee internal controls, assessing a lender’s track record before raising net worth, increasing FHA

educational requirements, stepping up enforcement, and increased prosecution of fraud cases. Commenters also expressed the view that mortgagees engaged solely in multifamily and Home Equity Conversion Mortgage ("HECM" or reverse mortgage) lending should not be held to the same requirements as single family mortgagees due to the differences in business models and products. One commenter recommended grandfathering existing mortgagee's/servicer's multifamily portfolios and making the net worth increase prospective for new insurance commitments applied for after the effective date of the rule.

A few commenters stated that credit unions face unique problems in meeting increased capital requirements, because credit unions do not have access to capital markets and can increase their net worth only by cutting expenses or increasing their net income.

HUD Response: In proposing an increase in net worth requirements of FHA-approved mortgagees, HUD strives to balance two components of FHA's mission: (1) to operate with a high degree of public and fiscal accountability, and (2) to stabilize housing credit markets in times of economic disruption. HUD recognizes that raising net worth requirements in the midst of current economic conditions may present some challenges for businesses in this sector. While the Nation's economy, and the mortgage and real estate industries in particular, currently face difficulties, it is just these difficulties, and the potential risks that accompany them, that necessitate FHA taking prudent action to protect its insurance funds. An increase in net worth is essential to ensure the stability of FHA mortgagees, especially given how low the current net worth requirements are; net worth requirements that were established in 1993 and not raised since that date.

Additionally, the increase in net worth requirements does not ignore the fact that small mortgage lenders with lower capital reserves can and do originate quality loans. The fact remains, however, that the net worth level required by FHA prior to this final rule was established almost 20

years ago, and that passage of time is significant. Ensuring appropriate capitalization of firms engaged in lending activities is a fundamental principle of sound business regulation. Although many of FHA's program participants engage in responsible and diligent lending practices, effective underwriting and quality control procedures alone do not guarantee the continued financial viability of a lending entity. Therefore, requiring appropriate capitalization of FHA program participants is an essential baseline by which FHA can measure the soundness of its program participants.

With respect to commenters' statements about Ginnie Mae not having raised net worth requirements, Ginnie Mae raised its net worth requirements for new applicant single family issuers in 2008. Additionally, the higher net worth requirements imposed by Fannie Mae and Freddie Mac were not the business practices that were reported to contribute to their financial difficulties.

While HUD's position remains that an increase in net worth requirements is essential, it has revised the proposed rule to mitigate the potential economic burden on current participants in the FHA single family and multifamily mortgage insurance programs and avoid disrupting their continued ability to provide FHA mortgage insurance. Although new applicants for FHA approval that do not currently participate in the single family or multifamily programs would be required to comply with the new net worth requirements commencing on the effective date of this final rule, currently approved program participants would have one year from the effective date of the rule to comply with the net worth increase.

As already noted in Section II of this preamble, in response to commenters' concerns and as a result of further consideration of the net worth proposal by HUD, this final rule provides FHA-approved mortgagees that meet SBA's standards for classification as a small business an even more gradual transition period to meet the new net worth requirements. While HUD believes that a net worth of $1 million is prudent and appropriate for mortgagees, the Department very much values its

existing relationships with FHA-approved small business mortgagees and realizes that the one year time frame for compliance with the increase in required net worth may have proven prohibitive for some of these firms. In recognition of this reality, FHA has determined that a more gradual increase in the required net worth for small business mortgagees is appropriate. Unlike new applicants for FHA approval, these mortgagees already possess unique knowledge and competency with regard to FHA products and have demonstrated their responsibility and reliability in the exercise of FHA activities. Therefore, due to the mutually beneficial relationships that exist between FHA and these small business mortgagees, HUD believes it is appropriate to take measures to permit their continued participation in FHA programs, while simultaneously taking steps to appropriately manage FHA's counterparty risks.

Additionally, as described in Section II of this preamble, this final rule recognizes the key distinctions between the single family and multifamily business models, and this final rule provides net worth requirements that HUD determined are appropriate for single family and multifamily mortgagees. As noted in Section III of this preamble, HUD is considering requiring FHA-approved mortgagees that process multifamily mortgages of $25 million or more to retain a portion of their fee income from such transactions as additional net worth, and to increase the maximum required net worth for these mortgage lenders. These mortgages present higher risk to the multifamily mortgagees, and consequently to FHA, and the higher net worth better protects both the mortgagees and FHA against such increased potential liability. HUD will take comments on this single issue for the next 30 days, as provided in Section V of this preamble.

With respect to credit unions, HUD believes that the changes made at this final rule stage alleviate the concerns expressed by credit union commenters. Following the initial increase in required net worth within one year following the effective date of this final rule, mortgagees will be granted an

additional 2 years (after the first-year increase) in which to accumulate the required incremental net worth based on volume in excess of $25 million of FHA single family insured mortgages originated, underwritten, purchased, and/or serviced during the prior fiscal year.

Elimination of FHA Approval of Loan Correspondents

Comment: Some commenters opposed FHA elimination of loan correspondent approval. Commenters suggested that FHA continue to approve, set requirements for, and monitor loan correspondents. Commenters suggested that in addition to continuing loan correspondent approval, FHA should increase its approval requirements for loan correspondents as an alternate means of strengthening its risk management. Commenters raised concerns about administrative difficulties that would arise through elimination of loan correspondent approval and that such difficulties would hinder effective program operations. Commenters stated that mortgagees will incur significant costs in employing and training new staff to process and close additional loans from correspondents, because mortgagees would not be able to handle correspondent functions on their own.

Other commenters stated that elimination of loan correspondent approval would cause undue stress for mortgage lenders as they struggle to maintain compliance by their sponsored TPOs. Further, commenters expressed concern that mortgage lenders will inconsistently enforce standards, and this will ultimately be more costly than compliance with existing FHA requirements. In addition, a commenter noted that eliminating loan correspondent approval and certification increases risk to the insurance fund by opening the door to many new correspondents and the inherent conflict of interest sponsors will have between monitoring compliance and closing loans.

HUD Response: HUD appreciates and carefully considered the issues raised by commenters, but HUD maintains its position that the elimination of FHA approval of loan correspondents is prudent for FHA and efficient for both FHA and mortgage lenders. Limiting approval to mortgagees reflects

the recognition that the mortgagee, by underwriting, servicing, or owning a loan, is the most critical lending party to a mortgage transaction. It is the mortgagee that determines whether a borrower qualifies for the mortgage for which the borrower applied, and, therefore, determines the risk of lending money to the borrower. This is the most critical determination of the mortgage process. Accordingly, it is appropriate that FHA's approval process and oversight be focused on mortgagees, the parties to the loan transaction that pose the greatest risk to HUD.

As noted earlier in this preamble, FHA-approved mortgagees currently have, and have always had, significant responsibility and liability for actions of sponsored loan correspondents. HUD's regulations have long provided that each sponsoring mortgagee shall be responsible for the actions of its loan correspondent lenders or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to be held responsible (see 24 CFR 202.8(b)(7)).

HUD further defined the quality control requirements of a sponsoring mortgagee in its Mortgagee Approval Handbook (HB 4060.1 REV2 Ch. 7), by requiring sponsoring mortgagees to provide for a review of mortgage loans originated and sold to it by each of its loan correspondents. As part of this review, sponsors determine the appropriate percentage of mortgage loans to review based on volume, past experience, and other factors. Sponsors are required to document their methodologies and the results of these reviews. In addition, all mortgagees/sponsors must identify patterns of early defaults by location, program, loan characteristic, loan correspondent, etc. Mortgagees/sponsors may use HUD's Neighborhood Watch Early Warning System to identify patterns. Mortgagees/sponsors must identify commonalities among participants in the mortgage origination process to learn the extent of their involvement in problem cases. Mortgages and loans involving appraisers, loan officers, processors, underwriters, etc., who have been associated with problems must be included in the review

sample. Accordingly, HUD’s existing regulations reflect the responsibilities to be fulfilled by FHA-approved mortgagees, which are responsibilities that should be assumed by any lender, given the discretion and control that lenders have over the loans they underwrite.

