

Supplemental Directive 10-08

August 6, 2010

Making Home Affordable Program – Treasury/FHA Second Lien Program (FHA2LP) to Support FHA Refinance of Borrowers in Negative Equity Positions

Background

On March 26, 2010, the Department of Housing and Urban Development (HUD) and Department of the Treasury (Treasury) announced enhancements to the Making Home Affordable (MHA) Program and to the Federal Housing Administration (FHA) refinance program that could make homeownership more affordable for borrowers whose homes are worth less than the remaining amounts owed under their mortgage loans (negative equity). These enhancements allow borrowers who are current on a negative equity mortgage to restructure their debt and refinance into an FHA insured loan where the unpaid principal balance (UPB) of the original first lien mortgage has been written down by at least 10 percent and the amount of all mortgage debt, after the FHA refinance, does not exceed 115 percent of the current value of the property. To facilitate this FHA refinance opportunity, Treasury will provide incentives to servicers and investors when there is a partial or full extinguishment of second liens associated with FHA Refinance.

On August 6, 2010, FHA released guidance for implementation of the FHA Refinance of Borrowers in Negative Equity Positions (FHA Refinance) Program through Mortgagee Letter 2010-23 (ML 10-23).

This Supplemental Directive provides guidance to second lien servicers for adoption and implementation of the corresponding Treasury/FHA Second Lien Program (FHA2LP). Second mortgage lien loans that are not owned or guaranteed by Fannie Mae or Freddie Mac (Non-GSE Second Liens) are eligible for this program. In addition, this Supplemental Directive provides guidance to first lien servicers who have modified loans through the Home Affordable Modification Program (HAMP) with respect to the servicer's responsibility for terminating those loans in Treasury's system of record upon closing of the FHA Refinance.

FHA2LP is not yet effective and is conditional upon the finalization of certain loss coverage to be provided on the new refinanced FHA loans under the Emergency Economic Stabilization Act of 2008 (EESA). A subsequent Supplemental Directive will be issued when FHA2LP is operational and when interested servicers are able to execute a Commitment to Purchase Financial Instrument and Servicer Participation Agreement (SPA) or a Service Schedule to the SPA, as applicable.

This Supplemental Directive covers the following topics:

- Eligibility and Underwriting Requirements
- Extinguishment
- Incentive Compensation
- Mortgage Insurer Approval
- Coordination with the Hardest-Hit Funds
- Credit Bureau Reporting
- Program Reporting Requirements
- Compliance
- Servicer Safe Harbor
- Effectiveness

Eligibility & Underwriting Requirements

The guidance in ML 10-23, including any attachments and Questions and Answers (hereafter referred to as the FHA Refinance ML) is incorporated by reference into this Supplemental Directive. Servicers should rely on the FHA Refinance ML and other relevant FHA documents for requirements related to eligibility, underwriting and administration of FHA Refinance, while this Supplemental Directive addresses the specific requirements of FHA2LP.

Treasury will provide incentives to existing second mortgage lien servicers and investors who agree to full or partial extinguishment of a second lien in conjunction with an FHA Refinance that closes on or before December 31, 2012. In addition to the eligibility requirements for FHA Refinance, to qualify for FHA2LP incentives, the second lien:

- Must have been originated on or before January 1, 2009;
- Must hold second mortgage lien priority prior to the FHA Refinance, however, a mortgage loan that would be in second lien position but for a tax lien, mechanic's lien or other non-mortgage related lien is eligible; and
- Must have required the borrower to make a monthly payment. For example, second liens on which payments have been deferred for 36 or more months are not eligible.

Additionally, second mortgage liens with a UPB of less than \$2,500 (Low Balance Loans) on the day prior to the FHA Refinance closing are not eligible for FHA2LP servicer incentives.

Extinguishment

Under FHA2LP, a servicer, in accordance with any applicable pooling and servicing agreement or other investor servicing agreement, may elect to extinguish a portion of or the entire second mortgage lien balance in order to facilitate an FHA Refinance. Because servicers have discretion in offering partial or full extinguishment, servicers must develop and adhere to a written policy for making extinguishment determinations that treats all similarly-situated loans in a consistent manner and in compliance with fair lending and other applicable laws and regulations. In

exchange for such extinguishment, the second lien investor will be eligible for a one-time investor incentive payment in accordance with the formula set forth below in the “Incentive Compensation” section and the second lien servicer will also be eligible for incentive compensation.

