MORTGAGE BANKERS ASSOCIATION
Investing in communities

Testimony of David G. Kittle, CMB

Chairman

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Oversight and Investigations

Hearing on

"Strengthening Oversight and Preventing Fraud in

FHA and other HUD Programs"

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Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA)[1] on strengthening oversight and preventing fraud in the Federal Housing Administration (FHA). I am David Kittle, Executive Vice President of Vision Mortgage Capital in Louisville, Kentucky, and MBA's Chairman.

I have been in the mortgage business and working with FHA insured loans since 1978. In 1983, 90 percent of the loans I closed as a loan officer were FHA loans (320 out of 343 loans made that year). From 1994 through 1999, FHA loans were about 38 percent of my company's business. I even financed my first home with an FHA mortgage. Over the last decade, prior to the current market crisis, FHA's prominence in and usefulness to the market dropped precipitously. As I will discuss, that is no longer the case today and is not likely to be the case going forward, and I commend the subcommittee for holding this important oversight hearing.

I want to preface my remarks today with an appeal to the members of this subcommittee and the Congress – please take this opportunity to be proactive and get FHA the resources it needs *before* there is a problem. Our government frequently finds itself in the position of reacting to problems, often when they have reached a crisis level. We have a chance, starting with this hearing today, to prevent possible problems at FHA by getting the agency the resources and tools it needs to succeed in the new mortgage environment. FHA is an important agency and meeting its needs now and for the future is critical to the health of the mortgage industry and housing consumers in America.

MBA has always advocated for a strong and vibrant FHA. We have been calling for updates to FHA's scope and operations since well before the current market disruptions re-established FHA's prominence as a catalyst for bringing liquidity to the housing finance system. MBA continues to believe that staff increases and technology upgrades are necessary for FHA to face the current market challenges and ensure its future viability.

FHA is especially important to segments of the population who have needed a little extra help to achieve the dream of homeownership. More than any other nationally available program, FHA focuses on the needs of first-time, minority, and low-and moderate-income borrowers. According to recent data provided by HUD, both first-time homebuyers and minorities continue to make up a significant portion of FHA's customer base. For example, in fiscal year (FY) 2009 to date, 78 percent of FHA-insured home

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

purchase loans were made to first-time homebuyers, and 32 percent were to minorities. Minorities also comprise a higher percentage of FHA borrowers than they do the conventional mortgage market.

The Growth of FHA and Increased Potential Impact of Fraud

The pace and magnitude of FHA's recent growth is further evidence of its significance to the nation's housing market. In FY 2009 to date, FHA has insured 550,000 home purchase loans, compared to 254,000 at this time in FY 2008. Considering that only three years ago, FHA's share of originations was three percent, its current 30 percent market share is truly astounding. MBA cites the following as the primary reasons for this dramatic growth:

- FHA loans usually require lower downpayments than loans purchased by secondary market participants such as the government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. The maximum loan to value (LTV) ratio for FHA-insured loans is 96.5 percent, compared to 95 percent for the GSEs.

- The Economic Stimulus Act of 2008 (EESA) temporarily raised the FHA and GSE loan limits for much of the country, which made FHA a more viable option for many homebuyers. Those temporary loan limits were replaced by new loan limits included in the Homeownership and Economic Recovery Act of 2008 (HERA), which were later temporarily modified by the American Recovery and Reinvestment Act of 2009. These limits are leading to many more loan originations.

Prudence and sound risk management principles suggest that the substantial increase in FHA volume should be accompanied by an equally sizeable emphasis on quality controls. Heightened vigilance is also required because there is evidence that some of the unscrupulous brokers, lenders and borrowers who once plied their fraudulent trade in the subprime market are migrating to the FHA market.

One issue that merits attention from a risk management perspective is the fact that mortgage brokers can be approved as FHA correspondents[2] even though they are less regulated than mortgage bankers.[3] MBA believes the vast majority of FHA originators are fair and responsible. Nevertheless, the market's dynamics and the distressed circumstances of many borrowers are attractive to those who seek out exploitative conditions. MBA is staunchly opposed to any and all deceptive, abusive or dishonest lending practices because of the harm they inflict on consumers, the damage they

[2] For purposes of this testimony, MBA is using the terms "FHA-approved lender" and "mortgagee" synonymously, and "FHA-approved broker" and "correspondent" synonymously.

