

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

[Docket No. FR-4835-I-01]

RIN 2502-AI00

FHA TOTAL Mortgage Scorecard

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

ACTION: Interim rule.

SUMMARY: This interim rule would codify the procedures that mortgagees and automated underwriting system vendors must observe if they opt to use the "Technology Open To Approved Lenders" (TOTAL) mortgage scorecard offered by the Federal Housing Administration (FHA). This rule follows a December 6, 2000, **Federal Register** notice, which announced the Department's intention to deploy the TOTAL mortgage scorecard. The interim rule also clarifies that the underwriting requirements to which FHA mortgagees must adhere are not altered by this rule. This rule only provides the requirements and procedures for use of the TOTAL mortgage scorecard.

EFFECTIVE DATE: December 22, 2003.

Comment Due Date: January 20, 2004.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, 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. Facsimile (FAX) comments are not acceptable. 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.

FOR FURTHER INFORMATION CONTACT: Vance T. Morris, Director, Office of Single Family Program Development, Room 9278, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone (202) 708-2121. (This is not a toll-free number.) Hearing- or speech-impaired persons may access this number by calling the toll-free Federal Information Relay Service number at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:**I. Background**

On December 6, 2000, the Department published a notice in the **Federal Register** (65 FR 76273), announcing its intention to deploy the FHA TOTAL

(originally an acronym for "Technology Open To All Lenders," but now more accurately standing for "Technology Open To Approved Lenders") Mortgage Scorecard for mortgage industry use. The TOTAL Mortgage Scorecard (or Scorecard), developed by HUD, assesses the credit worthiness of FHA mortgagors by evaluating certain mortgage application and mortgagor credit information that has been statistically proven to accurately predict the likelihood of mortgagor default. The TOTAL Mortgage Scorecard is not an automated underwriting system (AUS); rather, it is a mathematical equation intended for use within an automated underwriting system.

The December 6, 2000, notice (Notice) described the Department's purpose and objectives in deploying the TOTAL Mortgage Scorecard. The objectives for the use of the TOTAL Mortgage Scorecard, which were first stated in the Notice, are (1) to provide an improved credit evaluation system for FHA loans that has been statistically proven to accurately predict the likelihood of mortgagor default while providing a uniform system protective of borrowers; (2) to expand access to mortgage credit for low- and moderate-income mortgagors and discourage unlawful discrimination against mortgagors protected by the Fair Housing Act and the Equal Credit Opportunity Act; (3) to facilitate access to, and reduce the cost and time associated with, originating HUD/FHA-insured mortgages; and (4) to encourage a standardized, industry-wide capability for communication and exchange of information among members of the mortgage lending community.

The Notice also advised that approval would be rescinded for the two individual privately developed mortgage scorecards used in the processing of FHA mortgage loans, and that after deployment of the TOTAL Mortgage Scorecard, HUD would require use of the Scorecard in any AUS. The Notice also indicated that users of the TOTAL Mortgage Scorecard would receive documentation relief and credit policy waivers provided by HUD. Further, the Notice advised that HUD also had developed a Use Agreement that established the requirements and responsibilities for implementation and use of the TOTAL Mortgage Scorecard by qualified mortgagees and others that purchase, sell, underwrite, or document HUD mortgage loans for mortgagees under HUD's Direct Endorsement program. Two organizations have been working with HUD to test the use of the TOTAL Mortgage Scorecard. While HUD, through individual approvals,

could authorize other organizations to use the TOTAL Mortgage Scorecard, HUD has decided that a more efficient course of action is to promulgate regulations for the use of the Scorecard consistent with the purpose and objectives announced in the Notice instead of executing individual approvals that establish the requirements and responsibilities for use of the Scorecard.

Current regulations at 24 CFR 203.255 describe the documentation requirements mortgagees must follow when underwriting mortgage loans to be insured by FHA, and state that for mortgage loans rated as acceptable risks by an approved AUS, a Direct Endorsement underwriter need not certify that he/she has personally reviewed the credit application. The regulations do not, however, describe the rules and procedures that mortgagees and automated underwriting system vendors must observe if they opt to use the TOTAL Mortgage Scorecard, and to receive the inherent benefits accompanying its use, including documentation relief and credit policy revisions.

