Appendix D: Current Alignment and Prospective Future Alignment of Fannie Mae and Freddie Mac Policies and Practices Related to the Removal of Mortgage Loans from Securities

Introduction

The *Request for Input: Single Security Structure* (RFI) released by the Federal Housing Finance Agency (FHFA) in August 2014 outlined the key features of a proposed Single Security and invited industry feedback. In addition to reviewing written responses to the RFI, FHFA and Fannie Mae and Freddie Mac (the Enterprises) have met with key investors, industry groups, and other interested parties to gather additional feedback on the proposal.

One of the most common themes in the industry feedback has been the need to understand better where the Enterprises' key policies and practices are currently substantively aligned today and, where appropriate, to increase that alignment so that the Enterprises' securities can be seen as more fungible. Industry feedback has focused particularly on the need for alignment of Enterprise policies and practices related to the removal of mortgage loans from mortgage securities (also known as loan "buy-outs" or "repurchases"), because such actions can have a large effect on security prepayments.

The purpose of this document is to summarize the key current loan removal policies and practices of the Enterprises where the Enterprises' are already substantially aligned and to provide information on several additional policies and practices where the Enterprises have agreed to become substantially aligned as part of the Single Security initiative.[1]

It should be noted that two types of loan removals discussed below—"Optional Removal Delinquency Trigger" and "Removal Due to Breach of Delivery-Based Representations and Warranties"—comprise well over 90 percent of all loan removals by the Enterprises, and that the Enterprises are already substantially aligned with respect to their policies and practices related to these types of removals. In addition, FHFA has worked with the Enterprises since 2012 on the "Representation and Warranty Framework" to create greater certainty with respect to when the Enterprises can exercise their right to put back loans to a seller.

[1] Each Enterprise's legal documents describe the factors (such as loss mitigation strategies, cost of funds, accounting implications, etc.) that it considers in deciding whether to remove a mortgage loan from a security where such removal is permitted but not required.

Policies and Practices Where the Enterprises Are Already Substantially Aligned

The Enterprises' loan removal policies and practices are already substantially aligned today in the following areas:

- **Optional Removal Delinquency Trigger.** The permitted removal from a security of a loan where the borrower has missed four monthly installments. The current practice of both Enterprises is to remove substantially all loans that reach 120 days of delinquency.
- **Removal Due to Breach of Delivery-Based Representations and Warranties.** The permitted removal of a loan from a security where there has been a material breach of a representation or warranty by a seller or a material loan documentation defect.[2]
- **Court or Governmental Actions.** The required removal of a loan from a security if the Enterprise was not authorized to acquire the loan (i.e., the loan was not Charter compliant or in violation of law) or if a court has ordered the removal of the loan from the security.
- **Removal in the Case of a Purchase by a Mortgage Insurer or Other Third-Party Guarantor.** The required removal of a loan from a security if a mortgage insurer or other third-party guarantor exercises its option to purchase the loan.
- **Final Payment Date.** The required removal of a loan from a security due to the maturing of—and the final payment on—a security.
- **Removal to Maintain Tax Status of Trust.** The permitted removal of a loan from a security if necessary or advisable to maintain the security's status as a fixed investment trust or grantor trust for purposes of Federal tax law.
- **Mandatory Removal Delinquency Trigger.** The required removal from a security of a loan that is 24 months past due.
- **Removal Due to Court-Ordered Change in Loan Terms.** The permitted removal of a loan from a security if a bankruptcy court has approved a plan that materially affects the mortgage terms or authorizes transfer or substitution of real property.

[2] Each Enterprise's Selling and Servicing guide defines its representation and warranty framework.

- **Loss of Security.** The permitted removal of a loan from a security if the loan ceases to be secured by the related mortgage property and the debt has been accelerated.

- **Real Estate Owned (REO) and Trusts.** The general practice of removing loans from securities as they transition to REO.

Policies and Practices Where the Enterprises Have Agreed to Substantially Align

In addition to the policies and practices listed above where the Enterprises are already substantially aligned today, the Enterprises have agreed to substantially align the following policies and practices for prospective Single Security securities prior to the issuance of any Single Securities:

- **Reasonably Foreseeable Default (Imminent Default).** The permitted removal of a loan from a security if default is deemed to be imminent.

- **Removal Permitted Due to Servicer Performance Error.** The permitted removal of a loan from a security in a case of a failure by a seller or servicer to comply with requirements set forth in the Enterprise's Seller/Servicer Guide.

- **Compliance with Law.** The permitted removal of a loan from a security if compliance with applicable law (e.g., the Servicemembers Civil Relief Act) requires a change in certain significant loan terms, e.g., the interest rate or unpaid principal balance.

- **Optional Removal Delinquency Status.** The permitted removal of a loan from a security if four consecutive payment dates have passed while the loan is delinquent, i.e., a delinquent loan where the borrower has resumed making payments but cannot make up the arrearages (including circumstances where the borrower has failed to make up at least one month's arrearage).

In addition, each Enterprise has agreed to eliminate the provisions in its legal documents that allow it to substitute mortgage loans under certain circumstances as an alternative to removal.

Although the specific language in the provisions in the Enterprises' trust agreements or other legal documents is not always exactly the same, once the policies and practices listed above are substantially aligned, the Enterprises' loan removal policies and practices will be generally similar and aligned for purposes of the Single Security.

Going Forward

FHFA recognizes that the success of the Single Security initiative will require continued close alignment of the Enterprises' policies and practices on removal of mortgage loans from mortgage securities. As proposals to revise those policies and practices arise, the Enterprises and FHFA will analyze their potential effects on security prepayment speeds, and FHFA will seek to ensure continued alignment in this area, to the extent feasible. FHFA recognizes that Enterprise-specific proposals may arise that FHFA will need to address. In considering and making decisions about potential changes to the Enterprises' loan removal policies and practices, the Director of FHFA will have the discretion to balance policy objectives that he believes to be appropriate, given FHFA's statutory obligations.