STRENGTHENING OVERSIGHT AND PREVENTING FRAUD IN FHA AND OTHER HUD PROGRAMS

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BEFORE THE

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OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

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STRENGTHENING OVERSIGHT AND PREVENTING FRAUD IN FHA AND OTHER HUD PROGRAMS

Thursday, June 18, 2009

U.S. House of Representatives,
Subcommittee on Oversight
and Investigations,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Dennis Moore [chairman of the subcommittee] presiding.

Members present: Representatives Moore, Lynch; and Biggert.

Also present: Representative Posey.

Chairman Moore of Kansas. Good morning. Welcome to the Committee on Financial Services, Subcommittee on Oversight and Investigations. This subcommittee will come to order.

Our hearing this morning is entitled, "Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs." I would like to welcome my distinguished colleague and the ranking member, Judy Biggert, Congresswoman Biggert. And we might have some other people show up, but we just got word that there are going to be 28 votes in about 15 or 20 minutes. So I doubt that we can get all of this in, in the next few minutes, but we will move as quickly as we can here.

I would like to start my opening statement if that is all right. And if there is time for Mrs. Biggert to complete her opening statement, then so be it.

This hearing of the Subcommittee on Oversight and Investigations of the House Financial Services Committee will come to order. Our hearing this morning is entitled, "Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs."

We will begin this morning's subcommittee hearing with members' opening statements, up to 10 minutes per side, and then we will hear testimony from our witnesses. After that, members will each have 5 minutes to question witnesses.

Without objection, all members' opening statements will be made a part of the record.

Without objection, I ask that written testimony from the Department of Housing and Urban Development and the National Association of Realtors be entered into the record.

I now recognize myself for up to 5 minutes for an opening statement.

On April 27th, I hosted a press conference at the Federal Courthouse in Kansas City, Kansas, with Missouri Attorney General Chris Koster, Kansas Attorney General Steve Six, as well as the local FBI Supervisory Special Agent and a Special Agent from the Office of the Inspector General from HUD. At that event, our goal was to raise public awareness of the mortgage fraud schemes that have been going on.

In the current economic environment, too many homeowners are encountering significant difficulty in making their mortgage payments. Too many are at risk of losing their homes. There are a number of great people and resources out there to help homeowners work with their lenders so they can meet their mortgage obligations. Unfortunately, as a former district attorney, I know all too well there are also people out there who will exploit weakness and prey on the fear of others.

Over the last few months, we have seen an increase in the number of fraudulent mortgage loan schemes that take advantage of those homeowners in desperate situations. Under the pretense of helping homeowners modify their mortgage obligations, these schemes result in the loss of money, equity, and in many cases the home itself. We often think of robbery as taking place with a knife or a gun, but these thieves instead come with a smile, a handshake, and a ballpoint pen, ultimately leaving a family in deeper trouble.

Through my role as chairman of the Financial Services Oversight and Investigations Subcommittee, I am determined to ensure that local, State, and Federal law enforcement agencies have all the resources and tools they need to prosecute these horrible thieves. That is why I was a cosponsor of the Fight Fraud Act, which was renamed the Fraud Enforcement and Recovery Act by the Senate.

No matter what you call it, this legislation is important. It strengthens the accountability standards for financial, mortgage lending, and securities agents and institutions, and authorizes additional funds for the Department of Justice, the FBI, HUD's Inspector General, and other Federal agencies so they can hire the investigators they need to examine and prosecute fraudulent activity.

Ranking Member Judy Biggert was a lead sponsor of the bill as well, and I would like to commend her for all the work she has done over the years fighting mortgage fraud. I am sure she shares my sentiment that I was pleased when President Obama signed this important legislation into law.

One of the issues we will be focusing on today as we consider strong oversight of HUD is the role of FHA and its rapid expansion of lending in the mortgage market. Even after the subprime market collapse, FHA has continued to provide mortgage credit to responsible borrowers. But we must be vigilant to ensure that the same bad actors who contributed to the housing crisis don't make their way into the FHA program.

In addition to the Fraud Enforcement and Recovery Act, President Obama also signed into law the Helping Families Save Their Homes Act. These two new laws improve FHA requirements and give the FHA more authority to keep bad actors out of the FHA program and provide additional enforcement tools to police those lenders who employ false or misleading tactics. In fact, just last week HUD announced they suspended three lenders from the FHA based on evidence of serious violations under HUD's regulations.

Another area of concern is the use of reverse mortgages that are primarily used by seniors. I agree with the Comptroller of the Currency, John Dugan, who recently raised a red flag on these reverse mortgages and noted that closer Federal oversight may be necessary to protect the FHA and homeowners.

I am also interested in learning more about the need for accurate and independent appraisals, and the role appraisals currently play with respect to FHA-insured loans.

If there is one lesson we have learned from the financial crisis, it is that we need to eliminate conflicts of interest and strengthen the integrity of any valuation process, everything from credit rating agencies to appraisals. I look forward to hearing from our witnesses on these and other important oversight issues.

I will conclude my remarks by reminding everyone to be on high alert for mortgage fraud. If you or someone you know is suspicious of or unsure if someone is legitimately trying to help, please contact local law enforcement and let them know so they can investigate. It is imperative that we protect ourselves, our neighbors, and put those people preying on the victims of this housing crisis behind bars.

I now recognize our distinguished ranking member of the subcommittee, my colleague and friend from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you very much, Chairman Moore, and thank you for scheduling this hearing today on mortgage fraud. Some years ago, the Chicago Tribune published a series that revealed that gangs in the Chicago area were increasingly turning to mortgage fraud. They found it easier and more lucrative, believe it or not, than selling drugs. And it turns out that the gangs were not alone. Everyone, it seems, was in on the act.

Earlier this year, a U.S. attorney in Chicago, Patrick Fitzgerald, brought mortgage fraud indictments against two dozen players. They are brokers, accountants, loan officers, and processors and attorneys. So mortgage fraud comes in all sizes and shapes. Scam artists inflate appraisals, flip properties, and lie about information, including income and identity on loan applications. Some use the identity of deceased persons to obtain mortgages. And other desperate thieves bilked the most vulnerable homeowners and seniors in dire financial straits out of their homes and home equity.

Let's face it; I think this is just the tip of the iceberg. And as we in Congress work to get the economy back on track and credit flowing again, we have to address what was the root of the mortgage meltdown in the first place, and that was mortgage fraud. Mortgage fraud is at the root of the meltdown that has undermined our housing market and contributed to this economic downturn.

To restore confidence in the home buying process, it is critical that we provide our investigators and prosecutors the tools and resources that they require to accomplish their mission and put bad actors behind bars.

As a former real estate attorney, and a member of the House Committee on Financial Services, I have seen firsthand the devastating effect of mortgage fraud. It has plagued our financial system and economy. Most tragically, it has cost millions of American families their houses, and required taxpayers to commit trillions of their hard-earned dollars to prop up the financial industry. It is just not fair to the good actors in the industry and the 90 percent of homeowners who are paying their mortgages on time.

According to the FBI, its mortgage fraud caseload increased by 237 percent in the last 5 years, and investigations more than doubled in 3 years. During a 12-month period ending in 2008, mortgage fraud reports increased by 44 percent, reaching over 63,000 reports, with predictions of up to $25 billion in losses.

That said, I am not surprised that, with FHA's significant increase in market share, that fraud has quickly followed. And I did introduce several bills, starting in 2007. Several passed the House, and then went over to the Senate, where somehow they got lost. And so we kept introducing and introducing, and finally went to the Judiciary Committee, and put the mortgage fraud into a bill that was introduced by Chairman Conyers and Chairman Moore and other members. And this was H.R. 1748, the Fight Fraud Act, which was the House version of Senate 386. And with that, we both had the ability to go to the White House while this bill was signed into law by the President.

So as we work to pinhole loopholes and close them as we work to modernize the financial laws and regulations, it is also our duty to supply Federal law enforcement with the tools and resources that they need. And in addition, I think it is critical that we hold a hearing to learn more about the kinds of technology that can be used to increase transparency in the mortgage process to quickly flag illegal activity and apprehend the perpetrators.

So, Chairman Moore, I would really like to request that we hold a hearing on technology, which I think would be helpful to this. By increasing the transparency in the process through technology, this would help.

So with that, I would like to thank today's witnesses and my colleagues on the committee for their commitment to one of the most important issues today.

Chairman MOORE OF KANSAS. Thank you to my ranking member. And I really appreciate her service on the committee and the insight she brings to this.

I want to say, very quickly here, we have received some unpleasant information, which is that at about 10:15, 28 votes are going to be called. I don't know, this was not planned, we certainly didn't know about this, but I want to introduce at least three of the witnesses who traveled here first. And we may have to take written testimony from the others. If we are going to be gone for 2 hours over there voting, which may be the case, seriously—I would love to say differently—but the problem is that Secretary Geithner is coming at 1 p.m., so we need to be ready for him.

I want to introduce Mr. Kenneth Donohue, the Inspector General for the Department of Housing and Urban Development. During the savings and loan crisis, Mr. Donohue served as Assistant Director in the Office of Investigations in the RTC.

And I am going to shorten the introductions right now, and I hope all the witnesses understand. I am not trying to slight anybody, but we have to move along here.

Mr. Kevin Nunnink—I invited him—who is chairman of the IRR-Residential and chairman, Integra Realty Resources, is from Kansas, and he will be testifying as well.

We are going to ask Mr. Pellegrini to testify. And would you like to introduce Mr. Pellegrini very quickly?

Mrs. BIGGERT. Yes. I would like to welcome from Chicago a fellow lawyer, Mr. Frank Pellegrini. He is the founder, president, and chief executive officer of Prairie Title Services in Oak Park, and serves many of my constituents in the 13th Congressional District. And he is a principal of the law firm of Pellegrini and Cristiano, a general practice firm that specializes in real property law, business formation and counseling, and estate planning. Welcome.

Chairman MOORE OF KANSAS. Thank you. I am not going to introduce the other witnesses right now, and I apologize for that. I am not trying to slight anybody, but I hope you understand. We want to get moving here so we can move as quickly as possible. Without objection, the written statements of all the witnesses will be made a part of the record. You will each be recognized for a 5-minute statement. We are going to start with you, Mr. Donohue.

And please, I am not trying to slight the other witnesses by not introducing you, but I hope you understand why I am doing this.

Mr. Donohue, please. You have 5 minutes, sir.

STATEMENT OF KENNETH M. DONOHUE, SR., INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. DONOHUE. Thank you, Chairman Moore, Ranking Member Biggert, and members of the subcommittee. I appreciate the opportunity to testify on the role of FHA in addressing the housing crisis, as well as other HUD-related topics. Through our work in auditing and investigating many facets of the FHA program over the course of many years, we have had concerns regarding FHA's systems and infrastructure to adequately perform its current requirements. This was expressed by the OIG to the FHA prior to the current influx of loans and to the numerous proposals that expand its reach. We remain keenly interested in FHA's ability and capacity to oversee newly generated businesses.

The past year-and-a-half have certainly produced a lot of changes. With the collapse of the subprime market, FHA has seen a dramatic increase in new businesses. The Housing and Economic Recovery Act created a program to enable FHA to refinance the mortgages of at-risk borrowers and authorize changes to the Home Equity Conversion Mortgage program that will enable more seniors to tap into their home equity. The volume of single-family loans has increased by a tripling from $59 billion in 2007 to over $180 billion in 2008. FHA's share of insured endorsements has increased from 24 percent to 63 percent, which includes home sales and refinances.

Though HUD is hiring some new personnel, we believe there is a critical need for more resources for FHA to enhance its IT systems, to increase its personnel to deal with escalating and processing requirements, to increase its training to maintain the workforce with the necessary skills, to oversee the numerous contractors it maintains, and to increase its oversight of all critical front-end issues, including areas such as the appraisal and underwriting process.

We are gratified the new penalty provision we helped craft was inserted into the HERA bill. The statute now creates a penalty for committing fraud against FHA programs, and it will be a useful tool for prosecutors and the law enforcement community to employ.

We are also very pleased that many of the provisions we advocated to Congress to improve internal control process and enhance penalties were incorporated both in the Fraud Enforcement and Recovery Act and the Helping Families Save Their Home Act.

The Secretary also announced a number of new transformations, initiatives designed to address some of the concerns we are raising. The results of the last actuarial study shows that HUD has sustained significant losses in its single family program, making a robust program's reserves smaller. As of September 30, 2008, the fund's economic value was an estimated $12.9 billion, an almost 40 percent drop from over $21 billion the year before. That represents 3 percent of the mortgages insured by the FHA. Although above the 2 percent ratio required by law, it is well below the 6.4 percent ratio at the same time last year.

If more pessimistic assumptions are factored in, the ratio could dip below 2 percent in succeeding years, requiring an increase in premiums or congressional appropriations intervention to make up the shortfall.

As the Department is in the process of reforming its annual actuarial reviews, it is critical that assumptions used to drive the current estimates of the health of the fund be supportable.

Among many different areas we have reviewed, we have found the FHA needs to improve its internal control structure. Our audit over the FHA appraisal roster identified weaknesses in the quality control review and the monitoring of that roster. Results from a number of other audits have noted significant lender underwriting deficiencies and other operational irregularities.

The tightening credit market has increased FHA's position as a loan insurer. And with that is coming increases in lender-brokers seeking to do business with the Federal program, and a concern regarding some of these loan originators.

For example, we currently have under investigation several FHA lenders who were also lenders in the subprime market. FHA lender approval increases 525 percent in the last 2-year period. Newly signed legislation mandates an enhanced eligibility approval process, and we look forward to its implementation.

We recently completed inspection of the Mortgage Review Board enforcement action and its effectiveness in resolving cases of serious noncompliance with FHA regulations, particularly during this period of significant change in the housing market. Again, the new legislation contains some provisions to strengthen this board, an important recommendation from our inspection.

Another area of concern is the growing HECM, or reverse mortgage program. We are aware that the larger loan limits can be attractive to exploiters of the elderly, whether it be by third parties, or even family members who seek to strip equity from seniors. Due to the vulnerability of the population this program serves, we are also concerned about evasion of statutory counseling requirements.

Finally, since you are about to undertake financial regulatory reform shortly, I think it is important to raise a few issues. The fact that our nationwide mortgage lending system is fragmented, with separate players embracing different requirements, creates opportunities for waste, fraud, and abuse that a more unified approach could potentially mitigate. We think it would be beneficial for the FHA to come together more significantly, in a unified lender oversight consortium with Fannie Mae, Freddie Mac, the FDIC, and Ginnie Mae, in order to create standardized forms.

Chairman MOORE OF KANSAS. Excuse me, Mr. Donohue. I apologize. We are going to have to wind up, and your written statement will be made a part of the record. I am going to move on to the other two witnesses and then to the other three for a brief statement as well, if that is okay. And I apologize for this. This was not planned at all.

[The prepared statement of Inspector General Donohue can be found on page 39 of the appendix.]

Chairman MOORE OF KANSAS. At this point, the Chair recognizes Mr. Nunnink. And everybody's statements will be made part of this record.

STATEMENT OF KEVIN K. NUNNINK, CHAIRMAN, IRR-RESIDENTIAL, LLC, AND CHAIRMAN, INTEGRA REALTY RESOURCES

Mr. NUNNINK. Thank you. Chairman Moore, Ranking Member Biggert, and members of the subcommittee, thank you for inviting me to testify today.

As a real estate appraiser for 30 years, I appreciate this opportunity to speak on an important topic critical to restoring the confidence in the real estate mortgage industry. I am chairman of both Integra Realty Resources and IRR-Residential, and we have a thousand licensed appraisers working throughout the United States.

Sound mortgage underwriting includes two separate but equally important components: First, a borrower's ability to pay as evidenced by their income and credit score; and second, sufficient value of the real estate to support the loan type, as evidenced by the appraised value. It should be noted that of all the professionals involved in the mortgage origination process, the appraiser is frequently the only professional who visits the property implicitly for the purpose of providing due diligence for their lender client. He inspects the property and makes sure the property has sufficient value to support the intended loan. Appraisers are licensed and professionally trained to value real estate, and must meet education and experience requirements.

Appraiser separation is particularly important in today's mortgage industry, where virtually all mortgage originators sell their mortgage paper to the secondary market, and thereby hold minimal long-term risk.

An independent appraiser makes it much more difficult to initiate mortgage fraud. An independent appraiser serves as the safeguard for the protection of the current and future parties to the loan transaction, including the borrower, the originating lender, the secondary market participant, and as we are now seeing, the taxpayer.

Any effort to circumvent the independence of the appraised value heightens mortgage risk. Because of the housing slump and corresponding disruption in the credit markets over the past couple of years, there have been a number of initiatives, legislatively and by regulation, increasing the separation between the contingent fee real estate mortgage professional and the appraisal process. We support those efforts.

Congress appropriately restricted this type of influence in FIRREA in 1989, but because mortgage bankers and brokers were not regulated by the FDIC, they did not have to provide separation between the appraisal process and the mortgage originator. The Fraud Enforcement and Recovery Act of 2009 appropriately provided further regulation upon these nontraditional bank lenders.

There have been two structural conflicts of interest in the appraisal process: one, loan originators selecting and regulating the volume of work to the appraiser; and two, real estate mortgage companies providing bundled services, including appraisal, whose primary goal is to drive EBITDA, is contingent upon a successful loan closing. In both cases emphasis is upon the loans, not protecting the independence of the appraisal process.

We were disappointed when the final version of the Home Valuation Code of Conduct gave a pass to those companies, lender-owned or not, that also provide title insurance, loan closing services, etc. In those cases, the company's ability to receive the title and closing fees is contingent upon the loan going forward, which in part is conditioned upon the appraised value process they manage, and an inherent conflict of interest.

Chairman MOORE OF KANSAS. Excuse me, Mr. Nunnink. I apologize, but we are going to have to wind up with that. And we will receive your written statement in the record.

Mr. NUNNINK. Thank you, Mr. Chairman.

[The prepared statement of Mr. Nunnink can be found on page 67 of the appendix.]

Chairman MOORE OF KANSAS. And I want to recognize the other witness who traveled to come here. Then we are going to take 2- or 3-minute statements from each of the other witnesses if we have time. Votes have not yet been called yet.

Mr. Pellegrini, if you would please. And again, please forgive this. We did not plan it this way.

STATEMENT OF FRANK PELLEGRINI, PRESIDENT, PRAIRIE TITLE, ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION (ALTA)

Mr. PELLEGRINI. Thank you, Mr. Chairman. Good morning, Ranking Member Biggert, and distinguished subcommittee members. I am a member of the board of governors of the American Land Title Association, which I am here today to represent.

ALTA is the national association for the title industry, representing nearly 3,000 member companies, with more than 100,000 employees, including title insurers, title insurance agents, abstracters, and attorneys that operate in every State and county throughout the United States.

In my hometown of Chicago, as in many large urban areas, the proliferation of mortgage fraud activities is particularly disturbing.

As Mrs. Biggert pointed out, the profile of the typical Chicago gang leader has evolved into a picture of a graying, suburban technology-friendly convict overseeing operations as diverse as mortgage fraud and drug dealing.

This form of criminal activity is spreading. Fraud, in fact, is the second leading cause of title claims, so we track it very closely. Our experience dictates that mortgage fraud schemes change with the economy. In a more robust economy, we witnessed that claims involve inflated values. As prices have fallen and equity has dried up, we now see loan-slamming claims. Additionally, with large numbers of mortgage defaults, short-sale mortgage fraud claims are becoming more prevalent.

Title professionals enjoy a unique vantage point from which to observe, identify, and thwart instances of fraud. We are the independent third party to the transaction, whose only interest is to the integrity of the transaction and the protection of our customers. Through training and experience, we hone our ability to spot improper transactions every day. We look for a number of mortgage fraud indicators, including earnest money deposit that comes from someone other than the borrower, or lack of information about the source of the deposit; similar carry-back documents that are not being disclosed to the lender; payments to third parties that will not appear on the HUD settlement statement; wide swings in the mortgage amount; recent sales with increases in price, and checks to others at closing, which could be a sign of flipping; substitution of sales contract for a higher amount; the signing of blank documents, and changes or increases in the purchase price.

As settlement service providers, we prevent fraud by carefully checking identification. In fact, we know of a case in which a caregiver stole the information of an elderly gentleman whom he worked for by merely acquiring the driver's license and replacing the picture on it. The caregiver then applied for a mortgage refinance and walked away with $65,000. In this case, a check of the birth date would have been a tip-off that something was wrong. We also prevent fraud by knowing our customers.

Chairman MOORE OF KANSAS. Mr. Pellegrini, I apologize to you, too. If we can, we are going to give each of the other witnesses 2 minutes to try to summarize their testimony. Then we are going to start with some questions. All of your written statements will be received for the record.

[The prepared statement of Mr. Pellegrini can be found on page 69 of the appendix.]

Chairman MOORE OF KANSAS. Mr. Kittle. And again, please accept our apologies. Mr. Kittle, if you would, please, sir.

STATEMENT OF DAVID G. KITTLE, CMB, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Mr. KITTLE. Thank you, Mr. Chairman.

FHA is a program that is vital to the American home buyers. It is one that is important to me personally, as I purchased my first home in 1978 with the FHA program. Currently, FHA is experiencing a rebirth, and I want to preface my remarks this morning with a direct appeal to Congress that if we don't take this opportunity to be proactive and get FHA the resources it needs, the recent reemergence of FHA won't last long. We have a chance to prevent future problems, and we must start today.

First and foremost, we need to give FHA the resources it needs to operate in an increasingly nimble and high-tech real estate finance industry. Its market share has risen from 3 to 30 percent virtually overnight, but it is still hampered by outdated technology, and its staff is stretched dangerously thin.

The solution is fairly straightforward. Under HERA, Congress has already authorized $25 million per year for staffing and technology upgrades. We now need to work together to make sure this funding is appropriated.

We also need to make sure Ginnie Mae has the resources it needs to keep pace with the spike in government lending. From 2007 to 2008, its issuance has increased from $85 billion to $221 billion, with a staff of 65. That needs to be increased to at least 90. Currently, FHA requires mortgagees to have a minimum net worth of $250,000 in order to be qualified to underwrite FHA loans. Brokers must have a net worth of $63,000. MBA believes that both these standards should be increased to make these industries more accountable.

Specifically, we recommend mortgage bankers should have a minimum corporate net worth of the greater of $500,000 or 1 percent of FHA loans, up to a maximum of $1.5 million. Mortgage brokers should have a minimum corporate net worth of $150,000, with half of 1 percent of their loan volume, up to the minimum of the mortgage bankers.

Finally, Congress needs to address FHA's loan limits which are scheduled to expire January 1st. The markets crave certainty, and this is not the time to be reducing loan limits. We support permanently raising FHA loan limits to $625,500, and allowing it to go to $729,750 in high-cost areas.

Now is the time for Congress to improve resources for these agencies in order to prevent problems from occurring in the future. Thank you.

Chairman MOORE OF KANSAS. Thank you, Mr. Kittle, for summing up so quickly.

[The prepared statement of Mr. Kittle can be found on page 58 of the appendix.]

Chairman MOORE OF KANSAS. Mr. Savitt, if you would, please.

STATEMENT OF MARC SAVITT, CRMS, PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Mr. SAVITT. Good morning, Mr. Chairman, Ranking Member Biggert. As a Main Street mortgage professional for the past 28 years, I am here to inform you that our fragile housing market is once again on the verge of collapse. This time it has nothing to do with exotic programs or high interest rates, although it does involve serious acts of misconduct.

The country's largest providers of mortgage financing, Fannie Mae and Freddie Mac, have seriously strayed from their chartered missions, aided by the New York Attorney General, Andrew Cuomo. At issue here is the Home Valuation Code of Conduct, known as the HVCC.

In 2007, the Attorney General began an investigation of Washington Mutual and an unregulated appraisal management company known as eAppraiseIT. His investigation also warranted subpoenas of Fannie and Freddie, where certain information was discovered in that investigation which the Attorney General has refused to turn over. That investigation is now being concluded.

As a result of that investigation, we now have the HVCC or the Home Valuation Code of Conduct. The same failed and flawed model that the Attorney General discovered all of this misconduct is now the solution, or the supposed solution, for the problem. And what we are seeing here is that the consumer is being seriously harmed by this code.

We estimate that it is costing consumers conservatively $2.8 billion a year in extra charges. This code has created long delays in the mortgage financing process, which requires extended lock-in fees the consumer pays for. Appraisals have gone from anywhere from $150 to $300 more than their normal costs. So what is involved here is serious expenses for the consumer.

