



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

**Date:** May 1, 2013  
**To:** All Approved Mortgagees  
**Mortgagee Letter 2013-12**

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**Subject** Lender Insurance Program

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**Purpose** This Mortgagee Letter supersedes Mortgagee Letter 2013-10 in its entirety.

This Mortgagee Letter explains enhancements to the Lender Insurance program based on a Final Rule published in the Federal Register on January 25, 2012 (See 77 Fed. Reg. 3598 or <http://www.gpo.gov/fdsys/pkg/FR-2012-01-25/pdf/2012-1508.pdf>).

Under the Lender Insurance Program high-performing mortgagees have the authority to conduct pre-endorsement reviews and insure loans.

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**Effective Date** This guidance is effective immediately except as noted in this Mortgagee Letter.

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**Revised Lender Insurance Guide** A revised *Lender Insurance Guide* is attached to this Mortgagee Letter. It may also be found on HUD's Lender Insurance web site at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/sfh/lender/lendins](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/lendins). The revised *Lender Insurance Guide* provides additional details on initial and continuing eligibility for Lender Insurance, HUD monitoring of Lender Insurance program participants, and other topics discussed in this Mortgagee Letter.

The *Lender Insurance Guide* also provides information on the submission of case binders when required and other processing activities.

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## Mortgagee Letter 2013-12, Continued

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**Affected Topics** The topics summarized below were created as a result of changes to the Lender Insurance program. The following sections within HUD Handbook 4155.2 will be replaced with guidance provided in this Mortgagee Letter.

<b>HUD 4155.2, Lenders Guide to the Single Family Mortgage Insurance Process</b>
2.C.1.d. Regulations Governing LI (References)
2.C.2.a. LI Program Eligibility
2.C.2.b. Acceptable Claim/Default Rate for LI Lenders
2.C.2.d. Duration of LI Program Approval
2.C.2.e. Termination of LI Approval
8.B.7.a. When an LI Lender May Need to Submit a Case Binder
8.B.7.b. LI Lender Electronic Case Binder (eCB) Submission Requirements
9.D.4.a. Use of Indemnification Agreements
9.D.4.b. Who Requests Indemnification

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### Summary of Changes in Final Rule

- Initial and ongoing eligibility for Lender Insurance is based on a comparison of a mortgagee's previous two year claim and default rate to the two year claim and default rate for the state(s) in which the mortgagee has underwritten FHA-insured loans. Previously, a mortgagee's claim and default rate was compared to the national claim and default rate, or to the state rate if the mortgagee underwrote loans in only one state (see Chapter 2 of the *Lender Insurance Guide* for more information on compare ratios).

**Note:** The term *seriously delinquent and claim rate* used in Neighborhood Watch may be used interchangeably with the term *claim and default rate* used in this Mortgagee Letter.

- HUD has established a process under which new mortgagees created through corporate mergers, acquisitions or reorganizations may be approved for Lender Insurance even though they do not have a two year claim and default rate history (see Chapter 3 of the *Lender Insurance Guide*).

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### Summary of Changes (continued)

- The revised regulations for Lender Insurance provide for an ongoing review of Lender Insurance mortgagee performance. While these regulations permit more frequent review at HUD's option, HUD will initially review Lender Insurance mortgagee performance on a quarterly basis consistent with Credit Watch to determine continued eligibility for Lender Insurance. Previously HUD monitored a mortgagee's Lender Insurance performance on an annual basis (see Chapter 4 of the *Lender Insurance Guide*).
  - HUD has established new requirements for applying for reinstatement in the Lender Insurance program for those mortgagees that have had their Lender Insurance authority withdrawn or terminated (see chapter 4 of the *Lender Insurance Guide*).
  - HUD may now demand Lender Insurance mortgagees indemnify HUD against possible losses in instances of fraud, misrepresentation, or serious and material violations of HUD requirements. Previously HUD sought the mortgagee's agreement to indemnify HUD (see Chapter 8 of the *Lender Insurance Guide*).
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### Eligibility for initial and ongoing Lender Insurance authority

To be eligible for Lender Insurance, a mortgagee must have:

- Unconditional Direct Endorsement approval and
- A two year claim and default rate that does not exceed 150% of the two year claim and default rate for the states in which the mortgagee has underwritten loans.

**Example:** In the last two years Model Mortgage Company has underwritten loans in Maryland, Virginia, West Virginia and the District of Columbia. Model Mortgage Company's eligibility for Lender Insurance will be based on a comparison of its two year claim and default rate, to the two year claim and default rate for all loans underwritten in Maryland, Virginia, West Virginia and the District of Columbia (see Chapter 2 of the *Lender Insurance Guide*).

