

Alternative Methods of Compliance

(h) The Manager, Boston Aircraft Certification Office, has the authority to approve alternative methods of compliance for this AD if requested using the procedures found in 14 CFR 39.19.

Related Information

(i) Contact Michael Schwetz, Aerospace Engineer, Boston Aircraft Certification Office, FAA, Engine and Propeller Directorate, 12 New England Executive Park, Burlington, MA 01803; e-mail: michael.schwetz@faa.gov; telephone (781) 238-7761; fax (781) 238-7170, for more information about this AD.

(j) Hamilton Sundstrand Service Bulletin 247F-61-54, Revision 1, dated January 12, 2004, pertains to the subject of this AD. Contact Hamilton Sundstrand Propeller Technical Team, One Hamilton Road, Mail Stop 1-3-AB43, Windsor Locks, CT 06096-1010; fax (860) 654-5107, for a copy of this service information.

Issued in Burlington, Massachusetts, on October 4, 2010.

Diane S. Romanosky,

Acting Manager, Engine and Propeller Directorate, Aircraft Certification Service.

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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**24 CFR Part 203**

[Docket No. FR-5156-P-01]

RIN 2502 AI58

Federal Housing Administration (FHA) Single Family Lender Insurance Process: Eligibility, Indemnification, and Termination

AGENCY: Office of the Assistant Secretary of Housing—Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: Through this proposed rule, HUD continues its efforts to improve and expand the risk management activities of the Federal Housing Administration (FHA). The proposed regulatory changes will update and enhance the Lender Insurance process through which the majority of FHA-insured mortgages are endorsed for insurance. Most significantly, the proposed rule would provide additional guidance on HUD's regulations implementing the statutory requirements regarding mortgagee indemnification to HUD of insurance claims in the case of fraud, misrepresentation, or noncompliance with applicable loan origination requirements. The proposed rule also provides that mortgagees must continually maintain the acceptable

claim and default rate required for eligibility to initially be delegated Lender Insurance authority, in order to retain such authority. In addition, this proposed rule also provides that HUD will review Lender Insurance mortgagee performance on a continual basis. HUD also proposes to revise the methodology for determining acceptable claim and default rates, to more accurately reflect mortgagee performance, and to streamline the approval process for Lender Insurance mortgagees that have undergone a corporate restructuring. The Department has also taken the opportunity afforded by this proposed rule to make two technical corrections to the regulations and to solicit public comment on whether FHA mortgagees should be required to submit mortgage loan case binders to HUD electronically.

DATES: *Comment Due Date:* December 7, 2010.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. *Submission of Comments by Mail.* Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0001.

2. *Electronic Submission of Comments.* Interested persons may submit comments electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule. No *Facsimile Comments*. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT:

Mark Ross, Acting Director, Office of Single Family Program Development, Office of Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 9278, Washington, DC 20410-8000; telephone number 202-708-2121 (this is not a toll-free number). Persons with hearing or speech impairments may access this number via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:**I. Background**

The Federal Housing Administration (FHA) was established by Congress in 1934 to improve nationwide housing standards, to provide employment and stimulate industry, to improve conditions with respect to home mortgage financing, to prevent speculative excesses in new mortgage investment, and to eliminate the necessity for costly second mortgage financing. FHA-insured single family mortgages are originated and underwritten through the Direct Endorsement process. A majority of FHA-insured mortgages that are originated under the Direct Endorsement process are endorsed for insurance by mortgage lenders through a second process, the Lender Insurance process.

The Direct Endorsement and Lender Insurance processes are not separate programs; rather, they are the mechanisms that enable FHA-approved lenders to consider single family mortgage applications without first submitting paperwork to HUD. The Lender Insurance process is authorized under section 256 of the National Housing Act (12 U.S.C. 1715z-21). The HUD regulations that presently govern the Direct Endorsement and Lender

Insurance processes are codified at 24 CFR part 203 (entitled Single Family Mortgage Insurance).

The Direct Endorsement process is described in § 203.5 and is available to mortgagees who meet the requirements set forth in § 203.3. Under Direct Endorsement, the mortgagee determines that the proposed mortgage is eligible for insurance under applicable regulations, and submits the required documents to FHA in accordance with § 203.255. The Direct Endorsement mortgagee's performance is subject to pre-endorsement and post-endorsement review by the Secretary.

Direct Endorsement mortgagees that meet the requirements of § 203.4 may be approved for Lender Insurance, as described in § 203.6. Under the Lender Insurance process, a mortgagee conducts its own pre-insurance review and insures the mortgage without a pre-endorsement review by HUD. In order to be eligible to participate in the FHA single family programs as a Lender Insurance mortgagee, an FHA mortgage lender must be an unconditionally approved Direct Endorsement mortgagee that is high performing—i.e., for at least 2 years prior to its application for Lender Insurance authority, the mortgagee must have had a claim and default record acceptable to HUD.

