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Robert R. Davis
Executive Vice President
Mortgage Markets, Financial
Management & Public Policy
(202) 663-5588
RDavis@aba.com

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Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street SW., Room 10276
Washington, DC 20410-0500
www.regulations.gov

Re: **Docket No. FR-5742-P-01**
Federal Housing Administration (FHA): Single Family Mortgage Insurance Maximum Time
Period for Filing Insurance Claims, Curtailment of Interest and Disallowance of Operating
Expenses Incurred Beyond Certain Established Timeframes

Dear Sir or Madam:

The American Bankers Association (“ABA”)¹ appreciates the opportunity to comment on the Department of Housing and Urban Development’s (“HUD”) proposed rule that would terminate a mortgagee’s contract for Federal Housing Administration (“FHA”) insurance if the mortgagee does not file a claim for insurance benefits within timeframes specified in the proposal. The proposal would also revise HUD’s policies concerning the curtailment of interest and the disallowance of certain expenses incurred by a mortgagee.²

ABA appreciates the operational challenges that FHA has incurred as a result of the financial crisis, and we can understand the strain that the high volume of insurance claims has placed on FHA resources. However, we do not believe that HUD has presented sufficient data articulating the need for this proposal. Furthermore, the proposed claim filing timeframes would be unworkable in light of HUD’s existing requirements, and unilaterally terminating FHA insurance benefits would be an excessively harsh penalty if HUD were to implement the claim filing deadlines as proposed. Taken together, these elements of the proposal would detrimentally impact the FHA program as well as the availability and cost of mortgage credit. The risk and expense associated with servicing FHA loans would increase; originators would be incentivized to adopt additional underwriting overlays or other measures to offset additional credit risk and uncertainty created by the proposal; and lenders, investors, and servicers may ultimately be discouraged from participating in the FHA program. We are also concerned that the proposal would negatively impact Ginnie Mae’s securitization of FHA loans.

For these reasons, we recommend that HUD withdraw the proposed rule. If HUD elects to establish a claim deadline, any such requirement should be realistic and any associated penalties should not be overly punitive. Any revised claim filing timeline and penalty should be subject to public notice and comment and should better reflect the actual cost that “untimely” filings pose to FHA.

¹ The American Bankers Association is the voice of the nation’s \$15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits and extend more than \$8 trillion in loans. Learn more at www.aba.com

² [80 Fed. Reg. 38410 \(July 6, 2015\)](#).

I. Overview of Proposal

HUD's existing rules set forth the steps that a lender must take to file a claim for single-family mortgage insurance. These rules do not establish a deadline by which a lender must file a claim for FHA insurance benefits. According to HUD data, mortgagees generally file insurance claims within 60 days of (1) receiving good and marketable title to the property or (2) the expiration of any extension permitted under HUD rules.³

In recent years, however, some lenders have opted not to file claims on a rolling basis and have chosen instead to file multiple claims at once at a later point in time. HUD finds this practice to be problematic and therefore proposes to establish two deadlines for filing insurance claims. Mortgagees would be required to meet both deadlines. According to the Supplementary Information to the proposal, each of these proposed deadlines would all apply only prospectively to loans endorsed for insurance after the regulation takes effect.

- **12-Month Rule.** The first proposed filing deadline would be measured beginning with the date of default and would add 12 months to HUD's "reasonable diligence timeframe." The reasonable diligence timeframe varies by state and begins with the first legal action required to commence foreclosure and ends when the mortgagee obtains marketable title to and possession of the property. For example, the reasonable diligence timeframe is three months in Texas and 19 months in New York. Under the proposal, if a mortgagee does not file a claim within 12 months of the end of the reasonable diligence period for the state in which the collateral is located, the FHA insurance would terminate automatically.
- **3-Month Rule.** In addition, the proposal would require lenders to file a claim for FHA insurance benefits within three months of foreclosure, conveyance of the property through a deed-in-lieu, or a pre-foreclosure sale.

Once the claims filing deadline passes, the mortgagee would be prohibited from filing a claim for insurance benefits, and the insurance policy would be unilaterally terminated by FHA without notice to the mortgagee. In this situation, the mortgagee would retain ownership of the collateral securing the loan. Importantly, the filing of an insurance claim would not toll the proposed timelines or guarantee an extension of time in which to file or re-file a claim that has been withdrawn or denied for any reason, including claims that are resubmitted after the initial claim resulted in a repurchase of a loan or reconveyance of the property.

