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May 4, 2010

To: Clients and Friends

From: David F. Dulock

Subject: Correction to FHA Reform Rules - *Federal Register* (75 FR 23582)

In the May 4, 2010 issue of the *Federal Register* HUD published a correction to the FHA reform rules published in the April 20, 2010 issue of the *Federal Register* (75 FR 20718). The FHA reform rules adopted changes to the approval of mortgage lenders by the FHA and was the subject of our April 22, 2010 memorandum, which is reprinted below with HUD's May 4th correction, to-wit: *"In Section 202.5 General approval standards, in paragraph (n)(2)(i), 'Effective on June 21, 2010, applicants shall comply with the net worth requirements set forth in paragraphs (n)(2)(iii) of this section.' is corrected to read 'Effective on May 20, 2010, applicants shall comply with the net worth requirements set forth in paragraph (n)(2)(iii) of this section.' "*

In the April 20, 2010 issue of the *Federal Register* (75 FR 20718) the Federal Housing Administration (FHA) published its final rule, effective May 20, 2010, amending part 202 of FHA regulations (24 CFR Part 202) that:

(1) increases the net worth requirements for FHA-approved lenders;
(2) eliminates the FHA approval process for loan correspondents; and,
(3) incorporates criteria specified in the Helping Families Save Their Homes Act of 2009 (HFSH Act).

This memorandum attempts to redact what we consider are the more important parts of the final rule and HUD's preamble published with the final rule in the above-cited issue of the *Federal Register* and does not address all aspects of the final rule or HUD's preamble. You are advised to read the complete text of the final rule and HUD's preamble and not to rely solely on this memorandum. The complete text of the final rule is attached to this memorandum for your information and use.

Net Worth Requirements For FHA-Approved Lenders

1. For new applicants for FHA approval, the following net worth requirements are effective on May 20, 2010. For all approved supervised and nonsupervised mortgagees and all approved investing mortgagees with FHA approval as of May 20, 2010, the following net worth requirements are effective on May 20, 2011[1].

(i) An applicant for FHA approval or an approved mortgagee that exceeds the Small Business Administration (SBA) size standards for its industry classification (13 CFR 121.201, Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities)) must have a net worth of not less than $1,000,000, of which no less than 20 percent must be liquid assets.

(ii) An approved mortgagee that meets the SBA size standards for its industry classification must have a net worth of not less than $500,000, of which no less than 20 percent must be liquid assets. The net worth requirements for small business mortgagees

remain applicable as long as the mortgagee continues to meet the SBA size standard for a small business. If, based on the audited financial statement prepared at the end of its fiscal year and provided to HUD at the commencement of the new fiscal year, a small business mortgagee no longer meets the SBA size standard of a small business, the mortgagee must meet the net worth requirements for a non-small business mortgagee (*see subsection (i) above*) by the last day of the fiscal year in which the audited financial statements were submitted.

2. For new applicants for FHA approval, for all FHA-approved supervised and nonsupervised mortgagees, and for all FHA-approved investing mortgagees, the following net worth requirements are effective on May 20, 2013:

(i) Irrespective of size, all FHA-approved mortgagees and applicants for approval to participate solely in FHA single family programs must have a 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, of which no less than 20 percent must be liquid assets.

(ii) Irrespective of size, all FHA-approved mortgagees and applicants for approval to participate solely in FHA multifamily programs must have a minimum net worth of $1 million. For those multifamily FHA-approved mortgagees that also engage in multifamily mortgage servicing, an additional net worth of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. For multifamily FHA-approved mortgagees that do not perform multifamily mortgage servicing, an additional net worth of one half of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. No less than 20 percent of the applicant's or FHA-approved mortgagee's required net worth must be liquid assets.

(iii) Irrespective of size, all FHA-approved mortgagees and applicants for approval to participate in both FHA single family and multifamily programs must meet the net worth requirements for a single family mortgagee (*see subsection (i) above*). Therefore, if a mortgagee is a participant in both the multifamily and single family programs, it is required to meet the greater net worth requirements for single family mortgagees.

