



Announcement 08-23

September 16, 2008

Amends these Guides: Selling and Servicing

Policy Changes with Respect to Lender Eligibility and Contractual Requirements

Introduction

The extraordinary circumstances occurring in the mortgage industry over the past several months have prompted Fannie Mae to conduct a full review of existing policies related to counterparty exposure. Many of the lender eligibility standards and requirements have not been modified for several years, even though the mortgage market has changed dramatically over the past two decades. As Fannie Mae and lenders face this challenging market together, a number of counterparty eligibility policies and requirements have been identified that need clarification or revision. The purpose of these clarifications and revisions is to ensure that Fannie Mae's funds are protected and that business partners are capable of fulfilling their obligations, but also to provide a range of possible remedies for lenders that Fannie Mae may utilize in lieu of more severe actions.

Purpose

This Announcement clarifies existing requirements that are currently being applied and sets forth additional eligibility standards that lenders must meet to become a Fannie Mae lender, or to remain an eligible Fannie Mae lender.

Effective Date

Unless otherwise noted in this Announcement, all policy changes outlined below are effective immediately. The financial eligibility requirements are effective as of December 31, 2008, and lender's compliance shall be based on the quarterly results ending on December 31, 2008.

Clarification and Enhancement of Existing *Selling and Servicing Guide* Sections

This Announcement supplements the requirements currently contained in the Mortgage Selling and Servicing Contract, the Fannie Mae *Selling and Servicing Guides (the Guides)* as updated by announcements, any Master Agreement(s), and any other contracts and agreements between Fannie Mae and a lender (collectively referred to as the “Contract”) and is not intended to replace or limit any existing requirements except where specifically stated. The goal in establishing and clarifying these standards is to ensure that lenders who do business with Fannie Mae can fully assume the financial and operational responsibilities of being a Fannie Mae approved seller and/or servicer. Some of these standards are new, while others are clarifications of existing rights that are currently available to Fannie Mae. The following list summarizes the clarifications and modifications that are further described in the sections:

- Fannie Mae is re-emphasizing the unified and interrelated nature of the selling and servicing obligations that arise under the Mortgage Selling and Servicing Contract, including that when servicing is sold to another lender, both the transferee lender and transferor servicer are obligated for all selling representations and warranties and recourse obligations.
- Additional and more flexible remedies that Fannie Mae may use with lenders are outlined. When a lender fails to comply with certain provisions of its agreements with Fannie Mae, often more flexible solutions are needed so that the lender’s ability to do business with Fannie Mae is preserved without resulting in a formal suspension or termination.
- Fannie Mae’s minimum net worth requirements are being increased and are further clarified. For many years, the minimum net worth required for lenders to do business with Fannie Mae has remained unchanged while the conforming loan limit has significantly increased.
- Fannie Mae is establishing several new requirements, including
 - a broader material adverse change provision;
 - provisions related to significant declines in the lender’s net worth, minimum profitability standards, minimum capital requirements, and a cap on outstanding repurchase obligations;
 - cross default provisions with other obligations, and
 - a minimum servicer rating.

Selling Guide, Part I, Section 201: Mortgage Selling and Servicing Contract

The following provisions are being added to this section of the *Guide* with respect to the integration and non-divisibility of the selling and servicing provisions of the Contract:

Notwithstanding any other provisions in the *Guides*, or any assignment or transfer of servicing by a lender to another entity

- A lender’s benefits and obligations with respect to its contractual rights to service loans are, and were at the time of execution of the Contract, fully integrated and non-divisible from the lender’s benefits and obligations with respect to its contractual rights and obligations to sell loans under the Contract.
- Absent such integration, Fannie Mae would not have entered into, or continued to be bound by, the Contract and would not have entered into, or continued to be bound by, separate agreements with a lender providing for the contractual right to sell or to service loans for Fannie Mae.
- When Fannie Mae consents to a transfer of servicing by a lender, it relies on the integration and non-divisibility of the Contract. Fannie Mae requires that the transferor lender remain obligated for all selling representations and warranties and recourse obligations upon the transfer of servicing, and requires that the transferee servicer, whether the original seller or a transferee servicer, undertake and assume joint and several liability for all selling representations and warranties and recourse obligations related to the loans it services unless explicitly agreed to the contrary in writing by Fannie Mae.

The existing provisions in Section 201 remain in full force and effect.

Selling Guide, Part I, Section 201.08: Remedies for Breach of Contract;
Servicing Guide, Part I, Section 201.09: Remedies for Breach of Contract

A number of changes are being made to the above referenced sections of the *Selling* and *Servicing Guides*.

