

Mortgagee Letter 2001-23 may be obtained through HUD's Client Information and Policy Systems (HUDCLIPS) Internet Home page at <http://www.hudclips.org>.

HUD will no longer provide mortgagees with written notification of placement on Credit Watch Status. Rather, each mortgagee will be responsible for using the Neighborhood Watch Early Warning System to monitor its performance. A mortgagee will be considered to be on Credit Watch Status if, at any time, it has a rate of defaults and claims on insured mortgages originated, underwritten or both in the geographic area served by a HUD field office which exceeds 150 percent of the normal rate, and its Agreement has not been terminated by HUD. Further, the Neighborhood Watch Early Warning System, which is updated monthly, will allow the ongoing tracking of mortgagee performance, allowing for the elimination of the current six-month tracking period for evaluating mortgagees placed on Credit Watch Status.

B. Default and Claim Rates for Placement on Credit Watch Status

Under the current regulation, a mortgagee may be placed on Credit Watch Status if it has a rate of defaults and claims on insured mortgages which exceeds "150 percent but not 200 percent of the normal rate." The regulation, therefore, establishes a "cap" on the default and claim rates for placing a mortgagee on Credit Watch Status. The existing regulation also authorizes HUD to terminate a mortgagee's Agreement if the mortgagee's default and claim rate exceeds 200 percent of the normal rate.

In the past, HUD has used its administrative discretion to focus its resources on those mortgagees with default and claim rates higher than the 200 percent threshold. This has had the potential to create a gap in HUD's Credit Watch monitoring and enforcement efforts, since mortgagees with default and claim rates falling between 200 percent of the normal rate and the higher threshold being used for terminations would neither be placed on Credit Watch Status nor have their Agreements terminated. HUD addressed this potential concern by issuing a series of regulatory waivers of the Credit Watch cap to authorize placement of such mortgagees on Credit Watch Status. This proposed rule would eliminate the need for these regulatory waivers by removing the cap, and providing that a mortgagee will be considered to be on Credit Watch Status if, at any time, it has a rate of defaults

and claims on insured mortgages that exceeds 150 percent of the normal rate and its Agreement has not been terminated.

The proposed change would not restrict HUD's ability to terminate a mortgagee whose claim and default rate exceeds 200 percent of the normal rate, but merely provides that such mortgagees will be considered to be on Credit Watch Status unless HUD determines that termination may be appropriate.

C. Limitation on the Establishment of New Branches

In reviewing the Credit Watch Termination process, HUD learned that some mortgagees were establishing new branches for the origination of FHA-insured mortgages subsequent to receiving proposed termination notices for existing branches. The mortgagees would establish the new branches to replace the authority which was lost, or which might be lost, as a result of the proposed termination of the existing branches. The result was that these mortgagees were able to evade the intended effects of the Credit Watch Termination Initiative. HUD's interest is in the mortgagee determining the reasons for its high default and claim rate in a lending area and correcting the underlying causes that led to the termination before the mortgagee is allowed to establish a new branch for the origination of FHA-insured mortgages.

In order for FHA to effectively address this evasion of the intended effect of Credit Watch Termination, this proposed rule would prohibit a mortgagee that receives a notice of proposed termination of its Agreement from establishing a new branch for the origination of FHA-insured mortgages in the lending area covered by the proposed termination notice. Upon the effective date of this regulation at the final rule stage, a mortgagee that is in receipt of a notice of proposed termination may not establish any new branch in the location(s) cited in the proposed termination notice until either: (1) The proposed termination notice is rescinded; or (2) the Agreement for the affected branch or branches has been terminated for at least six months and the Secretary has determined that the underlying causes for termination have been remedied.

D. Inclusion of Underwriting Mortgagees

Under the current Credit Watch Termination regulation, HUD evaluates the performance of a mortgagee based solely on the loans it originates. HUD's Credit Watch Termination evaluation,

therefore, excludes underwriting which is an important part of the mortgage loan process. While the mortgagee that originates a loan may also be the mortgagee that underwrites the loan, often there are two different entities involved. Specifically, an FHA approved loan correspondent only originates loans and does not underwrite. Rather, the loan correspondent has "sponsor mortgagees" that perform the underwriting function.

HUD's emphasis on accountability extends beyond the origination of loans to include the mortgagee that underwrites the loan. For example, HUD's regulations provide for the termination of a mortgagee's ability to underwrite FHA loans when the Agreement is terminated pursuant to the Credit Watch Termination Initiative (see 24 CFR 203.3(d)(2)(iv)). HUD has determined that to minimize the risk associated with the FHA single family mortgage insurance programs, HUD should also periodically evaluate the performance of underwriting mortgagees. Accordingly, this proposed rule would include underwriting mortgagees within the scope of the Credit Watch Termination Initiative. The proposed amendment would emphasize HUD's authority to terminate the ability of a mortgagee to originate or underwrite FHA-insured single family mortgages where the mortgagee has demonstrated an unacceptably high default and claim rate. HUD will analyze data for mortgagees that underwrite their own loans, and for mortgagees that underwrite loans for their loan correspondents as well as for mortgagees that underwrite both their own loans and loans for their loan correspondents.

E. Mortgage Origination Date

Under the current regulations for the Credit Watch Termination Initiative, a mortgage is considered to be originated in the same federal fiscal year in which HUD endorses it for FHA mortgage insurance. Although HUD requires that the mortgagee submit a mortgage for endorsement within 60 days after closing (see § 203.255(b)), there may be delays in the submission of the endorsement packages. Consequently, the endorsement dates for loans originated during the same period can vary greatly. Given these discrepancies in the timing of endorsement, linking the date of origination to the endorsement date does not allow for the most accurate comparison of loan performance.

This proposed rule would provide that, for purposes of the Credit Watch