Supplemental Directive 12-01 *February 16, 2012*

Making Home Affordable Program –Principal Reduction Alternative and Second Lien Modification Program Investor Incentives Update

In February 2009, the Obama Administration introduced the Making Home Affordable (MHA) Program to stabilize the housing market and to help struggling homeowners get relief and avoid foreclosure. In March 2009, the U.S. Department of the Treasury (Treasury) issued uniform guidance for loan modifications by participants in MHA across the mortgage industry and subsequently updated and expanded that guidance. On December 15, 2011, Treasury issued version 3.4 of the *Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages (Handbook)*, a consolidated resource for guidance related to the MHA Program for mortgage loans that are not owned or guaranteed by Fannie Mae and Freddie Mac (Non-GSE Mortgages).

On June 3, 2010, Treasury issued Supplemental Directive 10-05 announcing a Principal Reduction Alternative (PRA) giving servicers additional flexibility to offer relief to borrowers whose homes are worth significantly less than the remaining amounts owed under their first lien mortgage loans (negative equity). Subsequently, on October 15, 2010, Treasury issued Supplemental Directive 10-14 providing further guidance on implementing PRA. Under PRA, investors are eligible for certain financial compensation incentives whenever the servicer provides a borrower with a permanent modification under the Home Affordable Modification Program (HAMP) that reduces mortgage principal in accordance with the PRA requirements. The guidance set forth in Supplemental Directives 10-05 and 10-14 have been incorporated into the *Handbook*.

On March 26, 2010, Treasury issued Supplemental Directive 09-05 *Revised* to implement the Second Lien Modification Program (2MP), which is designed to work in tandem with HAMP. Together, HAMP and 2MP create a comprehensive solution to help borrowers achieve greater affordability by lowering payments on both first lien and second lien mortgage loans. Under 2MP, when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, the 2MP servicer must offer to modify the borrower's second lien according to a defined protocol. An investor incentive may be paid by Treasury in connection with such modifications that include (a) full extinguishment of the second lien or (b) a partial extinguishment. Treasury has issued subsequent Supplemental Directives providing further guidance on implementing 2MP, which along with Supplemental Directive 09-05 *Revised*, have been incorporated into the *Handbook*.

This Supplemental Directive increases the amount of investor incentive compensation that can be earned for (i) permanent modifications under HAMP that include PRA principal reduction and

(ii) full extinguishment or permanent modifications with partial extinguishment under 2MP, and amends and supersedes the notated portions of the *Handbook*.

This Supplemental Directive is applicable to:

- all permanent modifications under HAMP that include PRA principal reduction that have a trial period plan effective date on or after March 1, 2012; and
- all 2MP full extinguishments or permanent modifications incorporating partial extinguishment, in each case with effective dates on or after June 1, 2012.

Servicers that are subject to a servicer participation agreement and related documents (SPA) must follow the guidance set forth in this Supplemental Directive. This guidance does not apply to mortgage loans that are owned or guaranteed by Fannie Mae or Freddie Mac, insured or guaranteed by the Veterans Administration or the Department of Agriculture's Rural Housing Service or insured by the Federal Housing Administration.

This Supplemental Directive covers the following topics:

- Increased PRA Investor Incentive Compensation
- Updated Net Present Value (NPV) Model
- PRA Mark-to-Market Loan-to-Value (MTMLTV)
- Increased 2MP Investor Extinguishment Incentive Compensation

Increased PRA Investor Incentive Compensation

As to those loans with trial period plan effective dates on or after March 1, 2012, PRA investor incentive payments payable for first lien mortgage loans modified under HAMP that incorporate PRA principal reduction as described in Section 6.4 of Chapter II of the *Handbook* will be paid in accordance with the below schedule.

Principal Reduction Incentive Schedule:
PRA Compensation
Per Dollar of Unpaid Principal Balance (UPB) Forgiven in
MTMLTV Ratio Range
(Loans Less than or Equal to Six Months Past Due)

105% to <115%	115% to 140%	>140%
0.63	0.45	0.30

With respect to loans which were less than or equal to six months past due at all times during the 12-month period prior to the NPV evaluation date, investors will be entitled to receive $0.63 per dollar of principal reduction equal to or greater than 105 percent and less than 115 percent MTMLTV ratio; $0.45 per dollar of principal reduction equal to or greater than 115 percent and less than or equal to 140 percent MTMLTV ratio; and $0.30 per dollar of principal reduction in excess of 140 percent MTMLTV ratio.