- The following is added as an event that constitutes a breach of the Contract: “A change in the lender’s financial or business condition, or in its operations, which, in Fannie Mae’s sole judgment, is material and adverse.”
- The following language will be substituted with respect to right to offset obligations: “Fannie Mae may offset any obligations that it may owe the lender against any obligations the lender may owe Fannie Mae under any existing agreement, whether or not Fannie Mae has made any demand under such agreement and even though such obligations may not yet be immediately due.”
- Although many of these remedies are available to Fannie Mae now (through contracts or agreements other than the Mortgage Selling and Servicing Contract, Master Agreement, or the *Guides*), the following possible remedies are being incorporated into the above sections of the *Guides* to more clearly provide Fannie Mae with the ability to be more flexible in the range of possible remedies that may be utilized. Any remedies that are applied are intended to be commensurate with the associated level of risk.
 - Requiring additional and more frequent financial and operational reporting;
 - Requiring the lender to indemnify us for actual and prospective losses, if and when incurred;
 - Requiring the lender to repurchase a mortgage or an acquired property;
 - Accelerating the processing and rebuttal time periods and payment of outstanding repurchases and repurchase/indemnification obligations;

- Requiring the lender to take steps to sell and transfer all of its Fannie Mae servicing, or portions thereof as designated by Fannie Mae, to an unrelated entity upon 90 days written notice from Fannie Mae;
- Limiting the lender from acquiring additional Fannie Mae servicing (over and above its existing servicing) in either of its servicing or subservicing portfolios;
- Modifying or suspending any contract or agreement with a lender, such as a Master Agreement, including termination, suspension, or rescission of any variance approved under the terms there of;
- Requiring the lender to post collateral in the form of cash or cash equivalents reasonably acceptable to Fannie Mae in an amount determined by Fannie Mae based on the particular circumstances;
- Imposing limitations on early funding products or recourse transactions;
- Imposing limits on trading desk transactions;
- Imposing a compensatory fee; and
- Requiring advance payment of fees for technology services, including Desktop Originator[®]/Desktop Underwriter[®].

Fannie Mae is also willing to work with lenders and consider other solutions that can correct or adequately address the concerns of Fannie Mae.

Selling and Servicing Guides, Part I, Section 302: Net Worth and Liquidity Requirements

These *Guide* sections, which outline a higher minimum net worth requirement, are being restated in their entirety as follows:

Fannie Mae’s net worth requirements, as outlined below, represent the minimum amount that is considered acceptable net worth for demonstrating that the lender’s financial condition will be sufficient to support its obligations to Fannie Mae, assuming no other extenuating circumstances exist. Based on the assessment of market conditions or other relevant factors, Fannie Mae may, at any time, request additional reporting of financial information and impose additional net worth, liquidity, or financial condition requirements, including:

- provisions relating to declines in net worth,
- profitability,
- minimum capital requirements,
- cross default provisions,
- recourse, and
- outstanding repurchase limitations.

Any additional requirements that are imposed may apply to a particular lender, a defined group or type of lender, or all lenders.

If a lender fails to maintain a financial condition that is satisfactory to Fannie Mae (including maintaining an acceptable net worth and satisfying liquidity requirements or meeting other

measures of financial soundness that are established), such failure will constitute a breach permitting Fannie Mae to terminate the lender's selling and/or servicing approvals (or to take other appropriate actions) under its Mortgage Selling and Servicing Contract.

Minimum Net Worth Requirements – Effective as of December 31, 2008

Fannie Mae requires lenders to meet minimum net worth requirements to remain an eligible seller/servicer. Lender net worth, as defined and calculated by Fannie Mae, is the lender's Total Equity Capital as determined by Generally Accepted Accounting Principles (GAAP), less goodwill and other intangible assets (excluding Mortgage Servicing Rights) and, based on Fannie Mae's assessment of associated risks, a possible deduction of "affiliate receivables" and "pledged assets net of associated liabilities" (hereinafter referred to as "Lender Adjusted Net Worth"). Effective as of December 31, 2008, the minimum Lender Adjusted Net Worth required to be maintained by a lender must be at least \$1.65 million for approved seller/servicers and \$2.5 million for new lenders seeking Fannie Mae approval, plus a dollar amount that represents one-quarter of one percent (.25%) of the outstanding principal balance of its total portfolio of mortgages serviced for Fannie Mae. (A lender's total Fannie Mae servicing portfolio includes first and second whole mortgages held in Fannie Mae's portfolio, participation interest in first and second mortgages in participation pools held in the portfolio, mortgages and participation interests in MBS pools, and multifamily mortgages.) Lenders approved for selling and/or servicing HomeStyle[®] Construction-to-Permanent mortgages or mortgage loans with an Expanded Approval[®] recommendation are also subject to the increased net worth requirements (i.e., the current HomeStyle and Expanded Approval net worth requirements are no longer applicable as of December 31, 2008).