In issuing the proposal, HUD asserts that delayed filing of FHA insurance claims has the potential to negatively impact HUD's ability to project the future state of the Mutual Mortgage Insurance Fund ("MMIF") and that the ability to better project capitalization of the MMIF will lessen the likelihood that the fund will require a capital infusion. In addition, by requiring claims to be filed sooner, HUD expects to reduce claim costs, primarily due to taxes and insurance, of more than \$1,000 per loan.

³ 80 FR 38413.

II. The Proposed Claim Filing Deadlines Are Unrealistic and Conflict with Existing Guidelines

We are concerned that the proposed claim filing deadlines are at odds with HUD's existing requirements and will create situations where lenders are commonly at high risk of forfeiting the right to file a claim for FHA insurance.

12-Month Reasonable Diligence Timeframe. One aspect of the proposed claim filing deadline would be based on existing FHA guidelines pertaining to the reasonable diligence timeframe. Specifically, if a mortgagee does not file a claim within 12 months of the end of the reasonable diligence period for the state in which the collateral is located, the FHA insurance would terminate automatically.

Our concerns with the 12-month reasonable diligence deadline are twofold. First, we are concerned that HUD's existing reasonable diligence timeframes do not accurately reflect the time that it takes to foreclose in each jurisdiction nor do they take into consideration changing market and legal conditions. Second, we are highly skeptical that the 12-month deadline is workable based on the reasonable diligence timeframes set forth in existing HUD guidelines. A recent study by the Urban Institute analyzed the proposed 12-month reasonable diligence timeframe using CoreLogic servicing data on loans conveyed to HUD in 2014 and the first half of 2015. The study found that in 48 out of 51 states (including the District of Columbia), the mean timeline from default to conveyance to HUD is longer than the reasonable diligence timeframe plus 12 months. The difference is greater than six months in 33 states; greater than one year in 16 states; and greater than 18 months in six states.⁴ In these situations, mortgagees would lose their ability to file an insurance claim. This would be an astonishing outcome, and the study illustrates the highly problematic nature of the proposed claim filing requirement and why the proposal should be withdrawn.

Conveyance Condition and Marketable Title. The proposal would require that mortgagees submit insurance claims within three months of foreclosure, deed-in-lieu, or a pre-foreclosure sale. Prior to doing so, mortgagees must comply with existing HUD guidelines pertaining to "conveyance condition" and marketable title. Specifically, Mortgagee Letter 2010-18 provides that a property conveyed to HUD must be undamaged by fire, flood, earthquake, hurricane, tornado, or mortgagee neglect.⁵ In addition, mortgagees must:

- Pay outstanding HOA fees and liens and ensure that any HOA liens are removed from the title to the property;
- Research, obtain, and pay all utility bills; and
- Provide certain title evidence with respect to manufactured housing, such as evidence that the manufactured home is attached to the land and that the manufactured home is classified and taxed as real estate.⁶

⁴ Laurie Goodman, [FHA's Proposed Servicing Reforms Need More Thought](#) (August 2015).

⁵ [HUD Mortgagee Letter 2010-18](#) (May 13, 2010); *see also* 24 CFR §203.378.

⁶ [HUD Mortgagee Letter 2013-18](#) (May 31, 2013).

It has been very challenging for lenders to apply the conveyance condition standard in practice. For example, our members commonly encounter situations where a property has been neglected or vandalized. In these instances, extensive repairs are required to put the property in conveyance condition. *Importantly, the completion of such repairs can easily exceed the proposed three-month timeframe for filing a claim for FHA insurance. In fact, HUD's own data shows that the average time from foreclosure to HUD acquisition of a property is currently 10.09 months – seven months longer than the proposed claim filing deadline.*⁷

We also note that the definition of conveyance condition is unclear and is subject to wide-ranging interpretation. Depending on the view of the FHA claims processor working on a particular loan, mortgagees are sometimes required to take varying actions to put a home in conveyance condition. In some cases, conveyance condition has been interpreted to mean removing hazardous material and broom sweeping. However, some FHA officials require mortgagees to put a property into marketable condition, which is a much higher standard.