Lien Release

The second lien servicer, investor and any mortgage or other insurer must relinquish all rights and remedies against the borrower(s) related to the portion of the second lien obligation that is extinguished. The borrower may not be required to sign a promissory note and may not be charged a fee as a condition of, or in conjunction with, such release.

In conjunction with the closing of an FHA Refinance, the second lien servicer, either on its own or through the settlement agent, must take all necessary action(s) to cancel the indebtedness and release the second lien, or the extinguished portion thereof, in a timely manner. When the cancelled or modified mortgage note and the required release and/or satisfaction documents are executed and recorded, the servicer or settlement agent must promptly send the documents to the borrower.

Partial Extinguishment

In conjunction with partial extinguishment of a second mortgage lien, servicers may curtail the UPB by the agreed upon extinguishment amount and leave all other repayment terms as scheduled, or may elect to modify the loan by re-amortizing the payment schedule based on the reduced UPB, reducing the interest rate or extending the repayment term to achieve a lower monthly payment. Additionally, servicers may convert an adjustable rate or interest-only second lien to a fixed rate, fully amortizing second lien.

All loans partially extinguished under FHA2LP must result in closed-end second mortgage liens. If the second mortgage lien is an open-end line of credit, participating servicers must terminate the borrower’s ability to draw additional amounts on the credit line when FHA Refinance becomes effective. When terminating the borrower’s ability to draw additional amounts under an open-end line of credit, the servicer of the second mortgage lien must provide the borrower with disclosures in a manner consistent with applicable law. Any permanent changes to the loan terms must be documented in a written modification agreement signed by the servicer and borrower.

Servicers may not, as a condition of extinguishment, increase the scheduled interest rate or change the payment terms to include an interest-only or an adjustable rate interest repayment schedule.

The second lien servicer, either on its own or through the settlement agent, must take all necessary action(s) to subordinate the remaining portion of the lien to the new FHA first lien.

Incentive Compensation

To be eligible for incentive compensation through FHA2LP, a servicer must execute a SPA with Fannie Mae in its capacity as financial agent for the United States (as designated by Treasury) on or before October 3, 2010. Servicers that have previously executed a SPA will be required to

execute an Amended and Restated SPA or an additional Service Schedule that includes FHA2LP, as applicable. No incentive compensation of any kind will be paid to servicers who have not executed an Amended and Restated SPA or signed the FHA2LP Service Schedule to participate in FHA2LP.

Servicers that have not executed a SPA should follow the online registration process at www.HMPAdmin.com (click on the Registration tab) or call the HAMP Support Center at 1-866-939-4469. Servicers who have executed a SPA must complete the appropriate registration form(s) for FHA2LP and email them to the HAMP Support Center at setup@HMPAdmin.com.

The amount of funds available to pay servicer and investor compensation in connection with each servicer's partial or full extinguishment under FHA2LP will be capped pursuant to each servicer's SPA (Program Participation Cap). Treasury will establish each servicer's initial Program Participation Cap by estimating the number of full or partial second mortgage lien extinguishments expected to be performed by the servicer during the term of FHA Refinance. The Program Participation Cap shall be adjusted based on Treasury's full book analysis of the servicer's loans.

The funds remaining available for a servicer's extinguishment of second liens under that servicer's Program Participation Cap will be reduced by amounts paid for full or partial extinguishment. Treasury may, from time to time and in its sole discretion, revise a servicer's Program Participation Cap. Fannie Mae will provide written notification to a servicer of all changes made to the servicer's Program Participation Cap. Once a servicer's Program Participation Cap is reached, a servicer may continue to partially or fully extinguish second mortgage liens in accordance with the FHA Refinance guidelines; however, no incentive payments will be made with respect to any new partial or full extinguishment of a second lien.

Servicer Incentive Compensation

A servicer of a second lien that is partially or fully extinguished under FHA Refinance will receive one-time compensation of \$500 for each second lien with a UPB equal to or greater than \$2,500 on the day prior to the closing date of the FHA Refinance.

