FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
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September 4, 2007

SERVICING FOR MORTGAGE LOANS

Loss Mitigation Strategies

Summary: The federal financial agencies and the Conference of State Bank Supervisors encourage institutions and their subsidiaries that service mortgage loans to pursue strategies to mitigate losses while preserving affordable, sustainable mortgage obligations. The agencies have prepared the attached "Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages."

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Related Topics:
Nontraditional Mortgage Product Risks
Subprime Mortgage Lending
Workout Arrangements for Residential Borrowers
Securitized Subprime Residential Mortgage Loans
Implications of Restructuring Certain Securitized Residential Mortgage Loans
Loss Mitigation Strategies

Attachments:
Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages

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Highlights:

- Many subprime and other mortgage loans have been transferred into securitization trusts. Servicing for these securitized loans are governed by the terms of the contract documents, typically referred to as Pooling and Servicing Agreements.
- A significant number of adjustable-rate mortgages are scheduled to reset in the coming months. These resets may result in significant payment shock to borrowers, which can increase the likelihood of default.
- Servicers of these loans should review the governing documents for the securitization trusts to determine the full extent of their authority to restructure loans that are delinquent or in default or are in imminent risk of default.
- The governing documents may allow servicers to proactively contact borrowers at risk of default, assess whether default is reasonably foreseeable, and, if so, apply loss mitigation strategies designed to achieve sustainable mortgage obligations.
- Loss mitigation techniques that preserve homeownership are generally less costly than foreclosure, particularly when applied before default.
- When considering and implementing loss mitigation strategies, servicers are expected to treat consumers fairly and to adhere to all applicable legal requirements.

Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages

The Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and Conference of State Bank Supervisors (CSBS) encourage federally regulated institutions[1] and state-supervised entities that service mortgage loans (collectively referred to as "servicers") to pursue strategies to mitigate losses while preserving homeownership to the extent possible and appropriate.

Previously, in April 2007, the federal financial agencies issued a *Statement on Working with Mortgage Borrowers* and followed this with the July 2007 *Statement on Subprime Mortgage Lending.* Both interagency statements encouraged federally regulated institutions to work constructively with residential borrowers at risk of default and to consider prudent workout arrangements that avoid unnecessary foreclosures. In these statements, the federal financial agencies stated that prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower. CSBS, the American Association of Residential Mortgage Regulators (AARMR), and the National Association of Consumer Credit Administrators developed a parallel *Statement on Subprime Mortgage Lending* that applies to state-supervised mortgage brokers and lenders. In June 2007, CSBS and AARMR issued a consumer alert and an industry letter to address resetting mortgage loans.

These previous statements focused on residential loans retained by federally regulated institutions and state-supervised entities. However, many subprime and other mortgage loans have been transferred into securitization trusts. Servicing for these securitized loans is governed by the terms of contract documents, typically referred to as Pooling and Servicing Agreements. A significant number of adjustable-rate mortgages are scheduled to reset in the coming months. As indicated in the *Statement on Subprime Mortgage Lending* and the October 2006 *Interagency Guidance on Nontraditional Mortgage Product Risks*, these resets may result in a significant payment shock to the borrower, which can increase the likelihood of default.

Servicers of securitized mortgages should review the governing documents for the securitization trusts to determine the full extent of their authority to restructure loans that are delinquent or in default or are in imminent risk of default. The governing documents may allow servicers to proactively contact borrowers at risk of default, assess whether default is reasonably foreseeable, and, if so, apply loss mitigation strategies designed to achieve sustainable mortgage obligations. The Securities and Exchange Commission (SEC) has provided clarification that entering into loan restructurings or modifications when default is reasonably foreseeable does not preclude an institution from continuing

[1] For purposes of this Statement, the term "federally regulated institutions" refers to state- and nationally-chartered banks and their subsidiaries; bank holding companies and their nonbank subsidiaries; savings associations and their subsidiaries; savings and loan holding companies and their subsidiaries; and credit unions.

to treat serviced mortgages as off-balance sheet exposures.[2] Also, the federal financial agencies and CSBS understand that the Department of Treasury has indicated that servicers of loans in qualifying securitization vehicles may modify the terms of the loans before an actual delinquency or default when default is reasonably foreseeable, consistent with Real Estate Mortgage Investment Conduit tax rules.[3]

Servicers are encouraged to use the authority that they have under the governing securitization documents to take appropriate steps when an increased risk of default is identified, including:

- proactively identifying borrowers at heightened risk of delinquency or default, such as those with impending interest rate resets;
- contacting borrowers to assess their ability to repay;
- assessing whether there is a reasonable basis to conclude that default is "reasonably foreseeable"; and
- exploring, where appropriate, a loss mitigation strategy that avoids foreclosure or other actions that result in a loss of homeownership.