It is also hurting small business. Appraisers are being paid approximately 60 percent of what they were being paid before May 1st, when this code first went into effect. Mortgage brokers do not have the ability to deal with the appraisers that they have been dealing with. Years of business relationships have been destroyed. And again, these are also causing long delays.

We have several examples which we would like to submit for the record of what this is doing to the American consumer. And we see that if this code is not withdrawn shortly, we are going to see even more serious consequences. Thank you.

Chairman MOORE OF KANSAS. Thank you, Mr. Savitt.

[The prepared statement of Mr. Savitt can be found on page 85 of the appendix.]

Chairman MOORE OF KANSAS. Mr. Berenbaum, sir.

STATEMENT OF DAVID BERENBAUM, EXECUTIVE VICE PRESIDENT, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. BERENBAUM. Mr. Chairman, thank you. Ms. Biggert, thank you for having us here this morning.

I would like to start by taking strong exception to Mr. Savitt's remarks with regard to the Home Valuation Code of Conduct. We believe a strong HVCC that should be expanded to reach FHA and VA loans is critical to protect the consumers' interests. Quite candidly, lender pressure brought about widescale overvaluation of properties. And today the opposite issue of, in fact, lower prices through broker price opinions are driving down values and impacting on the tax base around the Nation.

Second, I would quickly like to make the point that we strongly believe there is a need for additional regulation and oversight in the FHA program and related government programs, particularly with regard to the HECM program and the proprietary products.

As a national HUD-certified counseling agency, we are seeing widescale abuse of seniors at this moment in time who are being victimized, as the Comptroller of the Currency noted, by predatory practices in that area.

Third, we are about to release a report where we tested over 200 providers of foreclosure prevention services. And we completely agree with your remarks that in fact it is the Wild West out there. What we are seeing is average fees of $2,900 for a service you can get for free from your servicer or a HUD-certified counseling agency, coupled with widescale misinformation.

Last, I would like to speak to some of the issues that we are seeing right now with regard to fraud in the FHA program. We do believe there is a need for greater staffing and oversight within FHA, coupled with, in fact, the President's announcement yesterday that there was a need for a consumer financial protection agency. We know when there are CRA loans, we know when there is responsible lending. Both consumer protection and profit go hand-in-hand. And we hope that working with this committee and each of you in the coming year we can realize that environment. Thank you.

Chairman MOORE OF KANSAS. Thank you, sir.

[The prepared statement of Mr. Berenbaum can be found on page 20 of the appendix.]

Chairman MOORE OF KANSAS. I thank the witnesses for their statements. Again, I apologize for this. We are going to move very quickly here. I am going to ask unanimous consent from members present that each member have 2 minutes to ask a question or ask questions. And we will alternate sides. We will get in as many questions as we can, and follow up with written questions.

And each of your testimony will be received, the written statement, in the record, as well as what you have said here today.

So we are going to start, I would like to ask the first question. Mine for 2 minutes is Mr. Donohue. Judging from your statements, your testimony, it sounds as if Congress has taken some good steps with the Fraud Enforcement and Recovery Act, but unless Congress provides the funding to follow through, some of this is going to be for naught. Is that a fair assessment of your testimony, sir?

Mr. DONOHUE. I do believe that, sir. I think it is very important that the funding be addressed in this regard. And, in fact, most recently the Secretary testified to the fact as far as the need of additional IT funding for FHA as well as staffing. They do have a need for staffing programs.

Chairman MOORE OF KANSAS. Mr. Nunnink, do you have any comments on that, sir?

Mr. NUNNINK. I agree with that.

Chairman MOORE OF KANSAS. All right. Do any other witnesses have any other comments besides that they agree funding is necessary for this? Any other comments?

Mr. PELLEGRINI. Mr. Chairman?

Chairman MOORE OF KANSAS. Mr. Pellegrini?

Mr. PELLEGRINI. I would like to point out that—we believe that Congress should require borrowers to receive their key closing documents in advance of closing, a consumer protection measure which is strongly encouraged and supported by HUD. This would give the borrowers the early opportunity, and the closing agents, to review those documents. And that would be a strong way to thwart fraud.

Mr. BERENBAUM. Mr. Chairman, I would also like to add we would like to see HUD collaborating with the Federal Trade Commission in the future on issues that are relevant to marketing of products, misrepresentation, and fraud.

Chairman MOORE OF KANSAS. Mr. Savitt or Mr. Kittle, any comments, sir, either one of you?

Mr. KITTLE. Well, only to the money issue. The money has been authorized. We just want to make sure that it is appropriated.

And I will give you a specific example. There are HUD systems over there right now that are on a system called COBOL, which is pre-DOS, which is pre-Windows 2003. And I think there is only—and I am not making this up—three or four people left alive who can work on the system if it breaks down. It is incredibly antiquated. We can't talk to them as lenders. And if you want to streamline it and save money, we have to appropriate the funds.

Chairman MOORE OF KANSAS. Thank you to the witnesses, and I apologize. My time is up. I am going to yield 2 minutes now to the ranking member, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Mr. Pellegrini, you mentioned in your testimony that for borrowers, and to root out fraud more effectively, it would be helpful for consumers to have their completed closing documents 24 hours in advance of the closing.

Congresswoman Bean, in one of our markups on mortgages, wanted to require that completed documents be presented to the consumers 2 days in advance of the closing. That amendment was withdrawn because there was some objection, but they are working on it. It appears that the 24-hour requirement may be more feasible. Would you just address that a little bit?

Mr. PELLEGRINI. Well, Congresswoman, the more time that we can allow a borrower to examine documents and have them available at the closing, or prior to the closing, would be beneficial. We would support any bill that would allow a greater amount of time to examine and go over and educate the borrower on the loan process.

Mrs. BIGGERT. Sometimes I just remember that at the closings everything was fine, but there might be something on the title policy that hadn't been cleared yet, and then that would mean that the closing took a little bit longer. Does that still happen a lot? Let's say a fence is over the line and how is that going to be resolved?

Mr. PELLEGRINI. Of course, those issues always present themselves at the closing table. Often, the closing table is not the culmination of the transaction; sometimes it is merely the beginning of the transaction in some instances. But we find those title issues to be in place in many situations. But certainly the more preparation that can be done in advance would certainly expedite the closing.

Mrs. BIGGERT. Thank you. And then I want to go to Mr. Donohue. I am concerned about the seniors being victims of fraud. How many actual complaints has your office received about the HUD programs? Do you have the data or can you get it for us?

Mr. DONOHUE. I can get the data for you. We have seen an increase.

Chairman MOORE OF KANSAS. Your microphone, sir?

Mr. DONOHUE. I don't have the numbers, Congresswoman, but I can certainly get them to you. We have seen an increase in volume with regard to cases. I have an active sampling of egregious cases to present to you if you would like.

Mrs. BIGGERT. Good. I would like that very much.

Chairman MOORE OF KANSAS. Thank you. Your time is up. And Mr. Lynch, you are recognized for 2 minutes, sir.

Mr. LYNCH. Thank you, Mr. Chairman. I appreciate it. I apologize to the witnesses as well. We had no idea this was going to happen.

Mr. Donohue, very quickly. We have concerns about the mutual insurance fund, whether we are below 2 percent. And I know FHA is only required to report once a year. I am very nervous about that, given that we were down 40 percent the last time we checked. Do you have any information for the committee with respect to whether or not we are below that 2 percent minimum?

Mr. DONOHUE. Sir, they are currently doing—first of all, we have met with your office as well. We support your legislation.

Mr. LYNCH. Right. You are very good on that. I appreciate it.

Mr. DONOHUE. I certainly support the idea of doing the actuarial study twice a year, as you have recommended. But the thing as far as the numbers are concerned, we are watching this closely. We have our own independent auditors that are watching the actual study itself. The one problem that is faced with, as you might be aware, is the recovery rates on foreclosure properties. They had estimated that last year at 60 percent. It is down more like 40 percent.

Mr. LYNCH. Right.

Mr. DONOHUE. So the question has come back down as to what point it is. The Secretary made some comments last week, but we will watch this very closely.

Mr. LYNCH. All right. I am running out of time here, the little that I have.

Now, you know, you were doing 3 percent of the market, now FHA is doing 30 percent of the market, and the market is tanking. I can't imagine how we are going to end up with a result where we are above our 2 percent. I think we are going to have problems.

I would like to have an opportunity, if we can't have a hearing—and I know that the chairman is jammed because he has a certain set of schedules for hearings going into August, ending in August. Would you be willing to meet with me and my office? I would like to meet with FHA and also Ginnie Mae. I have problems over there as well. And it is just a shame that this has happened on this day, but some of this stuff is out of our control. But we are going to have to take a real hard look at this.

Mr. DONOHUE. I am more than happy and more than willing, sir, to sit down with you and discuss this in detail.

Mr. LYNCH. Thank you. I yield back.

Chairman MOORE OF KANSAS. Thank you, Mr. Lynch.

And I want to ask another question. We are going to have another round. I think we have time for 2 minutes each.

Mr. Nunnink, one issue that concerns me is appraisal fraud and the role of appraisals in our mortgage systems. I think this is an important issue. The Inspector General suggested bringing back the FHA Appraiser Fee Panel.

Can you talk about appraisal fraud? How much of an issue is it in our current system? And what can be done to correct it? In about 1 minute, 44 seconds.

Mr. NUNNINK. Yes. Very simply stated, that FIRREA has effectively dealt with eliminating appraisal fraud, and it was passed in 1989. It is entirely possible to have separation at a bank between those ordering the appraisal and those originating mortgages. So I don't think a panel like FHA is necessary. I think less government is better than more government.

And so my conclusion is that the existing system, if you follow Home Valuation Code of Conduct, will suffice.

Chairman MOORE OF KANSAS. Do any other witnesses have comments on this?

Mr. BERENBAUM. I would like to comment on that, Mr. Chairman.

Chairman MOORE OF KANSAS. Yes, sir, Mr. Berenbaum.

Mr. BERENBAUM. I believe actually the valuation issue remains one of the outstanding issues that has not been addressed by either statute or regulatory reform discussions at this point. The Appraisal Foundation and other key players in this industry have not really done enough to ensure accuracy in valuation. We have been commenting on this issue for several years now. And again here we are today with broker price opinions being used that are depressing values across the country, and they are conflicted. So this is an issue that needs more attention.

Chairman MOORE OF KANSAS. Do any other witnesses have—we have 20 seconds? Yes, sir, Mr. Savitt?

Mr. SAVITT. Mr. Chairman, what we are looking at here with appraisals, we are looking for appraisal independence, and we don't have that with the Home Valuation Code of Conduct. The results of the Attorney General's Office was from an investigation of a federally chartered bank and an unregulated appraisal management company. That is the model they are using today. As a matter of fact, the banks and some of the lenders actually have joint ventures, where they own up to 20 percent of those appraisal management companies. It is the same failed, flawed model that created the investigation. So with that, how do we have appraisal independence? We don't.

Chairman MOORE OF KANSAS. Thank you. Again, I apologize. Ranking Member Biggert is recognized for 2 minutes.

Mrs. BIGGERT. Thank you. Mr. Savitt, could you tell me how the implementation of the Home Valuation Code of Conduct has impacted your members and consumers? What type of cost increases have been to consumers as a result of the implementation? And how is the average consumer affected by that?

Mr. SAVITT. The average consumer is affected by it costing them substantially more money. We used data from HMDA and also from Wholesale Access, and we came up with a number of $2.8 billion. And that is a very conservative number, because we knew that number might be attacked, so we wanted to go on the low side. That is additional lock-in fees because the appraisals are taking anywhere from 35 to 40 days longer than they used to. That results in longer lock-in fees which the consumer pays, usually a minimum of a quarter percent. And then appraisals that used to cost anywhere between $350 and $400 are now costing anywhere between $500 and $750. My own office, we used to pay $350. We are now paying $750 for appraisals. And this works, as I said, out to $2.8 billion. This is hurting mortgage brokers, it is hurting—by losing deals over this. It is destroying relationships, it is hurting the appraisers, who are being paid 60 percent less.

Mrs. BIGGERT. Thanks. I have one more question I want to get in to Mr. Kittle. FHA may require taxpayer funding next year for the first time in its history. Is there anything that we can do today proactively to avert large losses in the years to come?

Mr. KITTLE. Well, you can appropriate the funds to make them—technologically bring them into the 20th Century. That is the first thing you could do. And to go back to Mr. Lynch's comment just a minute ago, or his issue, if they have the right computer systems and the right reporting systems, he can get the reports he needs not once a year or twice, but maybe monthly. We need to just bring them up technologically. It will help stop fraud. I mean fraud is rampant, but—

Mrs. BIGGERT. Every year they say they are going to do this, and it never comes to fruition. Thanks.

Mr. KITTLE. We need to appropriate the money.

Chairman MOORE OF KANSAS. Again, my thanks to the panel members and my thanks to the witnesses who have testified here today. I look forward to working with our witnesses, and my Republican and Democratic colleagues, to ensure our constituents are protected to the greatest extent possible.

The Chair notes that some members may have additional questions, and other members who are not present may have additional questions for this panel which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Again I apologize for this. I thank the witnesses for traveling here and for your testimony. This hearing is adjourned.

[Whereupon, at 10:47 a.m., the subcommittee was adjourned.]

A P P E N D I X

June 18, 2009

Subcommittee on Oversight and Investigations
House Financial Services Committee
June 18, 2009

"Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs"

Opening Statement from Chairman Dennis Moore [KS-03]

On April 27th, I hosted a press conference at the Federal Courthouse in Kansas City, Kansas, with Missouri Attorney General Chris Koster, Kansas Attorney General Steve Six, as well as a local FBI Supervisory Special Agent and a Special Agent from the Office of Inspector General for HUD.

At that event, our goal was to raise public awareness of the mortgage fraud schemes that have been going on. In the current economic environment, too many homeowners are encountering significant difficulty in making their mortgage payments. Too many are at risk of losing their homes. There are a number of great people and resources out there to help homeowners work with their lenders so they can meet their mortgage obligations.

Unfortunately, as a former DA, I know all too well that there are also people out there who will exploit weakness and prey on the fear of others. Over the last few months, we have seen an increase in the number of fraudulent mortgage loan schemes that take advantage of those homeowners in desperate situations.

Under the pretense of helping homeowners modify their mortgage obligations, these schemes result in the loss of money, equity and in many cases the home itself. We often think of robberies taking place with a knife or a gun, but these thieves instead come with a smile, a handshake and a ballpoint pen – ultimately leaving a family in deeper trouble.

Through my role as Chairman of the Financial Services Oversight and Investigations Subcommittee, I am determined to ensure that local, state and federal law enforcement agencies have all the resources and tools they need to prosecute these horrible thieves.

That's why I was a cosponsor of the Fight Fraud Act, which was renamed the Fraud Enforcement and Recovery Act by the Senate. No matter what you call it, this important legislation:

- strengthens the accountability standards for financial, mortgage lending and securities agents and institutions, and;
- authorizes additional funds for the Department of Justice, FBI, HUD's Inspector General, and other federal agencies so they can hire the investigators they need to examine and prosecute fraudulent activity.

Ranking Member Judy Biggert was a lead sponsor of the bill as well, and I'd like to commend her for all the work she has done over the years fighting mortgage fraud. I'm sure she shares my sentiment that I was pleased when President Obama signed this important legislation into law.

One of the issues we will be focusing on today as we consider strong oversight of HUD is the role of FHA and its rapid expansion of lending in the mortgage market.

Even after the subprime market collapsed, FHA has continued to provide mortgage credit to responsible borrowers. But we must be vigilant to ensure the same bad actors that contributed to the housing crisis don't make their way into the FHA program.

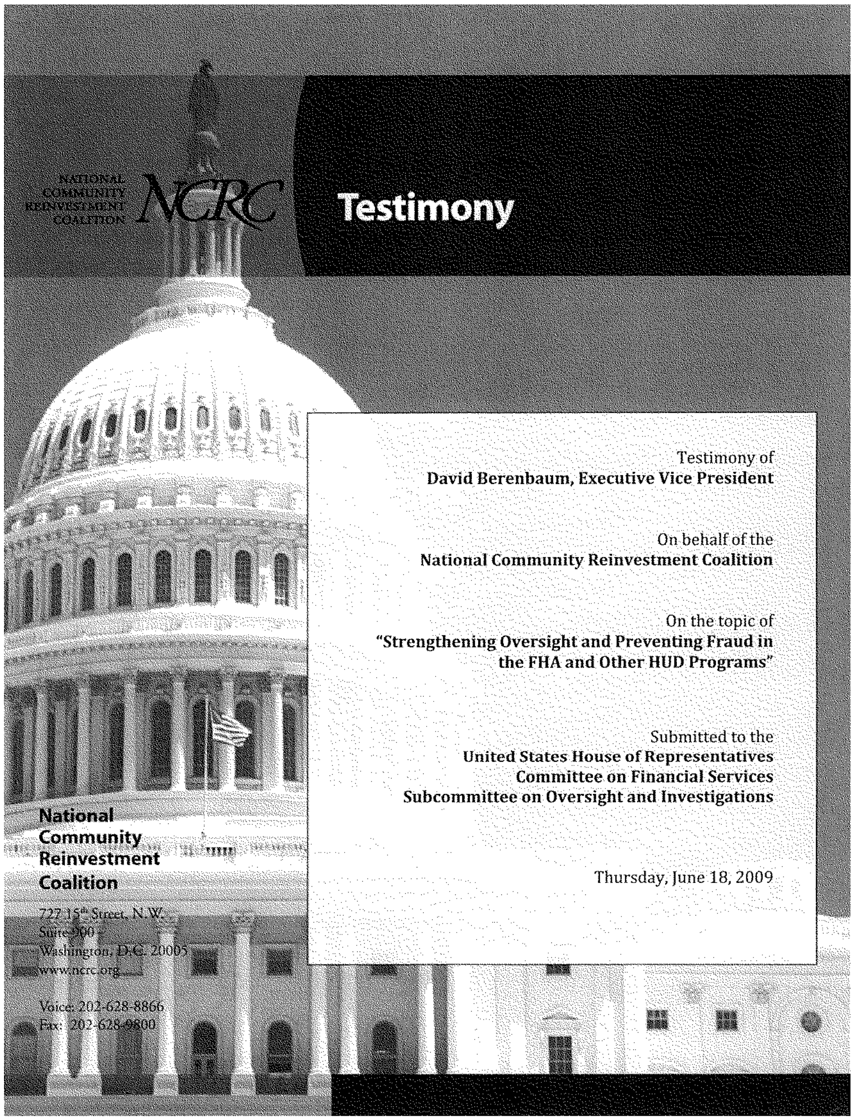
In addition to the Fraud Enforcement and Recovery Act, President Obama also signed into law the Helping Families Save Their Homes Act. These two new laws improve FHA requirements and give the FHA more authority to keep bad actors out of the FHA program and provide additional enforcement tools to police those lenders who employ false or misleading tactics. In fact, just last week, HUD announced they suspended three lenders from FHA based on evidence of serious violations under HUG's regulations.

Another area of concern is the use of reverse mortgages that are primarily used by seniors.
I agree with the Comptroller of the Currency, John Dugan, who recently raised a red flag on these reverse mortgages and noted that closer federal oversight may be necessary to protect the FHA and homeowners.

I'm also interested in learning more about the need for accurate and independent appraisals, and the role appraisals currently play with respect to FHA-insured loans. If there's one lesson we've learned from the financial crisis, we need to eliminate conflicts of interest and strengthen the integrity of any valuation process – everything from credit rating agencies to appraisals. I look forward to hearing from our witnesses on these and other important oversight issues.

I will conclude my remarks by reminding everyone to be on high alert for mortgage fraud. If you or someone you know is suspicious or unsure if someone is legitimately trying to help, immediately contact the local law enforcement and let them know so they can investigate.

It is imperative that we protect ourselves, our neighbors, and put those people preying on the victims of this housing crisis behind bars.



NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of
David Berenbaum, Executive Vice President

On behalf of the
National Community Reinvestment Coalition

On the topic of
"Strengthening Oversight and Preventing Fraud in the FHA and Other HUD Programs"

Submitted to the
United States House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations

Thursday, June 18, 2009

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I. Introduction

Good morning, Chairman Moore, Ranking Member Biggert, and other distinguished members of the Subcommittee. I am David Berenbaum, Executive Vice President of the National Community Reinvestment Coalition (NCRC), and I am honored to testify today before the House Financial Services Subcommittee on Oversight and Investigations on behalf of NCRC on the topic of "Strengthening Oversight and Preventing Fraud in the FHA and other HUD Programs."

NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

II. Reform the Mortgage Market by Strengthening Laws and Regulatory Oversight

The sharp economic decline resulting from the foreclosure crisis can be traced to out-dated consumer protection laws and failed regulatory oversight. Loopholes in the law and inadequate regulatory enforcement allowed abusive and problematic lending to flourish, which led to the destabilization of the US economy. The foreclosures that arose from predatory lending have not only severely undermined the financial stability of working families and communities but also are now weakening the credit markets and diminishing overall economic activity and performance. Massive foreclosures are spurring a self-reinforcing cycle of defaults, declines in home values, and rising unemployment.

Widespread unemployment is now accelerating the economic crisis, as evidenced in a recent report published by Credit Suisse. The study projects 8-10 million foreclosures over the next four years, given an 8 percent unemployment rate. With the nationwide unemployment now at 9.4 percent, the highest rate in more than 25 years, it seems likely that the United States can expect to experience millions more foreclosures absent immediate intervention. Loose underwriting combined with a rise in unemployment has contributed to 803,489 foreclosure filings during the first quarter of 2009, a 24 percent increase from the first quarter of 2008 according to RealtyTrac.[1] On an annual basis, the first quarter filings would equal an astounding 3.2 million foreclosure filings for 2009.

The foreclosure crisis has destroyed significant amounts of national wealth and household wealth. Since the onset of the crisis, home prices have declined by at least 25 percent, with approximately 10 percent more in declines projected in the next few years.[2] And, American homeowners have lost more than $13 trillion in household wealth.[3] While the crisis is becoming widespread, it has not been an equal opportunity crisis. During the boom years of subprime lending, subprime lending was targeted disproportionately to minority communities, as documented in NCRC research and similar research in the field.[4] Subsequent research has shown that foreclosures that stem from subprime lending have also been concentrated in minority communities.[5] The situation is so dire within the African-American community that United for a Fair Economy, a Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since Reconstruction.

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[1] "Foreclosure Activity Increases 9 Percent in First Quarter," April 16, 2009, Realtytrac, via http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=6180&accnt=64847.

[2] S&P / Case-Shiller Composite -20 Home Price Index (as of December 2008).

[3] Presentation to the Forecasters Club of New YorkNew York, NY, by Janet L. Yellen, President and CEO, Federal Reserve Bank of San Francisco, March 25, 2009, http://www.frbsf.org/news/speeches/2009/0325.html.

[4] National Community Reinvestment Coalition, Assessing the Double Burden: Examining Racial and Gender Disparities in Lending, http://www.ncrc.org/images/stories/supportNCRC/incomenosheild05.pdf. Also, see Robert B. Avery, Kenneth Brevort, and Glenn Canner, *Higher-Priced Home Lending and the 2005 HMDA Data*, Federal Reserve Bulletin, September 2006, via http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf.

[5] Kristopher S. Gerardi and Paul S. Willen, *Subprime Mortgages, Foreclosures, and Urban Neighborhoods, Public Discussion Papers*, Federal Reserve Bank of Boston, December 22, 2008 and Lisa Nelson, *Foreclosure Filings in Cuyahoga County* in A Look Behind the Numbers, Fall 2008, published by the Federal Reserve Bank of Cleveland, via http://www.clevelandfed.org/Our_Region/Community_Development/Publications/Behind_the_Numbers/2008/0908/BTN_20080929.cfm.

An inadequately regulated marketplace financed large amounts of problematic subprime and non-traditional loans over the last several years, with no regard for the long-term implications for borrowers with unsustainable debt. More recently, unscrupulous lenders have migrated to the Federal Housing Administration (FHA) program, which is now experiencing a rapid increase in defaults. In addition, the old predators who peddled subprime loans are now transforming themselves into new predators posing as foreclosure prevention consultants. NCRC's investigation into foreclosure scams shows that formerly abusive mortgage brokers and other loan originators are now reemerging as foreclosure prevention consultants, exploiting distressed families by charging exorbitant fees and then not engaging in any legitimate foreclosure prevention activities.

