By electronic submission

July 14, 2015

Dear Ms. Pollard,

The undersigned appreciate the opportunity to comment on the Federal Housing Administration’s (FHA) proposed changes to the certification that a lender must sign when submitting a loan for FHA insurance. In this submission we summarize the challenge that FHA faces and offer a recommendation on how best to address that challenge.

*The Challenge*

We believe strongly that access to mortgage credit remains overly tight and that one of the causes for that tightness is lender concern about the rules governing the origination and servicing of government-backed loans. For more of our thinking on this topic generally, see [here](#), [here](#) and [here](#).

One of the most significant causes of this uncertainty is the process by which lenders certify to the accuracy and compliance of each loan they submit to the FHA for insurance. Under current rules, the FHA requires that lenders certify that each loan is virtually perfect in its factual content and its compliance with the applicable rules. If a loan defaults, the lender submits a claim for coverage to the FHA and if the loan file contains a mistake, a lender faces possible liability under the False Claims Act (FCA) for submitting a false claim to the government. If found liable, the lender could face treble damages.

The problem is that a large number of loan files contain small errors that are difficult if not impossible for lenders to eliminate through improved underwriting. Because they can’t sufficiently minimize their risk under the FCA by improving their underwriting, lenders do so instead by reducing the level of risk they are willing to originate. By reducing the risk of default, they reduce the risk that they have to submit a claim, and with it the risk that they face liability for submitting one that contains a false certification.

The effect of this enforcement regime is thus not better underwriting, but tighter lending. A better policy outcome, one presumably more in line with the intent of policymakers, would be an enforcement regime that leads to improved underwriting and broader access to credit.
While we applaud the FHA for tackling this difficult issue in their proposed modification of the loan-level certification (see here), we believe that their proposal would not adequately address the problem. In the attached proposal (titled “Revised Loan-Level Certification Proposal”), we offer an alternative that we believe would, leading to improved underwriting and broader access to credit.

The Proposal in Brief

In the proposal we recommend requiring lenders to certify that the loan they submit contains no mistakes that affect its insurability and arise from either lender fraud or a quality control process that falls short of FHA’s clear rules for quality control.1 The proposal also requires that lenders fix or remediate any mistakes affecting a loan’s insurability in accordance with FHA’s rules and processes for addressing such mistakes. A failure to meet any of these obligations would give rise to liability under the FCA. Thus, even if a lender fixes their mistakes, if those mistakes arise from lender fraud or a failed QC process, they will remain liable under the FCA.

We believe that revising the loan-level certification in this manner would render the FCA a much more effective enforcement tool than it is today or would be with the FHA’s proposed changes. By finally targeting the kinds of bad acts and actors that such a powerful instrument of enforcement should be focused on, the modified certification that we propose would create an incentive for lenders to improve their underwriting and quality control processes rather than simply reduce their lending.

Implementing the Proposal

In order to implement this proposal with the resources available to it today, FHA can use its considerable range of performance metrics to focus its in-depth QC monitoring on lenders that are at the greatest risk of non-compliance. Here are two such metrics to illustrate the point, though there are more:

- **Early payment defaults.** Early defaults well in excess of industry norms would suggest that a lender may not be complying with FHA’s underwriting or QC standards.
- **Supplemental performance metric.** Similarly, if the supplemental performance metric indicates that a lender poses a much higher level of risk to the FHA than its regional peers, this would suggest that a lender may not be complying with FHA’s underwriting or QC standards.

A red flag along metrics like these should trigger a deep dive into a lender’s QC processes to determine whether they are in compliance with FHA’s rules. Where FHA finds significant mistakes arising from a lender’s failure to meet FHA’s QC standards, they can then pursue actions under the FCA.

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1 These rules are laid out in Chapter 7 of its Mortgagee Approval Handbook (see here).
By specifying thresholds for performance and limiting QC audits to lenders that pose a greater risk to the FHA, through non-compliance with their QC standards or otherwise, FHA will not only create additional incentives for lenders to perform well across each of these metrics, but they will also much more effectively and efficiently identify the bad actors that should be subject to FCA liability.

Finally, this approach is in keeping with how an effective insurance company should operate. Insurance companies price their business to cover the risk that they have agreed to take, which is controlled by the standards that they require of those they will insure. With clear standards come clear norms of performance by the insured, and thus risk that is easier to manage and price. It is behavior that falls outside of the norm that is not well captured in the price. So it is precisely on those outliers that the FHA should focus.

**Conclusion**

Access to credit remains a serious problem in this country, and it is particularly problematic in the channel that is intended to provide the broadest access of all, the FHA. While there are many causes of this constraint—the high cost of servicing defaulting loans, soft demand associated with unemployment and underemployment, and a general uneasiness with taking on credit related risk coming out of a credit-driven crisis, to name but a few—the uncertainty that surrounds the certification process and the associated liability under the FCA is without a doubt a significant contributor. We urge you to consider adopting the approach outlined here to address that uncertainty.

