Federal Deposit Insurance Corporation
Division of Resolutions and Receiverships
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Risk Sharing Asset Management
Guidance RSAM-2010-006

To: **Acquiring Institutions under Share Loss Agreements and LLC Servicers under LLC Servicing Agreements**

From: **Loss Mitigation Advisory Group ("LMAG")**
Risk Sharing Asset Management ("RSAM")

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Subject: **Share Loss Agreements and LLC Servicing Agreements Guidance**

Summary: FDIC Loan Modification Guidance Single Family Residential (SFR) Loans.

Highlights:

- This document is intended to clarify the Program and provide AIs and Servicers with guidance on the FDIC's expectations for loan modification documentation which will be examined during compliance reviews.
- Introduction of the FDIC Loan Modification Program.
- Loan Modification Program Solicitation and Eligibility.
- Underwriting.
- Best practices and Additional Requirements
- Compliance with Applicable Laws.
- Alternative Modification Programs.
- Resources.

Contact: Acquiring Institutions should contact their Loss Share Specialist with any questions regarding this Guidance.

FDIC
Federal Deposit Insurance Corporation

Loan Modification Guide

FDIC Loan Modification Program Guidance
Single Family Residential (SFR) Loans
Guidance RSAM-2010-006

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1.0 Introduction of the FDIC Loan Modification Program

The Single Family Shared-Loss Agreements ("SLA") and LLC Servicing Agreements (the "Agreement" or "Agreements") require the Assuming Institutions to implement a loan modification program. According to the terms of the applicable Agreement, the Assuming Institutions ("AIs") and Servicers may choose to implement the FDIC Mortgage Loan Modification Program, set forth in Exhibit 5 of the SLA or Exhibit C of the LLC Servicing Agreement, or the Treasury's Home Affordable Modification Program ("HAMP"), (collectively the "Program" or "Programs").[1] Both Programs specify a uniform loan modification process designed to reduce a distressed borrower's monthly mortgage payment to a sustainable monthly payment if the modification maximizes the value of the loan. This document is intended to clarify the Program and provide AIs and Servicers with guidance on the FDIC's expectations for loan modification documentation which will be examined during compliance reviews.

This guidance is for informational purposes only. The FDIC reserves the right to change or amend any section of this guidebook and will provide periodic updates as the Program evolves.

AIs and Servicers shall submit a plan for the implementation of either program (HAMP or FDIC) to the FDIC no later than 30 days after the effective date of the applicable Agreement. AIs and Servicers are expected to implement the loan modification program selected (either HAMP or FDIC) within 90 days of the effective date of the applicable Agreement. If the AI wishes to utilize alternate loan modification programs in lieu of the HAMP or FDIC Programs, documentation of the alternative program's policies and valuation procedures must be submitted to the assigned FDIC Account Specialist for approval before implementation.

This Guide covers the following topics:

2.0 Loan Modification Program Solicitation and Eligibility

3.0 Underwriting

4.0 Best Practices and Additional Requirements

5.0 Compliance with Applicable Laws

6.0 Alternative Modification Programs

Resources

1.1 Purpose

The objective of the Programs is to encourage AIs and Servicers to modify existing terms of certain residential mortgage loans to improve borrower affordability, increase the probability of loan performance, allow borrowers to remain in their homes and increase the value of the loans

[1] Additional information on HAMP can be found at: www.hmpadmin.com.

to the FDIC and its assignees. The Programs provide for the modification of Qualifying Loans (as defined below) by reducing the borrower's monthly housing debt to income ratio ("DTI Ratio") to 31% at the time of the modification.

2.0 Loan Modification Program Solicitation and Eligibility

2.1 Borrower Solicitation

When soliciting borrowers for modification, use appropriate care to ensure that modification materials comply with state, local, and federal regulations.

The FDIC expects the AIs and Servicers to provide borrowers with information designed to help them understand the modification terms that are being offered and the modification process. Such communication should help minimize potential borrower confusion, foster good customer relations, improve legal compliance, and reduce other risks in connection with the transaction. The FDIC receives frequent congressional, local municipality, and advocacy group correspondence. This correspondence is tracked and monitored by the FDIC. Establishing a strong outreach and communication approach to modification activities will minimize disruptions for all parties to the Agreements.