II. This Proposed Rule

Through this proposed rule, HUD continues its efforts to improve and expand the risk management activities of FHA. The proposed regulatory changes will update and enhance the Lender Insurance process. Most significantly, the proposed rule would revise HUD's regulations implementing the statutory requirements regarding lender indemnification to HUD of insurance claims in the case of fraud, misrepresentation, or noncompliance with applicable loan origination requirements. The proposed rule will also provide that mortgagees, in order to retain their Lender Insurance authority, must continually maintain the acceptable claim and default rate required of them when they were initially delegated such authority. In addition, this proposed rule provides that HUD will review Lender Insurance mortgagee performance on a continual basis. HUD also proposes to revise the methodology for determining acceptable claim and default rates to more accurately reflect mortgagee performance, and to streamline the approval process for Lender Insurance mortgagees that have undergone a corporate restructuring. The Department has also taken the opportunity afforded

by this proposed rule to make two technical corrections to the regulations.

The proposed regulatory changes are as follows:

1. *Lender indemnification for insurance claims.* Under section 256(c) of the National Housing Act (12 U.S.C. 1715z–21(c)), an FHA-approved Lender Insurance mortgagee may be required to indemnify HUD for the loss if the mortgage loan was “not originated in compliance with the requirements established by the Secretary, and the Secretary pays an insurance claim * * * within a reasonable period specified by the Secretary.” HUD may also require indemnification at any time “if fraud or misrepresentation was involved in connection with origination” of the mortgage loan. FHA may impose indemnifications, irrespective of whether the noncompliance, fraud, or misrepresentation caused the mortgage default. Currently, the section 256 statutory indemnification requirement is limited to mortgagees with Lender Insurance authority. On January 20, 2010, the Department announced that it would seek changes to section 256 of the National Housing Act, to apply the indemnification provisions to all Direct Endorsement lenders.¹

The section 256 statutory indemnification requirements are currently codified at § 203.255(f)(4). HUD proposes to create a new § 203.255(g) that would provide additional guidance on the statutory requirements of section 256.

As discussed, the section 256 indemnification requirements are applicable to claims paid in connection to a mortgage that was not “originated” in accordance with FHA requirements. For purposes of § 203.255(f), this proposed rule would define the term “origination” as meaning “the process of creating a mortgage, starting with the taking of the initial application, continuing with the processing and underwriting, and ending with the mortgagee endorsing the mortgage note for FHA mortgage insurance.” The proposed definition of “origination” would apply only to indemnifications for mortgages endorsed for FHA mortgage insurance under section 256 of the National Housing Act by authorized Lender Insurance mortgagees, and is not being proposed by HUD to apply in any other contexts related to the FHA programs.

¹ See HUD press release HUD No. 10–016, available at: http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2010/HUDNo.10-016.

As noted, cases of fraud or misrepresentation may require indemnification at any time. However, for cases not involving fraud or misrepresentation, section 256(c) limits the Department's ability to require indemnification to insurance claims paid within a “reasonable time period” established by HUD. New § 203.255(g) would implement this timing requirement by codifying HUD's longstanding practice of requiring indemnification for FHA insurance claims paid “within five years from the date of mortgage insurance endorsement.” The date of endorsement is a fixed date, and therefore has the benefit of being known to both HUD and the Lender Insurance mortgagee. Moreover, 5 years is a reasonable “seasoning” period for a particular mortgage loan to either perform or go into default and for the Department to ascertain whether errors in the origination of the mortgage loan were made, while not being so long a time frame so as to burden mortgagees with the possibility of indemnification for a long-ago endorsed mortgage loan.

Section 256(c) authorizes HUD to require indemnification where the mortgage was not originated in compliance with the HUD-established requirements. Proposed § 203.255(g) identifies the origination requirements for which HUD may seek indemnification if the Lender Insurance mortgagee knew or should have known that the requirements were not followed in the origination of the mortgage. HUD will seek such remedy for violations of FHA origination requirements that HUD deems serious and material; for example, in cases where the mortgage should never have been endorsed by the mortgagee, because FHA would not have insured the mortgage absent proper adherence to the Lender Insurance process. Specifically, a mortgagee may be required to indemnify HUD if it failed to, among other actions: (1) Verify and analyze the creditworthiness, income, and/or employment of the mortgagor in accordance with FHA requirements; (2) verify the source of assets brought by the mortgagor for payment of the required down payment and/or closing costs in accordance with FHA requirements; (3) 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 FHA requirements; or (4) ensure, in accordance with the requirements of § 203.5(e), that the appraisal of the property serving as security for the mortgage loan satisfies FHA appraisal

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

HUD deems violations of the origination requirements identified in the proposed rule as serious and material, because they pertain to the core analyses that must be performed for all properly underwritten mortgage loans. The purpose of mortgage loan underwriting is to evaluate the willingness and financial capability of the mortgagor to pay the loan, and to assess the physical condition of the property that is to serve as security for the mortgage loan, in order to determine whether it constitutes adequate collateral. These basic underwriting principles are enshrined in the so-called "Four C's of Credit" (credit, capacity, capital, and collateral) commonly referred to in the mortgage lending industry. The origination requirements listed above correspond to these fundamental underwriting functions. Accordingly, HUD believes that indemnification may be an appropriate remedy where the mortgagee knew or should have known that these requirements were not followed in the origination of the mortgage loan.

