



By Jonathan Foxx

On June 11, 2010, the U.S. Department of Housing & Urban Development (HUD) issued Mortgagee Letter 2010-20,¹ which provided the long-awaited guidance regarding the implementation of its Final Rule.² The Rule adopted changes pertaining to the approval of mortgage lenders by the Federal Housing Administration (FHA) that are designed to strengthen FHA by improving its management of risk.

This Final Rule, among other things, has increased the net worth requirement for FHA-approved mortgagees and also provided for elimination of the FHA approval process for loan correspondents. Loan correspondents will no longer be approved participants in FHA programs, but they will continue to have the opportunity to participate in FHA programs as third-party originators (TPOs) through sponsorship by FHA-approved mortgagees, as is currently the case, or through application to be approved as an FHA-approved mortgagee.

In eliminating the FHA's approval of loan correspondents, FHA-approved mortgagees assume full responsibility to ensure that a sponsored loan correspondent adheres to the FHA's loan origination and processing requirements.

Increased net worth requirements: Two phases

HUD is phasing in the increased net worth mandates through 2013.

Phase one

The first stage of Phase One has already passed, since all new applicants for FHA approval, beginning on May 20, 2010, must now possess a net worth of at least \$1 million. And the net worth must consist of at least 20 percent in liquid assets (i.e., cash or cash equivalent).

The second stage, which begins on May 20, 2011, is a little tricky, since a metric is introduced using a Small Business Administration (SBA) statute in order to bifurcate lender approval criteria. On and after that date, a standard will be applied using the Table of Small Business Size Standards for a small business, as defined by the SBA at 13 CFR 121.201, Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities).³

- ❖ Effective May 20, 2011, lenders that exceed the size standards as provided in the above-cited statute must possess a net worth of at least \$1 million of which no less than 20 percent must be liquid assets (i.e., cash or cash equivalent).⁴
- ❖ Effective May 20, 2011, lenders that meet the size standards as provided in the above-cited statute must possess a net worth of at least \$500,000, of which no less than 20 percent must be liquid assets (i.e., cash or cash equivalent).

The most recent August 2008 Table of Small Business Size Standards, published through the Small Business Administration, indicates the following thresholds:

Subsector 522—Credit Intermediation and Related Activities

522110	Commercial Banking ^a	\$175 million in assets ^a
522120	Savings Institutions ^a	\$175 million in assets ^a
522130	Credit Unions ^a	\$175 million in assets ^a
522190	Other Depository Credit Intermediation ^a	\$175 million in assets ^a
522210	Credit Card Issuing ^a	\$175 million in assets ^a
522220	Sales Financing	\$7.0
522291	Consumer Lending	\$7.0
522292	Real Estate Credit	\$7.0
522293	International Trade Financing ^a	\$175 million in assets ^a
522294	Secondary Market Financing	\$7.0
522298	All Other Non-Depository Credit Intermediation	\$7.0
522310	Mortgage and Non-Mortgage Loan Brokers	\$7.0
522320	Financial Transactions, Reserve and Clearinghouse Activities	\$7.0
522390	Other Activities Related to Credit Intermediation	\$7.0

A size standard is the largest that a concern can be and still qualify as a small business for federal government programs.⁵ From the table above, it should be noted that SBA's current requirements for classification as a small business, as set forth in this Subsector, are less than \$7 million in annual receipts for non-depository institutions and less than \$175 million in assets for depository institutions.⁶

Phase two

Phase Two begins on May 20, 2013 and affects the category of participation in FHA programs. Identify the institution's participation to determine the net worth thresholds:

- ❖ *Single family programs:* Minimum net worth of not less than \$1 million plus an additional net worth of one percent of the total volume in excess of \$25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. Not less than 20 percent of a mortgagee's required net worth must be liquid assets (i.e., cash or cash equivalent).

