



FDIC Loan Modification Program

A message from FDIC Chairman Sheila Bair

I have long supported a systematic and streamlined approach to loan modifications that puts borrowers into affordable, long-term mortgages while achieving an improved return for bankers and investors compared to foreclosure. Using this type of approach, we can help stabilize the U.S. financial markets by minimizing foreclosures on the 6.4 million loans that are currently past due or are projected to become delinquent by mid-2010. Avoiding foreclosure, when it is financially prudent to do so, reduces the downward pressure on the price of nearby homes and helps communities to maintain the services they provide to neighborhoods. Unnecessary foreclosures perpetuate the cycle of financial distress and risk aversion, which potentially could cause housing prices to overcorrect and create even larger losses for both borrowers and the financial industry.



*Chairman Sheila C. Bair
Federal Deposit Insurance Corporation*

At IndyMac Federal Bank, the FDIC initiated a systematic and streamlined loan modification program for delinquent borrowers who occupy their home. These distressed mortgages are being rehabilitated into performing loans while avoiding unnecessary and costly foreclosures. By achieving mortgage payments for borrowers that are both affordable and sustainable, we expect to reduce future defaults, improve the value of the underlying mortgages, and cut servicing costs. This approach makes good business sense and creates a 'win-win' solution for everyone. I strongly encourage bankers, servicers, and investors to implement systematic and streamlined loan modifications that result in monthly mortgage payments that borrowers can afford over the long term.

To assist bankers, servicers, and investors in this process, this guide provides an overview of the FDIC's loan modification program. It outlines our program terms at IndyMac Federal Bank, offers insight into the specific portfolio characteristics that drive modification modeling at that bank, and provides a framework for developing and implementing a similar program at your institution. While the final program each of you implements will be based on the characteristics specific to your respective portfolios, I am confident that the value of such a program will benefit both your institution and your investors while helping many troubled borrowers remain in their homes. Your support in this industry-wide effort will help avoid unnecessary foreclosures and bring stability to the housing and mortgage markets during this time of unprecedented economic turmoil.

Sincerely,

Sheila Bair

Loan Modification



As indicated in the summary table below, the FDIC’s Loan Modification Program is primarily based on two principals:

- 1) Determining a payment the borrower can afford by multiplying the borrower’s gross monthly income times the appropriate housing-to-income (HTI) ratio, less taxes and insurance to achieve a minimum payment reduction of 10 percent, and
- 2) Protecting investors’ interests by requiring that the cost of the modification is less than the estimated cost of foreclosure (the Net Present Value (NPV) floor).

FDIC Loan Modification Program		
	Strategy	Process
Borrower Affordability Determination	<ul style="list-style-type: none"> ▪ Offer proactive workout solutions designed to address borrowers who have the willingness but limited capacity to pay. 	<ul style="list-style-type: none"> ▪ Return the loan to a current status. ▪ Capitalize delinquent interest and escrow. ▪ Modify the loan terms based on waterfalls, starting at a front-end 38 percent HTI ratio down to a 31 percent HTI ratio, subject to a formal NPV floor. ▪ Reduce interest rate to as low as 3 percent. ▪ Extend, if necessary, the amortization and/or term of the loan to 40 years. ▪ Forbear principal if necessary.
	<ul style="list-style-type: none"> ▪ Provide borrowers the opportunity to stay in their home while making an affordable payment for the life of the loan. 	<ul style="list-style-type: none"> ▪ Require the borrower to make one payment at the time of the modification. ▪ Cap the interest rate at the Freddie Mac Weekly Survey rate effective at the time of the modification. ▪ Lower the interest rate as required to meet the target HTI ratio, fixing the adjusted rate and monthly payment amount for 5 years. ▪ Step up the initial interest rate gradually starting in year 6 by increasing it one percentage point each year until reaching the Freddie Mac Weekly Survey rate cap.
Investor Protection Via NPV Tool	<ul style="list-style-type: none"> ▪ Use a financial model with supportable assumptions to ensure investor interests are protected. 	<ul style="list-style-type: none"> ▪ Input borrower specific income information into the NPV Tool, which provides a real-time workout solution. ▪ Perform automated loan level underwriting across large segments of the portfolio to support pre-approved bulk mailings. ▪ Verify income information the borrower provided via check stubs, tax returns, and/or bank statements. ▪ Compare the cost of the modified concessions to the estimated cost of foreclosure to mitigate losses. ▪ Mandate that the cost of the modification must be less than the estimated foreclosure loss.