The proposed rule would also specify that the demand for indemnification will be made by either the Secretary or the Mortgagee Review Board. Under an indemnification agreement, the originating mortgage lender agrees to either abstain from filing an insurance claim, or to reimburse FHA if a subsequent holder of the mortgage files an insurance claim and FHA suffers a financial loss.

2. Acceptable claim and default rate for Lender Insurance mortgagees. Section 256(b) of the National Housing Act requires that the Secretary of HUD, in deciding whether to grant a mortgagee's application for Lender Insurance approval, consider "the experience and performance of the mortgagee compared to the default rate of all insured mortgagees in comparable markets." HUD has implemented this statutory requirement at § 203.4(b), which requires that "a mortgagee must have had an acceptable claim and default record for at least 2 years prior to its application for" Lender Insurance authority. The present regulation defines an acceptable claim and default 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 mortgagee to

meet the acceptable standard if the mortgagee operates in a state that has a high default rate. In contrast, a mortgagee would be disadvantaged by having its claim and default rate compared to the national average if the mortgagee operates in two states that have high default rates, even if the mortgagee is in full compliance with FHA requirements and otherwise eligible for Lender Insurance approval. To address these potential concerns, HUD proposes to revise the methodology for computing the acceptable claim and default rate for Lender Insurance approval. The proposed rule would revise § 203.4(b) by providing that a mortgagee is eligible for the Lender Insurance program if its claim and default rate is at or below 150 percent of the average rate in the state(s) where the mortgagee operates. The proposed methodology will more accurately reflect mortgagee performance by evaluating each mortgagee based on its actual area of operations.

3. Need to maintain acceptable claim and default rate. As noted, § 203.4(b) requires that mortgagees have an acceptable claim and default rate as an eligibility criterion for initial Lender Insurance approval; however, the regulation does not specify what constitutes an acceptable claim and default rate for purposes of maintaining Lender Insurance approval. This proposed rule emphasizes that a Lender Insurance mortgagee must continually maintain the acceptable claim and default rate required of them when they were initially granted Lender Insurance authority. HUD will review Lender Insurance mortgagee performance on a continual basis, and mortgagees that fail to maintain the required claim and default rate will be subject to termination of their Lender Insurance authority.

4. Lender Insurance approval in the case of merger, acquisition, or restructuring. Section 256 of the National Housing Act requires that HUD consider "the experience and performance of the mortgagee" in determining the appropriateness of delegating the Secretary's authority to endorse mortgages for FHA insurance. HUD's implementing regulations at § 203.4(b) elaborate on the statutory requirement by providing that "a mortgagee must have had an acceptable claim and default record for at least 2 years prior to its application for" Lender Insurance authority. As discussed above in this preamble, the Lender Insurance process is reserved for high-performing mortgagees. The performance history requirement helps to ensure that only

those mortgagees with a proven track record are eligible for Lender Insurance authority.

Newly formed business entities that do not have a performance record are, therefore, ineligible for Lender Insurance approval. This is true even if the newly formed lending institution was created by a merger, acquisition, or reorganization where one or more of the participating entities had Lender Insurance approval, and the new resulting lending institution retains the structure, staff, and operational protocols that would—absent the 2-year historical performance requirement—make the new entity eligible for Lender Insurance authority under section 256 of the National Housing Act. Deferral of Lender Insurance eligibility is merited for new corporate entities that have not had the time to establish an acceptable performance track history. However, in the case of new entities created by a merger, acquisition, or reorganization, it is possible to forecast future performance with a high degree of certainty based on the performance history of the predecessor entities. To deny Lender Insurance eligibility to such mortgagees simply for purposes of "running out the clock" is contrary to the rationale of the performance history requirement and the Lender Insurance process.

In the past, the Department has addressed this issue through the granting of case-by-case regulatory waivers, a process that has the potential to be lengthy and, on occasion, administratively burdensome. This proposed rule would eliminate the need for regulatory waivers by codifying the conditions under which the Secretary may grant Lender Insurance authority to a mortgagee with less than the required historical performance record. The proposed criteria would permit HUD to evaluate the performance of the new mortgagee based on the performance history of the predecessor corporate entities, while also safeguarding against the possibility that a mortgagee with a poor track record might attempt to circumvent the purposes of section 256 by acquiring or merging with a high-performing lending institution.

First, the mortgagee must be an entity created by a merger, acquisition, or reorganization completed less than 2 years prior to the date of the mortgagee's application for Lender Insurance approval. Secondly, one or more of the entities participating in the merger, acquisition, or reorganization must have had Lender Insurance approval at the time of the corporate restructuring. Third, all of the lending institutions participating in the corporate

restructuring must have had an acceptable claim and default record for the 2-years preceding the mortgagee's application for Lender Insurance approval. Fourth, and last, the extrapolated claim and default record of the mortgagee derived by aggregating the claims and defaults of the entities participating in the merger, acquisition, or reorganization, for the 2-year period prior to the mortgagee's application for Lender Insurance approval, constitutes an acceptable rate of claims and defaults.