Approved seller/servicers will have until June 30, 2009 to comply with the increased Lender Adjusted Net Worth requirement, provided they are in compliance with all other Fannie Mae eligibility standards, including the previously applicable minimum net worth requirement.

Minimum Net Worth Requirements – Effective December 31, 2009

As of December 31, 2009, the minimum Lender Adjusted Net Worth requirement for all seller/servicers will be \$2.5 million plus a dollar amount that represents one-quarter of one percent (.25%) of the outstanding principal balance of the lender's total portfolio of mortgages serviced for Fannie Mae.

Minimum Lender Adjusted Net Worth requirements may be indexed to future conforming loan limits. Fannie Mae will announce new net worth requirements and their effective dates when applicable.

Note: For entities (such as nonprofit corporations) whose financial reporting requirements or standards do not facilitate calculation of Lender Adjusted Net Worth, as discussed above, Fannie Mae will determine equivalent financial data to monitor compliance with the minimum net worth requirements. The above definition of "Lender Adjusted Net Worth" will be added to the Glossary section in both the *Selling* and *Servicing Guide*.

Selling and Servicing Guides Part I, Section 302.01: Decline in Net Worth

The following new section is being added to both *Guides*.

Fannie Mae is imposing additional requirements to protect itself against the material and adverse impact of rapid declines in a lender's net worth. Fannie Mae will consider a decline in a Lender's Adjusted Net Worth by more than 25 percent over a quarterly reporting period, or more than 40 percent over a two-consecutive-quarter reporting period, to be a material and adverse change in the lender's financial condition that constitutes a breach of the Contract.

The first measurement period will be (i) a decline in Lender Adjusted Net Worth between September 30, 2008 and December 31, 2008, for the one-quarter reporting period test, and (ii) a decline in Lender Adjusted Net Worth between June 30, 2008 and December 31, 2008, for two-consecutive quarter reporting period test.

Selling and Servicing Guides, Part I, Section 302.02: Profitability

The following new section is being added to both *Guides*.

Effective December 31, 2008, if a lender records four or more consecutive quarterly losses, and experiences a decline in Lender Adjusted Net Worth of 30 percent or higher during the same period, the lender shall be in breach of the Contract, and Fannie Mae may pursue any of its available remedies, including suspension or termination. The look-back period to count four quarters of consecutive losses starts from the quarterly reporting period ending March 31, 2008.

Selling and Servicing Guides, Part I, Section 302.03: Minimum Capital Requirements

The following new section is being added to both *Guides*.

A lender's capital position is a critical factor in maintaining eligibility. Therefore, effective December 31, 2008, a lender must at all times maintain minimum acceptable levels of capital as follows:

Type of Entity	Minimum Acceptable Levels of Capital*
Commercial Banks and Thrifts	Total Risk-Based Capital ratio of 10 percent or higher
	Tier 1 Risk-Based Capital ratio of 6 percent or higher
	Tier 1 Leverage Capital ratio of 5 percent or higher
All Others	Lender Adjusted Net Worth/Total Assets ratio of 6 percent, or equivalent, as determined by Fannie Mae, for entities/peer groups not reporting such data

** For commercial banks and thrifts, as reflected in Call Reports and Thrift Financial Reports*

Failure to maintain such capital levels shall constitute a failure to meet Fannie Mae's standards for eligible lenders.

Selling and Servicing Guides Part I, Section 302.04: Cross Default Provisions

The following new section is being added to both *Guides*.

The following events shall each constitute a lender's breach of the Contract, to the extent permitted by applicable law or regulation:

- A breach by a lender on a credit or funding facility, including warehouse lines;
- A breach by any lender-affiliated or related entity in any of its obligations with Fannie Mae, including parental guaranties; or
- A breach of any agreements with any other creditors where such breach involves an amount that exceeds 3 percent of the lender's Lender Adjusted Net Worth and which extends beyond any applicable cure period provided the lender in such agreement.

Effective immediately, lenders must provide Fannie Mae with written notification in the form of an updated Lender Record Information (*Form 582*) of any of the above cross default events within 30 days of occurrence. Such notice must be provided to Fannie Mae electronically (refer to the *Form 582* instructions on eFannieMae.com).

