



FHA's Proposed Supplemental Performance Metric

Intro

FHA proposes the implementation of an additional metric to evaluate lenders, tentatively named the "Supplemental Performance Metric". It will only be used as an additional compensating factor after the Credit Watch Termination Initiative is executed under current policy, and will help paint a clearer picture and provide a more well-rounded analysis of a lender's performance when FHA is considering further action. The inclusion of the Supplemental Performance Metric in this analysis reflects FHA's belief that a number of factors are relevant to and indicative of a lender's performance, and that a lender's story cannot be summarized by only its Compare Ratio.

Background

Compare Ratio

FHA currently calculates a Lender Compare Ratio for all FHA-approved lenders, which compares the rate of early defaults and claims for insured single family mortgage loans originated or underwritten by the mortgagee in an area with the rate of early defaults and claims for other mortgagees originating or underwriting insured single family mortgage loans in that same area.

The Compare Ratio is utilized to execute FHA's Credit Watch Termination Initiative, in which lenders with excessive default and claim rates compared to their peers may have their authority to originate and/or underwrite FHA loans terminated. In considering whether or not a lender's authority should be terminated, FHA evaluates all lenders with a compare ratio above 150%, and may propose termination for those with compare ratios that meet or exceed 200%, and whose default and claim rate exceeds the national average.

The Compare Ratio is also used to evaluate lender performance in determining eligibility for Lender Insurance (LI) authority. Lenders seeking LI authority must possess and maintain a compare ratio of 150% or less. FHA evaluates lender performance on a quarterly basis and may terminate a lender's LI authority if their compare ratio exceeds 150% at the time of evaluation.

Supplemental Performance Metric

FHA is aware of the recent difficulty of sub-680 credit score borrowers' ability to access credit, especially for those that are below 640. Because the Compare Ratio is a comparison to one's peers rather than to FHA's risk tolerance, lenders have expressed concern about lending to these underserved borrowers because of the impact of the compare ratio and the Credit Watch Initiative on their business at lower ends of the spectrum if their peers do not do the same, regardless of FHA's stated credit access goals and willingness to insure loans to borrowers with lower credit scores. Therefore, FHA proposes the implementation of an additional metric, which allows FHA to consider its portfolio risk tolerance in addition to the Compare Ratio. This new metric will provide more nuanced insight into a lender's specific performance and encourage lenders to serve creditworthy underserved borrowers. The methodology used to create this metric is outlined below.



Proposed Methodology

Distribution and SDQ Rates				Scores		
	<640	640-680	>680	Weighted SDQ	Compare Ratio	Supplemental Metric Ratio
Target						
Mix	25%	50%	25%	1.60%		
SDQ	3.0%	1.5%	0.4%			
FHA Portfolio						
Mix	9%	38%	53%	1.01%		
SDQ	2.6%	1.5%	0.4%			
Lender 1						
Mix	30%	60%	10%	1.89%	187%	118%
SDQ	2.9%	1.6%	0.6%			

The Supplemental Performance Metric will compare lender performance to a targeted risk mix and default rate, weighting defaults within three different credit score bands. This will create a lender's weighted average default rate that will be compared to an FHA target rate to derive a Supplemental Performance Metric Score. FHA will then consider this score when considering further action under the Credit Watch Termination Initiative. The loan populations used to develop the compare ratio are the same ones that will be drawn from when applying the Supplemental metric. Currently, termination of a lender's origination or underwriting authority under the Initiative may be pursued if:

- The lender's Compare Ratio exceeds 200%, **and**
- The lender's default and claim rate exceeds the national average.

This initial two-pronged evaluation will not change. The lender's Supplemental Performance Metric Score may only be considered as an additional factor in the total evaluation after the initial evaluation has triggered possible termination.

The target weighted seriously delinquent (SDQ) rate is initially proposed to be 1.60%, but may be revised on at least an annual basis. If the lender's Supplemental Metric Performance Score is less than 125% of the target rate, this may be a consideration to not take further action under the Initiative, along with other factors, such as de minimus volumes. Alternatively, if it is equal or greater than 125% of the target rate, that may be a consideration to move forward under the Credit Watch Initiative.

In the public view in Neighborhood Watch, users will be able to see the Supplemental Performance Metric Score for a lender as an additional column following the Compare Ratio, and would be able to access a definition of the metric and the display of FHA's targeted risk mix and default rate. In the lender view, in addition to the FHA's target mix and rate, lenders will be able to view their performance information at the national level.

Next Steps

FHA believes the Supplemental Performance Metric will improve its analysis under the Credit Watch Termination Initiative, and will help us capture more information than the compare ratio provides on a standalone basis. We encourage your feedback on this proposal. Please send all comments by Friday, June 13th, 2014 to SFFeedback@hud.gov.