With respect to loans which were more than six months past due at any time during the 12-month period prior to the NPV evaluation date, irrespective of MTMLTV ratio range, investors will be paid $0.18 per dollar of principal reduction and will not be eligible for incentives in the above extinguishment schedule. As set forth in Section 13.3.4.1 of Chapter II of the *Handbook,* PRA investor incentive payments will be earned by investors in the month in which the applicable principal reduction amount is actually applied to reduce the borrower's UPB as set in the *Handbook*.

As provided in Section 13.3.4 of Chapter II of the *Handbook,* servicers are not precluded from reducing principal below a 105 percent MTMLTV ratio; however, PRA incentives will not be paid on the portion of any principal reduction that reduces the MTMLTV ratio below 105 percent. Also, as provided in Section 6.3.5 of Chapter II of the Handbook, servicers may continue to substitute principal reduction for any step in the waterfall and may reduce principal at any time during the life of the loan. As set forth in Section 13.3.4 of Chapter II of the *Handbook*, PRA investor incentives will only be paid in conjunction with principal reduction that is deferred over three years in accordance with the requirements of the Section 6.4.5 of Chapter II of the *Handbook*.

Additionally, investors will continue to receive the Investor Payment Reduction Cost Share and if applicable: (i) the one-time current borrower incentive payment described in Section 13.3.2 of Chapter II of the *Handbook* and (ii) the Home Price Decline Protection incentive payments described in Section 13.3.3.1 of Chapter II of the *Handbook*.

Updated NPV Model

Pursuant to Section 7 of Chapter II of the *Handbook,* all loans that meet the HAMP eligibility criteria and are deemed to be in imminent default or delinquent as to two or more payments must be evaluated using a standardized NPV model that compares the NPV result with a modification to the NPV result without a modification. NPV model 4.0 reflects principal reduction incentives announced in Supplemental Directive 10-05. An updated NPV model (NPV "5.0") that reflects the increase in investor compensation incentives is under development. The software application for NPV 5.0 is expected to be available on the Home Affordable Modification Program servicer web portal accessible at www.HMPadmin.com in May of 2012. Until the updated model is available, servicers should continue to use NPV 4.0.

PRA Mark-to-Market LTV

While all servicers are required to evaluate any mortgage loan being considered for HAMP with a MTMLTV ratio greater than 115 percent to determine if principal reduction will produce a positive NPV result, servicers have discretion to offer principal reduction or not, in accordance with the servicer's documented policies and process for evaluating and approving borrowers for PRA (PRA Policy).

Current guidance requires a servicer to run the alternative modification waterfall and NPV as if it intended to reduce principal to 115 percent MTMLTV, whether or not its PRA Policy allows principal reduction at all or allows principal reduction to a higher or lower MTMLTV level. If a servicer's PRA Policy requires evaluation of loans for principal reduction with different terms (for example, only offering principal reduction on loans with a MTMLTV over 125 percent or principal reduction down to 105 percent or 100 percent MTMLTV), the servicer currently must run the standard modification waterfall and NPV and the alternative modification waterfall and NPV as if it intended to reduce principal to 115 percent MTMLTV and a third modification waterfall and NPV using the unique parameters under its PRA Policy.

Effective immediately, servicers that have provided a PRA Policy to MHA-Compliance that allows for principal reduction under terms that are different from the PRA terms described in Section 6.4 of Chapter II of the *Handbook*, may alter the alternative modification waterfall and NPV inputs to reflect principal reduction terms consistent with its PRA Policy. Servicers who utilize this option must clearly describe the circumstances under which principal reduction will be offered in their written PRA Policy and must treat all similarly situated borrowers in the same manner. Such servicers are permitted to run and report only the standard modification waterfall and NPV and a second modification waterfall and NPV evaluation based on the unique parameters of its PRA Policy.

At this time the HAMP Reporting Tool cannot accept PRA transactions where the pre-modification UPB (including capitalization) is less than or equal to a MTM LTV of 105 percent. The HAMP Reporting Tool is being modified to accept input of loans with a pre-modification UPB (including capitalization) equal to or greater than a MTMLTV of 100 percent.