The additional responsibility that HUD will require of sponsoring FHA-approved mortgagees through this final rule is minimal. Since mortgagees are already responsible for ensuring that FHA requirements are met for mortgage loans originated by loan correspondents, HUD believes it is appropriate for mortgagees to continue doing so for TPOs. A mortgagee will be subject to sanctions (e.g., civil money penalties) should it fail in its responsibility to ensure that mortgage loans presented to FHA for endorsement, or those that the mortgagee endorses for insurance under the FHA Lender Insurance process, comply with processing and origination requirements. HUD’s position is that, given the existing sponsor relationships between mortgagees and loan correspondents, mortgagees will continue to be able to undertake a threshold determination of a TPO’s qualifications. Moreover, making sponsors responsible for this oversight actually relieves loan correspondents from the administrative burden of FHA’s lender approval and recertification processes.

Commenters raised concerns that elimination of approval of loan correspondents will result in mortgagees incurring significant costs in employing and training new staff to process and close mortgage loans. It is HUD’s view, after careful consideration, that approved mortgagees will continue to rely upon loan correspondents with whom they have worked for years and who have demonstrated to sponsoring mortgagees their competency, compliance with applicable requirements, and integrity in their participation in the origination of FHA-insured mortgage loans. HUD believes that it would be contrary to current and financially sound business practices for approved mortgagees to sever ties with experienced loan correspondents with whom they have had a positive relationship for years, and have to hire and train new staff to perform correspondent functions.

With respect to concerns that were raised about the integrity of TPOs without FHA approval, and the possibility of borrowers being exposed to unscrupulous loan originators, HUD believes that recent changes to mortgage lending licensing and regulatory requirements provide additional safeguards that did not exist when FHA established its lender-approval requirements. Specifically, the SAFE Act and the Nationwide Mortgage Licensing System have created standards that govern mortgage lending activities for loan officers and loan origination entities, and systems for tracking compliance with applicable mortgage lending laws. Further, recent changes in regulations for RESPA and the Good Faith Estimate have strengthened requirements to combat fraud and have improved disclosure of information to borrowers. These new or improved mechanisms to protect the public from inappropriate lender practices are in addition to state and local regulations and requirements governing mortgage lending practices. It should also be noted that the HFSH Act expanded HUD's authority to impose civil money penalties upon entities and individuals to include non-FHA-approved entities and their employees or representatives. HUD will judiciously use this new authority in conjunction with the changes enacted under this final rule.

While this final rule proceeds to adopt the proposal to eliminate approval of loan correspondents, as provided in Section II of this preamble, HUD emphasizes that currently approved loan correspondents as of the effective date of this final rule may continue to act as FHA-approved loan correspondents through December 31, 2010, and loan correspondents are eligible to apply for approval as an FHA-approved mortgagee.

FHA Approval of HECM Loan Correspondents Is Required by Law

Comment: Commenters stated that HUD's November 30, 2009, proposed rule overlooked changes in statutory language made to section 255 of the National Housing Act (NHA), by the Housing and Economic Recovery Act of 2008 (HERA) (Public Law 110-289, approved July 30, 2008),

which provide that only FHA-approved entities may participate in the home equity conversion mortgage (HECM) program. The commenters state that section 2122 of the HERA provides that "All parties that participate in the origination of a mortgage to be insured under this section shall be approved by the Secretary." The commenters state that section 203 of the HFSH Act provides: "Any person or entity that is not approved by the Secretary to serve as a mortgagee, as such term is defined in subsection (c)(7) of the NHA shall not participate in the origination of an FHA-insured loan except as authorized by the Secretary." The commenters state that the language amending section 255 of the National Housing Act does not contain the phrase "except as authorized by the Secretary" that is included in section 203 of the HFSH Act. The commenters state that to comply with the HERA language, HUD must continue to approve and monitor loan correspondents engaged in HECM originations.

HUD Response: The commenters identify a perceived contradiction between section 203(b) of the HFSH Act and section 2122(a)(9) of HERA, both pertaining to approval by the Secretary of HUD of parties engaged in the origination of FHA-insured mortgages. HUD appreciates the question posed by the commenters but, for the following reasons, disagrees with their analysis of the two statutory provisions in question.

As noted by the commenters, the HERA amendments to section 255 of the National Housing Act require that mortgage lenders participating in the origination of HECM mortgages must be "approved by the Secretary." Subsequent to enactment of HERA in July 2008, the HFSH Act was enacted on May 20, 2009. While the HERA changes to section 255 were limited to the origination of HECM mortgages, the HSFH amendments to section 202 of the National Housing Act more broadly encompass the origination of all single family mortgages insured by FHA, including those insured under the HECM program. Section 203(b) of HFSH also requires HUD approval of mortgage lenders

participating in the origination of FHA-insured mortgages, “except as authorized by the Secretary.” This statutory exception to the approval requirement signifies that Congress intended to provide FHA with the authority to permit some limited participation by TPOs, which otherwise will not be FHA-approved mortgagees in the FHA mortgage insurance programs (including the HECM program), as provided for under this final rule.

Rather than putting forth contradictory instructions from Congress, as the commenters assert, HUD views the statutory mortgagee approval requirements of sections 203 and 255 of the National Housing Act as being reconcilable. The statutory change to section 255 recognizes that the beneficiaries of the HECM program -- elderly homeowners -- are vulnerable to unscrupulous players in the lending market that target the elderly with overpriced or unneeded financial products. By specifying that mortgage lenders must be “approved by the Secretary,” Congress did not restrict the Secretary’s ability to “authorize” TPO participation in the origination of HECM mortgages under section 202 of the NHA. Instead, HUD has determined that Congress emphasized the need of FHA to take steps to protect elderly borrowers, who may lack the sophistication of the mortgage marketplace. FHA has addressed this need by allowing only mortgage lenders with professional and financial competency and integrity to participate in the origination of HECM mortgages. The provisions of this final rule regarding the relationship of sponsoring mortgagees and TPOs are consistent with the congressional intent of safeguarding HECM borrowers underlying the HERA statutory language. As discussed previously in this preamble, FHA-approved mortgagees have had, prior to this rulemaking, significant responsibility for actions of sponsored TPOs. As a result of this ongoing relationship between the sponsoring mortgagee and TPO, the sponsoring mortgagee is in a better position than FHA to immediately detect deficiencies with TPO performance and to remedy those deficiencies. Accordingly, HUD will look to FHA-approved sponsoring mortgagees to ensure that HECM mortgage

loans are properly originated, and each sponsor shall be responsible to FHA for the actions of its loan correspondent lenders or mortgagees in originating HECM loans or mortgages.

Additional Guidance Requested Concerning Mortgagee Oversight of TPOs

Comment: Commenters requested additional guidance regarding requirements of FHA-approved mortgagees for the approval, monitoring, and liability for actions of the TPOs they sponsor. Some commenters requested that FHA establish minimum approval guidelines for TPO approval by a sponsoring mortgagee. Others asked for clarification about the extent of monitoring required by mortgagees for the TPOs they sponsor, and of the specific TPO actions or violations for which mortgagees will be liable. Other commenters noted that lenders would be unable to perform the regulatory function that HUD performs in monitoring TPOs. Commenters stated that FHA should continue to monitor "mini-eagles" and others directly. Other commenters expressed concern about the elimination of audits of loan correspondents, which serve an important function.

HUD Response: HUD will not establish FHA requirements related to sponsor approval of TPOs. To do so defeats the aforementioned efficiency and improved risk management that HUD is striving to achieve. By focusing approval solely on lenders that underwrite loans, HUD's approval process should yield improved results in ensuring that only responsible lenders of integrity and competence are FHA-approved lenders. Such lenders will ensure that their employees and the TPOs that they sponsor are individuals and entities of integrity and competence. While, as noted in the response to a preceding comment, FHA-approved mortgagees will now make the initial determination of TPO qualifications, and not FHA, this assessment should not differ significantly from the manner in which FHA-approved mortgagees hire loan officers and appoint officials in their organizations. Moreover, sponsoring mortgagees have the authority to establish oversight requirements to monitor the ongoing performance and financial capacity of their TPOs, as the mortgagees may determine

appropriate, including the submission of audited financial statements from sponsored TPOs.

To the extent that mortgagees seek guidance from HUD on how best to determine if TPOs adhere to FHA's processing and origination requirements and are eligible to participate in the origination of FHA-insured mortgage loans, HUD recommends that mortgagees develop and implement measures such as the following: (1) procedures to verify TPO compliance with all federal, state, and local requirements that govern their activities; (2) procedures to verify TPO compliance with the requirements of the SAFE Act; (3) procedures to ensure that TPOs are not suspended, debarred, or under a limited denial of participation (LDP), in HUD's Credit Alert Interactive Voice Response System, or on the Federal Government's Excluded Parties list; (4) institutional guidelines and systems for establishing and maintaining relationships with TPOs; (5) procedures that govern the performance of due diligence; (6) systems for monitoring loan quality and performance for each sponsored TPO; (7) procedures for addressing potential problems with TPO operations, business practices, or customer service, and clearly articulated remedial processes for instances when such problems occur; (8) enhanced quality control plans and procedures that ensure appropriate evaluation of TPO originations; (9) ongoing renewal processes to ensure that TPOs continue to meet the mortgagee's approval standards; and (10) procedures for evaluating the financial capacity of TPOs. These are only recommendations on HUD's part, and no doubt many mortgagees already have such procedures, protocols, and systems in place.