In addition to creating conflict with existing HUD guidelines and practices, it is unclear how HUD's proposed claim filing deadlines would impact reconveyances. Currently, if a mortgagee conveys a property to HUD and the property is later determined not to be in conveyable condition, HUD will reconvey the property to the lender. Under the proposal, the filing of a claim would not toll the proposed filing deadlines or guarantee an extension of time in which to file or refile a claim that has been withdrawn or denied for any reason, including claims resubmitted after the initial claim resulted in a repurchase of a loan or reconveyance of the collateral. As a result, it is possible that the claim filing deadline could expire before HUD notifies the mortgagee of a reconveyance. Even if any time remains between reconveyance and the claim filing deadline, we question whether a mortgagee would have sufficient time to remedy the issues that led to the reconveyance and to resubmit the claim. In light of the ambiguities regarding conveyance condition, FHA insurance should not be automatically terminated in reconveyance situations that exceed the proposed three-month filing deadline.

ABA unequivocally opposes the proposed three-month timeframe because it is inconsistent with the time that it takes to put a property into conveyance condition. However, if HUD elects to implement a claim filing deadline, we strongly urge HUD to establish a process that enables mortgagees to address the issues that led to reconveyance. In addition, we request that HUD provide greater clarity regarding what constitutes "conveyance condition." In sum, if HUD adopts strict claim filing deadlines and excessive penalties as proposed, it must provide unambiguous, written standards that describe acceptable conveyance condition.

In addition to requiring mortgagees to address property damage and neglect, Mortgagee Letter 2013-18 requires mortgagees to clear HOA liens and produce certain title evidence for manufactured housing. The timing for completing these requirements rests with parties over which the mortgagee has no control and further increases the risk that the mortgagee will be

⁷ [FHA Single Family Loan Performance Trends](#) p. 6 (June 2015).

barred from submitting a claim for FHA insurance benefits. Delays in accomplishing tasks that are beyond a mortgagee's control should not result in the termination of a loan's FHA insurance.

Loss Mitigation. The proposed claim filing deadline also seems to be at odds with HUD requirements that lenders engage in loss mitigation outreach efforts and attempt to help financially distressed borrowers arrange a loan workout. In contravention of this public policy objective, the proposed claim filing deadline and associated penalty would incentivize mortgagees to initiate foreclosure at the earliest possible date to minimize the risk that the FHA insurance policy would be terminated.

We also note that the loss mitigation procedural requirements and timelines set forth in the Consumer Financial Protection Bureau's mortgage servicing rules may prohibit mortgagees from initiating foreclosure within the FHA's existing requirements for taking the first legal action necessary to initiate foreclosure on a mortgage. This issue has been discussed in public policy circles, but within the context of the claim filing proposal, we point out that it would be patently unfair to punish servicers for claim filing delays because the FHA's filing deadlines are at odds with consumer protection regulations established by another federal agency.

Extensions. Existing HUD regulations establish a process by which mortgagees may obtain extensions from various HUD timing requirements. The proposal would leverage these processes and would allow mortgagees to request extensions from the proposed claim filing deadlines. However, it appears that HUD approval would be required for *any* extension of HUD's required time frames, including time frames, such as the reasonable diligence time frame, that currently do not require HUD approval.

If HUD adopts the claim filing requirements as proposed, FHA will likely receive a high volume of extension requests by lenders seeking to avoid termination of FHA insurance policies. It is imperative that HUD ensure that it has the operational capacity to timely manage an influx of extension requests. It would be inappropriate for HUD to bar a mortgagee's insurance claim if there is not a predictable and efficient process for reviewing and responding to such requests. Because the proposed claim filing deadlines are overly strict and are at odds with existing guidelines and regulations (as described above), it is critical that the extension process be workable, transparent, and consistent. Untimely responses and/or failure to grant legitimate extension requests could be viewed as an attempt by FHA to avoid paying insurance claims.

Summary. ABA strongly opposes the proposed deadlines because they are unrealistic. We also note that the creation of two claim filing deadlines (a 12-month timeframe and a three-month timeframe) further complicates the proposed rule and would create unnecessary confusion and increase the operational complexities of servicing FHA loans.

Given the extreme penalties associated with the proposed claim filing deadlines, any final rule must be absolutely clear as to how to calculate the filing deadlines and how those filing deadlines will impact reconveyances. Moreover, it is imperative that FHA have the operational capacity to manage the high volume of extension requests that are sure to follow.