II. This Interim Rule

This interim rule would revise HUD's regulation at 24 CFR 203.251 to add a definition for "TOTAL," and § 203.255(b)(5) would be revised to remove the reference to "an automated underwriting system approved by the Secretary or Commissioner" and substitute "TOTAL Mortgage Scorecard." The requirements governing the use of the TOTAL Mortgage Scorecard would also be added to § 203.255(b)(5). Any AUS vendor that "calls" the TOTAL Mortgage Scorecard, and any FHA-approved mortgagee that obtains a risk assessment from the Scorecard, must abide by the requirements set forth in this regulation. Only AUSs developed, operated, owned, or used by FHA-approved Direct Endorsement mortgages, Fannie Mae, or Freddie Mac will be able to access the scorecard, and only FHA-approved mortgagees will be able to obtain risk assessments using the TOTAL Mortgage Scorecard. The rule affirms that Direct Endorsement mortgagees remain solely responsible for the underwriting decision. Implementation of this regulation will rescind Mortgagee Letters 96-34, 98-14, and 99-26, which address FHA's review of individual automated underwriting procedures. This rule does not alter the underwriting requirements to which FHA mortgagees must currently adhere. This rule only addresses the use of the TOTAL Mortgage Scorecard and the

requirements and procedures to which FHA mortgagees must adhere if they opt to use the Scorecard. Specifically, this regulation establishes the conditions for use of the Scorecard.

The TOTAL Mortgage Scorecard is only a tool to assist the mortgagee in managing its workflow and expediting the endorsement process and is not a substitute for the mortgagee's reasonable consideration of risk and credit worthiness. The Department believes that the TOTAL Mortgage Scorecard is a valuable tool, but that value depends upon proper use of the Scorecard in accordance with HUD requirements and procedures. To help assure the TOTAL Mortgage Scorecard is not misused, the rule would require mortgagees to provide full manual underwriting for mortgage applicants when the scorecard returns a "refer" risk score. The Scorecard results must not be used as the basis for rejecting any mortgage applicant.

In addition, the rule would provide that both mortgagees and vendors must:

- use the scorecard to process FHA and other loan products specified by the FHA Commissioner only, and for no other purpose;
- implement quality control procedures for scorecard usage and provide, at FHA's request, reports and loan samples that enable FHA to evaluate program operation;
- not use the TOTAL Mortgage Scorecard to direct mortgagors into other non-FHA product offerings (this requirement does not relieve a mortgagee from its obligations under § 203.10 concerning informed consumer choice for prospective FHA mortgagors);
- not disassemble, decompile, reverse engineer, derive or otherwise reproduce any part of the source code or algorithm in the TOTAL Mortgage Scorecard;
- not provide feedback messages that conflict with the Equal Credit Opportunity Act; and
- comply with any additional HUD/FHA requirements or procedures, that are applicable to the TOTAL Mortgage Scorecard and may be issued through handbooks, mortgagee letters, TOTAL User Guides, or TOTAL Developers Guide following appropriate advance notification, where applicable.

Automated underwriting system vendors and mortgagees found to violate these conditions may have their access to the Scorecard terminated with appropriate notice. HUD will provide a vendor or mortgagee with a 30-day notice of a violation and loss of privilege. The notice will state the

nature of the violation, the effective date of the loss of privilege, and the duration of the loss of privilege. A party receiving such a notice may appeal to the Deputy Assistant Secretary for Single Family Housing (DAS-SFH), or the Deputy Assistant Secretary's designee, before the effective date by providing evidence to refute the violation. The loss of privilege is stayed until the DAS-SFH notifies the party that the loss of privilege has been affirmed, rescinded, or modified. As an additional measure to ensure compliance with these requirements, access to the TOTAL Mortgage Scorecard by a FHA mortgagee will be conditioned upon the mortgagee's certification to comply with the requirements as provided in this rule.