Although not a change from existing requirements, it is nevertheless important to reiterate that mortgagees may not knowingly or willingly conduct business with TPOs that are not in compliance with all laws and regulations that govern their practices. If a mortgagee becomes aware of TPO noncompliance with any provision of law or regulation, FHA requires that the mortgagee cease sponsoring FHA loans on behalf of the TPO in question and proceed accordingly with regard to

notifying HUD of such occurrences. Mortgagees that continue to engage with such entities will be held responsible for such activities by HUD. Moreover, HUD will hold mortgagees accountable for FHA loan origination and processing violations committed by TPOs.

Processing a Loan in Name of FHA-Approved Mortgagee

Comment: Some commenters requested that HUD permit non-FHA-approved TPOs to process a loan and close it in the entity's own name, and not that of the FHA-approved mortgagee. The commenters stated that the removal of this authority would yield a number of adverse impacts for TPOs, including impacts on state licensing and regulatory matters and TPO funding arrangements. Some commenters expressed concern that the elimination of processing authority would limit TPO revenues, and would present a significant administrative burden for mortgagees.

HUD Response: HUD has not revised the rule in response to these comments, but as noted earlier in this preamble and discussed at the end of this response, HUD is further considering this issue. Section 203(b)(1) of the National Housing Act (12 U.S.C. 1709(b)(1)) requires that a mortgage "[h]ave been made to, and be held by, a mortgagee approved by the Secretary" in order to be eligible for FHA mortgage insurance. Accordingly, only FHA-approved mortgagees may close mortgage loans in their names (that is, using the statutory terminology, have the mortgage "made to" the FHA-approved mortgagee). Since FHA will no longer be approving loan correspondents, TPOs will be statutorily prohibited from closing FHA-insured mortgage loans in their own names; however, TPOs may continue to close such mortgages in the name of their sponsoring FHA-approved mortgagees. Further, only the sponsoring FHA-approved mortgagee may submit the loan to FHA for insurance endorsement.

HUD emphasizes that currently approved TPOs (loan correspondents) as of the effective date of this final rule may continue to act as FHA-approved TPOs and close FHA-insured mortgages in

their name through December 31, 2010. Loan correspondents are also eligible to apply for approval as an FHA-approved mortgagee.

As noted earlier in this preamble, HUD will further consider this issue, but unless such change is made, currently FHA-approved loan correspondents (that subsequently will become TPOs), commencing on January 1, 2011, may no longer close FHA-insured mortgages in their own names, although they may continue to do so through December 31, 2010.

Third-Party Originators Should Be Permitted to Access and Utilize FHA Connection

Comment: Commenters expressed concern about the inability of TPOs to access and utilize the FHA Connection system for loans they originate. These commenters advised that the data input and other tasks performed by TPOs in FHA Connection were an important part of the services they provide to mortgagees.

HUD Response: HUD information technology security requirements do not permit non-FHA-approved entities to access or utilize FHA Connection. Therefore, only FHA-approved mortgagees will be authorized to utilize this system to carry out necessary processes associated with a loan transaction. However, as explained in Mortgagee Letter 2004-31, which remains applicable, FHA Connection's Business-to-Government (FHAC B2G) Specification "allows lenders to transmit data directly from their own internal loan processing systems to FHA without re-keying data into the FHA Connection or functional equivalent." This functionality allows TPOs to input data into a sponsoring mortgagee's loan origination system, as may be permitted by the sponsoring mortgagee, which will then carry out FHA Connection tasks via an automated process. Such practices will enable TPOs to continue to provide important loan processing services to mortgagees. Additional information regarding FHAC B2G can be found in the "FHA Connection Business to Government User's Guide" at http://www.hud.gov/offices/hsg/sfh/f17c/b2g.pdf.

Tracking TPO Performance through Single Family Neighborhood Watch

Comment: Commenters suggested that HUD continue to track TPO performance through the Single Family Neighborhood Watch (Neighborhood Watch) system. The commenters were concerned that with the removal of loan correspondent approval, the ability to analyze performance data for sponsored TPOs would be eliminated. These commenters requested that TPO tracking in Neighborhood Watch continue.

HUD Response: FHA will make available to sponsoring mortgagees aggregate comparison TPO performance data at a national level. HUD anticipates that mortgagees will use this data in carrying out their responsibilities under this final rule to monitor the performance of their TPOs on an ongoing basis. The information will be available to FHA-approved mortgagees by accessing Neighborhood Watch through their FHA Connection account.

Geographic Limitations on Originations

Comment: Commenters requested clarification regarding the impact of this rule on FHA's "Areas Approved for Business." The commenters expressed concern that the rule would result in geographic limitations on originations.

HUD Response: When conducting retail and direct lending originations, FHA-approved mortgagees must continue to comply with the existing Single Family Origination Lending Areas (Areas Approved for Business or AAFB), as outlined in HUD Handbook 4155.2, Section12.E.2. FHA-approved mortgagees must also continue to be licensed to perform loan origination in each state in which they desire to originate FHA loans. For purposes of wholesale origination, FHA-approved mortgagees may underwrite loans originated in any state in which they are permitted by the state to do so, and in which the originating TPO is permitted to conduct mortgage origination activities. Hence, a mortgagee's wholesale AAFB consists of all states in which it sponsors a TPO that meets the

applicable requirements for loan origination of that state and in which the mortgagee is permitted by the state to underwrite mortgage loans and sponsor TPOs.

Principal-Authorized Agent Relationship

Comment: Commenters requested clarification of possible impacts, or lack thereof, of this rule on Principal-Authorized Agent relationships.

HUD Response: For FHA-insured loans, the Principal-Authorized Agent Relationship provides FHA-mortgagees with flexibility in the origination of FHA-insured single family loans in situations where the FHA-approved mortgagee seeks to collaborate with another FHA-approved mortgagee. Through this flexibility, FHA-approved mortgagees may offer diversified loan products or programs because of the ability to team with firms that may have more expertise in specialized areas.

As a result of HUD's elimination of the FHA approval process for loan correspondents, the requirements regarding Principal-Authorized Agent relationships will also change. Loans originated through Principal-Authorized Agent relationships will be permitted to close in either party's name. However, to participate in this relationship, both the Principal and Authorized Agent must be approved as Direct Endorsement lenders under 24 CFR 203.3. Further, for loans insured under the relationship, the Principal must originate and the Authorized Agent must underwrite, and the relationship must be recorded as such in FHA Connection (FHA's Computer Home Underwriting Mortgage System).

Rulemaking Issues

Abbreviated Comment Period

Comment: Several commenters objected to the reduced comment period for the proposed rule. One of the commenters objected on the grounds that the regulatory amendments constitute major changes to FHA's regulatory structure that may affect the taxpayer. Another commenter wrote that the reduced comment period gave the impression that HUD wanted to "push through" the changes. One

commenter suggested that HUD issue a revised proposed rule for additional public comment.

HUD Response. As more fully discussed in the preamble to the November 30, 2009, proposed rule, the regulatory changes proposed in November would largely conform to HUD's regulations to recent statutory requirements and update FHA business practices to current industry standards. Although HUD acknowledges that streamlining FHA's approval process to mortgagees is not an insignificant change, as discussed in the November 30, 2009, proposed rule and the preamble to this final rule, the elimination of approval of loan correspondents does not mean that these entities are barred from participation in FHA programs. The expectation is that they will continue to participate as they always have, through sponsorship by FHA-approved mortgagees, and can avail themselves of that benefit without the necessity or burden of having to go through the FHA lender approval process. Additionally, as noted already in this preamble, loan correspondents may apply for approval as FHA-approved mortgagees. In the case of the changes to conform HUD's regulations to the explicit statutory restrictions on loan origination contained in the HFSH Act, HUD does not have authority to modify these requirements in response to comment.