Elimination Of The FHA Approval Process For Loan Correspondents

1. The final rule limits FHA approval only to mortgagees that are authorized to underwrite, service or own FHA-insured loans. Since loan correspondents can only perform origination functions, except underwriting, and cannot service or own FHA-insured loans, FHA will no longer approve them as loan correspondents. Loan correspondents, however, will continue to have the opportunity to participate in the origination of FHA-insured loans as third-party originators (TPOs) through association with FHA-approved mortgagees. Since FHA will no longer be approving loan correspondents, and recognizing that loan correspondents, as TPOs, will continue to be involved in the origination of FHA-insured loans through association with FHA-approved mortgagees, the final rule requires FHA-approved mortgagees to assume full responsibility for the TPOs they are associated with to ensure that their TPOs adhere to FHA

origination and processing requirements, including determining and verifying that their TPOs are qualified to participate in FHA-insured loans by meeting the eligibility requirements contained in the final rule. The final rule permits loan correspondents with FHA approval as of May 20, 2010, to continue that approval through December 31, 2010. However, commencing May 20, 2010, FHA will no longer approve new applicants for approval as loan correspondents.

2. Proposed §202.5(a)(3)[2] specifically stated, "[t]he loan to be insured by FHA must be underwritten by **and closed in the name of the FHA-approved lender or mortgagee**." (emphasis added). However, §202.5(a)(3) of the final rule simply states, "[t]he loan to be insured by FHA must be underwritten by the FHA-approved lender or mortgagee." The deleted phrase was not placed elsewhere in the final rule and there is no other language in the final rule that specifically prohibits TPOs from closing FHA-insured loans in their own names. Notwithstanding that, on page 20721 of the above-cited issue of the *Federal Register*, Section III of the preamble states:

> This final rule provides … that a TPO may not close a loan in its name, and HUD is not considering withdrawing this prohibition in this final rule. However, HUD will further examine this issue. Until and unless HUD announces a change to this prohibition, the prohibition for currently FHA-approved loan correspondents (that subsequently will become TPOs) closing any FHA-insured mortgages in their own names will be applicable commencing January 1, 2011. Currently FHA-approved loan correspondents may continue to close FHA-insured mortgages in their own name through December 31, 2010. (**emphasis added**)

As a legal rationale, on page 20725 of the above-cited issue of the *Federal Register*, Section IV of the preamble states:

> Section 203(b)(1) of the National Housing Act (12 U.S.C. 1709(b)(1)) requires that a mortgage ''[h]ave been made to, and be held by, a mortgagee approved by the Secretary'' in order to be eligible for FHA mortgage insurance. Accordingly, only FHA-approved mortgagees may close mortgage loans in their names (that is, using the statutory terminology, have the mortgage ''made to'' the FHA-approved mortgagee). Since FHA will no longer be approving loan correspondents, TPOs will be statutorily prohibited from closing FHA-insured mortgage loans in their own names; however, TPOs may continue to close such mortgages in the name of their sponsoring FHA-approved mortgagees. (**emphasis added**)

We can only surmise that HUD, on second reflection after reviewing the comments on the proposed rule, felt it unnecessary to specifically state in the final rule that only FHA-approved mortgagees are permitted to close FHA loans in their own names since non-FHA-approved originators are statutorily prohibited from doing so.

Incorporation Of Criteria Specified In The HFSH Act

Although implementation of the criteria in section 203 of the HFSH Act did not require rulemaking, as these statutory requirements were in effect upon enactment of the HFSH Act[3], they are codified in the final rule. In summary, they:

1. preclude any non-approved or authorized entity from participating in FHA programs;

2. prohibit participation in FHA programs by an entity currently ineligible under §202.5(j) of the final rule;
3. require FHA-approved mortgagees to use their HUD-registered business names in all advertisements and promotional material related to FHA programs, including alias or DBAs on file with FHA; and
4. require FHA-approved mortgagees to notify FHA if individual employees are subject to any sanction or other administrative action.

In addition, the final rule codifies the requirement in ML 2009-31[3] that FHA-approved mortgagees maintain copies of all advertisements and promotional materials for a period of two years from the date that the materials are circulated or used for advertisement purposes.