In July, NCRC will release a Fair Lending Audit using mystery shopping of almost 100 for-profit national foreclosure prevention service providers. Appraisal fraud and pressure brought by originators contributed to unsustainable increases in property values during the housing boom. Now, broker price opinions are further destabilizing neighborhood markets by under-valuing homes. And, as John Dugan, Comptroller of the Currency, noted in a speech before the American Bankers Association Regulatory Compliance Conference, predatory practices surrounding Home Equity Conversion Mortgages (HECMs) are reemerging as more market players offer the product. If regulatory enforcement is not immediately tightened, the unsafe and reckless lending practices of the past will recycle into different predatory products, prolonging the economic crisis and hampering recovery.

NCRC recommends that HUD conduct a rulemaking process to further develop regulations mandating responsible FHA lending and related HECM lending. HUD should ensure that FHA is sufficiently staffed to safeguard FHA lending and eliminate fraud. In addition, HUD should collaborate with the Federal Trade Commission (FTC) in developing regulations outlawing unfair and deceptive practices in the foreclosure consultant market and in appraisals. NCRC commends the FTC for starting a rulemaking process and recommends that the FTC partner with HUD in this effort. On its part, NCRC recommends that Congress enact comprehensive anti-predatory lending legislation that eliminates abusive terms and conditions in conventional lending and FHA lending. NCRC also recommends that Congress apply an anti-predatory lending law to all financial services entities including lending institutions, brokers, servicers, investors, and appraisers. Finally, NCRC recommends that Congress update the *Community Reinvestment Act* (CRA) in a manner consistent with the *Community Reinvestment Modernization Act of 2009* (H.R. 1479). According to Federal Reserve research, bank lending (which is covered under CRA) is safer and sounder than mortgage company lending (which is not covered under CRA). If CRA's mandate of safe and sound lending had been applied broadly throughout the financial services industry, it is likely that the US economy would not be experiencing a foreclosure crisis of this scale and magnitude.[6]

III. End Fraud and Unsafe Lending in the FHA Program Now

FHA lending will likely become a major source of credit for financially vulnerable borrowers and consumers not familiar with the lending industry. Over the last decade, subprime lending virtually replaced FHA lending. With the demise of subprime lending, FHA lending is likely to resume its role in the marketplace of serving substantial numbers of first-time homebuyers, minorities, and families with modest incomes and/or imperfect credit or little credit history. Before the advent of subprime lending, fair lending advocates were concerned about the possible steering of minorities into FHA loans that had higher fees and premiums than conventional loans. Steering then became a prominent issue in subprime lending, with a tremendous loss of equity in minority communities because of concentrations of high-cost and high-risk lending. In order to avoid the catastrophe of steering irresponsible loan products to minorities in the future, it is imperative that HUD eliminate the troubling signs that are emerging in FHA lending.

[6] Only 6 percent of the high-cost loans in 2005 and 2006, boom years for subprime lending, were issued by banks to low- and moderate-income borrowers and considered on bank CRA exams. Randall Kroszner, former Federal Reserve Governor and currently at Booth School of Business, University of Chicago, "The Community Reinvestment Act and the Recent Mortgage Crisis," in "Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act," A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, http://www.frbsf.org/publications/community/cra/index.html.

This spring, the *Washington Post* reported on the spike in defaults of FHA loans, and on the difficulties HUD is experiencing monitoring lenders using FHA.[7] More than 9,200 FHA loans during the past year have entered into default after no, or only one, borrower payment (which is triple the rate of previous years'). HUD's inspector general is quoted in the article that immediate defaults suggest "impropriety and fraudulent activity."

One cause of the sudden defaults appears to be a rapid increase in FHA activity—as the FHA program has increased its share from 2 percent to 33 percent of all loans in the marketplace. The number of FHA-approved brokers has likewise surged from 16,000 in 2007 to 36,000 currently, while the number of FHA lenders has increased more than five-fold since 2006 to 3,000. HUD's inspector general testified that some of the unscrupulous subprime lenders are now operating as FHA lenders.[8] The *Washington Post* article reports that HUD dismantled an FHA fraud unit in 2003, and that an office responsible for overseeing FHA lenders had not increased staff despite the rapid increase in FHA brokers and lenders. As a result, there has been inadequate monitoring by HUD, and the article suggests that "the same flawed lending practices that contributed to the mortgage crisis are now eroding one of the main federal agencies charged with addressing it." These practices include increasing loan volume by brokers and small lenders for the purpose of increasing fees and commissions, with little regard for whether loans could be repaid.

Related to inadequate staffing are technology issues that currently prevent HUD and FHA are from detecting the rogue operators in the industry. What type of national database will be compiled to register and track mortgage originators who have previously committed fraud (and many have actually been convicted of mortgage fraud)? When will HUD/FHA roll out compliance controls and testing to ensure that financial professionals who provide mortgage advice in connection with the loan origination are licensed and

[7] Dina Elboghdady and Dan Keating, *The Next Hit: Quick Defaults – More FHA-Backed Mortgages Go Bad Without a Single Payment* in The Washington Post, Sunday, March 8, 2009.

[8] Inside Regulatory Strategies, Vol. 20, No. 8, April 13, 2009, "Legislative Fix for H4H Could Open Door to Mortgage Fraud," pp. 6-7.

monitored? For example, a loan officer who loses his license in one state can currently move to another state and originate loans. Similarly individuals who are disbarred from the financial industry such as NASD brokers can obtain licenses to originate loans. Why does it make sense that a broker who defrauds a consumer in a stock or mutual fund transaction be allowed to work a consumer to obtain financing on the largest investment they will ever make -- their home?

HUD acknowledges that the FHA guarantee may encourage loose underwriting practices by lenders. In a recent Mortgagee Letter 09-12, HUD states that "The Department expects each mortgagee to exercise the same level of care in originating, underwriting and servicing an FHA-insured mortgage as it would for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment."[9] This letter exhorts lenders to exercise as much care in making and servicing an FHA-guaranteed loan as a loan without a loan guarantee.

As the House of Representatives was considering the *Mortgage Reform and Anti-Predatory Lending Act of 2009* (H.R. 1728), the House instituted an important anti-fraud provision for FHA lending. Specifically, the House required HUD to write regulations defining the characteristics of safe and sound FHA lending. HUD was required to define loan terms and conditions that would qualify FHA loans for the safe harbor (or the presumption that the loans complied with the bill's ability-to-repay and net tangible benefit requirements). Whether such a requirement is in H.R. 1728 or in a regulatory restructuring bill, NCRC recommends that Congress require HUD to update its regulations to define the characteristics of safe and sound FHA lending. In addition, HUD should ensure that FHA is adequately staffed to identify fraud and debar and prosecute fraudulent lenders. Finally, the Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act requires states, in cooperation with the federal government, to create a database of mortgage companies and loan officers of banks. HUD should be

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[9] See Mortgagee Letter 09-12 issued April 2, via http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-12ml.doc.

examining how the database required by the SAFE Act can help it detect and track perpetrators of fraud in the FHA program.

III. Strengthen the Market's Valuation and Appraisal Requirements

NCRC's "Predatory Appraisals: Stealing the American Dream" (2005) documented the prevalence and harm caused by inflated appraisals. NCRC found that where there were incidences of appraisal fraud in either purchasing or refinancing, mortgage payments increased substantially over time. Fifty-three percent of borrowers subjected to appraisal fraud experienced a 20-50 percent increase on their monthly payments; 29 percent experienced up to a 20 percent increase on their monthly payments; and 18 percent experienced a 50 percent or higher increase on monthly payments. Moreover, the study found that 83.3 percent of sampled consumers experiencing appraisal fraud resided in low- and moderate-income census tracts, strongly indicating that vulnerable low- and moderate-income communities have been targeted for appraisal fraud.[10]

Replace Broker Price Opinions (BPOs) with Appraisals

Owners of REOs are eager to dispose of REOs because REOs are costly to maintain and attract vandalism and crime. These REO owners have enlisted real estate brokers to issue BPOs of the value of the REOs. The real estate brokers, acting as agents of the REO owners, develop hasty and inaccurate BPOs that underestimate the values of the REOs. Undervaluation is often destructive to local markets and depresses the value and equity of neighbors of REO properties.

H.R. 1728 contains a provision that prohibits BPOs from being the primary means of determining the value of property for home purchases. This protection should be extended to refinance loans in H.R. 1728 or any other anti-predatory bill considered by

[10] NCRC, Predatory Appraisals: Stealing the American Dream, NCRC 2005.

Congress. Moreover, since valuation of REOs can be difficult and prone to abuse, BPOs should be outlawed in the case of REOs.

Codify the Home Valuation Code of Conduct for Appraisals

NCRC founded the Center for Responsible Appraisals and Valuations (Center) after receiving a significant number of complaints from borrowers about overvalued appraisals. The Center encourages mortgage finance professionals to adopt a code of conduct pledging to ensure fair and accurate appraisals for borrowers; informs the public about those who have taken the code of conduct so that borrowers can make more informed choices about mortgage finance professionals; and mediates differences between professionals about valuations, as well as files complaints on behalf of appraisers when they report pressure by lenders, brokers, and others to inflate housing values.

NCRC's Center endorses valuation best-practices for all industry participants. Therefore, NCRC recommends that this Committee consider that the FHA adopting specific provisions from the Home Valuation Code of Conduct (HVCC) negotiated among New York Attorney General Andrew Cuomo, the Government Sponsored Enterprises (GSEs), and the GSE's regulator (first OFHEO and then FHFA) for all loan programs that it administers. These provisions provide additional clarity regarding no intimidation and coercion of appraisers, and also establish procedures for ensuring that appraisals are conducted impartially when the lending institution owns an affiliate that conducts appraisals.[11]

In particular, NCRC strongly endorses the HVCC ban on appraisals directly ordered by mortgage brokers. In a white paper issued in 2006, NCRC's Center reasoned that if a regulated institution buys the loan package from a broker, the broker, as an interested party, clearly cannot order, manage, influence, review, or control the appraisal. Because

[11] http://www.orea.ca.gov/pdf/HVCCFinalCODE122308.pdf.

this would interfere with the normal functions performed by the broker in "shopping the loan" for the borrower, it is necessary for the broker to place a qualified, independent intermediary between it and the appraisal function. That intermediary, such as an appraisal management company or the credit policy staff appraisal management function of a lender, must be totally independent of the transaction. Thus, the utilization of any entity that has, or might have, an interest in the transaction would not be compliant with proper appraisal practices. In fact, in a surprising number of fair lending mystery shops conducted by mortgage brokers at NCRC, the broker being audited represented to the shoppers that they knew appraisers who could ensure the origination because they "knew how to get value out of homes."

In addition, NCRC recommends that Appraisal Management Companies (AMC) be required to register with appropriate state oversight agencies, and be appropriately regulated by these authorities to ensure accurate valuations in the provisions of H.R. 1728. The Appraisal Subcommittee of Federal Financial Institutions Examination Council should be charged with developing oversight standards for AMCs that ensure the integrity of the valuation process and the objectivity and independence of valuation professionals. According to the provisions in H.R. 1728, the Subcommittee would also be responsible for proposing new guidance and quality control checks relative to the use of Automated Valuations Systems and BPOs. NCRC recommends that Congress consider codifying the HVCC in statute, and encourage HUD to work with the FTC in developing regulations regarding unfair and deceptive practices in appraisals. HUD should take aggressive action in prohibiting brokers from ordering appraisals in FHA lending since broker participation in FHA lending has increased dramatically.

IV. Stop Foreclosure Scams

Economic distress caused by national mortgage delinquency rates and job loss has been compounded by the proliferation of abusive foreclosure rescue scams that target financially distressed homeowners. Foreclosure rescue scams include the "Phantom Help Scam," in which victims pays thousands of dollars in fees, receive few or no services, and ultimately lose their homes. Other foreclosure scams involve homeowners unknowingly signing over the title of their homes or power of attorney to the scammer, who then either evicts the homeowners, sells the house to a third party, or may even file for bankruptcy in the homeowner's name. NCRC is currently engaged in an investigative project that is revealing a multitude of exploitative practices directed towards distressed and financially vulnerable homeowners. NCRC's July 2009 will detail how former mortgage brokers and other predators are migrating to this unregulated business scheme.

NCRC conducted over 200 "mystery shops" or fair lending "tests" of more than 100 for profit providers. Mystery shoppers called national and local foreclosure prevention service providers to ascertain:

1. Fees for their services
2. Types of services offered
3. Documents required to receive services
4. Types of agreements/arrangements troubled homeowners must enter to receive services and/or keep their homes, and other recommendations that were made

These mystery shoppers posed as distressed borrowers who are delinquent in their mortgage payments and need foreclosure prevention assistance. Fees were found to vary greatly across the project, from $199 for a do-it-yourself foreclosure prevention kit, to a modification fee of $5,600 over four months—all for services that can be obtained at no cost by contacting a HUD Certified Counseling agency, the Hope for Homeowners Hotline, or even the mortgage holder's servicer. The median fee quoted was $2900. Many companies gave bad advice, counseled consumers inappropriately, and maligned both the Obama Administration's and HUD's foreclosure prevention programs and services.

This regulatory loophole that allows foreclosure scam artists to multiply must be eliminated. NCRC supports the passage of the *Foreclosure Rescue Fraud Act of 2009* (S.

117), introduced by Senator Herbert Kohl (D-WI) on January 6, 2009, and introduced as H.R. 1231 by Representative Gwen Moore (D-WI) and Representative Barney Frank (D-Mass) on February 26, 2009, in the House. This legislation requires that all contracts between a foreclosure consultant and a homeowner be in writing and fully disclose the nature of the services rendered and the exact cost. In addition, this bill prohibits up-front fees from being collected, and prohibits a foreclosure consultant from obtaining the power of attorney from a homeowner. This legislation also includes a non-preemption clause that allows stronger state laws and encourages states and federal agencies to work together to combat these abuses. States have been proactive in addressing foreclosure rescue scams, and at least nine states have already enacted legislation.[12] Most of the laws require foreclosure rescue consultants to disclose a customer's right to cancel the agreement, cap fees, and rescind or ban the transfer of property to the consultant. H.R. 1231 needs to be strengthened, however, as exempts attorneys from the protections applied to foreclosure consultants. NCRC's investigation has found numerous instances of attorneys partnering with the consultants to prey upon unsuspecting homeowners.

V. Protect Consumers from Risks Associated with Reverse Mortgages

Risks associated with the origination of reverse mortgages pose a new threat to consumers. The number of lenders that are offering reverse mortgages is surging as the nation's population is aging. While reverse mortgages can provide real benefits, they also have many of the same characteristics as the riskiest types of subprime mortgages– and to quote the Comptroller of the Currency, that "should set off alarm bells."

There are two basic types of reverse mortgage products: proprietary products offered under lender-specific criteria, and products insured by the FHA called "home equity conversion mortgages" or "HECMs." To date, HECMs have predominated over proprietary products, accounting for approximately 90 percent of all reverse mortgages. Since the FHA program was authorized in 1988, HECM originations have grown substantially, from fewer than 200 in 1990 to more than 112,000 in 2008. While this rate

[12] Colorado, Connecticut, Florida, Illinois, Iowa, Maryland, Massachusetts, New York, and Texas.

of growth is noteworthy, the number of reverse mortgages is still very small in relation to the overall number of mortgages outstanding or, for that matter, the target market of elderly homeowners that have lots of home equity.

Experts expect that HECMs will continue to be the predominant reverse mortgage product, at least in the near-term. Lenders find the product attractive because FHA insurance substantially limits their credit risk. In addition, HECMs are eligible for purchase by government-sponsored enterprises, providing a way for lenders to move the loans off their balance sheets. Moreover, Congress recently increased the FHA loan limit applicable to HECMs to $625,500 in 2009, and this expanded limit means that a large majority of elderly homeowners will qualify.

Many industry economists also expect substantial growth in proprietary reverse mortgages in the coming years. Reasons for this include the growing senior market demographic for the product, many of whom may not qualify for the HECM. It is estimated that within the next ten years more than 55 million people in the United States will be 62 years of age or older. Many of these individuals are homeowners, and, despite the recent downturn in house prices across the country, many own their homes outright or have built up substantial home equity over a period of many years. Moreover, given recent job losses, reduced pension benefits, and declining retirement accounts, a large number of "house-rich" Americans will have an increased need to supplement income as they grow older. A reverse mortgage may fill that need, and if demand for the product mushrooms, lenders are likely to develop more attractive proprietary products that will compete with HECMs and also become available for consumers who don't qualify for HECMs. However, if we were to base our forecast on past market activity, lenders are also likely to develop predatory products if Congress does not act.

NCRC as a HUD Certified Housing Counseling Intermediary has identified the following problems associated with reverse mortgages:

- Many lenders take advantage of family crises, e.g, health issues, death of a spouse, or limited financial resources by inappropriately leveraging the senior homeowners' access to their home equity through immediate and large lump-sum payments. In many cases there are options aside from the costly HECM or reverse annuity mortgage product that are better alternatives for financial planning and estate planning purposes for the senior consumer.

- The substantial home equity that seniors can access may tempt lenders to simultaneously and aggressively market investment, insurance, and annuity products or, worse, attempt to condition loan approval on the purchase of such products. With access to large lump sums, senior borrowers can be particularly vulnerable to coercive sales of annuity and long-term care insurance products that are expensive and may not be appropriate to their individual needs. This is analogous to the use of single premium credit life insurance in the non-prime marketplace, which has now been uniformly banned.

- Many borrowers, because they have no immediate repayment obligations, may overlook substantial and, in some cases, usurious fees that are attached to a loan.

- Some homeowners whom NCRC member organizations have counseled after receiving reverse mortgage product have spent their funds too rapidly or unwisely. Some seniors have fallen into this situation and then are unable to pay their property taxes, putting them at risk of foreclosure.

- Seniors are often the unfair targets of misleading or dishonest marketing claims, especially when providers have loan origination incentives and fees that put more of a premium on making the sale than on providing a product that is appropriate for the consumer and safe and sound.

Reverse mortgages, as a rule, are often more costly than other types of mortgages because of origination and servicing fees, mortgage insurance premiums if applicable, and lender compensation for the risk in the proprietary products that the outstanding balance may exceed the value of the collateral over time. If a consumer does not fully understand how much the loan will cost, how much can be borrowed, or all the circumstances under which the loan can become due then the risk increases for a transaction that is not appropriate to the consumer's needs.

NCRC strongly urges this Congress and HUD to become proactive on this increased consumer protection for seniors before substantial predatory practices and equity theft targeted at the nation's mature adults and elderly homeowners become more prevalent and devastating. HECMs should be and must be originated by well-regulated, responsible lenders with meaningful consumer protections in place and counseling provided by HUD Certified Housing Counseling organizations. The HECM origination platform must be a sustainable business environment replete with safeguards created by HUD to ensure that that reverse mortgage providers make these loans in a way that is prudent for both lenders and borrowers. NCRC recommends that Congress consider increased Truth in Lending protections, limits on loan fees for this costly product, and more meaningful and robust counseling for both the HECM and proprietary products.

VI. Expand Loan Modification Programs and Foreclosure Mitigation Efforts

A strengthened H.R. 1728 will prevent future foreclosure crises similar in scale and magnitude as the one the US is currently experiencing. To address the current crisis, the Administration has implemented a Home Affordable Modification Program (HAMP). HAMP is a voluntary program that provides monetary incentives to lenders, servicers, and borrowers to encourage financial institutions to modify mortgages and make them affordable to borrowers who experience difficulties paying their mortgages. HAMP is the most comprehensive approach to-date to stem the rising tide of foreclosures, as it commits up to $75 billion to assist 3-4 million homeowners faced with foreclosures. But, as several lenders have ended their voluntary moratoria on foreclosure proceedings, lenders estimate that only a small percentage of distressed borrowers will qualify for HAMP. GMAC, for example, estimates that only 10 percent of their borrowers threatened with foreclosure would qualify for HAMP.[13] If these initial estimates prove to be accurate, lenders are likely to move the great majority of their distressed borrowers to foreclosure.

Therefore, NCRC recommends that this Committee consider our HELP Now proposal, in which the government would purchase troubled mortgages at a significant discount using its power of eminent domain (or other strategies) to enable affordable and sustainable loan modification. After an initial outlay of up to $50 billion, the government would finance a HELP Now program by selling the modified loans to the private sector using a reverse auction approach. Unlike the voluntary efforts of the government-sponsored programs that are proving unsuccessful, HELP Now mandates that financial institutions participate in the discounted purchase of troubled assets to accomplish broad-scale loan modification.

NCRC appreciates the reforms to the Hope for Homeowner's program in the recently enacted Helping Families Save Their Homes Act (P.L. 111-22). These reforms are designed to make the program more attractive to lenders and borrowers by limiting premiums paid by borrowers and reducing the equity that must be shared with the federal government. Additional anti-fraud efforts in FHA are critical to ensure the proper functioning of Hope for Homeowners. In addition, Hope for Homeowners can be combined with a HELP-Now approach to realize a large volume of sustainable refinances of distressed loans.

The rapidly increasing unemployment rate is now driving foreclosures. In order to keep pace with rising unemployment, Congress and the Administration should consider implementing a program like Pennsylvania's Home Emergency Mortgage Assistance

[13] Ruth Simon, "Banks Ramp Up Foreclosures Increase Poses Threat to Home Prices; Delinquent Borrowers Face New Scrutiny," in the *Wall Street Journal*, April 15, 2009.

Program (HEMAP). When a homeowner becomes unemployed involuntarily, the state's housing finance agency will arrange for a two-year loan of up to $60,000 to enable the homeowner to continue making payments until the borrower's income recovers.[14] Since the program's inception in 1983, HEMAP has assisted more than 40,000 homeowners. The program is cost-effective, in that it received an initial state appropriation with subsequent funding that came from borrower loan repayments. A federal program like HEMAP would most likely require a significant initial capital outlay, but could be sustainable through self-financing.

VII. Conclusion

While a comprehensive anti-predatory lending bill will provide needed protections and FHA reform can root out fraud, NCRC recommends that Congress reform the regulatory structure so that all entities in the financial services industry, including credit ratings agencies, investment banks, and other secondary market institutions, be required to adhere to legislative mandates that increase consumer protection and eliminates predatory lending practices. The regulatory agencies responsible for enforcing fair lending and fair housing law repeatedly failed to heed warnings from community groups about the reckless lending practices that have now destabilized the national economy and driven widespread unemployment.

NCRC believes that Congress must require that regulatory agencies review regulations biannually to determine the extent to which these regulations promote access to responsible credit, investments, and banking products for consumers. The agencies must also be required to have public comment periods to determine the need to amend any regulations. After this process, the agencies would be required to report to Congress on their public deliberations and whether those deliberations led to enhanced consumer protections. Until the agencies prove that they are capable of monitoring and enforcing fair housing and fair lending laws, Congress should appoint an independent reviewing

[14] See http://www.phfa.org/consumers/homeowners/hemap.aspx and http://www.phfa.org/forms/brochures/foreclosure_prevention/HEMAP_2008.pdf.

body to oversee enforcement activities and Congress should also hold annual oversight hearings.

NCRC supports Elizabeth Warren's proposal to form a Financial Product Safety Commission (FPSC), which would be dedicated to enhancing consumer protections and ensuring that consumer protection laws and regulations be applied to all segments of the financial services industry. FPSC would also create standards for disclosure and transparency, eliminate unfair and deceptive practices, and promote the responsible provision of credit. The FPSC could also assume the federal banking agencies' CRA responsibilities of conducting CRA exams and enforcing CRA through the merger and applications process. Though the existing agencies have mostly succeeded in adopting a uniform approach to enforcing CRA during its three decades, the agencies did splinter recently in a potentially destructive race towards dismantling CRA. In order to prevent future regulatory arbitrage of CRA and to ease its implementation, it is time to consider enforcement of CRA by a single agency.

The Obama Administration's regulatory restructuring plan adopts many of Professor Warren's recommendations and proposes the establishment of a Consumer Financial Protection Agency (CFPA) that would have sole supervisory, examination, and enforcement responsibilities regarding CRA, fair lending, and consumer protection statutes. In our initial examination of the Obama Administration's CFPA proposal, we see many promising elements, and we look forward to working with Congress and the Administration on to flesh out the details.

NCRC believes that updating and modernizing CRA must be part of any regulatory restructuring. CRA requires that community credit needs be met consistent with safety and soundness. A law that establishes an affirmative and continuing obligation to meet credit needs responsibly is an integral part of preventing abusive lending. It is likely that a foreclosure crisis would not have occurred had CRA been extended to cover broad segments of the financial services industry (e.g., banks, credit unions, mortgage companies, investment banks, insurance companies, securities firms, and other financial institutions).