Given the narrow scope of the changes proposed in HUD's November 30, 2009, final rule, HUD remains of the position that 30 days was a sufficient period for public comment – a determination that is supported by more than 200 public comments received, the thoughtfulness of the comments, and the support provided in suggesting alternatives.

Unfunded Mandate

Comment: One commenter wrote that this rule imposes unreimbursed costs on the private sector and may be an unfunded mandate. The commenter stated that according to the numbers provided in the proposed rule itself, 68 percent of the 13,831 FHA-approved lending entities are approved correspondents, i.e., approximately 9,405. HUD's rule shifts the oversight of these 9,405

loan correspondents to FHA's approved mortgage lenders. This commenter stated that if HUD's proposal meets the definition of an unfunded mandate, HUD may be required to have the Congressional Budget Office identify and estimate its costs, which the commenter states has not been done.

HUD Response. The commenter is incorrect in asserting that this rule imposes an unfamiliar and economically burdensome mandate on FHA-approved mortgagees. While it is correct that the rule would make FHA-approved mortgagees responsible for ensuring that their TPOs adhere to FHA loan origination and processing requirements, the rule does not mandate that sponsors adopt any specific new oversight protocols or bear new economic costs. The responsibility to ensure that TPOs that originate mortgage loans under a sponsorship relationship with mortgagees are responsible, knowledgeable, competent, and have integrity is, or should be, common and prudent business practice. In this regard, loan correspondents already provide their sponsoring mortgagees with data regarding their performance, and sponsoring mortgagees currently review the operations and performance of their loan correspondents as a good business practice.

Continued participation in the FHA-insurance programs as approved mortgagees by present participants is voluntary. Section 101 of the Unfunded Mandates Reform Act (2 U.S.C.1531-1538) (UMRA) specifically excludes conditions for receipt of federal assistance and duties arising from participation in a voluntary federal program from the definition of "federal private sector mandate" subject to the requirements of UMRA. Accordingly, the commenter is also incorrect, as a matter of law, that the rule imposes an unfunded mandate.

Legal Authority for Rule

Comment: Some commenters questioned HUD's statutory authority to terminate approval and to delegate to lenders this governmental authority to approve and oversee loan correspondents. One

commenter wrote that the rule ignores the HFSH Act, which requires all loan originators and loan origination companies to register and become licensed. Several commenters wrote that the rule appears to contradict the statutory requirements for HUD's Home Equity Conversion Mortgage (HECM) program in 12 U.S.C. 1715z-20(n)(2), which, according to the commenters, requires all parties that participate in the origination of a HECM mortgage to be approved by the Secretary. Other commenters wrote that under the rule private companies must be empowered to conduct not only the normal quality-control audits, but also site audits and reviews, as well as financial audits and reviews, including auditing whether each person who originates a mortgage is an employee of the mortgagee or correspondent and has payroll taxes properly deducted. The commenter questioned whether such authority can be granted to a private company.

HUD Response. The concerns expressed by these commenters, such as the HECM issue, and the perceived abdication of regulatory oversight, have already been addressed in this preamble. However, HUD emphasizes that it is not delegating its rulemaking authority and regulatory functions to nongovernmental entities. Rather, through this rulemaking, FHA is limiting the type of entity that will be an FHA-approved mortgagee. This limitation is consistent with FHA's authority under the National Housing Act. Additionally, HUD is not asking FHA-approved mortgagees to perform a regulatory function, but rather to undertake the type of due diligence, vetting, and oversight of any party that the lender employs or relies upon for functions related to its FHA lending activities. As stated in the proposed rule, such responsibility rests more appropriately with the FHA-approved mortgagee rather than with FHA.

The final rule is also consistent with the HFSH Act, the rulemaking authority provided to the Secretary to carry out the FHA programs under section 211 of the National Housing Act (12 U.S.C. 1715b), as well as the general rulemaking authority conferred to the Secretary of HUD under section

7(o) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(d)).

Economic Impact of Rule

Comment: Commenters raised questions and concerns regarding the economic impacts of the regulatory changes and, in particular, the potential impact on small lending institutions. Several of the commenters wrote the economic impacts of the rule would exceed $100 million and, therefore, that the rule should be classified as an "economically significant" regulatory action under Executive Order 12866 regarding "Regulatory Planning and Review." Other commenters focused on the costs that would be borne by lenders to comply with the new requirements, such as the updating of systems and compliance with state licensing requirements. Commenters stated that HUD underestimated the significance of these costs. Other commenters stated that HUD ignored the negative impact that the loss of simply being able to post "FHA approval" will have on the business of loan correspondents.

HUD Response. HUD recognizes that the changes being implemented by this final rule will not be without costs, but as fully addressed in the analysis provided in HUD's November 30, 2009, proposed rule, HUD maintains that such changes will not result in an annual impact on the economy of $100 million or more. HUD recognizes that the increase in net worth requirements must be addressed by lenders, but as provided in the economic analysis in the proposed rule, the majority of FHA-approved lenders already meet the $1 million net worth requirement, and HUD is allowing sufficient time for those FHA-approved lenders that currently do not meet this requirement to be able to achieve this level. As noted earlier in this preamble, the final rule not only maintains the proposed rule's timetable of one calendar year to achieve the initial $1 million net worth requirement and 2 additional calendar years beyond the first year to achieve the additional volume-based net worth requirements, but allows even more time for mortgagees that meet SBA's definition of a small business, and recognizes the key distinctions between single family and multifamily mortgagees.

With respect to the elimination of approval of loan correspondents, loan correspondents will be relieved of the costs associated with the formal process of FHA approval, and will retain their loan correspondent approval through December 31, 2010. This extension of their current FHA approval provides loan correspondents with additional time to seek FHA approval as an approved mortgagee or confirm the continuation of existing relationships with sponsoring mortgagees. As has been stated in this preamble, it is HUD's expectation that trusting and profitable relationships between sponsoring mortgagees and sponsored loan correspondents will continue.

While TPOs will no longer be permitted to advertise that they are "FHA Approved," they will be allowed to state that they are authorized to originate FHA products. HUD believes that the ability of TPOs to advertise the availability of FHA products will mitigate any adverse impacts of the removal of the specific "FHA Approved" verbiage from TPO advertising.

V. Public Comment Solicitation on Additional Net Worth Requirements for Originators of Multifamily Mortgages of $25 Million or More

DATES: Comment Due Date: [**Insert date 30 days from the date of publication in the Federal Register**].

HUD is soliciting comment on a proposal to require FHA-approved mortgagees that originate multifamily mortgages of $25 million or more to retain as additional net worth 50 basis points (0.5%) of the fee income resulting from such loans in addition to their required net worth as set forth in this rule, up to a maximum of $5 million. This is the only issue for which HUD solicits comment, and HUD will not consider comments submitted on other aspects of this final rule.

ADDRESSES: Interested persons are invited to submit comments on this issue to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket

number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an appointment to review the public comments must be scheduled in advance by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay

Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

VI. Findings and Certifications

Executive Order 12866, Regulatory Planning and Review.

The Office of Management and Budget (OMB) reviewed this final rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). This final rule, as was the case with the proposed rule, has been determined to be a "significant regulatory action," as defined in section 3(f) of the Order, but not economically significant, as provided in section 3(f)(1) of the Order. The analysis of this rulemaking provided in HUD's November 30, 2009, proposed rule (74 FR 62525-62527) continues to support that this rule is not economically significant. Additionally, HUD's decision to modify the requirements for increased net worth to accommodate small business concerns and the distinctions between single family and multifamily mortgagees, combined with the removal of potential barriers to TPO revenue generation, further confirms HUD's assessment that this rule will not have an annual impact on the economy of $100 million or more. The reasons for HUD's determination are as follows:

A. Increased Net Worth Requirements

1. Current Mortgagee Net Worth. Because loan correspondent approval will be eliminated via this rule, an analysis of the impact of increased net worth requirements is limited to a review of data for approved mortgagees. Further, FHA does not presently collect audited financial statements from supervised institutions. As a result, it is not possible to determine if any of these entities will be unable to meet the increased net worth requirements. Based upon the fact that supervised institutions must meet much higher capital standards established by federal banking regulators, it is very unlikely that any supervised firms will fail to meet the higher net worth threshold. As a proxy, FHA analyzed

Ginnie Mae net worth data for its supervised lenders and discovered that none of these lenders had a net worth below FHA's increased requirement. In fact, the average net worth of this cohort was $2.4 billion.

