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As FHA has now moved into a new fiscal year, I want to take the opportunity to update you on several FHA policy initiatives that went into effect earlier this month (October 4). These include a new product option for FHA's Home Equity Conversion Mortgage (HECM), changes to our Mortgage Insurance Premiums (MIPs), and new credit score and down payment requirements for FHA borrowers.

In addition, I want to provide you with details of a proposed rule on lender indemnification that was published on October 8. Each of these measures is designed to strengthen our risk management practices as we continue to work to increase our capital reserves.

HECM Saver

HUD has just introduced a major new FHA insurance product for reverse mortgages. *HECM Saver* gives seniors a new option for accessing their home's equity to pay for health care costs, home repairs and other needs. Despite the popularity of the HECM loan product, we have noted concerns that some senior citizens find that the upfront fees are too high for them. In response, we created this new product which will provide seniors with another reverse mortgage option that significantly lowers costs by almost eliminating the upfront Mortgage Insurance Premium that is required under the standard HECM option.

The new product enables seniors to borrow a smaller amount than would be available with a HECM Standard loan. This option will be available for all HECM case numbers assigned on or after October 4, 2010.

As described in Mortgagee Letter 2010-34, *HECM Saver* will have an upfront premium of only .01 percent of the property's value. This provides the borrower with significant savings in comparison to HECM Standard's two percent upfront premium. Under *HECM Saver*, the principal limit, or amount of money available to a borrower, is lower than under HECM Standard. Borrowers will receive approximately 10 to 18 percent less proceeds under the *HECM Saver* option than they would receive under HECM Standard, which lowers the risk to the FHA insurance fund.

The annual MIP for both HECM products is 1.25 percent of the outstanding loan balance.

MIP Changes
Legislation signed by President Obama on August 12 gave FHA the flexibility to increase the annual premium on FHA single family mortgages up to a maximum of 1.50 or 1.55 percent of the remaining insured principal balance, depending on the loan's initial loan-to-value ratio.

Beginning October 4, the annual premium for FHA Borrowers with a loan-to-value ratio of 95 percent or higher is 90 basis points. Borrowers who have a loan-to-value less than 95 percent will pay an annual premium of 85 basis points.

Simultaneously with the increase in the annual premium, we have reduced the upfront premium by 125 basis points, from 2.25 percent to one percent. This reduces the barriers to consumers in purchasing a home because the annual premium is paid over the life of the loan instead of at closing. Thus, the new premium structure should help FHA increase the capital ratio in the MMI Fund without disrupting the housing market. For details on the new MIP structure, see Mortgagee Letter 2010-28.

We are confident this new premium structure is sound policy, more in line with private mortgage insurers' pricing, and will facilitate the return of private capital to the mortgage market. This change is estimated to yield approximately $300 million per month of additional income for the MMI Fund.

Credit Score and Down Payment Requirements
Also effective October 4, FHA introduced a two-tiered down payment requirement based on the credit scores of new borrowers. To qualify for FHA's 3.5 percent down payment program, new borrowers must have a minimum credit score of 580. Borrowers with credit scores between 500 and 579 are now required to make a down payment of at least 10 percent. Those borrowers with credit scores less than 500 are no longer qualified to obtain an FHA-insured mortgage.

These new requirements should help strengthen the MMI Fund by both reducing the claim rate on new loans and decreasing the losses experienced as a result of those claims. These changes will help FHA manage its risk while continuing to provide access to homeownership opportunities for borrowers who have historically performed well.

For details, read Mortgagee Letter 2010-29.

New Proposed Rule
On October 8, HUD published a proposed rule for comment in the Federal Register that would strengthen its authority to force certain lenders to indemnify FHA for insurance claims paid on mortgages that are found not to meet the agency's guidelines. This rule is one of the initiatives announced earlier this year as part of FHA's increased focus on risk management.

HUD's proposed rule would require all new and existing lenders with the authority to insure mortgages on FHA's behalf (Lender Insurance or "LI" lenders) to meet stricter performance standards to gain and maintain their approval status.

The proposed rule would create a regulatory framework and codify the legal authority FHA currently has under the National Housing Act. It clarifies the circumstances under which we will require indemnification and the level of loan performance we expect lenders to maintain.

For LI lenders, HUD seeks to force indemnification for violations of FHA origination requirements that are 'serious and material' to the extent that the mortgage never should have been endorsed by the lender in the first place, just as FHA would not have insured the mortgage on its own.

Specifically, these lenders may be required to indemnify HUD if they failed to:

(1) verify and analyze the creditworthiness, income, and/or employment of the borrower;
(2) verify the source of assets brought by the borrower for payment of the required down payment and/or closing costs;
(3) address property deficiencies identified in the appraisal affecting the health and safety of the occupants or the structural integrity of the property, or
(4) ensure that the property appraisal satisfies FHA appraisal requirements.

HUD may seek indemnification irrespective of whether the violation caused the mortgage default.

Tightening Performance Standards
The proposed rule will also require LI lenders to continually maintain an acceptable claim and default rate, both to gain and preserve this special lender status. We are proposing that for initial and continuing approval to self-insure mortgages, unconditional direct endorsement lenders must demonstrate a default and claim rate at or below 150 percent for the previous two years. This standard would apply to the state/states where the lender does business, rather than a national default/claim average.

The present regulation defines an acceptable claim and default rate as at or below 150 percent of either: (1) the national average rate for all insured mortgages; or (2) if the mortgagee operates in a single state, the average rate for insured mortgages in the state.

The current regulation may make it easier for a single-state lender to meet the acceptable standard if that lender operates in a state that has a high default rate. In contrast, a lender would be disadvantaged by having its claim and default rate compared to the national average if it operates in states with comparatively high default rates, even if the lender is in full compliance with FHA requirements and otherwise eligible for "Lender Insurance" approval.

The proposed methodology will more accurately reflect lender performance by evaluating each lender based on its actual area of operations. Also, FHA will continually monitor lender performance rather than conduct an annual review of each Lender Insurance mortgagee.

In addition, FHA will consider the two-year default and claim performance of either entity in the case of an acquisition or merger without requiring these entities to seek a waiver.

The rule also clarifies that FHA, at its own discretion, without any judicial or administrative action, has the authority to immediately withdraw a lender's ability to self-insure mortgage loans. The proposed rule has a 60-day public comment period that runs through December 7.

In closing, I want to assure you that we are constantly working to maintain FHA's sound financial footing so FHA can continue to provide access to credit while meeting the unprecedented demands of the housing market. I will keep you posted as we move forward.

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