III. Justification for Interim Rulemaking

In general, HUD publishes a rule for public comment before issuing a rule for effect, in accordance with HUD's own regulations on rulemaking at 24 CFR part 10. Part 10, however, does provide for exceptions for that general rule where HUD finds good cause to omit advance notice and public participation. The good cause requirement is satisfied when prior public procedure is determined "impracticable, unnecessary, or contrary to the public interest."

HUD finds that good cause exists to publish this interim rule for effect without first soliciting public comment in that prior public procedure would be contrary to the public interest. Currently, loan originators underwrite FHA loans manually or through Fannie Mae and Freddie Mac's proprietary automated systems that employ scorecards that were built using data on FHA borrowers but with algorithms known only to the developers and not to FHA. Over the last four years, HUD has developed its own FHA TOTAL Scorecard and through validation determined that it provides an improved credit evaluation system for FHA loans that has been statistically proven to accurately predict the likelihood of mortgagor default while providing a uniform system protective of borrowers. Indeed, the TOTAL Scorecard, among other attributes, better predicts delinquencies that may occur under FHA loans than any other underwriting means currently available.

The release of the TOTAL Scorecard and its implementation without delay through the issuance of this rule will allow FHA to benefit immediately from this more refined, uniform instrument that will better measure the credit worthiness of potential borrowers and

better protect the Government from financial losses. This is especially true in an environment of relatively low interest rates, increased demand for FHA insurance products, and historically high FHA delinquency rates. Additionally, because the scorecard is government property and HUD is prepared to accept data on TOTAL Scorecard performance, immediate deployment will allow HUD to efficiently track the performance of FHA loans and FHA lenders and quickly fix and refine the scorecard further.

For borrowers, immediate deployment of the TOTAL Scorecard will result in the institution of a single system nationwide that will offer uniform processing.

The interim rule enables, but does not require, FHA mortgage lenders to use this new automated means of assessing the credit worthiness of FHA mortgagors. Although use of the TOTAL Scorecard is not required, the Department believes that this rule makes use of the TOTAL Scorecard possible for a greater number of mortgagees, and for the benefit of a greater number of mortgagors, at an earlier point in time and in a more efficient manner than would execution of individual approvals to use the TOTAL Scorecard issued in accordance with outstanding mortgagee letter instructions. For FHA mortgagees that opt to use the TOTAL Scorecard, use of the TOTAL Scorecard is subject to several conditions to protect borrowers including that borrowers who are classified "refer" will be processed through manual underwriting. For the TOTAL Scorecard to provide the intended benefits of accurate assessment, FHA mortgagees must abide by the terms and conditions for use. Also, FHA mortgagees may not disassemble, decompile, reverse engineer, derive or otherwise reproduce any part of the source code or algorithm in the TOTAL Scorecard. Such tampering may render the TOTAL Scorecard inaccurate and unusable.

IV. Findings and Certifications

Paperwork Reduction Act

The proposed new information collection requirements contained in § 203.255(b)(5) have been submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). Under this 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 valid control number.

The public reporting burden for this new collection of information is estimated to include the time for reviewing the instructions, searching

existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the

estimated public reporting burden is provided in the following table:

Information collection	Number of respondents	Responses per respondent	Total annual responses	Hours per response	Total hours
	6,000	1	6,000	1	6,000

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning the proposed collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received by January 20, 2004. Comments must refer to the proposal by name and docket number (FR-4835-I-01) and must be sent to:

Lauren Wittenberg, HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503-0009, Lauren.Wittenberg@omb.eop.gov, and Gloria Diggs, Reports Liaison Officer, Office of the Assistant Secretary for Housing-Federal Housing Commissioner, Room 9116, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000.

Environmental Review

A Finding of No Significant Impact with respect to the environment for this rule 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, SW., Washington, DC 20410-0500.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This interim rule does not impose a federal mandate that will result in expenditure by state, local, or tribal governments, within the meaning of the Unfunded Mandates Reform Act of 1995.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. The rule governs access to, and use of, an automated, electronic tool to assist mortgagees in managing workflow and expediting the endorsement process. There are no anti-competitive discriminatory aspects of the rule with regard to small entities, and there are not any unusual procedures that would need to be complied with by small entities. Although HUD has determined that this interim rule would not have a significant economic impact on a substantial number of small entities, HUD welcomes 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 (1) imposes substantial direct compliance costs on state and local governments and is not required by statute, or (2) the rule preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This interim rule

would 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.