[3] See *Mortgage Bankers and Mortgage Brokers: Distinct Businesses Warranting Distinct Regulation*, Mortgage Bankers Association, 2008: http://www.mortgagebankers.org/files/News/InternalResource/62646_Paper.pdf.

cause to the mortgage industry's reputation, and ultimately, the costs they impose on taxpayers.

Resources Necessary for Improved FHA Operations

MBA believes a critical requirement for achieving, sustaining and protecting the housing market's long-term vigor is ensuring that FHA has the resources it needs to operate in a high-tech real estate finance industry. FHA's staff levels have remained virtually unchanged even though its market share has risen from three to 30 percent. This ratio of activity to resources is currently unsustainable for FHA because it stretches limited resources to capacity. MBA therefore reiterates the request it has made to Congress on several occasions to provide FHA with additional funding to increase its staff and upgrade its technology, so it will be better equipped to handle the challenges of the current marketplace. Congress should also give FHA flexible authority to recruit and maintain staff outside of the government's standby personnel structure, much like the authority given to financial regulators. This will give FHA the ability to compete for the talented individuals that it might not be able to hire or retain.

MBA is grateful that Congress included in HERA authorization for $25 million to be allocated to FHA for each FY from 2009 through 2013. The Omnibus Appropriations Act of 2009[4] made $4 million available for FY 2009 and FY 2010 to be used "for planning, modernizing, improving and maintaining information technology applications and infrastructure supporting FHA." While this funding is appreciated, it is not enough to address FHA's needs. We urge Congress to ensure the complete and timely appropriation of $25 million in each fiscal year though 2013, as authorized in HERA. Furthermore, we request FHA be given the authority to use its future revenues to make additional technology upgrades as needed.

Ensuring these resources are available to FHA not only helps to support the viability of its products and services but it also protects the Mutual Mortgage Insurance Fund (MMIF), which is the insurance fund for FHA's programs. FHA is statutorily required to monitor the MMIF and provide an annual report on its condition to Congress. H.R. 2467 would increase the requirement to semiannual reports to Congress. MBA does not oppose more frequent reporting so long as the additional reporting requirements would not divert FHA's limited resources away from other important FHA initiatives, especially those related to quality control and loss prevention, which will guard the MMIF's safety and soundness.

[4] Pub. L. 111-8 (March 10, 2009).

Increase Resources to Prevent Losses at Ginnie Mae

Ginnie Mae also needs additional resources to keep up with the demand created by the dramatic increase in FHA-insured loan volume. The additional resources would help guard against mortgage fraud, among other efforts. Some fraudulent transactions are so complex that it takes years before the fraud results in an insurance claim with FHA. If it is among a pool of loans guaranteed by Ginnie Mae, a single loan can cause multiple repercussions. Regardless of how the fraud was perpetrated or the loss was brought about, the payout from Ginnie Mae and/or the MMIF adds to the strain on Ginnie Mae and FHA programs.

At a minimum, Ginnie Mae needs an increase in staff to meet the liquidity demands of the market, especially from FHA. An increase in operating expenses would provide funding for much-needed technology upgrades. MBA appreciates Congress granting additional commitment authority to Ginnie Mae earlier this year.[5] In general, additional funding also may be necessary if Ginnie Mae's market share increases beyond its current level. From 2007 to 2008, Ginnie Mae issuance increased from $85 billion a year to approximately $221 billion for the year – which is a 159 percent increase – and issuances for 2009 are projected to be greater. In that same period, however, the number of full-time employees has remained virtually stagnant around a mere 65 individuals, though some additional funds have been appropriated for approximately 15 additional employees just this year. MBA believes even more full-time employees are required. For these reasons, and considering that Ginnie Mae currently is one of the only providers of secondary market liquidity, MBA urges Congress to provide additional funds for staff and technology to Ginnie Mae as expeditiously as possible.

Improve the Quality of FHA Lenders and Originations

As a government housing finance program, FHA deserves, and borrowers should expect, exceptional quality standards. Because FHA-approved lenders and correspondents are the primary, and oftentimes the only, contact for most borrowers, MBA believes they should be held to the highest levels of accountability, knowledge and professionalism. For these reasons, MBA recommends raising FHA's existing qualification standards.