The proposed new process would permit, but not compel, HUD to grant Lender Insurance authority to those mortgagees meeting the criteria outlined above. While a rebuttable presumption in favor of granting approval would be established by a mortgagee that meets all four of the required criterions, HUD may consider other available evidence or data indicative of performance, and may deny the application for Lender Insurance authority and require the mortgagee to wait until it establishes an acceptable performance track record. The proposed regulatory provision is consistent with HUD's responsibility to evaluate mortgagee experience and ensure that Lender Insurance authority is provided only to high-performing lenders that comply with FHA requirements, while also facilitating the provision of FHA-insurance by new lending institutions created by a corporate restructuring.

5. *HUD reviews.* Consistent with its duty to protect the FHA insurance fund, HUD monitors mortgagee performance on an ongoing basis (*see*, for example, the present regulation at 24 CFR 202.3 providing for such HUD reviews). However, the current Lender Insurance regulation at § 203.4(c) only refers to an annual performance review. This proposed rule would clarify that HUD will monitor a mortgagee's eligibility to participate in the Lender Insurance program on a continual basis.

6. *Termination of Lender Insurance authority.* This proposed rule would revise § 203.4(d), which governs terminations of Lender Insurance authority, for purposes of clarity and readability. The proposed rule would provide additional specificity on the grounds for termination. Revised § 203.4(d) provides that HUD may immediately terminate the mortgagee's approval to participate in the Lender Insurance program, if the mortgagee violates any of the requirements and procedures established by the Secretary for mortgagees approved to participate in the Lender Insurance program, the Direct Endorsement program, or the Title II Single Family mortgage

insurance program, or if HUD determines that other good cause exists. In addition, the proposed rule clarifies that terminations of Lender Insurance approval are effective upon receipt of HUD's notice of such termination. The proposed rule would also revise § 203.4(d) to clarify that pursuant to section 256(d) of the National Housing Act (12 U.S.C. 1715z–21(d)), HUD termination decisions are not subject to judicial review and that terminations instituted under § 203.4(d) are distinct from withdrawal of mortgagee approval by the Mortgage Review Board under 24 CFR part 25.

7. *Lender insurance pre-insurance review.* The present regulations at § 203.255(f)(1) require that mortgagees conduct a pre-insurance review of mortgages insured under the Lender Insurance process. The regulations provide that the pre-insurance review must meet HUD requirements, but does not specify the requirements for applicable reviews, instead providing that "HUD will directly inform participating mortgagees of its minimum requirements for pre-insurance review." This proposed rule would codify existing Lender Insurance practice concerning the pre-insurance review provisions, by specifying that Lender Insurance mortgagees are responsible for conducting the pre-insurance review that would otherwise be performed by HUD under the Direct Endorsement process.

8. *Technical correction.* In addition to the proposed regulatory changes discussed above in this preamble, HUD has taken the opportunity afforded by this proposed rule to make a nonsubstantive change to the existing regulations. The proposed rule would make a technical correction to § 203.4(a), which incorrectly cross-references to § 203.5 as containing the requirements for Direct Endorsement approval. These approval procedures are codified at § 203.3.

III. Issue Under Consideration: Mandatory Electronic Submission of Case Binders

In addition to soliciting public comment on the proposed regulatory changes described above in this preamble, the Department solicits comment on a possible change to current recordkeeping and submission requirements that the Department is considering. The present Direct Endorsement regulations at 24 CFR 203.255(b) require mortgagees to submit to HUD specified documentation within 60 days after the date of closing of a mortgage loan (collectively, these documents and certifications are

referred to as the mortgage loan "case binder"). The Lender Insurance regulations at 24 CFR 203.255(f)(2) provide that mortgagees must maintain records, including origination files, in a manner and for a time frame prescribed by HUD, and must make these mortgage loan "case binders" available to HUD staff upon request.

Customarily, case binders are maintained and submitted to HUD in hard-copy paper format. Given changes in technology that facilitate the electronic submission and storing of mortgage loan records, HUD is now considering requiring by June 2012 that all case binders be submitted electronically regardless of the insurance process used by a mortgagee. Although Lender Insurance mortgagees are not currently required to submit case binders (except upon HUD's request for a post-endorsement technical review), under HUD's proposal they would be required to submit these mortgage loan records electronically within a specified time frame following insurance of the mortgage. The final rule may contain regulatory text requiring the electronic submission of case binders, and HUD invites public comment on such a possible change, including the appropriateness of a June 2012 implementation date, the costs and benefits that would be associated with the electronic submission of case binders, and what the required time frames should be for submission of electronic case binders following insurance of the mortgage. For more information about the costs and benefits of this provision, please see the regulatory planning and review section of this preamble.

IV. Findings and Certification

Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). OMB determined that this rule is a "significant regulatory action," as defined in section 3(f) of the Order (although not an economically significant regulatory action, as provided under section 3(f)(1) of the Order).