The final rule also codifies FHA's existing requirements pertaining to notification to FHA of business changes, such as changes in legal structure (currently found in HUD Handbook 4060.1, REV-2, Chapters 2 and 6).

Our Summary Of FHA Final Rule

1. Net worth requirements for FHA-approved mortgagees have increased dramatically.
2. FHA approval of loan correspondents is eliminated.
3. Loan correspondents are prohibited from closing FHA loans in their own names.

Please do not rely solely on this memorandum. You are advised to read the complete text of the final rule attached to this memorandum and HUD's preamble published in the above-cited issue of the *Federal Register*.

Endnotes

[1] "Supervised mortgagees" are financial institutions that are members of the Federal Reserve System, and financial institutions whose accounts are insured by the FDIC or the NCUA – *e.g*., banks, savings associations, and credit unions. "Nonsupervised mortgagees" are non-depository financial entities that have as their principal activity the lending or investment of funds in real estate mortgages. "Investing mortgagees" are organizations that are not approved as another type of institution and that invest funds under their own control – *e.g.*, charitable institutions and pension funds. (See definitions of these terms at 24 CFR 202.6(a), 202.7(a), and 202.9(a), respectively.)

[2] See the proposed rule published in the November 30, 2009 issue of the *Federal Register* (74 FR 62521).

[3] *See*, Mortgage Letter ML 2009-31 "Strengthening Counterparty Risk Management," issued September 18, 2009.

***Attachment**: Revised §§202.2, 202.3, 202.5, 202.6, 202.8, 202.9, 202.11, and 202.12 (24 CFR Part 202)*

PART 202—APPROVAL OF LENDING INSTITUTIONS AND MORTGAGEES

(**Federal Register** / Vol. 75, No. 75 / Tuesday, April 20, 2010)

1. In §202.2, revise the definitions of ‘‘*Lender or Title I lender*’’, and ‘‘*Mortgagee or Title II mortgagee,*’’ to read as follows:

§202.2 Definitions.

* * * * *

Lender or Title I lender means a financial institution that:

(a) Holds a valid Title I Contract of Insurance and is approved by the Secretary under this part as a supervised lender under §202.6, a nonsupervised lender under §202.7, an investing lender under §202.9, or a governmental or similar institution under §202.10; or

(b) Is under suspension or held a Title I contract that has been terminated but remains responsible for servicing or selling Title I loans that it holds and is authorized to file insurance claims on such loans.

* * * * *

Mortgagee or Title II mortgagee means a mortgage lender that is approved to participate in the Title II programs as a supervised mortgagee under §202.6, a nonsupervised mortgagee under §202.7, an investing mortgagee under §202.9, or a governmental or similar institution under 202.10.

* * * * *

2. In §202.3, revised paragraphs (a) introductory text, (a)(1), and (a)(3) to read as follows:

§202.3 Approval status for lenders and mortgagees.

(a) *Initial approval.* A lender or mortgagee may be approved for participation in the Title I or Title II programs upon filing a request for approval on a form prescribed by the Secretary and signed by the applicant. The approval form shall be accompanied by such documentation as may be prescribed by the Secretary.

(1) Approval is signified by:

(i) The Secretary’s agreement that the lender or mortgagee is considered approved under the Title I or Title II programs, except as otherwise ordered by the Mortgagee Review Board or an officer or subdivision of the Department to which the Mortgagee Review Board has delegated its power, unless the lender or mortgagee voluntarily relinquishes its approval;

(ii) Consent by the lender or mortgagee to comply at all times with the general approval requirements of §202.5, and with additional requirements governing the particular class of lender or mortgagee for which it was approved as described under subpart B at §§202.6 through 202.10; and

(iii) Under the Title I program, the issuance of a Contract of Insurance constitutes an agreement between the Secretary and the lender and which governs participation in the Title I program.