AIs and Servicers should maintain adequate staffing, resources, and facilities for implementing and maintaining the Programs. This requires a system for responding to inquiries and complaints about the Program and a standard procedure for informing interested borrowers, if applicable, of the basis for the determination of their ineligibility for the Programs, and suggesting possible alternative programs. **AIs and Servicers should not indicate to the borrowers in any way that the FDIC is responsible for the determination they are ineligible for the Program. Furthermore, failure to manage the loans in accordance with the applicable Agreement may be grounds for terminating SLA coverage.**

Inclusion of customized modified payment amounts in bulk mailings significantly increases customer response and completed modifications. Please see the 'Mod in a Box' Website (http://www.fdic.gov/consumers/loans/loanmod/appendix.pdf) for information on bulk mailings and sample mailing materials.

2.2 Eligibility Criteria

The following eligibility criteria apply to Qualifying Loans:

- The mortgage loan is a first-lien mortgage loan or a second-lien on a property subject to a first lien under loss share or asset management.

- The mortgage loan is delinquent, or the borrower displays imminent default characteristics (see below).

- The mortgage loan is secured by a one- to four-unit property, one unit of which is the borrower's principal residence. This property may not be vacant or condemned. Modifications are permitted for cooperative share mortgages and mortgage loans secured by condominium units or manufactured housing units.

- The modification must not endanger the lien position on the property.

- The borrower has a financial hardship and provides a signed hardship affidavit attesting to this hardship.

- The borrower has a monthly mortgage payment to gross income ratio of greater than 31% DTI.

- Borrowers in active litigation may be considered for modification.

- The mortgage loan may have already been modified under a legacy modification program (either before or during the transition period) or under loss share. *For 2nd modifications under loss share, additional financial hardship must be documented*.

Imminent Default:

a) The borrower is 60 days delinquent, or;
   i) Analysis of the loan payments, current borrower income, and any other relevant information indicates that default is reasonably foreseeable; or
   ii) If the analysis is based on an anticipated increase in loan payments (due to payment recast, interest rate adjustments, etc.), the anticipated payment increase will occur within nine months and be greater than 31% DTI.
b) Other reasons for imminent default could include death of a family member or a borrower on the note, long term or permanent illness or disability of the borrower(s), divorce or legally-documented separation of borrower(s).

The AIs and Servicers shall provide the FDIC with documentation on the imminent default criteria used.

Specifications for ARMs with upcoming resets
Loans with interest rate resets within the next 9 months may be analyzed for modification even if the current monthly mortgage payment is below 31%. All borrowers with negative amortization products may be assessed for eligibility at the scheduled fully amortizing payment even if the loan has not yet reset and the current monthly mortgage payment is less than 31% DTI ratio. If the borrower is current, the AI or Servicer should apply the imminent default criteria above for eligibility standards.

- With respect to an adjustable rate mortgage with an interest reset scheduled within 9 months from the date of the evaluation of the borrower's income, the regular mortgage payment used to determine eligibility for a modified loan will be the greater of the following:

- the borrower's currently scheduled monthly mortgage payment; or

- a fully amortizing monthly mortgage payment based on the note reset rate using the index value as of the date of the evaluation or using the appropriate interest rate index forecast.

3.0 Underwriting

FDIC contractors will conduct semi-annual compliance visits and may conduct additional servicing reviews. The FDIC instructs its auditors to verify that (1) hardship and income documentation are on file; (2) NPV analysis is documented; and (3) loss mitigation alternatives are considered.

3.1 Hardship Affidavit

Every borrower and co-borrower seeking a modification, whether in default or not, must sign a Hardship Affidavit that attests to and describes a financial hardship preventing the borrower from making the scheduled mortgage payment. Examples of such hardships are:

a) A reduction in or loss of income that was supporting the mortgage;

b) Income is used for other expenses (illness, hospital bills, curtailment in income, death in the family and related expenses such as emergency travel); and/or

c) Recent or upcoming increases in the monthly mortgage payment (see imminent default characteristics or ARM resets for more information).