This proposed rule would modify three existing areas affecting FHA-approved lenders. First, this rule would impose indemnification provisions to all approved mortgagees with Lender Insurance authority. Second, this rule would amend the methodology and requirements for determining an acceptable claim and default rate. Lastly, this rule would amend the 2-year

historical performance requirement for mortgagees resulting from merger, acquisition, or reorganization. Other provisions of this rule describe clarifying or technical changes which would not produce an economic impact. The proposed rule also solicits comments on a possible change to current recordkeeping and submission requirements that the Department is considering. To the extent that these amendments have any economic impact, it would be to reduce the compliance costs currently borne by lenders, by clarifying and providing additional instructions that supplement existing FHA requirements and procedures. This rule, as proposed, would not have an economic effect of greater than \$100 million and thus does not require a regulatory impact analysis. The reasons for HUD's determination are as follows:

Indemnification Requirements. With regard to the proposed indemnification provisions, this proposed rule codifies much of existing HUD practice, and this rule alone should not result in a dramatic change in underwriting practices and the quality of FHA loans, assuming that all of FHA's Direct Endorsement lenders currently conduct due diligence in extending FHA-insured loans. A marginal change will be encountered by those lenders with ineffective risk management practices and/or those lenders who have refused to execute an indemnification agreement. HUD expects there to be some reduction in claims paid by FHA, but not a noticeable reduction in the claims rate attributed to this change by itself. FHA's average loss rate on claims for first quarter Fiscal Year (FY) 2010 (October 1, 2009 to February 28, 2010) properties conveyed to HUD and subsequently sold was approximately 60 percent. For every claim averted, there would be a transfer (loss avoidance) of approximately \$73,000 to FHA.

The primary change is that all Direct Endorsement lenders with Lender Insurance authority will be subject to indemnification procedures and will not be able to negotiate the settlement, as is the current practice. This facet of the rule could lead to an efficiency: the initial process by a lender of deciding whether to indemnify FHA will be eliminated, and would be accompanied by reductions in the length and cost of negotiations. Time and effort may be saved because the costs of a lengthy preparation for both FHA and the lender in coming before the Mortgage Review Board are reduced by this proposed rule. The number of signed indemnifications for the last seven fiscal years (FY 2004 through the end of FY

2010) has averaged 1,282 indemnification agreements annually. If the average negotiation costs are one percent of the loan amount for both FHA and the lender (approximately \$140,000 is currently the average FHA-insured mortgage amount), then the transaction costs to avoid or delay the indemnification would be \$1,400 per loan. Over an average of 1,300 indemnifications, the aggregate transaction costs saved by this rule would be \$1.7 million.

Acceptable Claim and Default Rate. The proposed rule would make two changes regarding acceptable claim and default rates for Lender Insurance mortgagees. First, HUD proposes to more accurately evaluate a mortgagee's performance record by basing the claim and default rate comparison on the mortgagee's actual area of operations. The proposed rule also clarifies that, in order to retain their Lender Insurance authority, mortgagees must continually maintain the acceptable claim and default rate required of them when they were initially delegated such authority.

To simulate the impact of the proposed changes, HUD used data on active Direct Endorsement lenders. By moving to a consistent methodology, regional lenders are compared not to a national standard, but to their peers operating in the same area. Using as a base the total number of 1,945 currently active Direct Endorsement lenders, an additional 18 lenders would have the claim and default rate necessary for Lender Insurance authority under this proposed rule. However, the proposed requirement that Lender Insurance mortgagees maintain the acceptable default and claim rate initially required for Lender Insurance eligibility appears to result in a minimal reduction in the number of Direct Endorsement lenders that would be deemed to be eligible for Lender Insurance authority. Specifically, 113 out of the 1,945 currently active Direct Endorsement mortgagees would no longer have the necessary claim and default rate to maintain Lender Insurance authority; however, these mortgagees would retain their Direct Endorsement authority and could continue to participate in FHA programs.

The combined effect of the two proposed changes would be to reduce the number of Direct Endorsement mortgagees eligible for Lender Insurance authority (a reduction of 54). In the short run, this effect can be thought of as a transfer between lenders of different regions. In the longer run, HUD expects the impact of this rule to be geographically neutral. Lenders will not be permanently reduced as a result of

this rule; rather, HUD expects that lenders who can meet the eligibility criteria will eventually assume the business of those lenders who could not meet the new eligibility criteria.

Lender Insurance Approval in the Case of Corporate Restructuring. The proposed rule would facilitate the compliance of new lending institutions resulting from a merger, acquisition, or reorganization with the statutory requirements for Lender Insurance approval. The proposed rule would thus make changes designed to provide additional regulatory flexibility and better reflect existing market conditions. The regulatory 2-year performance history requirement may impose a burden on lenders whose compliance with FHA requirements was not affected by the business reorganization. Although HUD has in the past granted regulatory waivers to address this problem, the proposed rule will codify a solution that is less administratively burdensome than the regulatory waiver process.

Mandatory Electronic Submission of Case Binders. The present Direct Endorsement regulations require mortgagees to submit case binders to HUD within 60 days after the date of closing of a mortgage loan. Customarily, case binders are maintained and submitted to HUD in hard-copy paper format. Given changes in technology that facilitate the electronic submission and storing of mortgage loan records, the proposed rule solicits comments on whether HUD should require that all case binders be submitted electronically. Although Lender Insurance mortgagees are not currently required to submit case binders (except upon HUD's request), under HUD's proposal they would be required to submit these mortgage loan records electronically within a specified time frame following insurance of the mortgage.