MBA believes one area where FHA should consider enhancing its quality controls is by setting higher net worth and bonding requirements for single-family mortgage correspondents and bankers to participate in the program. Net worth requirements enable lenders and correspondents to be held accountable for their actions, and provide tangible evidence of their "skin in the game." Currently, FHA requires mortgagees to have a minimum net worth of $250,000 in order to be qualified to underwrite FHA loans.

[5] The FY 2009 Transportation, Housing and Urban Development Appropriations Bill (Pub. L. 111-8, March 11, 2009) increased Ginnie Mae's guarantee commitment authority from $200 billion in FY 2008 to $300 billion for FY 2009, a 50 percent increase.

Correspondents must have a net worth of $63,000. MBA recognizes that differences in net worth and bonding requirements for mortgagees and correspondents are based on the principle that mortgagees have greater responsibilities to the public and investors. However, MBA believes both standards should be increased to hold both groups to more significant levels of accountability.

Specifically, MBA believes mortgage bankers should have a minimum corporate net worth of the greater of $500,000 or one percent of FHA loan volume up to a maximum of $1.5 million. Mortgage brokers should have a minimum corporate net worth requirement of the greater of $150,000 or 0.5 percent of FHA loan volume up to the minimum mortgage banker status, which is currently $250,000 unless it is increased to the $500,000 level recommended by MBA. Also, mortgage bankers and brokers should maintain a bond where required. The amount of the bond should be sufficient to provide reasonable protection to consumers and others.

MBA has strongly objected over the last two years when some consideration was given to lowering FHA's requirements for correspondents. We are pleased that Congress rejected this proposal and sincerely hope it is not reconsidered.

MBA also supports strengthening FHA's approval and recertification requirements so that lenders and correspondents maintain high standards of excellence throughout their relationship with FHA. Furthermore, licensing and registration requirements, coupled with net worth and bonding requirements, are essential components of any compliance framework.

MBA supported the Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act, (enacted as part of Title V of HERA) which encourages states to enact strong licensing and registration requirements for originators, and authorizes HUD to do so for mortgage bankers and brokers in states that fail to enact their own. However, these new licensing requirements should not apply to individuals who are purely mortgage servicers because that would hamper loss mitigation efforts and stymie initiatives to reduce FHA's claim costs.

FHA should have the ability to regularly communicate and monitor compliance with its lending requirements and other supervisory guidance. Moreover, FHA should possess sufficient authority to enforce those requirements in a timely and effective manner. The President recently signed the Helping Families Save Their Homes Act of 2009, which, among other provisions, provides enhanced authority for FHA to dismiss lenders that violate its rules, and authorizes FHA to impose penalties on entities that misuse FHA or Ginnie Mae designations.[6] MBA appreciates the efforts to give FHA more powers to regulate its participants, but we are concerned that it does not go far enough to give FHA the ability to expel problem participants from the program in a speedy manner. The Act requires a rulemaking to carry out this authority, which is expected to be issued in the coming weeks. MBA looks forward to responding to FHA with comments.

[6] See Section 203 of the Helping Families Save Their Homes Act of 2009, Pub. L. 111-22 (May 20, 2009).

The Role of Home Valuations

One topic the Subcommittee asked MBA to address specifically is the role of appraisals in real estate finance transactions. Reliable and accurate collateral valuations are important tools to help FHA, the GSEs and other private market insurers, lenders and investors to estimate their risk of loss in a transaction. Determining a property's value is not an exact science, and is even more difficult in markets where home prices are volatile or declining. As a method of promoting reliable and accurate appraisal practices, FHA-approved lenders are required to use FHA-approved appraisers.

MBA notes that appraisers are sometimes subject to undue pressure or coercion from any party to the transaction to adjust the property's value, be it the real estate agent, loan originator, seller or buyer. Preventing this unscrupulous behavior is among the reasons the GSE Home Valuation Code of Conduct (Code) was established.

The Code, which became effective on May 1, 2009, governs appraisals and valuations for mortgages sold to the GSEs, and is generating a number of implementation challenges for all lenders, including FHA-approved lenders. MBA is working with the Federal Housing Finance Agency (FHFA) and the GSEs to resolve a number of questions stemming from terms in the Code that are unclear or vague.