NCRC applauds Chairman Frank for planning to hold hearings on CRA modernization. NCRC recommends that this Committee consider the *Community Reinvestment Modernization Act of 2009*. If passed, this legislation would meaningfully expand access to credit and capital for affordable housing, small business creation, and community development for working neighborhoods and communities. Regulatory restructuring, modernizing CRA, enacting a comprehensive an anti-predatory law, updating FHA and bolstering its anti-fraud enforcement, ensuring the integrity and accuracy of appraisals, combating foreclosure scams, and further developing the Obama Administration's national foreclosure prevention are all necessary elements of a multifaceted approach to restoring the health of the economy and the long-term sustainability of its housing and credit markets.

STATEMENT OF
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INSPECTOR GENERAL
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URBAN DEVELOPMENT

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS
UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 18, 2009

Chairman Moore, Ranking Member Biggert, and members of the Subcommittee, thank you for inviting me to testify today. I very much appreciate the opportunity to speak on oversight of the Department of Housing and Urban Development. In discussions with your subcommittee staff, it is my understanding that you want me to primarily focus on the important issue of the role of the Federal Housing Administration (FHA) in addressing the housing crisis currently confronting our nation and to touch briefly on a number of other limited topics but leave a more in-depth discussion of other areas of oversight concern for potential later hearings. As the Inspector General of the Department of Housing and Urban Development for the last seven years, as the former Assistant Director of Investigations for the Resolution Trust Corporation during the savings and loans crisis, and before that as a Special Agent in the United States Secret Service investigating financing misdeeds, I have witnessed many decades of financial and economic fluctuations. This is certainly one of the most challenging times.

Background

The U.S. Department of Housing and Urban Development (HUD) Inspector General is one of the original 12 Inspectors General authorized under the Inspector General Act of 1978. The OIG strives to make a difference in HUD's performance and accountability. The OIG is committed to its statutory mission of detecting and preventing fraud, waste, and abuse, and promoting the effectiveness and efficiency of government operations. While organizationally located within the Department, the OIG operates independently with separate budget authority. This independence allows for clear and objective reporting to the Secretary and to the Congress.

The Department's primary challenge is to find ways to improve housing and to expand opportunities for families seeking to improve their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans nationwide obtain affordable housing. These programs, which include Federal Housing Administration (FHA) mortgage insurance for Single-Family and Multifamily properties, are funded through a $45+ billion annual budget and, in the case of FHA, through mortgage insurance premiums. Recently, the Department also received over $13 billion in the American Recovery and Reinvestment Act funding for various programs to stimulate the economy. This is in addition to the almost $4 billion received for the Neighborhood Stabilization Program in July 2008.

The last two years have seen enormous and damaging developments in the mortgage market: the dissolution of the subprime and Alt-A loan markets; dramatic drops in housing prices in most areas of the country; a concomitant rise in default and foreclosures; financial insecurity in the mortgage-backed securities markets represented by the government takeover of Fannie Mae and Freddie Mac; the collapse of credit markets; and, as a primary vehicle to address these issues, an urgent reliance on the FHA to bolster the mortgage market. As the Mortgage Asset Research Institute has stated, the unprecedented onslaught of financial losses, reputational damages, and rehabilitative public policies will forever reshape the mortgage industry.

While there are other programs at HUD that are being utilized in a significant way to help stimulate the economy (i.e., billions of dollars in new funding to Community Development Block Grants, to increased Public Housing assistance, etc.), which are also vulnerable to fraudulent and abusive activities, the primary focus of this testimony is on the salient issues facing the FHA program due to the mortgage crisis and to an increased reliance on our Department to potentially resolve matters at this critical juncture. The current degree of FHA predominance in the market is unparalleled.

First off, to put the FHA issues into perspective, we have recently stated in testimony to the Congress that, through the multitude of our work in auditing and investigating many facets of the FHA programs over the course of many years, we have had, and continue to have, concerns regarding FHA's systems and infrastructure to adequately perform its current requirements and services. This was expressed by the OIG to the FHA through audits and reports regarding a wide spectrum of areas prior to the current influx of loans coming into the program and prior to the consideration of the numerous proposals that expanded its reach. We continue to remain concerned regarding FHA's ability and capacity to oversee the newly generated business.

Some of these are long-standing concerns that go back to unresolved issues highlighted in our work products from as far back as the early to mid-1990's. In my discussions with the Secretary, it is clear he is committed to positioning the Department as rapidly as he can to try to deal with the changing dynamics. As the President recently stated, however, the government is an ocean liner, and not a speed boat, when it comes to moving it in a new direction. The same can be said for some of our departmental programs. The Secretary, however, has recently announced a number of new transformation initiatives designed to address some of these concerns and we believe their implementation will be an important step in moving the program into safer territory.

We are also deeply gratified that a number of new legislative initiatives, culminating in recent signing by the President, were based on proposals and recommendations developed by this office (S. 386, the Fraud Enforcement and Recovery Act of 2009 – now P.L. 111-21, and S. 896, the Helping Families Save Their Homes Act of 2009 – now P.L. 111-22). I will elaborate on these developments later in the testimony. It gives our hard-working OIG staff great satisfaction to have been involved in a process that has so quickly resulted in public law.

The Evolving Landscape

The past year and a half have certainly produced a lot of changes and initiatives. In response to increasing delinquencies and foreclosures brought about by the collapsing subprime mortgage market, in September 2007, HUD acted administratively to provide mortgage assistance through the FHA Secure program to refinance existing subprime mortgages. The program was expanded in May 2008 to provide lenders the added flexibility to refinance and insure more mortgages, including those for borrowers who were late on a few payments and/or received a voluntary mortgage principal write-down from their lenders. This program served a fraction of its anticipated scope. The FHA recently issued a formal letter terminating the program stating that "maintaining the program past the original termination date would have a negative financial impact on the MMI Fund."

The Housing and Economic Recovery Act (HERA) passed last summer, created a new Hope for Homeowners program to enable FHA to refinance the mortgages of at-risk borrowers. While activity to date has been very limited, the FHA was authorized to guarantee $300 billion in new loans to help prevent an estimated 400,000 homeowners from foreclosure. The Congress recently passed and the President signed legislation to revise this program in order to increase participation. The Secretary recently testified, however, that these estimates will not likely be reached. Nevertheless, these changes, and others, to remedy a dysfunctional mortgage market are likely to increase the challenges to the OIG. While the goal to help homeowners in distress is important, relaxing qualification requirements for borrowers and lenders may create a situation that could be exploited by fraud perpetrators to take advantage of desperate homeowners, at risk-lenders, and the FHA insurance fund. The HERA legislation also authorized changes to the FHA's Home Equity Conversion Mortgage (HECM) program that will enable more seniors to tap into their home's equity and obtain higher payouts which raises new oversight concerns for this agency.

As we turn to today's environment, the volume of Single-Family FHA-insured loans has enlarged in Fiscal Year 2008 by tripling from $59 billion in Fiscal Year 2007 to over $180 billion in Fiscal Year 2008. The latest figures from Single-Family market comparisons from the first quarter of Fiscal Year 2009 show that FHA's total endorsements have increased from 24% of the market the year before to 63% of the market which includes both home sales and refinances. FHA's home sales' market share (excluding refinances) has increased from approximately 6% to close to 20% during this time period. Many potential homeowner loans may not have come to the agency yet as some of the new initiatives are still taking hold and the industry is flushing out its options and possibly posturing for more favorable terms.

FHA will be challenged to handle its expanded workload or new programs that require the agency to take on riskier loans than it historically has had in its portfolio. The surge in FHA loans is likely to overtax the oversight resources of the FHA, making careful and comprehensive lender monitoring difficult. In addition, our experience in prior high FHA volume periods (such as from 1997-2001) shows that the program was vulnerable to exploitation by fraud schemes, most notoriously flipping activities, that undercut the integrity of the program. In my conversations with the Secretary, and in initiatives recently announced, I know he is endeavoring to fix some inherent weaknesses. We are pleased that the Congress recently enacted, and the President signed, legislation that strengthens the requirements for lenders to be approved to originate FHA mortgages.

Departmental Issues

Though the recently-passed Omnibus Appropriations bill containing FY 2009 funding will help to alleviate some of its funding constraints, we believe there is a critical need for more resources for FHA: 1) to enhance its IT systems; 2) to increase its personnel to meet the escalation in processing requirements; 3) to increase its training of personnel to maintain a workforce with the necessary skills to deal with the responsibility of this new portfolio; 4) to oversee the numerous contractors it maintains; and 5) to increase its oversight of all critical front-end issues including such important areas as the appraisal, lender approval and underwriting processes. Though the Department will increase its hiring in these areas, it still needs additional resources to adequately deal with new, and ever increasing, program demands.

We are also concerned that increases in demand to the FHA program are having collateral implications for the integrity of the Government National Mortgage Association (Ginnie Mae) mortgage-backed securities (MBS) program including the potential for increases in fraud in that program. HUD too needs to consider the downstream risks to investors and financial institutions of Ginnie Mae's eventual securitization of Home Equity Conversion Mortgage (HECM) Single-

Family loans. Ginnie Mae securities are the only MBS to carry the full faith and credit guaranty of the United States. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility for it. Typically, Ginnie Mae defaults the issuers and assumes control of the issuer's MBS pools. Like FHA, Ginnie Mae has seen an augmentation in its market share (it has even in some recent months surpassed both Fannie Mae and Freddie Mac) and increased $150 billion in outstanding mortgage-backed securities and commitments during a one-year period from FY 2007 to FY 2008. It too has stretched and limited resources to adequately address this increase. From a different vantage point, the industry has noted that Ginnie's struggle to keep pace with FHA could also reduce liquidity at a critical moment in the housing market.

The OIG has initiated investigations of Ginnie Mae MBS fraud. In one recent case, the two former corporate officers of a Michigan financial company were convicted of defrauding Ginnie Mae by retaining the funds obtained from terminated and/or paid-off loans. The defendants failed to disclose to Ginnie Mae that the loans were terminated, while one of the defendants utilized the funds from the paid-off loans to invest in the stock market and to make fraudulent monthly payments to Ginnie Mae on the loans that were previously paid-off in order to conceal the fraud. The fraud began during July of 1998 and continued until October of 2007, resulting in a loss of approximately $20,000,000. Further, a recent audit of the Ginnie Mae program has found that it did not ensure that mortgage-backed securities pools were FHA insured within a reasonable period after pool issuance. Without proper corrective actions, the gap in the MBS program policies and procedures will continue to make Ginnie Mae susceptible to program risks including fraud.

Given all these enumerated issues, we are gratified that a new penalty provision was inserted into the Housing and Economic Recovery Act last summer (now 18 U.S.C. Section 1014). When we corresponded during consideration of that legislation, we stated our belief that a new penalty enunciated specifically for the FHA program would be beneficial from an oversight and enforcement perspective. We assisted in its development and were very pleased that it was included in the final passage. The statute now creates a penalty of up to $1 million and 30 years in prison for committing fraud against FHA programs, similar to the predicates established in the Financial Institutions Reform, Recovery and Enforcement Act, and will be a useful tool for prosecutors and the law enforcement community to employ in order to address those who would seek to defraud the program.

OIG Observations

The results of the latest actuarial study, though now somewhat dated, show that HUD has sustained significant losses in its Single-Family program making a once fairly robust program's reserves smaller. The study shows that FHA's fund to cover losses on the mortgages it insures are contracting. As of September 30, 2008 the fund's economic value was an estimated $12.9 billion, an almost 40 percent drop from over $21 billion a year ago. The $12.9 billion economic value represents 3 percent of the mortgages insured by the FHA. Although above the 2 percent ratio required by law, it is well below the 6.4 percent ratio from September 30, 2007. Moreover, these latest projections used macroeconomic forecast data as of June 2008 and are profoundly sensitive to the accuracy of those forecasts. If more pessimistic assumptions are factored in, the ratio could dip below 2 percent in succeeding years requiring an increase in premiums or Congressional appropriation intervention to make up the shortfall.

Since its inception in 1934, FHA has been self-sustaining and premiums paid to the fund have covered the losses due to fluctuating defaults and foreclosures. The Secretary testified last week that there should be a surplus but re-estimations will be done over the summer. The Department has begun the process of performing its annual actuarial review of the FHA fund. Through our oversight responsibility, our auditors are also performing an independent review of the Department calculation and economic assumptions. Given the current economic conditions, it is critical that the assumptions used to derive the current estimate of the health of the fund be supportable and not overly optimistic.

As we have stated before, we think it might be useful for the Department to conduct interim assessments of the viability of the fund and we are aware that Rep. Lynch recently introduced legislation that would require a more frequent semiannual actuarial study. Resources will need to be given to the Department to take on this new requirement if it should become law but a more frequent study would give lawmakers the ability to determine the health of the fund in a more timely way.

A significant problem facing FHA, and the lenders it works with, is the fallout from decreasing home values. This increases the risk of default, abandonment and foreclosure, and makes it correspondingly difficult for FHA to resell the properties. About 7 percent of FHA loans are currently in default (i.e., more than 90 days non-payment status, foreclosure or bankruptcy). The Mortgage Bankers Association reports a 30-day + delinquency rate for FHA loans of over 13 percent. A major concern is that even as FHA endorsement levels meet or exceed previous peaks in its program history, FHA defaults have already exceeded previous years. The Secretary recently testified that he is sending SWAT teams in to try to head off the ramifications from early defaults on the FHA fund.

This, however, reinforces the importance for FHA approved lenders to maintain solid underwriting standards and quality control processes in order to withstand severe adverse economic conditions. Another extensive problem confronting FHA has been its inability to upgrade and replace legacy (developed in the 1970s and 1980s) application systems that had been previously scheduled to be integrated. The FHA systems environment remains at risk and must evolve to keep up with its new demands. Add to that an escalation in the properties owned and managed by FHA and the overall picture becomes more complicated.

Increased Risks to FHA:

Until recently, FHA's market share remained quite low as conventional subprime loans were heavily marketed by lenders. The tightening credit market has increased FHA's position as a loan insurer and, with that, is coming an increase in lender/brokers seeking to do business with the federal program and an overall concern regarding some of these loan originators. For example, we currently have under investigation, for alleged inappropriate activities, several FHA lenders who were also lenders in the subprime market. The movement towards HUD is already underway as reflected in recent statistics. FHA approval of new lenders increased 525% in a two-year period. For example, as of the end of Fiscal Year 2008, FHA had over 3300 approved lenders as compared to 997 at the end of Fiscal Year 2007 for an increase of 330%. If you compare the FY 2008 totals (over 3300) to the FY 2006 totals (692) it is a 525% increase. Lender approvals for the first half of FY 2009 currently total about 1600.

The integrity and reliability of this crop of program loan originators is, in our view, unproven and, in light of the aggressive recent history of this industry, may pose a risk to the program. The Mortgage Bankers Association (MBA) in recent testimony stated the "MBA is concerned that since the once lucrative subprime market has evaporated, some of the less scrupulous lenders who specialized in that business are now turning their attention to FHA lending."

In addition, we have seen lenders reacquiring FHA approval despite past abuses. A previous investigation on an FHA lender in New York led to the debarment of its owner for a period of five years from originating FHA insured loans. After the debarment was served, the lender, under the same owner, resumed operations using the same fraudulent practices. We again reviewed some of the loans and determined that the originations were fraudulent similar to the loans investigated in the first case. The OIG, in conjunction with the U.S. Attorney's Office and departmental officials, sought and received an injunction against them in order to stop the business from operating. At the same time as the injunction, FHA withdrew their lender approval.

Our audit work also highlights how problem lenders may regain admission into the FHA program even when previous transgressions were apparent. For example, we reviewed an Arizona corporation that was approved as an FHA mortgage lender by HUD in 1996. This particular lender had 13 active branch offices and sponsored close to 2,000 FHA-approved loan correspondents nationwide. As highlighted in our audit, this lender had a number of serious issues related to Real Estate Settlement Procedure Act (RESPA) violations such as paying marketing fees, non-competition fees and quality incentives to real estate companies in exchange for more than $57 million in FHA mortgage business. The corporation's license was suspended by the State and it filed for bankruptcy. One of the principal owners and principal managers reconstituted under a different name but operates from the same location. In 2008, HUD approved the new entity to originate and process FHA loans despite its principals' prior citations for RESPA violations.

In our previous testimony and in our discussions with staff of Senate Committee on Banking we spoke to this dilemma regarding an FHA focus on entities rather than individuals. We are extremely gratified that S. 896 contains numerous provisions directed at this problem by, for example, extending civil monetary penalties to owners, officers, or directors and not just the "mortgagee or lender," and by denying eligibility for approval to officers, partners, directors, principals, managers, supervisors, loan processors, loan underwriters, or loan originators who may have been, among other things, suspended, indicted, convicted or had unresolved findings contained in an OIG audit or an investigation. We are also pleased that the Senate Committee on Judiciary included provisions in S. 386 to amend the definition of financial institution to include mortgage brokers. Our testimony on former subprime players entering into the FHA arena was of concern to the Committee during drafting of this important legislation.

Adding to the risk, FHA is now, due to loan limit increases, serving new metropolitan areas with which it previously has had little interaction. Recent legislation increased maximum FHA loan limits to $729,750. With such entry, into these new markets, come new players and unknown hazards. The effects of this significantly increased loan limit are potentially much greater losses sustained by FHA on defaulted loans and that the loans may be much more attractive to perpetrators of fraud who will be able to extract greater payouts in fraudulent loans schemes.

Simultaneous to this confluence of events, is an increase in the reported incidents of mortgage fraud. As the Federal Bureau of Investigation (FBI) points out, a significant portion of the mortgage industry is void of any mandatory fraud reporting and presently there is no central repository to collect all mortgage fraud complaints. Mortgage fraud incidents reports, as compiled, however, by the Mortgage Asset Research Institute in the overall marketplace, have increased by 45 percent in the second quarter compared to a year-ago period. Its most recent third quarter assessment states that fraud incidence is at an "all-time high" and that "reported mortgage fraud is more prevalent now than in the heyday of the origination boom."

Our long-term investigative exposure in the area of mortgage fraud schemes impacting both FHA and conventional loans (since most fraud schemes cross loan programs) has given us vast experience and extensive knowledge. Many "**traditional**" fraud schemes continue to affect FHA and are described below:

- **Appraisal Fraud** – typically central to every loan origination fraud and includes deliberately fraudulent appraisals (substantially misrepresented properties, fictitious properties, bogus comparables) and/or inflated appraisals (designed to "hit the numbers"); appraiser kickbacks; and appraiser coercion.
- **Identity Theft** – often includes use of bogus, invalid or misused Social Security numbers and may include involvement of illegal aliens, false ownership documents or certifications.
- **Loan Origination Fraud** - including false, fraudulent and substantially inaccurate income, assets and employment information; false loan applications, false credit letters and reports; false gift letters; seller-funded down payments; concealed cash transactions; straw buyers; flipping; kickbacks; cash-out schemes; fraud rings; and inadequate or fraudulent underwriting activities.

While these types of mortgage fraud schemes continue to operate, changing market conditions have generated **new, or variant**, schemes:

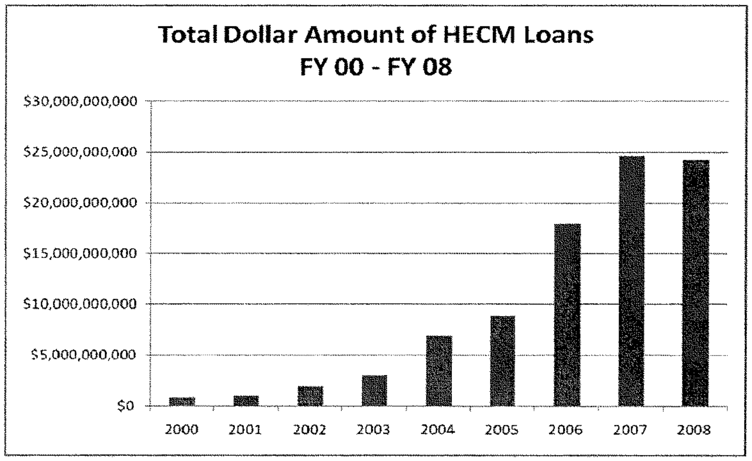
- **Rescue or Foreclosure Fraud** - recent trends show that certain individuals in the industry are preying on desperate and vulnerable homeowners who are facing foreclosure. Some improper activities include **equity skimming** [whereby the homeowner is approached and offered an opportunity to get out of financial trouble by the promise to pay off the mortgage or to receive a sum of money when the property is sold -- the property is then deeded to the unscrupulous individual who may charge the homeowner rent and then fails to make the mortgage payment thereby causing the property to go into foreclosure] and **lease/buy-back plans** [wherein the homeowner is deceived into signing over title with the belief that they can remain in the house as a renter and eventually buy back -- the terms are so unrealistic that buy-back is impossible and the homeowner loses possession with the new title holder walking away with most or all of the equity].
- **Bankruptcy Fraud** – typically Chapter 7 bankruptcy petitions are filed in lieu of Chapter 13 petitions on behalf of debtors; however, property sales information is fraudulently withheld

from the bankruptcy court and the properties are leased back to the debtors at inflated rents. The debtors' property ownership and equity are stripped from them.

- **Home Equity Conversion Mortgage (reverse mortgage) Fraud** – FHA reverse mortgages are a new and potentially vulnerable area for fraud perpetrators. We are aware that the larger loan limits can be attractive to exploiters of the elderly, whether it is by third parties or by family members, who seek to strip equity from senior homeowners. Due to the vulnerability of the population this program serves, we are also concerned about evasions of statutory counseling requirements, fraud by counseling entities, misleading sales claims, or incomplete compliance with the dispensing of required counseling information. We are working with the Chairman and members (Senator McCaskill, in particular) of the Senate Committee on Aging and the Chairman of the House Committee on Financial Services to address some of their concerns regarding these issues. We have also been partnering with the AARP and other groups to foster consumer protection education awareness. The following represent some of the types of schemes that we are encountering:
    - **Flipping** - the perpetrator creates a fake mortgage company and 'lends' funds to the borrower (no money changes hands, no loan is given, but a mortgage is filed). The subject refinances the borrower into a HECM. At closing the title company pays all outstanding debt including the fraud perpetrators' fake mortgage and the perpetrator walks away with the payoff.
    - **Recruitment** - Some HECM-related fraud activities involve an investor who sells the property to an elderly straw buyer and enters into a quit claim deed with the straw buyer. The buyer applies for the HECM loan within a short time frame and the appraisal used to originate the HECM loan is then fraudulently inflated. This allows the investor to illegally divert the proceeds of the loan. Straw buyers are "recruited" in residential areas with a high rate of renters. The buyers are often unaware that they must pay property taxes and some are unaware that the cash due to them at closing has been diverted. A current investigation involves recruiting elderly homeless to live in properties victimizing these seniors who often have desperate needs.
    - **Annuity** - Another activity that we currently have under investigation involves financial professionals fraudulently convincing HECM borrowers to invest HECM proceeds in a financial product, such as an annuity, in an improper way. The financial professionals receive increased fees and, in the case of annuities, the victims are unable to get access to their savings for many years or even past their projected life expectancy.
    - **Unauthorized Recipient** – Individuals, often family members, may keep HECM payments after the authorized recipient dies or permanently leaves the residence.
    - **Onerous Fee Payments/Consumer Fraud** – Just this last week, an OIG investigation led to an indictment in Maryland as a result of our participation in a local Elders Task Force. An elderly woman complained that her former health insurance representative stole approximately $200,000 from her HECM by convincing her she needed to pay him a fee to process her loan application and to repay him the reverse mortgage loan amount. He told the victim she had to repay the

loan by writing personal checks to him and she paid from funds received as well as from her retirement annuity and from cash advances on her credit card. We are currently in the process of identifying more reverse mortgage victims.

HECM loans represent a significant investment by FHA, with considerable recent increases. The chart below shows a 253% increase in the dollar amount of HECM loans from 2004 through 2008:



The OIG plans to work with the Office of the Comptroller of the Currency who is also concerned about this growing area and who believes particular attention needs to be paid to whether to impose additional requirements with respect to escrows of taxes and insurance. Nonpayment of taxes or insurance can trigger foreclosure. However, the new Federal Reserve Board escrow requirements for 'higher-priced' mortgages do not apply to reverse mortgages, and HUD does not require escrows to be established in connection with HECMs. The Comptroller thinks it would be a major step for HUD to issue guidelines addressing the escrow issue. We too are concerned about HUD's exposure on taxes and insurance on HECMs and that escrow may not be sufficient to support these fees. It is our belief that this may be caused by the misleading advertisement by lenders. Also, we note that the Department has recently requested close to $800 million for the HECM program. In its budget, it states that "the need for appropriated funding for this program reflects the sensitivity of reverse mortgages to changes in home price assumptions. An indefinite appropriation will support the program should actual demand exceed the Budget's projection."