The minimum cost of this change to mortgagee would be zero. Most companies already possess the technology to process electronic documents for their investors. In addition, there are currently seven lenders that submit a total of 250,000 electronic case binders annually. These firms would not incur additional costs for submitting electronic binders to FHA. Although most companies already subscribe to a service that transmits electronic documents, sending them to FHA would impose an additional cost. A reasonable estimate of the additional cost per loan is a transaction fee in the range of \$9 to \$17 per case binder, with an upfront cost of \$5,000 to \$15,000 per firm. With 4,000 firms, the aggregate

fixed cost of this portion of the rule would range from \$20 million to \$60 million. If FHA has an average of 1.5 million loans, then 1.25 million loans would be affected (1.5 million minus 250,000). The aggregate variable cost of this requirement would constitute from \$11 million to \$21 million (\$9 to \$17 multiplied by 1.25 million).

The low-cost-scenario is defined as the case where the fixed and variable costs are lowest and the high-cost scenario where the costs are highest. The annualized cost over 10 years at a 3 percent discount rate would be \$14 million in the low-cost scenario and \$29 million annually in the high-cost scenario. At a 7 percent discount rate, the annualized cost over 10 years would be \$15 million annually for the low-cost scenario and \$31 million for the high-cost scenario.

The net cost, however, of moving to mandatory electronic submission should not be lesser the gross cost described above, since there will be some substitution from more expensive postal to electronic submission. These benefits are expected to last for the next 10 years until a new investment is required. Consider, for example, if the case binders of one-half of all loans were mailed to FHA at a cost of \$30 per binder, then the annual savings of postal costs would be \$18.7 million. This provision generates net benefits for the low-cost of transmission scenario (a total of \$44 million at a 3 percent discount rate over 10 years) but not for the high-cost of transmission of scenario (a net cost of \$81 million at the 3 percent discount rate). The annualized net benefit in the low-cost scenario is \$5.4 million and the annualized net cost in the high-cost scenario is \$9.6 annually.

The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking

requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

The proposed rule would not add any new regulatory burdens on FHA-approved mortgage lenders. Rather, as noted above in this preamble (*see* the section captioned “Regulatory Planning and Review”), the proposed rule would codify much of existing practice regarding indemnification. Specifically, the proposed rule would codify a definition of the term “origination” for purposes of indemnification, specify time limits on HUD’s ability to demand indemnification in cases not involving fraud or misrepresentation, and identify specific defects in mortgage loan origination that may prompt HUD to seek indemnification. The primary change is that all Lender Insurance mortgagees will be subject to indemnification and will not be able to negotiate a settlement in lieu of indemnification. As noted in the “Regulatory Planning and Review” section of this preamble, this change may have a marginal impact on those lenders with ineffective risk management practices and who have refused to execute an indemnification agreement. Accordingly, to the extent that indemnification provisions of this proposed rule have any economic impact, it will be as a result of the lender’s own actions—i.e., its inability or unwillingness to comply with prudent risk management practices—and not as a result of HUD regulatory action.

HUD also proposes to revise the methodology for determining acceptable claim and default rates. The regulatory change will more accurately evaluate a mortgagee’s performance record by basing the claim and default rate comparison on the mortgagee’s actual area of operations, rather than on the national average. This change would have an overall beneficial economic impact on small business lenders.² HUD data indicates that an additional ten small business lenders would be deemed to have an acceptable claim and default rate for purposes of Lender Insurance authority as a result of this change. (There are currently 602 active small business Direct Endorsement mortgagees participating in FHA programs.)

The proposed rule also specifies that mortgagees must maintain the

acceptable claim and default rate required of them when they were initially granted Lender Insurance authority, in order to retain such authority, and that HUD will monitor mortgagee performance on an ongoing basis. As noted in the “Regulatory Planning and Review” section of this preamble, this provision of the proposed rule would result in a minimal reduction in the number of Direct Endorsement lenders that would be deemed eligible for Lender Insurance authority (113 out of a total of 1,945 currently active Direct Endorsement mortgagees). However, the economic impacts of this change should be minimal, as these lenders will continue to be able to participate in FHA programs as Direct Endorsement mortgagees. Moreover HUD reiterates that Lender Insurance authority is reserved for high-performing mortgagees that have a proven track record of risk management and sound underwriting practices. The regulatory change would merely require that Lender Insurance mortgagees maintain the same performance record that first made them eligible for Lender Insurance authority. To the extent that the proposed amendment has any impact, it will be as a consequence of the lender’s inability to maintain acceptable risk management practices, and not as a result a HUD regulatory mandate.