* * * * *

(3) *Authorized agents.* A mortgagee approved under §§202.6, 202.7, or 202.10 as a nonsupervised mortgagee, supervised mortgagee, or governmental or similar institution approved as a Direct Endorsement mortgagee under 24 CFR 203.3 may, with the approval of the Secretary, designate a nonsupervised or supervised mortgagee with Direct Endorsement approval under 24 CFR 203.3 as authorized agent for the purpose of underwriting loans. The application for mortgage insurance may be submitted in the name of the FHA-approved mortgagee or its designated authorized agent under this paragraph.

* * * * *

3. Revise §202.5 to read as follows:

§202.5 General approval standards.

To be approved for participation in the Title I or Title II programs, and to maintain approval, a lender or mortgagee shall meet and continue to meet the general requirements of paragraphs (a) through (n) of this section (except as provided in §202.10(b)) and the requirements for one of the eligible classes of lenders or mortgagees in §§202.6 through 202.10.

(a) *Business form.* (1) The lender or mortgagee shall be a corporation or other chartered institution, a permanent organization having succession, or a partnership. A partnership must meet the requirements of paragraphs (a)(1)(i) through (iv) of this section.

(i) Each general partner must be a corporation or other chartered institution consisting of two or more persons.

(ii) One general partner must be designated as the managing general partner. The managing general partner shall comply with the requirements of paragraphs (b), (c), and (f) of this section. The managing general partner must have as its principal activity the management of one or more partnerships, all of which are mortgage lenders or property improvement or manufactured home lenders, and must have exclusive authority to deal directly with the Secretary on behalf of each partnership. Newly admitted partners must agree to the management of the partnership by the designated managing general partner. If the managing general partner withdraws or is removed from the partnership for any reason, a new managing general partner shall be substituted, and the Secretary shall be immediately notified of the substitution.

(iii) The partnership agreement shall specify that the partnership shall exist for the minimum term of years required by the Secretary. All insured mortgages and Title I loans held by the partnership shall be transferred to a lender or mortgagee approved under this part prior to the termination of the partnership. The partnership shall be specifically authorized to continue its existence if a partner withdraws.

(iv) The Secretary must be notified immediately of any amendments to the partnership agreement that would affect the partnership's actions under the Title I or Title II programs.

(2) *Use of business name.* The lender or mortgagee must use its HUD-registered business name in all advertisements and promotional materials related to FHA programs. HUD-registered business names include any alias or ''doing business as'' (DBA) on file with FHA. The lender or mortgagee must keep copies of all print and electronic advertisements and promotional materials for a period of 2 years from the date that the materials are circulated or used to advertise.

(3) *Non-FHA-approved entities.* A lender or mortgagee that accepts a loan application from a non-FHA-approved entity must confirm that the entity's legal name and Tax ID number are included in the FHA loan origination system record for the subject loan. The loan to be insured by FHA must be underwritten by the FHA-approved lender or mortgagee.

(b) *Employees.* The lender or mortgagee shall employ competent personnel trained to perform their assigned responsibilities in consumer or mortgage lending, including origination, servicing, and collection activities, and shall maintain adequate staff and facilities to originate and service mortgages or Title I loans, in accordance with applicable regulations, to the extent the mortgagee or lender engages in such activities.

(c) *Officers.* All employees who will sign applications for mortgage insurance on behalf of the mortgagee or report loans for insurance shall be corporate officers or shall otherwise be authorized to bind the lender or mortgagee in the origination transaction. The lender or mortgagee shall ensure that an authorized person reports all originations, purchases, and sales of Title I loans or Title II mortgages to the Secretary for the purpose of obtaining or transferring insurance coverage.

(d) *Escrows.* The lender or mortgagee shall not use escrow funds for any purpose other than that for which they were received. It shall segregate escrow commitment deposits, work completion deposits, and all periodic payments received under loans or insured mortgages on account of ground rents, taxes, assessments, and insurance charges or premiums, and shall deposit such funds with one or more financial institutions in a special account or accounts that are fully insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration, except as otherwise provided in writing by the Secretary.