Overview



I. Philosophy

Modification improves the value of distressed mortgages by achieving long-term sustainable cash flows for lenders and investors that exceed the value achievable through foreclosure.

Modification provides an affordable payment and eliminates payment shock for the life of the loan.

Modification minimizes loss to the investor.

II. Program

Affordable payment is achieved through interest rate reduction, amortization term extension, and/or principal forbearance.

Net present value (NPV) test confirms modification minimizes loss to the investor.

III. Process

Program uses a scalable process which can be applied across a broad range of investors.

Streamlined process provides custom modification offers and minimal borrower paperwork.

IV. Promotion

Inclusion of customized modified payment amounts in bulk mailings significantly increases customer response and completed modifications. For bulk modification offer mailings, the initial letter includes a pre-approved modification offer with the modified payment amount.

The program uses a combination of existing origination/sales marketing to contact borrowers via direct mail and innovative point of sale approach via the call center. Call center staff have the capability to gather financial information and make a modification offer during the initial call.

This document provides a framework for establishing and implementing these standards.

I. Philosophy

Key objectives

- Keep borrowers in their homes when the borrower is willing and has the capacity to make an affordable mortgage payment.
- Provide borrowers with immediate payment relief and stable long term mortgage payments.
- Modification must always result in a positive NPV outcome for the investor, *i.e.*, the cost of the modification must be less than the estimated cost of foreclosure.

Determine what type of modification is most appropriate

The FDIC Loan Modification Program targets distressed borrowers who are currently having financial difficulty with the scheduled mortgage payment, but have the capacity to make a loan payment. It uses a streamlined approach to identify modification candidates and to provide a customized modification offer when the modification minimizes loss. If a borrower does not qualify for a streamlined modification, an individual loan review may result in a personalized modification that still maximizes value.

This approach is just one of many loss mitigation strategies that a prudent servicer must consider when dealing with a distressed borrower. Refinance is an alternative as well as traditional loss mitigation practices such as repayment plans. However, many borrowers are unable to refinance their loans in the current economic environment and repayment plans typically do not provide long- term solutions to borrowers' financial problems. In cases where the borrower cannot afford the lowest payment allowed by the NPV Tool, a short sale or deed-in-lieu of foreclosure with "cash for keys" assistance are preferred methods to avoid foreclosure.

Immediate relief and long term stability

Loan modification will result in a "life of loan" solution by capping interest rates at current market rates, requiring immediate principal amortization, and setting an initial interest rate subsidy to provide immediate relief. A predictable payment schedule after the fifth year will step the initial interest rate up to the market rate. Modification replaces adjustable-rate and interest-only mortgages with stable rate loans, and eliminates the possibility of future negative amortization.

Philosophy



Minimizes Losses on Distressed Mortgages

Once the borrower-specific modification is determined, the servicer must perform a valuation test between the cost of modification and the estimated cost of foreclosure to ensure modification results in a lower cost to the investor. By providing a transparent valuation comparing the cost of the modification and the estimated cost of foreclosure, the servicer fulfills the terms of most servicing agreements.

Program



II. Program

Key objectives

- Systematic determination of borrower specific modification terms using a standardized NPV test to minimize losses on distressed mortgages.
- Target distressed borrowers. Modifications may be available for loans that are at least 60 days delinquent or where default is reasonably foreseeable.¹
- Implement modification program that can be used across a broad range of investors.