3.2 Verifying Borrower Income and Occupancy Status

The FDIC requires that all income be documented and verified prior to the final modification. Specifically, FDIC auditors are instructed to confirm that the following borrower information is on file for modified loans:[2]

If the borrower is employed:
- A signed IRS Form 4506-T (Request for Transcript of Tax Return)
- Copies of the two most recent pay stubs indicating year-to-date earnings
- Evidence of other income such as unemployment, Social Security, or pension (if applicable)

If the borrower is self-employed:
- Tax Returns (last 2 years)

[2] AIs and Servicers may request additional documentation per customary servicing procedures.

- Bank Statements (12 months or 24 months)
- P & L Statement signed with borrower signature and CPA signature (as applicable per standard and customary servicing procedures)

The FDIC encourages AIs and Servicers to validate back-end debt (e.g., all of the monthly debt as reflected in the credit report and excluding property taxes, homeowner association dues, and homeowner insurance) via recent bank statements and credit reports and to encourage all borrowers to seek financial counseling. Financial documentation (pay stubs, bank statements) should be dated 90 days or less from the date the borrower is considered for modification.

The Program applies only to mortgages collateralized by owner-occupied residences. Verification of occupancy is expected in the form of an updated credit report coupled with recent utility bills evidencing that the borrower occupies and owns the property (e.g., utility bills coupled with the monthly mortgage bill). The report or billing statement should be no more than 90 days old at the time the borrower is being considered for modification.

The FDIC does not allow modification of mortgages where there are facts reasonably indicating that the borrower submitted false or misleading information or otherwise engaged in fraud in connection with the proposed modification.

3.3 Standard Modification Waterfall

The loan modification waterfall refers to the steps taken to adjust the borrower's current mortgage terms in order to reduce the scheduled monthly mortgage payment to a monthly mortgage payment ratio of 31% (the "DTI monthly mortgage payment") The DTI monthly mortgage payment is 31% of the borrower's (along with any co-borrowers') documented and verified gross monthly income. The borrower's monthly mortgage payment includes the monthly payment of principal and interest plus one-twelfth of the annual amount required to pay real property taxes, homeowner's insurance, and any homeowner's association dues with respect to the collateral. Verification of these expenses is expected.

The FDIC Program waterfall includes the following steps:

1) Capitalization to the outstanding principal balance the amount of all delinquent interest, delinquent taxes, past due insurance premiums, and permissible third party fees and escrow advances (the "Capitalized Balance");

2) Reduction of the interest rate to the then current Primary Mortgage Market Survey® (PMMS) for 30-year fixed rate mortgage loans, and adjust the term to 30 years (if the current term is less than 30 years);

3) If the DTI ratio is still in excess of 31%, reduction of the interest rate further, but no lower than 3%, until the DTI ratio of 31% is achieved;

4) If the DTI ratio is still in excess of 31% after adjusting the interest rate to 3%, extension of the remaining term of the loan by 10 years;

5) If the DTI ratio is still in excess of 31%, determination of the loan balance which ensures the DTI remains at 31%, payment at the 3% interest rate floor and extended term. The Capitalized Balance will be then split into two portions:

   a. The amortizing portion - the mortgage amount that will fully amortize over the extended term at an annual interest rate of 3% and monthly payments equal to the DTI ratio.

   b. The non-amortizing portion - the difference between the Capitalized Balance and the amortizing portion of the Capitalized Balance.

   No interest is charged on the non-amortizing portion of the Capitalized Balance, but repayment is secured by a first lien on the collateral. The non-amortizing portion of the Capitalized Balance is due and payable upon the earlier of any of the following:
   (i) Maturity of the modified loan;
   (ii) A sale of the property; or
   (iii) A pay-off or refinancing of the loan.

At this time, principal forgiveness is not permitted under the Program waterfall.

3.4 Modification Terms

The modification payment remains fixed for 5 years. After the fifth year, the interest rate increases annually by 1% until the modification interest rate cap - the PMMS rate as of the date of the loan modification – is achieved. The scheduled loan payment also adjusts to fully amortize the remaining Capitalized Balance over the remaining term of the modified loan.

Additional Terms:

- The borrower shall not be required to pay any modification, refinance or other similar fees or points in connection with the modification. These fees may not be capitalized into the modification balance.