Servicers of second mortgage liens that were previously modified under the Second Lien Modification Program (2MP) will not be eligible for the FHA2LP one-time compensation of \$500 if the closing date of the FHA Refinance occurs within 180 calendar days of the effective date of the 2MP modification.

Investor Incentive Compensation

A second lien investor is eligible for incentive payments for the amount of principal extinguishment that reduces the borrower's post refinance debt to any amount between 105 percent and 115 percent combined loan-to-value (CLTV) ratio. The post refinance CLTV is the ratio of all mortgage debt, including the new principal balance of the refinanced first lien and any subordinate lien(s) to the current FHA appraised value of the property.

However, the amount of investor incentive payment to be paid will be calculated using the pre-refinance (rather than post) CLTV ratio, the delinquency status of the loan and the dollar amount of the principal extinguishment. The pre-refinance CLTV is the ratio of the UPB of the existing

first lien and the UPB of the second lien prior to any extinguishment divided by the current FHA appraised value of the property.

**Treasury FHA2LP Compensation Per Dollar of UPB Extinguished
in CLTV Range
(Loans Less than or Equal to Six Months Past Due)**

105% to <115%	115% to 140%	>140%
0.21	0.15	0.10

With respect to second mortgage liens which were less than or equal to six months past due at all times during the 12 month period before the FHA Refinance closing date, second lien investors will be entitled to receive \$0.21 per dollar of principal extinguishment equal to or greater than 105 percent and less than 115 percent CLTV ratio; \$0.15 per dollar of principal extinguishment equal to or greater than 115 percent and less than or equal to 140 percent CLTV ratio; and \$0.10 per dollar of principal extinguishment in excess of 140 percent CLTV ratio.

With respect to second mortgage liens which were more than six months past due at any time during the 12 month period prior to the FHA Refinance closing date, regardless of the CLTV ratio range, second lien investors will be paid \$0.06 per dollar of principal extinguishment and will not be eligible for incentives in the above extinguishment schedule.

Mortgage Insurer Approval

Servicers must be able to identify second liens in their servicing portfolio that have mortgage insurance and should seek to obtain a blanket delegation of authority from the mortgage insurer(s) to partially or fully extinguish second liens under FHA Refinance. As an alternative to a blanket delegation of authority, servicers must obtain mortgage insurer approval to partially or fully extinguish the second lien under FHA Refinance on a case-by-case basis.

Coordination with the Hardest-Hit Funds

In February and March of 2010, President Obama announced \$2.1 billion in funding from the Trouble Asset Relief Program (TARP) for innovative measures to help families in the states that have been hit the hardest by the housing crisis and economic downturn. The Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest-Hit Fund) currently includes funding for Arizona, California, Florida, Michigan, Nevada, North Carolina, Ohio, Oregon, Rhode Island and South Carolina. In these states, TARP funds will be utilized for innovative programs developed by state Housing Finance Agencies (HFAs) to prevent foreclosures and stabilize housing markets, including funding to fully or partially extinguish second liens. Servicers and investors of second mortgage liens are not eligible for any FHA2LP incentives if they have accepted any amount of compensation from a Hardest-Hit Fund program for partial or full extinguishment of a second mortgage lien. Servicers may consult Supplemental Directive 10-07 for additional guidance on the interaction of MHA and the HFA Hardest-Hit Fund.

Credit Bureau Reporting

Reporting Full Extinguishments

For second liens that are extinguished in their entirety under FHA Refinance, the servicer must report the following to the credit repositories:

Account Status Code = 13 (Paid)

Payment Rating = the appropriate code that identifies the status of the account within the activity period being reported

Special Comment Code = AU (Paid in full for less than the full balance)

Current Balance and Amount Past Due = zero

Date Closed = date the accounts are forgiven and considered to be paid

Note that payment history for the forgiven accounts will be retained.

Reporting Partial Extinguishment

For second liens that are partially extinguished under FHA Refinance, the servicer must report the following to the credit repositories:

Servicers should continue to report one trade line under the original account number.