As of November 30, 2009, the number of the most recent accepted audit submission by nonsupervised mortgagees for renewal of FHA lender approval totals 1,297. A clear majority of these approved nonsupervised mortgagees (754, or 58 percent of the total) currently already have a net worth greater than $1 million. It should also be noted that of presently approved loan correspondents, 137 have a current net worth greater than $1 million.

2. Cost of Increased Net Worth Requirement for Mortgagees. The enactment of the proposed rule would present two options to mortgagees that currently possess a net worth below the proposed $1 million requirement: (1) increase their net worth from the current $250,000 to between $1 million and $2.5 million, 20 percent of which must be held in liquid assets; or (2) relinquish their status as an FHA-approved mortgagee and continue conducting FHA business as a third-party originator by initiating a sponsorship relationship with an approved mortgagee. The actual economic impact of the proposed rule is the opportunity cost of option 1 and the lost revenue and additional costs associated with option 2.

For mortgagees that choose the first option, this final rule will require them to increase their net worth from the current $250,000 to between $1 million and $2.5 million, 20 percent of which must be held in liquid assets. Thus, each approved mortgagee will be required to increase its liquid asset holdings from $50,000 to between $200,000 and $500,000. The calculated cost of this provision equals the opportunity cost[5] of the money held in liquid assets; i.e., the amount they could have earned in otherwise nonliquid accounts.

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[5] Opportunity cost is the value of the next best alternative. In this case, if mortgagees were not required to hold additional funds as liquid assets, the next best alternative would be a higher yielding nonliquid asset.

This method of calculating the opportunity cost of the rule assumes that moneys distributed as shareholder income will be invested by owners in other yield-bearing investments. Such a supposition may or may not be accurate, but provides a "best case scenario" for owner decision making, and therefore, the highest potential opportunity cost resulting from the rule. At the very least, if owners do not invest distributed income in yield-bearing investments, this rule is expected to result in a loss of personal income through an increase in the firm's retained earnings

Table 1 below calculates the opportunity cost of this increase to existing FHA-approved mortgagees. Based on data from FHA's Lender Assessment Sub-System (LASS)[6], 36 single family mortgagees have a net worth equal to $250,000, 233 mortgagees have a net worth between $250,000 and $500,000, 274 mortgagees have a net worth between $500,000 and $1 million, 363 mortgagees have a net worth between $1 million and $2.5 million, and 391 mortgagees have a net worth of greater than $2.5 million. Column B lists the average net worth of the mortgagees in each category. Column C subtracts the average net worth from the new requirement, which was calculated based on each mortgagee's total annual single family volume. Column D then calculates the average increase in liquid assets per mortgagee, equal to 20 percent of the increase in net worth.

For multifamily mortgagees that do not also originate FHA single family mortgages, four mortgagees have a net worth equal to $250,000, 10 mortgagees have a net worth between $250,000 and $500,000, 12 mortgagees have a net worth between $500,000 and $1 million, 12 mortgagees have a net worth between $1 million and $2.5 million, and 22 mortgagees have a net worth of greater than $2.5 million.

The cost of this provision totals the opportunity cost of holding the amount shown in Column D in liquid assets, rather than investing it in other potentially higher-yielding investments. The

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[6] This data is comprised of accepted audits received in the LASS system in support of the applications by currently approved nonsupervised mortgagees for renewal of FHA approval.

opportunity cost is therefore calculated as the difference between the average market rate of return and the risk-free interest rate. The average market rate is represented by the real annualized return of the S&P 500 between 1990 and 2008, which equals 4.5 percent. The risk-free interest rate is the average 10-year U.S. Treasury rate between 1990 and 2008, which equals 2.7 percent. The difference between these two rates equals 1.8 percent. Finally, the average opportunity cost of the increase in the net worth requirement per mortgagee, shown in Column E, was multiplied times the number of mortgagees in each category to calculate the total cost of the net worth requirement imposed by this regulation. As shown in Table 1, the opportunity cost of holding the additional funds in liquid assets totals $1,668,627.

Costs to mortgagees of meeting the higher minimum net worth requirements beyond those associated with the opportunity cost of liquid assets are not included in Table 1 because it is anticipated that the nonliquid increase in net worth would be met largely by changing the title of existing assets held by mortgagees' owners from individual holdings to holdings of the firm. Thus, increasing the minimum net worth requirement does not itself create an economic effect. FHA does acknowledge, however, that for transfers of non-cash assets there may be transaction costs associated with such transfers. Nevertheless, it is not possible to quantify these costs because it is impossible to know the types of assets that may be transferred and the number of mortgagees that would choose this method of asset reassignment to achieve a higher required net worth.

Table 1: Calculation of Opportunity Cost to FHA-Approved Mortgagees

A: Calculation of Opportunity Cost to SF FHA-Approved Mortgagees

	(A)	(B)	(C)	(D) = (C)*20%	(E) = (D)*1.8%	(F) = (A)*(E)
Net Worth	**# of Mortgagees**	**Average Net Worth**	**Average Required Increase in Net Worth**	**Average Increase in Liquid Assets**	**Average Opportunity Cost**	**Aggregate Opportunity Cost**
$250K	36	$250,000	$821,580	$164,316	$2,958	$106,477
$250K - $500K	233	344,237	717,824	143,565	2,584	602,111
$500K - $1M	274	706,911	493,486	98,697	1,777	486,775
$1M-$2.5M	363	1,535,246	252,322	50,464	908	329,734
>$2.5M	391	164,007,911	-	-	-	-
Total SF	**1,297**					**$1,525,097**

B: Calculation of Opportunity Cost to MF-Only FHA-Approved Mortgagees

	(A)	(B)	(C)	(D) = (C)*20%	(E) = (D)*1.8%	(F) = (A)*(E)
Net Worth	**# of Mortgagees**	**Average Net Worth**	**Average Required Increase in Net Worth**	**Average Increase in Liquid Assets**	**Average Opportunity Cost**	**Aggregate Opportunity Cost**
$250K	4	$250,000	$864,938	$172,988	$3,114	$12,455
$250K - $500K	10	355,183	937,407	187,481	3,375	33,747
$500K - $1M	12	660,627	552,090	110,418	1,988	23,850
$1M-$2.5M	12	1,585,506	39,655	7,931	143	1,713
>$2.5M	22	40,374,682	-	-	-	71,765
Total MF-Only	**60**					**$143,530**
Total Costs						**$1,668,627**

For mortgagees that choose option 2, the functional impact of the option would be the loss of income from those aspects of the FHA mortgage lending process they would no longer be permitted to perform and the added costs they would be required to pay to their sponsor for processing[7] and underwriting.

There are four primary ways in which a lender can receive income from the mortgage business: (1) origination fees, (2) servicing release premiums, (3) servicing fees, and (4) income derived from securitization. Origination fees are largely determined by the marketplace and are not currently regulated by FHA. The FHA industry average for servicing release premiums is between 75 to 100 basis points of a loan's unpaid principal balance at the time of sale. Average annual servicing fee of an FHA loan is 30 basis points on the unpaid principal balance. Income derived from securitization will not be considered because a mortgagee must meet the higher net worth already required by Ginnie Mae, Fannie Mae, and Freddie Mac in order to participate in the respective securitization programs. FHA analyzed the origination patterns of the mortgagees that would be affected over a recent 2-year period. HUD notes that the vast majority of lenders reviewed do not service a mortgage portfolio but rather sell their mortgages to aggregators.

As is seen in Table 2 below, of the 543 lenders with a net worth less than the proposed $1 million, 355 have originated at least one loan in the 2-year sample period. Since the affected mortgagees still would be permitted to originate FHA loans for a fee and would be entitled to income streams derived from servicing release premiums, the only economic impact would be from the costs these lenders pay to FHA-approved lenders for the processing and underwriting of the mortgages sold. Table 2 calculates the economic impact if all lenders opted to relinquish their FHA approval and operate via a relationship with an FHA-approved mortgagee.

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[7] Sponsoring mortgagees may choose whether or not to permit their sponsored TPOs to perform processing functions. Therefore, some TPOs may still receive processing income. The calculations of lost revenue used in this analysis assume the loss of <u>all</u> processing revenues for mortgagees that relinquish their FHA approval and become TPOs.

