

January 22, 2007

The Honorable Barney Frank  
Chairman  
Financial Services Committee

The Honorable Spencer Bachus  
Ranking Member  
Financial Services Committee

Dear Chairman Frank and Ranking Member Bachus:

For over 70 years the Federal Housing Administration (FHA) has contributed to the expansion of homeownership opportunities. FHA has accomplished this by focusing on the needs of first time homebuyers and through product innovations, such as the 30 year amortizing mortgage and low downpayment requirements. We applaud your leadership, as well as that of Congresswoman Waters, former Ranking Member of the Housing and Community Opportunity Subcommittee, and other members of the Financial Services Committee, for their dedication to improving and expanding FHA.

Last year, H.R. 5121 passed the House with overwhelming bipartisan support. We see this as a positive sign, indicating broad support for affordable lending options. As organizations that work closely with, or on behalf of, homebuyers who fit the traditional FHA profile, we share your goal of modernizing FHA and making it as accessible as possible. The rise of subprime lending and other changes in mortgage market recently seem to have cut into and reduced FHA market share. In addition to overall market shifts, we are also concerned that a rise in abusive lending practices is a contributing factor to the decline in FHA production. Thus we urge you to see this committee's efforts to address predatory lending as a complementary and necessary strategy to improve the accessibility of FHA.

In previous letters and in meetings, we have stated that some provisions of the bill are of concern to us. Namely, we urge members of the committee to proceed with caution when expanding the parameters of the FHA program, and to ensure that any expansion is balanced with advances in consumer safeguards designed to help vulnerable families maintain their home equity. Any changes to FHA should be in keeping with its mission to help underserved homebuyers realize their dream of safe and affordable homeownership. It is in this spirit that we reviewed H.R. 5121. Below we have listed two key areas where we think the bill could be enhanced to provide additional security to vulnerable low- and moderate-income borrowers.

- **Risk-based pricing.** We applaud Chairman Frank on his amendment that brought reasonable limits to the original risk-based pricing proposal. We also welcome ideas regarding the cross-subsidization of risk-based premiums. However, as mentioned above, we strongly believe that expansion of the FHA product or changes to its fee structure should not be considered without offsetting

- consumer protections. We recommend that the committee strengthen this proposal by making pre- and post-purchase counseling available to FHA clients and by building the capacity of the loss mitigation department. Specifically:
- **Create incentives for families to receive counseling.** We urge you to offer families who receive pre-purchase counseling at least two weeks before they sign their loan agreement a discounted insurance premium. FHA originators should be obligated to provide information regarding area HUD-certified housing counseling agencies at the time that FHA is considered as a viable loan option, leaving the family sufficient time to receive counseling before they sign their closing documents.
  - **Provide counseling options to families experiencing hardship.** FHA originators should prompt families as to whether they would give their counseling agency of choice permission to contact them in the event they become 45 days past due. By giving their consent, the servicer is able to share the family's information without violating privacy laws. The family also benefits by having an independent third-party provide delinquency intervention services, which have been proven to be more effective than servicer communications alone. In addition, when the counseling agencies resolve a delinquent loan case successfully, FHA servicers should pass through the fee they receive for providing loss mitigation to the counseling provider.
  - **Strengthen the FHA loss mitigation program.** Despite FHA's commitment to the homebuyer to make loss mitigation services available in the event they experience financial hardship, too often servicers do not comply with HUD's loss mitigation regulations. The FHA deed should be enhanced to clarify that a borrower has a right under the contract to loss mitigation. In addition, FHA's loss mitigation program needs to prioritize a homeowner's ability to save the home when facing foreclosure. This can be done by adjusting the servicer's fee schedule to provide at least equal compensation for loss mitigation services and a short sale or other loss of the home. Moreover, we recommend that HUD be given the affirmative responsibility for monitoring whether borrowers receive adequate loss mitigation services (and reporting to Congress on such monitoring and enforcement work). The current system in particular masks loss mitigation failures at large servicers due to its emphasis on percentages of loans serviced. HUD has the power to penalize servicers who fail to help homeowners save their homes; this power should be used as part of a vigorous enforcement program.
- **Mortgage brokers.** For many low- and moderate-income and disenfranchised borrowers, mortgage brokers are a primary resource for purchasing a home. Unfortunately, the integrity of this relationship has not been well protected. We are concerned that expanding the pool of mortgage brokers allowed to originate FHA mortgages could result in bad actors taking advantage of FHA products to the detriment of borrowers and American tax payers. Any expansion of the privilege of originating FHA loans must be balanced by an increase in consumer