(e) *Servicing.* A lender shall service or arrange for servicing of the loan in accordance with the requirements of 24 CFR part 201. A mortgagee shall service or arrange for servicing of the mortgage in accordance with the servicing responsibilities contained in subpart C of 24 CFR part 203 and in 24 CFR part 207, with all other applicable regulations contained in this title, and with such additional conditions and requirements as the Secretary may impose.

(f) *Business changes.* The lender or mortgagee shall provide prompt notification to the Secretary, in such form as prescribed by the Secretary, of:

(1) All changes in its legal structure, including, but not limited to, mergers, terminations, name, location, control of ownership, and character of business; and

(2) Any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, loan originator, of the lender or mortgagee, or the lender or mortgagee itself, that is subject to one or

more of the sanctions in paragraph (j) of this section.

(g) *Financial statements.* The lender or mortgagee shall furnish to the Secretary a copy of its annual audited financial statement within 90 days of its fiscal year end, furnish such other information as the Secretary may request, and submit to an examination of that portion of its records that relates to its Title I and/or Title II program activities.

(h) *Quality control plan.* The lender or mortgagee shall implement a written quality control plan, acceptable to the Secretary, that assures compliance with the regulations and other issuances of the Secretary regarding loan or mortgage origination and servicing.

(i) *Fees.* The lender or mortgagee, unless approved under §202.10, shall pay an application fee and annual fees, including additional fees for each branch office authorized to originate Title I loans or submit applications for mortgage insurance, at such times and in such amounts as the Secretary may require. The Secretary may identify additional classes or groups of lenders or mortgagees that may be exempt from one or more of these fees.

(j) *Ineligibility.* For a lender or mortgagee to be eligible for FHA approval, neither the lender or mortgagee, nor any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator of the lender or mortgagee shall:

(1) Be suspended, debarred, under a limited denial of participation (LDP), or otherwise restricted under 2 CFR part 2424 or 24 CFR part 25, or under similar procedures of any other federal agency;

(2) Be indicted for, or have been convicted of, an offense that reflects adversely upon the integrity, competency, or fitness to meet the responsibilities of the lender or mortgagee to participate in the Title I or Title II programs;

(3) Be subject to unresolved findings as a result of HUD or other governmental audit, investigation, or review;

(4) Be engaged in business practices that do not conform to generally accepted practices of prudent mortgagees or that demonstrate irresponsibility;

(5) Be convicted of, or have pled guilty or *nolo contendere* to, a felony related to participation in the real estate or mortgage loan industry:

(i) During the 7-year period preceding the date of the application for licensing and registration; or

(ii) At any time preceding such date of application, if such felony involved an act of fraud, dishonesty, or a breach of trust or money laundering;

(6) Be in violation of provisions of the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act of 2008 (12 U.S.C. 5101 *et seq.*) or any applicable provision of state law; or

(7) Be in violation of any other requirement established by the Secretary.

(k) *Branch offices.* A lender may, upon approval by the Secretary, maintain branch offices for the origination of Title I or Title II loans. A branch office of a mortgagee must be registered with the Department in order to originate mortgages or submit applications for mortgage insurance. The lender or mortgagee shall remain fully responsible to the Secretary for the actions of its branch offices.

(l) *Conflict of interest and responsibility.* A mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction or transactions to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgaged property, except that consideration, approved by the Secretary, may be paid for services actually performed. The mortgagee shall not pay a referral fee to any person or organization.

(m) *Reports.* Each lender and mortgagee must submit an annual certification on a form prescribed by the Secretary. Upon application for approval and with each annual recertification, each lender and mortgagee must submit a certification that it has not been refused a license and has not been sanctioned by any state or states in which it will originate insured mortgages or Title I loans. In addition, each mortgagee shall file the following:

(1) An audited or unaudited financial statement, within 30 days of the end of each fiscal quarter in which the mortgagee experiences an operating loss of 20 percent of its net worth, and until the mortgagee demonstrates an operating profit for 2 consecutive quarters or until the next recertification, whichever is the longer period; and

(2) A statement of net worth within 30 days of the commencement of voluntary or involuntary bankruptcy, conservatorship, receivership, or any transfer of control to a federal or state supervisory agency.