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**Eligibility criteria for new mortgagees created by mergers, acquisitions or reorganizations that are also issued a new HUD Approved Lender Identification Number**

A new mortgagee created by a merger, acquisition or reorganization that is issued a new HUD Approved Lender Identification Number will not have a two year claim and default history. Such mortgagees may still apply for Lender Insurance provided that:

- The new mortgagee has Unconditional Direct Endorsement approval;
- One or more of the mortgagees participating in the merger, acquisition or reorganization had Lender Insurance approval at the time of the merger, acquisition or reorganization;
- All of the HUD-approved mortgagees participating in the merger, acquisition or reorganization that had Lender Insurance authority at the time of the merger, acquisition or reorganization had an acceptable two year claim and default rate at the time of the merger, acquisition or reorganization;
- The two year claim and default rate of the new mortgagee derived by aggregating the claims and defaults of the formerly HUD-approved mortgagees participating in the merger, acquisition or reorganization, was not more than 150% of the combined two year claim and default rate for the states in which the HUD-approved mortgagees underwrote loans; and
- The management and staff who were involved with Lender Insurance processing will continue to exercise those responsibilities for the new mortgagee.

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**Initial Application for Lender Insurance**

As described in Chapter 3 of the *Lender Insurance Guide*, the decision to apply for Lender Insurance authority must be made in writing by an authorized official of the mortgagee registered with HUD.

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**Initial Application for Lender Insurance**  
(continued)

Following a written decision by an owner, officer, principal or other official of the mortgagee registered with HUD to apply for Lender Insurance and at the direction of such official, mortgagees apply for Lender Insurance authority through the Lender Functions menu in FHA Connection. After checking the box indicating that the mortgagee wishes to apply for Lender Insurance authority, enter the Lender Insurance contact information and certify agreement to the terms and conditions for Lender Insurance.

FHA Connection will determine the mortgagee's Direct Endorsement status and claim and default rate, and approval or denial of Lender Insurance authority will appear.

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**Initial application for Lender Insurance authority – new mortgagees created by mergers, acquisitions or reorganizations that are also issued new HUD Approved Lender Identification Numbers**

As described in Chapter 3 of the *Lender Insurance Guide*, new mortgagees created through mergers, acquisitions or corporate reorganizations that are issued new HUD Approved Lender Identification Numbers and that have Unconditional Direct Endorsement approval, but lack a two year claim and default history, may not use the process in FHA Connection to apply for Lender Insurance authority. Such mortgagees must submit the following to the Department:

- A hard copy of the *Acknowledgment of Terms and Conditions for LI* page from FHA Connection signed by an authorized official registered with HUD;
  - The name and contact information of the Lender Insurance contact person and, at the discretion of the mortgagee, the name and contact information for the back-up Lender Insurance contact person;
  - The name and the HUD Approved Lender Identification number of the new mortgagee; and
  - The names and, if applicable, HUD Approved Lender Identification numbers of the mortgagees participating in the merger, acquisition or reorganization.
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**Initial application for Lender Insurance authority – new mortgagees created by mergers, acquisitions or reorganizations that are also issued new HUD Approved Lender Identification Numbers**  
(continued)

- Information identifying the management and staff experienced with Lender Insurance processing at the mortgagee or mortgagees that previously held Lender Insurance authority who will be transferred to the new mortgagee, and describing how they will continue to exercise those responsibilities for the new mortgagee.

The written application should be submitted to:

U.S. Department of HUD  
Division Director  
Home Mortgage Insurance Division, Room 9266  
451 7<sup>th</sup> Street, SW  
Washington, DC 20410

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**Termination of Lender Insurance authority**

As described in Chapter 4 of the *Lender Insurance Guide*, Lender Insurance authority may be terminated where the mortgagee:

- Fails to maintain a two year claim and default rate equal to 150% or less of the two year claim and default rate for the states in which the mortgagee has underwritten loans;
  - Loses Unconditional Direct Endorsement approval at the institution level;
  - Fails to adopt and employ a pre-insurance review process as required by regulations at 24 CFR § 203.255(f);
  - Fails to submit requested case binders within established timeframes; or
  - Fails to submit electronic case binders with clear, legible documents in the prescribed stacking order and devoid of duplicate documents, multiple versions of documents, and documents not required by HUD.
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## Mortgagee Letter 2013-12, Continued

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**Termination of Lender Insurance authority (continued)** Lender Insurance authority may also be terminated for failure to meet any other Lender Insurance requirement, or based on actions taken by the HUD Mortgagee Review Board.