Servicers will be notified when this update is complete and PRA modifications with a pre-modification MTMLTV between 100 percent and 105 percent may then be submitted. Regardless of the pre-modification MTMLTV, PRA investor incentives will not be paid on any portion of principal reduction that reduces the MTMLTV ratio below 105 percent.

Increased 2MP Investor Extinguishment Incentive Compensation

As to those second lien loans with permanent modifications having effective dates on or after June 1, 2012 that include full or partial extinguishment, 2MP investor extinguishment incentive payments will be paid in accordance with the below schedule.

2MP Compensation Per Dollar of UPB Extinguished in
Combined LTV Range
(Loans Less than or Equal to Six Months Past Due)

<115%	**115% to 140%**	**>140%**
0.42	0.30	0.20

Notwithstanding the foregoing, the investor will be paid $0.12 per dollar of the UPB being extinguished for second mortgage liens that were greater than six months past due at any time during the 12 months prior to the date of extinguishment. As set forth in Section 11.3.2 of Chapter V of the *Handbook,* 2MP investor extinguishment incentive payments will be paid in the month following receipt by the Program Administrator of all required data relating to the second lien extinguishment. The 2MP servicer must represent and warrant that the second lien has been released in compliance with applicable laws when submitting a request for 2MP extinguishment incentive payment.

Additionally, investors will continue to receive the Investor Payment Reduction Cost Share described in Section 11.3.1 of Chapter V of the *Handbook*.

Reporting

The reporting and payment processes are currently being updated by the Program Administrator to implement the terms of this Supplemental Directive.

PRA Process Update

PRA reporting and payment processes will be in place by the time trial period plans with effective dates on or after March 1, 2012 convert to permanent modifications with PRA principal reduction.

2MP Process Update

2MP reporting and payment processes will be updated at a later date. 2MP servicers with completed 2MP permanent modifications that include full or partial extinguishment should continue to report their 2MP permanent modified loans. Until the reporting and payment processes implementing the terms of this Supplemental Directive relating to 2MP are in place, servicers will receive compensation under the existing compensation matrix. Upon implementation of such payment processes, the Program Administrator will make a one-time adjustment payment to the servicers to "true-up" the 2MP investor extinguishment incentive payment for 2MP permanent modifications that include full or partial extinguishment with effective dates on or after June 1, 2012. This adjustment may result in an additional payment of investor extinguishment incentives earned for 2MP loans including full or partial extinguishment.

EXHIBIT A
MHA HANDBOOK MAPPING

I. CONFORMING CHANGES TO EXISTING HANDBOOK SECTIONS

The following guidance amends and supersedes the notated portions of the *Handbook*. Changed or new text is indicated in italics. Text that has been lined out has been deleted.

A. Section 6.4.3 of Chapter II is amended to add the following in the first bullet

Under the alternative modification waterfall, servicers use principal reduction between Step 1 – Capitalization and Step 2 – Interest Rate Reduction of the standard modification waterfall. After the servicer has performed Step 1 – Capitalization, the servicer will perform the alternative modification waterfall as follows:

- Reduce the UPB by an amount necessary to achieve either *(i)* the target monthly mortgage payment ratio or *(ii)(a)* a mark-to-market LTV ratio equal to 115 percent *or (b) if applicable, the mark-to-market LTV ratio described in the servicer's PRA Policy*, whichever is reached first.
- If the UPB is reduced to create a mark-to-market LTV ratio of 115 percent *(or, if applicable, the mark-to-market LTV ratio described in the servicer's PRA Policy)* and the target monthly mortgage payment ratio has not been achieved (based on a fully amortizing principal and interest payment over the remainder of the current loan term and using the current mortgage interest rate), continue with the standard modification waterfall steps of interest rate reduction, term extension and principal forbearance, each as necessary, until the target monthly mortgage payment ratio is achieved.

B. Section 11.5.2 is deleted

11.5.2 ~~Reporting PRA Retroactively~~ *Reserved*

~~The following guidance applies to loans where principal reduction is offered after the loan has been permanently modified in accordance with Section 6.4.1.~~

~~During the time period between the application of PRA retroactively and the time the system is available to report such a transaction, servicers must hold their reporting of the principal reduction until such time as the system can accept the values.~~

C. Section 13.3.4.1 is amended as follows

With respect to loans that were less than or equal to six months past due at all times during the 12-month period prior to the NPV Date, investors will be entitled to receive $0.~~21~~*63* per dollar of principal reduction equal to or greater than 105 percent and less than 115 percent mark-to-market LTV ratio; $0.~~15~~*45* per dollar of principal reduction equal to or greater than 115 percent and less than or equal to 140 percent mark-to-market LTV ratio; and $0.~~10~~*30* per dollar of principal reduction in excess of 140 percent mark-to-market LTV ratio.