MBA believes changes must be made to the Code to overcome operational difficulties for lenders and borrowers. Even though the Code does not prohibit lenders from contracting directly with independent appraisers, many lenders prefer to minimize their compliance risk exposure by contracting with appraisal management companies (AMCs). As a result, appraisers affiliated with an AMC are being inundated with work, to the exclusion of independent appraisers. Another concern is that AMCs operating on a nationwide platform may not be as aware of valuation trends particular to a neighborhood as a local appraiser. Another concern is with the so-called "portability" of an appraisal from one lender to another. The Code permits a lender to accept an appraisal produced for another lender, but only after the receiving lender obtains confirmation in writing from the original lender that the appraisal is Code-compliant. Currently, there are no industry or supervisory standards regarding what is an adequate written confirmation of compliance with the Code. Therefore, receiving lenders are reluctant to accept another lender's appraisal because of the repurchase risk associated with breaching the Code. Thus, receiving lenders typically order a new appraisal at the expense of the borrower. Another concern relates to the Code's exemption for small institutions. The Code's definition of small business provides relief for small depository institutions, but does not address non-depository institutions. Therefore, some mortgage banks must comply with the Code even if they are smaller than exempted small depository institution counterparts.

Permanently Increase the FHA Loan Limits

As mentioned earlier, MBA believes that FHA's growth is partly due to the temporary increase in its loan limits for both the single-family and multifamily programs. The single-family loan limit for FHA varies throughout the nation according to home prices, ranging from $271,050 to $729,750. These higher loan limits will expire on December 31, 2009, when the limit in high-cost areas will drop to $625,500.

Currently, FHA, Ginnie Mae and the GSEs are the only significant housing finance liquidity resources. MBA believes it is imperative for these entities to provide secondary market support to the broadest spectrum of home prices possible during this period of market instability and beyond. Therefore, MBA encourages Congress to establish a permanent FHA single-family loan limit of $625,500 and up to $729,750 in high-cost areas. We urge Congress to act on this issue soon as the current loan limits expire at the end of this year.

Support Efforts to Combat Mortgage Fraud and Manage Risk

Recent statistics published by the Mortgage Asset Research Institute (MARI) indicate that reports of mortgage fraud increased 26 percent from 2007 to 2008.[7] This is particularly disturbing for FHA because its level of exposure to mortgage fraud is increasing with its market share. Regardless of whether a borrower, correspondent, lender or other participant in the transaction commits the fraud, the related claims payout reduces the level of the MMIF. Because taxpayers are ultimately responsible in the event the MMIF is depleted, MBA believes strong fraud deterrence, detection and enforcement measures are necessary ingredients of prudent risk management practices. MBA is pleased that the administration is requesting $20 million for HUD's Office of the Inspector General to combat fraud. MBA also is pleased that the Fraud Enforcement and Recovery Act of 2009 (FERA), which was signed into law on May 20, 2009, authorizes $266 million for federal law enforcement agencies to address mortgage fraud. This includes $30 million for the HUD Inspector General.

MBA works hand in hand with the Federal Bureau of Investigation (FBI), Financial Crimes Enforcement Network (FinCEN) and other law enforcement agencies to develop and implement mortgage fraud prevention programs. For example, MBA encourages all lenders to integrate the FBI's Mortgage Fraud Warning Notice[8] into their loan processes. MBA also supports additional dedicated funding for the FBI's mortgage fraud investigation and prosecution efforts, as well as additional appropriations for preventing losses due to mortgage fraud.

[7] See the 2009 MARI Mortgage Fraud Case Report to MBA: www.mortgagebankers.org/files/Advocacy/2009/2009MARIFraudCaseReport.pdf

[8] See http://www.fbi.gov/pressrel/pressrel07/mortgagefraudwarning.pdf for the notice.

Conclusion

Thank you for the opportunity to testify. MBA appreciates all that FHA and Ginnie Mae are doing to provide stability, liquidity and affordability during this difficult time in the housing finance market. As I have stated, now is the time for Congress to improve resources for these agencies in order to prevent problems from occurring. MBA stands ready to work with Congress to enhance and sustain FHA and Ginnie Mae now and in the future. I am happy to respond to your questions.