

January 28, 2022

Lopa Kolluri, Principal Deputy Assistant Secretary for Housing
Office of Housing / Federal Housing Administration
Department of Housing and Urban Development
451 7th Street SW
Washington, D.C. 20410-8000

RE: Joint Comment to FHA's Defect Taxonomy of the Single Family Housing Policy Handbook 4000.1 (Handbook 4000.1)

Dear Ms. Kolluri:

On behalf of the industries, clients, and communities we represent, we write to comment on HUD's proposed defect taxonomy for loan servicing reviews. This joint industry-consumer comment supplements our organizations' individual comments and sets out essential principles we see as vital in the creation of any defect taxonomy.

We appreciate HUD's work on developing a servicing defect taxonomy because we think an effective one can be a critical tool in clarifying HUD's expectations to servicers and thereby improving borrower outcomes. As described below, however, we believe that HUD's proposed taxonomy lacks sufficient detail needed to be effective, and we would greatly appreciate the opportunity to meet with HUD to discuss the proposal before any further action is taken.

HUD's defect taxonomy should provide detail to stakeholders about HUD's priorities and its expectations for servicer performance. Specifically, a successful taxonomy should:

- 1) Classify which violations of HUD policies are most severe and which are not;
- 2) Assess severity based on the level of concrete harm the conduct poses to borrowers and FHA;
- 3) Assign a range of appropriate remedies for each specific violation;
- 4) State the aggravating and mitigating factors that HUD will consider in determining the particular remedy and the process for how HUD will consider these factors; and
- 5) Describe how HUD will address systemic issues identified in the evaluation process.

A defect taxonomy satisfying these criteria will promote HUD's program and policy goals. It will facilitate compliance because servicers will use it to enhance their own quality control process. By promoting fairness and predictability, it will reduce FHA servicing costs and will help retain existing lenders and encourage new lenders to participate in the FHA program. It will ensure for all stakeholders that HUD's review process is focused on significant issues that support sustainable homeownership and the health of the MMI fund and not more minor violations.

The version of the taxonomy that was published by FHA on October 28th does not meet these essential criteria for a successful taxonomy. Outside of fraud or misrepresentation, which are

specifically addressed, the taxonomy does not provide insight into HUD's servicing policy priorities through the categorization of particular violations by severity. It instead provides broad statements of what conduct is unacceptable without detailing how the agency considers each issue. In addition, in those broad statements, HUD specifically fails to mention borrower harm and only focuses on harm to the property and FHA.

The proposed taxonomy also does not state the range of remedies available for a particular violation. Instead, HUD indicates that all remedies are available for any violation without giving any guidance on how the agency will employ particular remedies. The taxonomy states that a servicer may mitigate a defect finding through documentation; however, because the taxonomy lacks detail on the connection between violations and remedies, the precise role of mitigating and aggravating factors is also unclear. Finally, there is no discussion of how HUD will address systemic defects revealed through the use of the taxonomy.

In addition, the draft taxonomy does not provide detail about how HUD will apply it. It does not state whether reviews will take place post-claim, pre-claim, or under both time frames. HUD also does not define critical terms, such as "defect," "materiality," and "adverse impact."

The proposal appears designed for review of documentation in loan origination files and does not account for important differences between loan origination and servicing functions. Servicers, for example, are engaged in long-term relationships with many thousands of borrowers at one time. A severity assessment must differentiate between those defects that have an ongoing impact on multiple borrowers and those that reflect isolated errors with no material impact on borrowers.

Because HUD's draft defect taxonomy lacks sufficient criteria for it to be successful, HUD should not finalize it and should instead further engage with stakeholders in connection with developing a more detailed draft. We request that HUD meet with us, collectively or individually, so that we can better understand HUD's proposal and the policy goals that HUD seeks to achieve. This meeting would clarify a number of specific questions that we have regarding the structure of HUD's oversight of FHA servicers. Through an engagement process, stakeholders can discuss with HUD recommendations for how it should prioritize violations and assess remedies and HUD can incorporate feedback in creating a more detailed and comprehensive taxonomy.

We look forward to further dialogue regarding the taxonomy, and we appreciate the opportunity to comment on the draft.

Sincerely,

American Bankers Association
Americans for Financial Reform Education Fund
Center for Responsible Lending
Consumer Action

Housing Policy Council

National Consumer Law Center (on behalf of its low-income clients)

National Fair Housing Alliance

National Housing Conference

National Housing Law Project