- Date Opened = the date the account was originally opened
- Original Loan Amount = the original amount of the loan, including the Balloon Payment Amount, if applicable. If the principal balance increases due to capitalization of delinquent amounts due under the loan, the Original Loan Amount should be increased to reflect the modified principal balance
- Terms Duration = the modified terms
- Scheduled Monthly Payment Amount = the new amount as per the modified agreement
- Current Balance = the principal balance (including the Balloon Payment Amount, if applicable), plus the interest and escrow due during the current reporting period
- Account Status Code = the appropriate code based on the new terms of the loan
- Special Comment Code = CN
- K4 Segment = used to report the Balloon Payment information, if applicable:
 - Specialized Payment Indicator = 01 (Balloon Payment)
 - Payment Due Date = the date the balloon payment is due which is equal to maturity of the amortizing portion of the loan. Note: The payoff date can be used in this field
 - Payment Amount = the amount of the balloon payment in whole dollars only

Program Reporting Requirements

Treasury has designated Bank of New York Mellon (BNYM) as Incentives Processor for FHA2LP. In addition to executing a SPA with Fannie Mae, as financial agent, each FHA2LP servicer will be required to register with BNYM using the FHA2LP Registration Form on www.HMPAdmin.com. Servicers must provide to BNYM, electronically, FHA2LP loan set up file data using the attributes generally set forth in Exhibit A of this Supplemental Directive, as

applicable. Additional information on reporting will be provided at registration by BNYM. Servicers are required to provide the following categories of information to BNYM:

- General Transaction Information
- Loan Identifying Information
- General Loan Information
- Borrower/Co-Borrower Identifying Data
- Loan Characteristics Before Refinance
- Loan Characteristics After Refinance

The data must be accurate, complete and in agreement with the servicer's records and the servicing file. Data should be reported by the servicer no later than the third business day of the month following the closing of the FHA Refinance. Servicers should look for a full description and detail of these attributes in the FHA2LP Data Dictionary to be posted on www.HMPAdmin.com.

Servicers must represent and warrant that all or a portion of the second lien has been released in compliance with applicable laws when submitting a request to BNYM for FHA2LP extinguishment payment.

Effective Dates for Reporting and Payment

The FHA2LP reporting and payment processes are currently under development by BNYM. Subsequent guidance will be provided describing when the FHA2LP reporting processes will be available. After the reporting process is in place, servicers will have 60 days to begin reporting activity on all FHA2LP loans on a monthly basis. In the interim period, servicers must collect and store loan set up file data, using the attributes described in Exhibit A of this Supplemental Directive, as applicable, for all FHA2LP transactions so that the data can be reported when the reporting and payment processes become available.

Second lien extinguishment payments will be made in the month following the later of (i) the date of receipt by BNYM of all required data relating to the second lien extinguishment; or (ii) the date of confirmation from FHA that the new FHA first lien mortgage has been endorsed. BNYM will match the data entered into the BNYM system of record by the servicer with the data received from FHA related to the endorsed first lien mortgage. Payment of incentives is also contingent upon, if applicable, the servicer reporting the loan as "paid off" in the Treasury system of record as outlined below in "Reporting Conversion of HAMP or 2MP Loans to FHA Refinance."

All FHA2LP incentives relating to a loan which has been extinguished in full or in part in accordance with this Supplemental Directive and which have accrued prior to the implementation of the FHA2LP reporting and payment processes will be paid the month following implementation.

Reporting Conversion of HAMP or 2MP Loans to FHA Refinance

Servicers of any HAMP modified first lien that is paid off through FHA Refinance must follow the guidance in the HAMP Servicer Reporting Requirements on www.HMPAdmin.com regarding the reporting of the loan as "paid off" in the Treasury system of record. In addition, the servicer

must submit the Official Monthly Report (OMR) that reflects the payoff within the first four business days of the month following the FHA Refinance closing.

For 2MP loans that are partially or fully extinguished through FHA2LP or where the corresponding first lien is paid off through FHA Refinance, servicers must follow the guidance in the HAMP Servicer Reporting Requirements on www.HMPadmin.com regarding the reporting of the loan as “paid off” in the Treasury system of record. In addition, the servicer must submit the 2OMR that reflects the payoff within the first four business days of the month following the FHA Refinance closing.