PRA Compensation
Per Dollar of UPB Forgiven in Mark-to-Market LTV Ratio Range
(Loans Less than or Equal to Six Months Past Due)

105% to <115%	**115% to 140%**	**>140%**
~~0.21~~0*.63*	~~0.15~~0*.45*	~~0.10~~0*.30*

With respect to loans that were more than six months past due at any time during the 12-month period prior to the NPV Date, irrespective of mark-to-market LTV ratio range, investors will be paid $0.~~06~~*18* per dollar of principal reduction and will not be eligible for incentives in the above extinguishment schedule. PRA investor incentive payments will be earned by investors in the month in which the applicable principal reduction amount is actually applied to reduce the borrower's UPB as set forth in Section 6.4.5.

D. Section 6.5 of Chapter V is deleted

6.5 ~~Impact of PRA Retroactivity on 2MP~~ *Reserved*

~~Trial Period With respect to borrowers who have been offered a 2MP trial period and principal reduction under PRA is retroactively applied to the related first lien, the 2MP servicer may, but is not required to, apply PRA retroactively to the second lien under 2MP. With respect to borrowers who have not yet been offered a 2MP trial period, if the 2MP servicer is notified of a matching first lien modification that includes retroactive PRA principal reduction, the 2MP servicer must include the retroactive PRA principal reduction when determining the amount of principal forgiveness required as part of the 2MP modification as set forth in Section 5.1.4.~~

E. Section 7.6 of Chapter V is deleted

7.6 ~~Impact of PRA Retroactivity on 2MP Modification~~ *Reserved*

~~With respect to borrowers who have been offered a 2MP modification and principal reduction under PRA is retroactively applied to the related first lien, the 2MP servicer may, but is not required to, apply PRA retroactively to the second lien under 2MP.~~

~~A 2MP servicer may, subject to investor guidance, convert some or all of an existing principal forbearance amount to principal reduction or otherwise offer any amount of principal reduction pursuant to a principal curtailment, but may not change any other terms of the 2MP modification.~~

~~The servicer must memorialize this arrangement in a notice or agreement sent to the borrower that:~~

- ~~Explains how the deferred principal reduction will be applied to the loan;~~

- ~~States that the principal reduction amount will be reported to the IRS in the year in which the curtailment is applied and advises the borrower to seek guidance from a tax professional to determine any potential tax consequences; and~~
- ~~Explains that the borrower may elect not to accept the offered principal reduction and provide optout instructions.~~

~~Because 2MP servicers have this discretion in offering PRA retroactively on second liens, this treatment should be addressed in the servicer's Retroactive PRA Policy that treats all similarly situated loans in a consistent manner and in compliance with Section 1.6 of Chapter I.~~

F. Section 11.3.2 of Chapter V is amended as follows

For purposes of determining the incentive payment to the investor for extinguishing a second lien, the 2MP servicer must know the borrower's combined loan-to-value (CLTV) ratio. The CLTV is the ratio of the current total UPB of the HAMP-modified first lien and the current total UPB of the unmodified second lien divided by the property value obtained in connection with the permanent HAMP modification. LPS will provide the 2MP servicer with the current total UPB of the modified first lien and the value of the property that secures the HAMP-modified first lien in thesecond lien match notification.

Investors are entitled to compensation per dollar of UPB extinguished in CLTV range based on the table below.

2MP Compensation Per Dollar of UPB Extinguished in CLTV Range
(Loans Less than or Equal to Six Months Past Due)

<115%	115% to 140%	>140%
~~0.21~~0*.42*	~~0.15~~0*.30*	~~0.10~~0*.20*

Notwithstanding the foregoing, the investor will be paid $0.~~06~~*12* per dollar of the UPB being extinguished for second mortgage liens that were greater than six months past due at any time during the 12 months prior to the date of extinguishment.

Second lien extinguishment compensation is paid in the month following receipt by the Program Administrator of all required data relating to the second lien extinguishment. The 2MP servicer must represent and warrant that the second lien has been released in compliance with applicable laws when submitting a request for 2MP extinguishment payment.