safeguards. In addition to the counseling and loss mitigation recommendations made above, we also recommend:

- **Create an FHA-Approved Originator Code of Ethics.** A code of ethics would become the standard of quality service by which originators are evaluated. A code of ethics should protect the integrity of the borrower-broker relationship, promote transparency in the mortgage transaction, prohibit pressure sales tactics, and ensure that the borrower has access to accurate and timely information regarding the price of their loan. In addition to independent reviews of the performance of FHA-approved originators, HUD can also monitor the extent to which the code of ethics is being upheld by conducting random surveys or interviews with FHA borrowers shortly after closing. Violators of the code of ethics should be removed from the FHA-approved list.

In addition, we applaud the committee for inserting checks into the FHA program that will monitor the effect of the new mortgage product parameters and pricing structures. Requiring an annual report to Congress regarding the default rates related to any of the new provisions of the FHA program is vital to monitoring the overall health of the program and holding program administrators and loan originators accountable. We recommend adding a review of loss mitigation programs and making the report an annual requirement, regardless of the default ratios. We also believe that the incentive for on time payments is commendable. Families who pay on time consistently establish themselves as less of a credit risk and deserve to have their premium reduced. We urge you to require this to be explained to the consumer immediately upon receiving an FHA loan so they are aware of the potential benefit and that the price reduction occur automatically.

Finally, as organizations dedicated to the advancement of safe and affordable homeownership opportunities for all families, we also ask the committee to consider the recommendations below regarding ways to improve and maintain the availability of safe and affordable mortgage products in the market place.

- **Promote sustainable homeownership.** Many homeowners continue to be victims of abusive lending practices, jeopardizing their hard-earned home equity and financial safety net. Passing strong, comprehensive predatory lending legislation is essential to promoting sustainable homeownership. Cracking down on predatory practices also makes way for credible, affordable mortgage products, such as FHA-insured loans.
- **Create a mortgage rescue fund.** Congress should authorize FHA to create a homeownership preservation fund from program profits as a way to increase their loss mitigation capacity. The fund would target homeowners who are more than sixty days delinquent and who have a reasonable chance to cure their default within twenty-four months.

- **Hold originators and mortgage brokers accountable.** Families trust their mortgage providers to adhere to a certain level of professionalism, including representing their interests. Many borrowers believe their mortgage broker is required to get them the best deal. Congress must require mortgage brokers and originators to treat their clients fairly, establish their ability to repay the loan sold to them, and refrain from channeling clients to high-priced or risky mortgages unnecessarily.
- **Review the impact of risk-based pricing.** It is our understanding that the Government Accountability Office is still reviewing the impact of risk-based pricing on FHA and their borrowers. We urge the committee to take their assessment into account. Moreover, most risk-based pricing models are proprietary, thus their impact on borrowers with nontraditional profiles is unclear. This committee should further study this issue through hearings and inquiries to bank regulators.

Should you have any question or concerns, please do not hesitate to contact our organizations.

Sincerely,

Center for Responsible Lending  
Consumer Action  
Consumer Federation of America  
National Association of Consumer Advocates  
National Community Reinvestment Coalition  
National Consumer Law Center  
National Council of La Raza

cc: Nat Thomas, Policy Advisor, Office of Congresswoman Maxine Waters  
Scott Olson, Senior Professional Staff, House Financial Services Committee  
Cindy Chetti, Senior Professional Staff, House Financial Services Committee