In addition to the schemes described previously, the following case histories also illustrate some of the other types of prevalent mortgage fraud that the OIG typically encounters:

- In February, 2009, a former mortgage broker from Leawood, Kansas was sentenced to 154 months in prison and 60 months probation, and the former owner of a mortgage company from Olathe, Kansas was sentenced to 4 months in prison and 4 months house arrest and 36 months of probation for obtaining over $12 million in mortgage loans by submitting fraudulent information to lenders, including false representations on borrower income and employment, false lien information, false sales contracts and by laundering over $2 million in proceeds through straw business entities. Awaiting sentencing is a previously convicted felon (and former apprentice real estate appraiser) who pleaded guilty to stealing the identities of licensed appraisers approved by the FHA in order to create fraudulently inflated appraisals which then resulted in excess of $20 million in fraudulent loans. He obtained license numbers from the internet.

- In January, 2009, in Philadelphia, Pennsylvania, an appraiser and two settlement agents, were collectively sentenced to 45 months incarceration and 9 years probation and ordered to pay HUD $235,802 in restitution for their earlier guilty pleas to making false statements to HUD and committing a conspiracy and wire and identity fraud. The defendants and others provided fraudulent appraisals and other documents used by unqualified borrowers to obtain FHA-insured mortgages. HUD realized losses of $4,460,588 after 183 mortgages defaulted.
- In September, 2008, two defendants in South Florida were charged in a 21-count indictment for their participation in a mortgage fraud scheme that resulted in the approval and disbursement of six mortgage loans totaling $980,000. According to the indictment, one of the defendants, through his company, sold six properties in Miami-Dade County to unqualified buyers using FHA loans. In all six sales, the same defendant, through straw donors, fraudulently financed the down payments and closing costs of the buyers. The second defendant, one of the false donors, was also a silent investor in the scheme. Both defendants allegedly received sizable payments once the properties were sold. When the loans were closed, four of the six properties went into foreclosure.
- A sampling of FHA loans from a mortgage company in Olathe, Kansas indicated that the loans were issued to Social Security Numbers belonging to deceased individuals. An investigation revealed that this company originated 78 FHA insured loans totaling over $5 million and 31 conventional loans totaling close to $2.8 million to illegal aliens using stolen Social Security Numbers. The owners of the company were sentenced to 8 months in jail and 18 months probation and were ordered to repay $1.8 million in FHA insured loans.
- In Rockford, Illinois, a loan officer, realtor, loan processor, and company employers were charged with conspiracy, making false statements to HUD, and mail fraud, in a 35-count indictment. Specifically, the defendants were alleged to have engaged in a complex scheme to defraud HUD through a litany of false and fraudulent statements on FHA loan applications. These included, but were not limited to, the following: verifications of employment, pay stubs, W-2's, credit letters, cashier's checks, Social Security Numbers, Social Security cards, and letters containing Social Security Administration letterhead. Overall, 50 FHA loans were in question, with losses totaling in excess of $2 million.

- **Nursing Homes/Section 232** - The FHA insures mortgage loans (Section 232) to facilitate the construction and rehabilitation of nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. It also allows for the purchase or refinancing of existing projects not requiring substantial rehabilitation. It insures lenders against the loss on mortgage defaults. The current Section 232 regulatory agreement does not prevent transfer of the Transfer of Need associated with the property; does not include receivables in any security documents (which is a significant asset to the properties and can limit HUD's loss when retained); and does not require a lessee operating the project to abide by the same requirements as the owner. This allows lessees to use project funds for non-project expenses to the point of default with no recourse. With such a vulnerable population, the OIG has been recommending for years in numerous audits and investigations that the regulatory agreement needs to be changed.

  Currently, the Department has developed a new regulatory agreement for the owner and the lessee that will incorporate the above changes. However, this will only affect new owners and lessees in the program. The new agreement still requires OMB approval prior to being issued in the Federal Register for public comment again. This status has not changed since approximately the fall of 2006.

OIG Concerns Regarding Critical Front-End and Back-End Processes
(improving the quality of FHA originations and the enforcement of bad actors):

To some extent, the FHA has had to work with the hand it was dealt in terms of funding and of industry-led initiatives to diminish its authority. As others have noted, the FHA cannot keep pace with an industry that is increasingly technology driven, and it cannot use its revenues to invest in any new technology. Many of its deficiencies could be mitigated with additional resources dedicated to systems and staffing enhancement. Our audit and investigative work point to critical front-end and back-end process issues that, if strengthened, could enable the FHA to overcome some of its present vulnerabilities. Some of these areas, that we have previously testified to, were partially addressed in recently signed legislation and in newly-announced departmental initiatives.

Appraiser Oversight: Our work of the FHA appraiser roster identified more critical front-end weaknesses as evidenced in the quality control review and monitoring of the roster. The roster contained unreliable data including the listing of 3,480 appraisers with expired licenses and 199 appraisers that had been state sanctioned. In a further review, we found that HUD's appraiser review process was not adequate to reliably and consistently identify and remedy deficiencies associated with appraisers.

The FHA's current Single-Family insured exposure totals over $560 billion representing 4.8 million FHA-insured mortgages. Inflated appraisals cause higher loan amounts. If the properties foreclose, the loss to the insurance fund is greater. With significant increases in volume and new responsibilities in the mortgage marketplace, we do believe it may be time for the Department to return to an FHA Appraiser Fee Panel similar to the one dismantled by statute in 1994. It is essential if the mortgage industry wants to overcome perceptions regarding its integrity and its role in the current economic crisis that it ensures true market values are correctly estimated.

Such a move would relieve pressures on appraisers to return predetermined values and would change a system based on misplaced incentives. A recent study indicated that 90% of appraisers had felt pressure "to hit the number" provided (i.e., on the sales contract). The old FHA fee panel was rotational and guaranteed work as long as the appraiser met certain HUD requirements.

Our concern that appraisers tied to lenders may impact the quality of the FHA appraisal was also a matter of interest elsewhere as evidenced in last year's settlement involving Fannie Mae and Freddie Mac and the New York Attorney General whereby lenders selling loans to those entities were required to follow stricter guidelines to ensure that people involved in the processing of loans did not also choose the appraiser. The new Home Valuation Code of Conduct, while an improvement, contains vulnerabilities whereby the lending community still may have the potential to manipulate appraisal management companies who do not necessarily appraise in a way that some unscrupulous lenders may desire. Although still early in the new process, we are not sure that if such paid appraisers are not "hitting the mark," what is to stop those lenders from threatening to go elsewhere to do business? While the FHA fee panel was disbanded a number of years ago, the Department of Veterans Affairs has not abandoned this concept and we believe that this Department might want to follow suit thus eliminating the relationship between the loan officers, real estate agents and appraisers. We should remain cognizant that the downstream negative effect of overinflated appraisals is long-term and can be fundamentally corrosive to the housing market and to even, as we know today, the world economy.

Late Payment Endorsement Requirements Changed: Results from a number of other key audits have noted significant lender underwriting deficiencies, inadequate quality controls, and other operational irregularities. In another important front-end audit, we analyzed the impact of FHA late endorsement policy changes affecting FHA insured loans. On May 17, 2005, the Federal Housing Commissioner issued Mortgagee Letter 2005-23, which significantly changed the requirements for late endorsements for Single-Family insurance. A request for endorsement is considered late whenever the loan binder is received by the FHA more than 60 days after mortgage loan settlement or funds disbursement, whichever is later. The Mortgagee Letter removed the prior six-month good payment history requirement for these loans and provided an additional 15 days grace period before the current month's payment was considered late.

We conducted a review of this rule change and found that, although FHA asserted the change did not materially increase the insurance risk, FHA did not perform a risk analysis to support this determination. Our review of the performance of loans from seven prior OIG late endorsement audits (i.e., Wells Fargo, National City Mortgage, Cendant, etc.) found a three and one-half times higher risk of claims when loans had unacceptable payment histories within the prior six months. Since the issuance of the Mortgagee Letter, the default rate for loans submitted late has increased and is significantly higher than the default rate for loans submitted in a timely manner. The HUD Handbook itself acknowledged the risk of unacceptable payment histories by stating that "Past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions."

We issued an audit report in 2006 and recommended that HUD rescind the Mortgagee Letter until appropriate rule changes could be designed that were supported by an adequate risk assessment. The FHA disagreed with our audit report and declined to implement the audit recommendations. We referred this matter to HUD's Deputy Secretary who concurred with our recommendations on February 27, 2007 and ordered the FHA to immediately rescind the Mortgagee Letter.

Initially, the FHA agreed to implement the Deputy Secretary's directive but failed to take action, instead taking efforts to again dispute our audit results. This continued until April 2008, when the Deputy Secretary's office again intervened, at our request, and instructed the FHA to publish the proposed rule change in the Federal Register reinstating the six month payment history requirement for late endorsements. In June 2008, the proposed rule change was published in the Federal Register for comment.

Although the final rule rescinding the Mortgagee Letter was never published, FHA nevertheless closed the audit recommendation. Indeed it was not implemented, therefore, in a memorandum dated March 18, 2009, we informed the FHA that, given the amount of time that had lapsed and the absence of a corrective action, the OIG would report this in our next Semi-Annual Report to Congress. Given the current mortgage crisis, concerns over losses to the insurance fund, and requirements for transparency, we believe that this is an important recommendation that should not be dismissed.

The Department attempted to issue new rules for Good Faith Estimates under the Real Estate Settlement Procedures Act in 2002. The rule would have provided additional information to provide borrowers a better understanding of the condition and terms of their proposed mortgages. The Department was unable to finalize the rules. In 2008, due to the mortgagee crisis the Department again published proposed rules. The Department issued the final rules in November 2008. The new rules would have provided borrowers with additional information in the Good Faith Estimates. However, the implementation of the rules has been delayed due to procedural issues. The Department is currently working to resolve those issues.

Capturing Key Information in, and Upgrading, Data Systems: Another major concern, touched on earlier in the testimony, is the integration and upgrading of FHA legacy systems. While there has been much discussion on an overall plan, and what particular types of systems are needed to go forward, we think it would be useful at this juncture to reposition the discussion to ascertain which data should actually be collected, and maintained, in the system in order to control the new demands placed on the program. Our audit work and our investigative "Systemic Implication Reports" transmitted to the Department over the years, makes it clear that, at a minimum, we need the system to track identifying information on key individuals involved in the transaction such as the originating loan officer.

This person, for example, is central to the initiation part of the loan process where due diligence should hypothetically be done on the application material (i.e., credit scores, appraisal information, etc.). We would like to see that that person's name and corresponding identifying information (i.e., license, etc.) are put in FHA's data fields. This will allow the FHA and OIG to key in on a vital part of the loan process in which fraud typically can occur. If the system could also capture information on other key players such as the real estate agent for the seller and buyer, and other parties to the transaction, that too would be helpful for purposes of increasing integrity in the processes in our investigative and audit functions.

Further, we think it could be beneficial for the FHA to come together more significantly in a unified lender oversight consortium with Fannie Mae, Freddie Mac, the Federal Deposit Insurance Corporation, and Ginnie Mae in order to, among other things, create standardized forms that could produce common machine readable data fields with consistent information as well as to leverage existing data systems.

Additionally, FHA will be challenged within current resource constraints to keep up with the increasing volume of entities doing business. FHA controls currently rely upon random, manual processes by contractors to select for review approximately 2 percent of lender endorsements, a decrease from 5 percent due, in part, to an increase in volume and to funding limitations.

FHA then relies upon post-endorsement automated lender or service performance information, such as high delinquency or early default rates, to target these entities for examining a limited number of loans for quality assurance reviews. We believe FHA needs the resources to take advantage of commercial off-the-shelf pre-screening loan software, or to require at least the larger lenders use such tools as part of their underwriting process, and the Secretary has touched on software needs in recent testimony as well.

Lender Approval Process: Earlier in this testimony we discussed the increasing number of applicants coming into FHA for lender approval and the abuses that could result. It should be noted that FHA's lender approval process, like the review of loan processes described in the preceding paragraph, is largely manual. The FHA lender approval procedure has different requirements dependent on the type of lender making the application. The general process appears to try to strike a balance between not overburdening the applicant with extraneous requirements with a need for important oversight information. In light of the recent aggressive history of the industry that is now seeking to do business with this Department, we thought it prudent to enhance the standards and qualifications for participation. While we are currently auditing this process and will make recommendations when the work is completed, due to the urgent nature of the current circumstances confronting the nation and this Department from the fallout of the mortgage crisis, we recommended to Congress and the Department that some interim steps were needed.

S. 896, now public law, contains a new provision requiring the Department to expand the existing process for new applicants for approval to identify those who represent a high risk to the FHA fund and to implement procedures for those mortgagees approved during the 12-month period preceding to expand the number of mortgages originated by these mortgagees for review for compliance and to include a process for random reviews. In addition, we also spoke to the Senate Committee on Banking during the drafting of this legislation regarding the eligibility process for approval to the FHA program and are again gratified to see that sections were included to deny eligibility to those: suspended, debarred or under limited denial of participation; under indictment; subject to unresolved findings in an OIG investigation, audit or review; engaged in business practices that demonstrate irresponsibility; or are convicted of a felony related to participation in the real estate or mortgage loan industry. These are all provisions we had advocated and we look forward to these being implemented and believe they will go a long way to address some of the problems we have set forth.

Mortgagee Review Board: As we move to a discussion of essential back-end processes, we note that we have recently completed a review, at the request of Senator Grassley, of the Mortgagee Review Board (MRB) enforcement actions and its efficiency, effectiveness and impact in resolving cases of serious non-compliance with FHA regulations particularly during this period of significant changes in the housing market. FHA Single-Family endorsements total $71.7 billion in the first quarter of 2009, up 245% from the same period a year earlier, emphasizing the need for a strong deterrence to irregular mortgage lending practices. The MRB is a statutorily created board within the Department that has responsibility to sanction FHA-approved lending institutions that violate applicable housing laws and HUD regulations and policies. Established in 1989, it is the sole authorized enforcement body at HUD to remove noncompliant FHA lenders.

Specifically, our review found that the MRB's sanctions directly affected only a small number of lenders. The violations for which the MRB cited lenders rarely warranted withdrawal of FHA lending authority. The sanctions and fines obtained against lenders were frequently mitigated. Elapsed time to complete Board action was slow. The MRB's public visibility was also greatly reduced because the results of its rulings were not published in the Federal Register in FY 2008 as required or otherwise disseminated on HUD's Web site.

Since FHA lending authority is held by more than 12,000 mortgagees and loan correspondents, FHA relies on risk management tools other than the MRB to protect its portfolio and the insurance fund including computerized monitoring of loan default and claim rates, post-endorsement underwriting and appraisal reviews, and on-site lender monitoring. Nevertheless, we believe that a strong deterrence to abusive practices is an effective Board that reaches in a significant way to problematic lenders by, for example, imposing penalties viewed as of real financial consequence to the violating lender, by hearing cases against larger numbers of violators, and by better exposing decisions, in an effort to increase transparency, on more publicly visible sites such as the Department's website. Similarly, the Mortgage Bankers Association, in recent testimony, stated that the "FHA should have more aggressive, streamlined and timely processes to expel 'bad actors'." S. 896 contain a number of new provisions to address our concerns regarding the weaknesses in this area including a prohibition on certain limitations on the Board's power to take action against mortgagees.

This past week, the MRB suspended three lenders while an investigation into business practices was completed. Each had specific issues involving certain business activities and we note that the Department has enhanced its efforts in this regard. Our future inspections work relating to the MRB will focus on the collection of penalties and indemnifications and the referral process from internal HUD centers to the Board.

Other Concerns

In conversing with Subcommittee staff prior to the hearing, there were a few areas that were requested that this testimony touch on that were not related to the FHA or the Ginnie Mae programs.

Public Official/Management Corruption: The HUD OIG remains committed to vigorously investigating instances of malfeasance by those entrusted to run or to manage programs receiving federal funds. Last month, the HUD Multifamily Hub Director from Kansas City was indicted on 10 counts of theft of public funds and 10 counts of wire fraud. The Director supervised close to 90 employees and had responsibility for overseeing multifamily offices in Kansas, Missouri, Iowa, Nebraska and Oklahoma. He is alleged to have claimed to have worked when he was gambling at a casino or was playing tennis.

In another area, recent press reports highlighted that allegedly three employees affiliated with the Housing Authority of New Orleans (HANO) fabricated purchase orders and pocketed monies allocated for public housing. The three were placed on administrative leave. The HUD OIG recently released three audits at the request of Senator Landrieu related to the receivership of HANO including a report on the Authority's performance of its contracting activities and financial functions. In that report, we concluded that the Receiver did not ensure that the Authority correctly supported its expensed funds, monitored or correctly paid its contractor, or supported its disbursements.

In a New York case, a non-profit organization serving low-income tenants was charged with embezzling funds. This organization provided management services to two Section 8 properties. Between 2002 and 2008, representatives of the organization charged approximately $180,000 to its federally funded account purchasing personal items such as clothing, shoes, meals at restaurants, florists, groceries, and furniture. In addition, they paid for new flooring to an Assembly Member.

OIG Challenges

The task before the HUD OIG is a daunting one - addressing the elements of fraud that were involved in the collapse of the mortgage market; monitoring the roll-out of new FHA loan products in order to reduce exploitation of program vulnerabilities; and, combating perpetrators of fraud, including those who have migrated from the subprime markets, who would exploit FHA loan programs. The consequences of the current mortgage crisis, its worldwide economic implications, and the subsequent pressures placed on the Department and OIG could not have come at a more inopportune time. The Department, as a whole, has had significant new leadership responsibilities over the last seven years in rebuilding communities devastated by disasters (i.e., lower Manhattan post-September 11th; the Gulf Coast region after hurricanes Katrina, Rita and Wilma; the Galveston area after recent hurricanes; California fires; and Midwest flooding) that have added tens of billions of dollars in new program funds that require quick distribution and keen oversight. In addition, HUD received close to $4 billion in the Neighborhood Stabilization Program and over $13 billion in the American Recovery and Reinvestment Act that again requires rapid dissemination to an even more widespread area.

While there have been some monies appropriated for salaries and expenses needed for administering all these new programs and the recent passage of the Fiscal Year 2009 Omnibus Appropriation bill will help, the Department has historically not received analogous increases needed to deal with this new influx of requirements. They, and we, are quite stretched in our combined ability to keep up with the pace of new, critical needs and the changing dynamics of fundamental demands placed on the Department. The Subcommittee asked us to describe our personnel and resources.

The HUD OIG is organized into four offices: Audit, Investigation, Counsel, and Management and Policy. The Office of Investigation also contains Inspection and Evaluations, a rapid deployment group. The Offices of Audit and Investigation have offices in all 10 HUD federal regions as well as 48 duty stations throughout the nation. We currently have 650 full time staff members including 222 criminal investigators, 215 auditors, and 213 employees in other staff series such as attorneys, computer specialists, management analysts and administrative staff. In 2001, HUD OIG held a level of 705 FTEs.

While at one time, for example, we were able to operate mortgage fraud task forces on an exclusive basis, today's OIG agent is also tasked with conducting investigations related to HUD's designated management challenges, which include corruption in the administration of Community Planning Development grant programs; corruption in the administration of public housing authorities; multifamily projects; rental fraud by landlords and tenants; and disaster fraud, to name a few. These multiple challenges are supported by less investigative staff than were available in 1999. These staff members are the oversight for a Department that currently contains more than $62 billion in appropriated funds and has loan guarantee levels of hundreds of billions of dollars each for the FHA and Ginnie Mae programs. We are working diligently to address the range of audits and investigations needed to oversee all of the HUD's current operations. We recognize that our ability to keep pace is one component to the overall health of our national programs.

Subcommittee staff prior to this hearing asked if there were any legislative remedies that might alleviate some of our funding issues. The OIG is often confronted with situations where assets subject to forfeiture are associated with its investigative activities. Unlike the Department of Justice and Department of Treasury, with which OIG frequently conducts joint investigative efforts, and unlike other statutory OIGs such as the Department of Agriculture OIG or the Department of Defense OIG, the HUD OIG does not have the authority to retain awards for investigative or audit costs under various remedial statutes. It would be helpful to obtain the same legal authority as our law enforcement partners to participate in existing federal asset forfeiture programs. Other agencies have invited us to claim in the liquidation of forfeited property but we must turn them down for lack of statutory authority or turn it over to another agency as we did with the Postal Inspection Service. We thank the Subcommittee for asking us to address any ideas we may have and appreciate such consideration.

Lastly, we would like to note, and emphasize, that we are pleased to be partnering with the FHA in a marketing endeavor to increase the general public's awareness of departmental anti-fraud activities and enhance education through better outreach activities, and to heighten efforts aimed at fraud prevention and at fraud reporting. The HUD OIG is launching a new website, www.mortgagefraud.gov , and with the FHA will be using this, as well as other avenues, to better publicize our hotline and activities. Below is the new HUD OIG brand insignia that will accompany our marketing effort to reach the public.

PROTECTING YOUR AMERICAN DREAM

STOP MORTGAGE FRAUD

Conclusion

As can be deduced from reading through the totality of issues raised in this testimony, a number of cross-cutting concerns transverse many of the highlighted FHA processes. These include: A) inadequate quality controls; B) reliance on manual processes; C) over dependence on the honesty of program participant(s) to provide accurate and truthful information; D) tendency to focus on entities rather than individuals; and E) the need to work more with the mortgage industry to better capture data on individuals involved in the process. Further, although not within the control of the FHA, the fact that our nationwide mortgage lending system is fragmented with separate players embracing differing requirements creates opportunities for waste, fraud and abuse that a more unified approach could potentially ameliorate. We very much look forward to the implementation of the new secretarial efforts designed to mitigate many of the difficulties we have been highlighting in the last number of years and to working with him and the Department to try to improve programs so increasingly relied on by our citizenry during these trying economic times.

In conclusion, though the challenges and tribulations are increasing, the Office of the Inspector General stands ready to assist in whatever way is deemed necessary and will be vigilant in its efforts to protect the funds of the American taxpayer. We thank you for the opportunity to relay our thoughts on these important issues based on the body of our work and of our experience, and greatly appreciate the activities of the Congress to protect the Department's funds from predatory and improper practices and to ensure an effective response on oversight at this critical time.

Testimony of David G. Kittle, CMB

Chairman

Mortgage Bankers Association

Before the

House Financial Services Subcommittee on

Oversight and Investigations

Hearing on

"Strengthening Oversight and Preventing Fraud in

FHA and other HUD Programs"

June 18, 2009

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.

<u>The Growth of FHA and Increased Potential Impact of Fraud</u>

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

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[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.

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[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.

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[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.

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Local Knowledge ... Nationwide

June 18, 2009

Testimony of:
Kevin K. Nunnink, MAI, SRA, FRICS, Chairman
Integra Realty Resources, Inc.
IRR-Residential, LLC

Chairman Moore, Ranking Member Biggert, and members of the Subcommittee, thank you for inviting me to testify today. As a real estate appraiser for more than 30 years, I appreciate this opportunity to speak on an important topic critical to restoring confidence in the real estate mortgage industry.

I am chairman of Integra Realty Resources, a commercial appraisal organization, and IRR-Residential, a residential appraisal organization. Between the two, we have over 100 locally owned and operated appraisal firms and more than 1,000 licensed real estate appraisal professionals.

Sound mortgage underwriting includes two separate, but equally important components: first, a borrower's ability to pay, as evidenced by their income and credit score; and second, sufficient value of the real estate to support the loan type, as evidenced by the appraised value.

It should be noted that of all the professionals involved with the mortgage origination process, the appraiser is frequently the only professional that visits the property, implicitly for purposes of providing due diligence for their lender client – inspects the property and makes sure that the property has sufficient value to support the intended loan. Appraisers are licensed and professionally trained in valuing real estate and must meet minimum education and experience standards.

Appraiser separation is particularly important in today's mortgage industry where virtually all mortgage originators sell their mortgage paper into the secondary market and thereby hold minimal long-term loan risk. An independent appraiser makes it much more difficult to initiate mortgage fraud.