Step 1: Determine Eligibility

Servicers typically manage loans for other investors, including Government Sponsored Enterprises (GSEs), private investors owning securities collateralized by the mortgages, and whole loan investors. Each investor type has different standards for approving loan modification. The GSEs have authorized loss mitigation programs for seriously delinquent loans, however some loans owned by the GSEs may be modified based on eligibility standards similar to those used for private investors. The GSEs recently announced the adoption of more streamlined modification plans that apply many of the features of the FDIC Loan Modification Program model.

Loans serviced for private investors are governed by servicing contracts which often contain a standard clause allowing the servicer to modify seriously delinquent or defaulted mortgages, or mortgages where default is “reasonably foreseeable”.² This even holds true for complex private label securitizations with many tranches and investors.

Loans subject to these contracts are typically eligible for modification given:

- The loan is at least 60 days delinquent where the loan is considered one day delinquent on the day following the next payment due date.
- Foreclosure sale is not imminent and the borrower is currently not in bankruptcy, or has not been discharged from Chapter 7 bankruptcy since the loan was originated.
- The loan was not originated as a second home or an investment property.

Loans sold whole to individual investors often require a case-by-case approach. These loans are subject to both servicing and securitization contracts. The Appendix contains guidelines on how to evaluate whole loan servicing agreements.

¹ Due to contractual restrictions in IndyMac’s pooling and servicing agreements, IndyMac Federal Bank has not modified securitized loans where default is reasonably foreseeable. Most other agreements do allow modification of such loans.

² See the [*American Securitization Forum’s Streamlined Foreclosure and Loss Avoidance Framework for Securitized Mortgage Loans*](#), Issued Dec. 6, 2007 and revised July 8, 2008.

Program (Continued)



Step 2: Calculate an “Affordable” Payment

In order to calculate an affordable payment, recent financial income information must be available for the borrower. Efforts to contact the borrower via special mailings, calling campaigns, email, and other outreach methods are used.

The FDIC Loan Modification Program calculates the modified principal, interest, taxes, and insurance (PITI) payment per a borrower specific HTI ratio of no more than 38 percent. Housing expenses on a PITI basis may include:

- The modified principal and interest payment for the subject loan, as applicable,
- Real estate taxes,
- Property hazard, flood, and mortgage insurance premiums,
- Leasehold estate payments, and
- Homeowners’ association (HOA) dues.

Industry standards set forth by certain FHA lending programs indicate a mortgage payment based on a 31 percent to 38 percent HTI ratio is affordable. The FDIC Loan Modification Program follows these origination standards as illustrated below.

Example of HTI ratio calculation

Monthly Gross Income
\$3,618 - Borrower 1
\$2,756 - Borrower 2
\$6,374 - Total Monthly Gross Income

PITI Payment Determination
\$6,374 x **38%** = \$2,422

Monthly Housing Expense
\$2,422 - Maximum Total Monthly Housing Expense
\$ - 364 - Taxes, hazard, flood, and mortgage insurance, etc.
\$ - 85 - HOA dues
\$1,973 - Maximum modified principal and interest payment

Total HTI Ratio
\$2,422 / \$6,374 = **38%**

Program (Continued)



If the initial modification calculation at 38 percent does not decrease the borrower's payment by 10 percent or more, the HTI ratio is lowered to 35 percent and then lowered to 31 percent to achieve the 10 percent savings. In cases where a 10 percent reduction can not be achieved, the 31 percent HTI ratio is used for affordability.

Step 3: Determine the “Total Debt” by capitalizing certain costs in the unpaid principal balance

- Delinquent interest, taxes, and insurance escrows and
- Third party fees such as foreclosure attorney or trustee fees and property preservation costs.