- ❖ **Participation in multifamily programs with engagement in mortgage servicing:** Minimum net worth of not less than \$1 million, plus an additional net worth of one percent of the total volume in excess of \$25 million of FHA multifamily insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. Not less than 20 percent of a mortgagee's required net worth must be liquid assets (i.e., cash or cash equivalent).
- ❖ **Participation in multifamily programs without engagement in mortgage servicing:** Minimum net worth of not less than \$1 million, plus an additional net worth of one-half of one percent of the total volume in excess of \$25 million of FHA multifamily insured mortgages originated, underwritten, or purchased during the prior fiscal year, up to a maximum required net worth of \$2.5 million. Not less than 20 percent of a mortgagee's required net worth must be liquid assets (i.e., cash or cash equivalent).
- ❖ **Participation in single family and multifamily programs:** The higher net worth requirements for single family mortgagees.

Evidencing net worth is now requiring a higher due diligence review process, since all mortgagees (i.e., supervised, investing and non-supervised), with the exception of government mortgagees, are required to submit audited financial statements as a condition of their approval or renewal.

Loan correspondent approval for single family programs

Approvals

Effective May 20, 2010, FHA no longer accepts any new applications for loan correspondent approval. FHA will complete the processing of loan correspondent applications received prior to that date for those entities. If an application for loan correspondent approval was received by FHA on or after May 20, 2010, the application and fee will be returned to the applicant.

Loan correspondents approved, and in good standing, will be permitted to retain their approval through Dec. 31, 2010. For loan correspondents with fiscal years ending on or after Dec. 31, 2009, and that were required to renew their FHA approval prior to May 20, 2010, the FHA will rely on the submission of the prior year's audited financial statements for the renewal of loan correspondent approval.⁷

Therefore, loan correspondents whose fiscal years ended on or before Dec. 31, 2009 had to submit the Yearly Verification Report, the applicable recertification fee, and audited financials. Loan correspondents whose fiscal year ends after Dec. 31, 2009 are required to submit the Yearly Verification Report and the applicable recertification fee, but not audited financials.

After Dec. 31, 2010, loan correspondents (i.e., third-party originators, so-called "TPOs") will only be permitted to continue participation in FHA programs by establishing a sponsorship relationship with an FHA-approved mortgagee. Indeed, loan correspondents will no longer have access to non-public FHA systems, beginning Jan. 1, 2011 (i.e., FHA Connection). Only FHA-approved mortgagees will be permitted to order FHA case numbers from the FHA Connection. HUD will provide future guidance, with respect to the processing of case numbers ordered prior to the Jan. 1, 2011.⁸

Originations

HUD will hold FHA-approved mortgagees responsible for compliance with FHA requirements in all aspects of an FHA loan transaction, whether performed by the approved mortgagee or by its sponsored TPO (unless applicable law or regulation governing the violations in question require specific knowledge on the part of the party to be held responsible). It is, therefore, critical that sponsoring FHA-approved mortgagees set forth and clearly delineate policies, procedures, approval guidelines, quality control requirements, and many other features of FHA and regulatory compliance, with respect to their sponsored TPOs.⁹

- ❖ Approved as of May 20, 2010: May continue to originate mortgage loans insured by FHA through the end of the calendar year.
- ❖ Non-approved originators (and expired approvals)—sponsored: Permitted to participate through sponsorship by an FHA-approved Direct Endorsement mortgagee. An FHA-approved mortgagee may permit its sponsored TPO to perform all origination and processing tasks related to an FHA loan transaction (except for FHA Connection access). Sponsoring FHA-approved mortgagees will determine the "exact origination and processing duties their sponsored third party originators may perform."¹⁰
- ❖ An approved mortgagee may permit a sponsored TPO to originate Home Equity Conversion Mortgages (HECMs), provided that the sponsored TPO adheres to all other HECM origination requirements.
- ❖ Because of updates that HUD must make to its data systems, sponsoring mortgagees will enter their five-digit FHA ID in FHA Connection as the loan originator

for sponsored TPO loans; that is, for the time being all loan originations from sponsored TPOs will appear in FHA's systems as a retail origination of the sponsoring mortgagee. (HUD hopes to have their data systems updated by Sept. 30, 2010.)