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**Quarterly monitoring schedule**

As described in Chapter 4 of the *Lender Insurance Guide*, beginning in July, 2013, HUD will monitor on a quarterly basis, Lender Insurance performance and compliance with Lender Insurance requirements of mortgagees whose compare ratios exceed 150%. Lender Insurance authority for mortgagees who fail to meet lender Insurance requirements, may be terminated.

Using a compare ratio based on the two year claim and default rate of the states in which mortgagees underwrote loans rather than using the national two year claim and default rate, and monitoring on a quarterly rather than an annual basis, may affect eligibility for Lender Insurance for some mortgagees currently participating in the program.

All mortgagees are strongly encouraged to monitor their two year claim and default rate through Neighborhood Watch. Instructions for viewing the applicable claim and default rate are provided in Chapter 2 of the *Lender Insurance Guide*.

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### **Suspension of Lender Insurance authority**

Suspension of Lender Insurance authority is a temporary measure designed to formally notify the mortgagee of HUD's concerns with its performance, and to encourage prompt improved performance. Suspension of Lender Insurance authority will remain in effect until the mortgagee has resolved the issues that led to the suspension.

As described in Chapter 7 of the *Lender Insurance Guide*, Lender Insurance authority may be suspended if the mortgagee:

- Fails to submit requested case binders in a timely manner;
- Fails to submit electronic case binders that are clear, legible, and in the prescribed stacking order, and include only the documents appropriate for the loan type; or
- Fails to adequately employ a pre-endorsement review as evidenced by a large number of requests for Mortgage Insurance Certificate corrections.

Lender Insurance authority may also be suspended for failure to meet any other Lender Insurance requirement, or based on actions taken by the HUD Mortgagee Review Board.

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### **Mortgagees applying for reinstatement of Lender Insurance authority**

As described in Chapter 4 of the *Lender Insurance Guide*, mortgagees whose Lender Insurance authority was terminated and wish to reapply may not use the automated process in FHA Connection. These mortgagees must apply to HUD in writing for reinstatement.

A mortgagee whose Lender Insurance authority has been terminated may not apply for reinstatement for at least six months from the date of termination. At the time of the application for reinstatement the mortgagee must have Unconditional Direct Endorsement approval and a two year claim and default rate that does not exceed 150% of the aggregate claim and default rate for the states in which it underwrote loans.

Mortgagees must submit their application for reinstatement of Lender Insurance authority in writing. The application must include:

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## Mortgagee Letter 2013-12, Continued

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**Mortgagees applying for reinstatement of Lender Insurance authority**  
(continued)

- A hard copy of the *Acknowledgment of Terms and Conditions for LI* page from FHA Connection signed by an authorized official registered with HUD;
- A corrective action plan identifying the changes in internal policies and procedures that address the issues that resulted in the termination of Lender Insurance authority; and
- Documentation evidencing that the mortgagee has implemented the corrective action plan.

The written application should be submitted to:

U.S. Department of HUD  
Division Director  
Home Mortgage Insurance Division, Room 9266  
451 7<sup>th</sup> Street, SW  
Washington, DC 20410

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**Indemnification of Lender Insurance mortgages**

Mortgagees approved for Lender Insurance authority are subject to a revised indemnification policy pursuant to 24 CFR § 203.255(g). This revised indemnification policy applies to mortgagees who currently have Lender Insurance authority, mortgagees applying for Lender Insurance authority for the first time, and mortgagees applying for reinstatement after Lender Insurance authority has been withdrawn.

Acceptance of the revised indemnification policy is a condition of approval for Lender Insurance authority. By insuring a loan, the Lender Insurance mortgagee has agreed to indemnify HUD for serious and material violations of FHA origination requirements and for fraud and misrepresentation in connection with the origination of the loan as described below.

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**Effective date of revised indemnification policy**

The revised indemnification policy is effective for all loans insured by Lender Insurance mortgagees on or after the date of this Mortgagee Letter.

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**Identification of loans requiring indemnification** HUD reviews loans through, among other means, post-endorsement technical reviews, appraisal reviews, on-site mortgagee monitoring reviews and audits conducted by HUD's Office of Inspector General.

When fraud, misrepresentation, or serious and material violations of HUD policies and procedures are uncovered during the course of these reviews, HUD notifies the Lender Insurance mortgagee that a preliminary assessment based on file documentation indicates that the loan contains material findings such that HUD is exposed to an unacceptable level of risk. HUD provides the Lender Insurance mortgagee an opportunity to present additional documentation to address the review findings.