(n) *Net worth*—(1) *Applicability.* The requirements of this section apply to approved supervised and nonsupervised lenders and mortgagees under §202.6 and §202.7, and approved investing lenders and mortgagees under §202.9. For ease of reference, these institutions are referred to as ‘‘approved lenders and mortgagees’’ for purposes of this section. The requirements of this section also apply to applicants for FHA approval under §§202.6, 202.7, and 202.9. For ease of reference, these entities are referred to as ‘‘applicants’’ for purposes of this section.

(2) *Phased-in net worth requirements for 2010 and 2011*—(i) *Applicants.* Effective on May 20, 2010, applicants shall comply with the net worth requirements set forth in paragraphs (n)(2)(iii) of this section.

(ii) *Approved mortgagees.* Effective on May 20, 2011, each approved lender or mortgagee with FHA approval as of May 20, 2010 shall comply with the net worth requirements set forth in paragraphs (n)(2)(iii) or (n)(2)(iv) of this section, as applicable.

(iii) *Net worth requirements for non-small businesses.* Each approved lender or mortgagee that exceeds the size standard for its industry classification established by the Small Business Administration at 13 CFR 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities) shall have a net worth of not less than $1,000,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

(iv) *Net worth requirements for small businesses.* Each approved lender or mortgagee that meets the size standard for its industry classification established by the Small Business Administration at 13 CFR 121.201 Sector 52 (Finance and Insurance), Subsector 522 (Credit Intermediation and Related Activities) shall have a net worth of not less than $500,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the Secretary. If, based on the audited financial statement prepared at the end of its fiscal year and provided to HUD at the commencement of the new fiscal year, an approved lender or mortgagee no longer meets the Small Business Administration size standard for its industry classification, the approved lender or mortgagee shall meet the net worth requirement set forth in paragraph (n)(2)(iii) of this section for a non-small business approved lender or mortgagee by the last day of the fiscal year in which the audited financial statements were submitted.

(3) *Net worth requirements for 2013 and subsequent years.* Effective May 20, 2013:

(i) Irrespective of size, each applicant and each approved lender or mortgagee, for participation solely under the FHA single family programs, shall have a 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. No less than 20 percent of the applicant’s or approved lender or mortgagee’s required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

(ii) *Multifamily net worth requirements.* Irrespective of size, each applicant for approval and each approved lender or mortgagee for participation solely under the FHA multifamily programs shall have a minimum net worth of not less than $1 million. For those multifamily approved lenders or mortgagees that also engage in mortgage servicing, an additional net worth of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. For multifamily approved lenders or mortgagees that do not perform mortgage servicing, an additional net worth of one half of one percent of the total volume in excess of $25 million of FHA multifamily mortgages originated during the prior fiscal year, up to a maximum required net worth of $2.5 million, is required. No less than 20 percent of the applicant’s or approved lender’s or mortgagee’s required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

(iii) *Dual participation net worth requirements.* Irrespective of size, each applicant for approval and each approved lender or mortgagee that is a participant in both FHA single-family and multifamily programs must meet the net worth requirements as set forth in paragraph (n)(3)(i) of this section.

4. Revise §202.6 to read as follows:

§202.6 Supervised lenders and mortgagees.

(a) *Definition.* A supervised lender or mortgagee is a financial institution that is a member of the Federal Reserve System or an institution whose accounts are insured by the Federal Deposit Insurance

Corporation or the National Credit Union Administration. A supervised mortgagee may submit applications for mortgage insurance. A supervised lender or mortgagee may originate, purchase, hold, service or sell loans or insured mortgages, respectively.

(b) *Additional requirements.* In addition to the general approval requirements in §202.5, a supervised lender or mortgagee shall meet the following requirements:

(1) *Net worth.* The net worth requirements appear in §202.5(n).

(2) *Notification.* A lender or mortgagee shall promptly notify the Secretary in the event of termination of its supervision by its supervising agency.

(3) *Fidelity bond.* A Title II mortgagee shall have fidelity bond coverage and errors and omissions insurance acceptable to the Secretary and in an amount required by the Secretary, or have alternative insurance coverage, approved by the Secretary, that assures the faithful performance of the responsibilities of the mortgagee.