Table 2: Calculation of Opportunity Cost to FHA-Approved Mortgagees for Liquid Holdings						
	Total # of Lenders	Lenders W/ Originations in 2-yr period	Avg # of Yearly Originations	Avg. # of Orig/Lender	Avg. Loan[8] Processing Fee/Lender	Aggregate Loan Processing Fee
>$250K < $1M	543	355	87,455	246	$49,270	$17,491,000

B. Elimination of FHA Approval of Loan Correspondents

1. Loan correspondents. Loan correspondents currently face two costs as FHA-approved lenders. First, they are required to submit audited financial statements and pay a renewal fee annually. In addition, they must also meet a net worth requirement of up to $250,000[9], of which 20 percent must be held in liquid assets. As a result, loan correspondents that choose to continue participating in FHA programs as TPOs may presumably be able to utilize the capital retained in net worth for other purposes, and may not have to submit audited financial statements for approval by a sponsoring mortgagee.[10] If no sponsoring mortgagees required a minimum net worth for their sponsored TPOs, this could release $574,938,000[11] of capital currently retained by loan correspondents as net worth for uses in other ways. If no sponsoring mortgagees require the submission of audited financial statements by TPOs, this could yield a savings to loan correspondents of approximately $68,445,000.[12]

These savings are offset by the fact that 44 states plus the District of Columbia impose bonding or net worth requirements that will continue to apply to brokers, and that the minimum requirements of 12 states exceed those of FHA. It should be noted that the shift from the loan correspondent business model to the TPO model may require some TPOs to acquire a different type of state licensing, which would yield additional costs to these lenders. Because the requirements governing lenders vary across

[8] FHA estimates a $200 charge per loan for processing fees.
[9] The current net worth requirement for loan correspondents is $63,000 plus an additional $25,000 for each registered branch up to a maximum of $250,000.
[10] Because sponsoring mortgagees are permitted to establish their own standards for approval of sponsored TPOs, it is impossible to definitively calculate a savings resulting from the elimination of FHA requirements for loan correspondents.
[11] Based upon FHA's current minimum required net worth for loan correspondents of $63,000, multiplied by the total number of approved loan correspondents, 9,126.
[12] Based upon an average cost to loan correspondents of $7,500 for the compilation of audited financial statements, multiplied by the total number of approved loan correspondents, 9,126.

states, as do the licensing fees and associated costs, it is not possible to derive an actual or estimated cost for changes to TPO licensing, but it is a factor that must be taken into consideration when evaluating the impact of this rule on loan correspondents.

2. FHA-approved mortgagees. The majority of FHA-approved mortgagees engage in wholesale lending whereby they underwrite and endorse loans originated by outside FHA-approved loan correspondents. It is reasonable to expect that such relationships will continue. FHA mortgagees with wholesale loan operations are already required to monitor the performance of loans which are acquired from mortgage brokers and loan correspondents. They are currently held responsible for the underwriting and credit decisions made on loans acquired from brokers. Lenders use a variety of methods to track and monitor the performance of loans purchased from brokers and correspondents, including broker scorecards. Thus, requiring mortgagees to perform oversight of the non-FHA approved TPOs with which they partner should in essence be a codification of practices that are already the norm for prudent mortgagees. Although the costs of oversight may increase slightly, given the current practices of mortgagees to monitor the performance of loan correspondents with which they partner, the increase in these costs to lenders from the implementation of this regulation is expected to be minimal.

In addition to the costs associated with the ongoing monitoring and oversight of sponsored TPOs, it may also be assumed that some mortgagees will establish their own minimum criteria with which to vet potential TPOs seeking sponsorship. There will obviously be a cost to the mortgagee to evaluate potential candidates for sponsorship. However, because it is impossible to know how many mortgagees will employ such processes, the extensiveness of the requirements and evaluations used by mortgagees to analyze candidates, and the actual cost to a mortgagee for such activities, it is not possible for HUD to quantify the total costs to mortgagees of vetting potential TPOs. Nevertheless,

HUD does acknowledge that costs will be incurred for these processes.

The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. At the proposed rule stage, HUD certified that this rule, if issued in final, would not have a significant economic impact on a substantial number of small entities, within the meaning of the Regulatory Flexibility Act. HUD continues to stand by its findings on this issue. (See 74 FR 62528.)

The Office of Advocacy of the Small Business Administration (SBA-OA) expressed concern that the rule as proposed would adversely affect a large number of small businesses and encouraged HUD to conduct an Initial Regulatory Flexibility Analysis to further explore the impact of the rule upon such entities. SBA-OA was concerned specifically with the proposed increase to FHA's net worth requirements and the operational limitations that may be experienced by TPOs resulting from the elimination of loan correspondent approval. Of the 1,297 approved nonsupervised mortgagees that renewed their FHA approval during the sample period of December 1, 2008, to November 20, 2009, 888 mortgagees, or 68.5 percent, met the SBA specifications for classification as a small business. Of

these 888 mortgagees, 379 (42.7 percent of the total) already have a net worth in excess of $1 million and 629 (70.8 percent of the total) already have a net worth in excess of at least $500,000. Accordingly, a significant majority of currently approved small business nonsupervised mortgagees either already have a net worth of $1 million or greater, or are well on their way to complying with the new requirement. The remaining 259 small business nonsupervised mortgagees with a net worth of less than $500,000 constitute a small minority of 7.8 percent of the total number of approved mortgagees. While HUD determined that the proposed rule, if implemented without change at the final rule stage, would not have a significant economic impact on a substantial number of small entities, HUD nevertheless appreciated the small entity impact concerns expressed by commenters, and, as already discussed several times in the preamble to this final rule, this final rule provides for a more gradual transition to new net worth requirements for lenders that meet SBA's definition of a small business.

SBA-OA also expressed concern that small lender correspondents (to which HUD refers to in this preamble as TPOs) may lose income as a result of the loss of FHA approval. However, as HUD noted in the preamble to the proposed rule and in this preamble to the final rule, the changes to the lender approval process do not prevent participation by entities that have been involved in FHA programs. Rather, the rule limits the actual approval process to those entities that underwrite, service, or own FHA-insured mortgages. Loan correspondents and other TPOs may continue to be involved in FHA loan origination by working with FHA-approved mortgagees.

While HUD information technology security requirements do not permit non-FHA approved entities to access the FHA Connection, HUD's Business to Government Specification permits TPOs to utilize their sponsoring mortgagees' loan origination systems to perform many loan origination processes conducted in the FHA Connection. Further, all TPOs will continue to have access to all

FHA training and information resources. Therefore, with these additional changes made at the final rule stage, TPOs will continue to have access to the tools and resources necessary to participate in the origination of FHA-insured loans, and any remaining impacts upon TPO revenues will be extremely minimal.

In developing this final rule, HUD gave careful consideration to the concerns expressed by small entity commenters, and by SBA-OA on the behalf of small entities, and has made changes to address these concerns while maintaining the important policy changes needed to responsibly manage risk to FHA.

Environmental Impact

This rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition or new construction, or establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. This rule is limited to the eligibility of those entities that may be approved as FHA-approved lenders. Accordingly, under 24 CFR 50.19(c)(1), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule would not have federalism implications and would not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This final rule would not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance (CFDA) Program number is 14.183.

List of Subjects in 24 CFR Part 202

Administrative practice and procedure, Home improvement, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble above, HUD amends 24 CFR part 202 as follows:

PART 202 – APPROVAL OF LENDING INSTITUTIONS AND MORTGAGEES

1. The authority citation for 24 CFR part 202 continues to read as follows:

Authority: 12 U.S.C. 1703, 1709, and 1715b; 42 U.S.C. 3535(d).

2. In § 202.2, revise the definitions of "Lender or Title I lender", and "Mortgagee or Title II mortgagee," to read as follows:

§ 202.2 Definitions.

* * * * *

Lender or Title I lender means a financial institution that:

(a) Holds a valid Title I Contract of Insurance and is approved by the Secretary under this part as a supervised lender under § 202.6, a nonsupervised lender under § 202.7, an investing lender under § 202.9, or a governmental or similar institution under § 202.10; or

(b) Is under suspension or held a Title I contract that has been terminated but remains responsible for servicing or selling Title I loans that it holds and is authorized to file insurance claims on such loans.

* * * * *

Mortgagee or Title II mortgagee means a mortgage lender that is approved to participate in the Title II programs as a supervised mortgagee under § 202.6, a nonsupervised mortgagee under § 202.7, an investing mortgagee under § 202.9, or a governmental or similar institution under § 202.10.

* * * * *

3. In § 202.3, revised paragraphs (a) introductory text, (a)(1), and (a)(3) to read as follows:

§ 202.3 Approval status for lenders and mortgagees.