Selling and Servicing Guides Part I, Section 302.05: Recourse Obligation

The following new section is being added to both *Guides*.

For a lender to be permitted to take on unsecured credit recourse obligations, with credit recourse defined to include any lender contractual credit enhancement to Fannie Mae (over and above the standard selling and servicing representations and warranties) such as an automatic repurchase requirement upon loan default, unconditional indemnification, or loss participation obligation, for either a limited time period, or for life of loan, it must meet minimum long-term external credit rating requirements of AA- or Aa3 from two of the three following agencies: Moody's, Standard & Poor's, or Fitch. If long-term credit ratings are available from fewer than three agencies, all available rating(s) must comply with the standards above. If external ratings are not available, the lender must have internal ratings, as determined and assigned by Fannie Mae, equivalent to AA- or higher.

For lenders who do not meet this requirement, Fannie Mae may require collateral posting or other forms of risk reduction measures.

Selling and Servicing Guides, Part I, Section 302.06: Repurchase Limitation

The following new section is being added to both *Guides*.

The total unpaid principal balance of all outstanding Fannie Mae repurchase requests cannot exceed 25 percent of Lender Adjusted Net Worth as of the latest quarter end. If a breach of

this requirement occurs, the lender will have 30 days to reduce the outstanding repurchase requests to a level that complies with this requirement.

Selling and Servicing Guides, Part I, Section 303: Financial Statements and Reports

Having the ability to require lenders to provide more frequent and more detailed financial information and reports is essential to properly managing risk. Therefore, this section has been clarified to more clearly state the importance of getting financial information and Fannie Mae's right to require lenders to provide such information. This section is restated in its entirety below.

In addition to meeting Fannie Mae's net worth and liquidity requirements, the lender must otherwise demonstrate financial adequacy to us. To determine financial adequacy, Fannie Mae requires the lender to submit – within 90 days after its fiscal year-end – audited annual financial statements and an Authorization for Verification of Credit and Business References (Form 1001) (to identify the presence of any new principal officers, partners, or other owners who hold more than a five percent interest), electronically to audited_financial@fanniemae.com or via hard copy to the following address:

Fannie Mae
Attn: Counterparty Risk Monitoring Unit
One South Wacker, Suite 1400
Chicago, IL 60606

Untimely submission of financial statements, as well as untimely submissions of the Forms 1001, 1002, and 582 as referenced in this Chapter, constitutes an inadequate verification of the lender's ability to meet Fannie Mae's financial and eligibility requirements. Therefore, one or more of the following may occur:

- Fannie Mae may suspend the lender's privileges for selling or servicing mortgages or terminate the Contract if Fannie Mae does not receive the requested financial reports and information when they are due.
- Fannie Mae may exercise any other available and appropriate remedy, including charging a compensatory fee of \$1,000 per month until Fannie Mae receives the requested reports.
- Fannie Mae may also require lenders to provide special reports related to financial information about their operations.

In addition, Fannie Mae may, at any time, require the lender to submit unaudited financial statements, audited financial statements other than the annual statements (if reasonably available), or any other financial information that Fannie Mae considers necessary and reasonable. Fannie Mae also has the right to require more frequent and more detailed financial reporting from a lender so that it can better monitor the continuing eligibility of the lender. Based on applicable circumstances, Fannie Mae also may impose specific liquidity requirements, and require increased reporting on lender's liquidity at any time. A lender's

failure to timely provide the additional financial reporting upon Fannie Mae's request or its failure to comply with liquidity requirements or liquidity reporting may result in Fannie Mae imposing sanctions or other remedies, including termination or suspension of the Contract.

Servicing Guide, Part I, Section 304: Required Servicer Rating

This is a new section that is being added to the *Servicing Guide*.

If the lender is servicing loans on behalf of Fannie Mae and has external servicer ratings as primary servicer for prime residential mortgages, it must maintain at least the following ratings, from each of the rating agencies providing the ratings, as applicable:

- Moody's: SQ3-
- Standard & Poor's: Average
- Fitch: RPS3-

If the servicer services Alt-A or non-prime products for Fannie Mae and does not have any required minimum servicer ratings in its contract for those products, the servicer must maintain equivalent servicer ratings for such products. If servicer ratings are available from fewer than three agencies, all available rating(s) must comply with the standards above.

Lenders who have questions about Announcement 08-23 should contact their Customer Account Team for additional information.

Michael A. Quinn
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