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**Demand for indemnification** If the Lender Insurance mortgagee fails to respond to the material findings, or if HUD determines, after reviewing the Lender Insurance mortgagee's response, that the deficiencies cited have not been resolved, HUD will send a notice of indemnification to the Lender Insurance mortgagee.

The notice of indemnification will demand that the Lender Insurance mortgagee indemnify HUD against any possible financial loss stemming from that loan pursuant to 24 CFR § 203.255(g).

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**Mortgagee responsible for indemnification** HUD will seek indemnification to hold the underwriting mortgagee responsible for deficiencies in origination regardless of how the loan was originated or how the loan was insured. HUD will demand indemnification from the underwriting mortgagee where the loan was insured by the LI lender.

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**Indemnification standards** HUD may require indemnification if the Lender Insurance mortgagee knew or should have known of serious and material violations of HUD requirements. Actions which may be considered serious and material violations of FHA requirements include, but are not limited to:

- Failing to ensure that the borrower meets applicable eligibility requirements in accordance with HUD requirements;
  - Failing to verify the creditworthiness, income, and/or employment of a borrower in accordance with HUD requirements;
  - Failing to verify the assets used by the borrower for down payment and/or closing costs, or to meet applicable reserve requirements, in accordance with HUD requirements;
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### Indemnification standards (continued)

- Failing to ensure that the amount of the mortgage insured is consistent with the loan type, property value and other applicable HUD requirements;
- Failing to ensure that the loan was current and met any applicable payment history requirements at the time of insurance endorsement in accordance with HUD requirements;
- Failing to address property deficiencies identified in the appraisal affecting the health and safety of the occupants or the structural integrity of the property in accordance with HUD requirements; and
- Failing to ensure that the appraisal of the property satisfies HUD appraisal requirements and other applicable HUD requirements.

Indemnification may also be required if the Lender Insurance mortgagee knew or should have known of fraud or misrepresentation in connection with the origination of the loan.

**Note:** Indemnification will be required irrespective of whether fraud or misrepresentation caused the default.

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### Indemnification of loans and the TOTAL Scorecard

Lender Insurance Mortgagees are reminded that receiving a risk recommendation of Accept or Approve from HUD's TOTAL Scorecard does not absolve Lender Insurance mortgagees from their responsibility to consider information beyond that considered by the TOTAL Scorecard, as well as responsibility for the decisions to approve, close and insure loans through the Lender Insurance process. HUD may require indemnification of loans that meet the standards for indemnification described above regardless of the risk recommendation provided by the TOTAL Scorecard.

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### Indemnification periods

If the Lender Insurance mortgagee knew or should have known of serious and material violations of HUD requirements such that the loan should not have been approved and endorsed, the Lender Insurance mortgagee shall indemnify HUD for any loss on a loan which goes into default within five years of mortgage insurance endorsement.

If the Lender Insurance mortgagee knew or should have known of fraud or misrepresentation in connection with the loan, the Lender Insurance mortgagee shall indemnify HUD for any loss for the life of the loan.

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### **Non-credit qualifying Streamline refinances of indemnified loans**

Indemnified loans are eligible for Streamline refinances. Where HUD pays a claim on a non-credit qualifying Streamline refinance loan, HUD will continue to hold the mortgagee that indemnified the original loan responsible for any loss suffered by HUD. However, HUD will only seek to hold the originating mortgagee of the non-credit qualifying Streamline refinance responsible for any new serious and material violations of HUD requirements or fraud or misrepresentation in connection with its origination of the streamline refinanced loan.

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### **Credit- qualifying refinances of indemnified loans**

Where a new credit-qualifying determination has been made, including credit qualifying Streamline refinance loans, the indemnification on the previous loan is terminated. The underwriting mortgagee of the credit-qualifying refinance loan shall be responsible for any serious and material violations of HUD requirements or for fraud or misrepresentation in connection with the new refinanced loan.

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### **Indemnification and holders of loans**

In instances where an outstanding indemnification exists at the time of claim for insurance benefits, HUD will pay insurance benefits to the holder of the mortgage, as long as they are not the same entity that was named in the indemnification agreement.

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### **Information Collection**

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0059. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

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## Mortgagee Letter 2013-12, Continued

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**Questions**

Please address any questions about the topics addressed in this Mortgagee Letter to the FHA Resource Center at 1-800-CALLFHA (1-800-225-5342). Persons with hearing or speech impairments may reach this number via TTY by calling the Federal Information Relay Service at 1-800-877-8339. For additional information on this Mortgagee Letter, please visit <http://www.hud.gov/answers>.

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**Signature**

Carol J. Galante  
Assistant Secretary for Housing-Federal Housing Commissioner

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**[Attachment](#)**