(a) Initial approval. A lender or mortgagee may be approved for participation in the Title I or Title II programs upon filing a request for approval on a form prescribed by the Secretary and signed by the applicant. The approval form shall be accompanied by such documentation as may be prescribed by the Secretary.

(1) Approval is signified by:

(i) The Secretary's agreement that the lender or mortgagee is considered approved under the Title I or Title II programs, except as otherwise ordered by the Mortgagee Review Board or an officer or subdivision of the Department to which the Mortgagee Review Board has delegated its power, unless the lender or mortgagee voluntarily relinquishes its approval;

(ii) Consent by the lender or mortgagee to comply at all times with the general approval requirements of § 202.5, and with additional requirements governing the particular class of lender or mortgagee for which it was approved as described under subpart B at §§ 202.6 through 202.10; and

(iii) Under the Title I program, the issuance of a Contract of Insurance constitutes an agreement between the Secretary and the lender and which governs participation in the Title I program.

* * * * *

(3) Authorized agents. A mortgagee approved under §§ 202.6, 202.7, or 202.10 as a nonsupervised mortgagee, supervised mortgagee, or governmental or similar institution approved as a Direct Endorsement mortgagee under 24 CFR 203.3 may, with the approval of the Secretary, designate a nonsupervised or supervised mortgagee with Direct Endorsement approval under 24 CFR 203.3 as authorized agent for the purpose of underwriting loans. The application for mortgage insurance may be submitted in the name of the FHA-approved mortgagee or its designated authorized agent under this paragraph.

* * * * *

4. Revise § 202.5 to read as follows:

§ 202.5 General approval standards.

To be approved for participation in the Title I or Title II programs, and to maintain approval, a lender or mortgagee shall meet and continue to meet the general requirements of paragraphs (a) through (n) of this section (except as provided in § 202.10(b)) and the requirements for one of the eligible classes of lenders or mortgagees in §§ 202.6 through 202.10.

(a) Business form. (1) The lender or mortgagee shall be a corporation or other chartered institution, a permanent organization having succession, or a partnership. A partnership must meet the requirements of paragraphs (a)(1)(i) through (iv) of this section.

(i) Each general partner must be a corporation or other chartered institution consisting of two or more persons.

(ii) One general partner must be designated as the managing general partner. The managing general partner shall comply with the requirements of paragraphs (b), (c), and (f) of this section. The managing general partner must have as its principal activity the management of one or more partnerships, all of which are mortgage lenders or property improvement or manufactured home lenders, and must have exclusive authority to deal directly with the Secretary on behalf of each partnership. Newly admitted partners must agree to the management of the partnership by the designated managing general partner. If the managing general partner withdraws or is removed from the partnership for any reason, a new managing general partner shall be substituted, and the Secretary shall be immediately notified of the substitution.

(iii) The partnership agreement shall specify that the partnership shall exist for the minimum term of years required by the Secretary. All insured mortgages and Title I loans held by the partnership shall be transferred to a lender or mortgagee approved under this part prior to the termination of the partnership. The partnership shall be specifically authorized to continue its existence if a partner withdraws.

(iv) The Secretary must be notified immediately of any amendments to the partnership agreement that would affect the partnership's actions under the Title I or Title II programs.

(2) Use of business name. The lender or mortgagee must use its HUD-registered business name in all advertisements and promotional materials related to FHA programs. HUD-registered business names include any alias or “doing business as” (DBA) on file with FHA. The lender or mortgagee must keep copies of all print and electronic advertisements and promotional materials for a period of 2 years from the date that the materials are circulated or used to advertise.

(3) Non-FHA-approved entities. A lender or mortgagee that accepts a loan application from a non-FHA-approved entity must confirm that the entity's legal name and Tax ID number are included in the FHA loan origination system record for the subject loan. The loan to be insured by FHA must be underwritten by the FHA-approved lender or mortgagee.

(b) Employees. The lender or mortgagee shall employ competent personnel trained to perform their assigned responsibilities in consumer or mortgage lending, including origination, servicing, and collection activities, and shall maintain adequate staff and facilities to originate and service mortgages or Title I loans, in accordance with applicable regulations, to the extent the mortgagee or lender engages in such activities.

(c) Officers. All employees who will sign applications for mortgage insurance on behalf of the mortgagee or report loans for insurance shall be corporate officers or shall otherwise be authorized to bind the lender or mortgagee in the origination transaction. The lender or mortgagee shall ensure that an authorized person reports all originations, purchases, and sales of Title I loans or Title II mortgages to the Secretary for the purpose of obtaining or transferring insurance coverage.

(d) Escrows. The lender or mortgagee shall not use escrow funds for any purpose other than that for which they were received. It shall segregate escrow commitment deposits, work completion deposits, and all periodic payments received under loans or insured mortgages on account of ground rents, taxes, assessments, and insurance charges or premiums, and shall deposit such funds with one or more financial institutions in a special account or accounts that are fully insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration, except as otherwise provided in writing by the Secretary.

(e) Servicing. A lender shall service or arrange for servicing of the loan in accordance with the requirements of 24 CFR part 201. A mortgagee shall service or arrange for servicing of the mortgage

in accordance with the servicing responsibilities contained in subpart C of 24 CFR part 203 and in 24 CFR part 207, with all other applicable regulations contained in this title, and with such additional conditions and requirements as the Secretary may impose.

(f) Business changes. The lender or mortgagee shall provide prompt notification to the Secretary, in such form as prescribed by the Secretary, of:

(1) All changes in its legal structure, including, but not limited to, mergers, terminations, name, location, control of ownership, and character of business; and

(2) Any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, loan originator, of the lender or mortgagee, or the lender or mortgagee itself, that is subject to one or more of the sanctions in paragraph (j) of this section.

(g) Financial statements. The lender or mortgagee shall furnish to the Secretary a copy of its annual audited financial statement within 90 days of its fiscal year end, furnish such other information as the Secretary may request, and submit to an examination of that portion of its records that relates to its Title I and/or Title II program activities.

(h) Quality control plan. The lender or mortgagee shall implement a written quality control plan, acceptable to the Secretary, that assures compliance with the regulations and other issuances of the Secretary regarding loan or mortgage origination and servicing.

(i) Fees. The lender or mortgagee, unless approved under § 202.10, shall pay an application fee and annual fees, including additional fees for each branch office authorized to originate Title I loans or submit applications for mortgage insurance, at such times and in such amounts as the Secretary may require. The Secretary may identify additional classes or groups of lenders or mortgagees that may be exempt from one or more of these fees.

(j) Ineligibility. For a lender or mortgagee to be eligible for FHA approval, neither the lender or

mortgagee, nor any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator of the lender or mortgagee shall:

(1) Be suspended, debarred, under a limited denial of participation (LDP), or otherwise restricted under 2 CFR part 2424 or 24 CFR part 25, or under similar procedures of any other federal agency;

(2) Be indicted for, or have been convicted of, an offense that reflects adversely upon the integrity, competency, or fitness to meet the responsibilities of the lender or mortgagee to participate in the Title I or Title II programs;

(3) Be subject to unresolved findings as a result of HUD or other governmental audit, investigation, or review;

(4) Be engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility;

(5) Be convicted of, or have pled guilty or *nolo contendere* to, a felony related to participation in the real estate or mortgage loan industry:

(i) During the 7-year period preceding the date of the application for licensing and registration; or

(ii) At any time preceding such date of application, if such felony involved an act of fraud, dishonesty, or a breach of trust or money laundering;

(6) Be in violation of provisions of the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.) or any applicable provision of state law; or

(7) Be in violation of any other requirement established by the Secretary.

(k) Branch offices. A lender may, upon approval by the Secretary, maintain branch offices for the origination of Title I or Title II loans. A branch office of a mortgagee must be registered with the

Department in order to originate mortgages or submit applications for mortgage insurance. The lender or mortgagee shall remain fully responsible to the Secretary for the actions of its branch offices.

(l) Conflict of interest and responsibility. A mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction or transactions to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgaged property, except that consideration, approved by the Secretary, may be paid for services actually performed. The mortgagee shall not pay a referral fee to any person or organization.

(m) Reports. Each lender and mortgagee must submit an annual certification on a form prescribed by the Secretary. Upon application for approval and with each annual recertification, each lender and mortgagee must submit a certification that it has not been refused a license and has not been sanctioned by any state or states in which it will originate insured mortgages or Title I loans. In addition, each mortgagee shall file the following:

(1) An audited or unaudited financial statement, within 30 days of the end of each fiscal quarter in which the mortgagee experiences an operating loss of 20 percent of its net worth, and until the mortgagee demonstrates an operating profit for 2 consecutive quarters or until the next recertification, whichever is the longer period; and

(2) A statement of net worth within 30 days of the commencement of voluntary or involuntary bankruptcy, conservatorship, receivership, or any transfer of control to a federal or state supervisory agency.