Step 4: Solve for “Affordable Payment” through a three step waterfall process

- 1) **Interest Rate Reduction:** Cap the life-of-loan interest rate at the Freddie Mac Weekly Survey rate as of the week of the modification offer, then reduce the interest rate incrementally to as low as 3 percent to achieve the “affordable” payment per the adjusted unpaid principal balance (UPB) and remaining amortization term. An interest rate floor of 3 percent will enable the borrower to maintain approximately a 38 percent HTI ratio throughout the life of the loan, assuming modest borrower earnings growth commensurate with the inflation rate. The reduced rate remains in effect for 5 years. After this period, the interest rate increases by not more than one percent annually until the Freddie Mac Weekly Survey rate is achieved. If the “affordable” modified PITI payment amount has not been achieved, proceed to the next step.
- 2) **Extend Amortization Term:** For loans with an original term of 30 years, re-amortize the adjusted UPB at the reduced interest rate (3 percent floor) over an extended amortization term of 40 years from the original first payment date. For securitized loans, the amortization will be extended to 40 years from the original first payment date, but the maturity date will not change, resulting in a balloon payment. For loans with an original term of less than 30 years, extend the amortization period for only 10 years. If the modified PITI payment amount has not been achieved, proceed to the next step.
- 3) **Partial Principal Forbearance:** Reduce the adjusted UPB for amortization purposes and amortize over a 40 year period at the reduced interest rate (3 percent floor). This process splits the debt into an interest-bearing, amortizing portion and a zero percent, zero payment portion of the loan. The repayment of the “postponed” principal will be due when the loan is paid in full. For loans within securitizations, this principal forbearance should be passed as a write-off of principal to the trust, with any future collections at time of pay-off submitted to the trust as a recovery.

Program (Continued)



Step 5: Apply the NPV Tool

Run the modified loans through the NPV Tool in order to ensure that the modified payment creates a positive economic scenario for the investor.

Step 6: Market via systematic “bulk” approach

A bulk modification model processes large segments of delinquent loans with recent borrower financial information on file. The model performs automated loan-level underwriting based on the existing loan terms and recent financial information obtained from the customer, which is verified prior to completing the modification. The bulk modification process establishes modification eligibility and modification terms as detailed in the previous steps, then uses a traditional marketing approach to provide the borrower with an easy to follow, pre-populated modification offer. The marketing materials also instruct the borrower to either contact the servicer with questions or just send in the signed documents and the first payment to complete the modification offer. The modification offer explicitly states the amount of the borrower’s new monthly principal and interest payment as follows:

Reduce your monthly payment of principal and interest to \$x,xxx.xx and bring your loan current!

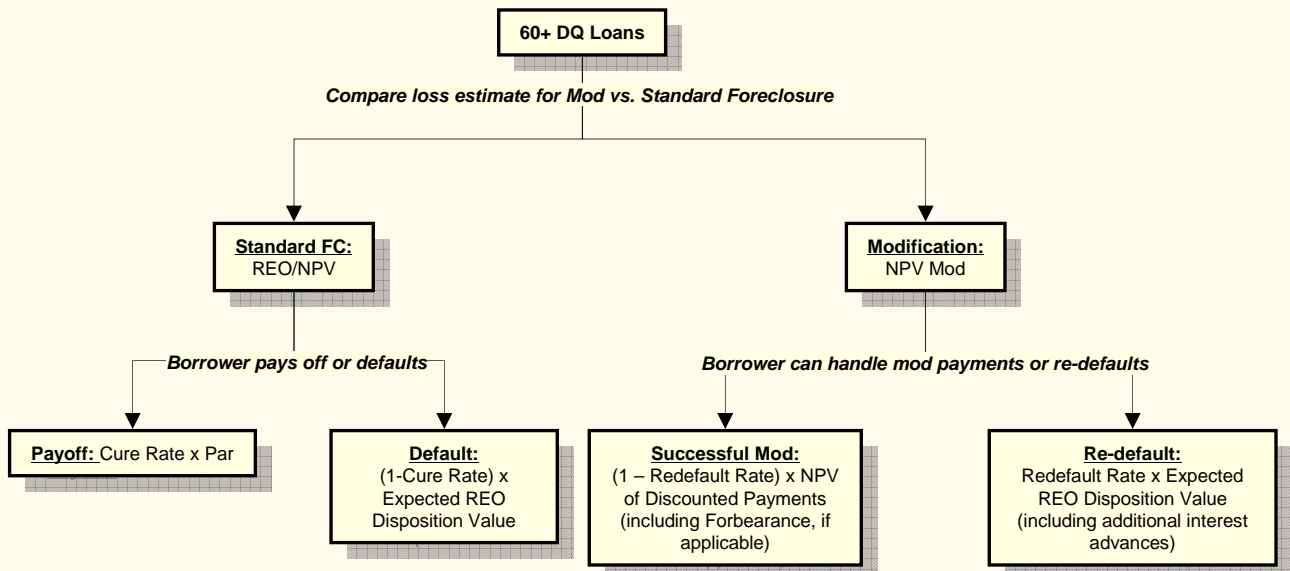
While some borrowers may appear to have the capacity to pay, their ability to do so may be inhibited by other debt obligations. Bankers and servicers should consider establishing relationships with community groups willing to contact and provide credit counseling to these borrowers. Entering into compensation agreements with local non-profit organizations with HUD-approved counselors also may assist in contacting borrowers, obtaining the requisite financial information, and completing the modification. Compensation should be based on a borrower contact and modification completion. For example, IndyMac Federal Bank pays participating community groups \$150 for borrower contact and counseling services, and an additional \$350 once the loan modification is completed. A copy of a counseling compensation agreement is provided in the Appendix.