An independent appraisal serves as a safeguard for the protection of current and future parties to the loan transaction, including the borrower, the originating lender, the secondary market participant and as we are now seeing - the taxpayer. Any effort to circumvent the independence of the appraised value heightens mortgage risk.

Because of the housing slump and corresponding disruption in the credit markets over the past couple of years there have been a number of initiatives, legislatively and by regulation, increasing the separation between contingent fee real estate mortgage professionals and the appraisal process. We support those efforts.

Congress appropriately restricted this type of influence in FIRREA in 1989, but because mortgage bankers and brokers were not regulated by the FDIC they did not have to provide separation between the appraisal process and the mortgage originator. The Fraud Enforcement and Recovery Act of 2009 has appropriately provided further regulations upon these non traditional bank lenders.

There have been two structural conflicts of interest in the appraisal process: 1) loan originators selecting and regulating the volume of work directed to an appraiser, and 2) real estate mortgage companies providing bundled services, including appraisals, that drive EBITDA, but contingent on successful loan closings. In both cases, emphasis is upon closing loans, not protecting the independence of the appraisal process.

We were disappointed when the final version of the Home Valuation Code of Conduct gave a pass to those companies, lender owned or not, that also provide title insurance and loan closing services. In those cases, the company's ability to receive title and closing fees is contingent upon the loan going forward, which in part is conditioned upon the appraised value process they manage, an inherent conflict of interest.

Valuation products and their providers should be compliant with the state laws in which the property is located. We have concerns about the use of Broker Price Opinions, or BPOs in certain circumstances. There can be potential conflicts of interest, but more importantly, they have not proven to be as reliable when compared to valuation products prepared by independent appraisers. We believe HUD, like Freddie Mac, should continue to disallow BPOs for mortgage origination purposes.

Many lenders are choosing to achieve appraisal independence through the use of intermediary firms, a business model called Appraisal Management Companies, or AMCs. The AMCs receive appraisal orders from the lender and then independently choose the local appraiser to perform the service, providing a separation between the loan origination staff and the appraiser, thereby limiting the ability to influence the appraised value.

We believe it to be an inherent conflict of interest for individuals whose income is fully or partially dependent upon the origination of a loan, to select or interface with the appraiser. More fully stated, we believe the real estate broker, the mortgage broker, the title company or loan origination staff members should not participate nor influence the selection of the appraiser, nor be in a position to influence the outcome of the appraised value.

In closing, we believe it is good public policy to continue efforts that support the independence of the appraisal process. HUD should adopt similar principles to those of the HVCC for FHA and reverse mortgage originations.

We believe such standards need to be in place to protect the integrity of the mortgage origination process. Eventual holders of mortgage loans need to have confidence that the appraised value of the properties at the time the loans were originated were true, independent estimations of value. To do otherwise will increase "perceived risk" which will in turn widen interest rate spreads and ultimately increase the costs to borrowers.

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TESTIMONY OF FRANK PELLEGRINI

ON BEHALF OF

THE AMERICAN LAND TITLE ASSOCIATION

"Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs"

BEFORE THE
HOUSE FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS

THURSDAY JUNE 18, 2009

10:00 AM

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Introduction

My name is Frank Pellegrini, and I am President of Prairie Title in Oak Park, Illinois, with offices in Chicago, Schaumburg, Deerfield, Oakbrook Terrace, Palos Hills, Lisle and O'Hare. I have been a practicing lawyer since 1976 and founded Prairie Title in 1983 along with my wife, Mary. I served as President of the Illinois Land Title Association in 2004 and 2005 and on the Board of Directors of the Illinois Mortgage Bankers Association. I am a title agent, and a member of the Board of Governors of the American Land Title Association, which I am here today to represent. ALTA is the national association for the land title industry, representing nearly 3,000 member companies, with more than 100,000 employees, including title insurers, title insurance agents, abstracters and attorneys. Our members operate in every state and county throughout the country.

On behalf of ALTA, I appreciate the opportunity to appear before you today to discuss mortgage fraud and the title industry's role in: (1) facilitating the real estate purchase and refinance process (2) conducting closings in real estate transactions; and (3) protecting borrowers and lenders by preventing fraud. Finally, I will offer thoughts on additional steps that can be taken to combat mortgage fraud. The title industry protects consumers and lenders from fraud every day, and we provide consumers with the certainty that when they walk away from the closing table they own their real estate and that it cannot be taken from them because the property has been properly and legally conveyed.

Mortgage Fraud

Mortgage fraud is a significant threat to our economy, to the stability of the nation's housing markets and to the peace of mind of millions of American homeowners. Mortgage fraud is one of the fastest growing white collar crimes in the United States. There are two types of mortgage fraud: fraud for property and fraud for profit.

Fraud for property, also known as fraud for housing, accounts for 20 percent of mortgage-related fraud and typically involves the borrower as the perpetrator on a single loan. The borrower may make a few misrepresentations, usually regarding their income, personal debt, and/or property value, or conceals the source of a down payment. The borrower wants the property and intends to repay the loan, and is sometimes coached by their realtor or broker in order to qualify for the loan.

Fraud for profit accounts for about 80% of mortgage-related fraud and involves defrauding one or more of the parties to the transaction and taking cash out of the deal. The Treasury Department estimates that mortgage fraud causes losses to consumers and the mortgage industry of between $15 billion to $25 billion every year. Unfortunately, the problem does not appear to be going away. Reports of potential fraud filed with the Treasury Department's Financial Crimes Enforcement Network exceeded 65,000 in 2008, up from 25,000 in 2005 and just 5,400 in 2002.

In my hometown of Chicago, as in many large urban areas, the proliferation of mortgage fraud activities is particularly disturbing. The Chicago Crime Commission, an independent, non-partisan crime watchdog organization, reports that the profile of the typical Chicago gang leader has evolved into a picture of a graying, suburban, and technology-friendly convict who oversees mortgage fraud operations to supplement such traditional gang enterprises as drug trafficking. And unfortunately, according to the FBI Financial Crime Report to the Public for Fiscal Year 2006, "mortgage fraud perpetuated by real estate industry insiders accounts for 80% of all reported mortgage fraud losses."

On May 20th, 2009, President Obama signed into law both the Fraud Enforcement and Recovery Act and the Helping Families Save Their Homes Act in an effort to combat the mortgage fraud crisis.

The Fraud Enforcement and Recovery Act provides the federal government with more tools to investigate and prosecute mortgage, corporate, and other financial frauds, and authorizes substantial funds for hiring fraud prosecutors and investigators at the Justice Department. With this funding, the FBI will almost double its mortgage-fraud task forces nationwide. In addition, the law makes a number of important improvements to fraud and money laundering statutes. The purpose of these improvements is to ensure that individuals and companies are held fully accountable under federal fraud statutes. Most importantly, the Act amends the definition of "financial institution" in the criminal code (18 U.S.C. § 20) in order to extend federal fraud laws to mortgage-lending businesses not directly regulated or insured by the federal government, thereby applying the federal fraud laws to private mortgage businesses.

The Helping Families Save Their Homes Act establishes a Nationwide Mortgage Fraud Task Force within the Justice Department to address mortgage fraud in the United States. The Task Force is required to: (1) establish federal, state, and local coordinating entities to organize initiatives to address mortgage fraud; (2) provide training to federal, state, and local law enforcement and prosecutorial agencies with respect to mortgage fraud; (3) collect and disseminate data with respect to mortgage fraud; and (4) perform other functions determined by the Attorney General to enhance the detection, prevention, and response to mortgage fraud in the United States. The Task Force is authorized to: (1) initiate and coordinate federal mortgage fraud investigations and, through the coordinating entities, state and local investigations; (2) establish a toll-free hotline for reporting mortgage fraud and providing the public with access to related information and resources; (3) create a database about suspensions and revocations of mortgage industry licenses and certifications to facilitate the sharing of such information by states; and (4) make recommendations and propose federal, state, and local government legislation.

Common mortgage fraud schemes include:

- Property flipping where property is purchased, falsely appraised at a higher value, and then quickly sold. The scheme typically involves one or more of the following: fraudulent appraisals, doctored loan documentation, or inflating buyer income, kickbacks to buyers, investors, brokers, appraisers. Unfortunately, participation of title company employees is common in this scheme.

- A "silent second," where the buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes that the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.

- Nominee loans or straw buyers where the identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

- The use of a fictitious or stolen identity in the loan application where the applicant may be involved in an identity theft scheme: an applicant's name, personal identifying information, and credit history are used without the actual person's knowledge.

- Inflated appraisals where an appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender which inaccurately states an inflated property value.

- Equity skimming where an investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.

- An air loan which is a non-existent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.

- "Liar loans," also know as stated income loans, NINA Loans (no income, no asset), or NINJA Loans (no income, no job, and no assets) which were originally created for high-income individuals or businesses that preferred not to document all assets and income. These loans required simply that the applicant state their income and assets. In order to compensate for the slightly higher risk, these loans often come with a higher interest rate. In fraudulent transactions, these loans are provided to applicants who would not otherwise qualify for a loan.

- "Loan slamming," where the borrower applies for several loans at the same time on the same property, and times the closings so that they occur within a few days of each other. It is important to note that the transactions happen so close to each other that they often go undetected. This is particularly troubling to the title insurance industry because the gap between the time a transaction is recorded and the document is indexed provides a prime opportunity for fraudulent activity.

- Property theft which is usually targeted at owners who leave their homes for a significant amount of time throughout the year, known by those of us in Oak Park as snowbirds. The culprit moves into the house, puts it up for sale and sells it to an unsuspecting buyer. No one knows the truth and, when the sellers return, they find a new family living in their home.

- Foreclosure rescue schemes where the perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. The perpetrator misleads the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator remortgages the property and/or pockets fees paid by the homeowner.

- Asset rentals where real estate agents or mortgage brokers misrepresent the borrower's ability to qualify for a loan by fabricating employment history, income verification, credit records and/or bank statement balances. For a fee, an "asset rental" company transfers money into the borrower's bank account to show the lender that the borrower has ample funds to close and even enough for reserve. Once the closing takes place however, the funds are transferred back to the asset rental company. These types of companies can also issue fake appraisals, credit reports, and employment verifications and even give the borrower a new Social Security number usually taken from someone who had died in the early part of the 20th century.

- "Chunking," where a borrower attends a "seminar" about how to invest in real estate with no money down, and a third party, possibly a presenter at the seminar/program, encourages the borrower to invest in 3 properties and acts as the borrower's counsel or agent. Under the perpetrator's guidance, the borrower completes the applications and perpetrator submits the applications to multiple lenders for multiple properties, let's say 10, instead of the original 3 that the borrower knows about. This scheme requires an appraiser, broker, and/or a title professional to ensure that the borrower does not have to bring money to the multiple closings. The perpetrator acts as the borrower's agent at closing, and while the borrower receives loan proceeds for 3 closings they are aware of, the perpetrator pockets the proceeds from the other 7 closings. Lenders are stuck with loans to a borrower who does not have the ability to repay the debt and are often forced to foreclose on the properties.

In addition, new mortgage fraud schemes are emerging all of the time. Some ALTA members are even seeing evidence of fraud using the recently-passed $8,000 First Time Homebuyer Tax Credit where loans are made to "monetize" the tax credit with exorbitant up-front fees or interest rates. All of these schemes contribute to mortgage fraud.

How does the title industry facilitate real estate transactions?

The "ownership" of real estate really involves the ownership of a bundle of rights that relate to the use and disposition of the property that we have come to associate with the general term "ownership" or, the more technically correct phrase, fee simple title. Ownership rights to real estate may be divided in a number of ways and over a period of time. Prior owners may have created interests in the property or suffered liens against the property that take precedence over the interests acquired by a new purchaser. And because of the value, permanence, and immovability of real estate, federal, state, county, and municipal governments have created or recognized a vast array of rights, liens, and encumbrances that may be asserted against real estate to encourage compliance with the law. Each of the documents used to determine ownership rights has the potential to be made fraudulent. These documents represent:

- liens against the property that serve as security for the payment of an obligation, such as mortgage liens, judgment liens for unpaid court judgments, tax liens, state and local liens for failure to pay real estate taxes or assessments, mechanic's liens to secure payment for improvements, liens for recovery of child support payments or, as in New York City, for unpaid parking tickets;

- easements that have been created by contract or arisen through use of adverse prescription, such as rights of way for utilities, rights acquired by neighbors because of an encroachment;

- building or use restrictions contained in a recorded plats, agreements or deeds; and

- rights or claims arising out of bankruptcy.

However, in any real estate transaction, the buyer must be certain that they will ultimately be acquiring ownership of the property subject only to those liens and encumbrances they know about and are willing to accept. Likewise, the seller has an interest in ensuring that the title obtained by the buyer will not be subject to any claims that will trigger any liability on their part. The mortgage lender must be certain that in providing financing for the transaction, the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable first mortgage lien that is not subject to any other lien or claim that could adversely affect that mortgage interest.

Nowhere else in the world is the creation and transfer of interests in real property accomplished more efficiently and securely than in the United States. Economic success in America relies on a clear system of property rights. This system was created during the times of the American frontier and is the basis for entrepreneurship and the creation of wealth and capital in our country. Our property recording and title insurance system, served by local public officials and the title industry, provides us with the legal underpinning that fosters the trust necessary for mortgage credit to flow and make homeownership possible.

The willingness of individuals and businesses to invest in real estate anywhere in the United States, or to loan money to those who own or are acquiring real estate and the ready marketability of those interests and loans is fostered and preserved by the title insurance industry. We do this by issuing insurance policies and completing the significant work title agents perform which is required to issue the policies. This effort has rendered real estate investments safer, more secure, and more marketable than at any time in history.

In general, there are two major types of title insurance policies, both of which are typically issued after the closing of a real estate or mortgage finance transaction: an owner's policy and a loan policy. Both policies are issued for a one-time fee, often simultaneously, which is paid during the closing. There are no renewal premiums for title insurance. Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim, including fraud.

An owner's policy insures the purchaser against financial loss or damage that may arise from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records but were not discovered during the search of those records or their significance was not appreciated, and against defects that even the most comprehensive search of the records would not reveal. These risks include, among others:

- fraud or forgery in the execution of documents in the chain of title, including deeds, mortgages or mortgage satisfaction pieces;
- mistakes in the interpretation of wills, divorce decrees, bankruptcy court directives and other legal documents;
- the execution of documents by minors or incompetent persons who could not legally convey property interests;
- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and
- mistakes in the recording or indexing of documents in the public records.

A loan policy essentially insures the lender that they will have a valid, enforceable lien on the property should they need to reacquire the underlying asset by foreclosure and that no other claimant, other than those specifically noted in the policy, has a prior, superior claim. The loan policy continues in force so long as there is a balance due on the loan. It is typically assigned in the secondary mortgage market to a purchaser of the loan or Mortgage Backed Security pool in which the loan is placed.

Because the history and current status of each parcel of property is unique, title insurance policies are not issued on a "casualty" basis, that is by making an actuarial assumption of risk. Rather, title insurance policies are issued on the basis of a thorough search and examination of the relevant public records pertaining to the ownership of the particular property to be insured, so as to determine whether the seller, in fact, owns the fee simple title rights they have contracted to convey to the buyer, and what liens or encumbrances exist that would limit the use or value of the property when it is acquired by the buyer.

The title search and exam, which is performed by title agents and is discussed in more detail below, is critical from the insurer's standpoint for proper underwriting in connection with the issuance of the policy, but also in that it identifies errors in the record, including potential fraud. The search and exam is also vital to the potential buyer because the preliminary title commitment or report, given by the insurer or agent to the prospective policyholder, identifies matters of record found in the title search and examination process that, if not resolved prior to closing, will be excepted from coverage when the policy is issued. This information enables parties to the transaction to detect fraud and provides the buyer, and/or their representative the opportunity to determine whether any action needs to be taken by the seller or others to eliminate defects identified in the commitment before the transaction is closed.

Title insurance is fundamentally different than other forms of insurance in three ways which provide an extraordinary incentive to detect and eliminate mortgage fraud. First, title insurance is issued for a one-time premium, and there are no recurring premiums that can be collected to boost claims reserves. Title insurers cannot simply raise rates the following year to make up for claims loss. Second, title insurance protects against existing title defects which arose before the policy is issued. While a claim may not be asserted until after the policy is issued, it must be based on matters which existed prior to the issuance of the policy. If fraud occurred before the policy was issued, an insurer, through their agent, would need to detect and eliminate or correct the fraud to prevent paying a claim. Third, the underwriting process for title insurance differs greatly from other forms of insurance. The underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and addressing title problems before a policy is issued. Through a thorough search and examination of the title, it is theoretically possible to identify all the defects that may exist and then to either eliminate them, insure over them, or exclude them from coverage.[1] While claims and

[1] Just as no homeowner's insurance company would insure a house if it knew at the time that a fire was raging in the basement, a title insurer will not insure against a significant lien or claim it knows to exist and to be enforceable against the property. Having informed the prospective insured in its preliminary commitment that the matter will be excepted from policy coverage, it is up to the prospective insured to decide whether to accept that defect as a limitation on the title, to negotiate with the seller for its removal, or to decline to go ahead with

losses are inevitably bound to occur, title insurers seek to do all that they can to minimize the possibility of a future claim.[2]

Risk identification and elimination is of unquestioned benefit to the purchaser, seller, lender, title agent, title underwriter and the public. The process identifies any possible problem with the title that affects the use of the property or its value before purchaser or lender buys or invests in the property. They have less risk of being challenged on their title and having to make a claim. The seller is notified of any liens or claims against them which affect their ability to sell the property. The title agent's constant search and clearance of the public record results in errors being found and corrected, reducing the instances of claims and cleaning the record they use each day to determine title. The title underwriter pays fewer claims, creating a more predictable, stable claims trend and the public benefits from thousands of experts constantly searching public records, discovering and correcting errors and identifying fraud. In fact, a 2008 ALTA study found that the public benefits as a result of this process since:

- At no cost to taxpayers, the title industry collects $1.75 billion per year in back income taxes.
- At no cost to taxpayers, the title industry collects $3 billion per year in delinquent real estate taxes.
- At no cost to taxpayers, the title industry collects $325 million per year in delinquent child support payments.
- The title industry spends $225 million per year to correct errors in the public property records that otherwise would lead to serious impairment of the property rights of millions of Americans.
- The title industry is an important source of revenue for local governments, paying $170 million per year to purchase copies of recorded documents.

In addition, a study by Association Research[3] found if problems were not eliminated prior to closing, one in three property purchasers and their lenders would be subject to a claim due to an error in the public record. These claims cost time, money and great anxiety amongst the homeowners who would otherwise risk the loss of their homes and lenders who would otherwise risk loss of their investment.

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the transaction if the defect is serious enough (e.g., it could affect the marketability of the property).

[2] In this regard, title insurance is somewhat akin to boiler insurance, where significant portions of premiums are devoted to inspecting and correcting any problems with the boiler before the policy is issued.

[3] "2005 Abstracter and Title Agent Operations Survey," Association Research, Inc. (April 2006)

Real estate closing process

The first step after an order for title insurance is received is to collect the relevant records and information pertaining to the property to be insured, as well as information regarding possible claims against the seller (or owner in a refinance transaction) that could affect the title to the insured property, including fraud. This is the "title search," and the information collected is "title evidence."

Having collected the title evidence, individuals experienced in real estate law and title insurance principles examine the title evidence to determine whether the seller has, and can convey, their title to the buyer, as well as what other liens or other objections must be resolved or cured, and what title defect exceptions may have to be included in the policy. It is at this "title examination" stage that the title agent performs one of the most valuable services, which is an inherent part of the title insurance underwriting function: curing defects and problems that may exist in the title records. This curative action includes obtaining releases or pay-offs for discovered liens including prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner's association debts, mechanic liens; obtaining releases for deeds and mortgages; and correcting typographical recording and indexing errors that could create problems like misspelled names or incorrect legal descriptions.

On the basis of the title examination, a commitment to insure is then sent to the prospective policyholder, which sets forth the conditions that must be met for a title insurance policy to be issued such as documents to be produced. This may include the execution of a deed, the execution of a new mortgage in favor of the buyer's lender, as well as items to be removed such as payoff of mortgages, judgments, liens, taxes, municipal bills, in addition to exceptions to the policy coverage that were found during the title search and examination process. All of this information is discovered in the public record, not by simply finding a document, but through the tedious reading and reviewing of all the documents whether they are found in an electronic form, as they are in 406 counties across the country, or whether they are found through a tedious search of multiple physical documents as they are in roughly 3,200 counties and other record-keeping jurisdictions across the country.

If exceptions pose problems for the prospective policyholder, an attempt may be taken by the parties, with the assistance of the title agent, to eliminate those exceptions. If an exception cannot be removed, the title underwriter may be willing to insure over it, either because the title underwriter concludes that the risk of assertion or financial damage is small, or because an indemnity is obtained from the seller. An exception that cannot be removed will be listed on the policy as an exception. If an exception is serious enough, the buyer may seek to modify the terms of his purchase contract with the seller or, in an extreme case, decline to proceed with the transaction. Because the title industry has been so effective over time in detecting and clearing titles errors and preserving the integrity of the public records it is rare that a seller's title is so defective as to be uninsurable or unmarketable. This fact keeps U.S. real estate markets exceptionally liquid.

The closing package is then prepared and a "bring-down" search is run to ensure that nothing has been filed of record since the date of the original search. This search is particularly important in detecting mortgage fraud perpetrated by individuals recording fictitious documents in the time between the title search and when the policy is issued.

The last steps in the process involve the closing of the transaction. The relevant deeds, mortgage instruments, and other documents are executed and funds are exchanged. The new deed and mortgage lien are recorded and title insurance policies are issued to the lender and the new owner. At this point, depending on the location, a gap may occur. A gap period is the time between when a deed or mortgage is recorded and the date that the recording office enters the instrument in the index which title agents use to conduct the title search. If a document is recorded "in the gap," a title agent simply will not find a document which has been recorded in the gap. The size of the gap depends on the local jurisdiction. For example, in Fairfax County, Virginia, the gap is almost non-existent. In some counties in Michigan, the gap can be several months long. This is particularly troubling to the title insurance industry because of the gap in the time between a transaction is closed and the mortgage instrument is recorded is a prime opportunity for fraudulent activity. The fraud risk arises because a dishonest borrower or other party could convey an interest in the property during the gap period. Title insurance policies insure against the risk that a mortgage instrument might be recorded during the gap. We protect borrowers, sellers and lenders during this vulnerable period of time to ensure that the transaction can go through quickly, safely and efficiently.

It is important to note that because of the differences in laws, customs, and practices in various parts of the country – and even within different areas of a single state – the title insurance issuance process described above is subject to numerous variations throughout the country. In some of the eastern United States, attorneys still play a significant role in residential real estate transactions and frequently act as title insurance agents on behalf of a title insurance underwriter or a "bar-related" title insurance entity. In the Midwest, abstracters generally prepare the title evidence (compiled in a document called an "abstract") from which a lawyer, title agent or a title underwriter will perform the examination. In some areas, the closing takes place when parties gather together around a "closing table" to sign and exchange documents, funds and keys. Closings in other areas are conducted electronically, at the buyer's preferred location or through an escrow agent, where the transaction is closed pursuant to written instructions received by the escrow holder from the parties. In California and other parts of the western United States, title companies or independent escrow companies handle this escrow function.

In addition, the extensive search of public records that is performed prior to the issuance of a policy is codified in many states through a minimum search requirement to ensure that a search is always performed and that title insurance is not issued on a "casualty" basis. These requirements are intended to preserve the integrity of the title industry by minimizing claims, but they have the added benefit of protecting the public record against fraud and by ensuring these records are reviewed on multiple occasions, increasing the likelihood of errors being detected and corrected.

To minimize title claims and thereby serve the primary need of their customers, title companies expend a substantial amount of time collecting and evaluating the title evidence, curing defects, making underwriting decisions relative to the issuance of the policy, issuing a title commitment that will enable the prospective policyholder to review and consider the exceptions to coverage. Each of these functions requires highly trained and experienced employees and professional personnel. In order to evaluate the condition of title, professionals must be familiar with local customs and practices as well as all applicable legal aspects of title, including real property law (which often varies by state and even communities within a state) as well as bankruptcy, probate and family law.