Sincerely,

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Disclaimer: The views expressed herein represent the views of the undersigned only, not necessarily the institutions with which they are associated.
Revised Loan-Level Certification Proposal

“ACCEPT” OR “APPROVE” LANGUAGE:

This mortgage was rated as an “accept” or “approve” by FHA’s TOTAL Mortgage Scorecard. As such, as the undersigned representative of the mortgagee I certify that I have reviewed the TOTAL Mortgage Scorecard findings and have determined, based on reasonable underwriting diligence and judgment, and to the best of my knowledge, the loan complies with the written credit guidelines currently established by FHA, as published in the Single Family Housing Policy Handbook and/or applicable Mortgagee Letters, and the mortgagee did not knowingly or recklessly rely on false statements in the loan application or its addendum.

If the loan contains a significant underwriting defect(s) that would render the loan uninsurable, the mortgagee will be in compliance with program requirements if the mortgagee and the loan meet ALL THREE of the following conditions: (1) the mortgagee submitted the certification in the good faith belief that the loan was free of such defect(s) and it did not knowingly or recklessly rely on false statements in the loan application or its addendum; (2) the mortgagee has a Quality Control plan that meets the standards set out in the Mortgagee Approval Handbook1 and/or any applicable Mortgagee Letters in effect at the time the loan was originated; and (3) the mortgagee undertakes remedies of such defect(s) as provided in the following paragraph.

If any significant underwriting defect(s) that would render the loan uninsurable is found before the loan has been endorsed for insurance and such defect(s) is corrected, then the loan will be treated as remedied in compliance with this certification. If any such defect(s) is discovered after the loans is endorsed for insurance, and if the mortgagee or its agent thereafter remedies that defect, withdraws a claim or reimburses a claim payment, or indemnifies FHA (each, whether before or after a claim for insurance is submitted) in accordance with FHA’s administrative rules and procedures in effect at the time the loan was endorsed then the loan will be treated as remedied in compliance with this certification, it being understood that nothing in this certification shall expand the quality control requirements set out in the Mortgagee Approval Handbook and/or applicable Mortgagee Letters. As the undersigned representative of the mortgagee I certify that it is the mortgagee’s understanding that, with respect to loans that contain a significant underwriting defect(s) that would render the loan uninsurable, the loan will be in compliance with program requirements if (a) the above conditions in this paragraph are met, and (b) conditions (1) and (2) above are true as of the date of this certification.

“REFER” LANGUAGE

This loan was rated as a “refer” by a FHA’s TOTAL Mortgage Scorecard, or was manually underwritten by the undersigned. As such, as the undersigned Direct Endorsement underwriter and representative of the mortgagee, I certify that I have personally reviewed the appraisal report (if applicable), credit application, and all associated documents used in underwriting this loan and have determined, based on reasonable underwriting diligence and judgment, and to the best of my knowledge, the loan complies with the written

1 These rules are currently set out in Chapter Seven.
credit guidelines currently established by FHA, as published in the appropriate Handbook(s) and/or Mortgagee Letters, and the mortgagee did not knowingly or recklessly rely on false statements in the loan application or its addendum.

I further certify that to the best of my knowledge:

- I have performed all specific responsibilities for underwriters and my underwriting of the loan is within the program parameters established by FHA in the appropriate Handbook(s) and/or Mortgagee Letters, and
- I have verified the Mortgage Insurance Premium and Mortgage Amount are true and correct and this loan is in an amount that is permitted by FHA for this loan type, property type, and geographic area.

If the loan contains a significant underwriting defect(s) that would render the loan uninsurable, the mortgagee will be in compliance with program requirements if the mortgagee and the loan meet all of the following: (1) the mortgagee submitted the certification in the good faith belief that the loan was free of such defect(s) and the mortgagee did not knowingly or recklessly rely on false statements in the loan application or its addendum; (2) the mortgagee has a Quality Control plan that meets the standards set out in Mortgagee Approval Handbook\(^2\) and/or any applicable Mortgagee Letters in effect at the time the loan was originated; and (3) the mortgagee undertakes remedies of such defects(s) as provided in this paragraph. If any significant underwriting defect(s) that would render the loan uninsurable is found before the loan has been endorsed for insurance and such defect(s) is corrected, then the loan will be treated as remedied in compliance with this certification. If any such defect(s) is discovered after the loan is endorsed for insurance, and if the mortgagee or its agent thereafter remedies that defect, withdraws a claim or reimburses a claim payment, or indemnifies FHA (each, whether before or after a claim for insurance is submitted) in accordance FHA’s administrative rules and procedures in effect at the time the loan was endorsed then the loan will be treated as remedied in compliance with this certification, it being understood that nothing in this certification shall expand the quality control requirements set out in the Handbook and/or applicable Mortgagee Letters. As the undersigned representative of the mortgagee I certify that, with respect to loans that contain a significant underwriting defect(s) that would render the loan uninsurable, it is the mortgagee’s understanding that the loan will be in compliance with program requirements if (a) the above conditions in this paragraph are met and (b) conditions (1) and (2) above are true as of the date of this certification.

\(^2\) These rules are currently set out in Chapter Seven.