Compliance

FHA and Treasury have agreed that each will perform certain compliance activities for FHA2LP. FHA will validate that each loan refinanced under FHA Refinance is an eligible mortgage loan under the eligibility criteria set forth in the FHA Refinance ML and will notify Treasury in a timely manner if any fraud is discovered in origination of a new FHA Refinance loan. In addition, FHA will assess each originator’s compliance with all FHA Refinance requirements, including such originator’s internal control program.

Treasury (or its designated Compliance Agent on its behalf) will perform the following activities with respect to FHA2LP loans:

- Review that a full or partial extinguishment of the related second lien occurred consistent with the amount reported by the servicer, and if applicable, appropriate reporting to Fannie Mae, in its capacity as financial agent, occurred for any related HAMP or 2MP loans;
- Determine the accuracy and timeliness of remittance by the servicer of investor incentive payments;
- Evaluate documented evidence to confirm adherence by the participating servicer to FHA2LP requirements, including modified loan terms following a Partial Extinguishment, as outlined in this Supplemental Directive;
- Review that the related borrower has been released from liability for the portion of second lien that was extinguished; and
- Review the effectiveness of each participating servicer’s internal quality control plan for FHA2LP.

Each servicer is required to develop and implement an internal control program designed to:

- Ensure effective delivery of services (as defined in the SPA) in connection with FHA2LP and compliance with applicable FHA2LP program documentation and reporting requirements, including the FHA Refinance ML and existing or future guidance issued by FHA for requirements related to eligibility, underwriting and administration of FHA Refinance;

- Monitor and detect mortgage loan fraud; and
- Monitor compliance with applicable consumer protection and fair lending laws.

The internal control program must include documentation of the control objectives for FHA2LP activities, the associated control techniques, and mechanisms for testing and validating the controls.

Each servicer is also required to provide FHA (or, for second lien servicers, Treasury and its Compliance Agent) with access to all internal control reviews and reports that relate in whole or in part to refinances under FHA Refinance performed by it and any external parties or consultants hired by such Servicer.

Document Retention

Servicers must keep copies of all lien releases, subordination agreements (if applicable) and other related documents in its files to be made available for verification by the Compliance Agent. Servicers must retain all documents and information received during the process of determining borrower eligibility for FHA2LP, including lien release documentation and, if applicable, the HUD-1. In addition, servicers must retain required documents for a period of seven years from the date of the document collection.

Servicer Safe Harbor

As part of Helping Families Save Their Homes Act of 2009, Congress established a servicer safe harbor (Servicer Safe Harbor) by amending Section 129A of the Truth In Lending Act, 15 U.S.C. 1639a (TILA) for the purpose of providing a safe harbor to enable such servicers to modify and refinance mortgage loans under a “qualified loss mitigation plan.” Treasury has determined that each modification and refinance under the program described in this Supplemental Directive is a “qualified loss mitigation plan” as defined in the Servicer Safe Harbor.

Effectiveness

FHA2LP is not yet effective and is conditional upon the finalization of certain loss coverage to be provided on the new refinanced FHA loans under EESA. A subsequent Supplemental Directive will be issued when FHA2LP is operational and when interested servicers are able to execute a SPA or a Service Schedule to the SPA, as applicable.

Exhibit A: FHA Refinance Loan Setup Data Elements

The following data elements will be provided to BNYM by the Second Lien Servicers and are necessary for the extinguishment and partial extinguishment transactions.

Name	Definition	Data Type/Data Length	Loan Setup for Second Lien Extinguishment Incentive Mandatory / Conditional	Allowable Values
Loan Identifying Information				
HAMP Registration Number	The unique identifier for the servicer participating in the HAMP Program	Numeric (15)	M	
FHA2LP HAMP Servicer Number	A unique identifier for the servicer participating in the 2LP HAMP Program	Numeric (9)	M	
FHA Case Number	The unique identifier assigned to the new FHA loan associated with this second lien extinguishment	Text (10)	M	
Second Lien Servicer Loan Number	The unique identifier assigned to the loan by the lender that is servicing the loan	Text (30)	M	
2MP Loan	Second lien was modified under 2MP prior to extinguishment	Boolean	M	Y or N
HAMP 2MP Servicer Number	A unique identifier for the servicer participating in the 2MP HAMP Program	Numeric (9)	C	
Original First Lien Servicer Name	The name of the original first lien servicer	Text (100)	C	
Original First Lien Servicer Loan Number	The unique identifier assigned to the loan by the original first lien servicer	Text (30)	C	