Loss mitigation techniques that preserve homeownership are generally less costly than foreclosure, particularly when applied before default. Prudent loss mitigation strategies may include loan modifications; deferral of payments; extension of loan maturities; conversion of adjustable-rate mortgages into fixed-rate or fully indexed, fully amortizing adjustable-rate mortgages; capitalization of delinquent amounts; or any combination of these. As one example, servicers have been converting hybrid adjustable-rate mortgages into fixed-rate loans. Where appropriate, servicers are encouraged to apply loss mitigation techniques that result in mortgage obligations that the borrower can meet in a sustained manner over the long term.

In evaluating loss mitigation techniques, servicers should consider the borrower's ability to repay the modified obligation to final maturity according to its terms, taking into account the borrower's total monthly housing-related payments (including principal, interest, taxes, and insurance, commonly referred to as "PITI") as a percentage of the borrower's gross monthly income (referred to as the debt-to-income or "DTI" ratio). Attention should also be given to the borrower's other obligations and resources, as well as additional factors that could affect the borrower's capacity and propensity to repay. Servicers have indicated that a borrower with a high DTI ratio is more likely to encounter difficulties in meeting mortgage obligations.

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[2] In general, default could be considered "reasonably foreseeable" when a lender has made actual contact with the borrower, has assessed the borrower's ability to pay, and has a reasonable basis to conclude that the borrower will be unable to continue to make mortgage payments in the foreseeable future. See the attachment to the July 24, 2007, letter from SEC Chairman Cox to Chairman Frank, House Committee on Financial Services.

[3] See 26 CFR 1.860G-2(b)(3)(i).

Some loan modifications or other strategies, such as a reduction or forgiveness of principal, may result in additional tax liabilities for the borrower that should be included in any assessment of the borrower's ability to meet future obligations.

When appropriate, servicers are encouraged to refer borrowers to qualified non-profit and other homeownership counseling services and/or to government programs, such as those administered by the Federal Housing Administration, which may be able to work with all parties to avoid unnecessary foreclosures. When considering and implementing loss mitigation strategies, servicers are expected to treat consumers fairly and to adhere to all applicable legal requirements.

APPENDIX

The following guidance and information should be consulted for additional details about matters discussed in this Financial Institution Letter.

Supervision

- *Interagency Guidance on Nontraditional Mortgage Product Risks,* and *Addendum to Credit Risk Management Guidance for Home Equity Lending*, FIL-89-2006, October 5, 2006, found at: http://www.fdic.gov/news/news/financial/2006/fil06089.html.

- *Home Equity Lending Credit Risk Management Guidance*, FIL-45-2005, May 2005, found at: http://www.fdic.gov/news/news/financial/2005/fil4505.html.

- *Expanded Guidance for Evaluating Subprime Lending Programs*, FIL-9-2001, January 31, 2001, found at: http://www.fdic.gov/news/news/financial/2001/fil0109.html.

- *Unfair or Deceptive Acts or Practices Under Section 5 of the Federal Trade Commission Act*, FIL-26-2004, March 2004, found at: http://www.fdic.gov/news/news/financial/2004/fil2604.html.

- *Unfair or Deceptive Acts or Practices: Applicability of the Federal Trade Commission Act*, FIL-57-2002, May 2002, found at: http://www.fdic.gov/news/news/financial/2002/fil0257.html.

- *Fair Debt Collection Practices Act*, 15 U.S.C. § 1692 et seq., found at: http://www.fdic.gov/regulations/laws/rules/6500-1300.html.

Consumer Information

- http://www.fdic.gov/consumers/consumer/index.html

- *FDIC Consumer News*, http://www.fdic.gov/consumers/consumer/news/index.html

- *Consumer Response Center*, http://www.fdic.gov/consumers/consumer/ccc/index.html

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Mailing Address:	Federal Deposit Insurance Corporation Consumer Response Center 2345 Grand Avenue, Suite 100 Kansas City, MO 64108-2638

E-mail Address:	Consumeralerts@fdic.gov
To File Complaint:	FDIC's Electronic Customer Assistance Form

- *Consumer Affairs Program,* http://www.fdic.gov/consumers/consumer/affairs/index.html
- *Money Smart financial education program information,* http://www.fdic.gov/consumers/consumer/moneysmart/index.html
- *Money Smart computer-based instruction (English or Spanish),* http://www.fdic.gov/consumers/consumer/moneysmart/mscbi/mscbi.html