The proposed rule also would make several changes designed to provide additional regulatory flexibility and better reflect existing market conditions. For example, the proposed rule would facilitate the compliance of new lending institutions created by a merger, acquisition, or reorganization with the statutory requirements for Lender Insurance approval. Under HUD’s regulations implementing section 256 of the National Housing Act, mortgagees must comply with a 2-year performance history requirement in order to qualify for Lender Insurance approval. As a new business entity, the lending institution created by a merger, acquisition, or reorganization would not be able to comply with the performance 2-year history requirements, and thus would be ineligible for Lender Insurance authority. The regulatory 2-year performance history requirement may impose a burden on lenders whose compliance with FHA requirements is not affected by the business reorganization. Although HUD has in the past granted regulatory waivers to address this problem, the proposed rule will codify a solution that is less administratively burdensome than the regulatory waiver process.

² The Small Business Administration size standard regulations at 13 CFR 121.201 define small business lenders and mortgagees as having less than \$7 million in annual revenues for nondepository firms and assets under \$175 million for depository firms.

The proposed rule also solicits comment on a possible change to current recordkeeping and submission requirements. In light of changes in technology that facilitate the electronic submission and storing of mortgage loan records, HUD is considering requiring that case binders be submitted electronically regardless of the insurance process used by a mortgagee. As discussed in detail in the "Regulatory Planning and Review" section of this preamble, the proposed change likely would reduce the economic burden imposed on mortgagees by no longer requiring that they incur the cost of maintaining paper records (except in the worst high-cost scenario). Moreover, these benefits are expected to last for the next 10 years until a new technology investment is required.

Accordingly, for the above reasons, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities. Notwithstanding HUD's determination that this rule will not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives, as described in this preamble.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule will not have federalism implications and would not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This proposed rule does not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of UMRA.

Environmental Impact

This proposed rule does not direct, provide for assistance or loan and mortgage insurance for, or otherwise

govern or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c)(1), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Paperwork Reduction Act

The information collection requirements for this proposed rule 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, an agency 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.

Catalogue of Federal Domestic Assistance

The Catalogue of Federal Domestic Assistance Number for the principal FHA single family mortgage insurance program is 14.117.

List of Subjects in 24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

Accordingly, for the reasons discussed in the preamble, HUD proposes to amend 24 CFR part 203 to read as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

1. The authority citation for part 203 is revised to read as follows:

Authority: 12 U.S.C. 1709, 1710, 1715b, 1715z–16, 1715u, and 1717z–21; 42 U.S.C. 3535(d).

2. In § 203.4, amend paragraph (a) by revising the reference "§ 203.5" to read "§ 203.3" and revise paragraphs (b), (c), and (d), to read as follows:

§ 203.4 Approval of mortgagees for Lender Insurance.

* * * * *

(b) *Performance: Claim and default rate.* (1) In addition to being unconditionally approved for the Direct Endorsement program, a mortgagee must have had an acceptable claim and

default rate (as described in paragraph (b)(3) of this section) for at least 2 years prior to its application for participation in the Lender Insurance program, and must maintain such a claim and default rate in order to retain Lender Insurance approval.

(2) HUD may approve a mortgagee that is otherwise eligible for Lender Insurance approval, but has an acceptable claim and default record of less than 2 years, if:

(i) The mortgagee is an entity created by a merger, acquisition, or reorganization completed less than 2 years prior to the date of the mortgagee's application for Lender Insurance approval;

(ii) One or more of the entities participating in the merger, acquisition, or reorganization had Lender Insurance approval at the time of the merger, acquisition, or reorganization;

(iii) All of the lending institutions participating in the merger, acquisition, or reorganization had an acceptable claim and default record for the 2 years preceding the mortgagee's application for Lender Insurance approval; and

(iv) The extrapolated claim and default record of the mortgagee derived by aggregating the claims and defaults of the entities participating in the merger, acquisition, or reorganization, for the 2-year period prior to the mortgagee's application for Lender Insurance approval, constitutes an acceptable rate of claims and defaults, as defined by this section.

(3) A mortgagee has an acceptable claim and default rate if its rate of claims and defaults is at or below 150 percent of the average rate for insured mortgages in the state(s) in which the mortgagee operates.

(c) *Reviews.* HUD will monitor a mortgagee's eligibility to participate in the Lender Insurance program on a continual basis.

(d) *Termination of approval.* (1) HUD may immediately terminate the mortgagee's approval to participate in the Lender Insurance program, in accordance with section 256(d) of the National Housing Act (12 U.S.C. 1715z–21(d)), if the mortgagee:

(i) Violates any of the requirements and procedures established by the Secretary for mortgagees approved to participate in HUD's Lender Insurance program, Direct Endorsement program, or the Title II Single Family mortgage insurance program; or

(ii) If HUD determines that other good cause exists.

(2) Such termination will be effective upon receipt of HUD's notice advising of the termination. Within 30 days after receiving HUD's notice of termination, a

mortgagee may request an informal conference with the Deputy Assistant Secretary for Single Family Housing or designee. The conference will be conducted within 30 days after HUD receives a timely request for the conference. After the conference, the Deputy Assistant Secretary (or designee) may decide to affirm the termination action or to reinstate the mortgagee's Lender Insurance program approval. The decision will be communicated to the mortgagee in writing, will be deemed a final agency action, and, pursuant to section 256(d) of the National Housing Act (12 U.S.C. 1715z-21(d)), is not subject to judicial review.