(continued)

Name	Definition	Data Type/Data Length	Loan Setup for Second Lien Extinguishment Incentive Mandatory / Conditional	Allowable Values
Borrower/Co-Borrower Identifying Data				
Borrower First Name	First name of the borrower of record	Text (100)	M	
Borrower Last Name	Last name of the borrower of record. This is also known as the family name or surname	Text (100)	M	
Borrower Social Security Number	The social security of the borrower	Text (9)	M	Min: 000000001 Max: 999999998
Co-Borrower First Name	First name of the co-borrower of record	Text (100)	C	
Co-Borrower Last Name	Last name of the co-borrower of record. This is also known as the family name or surname	Text (100)	C	
Co-Borrower Social Security Number	The social security of the co-borrower	Text (9)	C	Min: 000000001 Max: 999999998
Property Identifying Data				
Property - Street Address	The street address of the subject property	Text (200)	M	
Property Unit Number	The unit number of the property	Text (100)	C	
Property - City	The name of the city where the subject property is located	Text (100)	M	
Property – State	The 2-character postal abbreviation of the state, province, or region of the subject property	Text (2)	M	Enumeration: WY,WV,WI,WA,VT,VI,VA,UT,TX,TN,SD,SC,RI,PR,PA,OR,OK,OH,NY,NV,NM,NJ,NH,NE,ND,NC,MT,MS,MO,MN,MI,ME,MD,MA,LA,KY,KS,IN,IL,ID,IA,HI,GU,GA,FL,DE,DC,CT,CO,CA,AZ,AR,AL,AK
Property – Zip Code	The code designated by the postal service to direct the delivery of physical mail or which corresponds to a physical location. In the USA, this can take either a 5- digit for (ZIP Code) or a 9- digit form (ZIP + 4)	Text (9)	M	

(continued)

Name	Definition	Data Type/Data Length	Loan Setup for Second Lien Extinguishment Incentive Mandatory / Conditional	Allowable Values
Loan Characteristics				
Unpaid Principal Balance before Refinance (Second lien)	The total principal amount outstanding prior to refinancing (Original second lien)	Currency (20,2)	M	Data Range: Min: 0.01 Max: 9999999999999999.99
Unpaid Principal Balance after Refinance (Second lien)	The total principal amount outstanding after refinancing (Original second lien)	Currency (20,2)	M	Data Range: Min: 0.01 Max: 9999999999999999.99
Extinguishment Level	Indicates partial or full second lien extinguishment	Index (1)	M	Enumeration: 1. Partial Extinguishment 2. Full Extinguishment
Delinquency Indicator	Indicates if the loan was more than six months past due at any time during the 12 month period prior to the FHA refinance closing date	Index (1)	M	Enumeration: 1. Less than or equal to six months delinquency 2. More than six months delinquent
Length of Deferment	Number of months payment on the second lien has been deferred	Index (1)	M	Enumeration: 1. Less than 36 months 2. 36 or more months

(continued)

Name	Definition	Data Type/Data Length	Loan Setup for Second Lien Extinguishment Incentive Mandatory / Conditional	Allowable Values
General Loan Information				
Borrower Execution or Notification Date	This is the date the borrower signed the official partial extinguishment documents / modification agreement	Date (CCYY-MM-DD)	M	
Date of Original Note	The date the mortgage note was signed	Date (CCYY-MM-DD)	M	
Lien Position	Second mortgage lien priority, however, a mortgage loan that would be in second lien position but for a tax lien, mechanic's lien or other non-mortgage related lien is eligible and should be entered here as lien position 2.	Numeric (1)	M	
Investor Code	Owner of the mortgage	Index (1)	M	Enumeration: 1. FNM* 2. Freddie Mac * 3. Private * 4. Portfolio * 5. GNMA 6. FHA/VA 7. State or Local Housing Finance Agency * Indicates investor codes currently eligible for HAMP
Change Indicator	Indicates whether loan is an initial entry or change	Index (1)	M	Enumeration: 1. Initial Submission 2. Correction