November 12, 2009

MEMORANDUM TO: Board of Directors

FROM: Sandra L. Thompson
Director

SUBJECT: Final Rule on Capital Maintenance: Residential Mortgage Loans Modified Pursuant to the Making Home Affordable Program of the U.S. Department of Treasury

SUMMARY

Proposal: That the Board of Directors (Board) of the Federal Deposit Insurance Corporation (FDIC) approve the attached joint interagency Final Rule (Rule) titled, *Capital Maintenance: Residential Mortgage Loans Modified Pursuant to the Making Home Affordable Program of the U.S. Department of Treasury* (Treasury). If approved, the Rule would be published in the *Federal Register* by the FDIC, the Board of Governors of the Federal Reserve System (FRB), the Office of Thrift Supervision (OTS), and the Office of the Comptroller of the Currency (OCC) (together, the Agencies).

Under the Agencies' general risk-based capital rules, a banking organization may assign a 50 percent risk weight to loans that are fully secured by first liens on one-to-four family residential properties (either owner occupied or rented) and that meet other prudential criteria. Mortgage loans that do not qualify for the 50 percent risk weight are assigned a 100 percent risk weight.

The Rule provides that a mortgage loan modified under the Making Home Affordable Program (Program) will retain the risk weight assigned to the loan prior to the modification, so long as the loan continues to meet other applicable prudential criteria. Accordingly, under the Rule, a mortgage loan appropriately risk weighted at 50 percent before modification under the Program would continue to be risk weighted at 50 percent during the trial period and after modification, provided it meets other prudential criteria. The Rule would not change the existing regulatory capital treatment for state nonmember banks under 12 C.F.R Part 325, Appendix A. Accordingly, the revisions effected by the Rule are only clarifying in nature for the FDIC.

Recommendation: That the Board approve publication of this Rule.

Concur:

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Michael Bradfield
General Counsel

Discussion

Background

On March 4 and April 28, 2009, the Treasury announced guidelines under the Making Home Affordable Program (Program) to promote sustainable loan modifications for homeowners at risk of losing their homes due to foreclosure. The Program guidelines provide a detailed framework for modifying first- and second-lien mortgages on owner-occupied residential properties and offer incentives to lenders, servicers, and borrowers that participate in the Program. These incentives are designed to encourage participation in the Program and promote sustainable loan modifications for homeowners at risk of foreclosure in a way that meaningfully aligns the interests of borrowers, servicers, and lenders.

Under the Agencies' general risk-based capital rules, a banking organization may assign a 50 percent risk weight to loans secured by a first-lien on one-to-four family residential property that is either owner-occupied or rented and meets certain prudential criteria.[1] If a banking organization holds both a first- and junior-lien mortgage on the same property and no other party holds an intervening lien, both loans are treated as a single loan secured by a first-lien mortgage and risk weighted at 50 percent if the two loans, when aggregated, satisfy the criteria for the 50 percent risk weight. Other junior-lien mortgage loans receive a 100 percent risk weight.

If a mortgage loan does not qualify for a 50 percent risk weight, a bank must assign it to the 100 percent risk weight category. However, staff notes that there are slight variations among the agencies risk-based capital rules in the criteria for determining whether a mortgage loan qualifies for a 50 percent risk weight. Specifically, the OCC and FRB capital rules provide that a mortgage loan that is restructured through a loan modification does not qualify for a 50 percent risk weight, whereas the FDIC and OTS capital rules permit a bank or savings association to assign a 50 percent risk weight to a modified mortgage loan. Furthermore, where a mortgage loan is placed on non-accrual and must be risk weighted at 100 percent, the FDIC generally permits a bank to restore the 50 percent risk weight once the borrower has demonstrated timely payment for six consecutive payment intervals.

Comments on the Interim Rule

The Agencies received six comments on the Interim Rule, one from a banking organization, four from trade groups representing the financial industry, and one from an individual. The commenters that addressed the Interim Rule unanimously supported it, asserting that it is consistent with the important policy objectives of the Program and does not compromise the goals of safety and soundness. Commenters requested clarification as to whether the capital treatment provided under the Interim Rule applies to a mortgage loan that has been modified on a preliminary basis under the Program, but which still is within the trial period (and, thus, has not been permanently modified). Commenters also requested clarification regarding the circumstances under which a mortgage loan that was risk-weighted at 100 percent immediately prior to modification under the Program could receive a 50 percent risk weight. Some

[1] <u>See</u> 12 CFR part 325, Appendix A (FDIC).

commenters suggested that a loan should receive a 50 percent risk weight following completion of the trial period or following successful completion of the first pay-for-performance period. Other commenters requested clarification on whether a sustained period of repayment performance could include payments made after a loan had been modified under the Program. The agencies also received a comment on the interaction between private mortgage insurance and loan modifications, which was beyond the scope of the Interim Rule.

Based on an analysis of the comments, the agencies have modified the Rule to specify that a mortgage modified on a trial basis pursuant to the Program may continue to receive a 50 percent risk weight provided it meets other prudential criteria.

Final Rule

The Agencies' staffs believe that that the incentives provided by Treasury significantly reduce the credit risk associated with mortgage loans modified pursuant to Program guidelines. Accordingly, the Agencies' staffs have developed this Final Rule to provide that a mortgage loan modified under the Program will retain the risk weight assigned to the loan prior to the modification, so long as the loan continues to meet other applicable prudential criteria.

The Final Rule would not change the existing regulatory capital treatment for state nonmember banks under 12 C.F.R Part 325, Appendix A. The Final Rule simply clarifies the FDIC's current risk-based capital rules with respect to mortgage loans that are modified. FDIC staff recommends joining this Final Rule to provide explicitly the risk-based capital treatment for mortgage loans modified under the Program.

RECOMMENDATION

Staff recommends that the Board of Directors of the Federal Deposit Insurance Corporation approve the publication of the attached Interagency Final Rule on *Capital Maintenance: Residential Mortgage Loans Modified Pursuant to the Making Home Affordable Program of the U.S. Department of Treasury*.

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