Executive Order 12866, 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 economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the interim rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the Regulations Division, Office of the General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-0500.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance Numbers for 24 CFR part 203 are 14.117 and 14.133.

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 described 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 24 CFR part 203 continues to read as follows:

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

■ 2. Amend § 203.251 by adding paragraph (t) to read as follows:

§ 203.251 Definitions.

* * * * *

(t) *TOTAL* is an acronym that stands for "Technology Open To Approved Lenders." *TOTAL* is a mortgage scorecard based on a mathematical equation that is to be used within an automated underwriting system (AUS). *TOTAL* is a tool to assist the mortgagee in managing its workflow and expediting the endorsement process, and is not a substitute for the mortgagee's reasonable consideration of risk and credit worthiness. Direct Endorsement mortgagees using *TOTAL* remain solely responsible for the underwriting decision.

■ 3. Amend § 203.255 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 incorporates each of the underwriter certification items that 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 the *TOTAL* Mortgage Scorecard is used by the mortgagee, and the *TOTAL* Mortgage Scorecard 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 the underwriter has personally reviewed the credit application (including the analysis performed on any worksheets). The following requirements are also

applicable to the use of the *TOTAL* Mortgage Scorecard:

(i) Mortgagees and vendors must certify to compliance with these requirements:

(A) *Permissible users.* Only FHA-approved automatic underwriting systems (AUSs) developed, operated, owned, or used by FHA-approved Direct Endorsement mortgages, Fannie Mae, or Freddie Mac, may access *TOTAL*, and only FHA-approved mortgagees will be able to obtain risk-assessments using *TOTAL*;

(B) *Limitation on use.* Results from *TOTAL* must not be used as the basis for rejecting any mortgage applicant. Mortgagees must provide full manual underwriting for mortgage applicants when *TOTAL* returns a "refer" risk score.

(C) *Vendor and mortgagee requirements.* Both mortgagees and vendors must:

(1) Use *TOTAL* to process FHA and other loan products specified by the FHA Commissioner only and for no other purpose;

(2) Implement quality control procedures for *TOTAL* usage and provide, at FHA's request, reports and loan samples that enable FHA to evaluate program operation;

(3) Not use *TOTAL* to direct mortgagors into other non-FHA product offerings (this requirement does not relieve a mortgagee from its obligations under § 203.10 concerning informed consumer choice for prospective FHA mortgagors);

(4) Not disassemble, decompile, reverse engineer, derive or otherwise reproduce any part of the source code or algorithm in *TOTAL*;

(5) Not provide feedback messages that conflict with the Equal Credit Opportunity Act; and

(6) Comply with any additional HUD/FHA requirements or procedures that are applicable to the Scorecard and may be issued through handbooks, mortgagee letters, *TOTAL* User Guides, or *TOTAL* Developers Guide following appropriate advance notification, where applicable.

(ii) *Loss of privilege to use TOTAL.* Mortgagees and AUS vendors found to violate the requirements applicable to the use of *TOTAL* may have their access to *TOTAL* and all associated privileges terminated upon appropriate notice in accordance with the following procedure:

(A) *Notice.* HUD will provide a mortgagee or vendor with a 30-day notice of a violation and loss of privilege. The notice will state the nature of the violation, the effective date of the loss of the privilege, and the duration of the loss of the privilege. The notice will become effective on the date provided in the notice, unless the mortgagee or vendor appeals the violation and loss of privilege in accordance with paragraph (b)(5)(ii)(B) of this section.

(B) *Appeal.* A party receiving a notice of violation may appeal to the Deputy Assistant Secretary for Single Family Housing (DAS-SFH), or his or her designee, before the effective date of the notice by providing evidence to refute the violation. The loss of privilege is stayed until the DAS-SFH, or designee, notifies the party that the loss of privilege has been affirmed, rescinded, or modified.

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Dated: October 29, 2003.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

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