5. Revise §202.8 to read as follows:

§202.8 Sponsored third-party originators; Continued approval of loan correspondents through December 31, 2010.

(a) *Definitions—Sponsor.* (1) With respect to Title I programs, a sponsor is a lender that holds a valid Title I Contract of Insurance and meets the net worth requirement for the class of lender to which it belongs.

(2) With respect to Title II programs, a sponsor is a mortgagee that holds a valid origination approval agreement, is approved to participate in the Direct Endorsement program, and meets the net worth requirement for the class of mortgagee to which it belongs.

(3) Each sponsor shall be responsible to the Secretary for the actions of its sponsored third-party originators or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to be held responsible. If specific knowledge is required, the Secretary will presume that a sponsor has knowledge of the actions of its sponsored third-party originators or mortgagees in originating loans or mortgages and the sponsor is responsible for those actions unless it can rebut the presumption with affirmative evidence.

Sponsored third-party originator. A third-party originator does not hold a Title I Contract of Insurance or Title II Origination Approval Agreement and may not purchase or hold loans but is authorized to originate Title I direct loans or Title II mortgage loans for sale or transfer to a sponsor or sponsors, as defined in this section, which holds a valid Title I Contract of Insurance or Title II Origination Approval Agreement and is not under suspension, subject to the sponsor determining that the third-party originator has met the eligibility criteria of paragraph (b) of this section.

(b) *Eligibility to originate loans to be insured by FHA.* A non-approved third-party originator may originate loans to be insured by FHA, provided:

(1) The third-party originator is working with and through an FHA-approved lender or mortgagee; and

(2) The third-party originator or an officer, partner, director, principal, manager, supervisor, loan processor, or loan originator of the third-party originator has not been subject to the sanctions or administrative actions listed in §202.5(j), as determined and verified by the FHA-approved lender or mortgagee.

(c) *Continued approval of loan correspondents through December 31, 2010.* A loan correspondent (as that term was defined under the version of this section in effect immediately before May 20, 2010) with FHA approval as of May 20, 2010 will maintain its FHA approval through December 31, 2010.

6. **§202.9 [Amended]** In §202.9, remove the last sentence of paragraph (a).

7. Revise §202.11 to read as follows:

§202.11 Title I.

(a) *Types of administrative action.* In addition to termination of the Contract of Insurance, certain sanctions may be imposed under the Title I program. The administrative actions that may be applied are set forth in 24 CFR part 25. Civil money penalties may be imposed against Title I lenders and mortgagees pursuant to 24 CFR part 30.

(b) *Grounds for action.* Administrative actions shall be based upon both the grounds set forth in 24 CFR part 25 and as follows:

(1) Failure to properly supervise and monitor dealers under the provisions of part 201 of this title;

(2) Exhaustion of the general insurance reserve established under part 201 of this title;

(3) Maintenance of a Title I claims/loan ratio representing an unacceptable risk to the Department; or

(4) Transfer of a Title I loan to a party that does not have a valid Title I Contract of Insurance.

8. Revise §202.12(a)(1) to read as follows:

§202.12 Title II.

(a) *Tiered pricing*—(1) *General requirements*—(i) *Prohibition against excess variation.* The customary lending practices of a mortgagee for its single family insured mortgages shall not provide for a variation in mortgage charge rates that exceed 2 percentage points. A variation is determined as provided in paragraph (a)(6) of this section.

(ii) *Customary lending practices.* The customary lending practices of a mortgagee include all single family insured mortgages originated by the mortgagee, including those funded by the mortgagee or purchased from the originator, if the requirements of the mortgagee have the effect of leading to a violation of this section by the originator.

(iii) *Basis for permissible variations.* Any variations in the mortgage charge rate up to two percentage points under the mortgagee's customary lending practices must be based on actual variations in fees or cost to the mortgagee to make the mortgage loan, which shall be determined after accounting for the value of servicing rights generated by making the loan and other income to the mortgagee related to the loan. Fees or costs must be fully documented for each specific loan.