NPV Test



NPV Test

Once the modification terms are established, the impact of the modification concessions to the investor are compared to the estimated loss given foreclosure. If the modification is less costly than foreclosure, it is approved. This test ensures that modifications mitigate the loss for investors. This diagram illustrates the NPV test:



NPV Test



➤ **The formula used to estimate the cost of foreclosure is:**

$$\text{Loan Value} = \text{Cure Rate} * \text{Par} + (1 - \text{Cure Rate}) * \text{Expected REO Disposition Value}$$

Description of the formula terms:

- **Cure rate** is based on recent industry or servicer data. It is based on a combination of delinquency status, combined loan-to-value (LTV), FICO and original income documentation. A 12 month cure period is used.
- **Expected REO Disposition Value:**

$$\text{Liquidation value} - \text{Interest Adv/Accrual} - \text{Corporate Advances} - \text{Escrow Advances} - \text{Future Cost to Collect} + \text{MI Recovery}$$

➤ **Liquidation Value:**

$$\text{Forecasted Liquidation Value of property at REO} = \text{Current Property Value} * (1 - \text{Forecasted Depreciation} - \text{“REO Stigma” Discount} - \text{Selling Costs})$$

- **Forecasted Depreciation** is based on an industry standard such as Moody’s Economy.com metropolitan statistical area (MSA) level data. Depreciation timeline is one year in the future or case-specific.
- **Current Property Value** is determined by an interior appraisal, Broker Price Opinion (BPO), Automated Valuation Model (AVM), or original appraisal value adjusted by MSA level home price change to date. This value is then adjusted by forecasted MSA level home price changes.
- **REO Stigma Discount** reflects differences in experienced liquidation values versus estimated property values.
- **Selling Costs** include 10 percent for broker commission, potential repairs and maintenance costs.
- **Interest Advances/Accruals** includes delinquent interest advanced (securitized/sold loans) or accrued (owned loans).
- **Corporate Advances** include non-escrow advances already made on the borrowers behalf.
- **Escrow Advances** already made on the borrowers behalf.
- **Future Cost to Collect** is an estimate of future interest accruals, T&I payments, and FC expenses.
- **MI Recovery (if applicable)** is estimated based on MI coverage percentage adjusted for possible MI claim denial.

NPV Test (Continued)



- **The formula used to estimate the cost of modification is:**

$$\text{Loan Value} = (1 - \text{Redeferal Rate}) \times \text{NPV of Discounted Payments} + \text{Redeferal Rate} \times (\text{REO Disposition Value} + \text{Additional Accrued Costs})$$

Description of the formula terms:

- **Re-default rate** is estimated per historical re-default experience for other modification programs and a program specific projection.
- **NPV of discounted payments** is the net present value of the adjusted UPB (cash outflow) and the modified payment stream (cash inflow) discounted at the Freddie Mac Weekly Survey rate as of the week of the modification offer. An NPV example is provided in the Appendix.
- **REO disposition value** (see above).
- **Additional costs** include 9 additional months of accrued interest, taxes, and insurance payments plus additional forecasted home price depreciation, as applicable.³

³ Currently, the Case-Shiller forecast provided by Moody's Economy.com projects that home prices will reach their trough in about one year from today, which also is equivalent to the base case timetable for REO disposition in the NPV Tool. This means that delaying foreclosure will not lead to further home price declines at REO disposition for most geographical areas.