III. Termination of FHA Insurance is an Excessive Penalty

The proposed deadlines are even more problematic when considering the penalty for non-compliance. Terminating the insurance contract as a penalty for missing the proposed claim filing deadline is out of proportion relative to the operational challenges and costs that FHA may incur if a mortgagee does not file a claim within the proposed time period.⁸

Therefore, we request that HUD consider alternative penalty structures that are not overly punitive and that better balance the true costs of the proposal relative to the actual benefit provided to FHA. Other approaches could include a fixed late fee, a penalty that is a percentage of the insurance received, or a carriage charged based on the extent to which the mortgagee exceeds the filing deadline. In short, any penalty for missing a claim filing deadline should be in line with FHA's actual costs; unilateral termination of the insurance contract is excessive and is not an appropriate solution.

We note that HUD's Cost Benefit Analysis used to support the proposed rule is flawed. HUD asserts that the cost of compliance with the proposal would be \$100 per loan and that this "minimal" cost to mortgagees would be outweighed by the benefits to FHA. Specifically, HUD anticipates that the proposed rule would relieve strain on claims processing resources, increase accuracy in projecting the state of the MMIF, and reduce claims costs by \$1,000 per loan. This analysis, however, omits the key aspect of the proposed rule – the mortgagee's forfeiture of the right to file a claim for FHA insurance. Missing the claims filing deadline – even by a narrow margin – will cost a lender the entire FHA insurance benefit. This penalty is anything but "minimal." In addition to underestimating the impact that the proposal would have on mortgagees (and potential borrowers), we question the extent to which the proposed rule would meaningfully impact HUD's ability to project the capitalization of the MMIF, particularly in light of the delinquent loan reporting information that lenders currently provide to FHA on a monthly basis. Better leveraging existing data gathering processes would be a less drastic way to improve claims predictions. Accordingly, we request that HUD revisit its cost-benefit analysis and evaluate the full cost of the proposal relative to the actual benefit to FHA.

IV. The Proposal Would Have a Chilling Effect on FHA Lending and Servicing

The certainty of the FHA insurance guarantee is fundamental to lender participation in the FHA program because FHA-insured loans pose higher credit risk relative to other types of mortgage loans. The proposed regulations would increase the risk that FHA would not make good on its guarantee, which is central to lenders' willingness to extend mortgage loans to borrowers with

⁸ A delay in filing a claim also increases interest, property charges and other expenses included in the insurance benefit claim and can result in additional decline in the value of a property that had been the security for the FHA-insured mortgage foreclosed by the mortgagee, thereby reducing the amount FHA could recover on a real estate owned (REO) sales transaction.

lower credit scores and small down payments. If there is a risk that FHA could terminate the insurance contract – even for missing the claims filing deadline by one day – lenders may be deterred from participating in the FHA program. In recent months, several lenders have stopped or scaled back FHA lending. Establishing unrealistic claim filing deadlines and penalizing noncompliance by terminating the FHA insurance contract would further incentivize lenders and servicers not to originate and service FHA loans. As a result, low- and moderate- income borrowers and low-wealth borrowers would have more difficulty obtaining mortgage credit. This would not be a desirable public policy outcome.

For those lenders that elect to continue originating FHA loans, the strict claim filing deadline and excessive penalty for noncompliance will increase cost, risk, and uncertainty. As a result, lenders will likely adopt additional underwriting overlays and price the added risk into the cost of the loan. Similarly, we believe that the proposed rule is likely to impact the servicing value of FHA loans. The proposed claims filing timeframes will be one more factor that servicers must evaluate when considering their willingness to service FHA loans. In addition to impacting mortgagees and servicers, this consequence could potentially impact Ginnie Mae in situations where it needs to transfer the servicing of FHA loans to another servicer.

Finally, the proposed regulation is silent as to potential impacts to loans in Ginnie Mae securities. We are concerned that there could be significant disruptions to the administration of Ginnie Mae securities if a loan is no longer FHA-insured and is therefore no longer eligible for inclusion in a Ginnie Mae pool.

V. Conclusion

ABA recommends that HUD withdraw this proposal. The unworkable claim filing deadlines and excessively harsh penalty for noncompliance, together with the lack of clarity regarding reconveyances, the uncertainty regarding the calculation of the filing deadline, the need for a transparent and timely extension process, and the likelihood of significant market impacts make clear that additional vetting and analysis is necessary.

Thank you for considering ABA's views on this important matter. Should you have any questions, please contact Krista Shonk at 202-663-5014.

Sincerely,



Robert R. Davis