- Unpaid late fees and prepayment penalties must be waived; modified loans may not include any prepayment penalties.

- The FDIC recommends that an escrow account be established for the payment of future taxes and insurance premiums. In order to establish the escrow account, the required amount may be capitalized and claimed in the loss claim calculation. Please inform the FDIC Account Specialist of procedures chosen for establishing escrow accounts.

3.5 Net Present Value (NPV) Test

Once the modified loan terms are established, the loan is analyzed by a standardized NPV test that compares the NPV result for a modification to the NPV result for no modification. While the FDIC does not provide a standard NPV test to AIs and Servicers, information is available on the FDIC website at:

> 'Mod in a Box' Website (pages 11-14):
> http://www.fdic.gov/consumers/loans/loanmod/FDICLoanMod.pdf
>
> 'Mod in a Box' Test Scenario:
> http://www.fdic.gov/consumers/loans/loanmod/NPV.xls

A viable NPV test should take into consideration four cash flows under the following scenarios:

1. the loan is not modified and performs
2. the loan is not modified and defaults
3. the loan is modified and performs
4. the loan is modified and defaults

Cash flows under the no modification scenario are weighted by a probability of default and cure (1 minus the probability of default). This default probability may be determined using portfolio specific history or a probability of default model. Cash flows under the modification scenario are weighed by a probability of re-default and cure (1 minus the probability of re-default). This re-default probability may be based on industry standards or a probability of default model. In either case, the probability of default should vary based on loan characteristics such as delinquency history, FICO, LTV, and - for the re-default probability - the change in the borrower's payment given modification.

AIs and Servicers shall determine the NPV of the modified loan and provide the methodology employed to determine the NPV along with a certification that the AI's or Servicer's model assumptions are documented and validated through periodic and independent reviews.

If the NPV result for the modification scenario is greater than the NPV result for no modification, the result is deemed "positive" and the loan is eligible for modification. However, AIs and Servicers may choose not to modify loans where the amortizing portion of the Capitalized Balance is less than 75% of the Capitalized Balance. If a NPV result is negative, then AIs and Servicers should consider the borrower for other foreclosure prevention options such as short sale or deed *in lieu* programs and pursue the least loss mitigation option.

The AI or Servicer shall provide the FDIC Account Specialist with the specific formulas and documentation on their NPV model and valuation approach.

4.0 Best Practices and Additional Requirements

4.1 FDIC Expectations about Borrower Notices

The FDIC encourages AIs and Servicers to provide timely information to borrowers on their eligibility for loan modification. The FDIC receives and tracks public inquiry and complaints related to modification activity. The FDIC requires AIs and Servicers to implement a proactive approach to modifications to minimize these complaints and operational disruptions. If a borrower does not qualify for modification, the FDIC strongly encourages AIs and Servicers to communicate to the borrower the reason for disqualification in a standardized format and within 10 business days of determining ineligibility.

4.2 Document Retention

During the semi-annual compliance reviews, FDIC contractors will review and verify the AI's and Servicer's process of determining borrower eligibility, including borrower income verification, total monthly mortgage payment and total monthly gross debt payment calculations, NPV calculations (assumptions, inputs and outputs), evidence of application of each step of the standard waterfall, escrow analysis, escrow advances, and escrow set-up (as applicable). AIs and Servicers should retain the necessary documentation to satisfy these inquiries. AIs should refer to Section 2.1 of the SLA, *Loss Mitigation and Loan Modification,* for more information on this requirement.

Records should also be retained to document the reason(s) for a modification denial or modification default. If the modification is denied due to a "negative" NPV result, AIs and Servicers shall retain appropriate information documenting the reason for this outcome and the efforts to pursue other loss mitigation alternatives such as short sale or deed *in lieu* transactions before commencing foreclosure proceedings.

4.3 Principal Curtailments and Suspense Accounts

If the borrower makes principal payments on a loan that has non-amortizing principal forbearance, the FDIC recommends that the principal payments be applied to the interest bearing Unpaid Principal Balance first, with any excess applied to the non-amortizing portion (if applicable).

Positive amounts in suspense accounts at time of modification should be applied to reduce the modification loan balance and the restructure loss claim.