NPV Test (Continued)



In Addition to Updated Liquidation Value, a Servicer must Formally Backtest Servicer and/or Portfolio Specific Assumptions and Regularly Update Assumptions Based on Industry Standards

1. **Forecasted Depreciation** (industry standard)
 - Updated monthly to incorporate latest home price data.
2. **Cure Rates** (servicer and/or portfolio specific)
 - Updated quarterly and based on 12 month history (to adjust for current credit environment). Suggested cure factors include the current delinquency status of the loan, combined LTV, borrower FICO, and original income documentation.
3. **REO Stigma** (servicer and/or portfolio specific)
 - Updated monthly to incorporate latest experience by region.
4. **Re-default Rate** (servicer and/or portfolio specific)
 - Based on past re-default experience for other modification programs and a program specific projection. The servicer should carefully monitor and incorporate the program's actual re-default rate.
5. **Discount Rate** (both industry standard and servicer and/or portfolio specific)
 - Freddie Mac Weekly Survey rate as of the week of the modification offer is used to discount the modified payment cashflow. A required return methodology is used to discount the estimated foreclosure value.
6. **Prepayment rate** (servicer and/or portfolio specific)
 - The model assumes a voluntary prepayment rate of zero.

III. Process

Key Objectives

- Leverage large scale modification offer/delivery process.
- Give collections and loss mitigation staff the ability to offer tailored solutions based on borrower need, willingness and ability to pay, balanced with investor guidelines and a formal NPV test.
- Streamline paperwork and income verification process.
- Establish a protocol for community group referrals.

Once eligibility is established, the loan modification offer is based on the borrowers income information. For borrowers with recent income information on file, a firm offer may be extended, contingent on income verification. However, verified income may be different from that on file and tolerance for some variation should be established. For borrowers with no recent income information on file, a conditional offer may be extended, contingent on income verification. This type of offer should use a more rigorous verification process requiring both tax returns and recent pay stub information.

For both firm and conditional modification offers, the key to program success is a scalable offer delivery process, which immediately provides the borrower with modification terms and instructions.

Offer/Delivery process – Two-Tiered Approach:

- 1. Bulk Approach:** Loans processed through the bulk modification process are sent a pre-approved offer with pre-populated modification documents, income verification forms and informational material. This modification package provides the borrower with a custom modification offer and instructions to complete the modification with a quick one-touch close. Modification paperwork is handled via an automated process. The modification agreement is pre-populated and the loans are pre-qualified; as a result, the operations process is simplified to collecting the modification agreements, verifying income documentation, and completing system updates to ensure the borrower receives modified terms on the next statement.
- 2. Point of Sale Approach:** Use of traditional inbound and outbound customer service and collection staff should allow borrowers to obtain fast and customized solutions. Loss mitigation staff require access to a modification tool which allows the collector to discuss all viable workout options before proceeding with an offer. For example, a delinquent borrower calls collections and is unable to afford the current mortgage payment. The collector enters the borrower's information into a desktop tool which immediately provides the collector with possible workout solutions such as modification, short sale, and cash for keys programs. If the modification is NPV positive, the collector informs the borrower of modification eligibility, collects the first modified payment, updates the system, and either generates the modification documents from the system, or includes borrower in the next bulk mailing.

One of the Benefits: Saying “Yes” to the borrower and providing the reduced modified payment amount motivates the borrower to finish submitting the final documentation needed to complete the modification. Once the borrower verbally accepts the modified payment, the collector initiates a 60-day payment plan at the new amount and takes the paperwork off the foreclosure path. When the documents are received and income is verified, modification changes are processed permanently in the system.