- ❖ FHA-approved mortgagees will not be permitted to use a Direct Lending branch office identification number to order case numbers for loans originated by sponsored TPO, because this identification number can only be used to originate direct-to-consumer loans obtained by the FHA-approved mortgage through the Internet and Call Centers.
- ❖ Underwriting and approvals will be performed by an FHA-approved mortgagee for all loans originated by sponsored TPOs. Once approved by the sponsoring FHA-approved mortgagee, a loan must close in the name of the sponsoring underwriting mortgagee.¹¹ Finally, HUD officials fielded several questions regarding the current prohibition on closing an FHA-insured loan in the name of a TPO. The Department's representatives acknowledged that HUD cannot change the prohibition on TPOs closing in their own names unless and until Congress amends the National Housing Act. As you may know, HR 5072, the FHA Reform Act of 2010, would accomplish this goal. This piece of legislation was recently passed in the House of Representatives and currently awaits deliberation in the Senate.
- ❖ HUD will hold FHA-approved mortgagees responsible for compliance with FHA requirements in all aspects of an FHA loan transaction, whether performed by the approved mortgagee or by its sponsored TPO, unless applicable law or regulation governing the violations in question require specific knowledge on the part of the party to be held responsible. HUD expects that FHA-approved mortgagees will pursue sponsoring relationships with responsible originators, and that approved mortgagees will diligently monitor and evaluate the activities and performance of those they sponsor. HUD will continue to carefully review and evaluate FHA-approved mortgagees' activities and performance, and will take appropriate action to enforce its requirements when violations occur.

Loan performance

- Neighborhood Watch will post data for all loans originated via a sponsored TPO, and will be made available only to FHA-approved mortgagees for the pur-

continued on page 23

pose of evaluating sponsored TPO origination trends and performance

Third-party fees

■ HUD will review all fees charged to a consumer by both FHA-approved lenders and TPOs and will hold the lender accountable for all of the fees charged, including those charged imposed by a TPO. Acceptable fees will be those that appear to be reasonable, common, and customary for the geographic area.¹²

■ Broker consulting fees, which are charged by a broker, must be paid outside of closing from the consumer's own funds, and must be compliant with Real Estate Settlement Procedures Act (RESPA) guidelines.¹³

Employment requirements

FHA's employment requirements for approved mortgagees and lenders are outlined in Chapter 2 of Handbook 4060.1, Rev. 2. FHA-approved mortgagees shall ensure that sponsored TPOs involved in FHA loan transactions adhere to all applicable federal, state and local requirements governing their FHA loan origination and processing activities.

HUD will no longer monitor TPOs and will not impose restrictions on employment. Therefore, sponsored TPO employees can be paid on a W-2 or 1099 basis, and can have dual employment (i.e., mortgage originator, as well as real estate agent). Also, there will be no "brick and mortar" requirements for sponsored TPOs.¹⁴

As a reminder to currently approved mortgagees and lenders, HUD prohibits HECM mortgage originators from also engaging in the sale or solicitation of other financial or insurance products. FHA-approved mortgagees must carefully evaluate the specific guidelines governing the programs and activities in which they wish to participate, as well as relevant state and local laws and regulations governing such activities.

Principal-authorized agent relationships

Principal-authorized agent relationships can now only be entered into by two FHA-approved mortgagees, both of which must possess unconditional Direct Endorsement approval. This relationship, and the respective roles of the parties involved, must be documented accurately and accordingly in FHA Connection. Additional time is needed to support such documentation in FHA Connection. Due to impending system changes necessary to support and validate Principal-Authorized Agent transactions, FHA is issuing a regulatory waiver that will delay implementation of this provision until Jan. 1, 2011.¹⁵

- ❖ For forward mortgages, the principal can have either unconditional DE or unconditional HECM approval. The authorized agent must have unconditional DE approval.
- ❖ For HECM mortgages, the principal can have either unconditional DE or unconditional HECM approval. The authorized agent must have unconditional HECM approval.
- ❖ The principal in these relationships must originate the loan and the authorized agent must underwrite the loan.
- ❖ The loan may close in either the name of the principal or the authorized agent, and either party may submit the loan for insurance endorsement.

