

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

[Docket No. FR-4311-I-01]

RIN 2502-AH15

**Single Family Mortgage Insurance;
Electronic Underwriting**

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

ACTION: Interim rule.

SUMMARY: Currently, a Direct Endorsement underwriter must personally review the appraisal report and credit application, including the analysis performed on the worksheets. With the introduction of automated underwriting systems, the need for human underwriters to review certain aspects of the mortgage loan application is substantially diminished. This interim rule amends the regulations on Single Family Mortgage Insurance to allow the lender to substitute an "accept" risk classification from a FHA-approved automated underwriting system (AUS) in lieu of a personal review by a Direct Endorsement underwriter of the borrower's credit and capacity to repay the mortgage.

DATES: *Effective date:* June 29, 1998.

Comment due date: July 28, 1998.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500. Communications should refer to the above docket number and title. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address. HUD will not process facsimile (FAX) communications as comments.

FOR FURTHER INFORMATION CONTACT: John J. Coonts, Director, Office of Insured Single Family Housing, Room 9162, Department Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410, telephone (voice) (202) 708-3046. (This is not a toll-free number.) Hearing-impaired or speech-impaired individuals may access the voice telephone listed by calling the Federal Information Relay Service during working hours at 1-800-877-8339.

SUPPLEMENTARY INFORMATION: Currently, a Direct Endorsement (DE) underwriter must personally review the appraisal

report and credit application, including the analysis performed on the worksheets. With the introduction of automated underwriting systems, the need for human underwriters to review certain aspects of the mortgage loan application is substantially diminished. The current regulatory provision at 24 CFR 203.255(b)(5) requires a DE underwriter to certify that the underwriter has personally reviewed the credit application and appraisal report on all mortgages originated under the DE program. The regulatory change set forth in this interim rule allows the lender to substitute an "accept" risk classification from a FHA-approved automated underwriting system in lieu of a personal review by a DE underwriter of the borrower's credit and capacity to repay the mortgage.

An automated underwriting system (AUS) performs an analysis of the loan application and provides risk grades or classifications as to the probability of mortgage default. The AUS either accepts or approves the mortgage based on information provided by the lender, or refers the application for further review by an individual. FHA controls the approval of all proprietary AUS's, determines the risk it is willing to accept (i.e., the score necessary to allow the loan to be considered an "accept"), and enters into agreements with the AUS vendors outlining what elements of the mortgage application it is permitting the AUS to evaluate. FHA, at its discretion, may determine that the AUS may be used to review elements of the applicant's credit and capacity.

FHA will continue to require a personal review for those mortgage applications referred to an individual underwriter and to require that the lender certify that all other aspects of the mortgage transaction, including data integrity and eligibility rules, meet FHA requirements. Further, the mortgage lender remains responsible for those aspects of the credit and capacity not evaluated by the AUS, including eligibility requirements, as well as the integrity of the data used by the AUS to arrive at the "accept" risk classification.

Other Matters
Justification for Interim Rule

In general, the Department publishes a rule for public comment before issuing a rule for effect, in accordance with its own regulations on rulemaking, 24 CFR part 10. Part 10 does provide, however, for exceptions from that general rule where the Department finds good cause to omit advance notice and public participation. The good cause requirement is satisfied when prior

public procedure is "impracticable, unnecessary, or contrary to the public interest." 24 CFR 10.1. The Department finds that good cause exists to publish this rule for effect without first soliciting public comment, in that public procedure is contrary to the public interest and unnecessary. Failure to permit substitution of the AUS risk classification impedes lenders from benefitting from the efficiencies of automated underwriting systems, as well as FHA's ability to offer lower cost mortgage originations. Furthermore, this rule is not contrary to the public interest because applicants who do not receive the automated "accept" classification will be granted a manual underwriting review. Consequently, no applicant will be automatically denied approval as a result of the Department's use of this system. Also, in keeping with the Administration's effort to reduce the regulatory burden, this rule reduces the government regulation of private entities, allows mortgage lenders greater flexibility, and reduces underwriting time and expense.

Environmental Finding

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR Part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969. The Finding of No Significant Impact is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of the General Counsel, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, S.W., Washington, D.C. 20410.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, *Federalism*, has determined that the policies contained in this rule will not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the rule is not subject to review under the Order.

The Regulatory Flexibility Act

In accordance with 5 U.S.C. 605(b) (the Regulatory Flexibility Act), the Secretary by his approval of this rule hereby certifies that this rule does not have a significant economic impact on a substantial number of small entities because it allows mortgage lenders

greater flexibility and reduces underwriting time and expense. It does not negatively affect small businesses.

Executive Order 12866

This rule was reviewed by the Office of Management and Budget (OMB) under Executive Order 12866 on Regulatory Planning and Review, issued by the President on September 30, 1993. Any changes made in the rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection as provided under the section of this preamble entitled **Address**.

HUD recognizes that this rule has a potential economic impact. The adoption of AUS by FHA originators will result in system set-up and maintenance costs that they may not otherwise incur. The ability to use AUS has the potential to significantly reduce the cost of underwriting a substantial proportion of FHA loans. These reduced costs may be passed on to borrowers through lower origination fees. Alternatively, originators may shift Direct Endorsement underwriting personnel and other resources away from AUS "accept" borrowers to other borrowers. The ability to review more intensively applications not given an "accept" rating by the AUS, or to provide credit counseling or other services to these applicants, may increase the number of borrowers granted FHA loans.

This rule is not economically significant as described in E.O. 12866, however. While the rule allows lenders to use AUS "accept" risk classification in lieu of a personal review by a Direct Endorsement underwriter, it does not mandate it. Thus, any economic impact of the rule will result from voluntary actions of lenders. If lenders do not find that the individual benefits of using AUS outweigh individual costs, the rule would have no economic impact.

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.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number for this program is 14.117.

Accordingly, 24 CFR part 203 is amended as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

1. The authority for part 203 continues to read as follows:

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

2. Section 203.255 is amended by revising paragraph (b)(5) to read as follows:

§ 203.255 Insurance of mortgage.

* * * * *

(b) * * *

(5) An underwriter certification, on a form prescribed by the Secretary, stating that the underwriter has personally reviewed the appraisal report and credit application (including the analysis performed on the worksheets) and that the proposed mortgage complies with HUD underwriting requirements, and incorporating each of the underwriter certification items which apply to the mortgage submitted for endorsement, as set forth in the applicable handbook or similar publication that is distributed to all Direct Endorsement mortgagees, except that where an automated underwriting system (AUS) approved by the Secretary or Commissioner is used by the lender, and the AUS has determined that the application represents an acceptable risk under terms and conditions agreed to by the FHA, a Direct Endorsement underwriter shall not be required to certify that he/she has personally reviewed the credit application (including the analysis performed on any worksheets);

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Dated: April 29, 1998.

Art Agnos,

Acting General Deputy Assistant Secretary for Housing—Federal Housing Commissioner.
[FR Doc. 98-14043 Filed 5-28-98; 8:45 am]

BILLING CODE 4210-27-P