Community group referrals should be prioritized through a dedicated hotline and email address. Groups with a relationship with the servicer should be trained on the specific information required to complete the modification. This provides another venue to streamline the paperwork processing.

Process (Continued)



Income Verification

Income verification minimizes re-default and ensures the affordability standard is uniformly implemented.

The gross monthly income for all borrowers who have signed the mortgage note must be supported by either last years tax returns or recent pay stubs. A dedicated underwriting group reconciles verbal financial information on file to documented income.

IV. Promotion

Key objectives

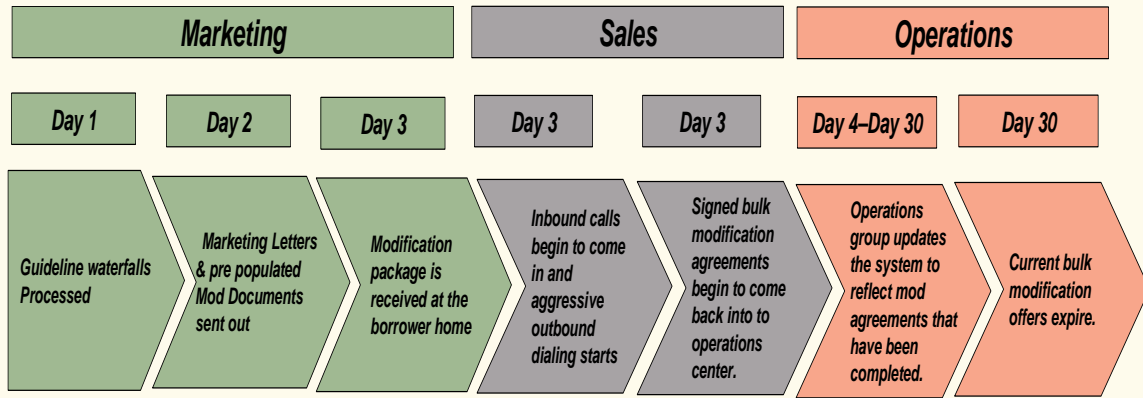
- Stimulate response and acceptance rates for all borrowers, including those who have not made recent contact with the servicing group.
- Leverage community group resources to contact unresponsive borrowers and to provide financial counseling.
- Establish reporting procedures to track program effectiveness.

The modification offer is sent to borrowers using either priority or overnight mail to stimulate open rates for all borrowers, particularly those who have not made recent contact with the servicing group. The offer is designed to have the look and feel of a traditional origination/sales marketing letter with the additional aspect of a pre-approved modification offer and a simple pre-populated agreement. This allows the borrower to complete the agreement without having to call the servicing group. See the Appendix for examples of marketing materials and the simplified loan modification documents.

Inbound and outbound call efforts are designed around a sales approach, not a traditional collections approach, to ease borrowers' concerns about foreclosure. The servicer should promote a "No borrower left behind" mentality, which gives even no contact customers an offer that can be completed without needing to call. Campaigns are supported by a dedicated "direct to consumer" marketing team.

Community groups are a valuable resource and the servicer should integrate national and local groups into the modification process. These groups can be contracted for outbound calling to unresponsive modification candidates and financial counseling for distressed borrowers. The modification offer may also offer an incentive for borrowers to seek financial counseling through these groups. A sample contract and compensation structure is included in the Appendix.

Promotion (Continued)



Modification Reporting

Accurate and up to date data on the loan modification program requires an integrated servicing platform and business unit. Internal and external reporting needs include:

Internal

- Responsiveness to modification campaigns: establish specific phone lines for each modification campaign, track inbound and outbound calling and contact rates.
- Process effectiveness: create one servicing template for all modifications which requires the loss mitigation staff to track all contact made with the borrower. The servicer should analyze timelines for mailing to borrower contact, contact to document return, and document return to modification completion.
- Delinquency and re-default rate: success is measured by performance following modification. These metrics are also important to the NPV Tool model.

External

- Investors require detailed modification tracking. This enhances program credibility and proves that modification is the least cost strategy. A sample investor reporting template is found in the Appendix.