Title industry professionals look for a number of mortgage fraud indicators including:

- Ensuring the earnest money deposit comes from someone other than the borrower, or lack of information about the source of the deposit.
- Seller carry-back documents that are not being disclosed to the lender.
- Payments to third parties in the form of loan proceeds, fees, or checks being made payable to individuals that will not appear on the HUD settlement statement. The HUD-1 Settlement Statement must show all receipts and disbursements.
- Wide swings in mortgage amount which often mean costs are being rolled into the loan amount, or additional funds may be for future property improvements which prompt a call to the lender.
- Recent sales with increases in price and checks to others at closing which could be a sign of "flipping".
- Substitution of sales contract for a higher amount.
- The signing of blank documents.
- Changes or increases in purchase price. Sometimes, the sale price may be adjusted to cover closing costs. If the original contract price has been increased, the lender should be made aware.

In addition, as settlement services providers, we help prevent fraud by:

- Carefully checking all aspects of the parties' identification. We know of a case in which a caregiver stole the information of the elderly gentleman he worked for by acquiring a replacement driver's license with his picture on it. The caregiver applied for a refinance and walked away with $65,000. In this case, a check of the birth date would have been a tip-off that something was wrong.

- Knowing our customers. A settlement services provider should call the mortgage broker's or banker's main office line on occasion, not just the direct or cell phone number. They can also make periodical checks with their local Better Business Bureau.

- Checking lenders' or realtors' licensing status to determine whether any complaints been filed.

- Always receiving lender approval for any HUD-1 Settlement Statement changes and accepting and distributing funds directly to and from the lender.

- Prohibiting employees from notarizing documents that they did not witness.

- Not accepting closing instructions from third parties.

- Never rendering legal advice to any party.

- Keeping all matters pertaining to the closings in strict confidence. Requests from outside parties unrelated to the closing for information regarding transactions, should be declined. If outside parties are entitled to information relating to a closing they can obtain a subpoena.

- Warning borrowers during the closing of potential future risk of fraud such as verifying letters indicating a transfer of mortgage servicing companies.

- Having parties sign deeds of trust and other documents by signing over the signature line and over the typed name – this makes signature scanning much more difficult.

- Calling the lender to verify when you see something that might look suspicious.

- Offering to serve as a resource to clients if questions about potential fraud arise in the future.

- Serving as a resource to local, state and federal law enforcement officials about mortgage fraud.

All of this work in the back office and at the closing table adds up to a successful and fraud-free transaction.

Fraud Protection

The single most important aspect of the title insurance industry that cannot be overlooked is that we are the independent third party to the transaction whose only interest is to the integrity of the transaction and the protection of our customers. We are the people who handle the money that comes from the borrower and the lender and disburse it to the appropriate parties in the transaction. Our job is to get the deal closed honestly, fairly, and in accordance with the agreed-upon instructions and to get the money into the right hands.

This is the key component of the transaction. At the end of the day, you can buy or sell a property without the assistance of a realtor, you can agree on a price of the property without the assistance of an appraiser, but what is absolutely essential, what must always be there is an independent closer; someone who ensures the transaction is legal and recognized and who ensures that when money changes hands, it is distributed properly.

When we as settlement services providers fail to do this, intentionally or not, a defalcation occurs. This is the type of fraud that worries our members the most because it involves a misappropriation or diversion of other people's money by those entrusted to get that money into the right hands. Unfortunately, the temptation to do this is something which we will never be able to eliminate, but our industry works very hard to prevent, detect and correct by establishing rigorous audit standards.

While we are not law enforcement officials, we must use our expertise and bring the human element to the transaction.

Title agents are the people who actually sit face-to-face with the parties at the closing table. It is in this setting that mortgage fraud is detected in many, many cases. If the loan application shows the borrower is a doctor, making a handsome salary, but the person appearing at the closing is agitated or does not appear to have the vocation listed on the application, it should be cause for further investigation. We look at people's identification and we see them face to face. We continually train our professionals to "ask someone" if they suspect fraud.

In addition to our human side, our industry has a fiduciary responsibility to protect our policyholders in the event of a claim, including mortgage fraud. The title industry pays millions of dollars each year in claims to protect mortgage lenders and consumers from the effects of fraud. We absorb that loss so that they don't have to.

Fraud is the second most leading cause of title claims. Our experiences indicate that mortgage fraud schemes change with the changing economy. For instance, in a more robust economy we witnessed claims involving inflated values. As prices have fallen and equity has dried up, we now see loan slamming claims on first lien mortgages. Additionally, with the large numbers of mortgage defaults, short sale mortgage fraud claims are becoming more prevalent. Through May of this year, one ALTA member has paid $11.6 million in fraud related claims, which represents 11.5

percent of all claims payments they have made so far this year. Another ALTA member has paid over $12 million in fraud related claims, which represents 10 percent of all claims payments they have made so far this year. We believe that the actual losses may be significantly higher because many fraud-related claims are difficult to detect or are only discovered after a different type of claim has been already been made. In addition, fraud is not always detected.

Additional steps

ALTA has taken its own steps to combat mortgage fraud and promote consumer protection. On September 18, 2007, we launched "The Title Industry Consumer Initiative," which details our five-point strategy for improving industry oversight and educating and protecting consumers. The initiative includes a consumer education program, the adoption of our "Principles of Fair Conduct," enhanced member education on regulatory compliance and ethical standards, and a strategy to work more closely with state and federal regulators to ensure that the title industry continues to meet the needs of consumers.

The thrust of ALTA's Consumer Initiative is to help consumers understand the closing process. ALTA has developed a consumer Web site, www.homeclosing101.org, which provides an overview of the closing process and explains the purpose of title insurance including the process of the title search and repairing title defects.

A major component of the Consumer Initiative is our "Principles of Fair Conduct," which state what ALTA expects of its members: (1) to engage only in business practices that are lawful and consistent with a high standard of ethical behavior, (2) to encourage a culture of compliance within their organizations for federal and state laws that govern the title insurance business, (3) to treat consumers in a fair and ethical manner, (4) to provide consumers with timely and comprehensive information regarding their policies, services, products, and prices so as to enable consumers to shop effectively among providers of title-related services, and (5) to encourage and assist consumers to be educated purchasers of title insurance and title-related services.

We work with the Property Records Industry Association (PRIA), HUD and law enforcement agencies to actively detect and counteract fraud within the industry. All of us in the real estate industry are in this together. The realtor needs to work with the appraiser who needs to work with lender who needs to work with secondary mortgage market who needs to work with title and escrow officer who needs to work with the recorder, and so on. Once the fraud case has come to law enforcement, it is too late to prevent harm. We need to avoid, prevent, detect and deter mortgage fraud before it takes place, and we all have to be a part of that solution.

ALTA's educational subsidiary, the Land Title Institute, Inc., has developed a presentation entitled "Ethics in the Title Industry" which will soon become an online course to educate Title Industry professionals about the dangers of mortgage fraud. The course includes specific steps that individuals and companies can take to combat fraud. In addition, we are developing a "Mortgage Fraud Resource Center" for the

ALTA website as a clearinghouse for the title industry regarding common fraud schemes and include information from the many organizations that combat mortgage fraud including state governments, BITS, MBA, PRIA, MISMO and the FBI.

Additional common-sense steps can be taken to assist in the prevention of mortgage fraud. One simple step which Congress can take is to protect a Borrower Right of Inspection by requiring that borrowers be given their closing documents prior to closing to prevent confusion when borrowers are presented with myriad complex forms and are pressured to sign documents that may be incorrect or against their best interests. Unfortunately, consumers often do not see their loan documents until they arrive at the closing and are asked to sign them. Congress should consider requiring that borrowers receive their key closing documents in advance of closing – a consumer protection measure which is strongly supported by HUD.

Under the Real Estate Settlement Procedures Act (RESPA), consumers currently have the right to request and review closing documents 24 hours before the closing. Few know of or make use of this option, nor is there a corresponding requirement that the documents be complete. In many cases documentation is still being faxed to the closing agent while the borrower is seated at the closing table.

A Borrower Right of Inspection would remedy the plight that borrowers face at settlement and strengthen the remedial disclosure provision of RESPA by giving borrowers 24 hours to review the following closing documents which, with the exception of extenuating circumstances, would be complete and finalized by the lender and settlement agent: the HUD-1 Settlement Statement, the promissory note, mortgage or deed of trust, and the final Truth-in Lending Act disclosure.

The consumer benefit conferred by the proposal is enormous: borrowers would be able to review the key documents, ask questions, obtain third party counseling and renegotiate terms during this one to two business days before the scheduled settlement. This would facilitate their understanding of the closing process and help to ensure that they do not enter to an unsuitable loan transaction that leads to non-performance down the road. It would also help prevent mortgage fraud by providing the settlement services provider and the borrower more time to review the documents on which fraud is perpetrated.

Finally, ALTA is an ideal gateway to stakeholders who can assist other organizations working to detect and prevent mortgage fraud, and ALTA can offer assistance, referrals, and expertise from title industry professionals around the country. We can leverage our nationwide network of land title associations, underwriters, agents and industry vendors. Simply put, on matters of detecting and preventing mortgage fraud, ALTA is eager to assist.

I thank you for the opportunity to serve as a resource to help combat mortgage fraud.

NAMB
National Association of Mortgage Brokers

Prepared Testimony of

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President

National Association of Mortgage Brokers

On

"Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs"

Before the

Committee on Financial Services,
Subcommittee on Oversight and Investigations

United States House of Representatives

Thursday, June 18, 2009

Good morning Chairman Moore, Ranking Member Biggert, and Members of the Committee. I am Marc Savitt, President of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting me to testify today on "Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs."

NAMB is the only national trade association that represents the mortgage broker industry. NAMB represents the interests of more than 70,000 mortgage broker professionals located in all 50 states and the District of Columbia. NAMB also works with 49 state affiliate associations nationwide. Additionally, NAMB represents the interests of homebuyers, and advocates for public policies that serve the mortgage consumer by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to promoting the highest degree of professionalism and ethical standards for its members. NAMB requires that its members adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. NAMB provides its members with access to professional education opportunities and offers rigorous certification programs to recognize members with the highest levels of professional knowledge and education. NAMB also serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

Although parties acting as mortgage brokers defy simple characterization, in today's market it can generally be said that a real estate financing professional or entity acts in a mortgage broker capacity when the professional or entity works with both borrowers and lenders, though representing neither, to obtain a mortgage loan.

Mortgage brokers work with consumers to help them through the complex mortgage origination process. Mortgage brokers add value to the process for both consumers and lenders by serving areas that are typically underserved by banks and other lending institutions. Mortgage brokers also add value by providing goods, facilities, and services with quantifiable value, including a customer base and goodwill.

I. Introduction

Numerous efforts have been undertaken recently to improve the quality and independence of real estate appraisals. For example, the Housing and Economic Recovery Act of 2008 makes it unlawful to improperly influence real estate appraisals, and Title VI of the Mortgage Reform and Anti-Predatory Lending Act (H.R. 1728) also addresses appraisal activities. Nevertheless, one other attempt to reform appraisal practices, known as the Home Valuation Code of Conduct ("HVCC"), threatens to undue all of the progress that has been made by these recent legislative efforts.

The HVCC is having a significant and negative impact on consumers and the residential mortgage market. The HVCC has created conflicts with other existing appraisal regulations, and has precipitated a tremendous decline in appraisal quality. For these reasons, we respectfully urge Congress to take whatever steps are necessary to eliminate these and other serious problems being created by the HVCC.

II. What is the HVCC

The HVCC is the result of a joint agreement made in March 2008 between Fannie Mae, Freddie Mac (together, the "GSEs"), the Federal Housing Finance Agency ("FHFA"), and New York Attorney General, Andrew Cuomo. The HVCC purports to enhance the independence and accuracy of the appraisal process. However, what the HVCC truly accomplishes is an increase in consumer costs, a decline in appraisal quality, the extension of closing deadlines, and the virtual extinction of local small business appraisers.

Despite being the product of an investigation into appraisal fraud at a lending institution and its affiliated Appraisal Management Company ("AMC"), the HVCC targets mortgage brokers and small independent appraisers, and forces consumers to rely exclusively on lenders and their AMCs for home valuations. This gives large national lenders and AMCs a virtual monopoly on the home appraisal process and removes the cost and quality checks and balances that a competitive marketplace provides.

Moreover, the HVCC is a substantive rule that affects consumers and regulates mortgage and appraisal professionals in all 50 states. Yet, the HVCC was enacted by one state's Attorney General, endorsed by the FHFA, and implemented by the GSEs without regard to for the federal rulemaking processes required under the Administrative Procedures Act ("APA").

a. The Impetus Behind the HVCC

The HVCC is the product of an investigation launched in 2007 by the New York Attorney General against Washington Mutual – at that time the largest savings and loan in the United States and a key player in the subprime lending market – and its affiliated AMC, eAppraiseIT.

In conjunction with this investigation, the New York Attorney General subpoenaed the GSEs "to determine the extent of [the companies'] knowledge of, and actions regarding, [appraisal] problems as they relate to past mortgage purchases and securitizations." The New York Attorney General sought information regarding mortgage loans purchased by the GSEs from any bank, as well as the due diligence practices of the GSEs and their policies and procedures regarding valuations and appraisals by originating lenders and the GSEs themselves.

While the investigation into WaMu and eAppraiseIT continued, an agreement was reached in March 2008 between the GSEs, the FHFA, and the New York Attorney General whereby the investigation into the GSEs would be halted and no findings released, provided the GSEs adopt new appraisal policies – the HVCC – and pledge more than $20 million to oversee the implementation of these new policies.

b. Requirements of the HVCC

Among other things, the HVCC requires lenders, or third parties authorized by lenders, to be responsible for selecting, retaining, and providing for payment of all compensation to appraisers. The HVCC specifically identifies AMCs and correspondent lenders as third parties who may receive such authorization. At the same time, the HVCC expressly prohibits this authorization to be granted to mortgage or real estate brokers.

c. What is an Appraisal Management Company ("AMC")

An AMC is a business entity that administers a network of appraisers to fulfill real estate appraisal assignments on behalf of mortgage lending institutions. AMCs recruit and qualify a network of third-party appraisers, and negotiate fees and service level expectations. AMCs do not engage in the practice of appraisal, which is a key difference between the AMCs and the appraisers they employ.

AMCs merely provide an outsourcing solution for lenders, whereby the AMC is employed by the lender – for a fee – to act on the lender's behalf, engage real estate appraisers, and perform the administrative functions involved in the appraisal ordering, tracking, and delivery process. However, because AMCs do not engage in the practice of appraisal, they are not regulated by current appraisal guidelines, regulations or policies designed to protect consumers with regard to the cost and quality of appraisals.

AMCs are entirely unregulated under federal law, and there are currently only three states with laws providing for any type of AMC oversight. By requiring the vast majority of all appraisals to be run through AMCs, the HVCC renders virtually all of the protections included in Regulation Z of the Truth-in-Lending Act ("TILA"), the Financial Institutions Reform Recovery and Enforcement Act ("FIRREA"), H.R. 1728, and various state laws inoperable. This is simply because AMCs are not subject to the requirements set forth in these statutes and regulations.

III. What is Wrong with the HVCC

a. Increased Consumer Costs

We are deeply concerned about the adverse effects the HVCC is already having on consumers throughout the market. NAMB conservatively estimates that the HVCC will ultimately cost consumers, in total, over $2.8 BILLION each year in additional fees, as compared to years previous to the HVCC's implementation.[1]

Specifically, delays in closing caused by the implementation of the HVCC are forcing consumers to extend their rate lock periods. Such extensions cost consumers, on average, an additional $561.95. Additionally, appraisal fees have risen significantly. Based upon conservative estimates, appraisal fees have increased, on average, a minimum of $150 since the implementation of the HVCC. Taking just these two examples together, consumers are experiencing an average cost increase of $711.95 on every loan originated under the HVCC.

b. Decline in Appraisal Quality

There are two primary factors that are driving down the quality of appraisals under the HVCC. First, because AMCs contract to pay appraisers such low fees, those appraisers most often willing to work with the AMCs are inexperienced and therefore less likely to make an adequate home valuation than a more tested and experienced appraiser.

Second, AMCs are assigning appraisers from different municipalities, counties, or even states to appraise target properties. These appraisers, in addition to likely being inexperienced, are also unfamiliar with the neighborhood and the community and are consequently unable to produce an accurate appraisal. Moreover, the assignment by AMCs of out-of-town or out-of-state appraisers is forcing those appraisers to violate the Uniform Standards of Professional Appraisal Practice ("USPAP"), which requires jurisdictional competence.

A specific example of this was recently brought to our attention by a NAMB member in Louisiana. This member was working with a consumer on a property located in downtown New Orleans, Louisiana. After the lender in the transaction chose an AMC, that AMC selected an appraiser from Gulfport, Mississippi to travel to downtown New Orleans and appraise the property. What's worse, the AMC imposed an additional "trip charge" on that consumer because of the travel involved by the out-of-state appraiser that was selected for this property.

c. Extended Closing Deadlines

Since the HVCC took effect on May 1, 2009, it is estimated that closing deadlines have had to be extended, on average, a minimum of 15 days. Our members are seeing appraisals take up to 30 days or more to be completed, and even then, the appraisals are often of inferior quality.

In another example shared with NAMB, a mortgage broker in California had to wait three weeks for a property appraisal to be conducted. The broker went through the lender's website to order an appraisal, but the consumer did not hear from the lender's appraisal company for six days. After that appraisal was canceled, the lender suggested another appraisal company. The borrower was then charged a fee by both of these appraisal companies. The broker was unable to receive any response from the first appraisal company whose appraisal had been canceled for over a week and this broker was forced to personally reimburse the borrower for the duplicative expense. The appraiser who finally arrived at the property was then asked by the lender to go back and do another comp, which extended the process by another week. Because the mortgage broker is prohibited from communicating with any appraiser under the HVCC, this

[1] 3,870,552 (2007 HMDA report of residential mortgage loans originated) x [$150.00 (avg. minimum increase in appraisal cost) + $561.95 (average loan amount of $224,778 x .25% for extended rate lock period)] = $2.8 billion.

broker was unable to expedite the appraisal process for the consumer. Ultimately, the consumer was left at the mercy of the lender and its timeframe.

d. No Appraisal Portability

The HVCC expressly encourages the portability of appraisals. Appraisal portability is important because it allows consumers to change lenders if a better deal becomes available without incurring the duplicative additional cost of ordering a separate appraisal for the new lender. However, in practice, there is no portability of appraisals under the HVCC. In fact, in a recent poll conducted by NAMB, 75.8% of respondents indicated that 0% of their appraisals have been portable since the enactment of the HVCC.

Consumers are essentially trapped into working with the first lender to whom they submit an application, or they are forced to incur the additional expense of a second appraisal if they later choose to obtain a loan with a better rate or terms from another lender. We are seeing that the vast majority of lenders are not allowing borrowers to transfer appraisals, regardless of the reason. Borrowers are thus forced to pay for another appraisal, wait for a new appraiser to be assigned by the AMC, and wait for the appraiser to complete the home valuation. This increases both the total cost and transaction time involved for consumers, and may force borrowers to miss contract deadlines and face penalties from the lender, the seller, or both.

e. Unregulated AMCs Dominating the Appraisal Process

As was mentioned above, AMCs are entirely unregulated at the federal level, and they are vastly unregulated in virtually every state. Moreover, AMCs have been the subject of numerous investigations and lawsuits centering on appraisal misconduct, and were a centerpiece of the original New York Attorney General's Office investigation that led to the creation of the HVCC.

Nevertheless, AMCs have been granted a virtual monopoly over the entire home valuation process by the HVCC. As a result, local small business appraisers and the mortgage and real estate brokers with whom they have worked for years are being driven out of business by these AMCs. In this absence of any real competition, the AMCs are seizing upon the opportunity to assume total control of the appraisal process and increase consumer costs indiscriminately. The AMCs are seeking to totally control both appraisers and the appraisal process, including reserving the right to "slice and dice" data from appraisals, and dictate to independent appraisers that they must follow the AMCs' instructions or they will not receive any more work.

f. RESPA Violations

NAMB is also greatly concerned about the possibility of serious Real Estate Settlement Procedures Act ("RESPA") violations resulting from the implementation of the HVCC. The mechanism for appraisal fee collection and distribution under the HVCC at best encourages, and arguably forces lenders into violations of Section 8b of RESPA for fee splitting and the collection of unearned fee.

One specific example of this comes from California. There, a local appraiser was contacted by a bank's AMC and notified that upon implementation of the HVCC borrowers would begin to be charged $500 for an appraisal, yet subcontracted appraisers would only be compensated up to $200 for conducting the appraisal. This type of fee splitting seems is occurring throughout the country and is a clear violation of RESPA.

g. Elimination of Local Small Business Appraisers

The most profound and immediate impact that the HVCC is having on the industry is the extent to which the AMCs are chasing highly qualified independent local appraisers out of business. Like many mortgage brokers, small business appraisers typically live in the communities in which they serve and they are the experts in their corner of the world. In fact, some small independent appraisers have been making home valuations in the same area for decades. These appraisers are now being driven to the point of extinction by the large national AMCs. The AMCs are employing inexperienced appraisers who are willing to travel from out-of-state and work for virtually no money, and there is simply no way for these small business owners to compete under the provisions of the HVCC.

In one example that was recently shared with NAMB, a small business owner whose family has been in the appraisal business for years was previously conducting over 60 appraisals each month. However, just one month following the implementation of the HVCC, this appraiser anticipates possibly conducting as few as 10 appraisals in the month of June.

IV. NAMB v. James B. Lockhart III, Director of the FHFA

Although NAMB strongly supports policy initiatives that seek to ban coercion of appraisers and improve the overall quality of the appraisal process, on February 23, 2009 we felt it was necessary to initiate legal proceedings against FHFA Director James B. Lockhart III to prevent the HVCC from taking effect. We filed this lawsuit because of a strongly held belief that the HVCC would impact mortgage brokers, independent appraisers, and consumers in a profoundly negative way.

We were concerned that the HVCC would place small-business mortgage professionals and appraisers at a significant and permanent competitive disadvantage, thereby impeding competition in the marketplace and inevitably resulting in higher costs and other negative consequences for consumers. Moreover, we felt that the FHFA was required to utilize notice and comment rulemaking proceedings under the Administrative Procedures Act ("APA") when promulgating the HVCC, but the agency failed to do so.

In April 2009, we elected to withdraw our complaint against the FHFA, without prejudice, in order to assess and evaluate a means of challenging a defense raised by the FHFA. The FHFA defended its actions in implementing the HVCC by claiming that that no court could review any decision made by the agency, with regard to the GSEs, while the GSEs are in conservatorship.

We feel strongly that the FHFA's contention that no court has jurisdiction over the agency's unilateral use of conservatorship power is unprecedented and, as our testimony above illustrates, it has become clear that this arbitrary exercise of authority is occurring at the expense of consumers. The elimination of competition in the marketplace for appraisals has increased consumer costs significantly and has adversely affected the timing and quality of home appraisals.

a. Comprehensive Regulation of Appraisal Practices

There already exists pervasive federal regulation of the mortgage lending industry's acquisition of real estate appraisals. In 1989, following the savings and loan crisis, Congress passed the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA"), which established a multi-faceted real estate appraisal regulatory system involving the federal government, the states, and The Appraisal Foundation. Since 1989, the federal agencies responsible for regulating financial institutions have promulgated regulations under FIRREA that set forth "generally acceptable appraisal standards," and have issued guidance relating to real estate appraisals, which, among other things, set forth standards for selecting qualified appraisers. These regulations and appraisal guidelines both prohibit improper influence on appraisers and work to ensure appraisal independence.

Moreover, in July 2008, the Federal Reserve Board ("Board") issued a final rule prohibiting all mortgage brokers, mortgage lenders and their affiliates "from coercing, influencing, or otherwise encouraging appraisers to misstate or misrepresent the value of a consumer's principal dwelling." In issuing this final rule, the Board concluded that "[no] particular procedure for ordering an appraisal necessarily promotes" fraudulent appraisals. Rather, the Board determined that the "coercion of appraisers," whether by lenders or mortgage brokers, "is an unfair practice" and the final rule should apply to lenders and mortgage brokers alike. NAMB fully supported the Board's final rule because, unlike the HVCC which arbitrarily singles out certain industry participants, the Board's rule targeted problematic practices.

Unlike the HVCC, these appraisal standards have gone through the legislative process or prescribed rulemaking procedures under the APA, were subject to open and public debate, and were ultimately approved by Congress or a federal agency.