4.4 Re-default

If a borrower defaults on a loan modified under the Program, the FDIC encourages the AI or Servicer to work with the borrower to cure the modified loan. A loan may be restructured twice, given additional borrower hardship, or further decrease in the borrower's income. *Documentation of both events is required*. The AI or Servicer may also re-modify a loan that was modified during the transition period to HAMP or FDIC program standards. The AI or Servicer shall determine the value of the new loan restructuring compared to the foreclosure or short-sale alternatives and pursue the alternative resulting in the least loss. Loss Share compensation for the second restructuring under the SLA will be reduced by the amount claimed on the loss certificate for the first modification (see SLA Exhibit 2(a)(2) *Calculation of Restructuring Loss – 2nd FDIC Modification*).

AIs and Servicers should retain all documentation of consideration of other loss mitigation alternatives prior to foreclosure disposition, and utilize Exhibit 2(a)(2) in the SLA to report loans to the FDIC that had been modified twice.

4.5 Transfers of Servicing

AIs and Servicers should notify the FDIC of any sub-servicing arrangements or servicing transfers which may impede the AI's or Servicer's ability to implement the Program. All sub-servicing arrangements must comply with the FDIC requirements set forth in the Agreements.

4.6 FDIC Request for Documentation

The FDIC may from time to time request information on the AI's or Servicer's modification pipeline, call center, or modification mailing activities and the records of tracking such activities.

4.7 Legal Documentation and Consideration

- Mortgage Insurer Approval - Please notify the FDIC of any issues with mortgage insurer approval.

- Recording the Modification - Please ensure that the modified mortgage loan retains its first lien position and is fully enforceable.

- Fraud Detection – The FDIC encourages the AIs and Servicers to implement and enforce a fraud detection program for modification verification documents. If there is reasonable evidence indicating the borrower submitted income information that is false or misleading or if the borrower has otherwise engaged in fraud in connection with the modification, the borrower should be denied modification.

- MERS - If the original loan was recorded through Mortgage Electronic Registration Systems or MERS, please ensure compliance with all applicable laws and regulations.

4.8 Property Valuations

An AVM-generated or BPO property valuation may be used in determining the property value. The valuation must be less than 90 days old on the date the servicer first evaluates the borrower for the loan modification. If the valuation appears to be inaccurate or the confidence level associated with the valuation is questionable, it is recommended that the AI obtain an additional opinion of the value of the property. The AVM-generated or BPO property valuation remains valid during the time the borrower is being considered for modification.

4.9 Borrower Signatures

The modification must be signed by all parties to the transaction.

5.0 Compliance with Applicable Laws

Each Servicer (and any sub-Servicer) should be aware of, and in full compliance with, all federal, state, and local laws (including statutes, regulations, ordinances, administrative rules and orders that have the effect of law, and judicial rulings and opinions) – including, but not limited to Section 5 of the Federal Trade Commission Act, the Equal Credit Opportunity Act and the Fair Housing Act, fair lending laws, the Real Estate Settlement Procedures Act, and the Fair Debt Collection Practices Act.

6.0 Alternative Modification Programs

The applicable Agreements permit the AIs or Servicers to use alternative modifications or Proprietary Programs for groups of loans with similar characteristics that are not eligible for HAMP or FDIC. AIs should refer to Section 3.2 *Duties of the Assuming Institution with Respect to Shared-Loss Loans* for details.

The FDIC strongly encourages AIs and Servicers to develop Proprietary Programs for non-owner occupied properties and other loan types such as junior liens, balloons etc. Relevant FDIC Guidance may be issued from time to time to the AIs and Servicers with clarification for certain of these asset types. In the absence of specific Guidance, specifications for Proprietary Programs must be sent to the FDIC for review and analysis.

Resources

IndyMac Modification Program

'Mod in a Box' http://www.fdic.gov/consumers/loans/loanmod/FDICLoanMod.pdf

HAMP Program

Making Home Affordable website – provides factsheets and broad program announcements http://www.MakingHomeAffordable.gov

Servicer specific HAMP website - http://www.hmpadmin.com

HAMP questions for non-GSE loans: 1-866-939-4469, support@hmpadmin.com