Areas Approved for Business (AAFB)

FHA-approved mortgagees may underwrite sponsored TPO loans in any state in which they are permitted by the state to do so, and in which sponsored TPOs are permitted to conduct mortgage origination activities. Hence, an FHA-approved mortgagee's wholesale Areas Approved for Business (AAFB) consists of all states in which it sponsors a mortgage originator that meets the applicable requirements for loan origination of that state and in which the mortgagee is permitted by the state to underwrite mortgage loans and sponsor mortgage originators.¹⁶

HUD will provide more detailed requirements for the submission of sponsored TPO loans in a subsequent Mortgagee Letter. That Mortgagee Letter will include instructions for data submission and the process for ordering and transferring FHA case numbers for loans originated by sponsored third party originators.

New Form 92900-A: Addendum to the URLA

HUD intends to amend Form 92900-A (Addendum to the Uniform Residential Loan Application) in order to obtain information related to sponsored TPOs.¹⁷ The new form will add additional boxes for a TPO's legal name, tax identification number, and Nationwide Mortgage Licensing System Registry (NMLS) number for the company (if applicable). A date of mid-September 2010 is anticipated for implementation of the new form.

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Footnotes

- 1—Mortgagee Letter 2010-20, June 11, 2010, Implementation of Final Rule FR 5356-F-02, "Federal Housing Administration: Continuation of FHA Reform-Strengthening Risk Management through Responsible FHA-Approved Lenders."
- 2—April 20, 2010 at 75 FR 20718, with technical correction published on May 4, 2010 at 75 FR 23582.
- 3—Under the final regulations, small businesses are those that meet the size standard for their industry classification established by the Small Business Administration at 13 C.F.R. § 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities). Non-small businesses are those lenders and mortgagees that exceed this size standard. Id. at 20,734 [citing new Section 202.5(n)(iii)].
- 4—Under the final regulations, small businesses are those that meet the size standard for their industry classification established by the Small Business Administration at 13 C.F.R. § 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities). Non-small businesses are those lenders and mortgagees that exceed this size standard. Id. at 20,734 [citing new Section 202.5(n)(iii)].
- 5—U.S. Small Business Administration Table of Small Business Size Standards Matched to North American Industry Classification System Codes, Aug. 22, 2008, p. 29 (Data—2007)
- 6—Op.cit. 1, Footnote (2).
- 7—See Mortgagee Letter 2009-01: Loan correspondents must submit the online annual certification and the annual renewal fee or be subject to administrative action leading to the possible withdrawal of their FHA approval.
- 8—Industry Conference Call, June 29, 2010: Hosted by HUD to summarize the new regulatory changes and the corresponding guidance provided in Mortgagee Letter 2010-20.
- 9—Additionally, FHA's employment requirements for approved mortgagees and lenders, as outlined in Chapter 2 of Handbook 4060.1, Rev. 2, requires FHA-approved mortgagees to ensure that sponsored TPOs involved in FHA loan transactions adhere to all applicable federal, state, and local requirements governing their FHA loan origination and processing activities.
- 10—Op.cit. 1, p. 4.
- 11—The current prohibition on closing in a TPO's name cannot be changed until Congress amends the National Housing Act. The FHA Reform Act of 2010 (HR 5072), which was recently passed in the House and currently awaits deliberation in the Senate, would accomplish this goal.
- 12—Op.cit. 8.
- 13—Op.cit. 8.
- 14—Op.cit. 8.
- 15—Op.cit. 8.
- 16—Mortgagees will order case numbers for any state in which they are approved to underwrite an FHA loan. Until system modifications are made, mortgagees will need to enter their five digit ID in the sponsor field in FHA Connection's case number assignment screen.
- 17—Op.cit. 8.