(n) Net worth. (1) Applicability. The requirements of this section apply to approved supervised and nonsupervised lenders and mortgagees under § 202.6 and § 202.7, and approved investing lenders and mortgagees under § 202.9. For ease of reference, these institutions are referred to as "approved lenders and mortgagees" for purposes of this section. The requirements of this section also apply to applicants for FHA approval under §§ 202.6, 202.7, and 202.9. For ease of reference, these entities are referred to as "applicants" for purposes of this section.

(2) Phased-in net worth requirements for 2010 and 2011. (i) Applicants. Effective on **[insert date that is 30 days after the effective date of this final rule]**, applicants shall comply with the net worth requirements set forth in paragraphs (n)(2)(iii) of this section.

(ii) Approved mortgagees. Effective on **[insert date that is one year after the effective date of this final rule]**, each approved lender or mortgagee with FHA approval as of **[insert effective date of final rule]** shall comply with the net worth requirements set forth in paragraphs (n)(2)(iii) or (n)(2)(iv) of this section, as applicable.

(iii) Net worth requirements for non-small businesses. Each approved lender or mortgagee that exceeds the size standard for its industry classification established by the Small Business Administration at 13 CFR 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities) shall have a net worth of not less than $1,000,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

(iv) Net worth requirements for small businesses. Each approved lender or mortgagee that meets the size standard for its industry classification established by the Small Business Administration at 13 CFR 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities) shall have a net worth of not less than $500,000, of which no less than 20 percent

must be liquid assets consisting of cash or its equivalent acceptable to the Secretary. If, based on the audited financial statement prepared at the end of its fiscal year and provided to HUD at the commencement of the new fiscal year, an approved lender or mortgagee no longer meets the Small Business Administration size standard for its industry classification, the approved lender or mortgagee shall meet the net worth requirement set forth in paragraph (n)(2)(iii) of this section for a non-small business approved lender or mortgagee by the last day of the fiscal year in which the audited financial statements were submitted.

(3) Net worth requirements for 2013 and subsequent years. Effective **[insert date that is three years after the effective date of this final rule]**:

(i) Irrespective of size, each applicant and each approved lender or mortgagee, for participation solely under the FHA single family programs, shall have a net worth of not less than $1 million, plus an additional net worth of one percent of the total volume in excess of $25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million. No less than 20 percent of the applicant's or approved lender or mortgagee's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary

(ii) Multifamily net worth requirements. Irrespective of size, each applicant for approval and each approved lender or mortgagee for participation solely under the FHA multifamily programs shall have a minimum net worth of not less than $1 million. For those multifamily approved lenders or mortgagees that also engage in mortgage servicing, an additional net worth of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. For multifamily approved lenders or mortgagees that do not perform mortgage servicing, an additional net

worth of one half of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. No less than 20 percent of the applicant's or approved lender's or mortgagee's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary

(iii) Dual participation net worth requirements. Irrespective of size, each applicant for approval and each approved lender or mortgagee that is a participant in both FHA single-family and multifamily programs must meet the net worth requirements as set forth in paragraph (n)(3)(i) of this section.

5. Revise § 202.6 to read as follows:

§ 202.6 Supervised lenders and mortgagees.

(a) Definition. A supervised lender or mortgagee is a financial institution that is a member of the Federal Reserve System or an institution whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration. A supervised mortgagee may submit applications for mortgage insurance. A supervised lender or mortgagee may originate, purchase, hold, service or sell loans or insured mortgages, respectively.

(b) Additional requirements. In addition to the general approval requirements in § 202.5, a supervised lender or mortgagee shall meet the following requirements:

(1) Net worth. The net worth requirements appear in § 202.5(n).

(2) Notification. A lender or mortgagee shall promptly notify the Secretary in the event of termination of its supervision by its supervising agency.

(3) Fidelity bond. A Title II mortgagee shall have fidelity bond coverage and errors and omissions insurance acceptable to the Secretary and in an amount required by the Secretary, or have alternative insurance coverage, approved by the Secretary, that assures the faithful performance of the responsibilities of the mortgagee.

6. Revise § 202.8 to read as follows:

<u>§ 202.8 Sponsored third-party originators; Continued approval of loan correspondents through December 31, 2010</u>.

(a) <u>Definitions</u>.

<u>Sponsored third-party originator</u>. A third-party originator does not hold a Title I Contract of Insurance or Title II Origination Approval Agreement and may not purchase or hold loans but is authorized to originate Title I direct loans or Title II mortgage loans for sale or transfer to a sponsor or sponsors, as defined in this section, which holds a valid Title I Contract of Insurance or Title II Origination Approval Agreement and is not under suspension, subject to the sponsor determining that the third-party originator has met the eligibility criteria of paragraph (b) this section.

<u>Sponsor</u>. (1) With respect to Title I programs, a sponsor is a lender that holds a valid Title I Contract of Insurance and meets the net worth requirement for the class of lender to which it belongs.

(2) With respect to Title II programs, a sponsor is a mortgagee that holds a valid origination approval agreement, is approved to participate in the Direct Endorsement program, and meets the net worth requirement for the class of mortgagee to which it belongs.

(3) Each sponsor shall be responsible to the Secretary for the actions of its sponsored third-party originators or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to be held responsible. If specific knowledge is required, the Secretary will presume that a sponsor has knowledge of the actions of its sponsored third-party originators or mortgagees in originating loans or mortgages and the sponsor is responsible for those actions unless it can rebut the presumption with affirmative evidence.

(b) <u>Eligibility to originate loans to be insured by FHA</u>. A non-approved third-party originator may originate loans to be insured by FHA, provided:

(1) The third-party originator is working with and through an FHA-approved lender or mortgagee; and

(2) The third-party originator or an officer, partner, director, principal, manager, supervisor, loan processor, or loan originator of the third-party originator has not been subject to the sanctions or administrative actions listed in § 202.5(j), as determined and verified by the FHA-approved lender or mortgagee.

(c) Continued approval of loan correspondents through December 31, 2010. A loan correspondent (as that term was defined under the version of this section in effect immediately before **[insert date effective date of final rule]**) with FHA approval as of **[insert effective date of final rule]** will maintain its FHA approval through December 31, 2010.

7. In § 202.9, remove the last sentence of paragraph (a).

8. Revise § 202.11 to read as follows:

§ 202.11 Title I.

(a) Types of administrative action. In addition to termination of the Contract of Insurance, certain sanctions may be imposed under the Title I program. The administrative actions that may be applied are set forth in 24 CFR part 25. Civil money penalties may be imposed against Title I lenders and mortgagees pursuant to 24 CFR part 30.

(b) Grounds for action. Administrative actions shall be based upon both the grounds set forth in 24 CFR part 25 and as follows:

(1) Failure to properly supervise and monitor dealers under the provisions of part 201 of this title;

(2) Exhaustion of the general insurance reserve established under part 201 of this title;

(3) Maintenance of a Title I claims/loan ratio representing an unacceptable risk to the Department; or

(4) Transfer of a Title I loan to a party that does not have a valid Title I Contract of Insurance.

9. Revise § 202.12(a)(1) to read as follows:

§ 202.12 Title II.

(a) Tiered pricing. (1) General requirements. (i) Prohibition against excess variation. The customary lending practices of a mortgagee for its single family insured mortgages shall not provide for a variation in mortgage charge rates that exceed 2 percentage points. A variation is determined as provided in paragraph (a)(6) of this section.

(ii) Customary lending practices. The customary lending practices of a mortgagee include all single family insured mortgages originated by the mortgagee, including those funded by the mortgagee or purchased from the originator, if the requirements of the mortgagee have the effect of leading to a violation of this section by the originator.

(iii) Basis for permissible variations. Any variations in the mortgage charge rate up to two percentage points under the mortgagee's customary lending practices must be based on actual variations in fees or cost to the mortgagee to make the mortgage loan, which shall be determined after accounting for the value of servicing rights generated by making the loan and other income to the mortgagee related to the loan. Fees or costs must be fully documented for each specific loan.

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Dated: _April 9, 2010________

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David H. Stevens
Assistant Secretary for Housing–Federal
Housing Commissioner

[FR-5356-F-02]