Additionally, legislation recently passed by the House of Representatives is aimed at further strengthening certain property appraisal requirements designed to improve appraisal quality and promote appraiser independence. NAMB fully supported the appraisal provisions in H.R. 1728, and we commend Representatives Kanjorski and Biggert for their tireless work towards reforming and strengthening the oversight of our home appraisal system.

b. APA Requirements for Federal Rulemaking

The consideration of these existing regulations, as well as other less burdensome alternatives, is required under the APA whenever a federal agency is promulgating a new rule. The FHFA is an agency and the HVCC falls within the definition of a rule under the APA. As such, the FHFA should have been required to utilize notice and comment rulemaking proceedings under the APA. The agency failed to do so.

Because the HVCC is a substantive rule that regulates the entire mortgage industry and the FHFA failed to follow proper rulemaking procedures, we believe that the HVCC must be withdrawn, or declared void, invalid, and unenforceable.

V. Congressional Hearings

We are deeply troubled by the immediate and adverse effects the HVCC has had on consumers, and we are equally troubled by the fact that these new appraisal policies were instituted nationally without being properly vetted through either the legislative or administrative process. Taking into consideration the FHFA's contention that the agency's actions are beyond the scope of judicial review, we turn to this Committee and respectfully request that a comprehensive hearing be held as soon as possible in order to finally engage in public discourse regarding the origins of the HVCC and its impact on consumers and the market.

VI. The FHA Program

FHA mortgage insurance was created to help provide lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. The insurance pool is paid for by premiums that homeowners pay when they utilize the program.

Although there is now some concern regarding the subprime industry entering the FHA market, existing rules and policies to some extent prevent this from happening. There are some significant differences between subprime and FHA originated loans. Borrowers that utilize the FHA program have to adhere to higher standards than they would in the subprime market, have down payments and are expected to meet strict loan-to-value ratios. Subprime and other high risk loans often had prepayment penalties and/or negative amortization. FHA loans do not permit these actions. Also, FHA loans are required to be made on owner-occupied primary residences, cannot be made on second homes or be non-owner occupied, and cannot be no-income or stated-income loans. Additionally, a large number of subprime loans that were made were on investment properties, second homes, or were no-income or stated-income loans

Although the controls in place in the FHA program will help to prevent losses similar to those seen in the subprime market, one must realize that FHA was created to absorb risk to lenders. If HUD is able to identify problematic individuals, properly monitor its mortgagees and is empowered to disbar them in a reasonable time frame, losses from that source should be minimal. However, even conservative mortgage lending is expected to have some losses. For decades, FHA has been able to absorb its losses from premiums collected. FHA was designed to promote homeownership in good markets and difficult markets. In times of economic instability, FHA premiums may need to be adjusted to cover added risk. In order to provide stronger protection to the FHA insurance pool, NAMB believes Congress should allow risk-based pricing for FHA premiums or implement a complete government subsidy of FHA loans. Even if Congress decides a subsidy is required, it would be considerably less expensive than many other stimulus programs already being implemented.

On October 1, 2008, the U.S. Department of Housing and Urban Development ("HUD") implemented a one-year moratorium on the FHA Risk-Based Premium structure pursuant to the Housing and Economic Recovery Act of 2008. NAMB supports lifting the moratorium so that the risk to the FHA fund is balanced by the premiums paid by borrowers.

The ability to match borrower characteristics with an appropriate mortgage insurance premium has been recognized as essential by every private mortgage insurer ("PMI"). PMI companies have established levels of credit quality, loan-to-value, and protection coverage to aid in this matching process. These companies also offer various programs that allow for upfront mortgage insurance premiums, monthly premiums, or combinations of both. This flexibility has enabled lenders to make conventional loans that are either not allowable under FHA or present a risk level that is currently unacceptable to FHA.

FHA is essentially a government mortgage insurance provider. Where FHA mortgage insurance is not available, PMI companies are free to increase premiums without fear of losing market share to a more competitively priced FHA loan product. FHA should be permitted to balance risk with premiums charged in order to increase competition and ultimately drive down costs for consumers. Since FHA is not required to make a suitable profit or demonstrate market growth to shareholders, it is likely that FHA can afford to assume greater risk levels than PMI companies can currently absorb. This increased capacity to assume and manage risk will allow FHA to not only serve borrowers who presently do not have PMI available as a choice, but also those borrowers whose premiums will be reduced because of the increased competition in the market.

VII. Mortgage Brokers & FHA Loans

A mortgage broker is a real estate financing professional or entity that works with both borrowers and lenders, while representing neither, to obtain a mortgage loan. A mortgage broker works with consumers throughout the complex mortgage origination process. Accordingly, a mortgage broker's role may include taking an application; performing a financial and credit evaluation; producing documents; satisfying underwriting conditions; working with realtors; ordering title searches, appraisals, and pay off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings.

There are eligibility requirements, including HUD policy and regulatory criteria, a mortgage broker must adhere to in order to become an approved FHA loan originator regarding operations, employees, credit checks and other issues.

FHA classifies approved mortgage originators based on the functions they will perform and type of organization.

A mortgagee may become FHA approved upon meeting HUD's requirements, and submitting an acceptable HUD form 11701, Application for Approval, the appropriate non-refundable application fee, and other materials which are described in HUD's Mortgagee Approval Handbook.

There are three basic types of FHA approved originating mortgagees including supervised mortgagees who are members of the Federal Reserve and whose accounts are insured by either the Federal Deposit Insurance Corporation (FDIC), or the National Credit Union Administration (NCUA); non-supervised mortgagees (i.e., mortgage lenders) who are not depositories; and finally, non-supervised loan correspondents who are often mortgage brokers that have as their principal activity the origination of FHA-insured mortgages for sale or transfer to one or more sponsors who underwrite the mortgages. A loan correspondent must be sponsored by a fully approved supervised or non-supervised direct endorsement mortgagee, who agrees to underwrite and fund the FHA loan. The loan correspondent can either close the loan in his/her own name or in the name of the underwriting sponsor. Traditionally, mortgage brokers close in the name of the underwriting sponsor. Mortgage brokers NEVER underwrite the FHA loan. An additional level of approval is called direct endorsement, or "DE" which is available to supervised and non-supervised mortgagees. The DE status enables mortgagees to underwrite and close an FHA loan before submitting the loan to HUD for insurance endorsement.

It is important to point out the specific role a mortgage broker plays in originating an FHA loan. The mortgage broker is responsible for taking the consumer loan application, obtaining merged credit reports and importing loan application data. The mortgage broker then enters his/her FHA correspondent ID and the sponsoring wholesaler FHA lender ID. The second step involves sending the borrower's information through Freddie Mac's Loan Prospector or Fannie Mae's Desktop Underwriter system which is programmed with the FHA Total Scorecard underwriting parameters. At this point, the mortgage broker receives a full "FHA Total Scorecard Feedback Certificate." The third step involves the mortgage broker processing the information he/she has collected from the consumer and then sending the full file to the sponsoring lender. Finally, the sponsoring lender reviews the "FHA Total Scorecard Feedback Certificate" and underwrites the loan per FHA requirements and makes the final lending decision.

VIII. FHA Resources

In order to increase efficiency and productivity and help to detect fraud, funding for HUD and the FHA program must increase. The FHA has too few employees reviewing new applicants. With the increase in volume of FHA loans, there is a clear need to increase funding for all areas relating to FHA, particularly including computerization, lender assessment, approval, fraud detection and enforcement. In addition, there is a need for better coordination between HUD and law enforcement, as well as increased enforcement of the Truth in Lending Act and the Real Estate Settlement Procedures Act.

IX. Legislative Efforts to Enhance the Strength and Security of the FHA

NAMB has long supported efforts to uniformly increase standards for loan originators, and we have fought hard to rid our industry of bad actors and unscrupulous tactics that harm consumers, jeopardize institutions, and soil the reputation of the entire industry.

This committee made some positive changes to enhance the strength and security of the FHA home mortgage insurance program through legislation approved by the House of Representatives this year. Such legislation was included in a broader housing package, the "Helping Families Save their Homes Act of 2009" which was signed into law. We commend Chairman Frank, Representatives Maxine Waters, Jackie Speier and Steve Driehaus for their work and leadership on this legislation.

NAMB specifically supports the provisions in the "Helping Families Save their Homes Act of 2009," which would increase HUD's scrutiny of applicants for participation in FHA loan origination and expand HUD's authority to penalize loan originators who attempt to circumvent the application process. NAMB also supports requiring HUD to expand its review of loans originated by recently approved applicants to ensure compliance with all applicable laws, regulations, and policies and to provide for uniformity with the recently enacted S.A.F.E. Mortgage Licensing Act.

With the credit crisis that remains squarely upon us, the safe, sound, and affordable loan programs offered through FHA can be a lifeline to borrowers and a key component of our nation's economic recovery. However, as borrowers and lenders rely more heavily on the FHA loan program, it becomes increasingly important to ensure that the program is protected from predators and other bad actors who pose a threat to consumers and to the insurance fund.

X. Conclusion

We appreciate Congress's ongoing bipartisan efforts to revitalize the FHA loan program and eliminate any fraud in the program. NAMB will remain supportive of further efforts to strengthen, secure, and expand access to the program to qualified borrowers and originators nationwide. We also support and appreciate any efforts to permanently increase the FHA loan limits as they have had a significantly positive impact on high cost areas such as California. Additionally, we appreciate the opportunity to discuss the many flaws associated with the implementation of the HVCC.

The HVCC took effect May 1, 2009, and almost immediately the costs to consumers of closing a mortgage loan increased by over $700. That number is only likely to grow as competition for home appraisals shrinks even further due to the AMCs pushing even more small independent appraisers out of business.

Appraisal independence is essential to protecting consumers from fraud and from unscrupulous actors. NAMB remains supportive of efforts to provide for appraisal independence standards like the ones included in H.R. 1728 and the Federal Reserve Board's 2008 Regulation Z Amendments.

Thank you for allowing us to share our serious concerns regarding the HVCC with you today. We hear from consumers, appraisers, and NAMB members every day who are being negatively affected by the HVCC. Therefore, we reiterate our earlier request that this Committee hold a hearing regarding the HVCC and its effect on consumers and small businesses. We look forward to continuing to work with this Committee on this and other issues critical to the success of FHA, other HUD programs, and the mortgage and real estate markets in general.

WRITTEN STATEMENT OF THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Hearing before the Committee on Financial Services
Subcommittee on Oversight and Investigations

Chairman Moore, Ranking Member Biggert, and members of the Subcommittee, Secretary Donovan thanks you for the opportunity to submit this written statement regarding the Federal Housing Administration's (FHA) efforts to strengthen program oversight and prevent fraud in its programs.

For the past 75 years, FHA has served as the bedrock of the nation's mortgage finance industry. Through good times and bad, FHA financing has been available to those seeking safe and affordable mortgages, focusing on the fundamentals of prudent underwriting, sound credit policies and a long held commitment to strong program oversight and risk management – practices that were all but forgotten during the subprime boom.

The turmoil in the housing market over the last few years has had a devastating effect on the nation's economy. Today, FHA is playing its traditional role by providing stability and liquidity to the housing market and access to credit for families seeking affordable financing options. This has resulted in dramatic changes in FHA's business. By some industry estimates, FHA has gone from less than 3% market share, just a few short years ago, to approximately 30% of the single family mortgage market today. In addition, FHA has managed a staggering surge of lenders seeking approval to participate in its programs. Over the last two years, FHA has seen a dramatic increase in lender applications.

FHA remains committed to the guiding principles that have protected FHA's programs and insurance funds and the public from undue risk. As you may recall, FHA provided detailed testimony to the House Financial Services Committee on January 9, 2009, that outlined our risk management activities as they relate to lender approval, oversight, and program enforcement. While these compliance and risk management practices have been effective, FHA continues to strengthen its risk management and fraud prevention framework to ensure that its programs are protected from fraud and abusive lending practices.

As part of the 2010 Budget, HUD is launching an expanded initiative designed to improve its ability to combat mortgage fraud, teach consumers how to avoid predatory practices and enhance oversight of FHA approved lenders. In addition, Congress's recent passage of the Helping Homeowners Save Their Homes Act of 2009 has provided much needed support to this end. This legislation provides FHA with expanded authority to ensure that those who are proven to be engaged in predatory lending practices are not allowed to participate in the FHA programs, as well as to take actions against those who violate program requirements.

Additionally, the Fraud Enforcement and Recovery Act of 2009 provides HUD's Office of Inspector General (OIG) with significant funding to target mortgage fraud. We hope to leverage the OIG's funding with our program knowledge and referral protocols to target those unscrupulous lenders that violate program requirements and seek to commit fraud.

Agency Wide Initiative to Combat Mortgage Fraud and Predatory Practices

As part of the agency's continuing efforts to improve oversight and protection of the FHA insurance funds, HUD has requested $37 million for an agency wide initiative to Combat Mortgage Fraud and Predatory Practices.

HUD recognizes that the current market environment increases the potential for mortgage fraud and predatory practices on multiple fronts. On one level, the significant expansion in the volume of FHA insured loans exposes the insurance funds to increased risk of abuses within the program. With increased volume and market share, the number of new participating lenders has increased 230 percent in the past years, from 997 to 3300 lenders. At the same time, new forms of predatory practices are on the rise. According to the FBI, the decline in the housing market has created an ideal climate for predators in the form of mortgage rescue scams. Almost half of the budget request will be used to boost fraud detection by training industry partners and giving FHA access to state-of-the art fraud detection tools, including automated valuation tools for verifying appraisals, and income verification mechanisms. These tools would be applied to all phases of the mortgage insurance process and give FHA the ability to more efficiently identify misrepresentations at the consumer, application, and property levels through the automated check and analysis of multiple data sources.

This effort is a part of the HUD's broader Transformation Initiative which is intended to revive, transform and reform the way the Department does business. HUD is seeking authority to set aside 1% of its total budget for an agency wide Transformation Initiative that would build transparency and accountability in the agency through the use of metrics to gauge performance, research to evaluate programs and assess the broader impact of federal interventions, technical assistance to identify and diffuse innovation and technology to track spending, inform decisions and curb fraud, waste and abuse.

Consumer Outreach and Education Campaign

HUD firmly believes that the first line of protection against predatory lending is an informed consumer. We will build on existing efforts to launch a comprehensive campaign, designed to inform homebuyers and homeowners about fraudulent and predatory lending practices. HUD will partner with multiple entities and jurisdictions – such as OIG, State Attorneys General, consumer advocacy groups, housing counseling agencies – for this grass roots campaign, which will include a series of local and regional roundtables and media opportunities to increase consumer awareness about mortgage fraud and loan modification scams.

Expanded Loan Modification Efforts

Traditionally, HUD has had an aggressive program to help delinquent FHA borrowers remain in their homes and mitigate FHA losses on FHA insured loans. In FY 2008, FHA's home retention efforts helped 96,000 families retain their homes. We are on target to assist even more families this year. As of May 31, we have helped 79,000 families retain their homes.

HUD intends to expand its loss mitigation efforts, by extending the benefits of Making Home Affordable to FHA borrowers in the near future. The program design ensures that borrowers are able to obtain sustainable mortgage payments through refinancing or loan modification.

FHA's National Servicing Center makes certain that families who are experiencing difficulty in making their mortgage payments are placed in the loss mitigation program that is most suitable for them and their circumstances. Lenders who fail to engage in loss mitigation activities prior to foreclosure are subject to both sanctions and civil money penalties. In addition, we intend to develop a tool that monitors a servicer's compliance with FHA's loss mitigation guidelines, preventing them from undermining the Department's efforts towards ensuring sustainable homeownership and protecting FHA from future losses.

Strengthen the Lender Approval and Recertification Process

Efforts are also underway to strengthen lender approval and recertification requirements. The Helping Homeowners Save Their Homes Act gives FHA the authority to deny approval to lenders that have unresolved findings from a field review by HUD or have been convicted of a felony related to participation in the real estate or mortgage industry. This provision also incorporates S.A.F.E. Act registration as a condition of approval. FHA will now have the ability to electronically evaluate new applicants and lenders seeking recertification against a nationwide database to ensure that those originating FHA loans are properly licensed in the states in which they operate. FHA is also pursuing contract services to acquire access to criminal background and credit reporting that will be used to enhance the applicant screening process. This service will also allow FHA to check the status of principals, agents, owners, and officers during a lender's annual recertification for continued participation in FHA programs. Additionally, HUD's General Counsel is working on language that will strengthen lender certification language, providing FHA with another avenue to pursue sanctions against those who violate FHA requirements.

The Act also prohibits anyone not approved by FHA from playing a role in the origination of an FHA loan. This practice has long been problematic, leading to excessive fees being charged to the borrower and introducing a party to the transaction that FHA has no enforcement authority over. The Act also provides clear enforcement authority to prohibit such third parties from playing a role in the origination of FHA-insured loans by allowing FHA to pursue civil money penalties against those that violate this provision.

The Act also expands current requirements for reporting a change in business status. Currently, lenders are required to notify FHA if the lender is denied or has lost a license to operate within a State. This new reporting provision requires that the lender must now also notify FHA if individual employees of the lender lose a State license. Additionally, this provision requires that the lender notify FHA if there is a revocation of a State-issued mortgage loan originator license issued pursuant to the S.A.F. E. Act. From our experience, lenders that have a material change in business seldom notify FHA. FHA has entered into discussions with the Conference of State Bank Supervisors to get direct feeds from the National Mortgage Licensing System. This will allow FHA to take timely action against those that fail to uphold their responsibility.

Finally, FHA is conducting a thorough evaluation of its existing lender approval requirements to determine if there are any additional controls that should be put into place.

Expanded Risk-Based Monitoring

FHA's nationwide risk-based monitoring program works to prevent and detect mortgage fraud and abusive lending practices. Monitoring reviews are conducted in order to discover findings of deficiencies related to the origination or servicing of loans. Functional areas (retail, wholesale, servicing, direct lending, quality control/compliance, etc.) are also carefully reviewed to determine how the lender monitors its activities and decreases risk throughout its FHA portfolio. FHA's targeting methodology is continually refined to incorporate various changes in mortgage industry business practices as well as advances in its targeting tools. Given the significant increase in new lenders and the significant increase in loan originations, FHA expanded its risk-based lender monitoring effort to proactively address the risks associated with an influx in new lenders. FHA also recently reactivated its Special Work Assessment Teams (SWAT) to conduct single-focus on-site reviews of lenders whose originations are exhibiting signs of distress. This additional oversight is critical to ensuring that emerging risks are effectively managed and mitigated. FHA will continue to forward all instances of potential mortgage fraud to HUD's Office of Inspector General for review. In fact, for FY 2009, as of May 31, we have referred 534 cases of suspected fraud to the OIG.

Furthermore, FHA's Credit Watch Termination Initiative identifies originators with excessive default rates relative to other lenders. Credit Watch Termination protects the integrity of the FHA insurance funds and sanctions those lenders who demonstrate imprudent or potentially abusive lending practices. This unique enforcement tool provides for a systematic review of a lender's early default and claim rate for loans originated during the initial 24 months from endorsement; and a comparison to the default and claim rate for all lenders in a specific HUD jurisdiction. Lender's with a compare ratio that exceeds a 200% threshold and national average are subject to proposed termination.

FHA is extending the Credit Watch Termination Initiative to include not only the originator of the loan but also the lender that made the underwriting decision. This extension will provide additional scrutiny on lenders that generate a majority of FHA production.

Finally, FHA is collaborating with industry trade groups, lenders and agencies that monitor fraud initiatives to ensure that FHA stays abreast of the ever changing methods used by those that seek to commit mortgage fraud.

System Enhancements to Better Detect Fraud and Abusive Lending

The ever increasing need for FHA to intensify its anti-fraud product arsenal requires early-warning detection tools and system enhancements to automate what are today, manual functions. The lack of critical early-warning detection tools was cited in a Government Accountability Office (GAO) audit in January 2004, as a high risk finding. FHA is currently evaluating several different fraud detection tools that may improve our ability to detect fraudulent loans prior to endorsement, uncover future potential fraud, and highlight other performance weaknesses. This effort has been on FHA's radar for several years but has been hindered by the unavailability of funding.

Aside from fraud detection tools, several system enhancements are underway that are material to combating mortgage fraud. FHA is working to automate its review of a lender's principals, agents, owners, officers, and others against various databases to determine eligibility to participate in FHA programs. These changes will increase process efficiency, data reliability, and will allow FHA to better focus on those lenders that attempt to circumvent procedures.

FHA is also working on a comprehensive strategy to improve risk metrics, benchmarking, and reporting across the various functions of FHA. FHA is exploring Business Intelligence (BI) applications that will allow FHA to decrease development costs at the system level and leverage the mountains of data that are already collected and stored. Improved analytics and transparent reporting will allow FHA to improve its targeting decisions, develop new mechanisms to detect fraud, and help FHA properly align its risk appetite.

FHA will continue to improve its ability to monitor and ensure compliance of its partners. As its business grows, FHA is evolving to meet the challenges presented by such growth, making great strides in its hiring practices, investments in improved information technology systems, and regulatory and programmatic reforms. Insuring mortgages inherently involves a degree of risk. For decades, FHA has successfully taken measured steps to help more Americans enjoy and sustain the opportunities of homeownership, while consistently evolving its programs to better protect taxpayers and ensure the integrity of its insurance funds.

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The National Association of REALTORS® welcomes this opportunity to share our thoughts as a part of this hearing on "Strengthening Oversight and Preventing Fraud in FHA and other HUD Programs". The members of the National Association of REALTORS® represent a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. NAR has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

FHA's role in the market has expanded exponentially. Today, both the number of applications from consumers wanting a home loan, and from lenders wanting to qualify as Direct Endorsed lenders, has greatly expanded. In order to keep up with this demand, while ensuring the high underwriting and oversight standards required for FHA are ably enforced, the program must be given sufficient resources to operate safely and effectively.

FHA's role in healthy housing markets has never been more apparent than today. As private lenders fled the market, FHA is now one of the primary sources of safe affordable mortgage financing for American families. Its market share has grown from less than 3% to more than 25% in a very short time. While this change was necessary to stabilize a weakened mortgage market, it also has fostered concern about the safety and soundness of FHA.

Despite media reports that FHA has become a "dumping ground" for subprime loans and high-risk borrowers, the FY 2008 independent Actuarial Review demonstrates that the FHA Mutual Mortgage Insurance Fund (MMIF) is fiscally sound, and projected to remain so over the next seven years. While the MMIF has experienced a decline in value, it remains above the congressionally mandated 2% capitalization ratio. And projections expect that trend to continue. A high percentage of the decline in the MMIF was the result of falling house prices – something even the most prudent underwriting could not avoid. But now the quality of borrowers utilizing FHA has improved. Borrowers now have higher credit scores and lower loan-to-value ratios; these changes are expected to further improve the financial status of the FHA MMIF. The average credit score for an FHA borrower as of February 2008 was 626. Today the average credit score is now 695. This increase in credit quality of borrowers will have a significant positive impact on FHA. In testimony before this Committee on May 21st, HUD Secretary Donovan reported that they expect the FHA to earn $1.7 billion in FY2010.

Media reports have also conveyed concern about FHA's oversight of loan originators. FHA has an approved group of lenders - called direct endorsers - who can perform necessary loan processing, underwriting, closing and insuring functions without HUD review. Lenders who are not direct endorsers must get approval from FHA of every loan. Using properly reviewed direct endorsers helps greatly with FHA's workload. In order for a lender to be a direct endorser for FHA, they must submit an application to HUD. The number of applications has skyrocketed in recent months, and we agree with the concerns expressed about both time to process applications – and necessary oversight over lenders.

To keep up with increasing demand, FHA needs to increase its capabilities. Unfortunately, FHA has not received the staffing and other resources commensurate with its role in financing mortgages. For years FHA has been held back by underinvestment in staff and information technology investment. Single Family FHA operates with a nation-wide staff of about 900, which is approximately 160 positions less than actually needed. FHA operates with technology that is an average of 18 years old. The authority to upgrade the dozens of incompatible systems, such as the 30 year old COBOL system, to web based customer centric applications is necessary for the agency's continued existence and future success.

As FHA's volume increases, it is imperative that FHA have the staff resources and the risk management processes in place to protect the Insurance Fund and the American taxpayer from unacceptable losses. We believe provisions Congress provided in S 896 (Public Law 111-22) regarding FHA loans will be a big step in providing the type of oversight that will be necessary now that FHA is such a major force in the market. Increasing its resources, in the areas of staffing and technology, will ensure FHA is up to the task.

FHA continues to be a stable, affordable, safe option for American families seeking to purchase a home of their own. Congress needs to provide FHA with the means necessary to complete this important role. NAR looks forward to working with Congress to ensure that this critical component of America's housing finance system continues to serve the nation's homebuyers in a safe and efficient manner.