(3) Termination of an origination approval agreement under part 202 of this chapter or termination of Direct Endorsement approval under § 203.3(d)(2) for a mortgagee or one or more branch offices automatically terminates Lender Insurance approval for the mortgagee or the branch office or offices, without imposing any further requirement on the mortgagee or such offices to comply with this paragraph.

(4) Any termination instituted under this section is distinct from withdrawal of mortgagee approval by the Mortgagee Review Board under 24 CFR part 25.

3. In § 203.255, revise paragraph (f)(1), remove paragraph (f)(4), and add paragraph (g) to read as follows:

§ 203.255 Insurance of mortgage.

* * * * *

(f) *Lender Insurance.* (1) *Pre-insurance review.* For applications for insurance involving mortgages originated under the Lender Insurance program under § 203.6, the mortgagee is responsible for performing a pre-insurance review that would otherwise be performed by HUD under § 203.255(c) on the documents that would otherwise be submitted to HUD under § 203.255(b). The mortgagee's staff that performs the pre-insurance review must not be the same staff that originated the mortgage or underwrote the mortgage for insurance.

* * * * *

(g) *Indemnification.* (1) *General.* By insuring the mortgage, a Lender Insurance mortgagee agrees to indemnify HUD, in accordance with this paragraph.

(2) *Definition of origination.* For purposes of indemnification under this paragraph, the term "origination" means the process of creating a mortgage, starting with the taking of the initial application, continuing with the processing and underwriting, and ending with the mortgagee endorsing the mortgage note for FHA insurance.

(3) *Serious and material violation.* The mortgagee shall indemnify HUD for an FHA insurance claim paid within 5 years of mortgage insurance endorsement, if the mortgagee knew or should have known of a serious and material violation of FHA origination requirements, such that the mortgage loan should not have been approved and endorsed by the mortgagee and irrespective of whether the violation caused the mortgage default. Such a serious and material violation of FHA requirements in the origination of the mortgage may occur if the mortgagee failed to, among other actions:

(i) Verify the creditworthiness, income, and/or employment of the mortgagor in accordance with FHA requirements;

(ii) Verify the assets brought by the mortgagor for payment of the required down payment and/or closing costs in accordance with FHA requirements; or

(iii) 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 FHA requirements, or

(iv) Ensure that the appraisal of the property serving as security for the mortgage loan satisfies FHA appraisal requirements, in accordance with § 203.5(e).

(4) *Fraud or misrepresentation.* The mortgagee shall indemnify HUD for an insurance claim if fraud or misrepresentation was involved in connection with the origination of the mortgage, regardless of when the mortgage was endorsed for insurance and irrespective of whether the fraud or misrepresentation caused the mortgage default.

(5) *Demand for indemnification.* The demand for indemnification will be made by either the Secretary or the Mortgagee Review Board. Under an indemnification agreement, the Lender Insurance mortgagee agrees to either abstain from filing an insurance claim, or reimburse FHA if a subsequent holder of the mortgage files an insurance claim and FHA suffers a financial loss.

Dated: September 16, 2010.

David H. Stevens,

Assistant Secretary for Housing—Federal Housing Commissioner.

[FR Doc. 2010-25441 Filed 10-7-10; 8:45 am]

BILLING CODE 4210-67-P

DEPARTMENT OF JUSTICE

28 CFR Part 2

Paroling, Recommitting, and Supervising Federal Prisoners: Prisoners Serving Sentences Under the United States and District of Columbia Codes

AGENCY: United States Parole Commission, Justice.

ACTION: Proposed rule.

SUMMARY: The United States Parole Commission seeks public comment on a proposed rule that would amend the Offense Behavior Severity Index in its paroling policy guidelines to equalize the ratings for crack cocaine and powder cocaine offenses.

DATES: Comments must be received by December 1, 2010.

ADDRESSES: Submit your comments, identified by docket identification number USPC-2010-03 by one of the following methods:

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the online instructions for submitting comments.

- *Mail:* Office of the General Counsel, U.S. Parole Commission, 5550 Friendship Blvd., Chevy Chase, Maryland 20815.

- *Fax:* (301) 492-5563.

FOR FURTHER INFORMATION CONTACT:

Johanna E. Markind, Office of the General Counsel, U.S. Parole Commission, 5550 Friendship Blvd., Chevy Chase, Maryland 20815, telephone (301) 492-5959. Questions about this publication are welcome, but inquiries concerning individual cases cannot be answered over the telephone.

SUPPLEMENTARY INFORMATION:

Background

The U.S. Parole Commission is responsible for making parole release decisions for those federal prisoners who are eligible for parole under the now-repealed indeterminate sentencing system. Under this system, a prisoner may be released to community supervision after he serves a minimum term required by his sentence or by operation of law. After the Commission makes a discretionary judgment to release the prisoner and imposes conditions of release, the released prisoner remains on supervision until the expiration of his sentence or his supervision is terminated early. Parole may be revoked and the offender returned to imprisonment for violating the conditions of release. The Commission carries out its duties under the statutes at 18 U.S.C. 4201-4218. The Commission also has similar