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Announcement 01-02 ***April 5, 2001***

Amends these Guides: Selling and Servicing

Changes to Our Policies for Terminating or Cancelling Mortgage Insurance for Conventional Mortgages

In 1999, we issued two Announcements -- 99-06 and 99-13 -- to address changes we were making to our servicing requirements and mortgage delivery policies as the result of the enactment of the Homeowners Protection Act of 1998. The American Homeownership and Economic Opportunity Act of 2000, which was enacted last December, made several technical changes to the provisions of the Homeowners Protection Act. Among other things, these changes relate to the treatment of adjustable-rate mortgages, certain balloon mortgages, and mortgages for which the terms have been modified; the definition of "value"; and the criteria for determining whether the mortgage insurance for a specific mortgage or a specific borrower is eligible for an automatic termination or a borrower-initiated cancellation. In determining the appropriate initial and periodic disclosures related to the termination or cancellation of mortgage insurance that must be made to borrowers, a lender should take into consideration all of the technical changes made in the American Homeownership and Economic Opportunity Act. This Announcement addresses the effect of some of the key technical changes on our previously announced policies, as well as offering additional guidance on areas that were not covered in our earlier Announcements.

Although the technical changes specifically relate only to eligible mortgages that were originated on or after 07/29/99 (the effective date of the Homeowners Protection Act of 1998), we are re-enforcing our earlier position on extending similar benefits to other borrowers (whenever applicable). Thus, a lender must apply these changes not only to those mortgages originated on or after 07/29/99 that are covered by the provisions of the Act, but also to other mortgages closed before, on, and after 07/29/99 (even though they are not covered by the provisions of the Act) in order to be consistent with our treatment of such mortgages in our earlier Announcements.

We also want to remind servicers that the deadline for executing all applicable outstanding terminations and cancellations for Fannie Mae-owned or –securitized mortgages was 01/01/01 –

and that all such actions were to be reported to us by 02/01/01. Any servicer that did not meet these deadlines should contact its designated Servicing Consultant or Servicing Specialist to discuss its plan for finishing these tasks as soon as possible. The lender must report all future terminations and cancellations to us by the second business day of the month after the month in which the mortgage insurance is terminated or cancelled.

Amortization Schedule for Adjustable-Rate Mortgages

The Homeowners Protection Act of 1998 required that the applicable termination or cancellation date for an adjustable-rate mortgage be based on the amortization schedules for the mortgage. The technical changes made by the American Homeownership and Economic Opportunity Act of 2000 clarified that the "then-current amortization schedule" should be used to determine when an adjustable-rate mortgage is scheduled to reach the required loan-to-value ratio at which automatic termination is required or a borrower-initiated cancellation request must be honored. Although adjustable-rate mortgages are periodically reamortized over their term (as the interest rate changes), the total term of the mortgage does not change; therefore, the technical changes do not affect the requirement that the original amortization period be used to determine the mid-point for a mortgage.

To illustrate the effect of the technical clarification, assume that an adjustable-rate mortgage was originally scheduled to reach a 78% loan-to-value ratio as of the 50th month of its term. Previously, the Act could have been interpreted as requiring automatic termination at that time. Under the clarification, automatic termination is not required as of the 50th month unless the mortgage has a loan-to-value ratio of 78% based on the amortization schedule that is in effect as of the 50th month. Conversely, an earlier automatic termination would be required if the 78% loan-to-value (based on the then-current amortization schedule) were reached before the 50th month.

Term Mid-Point for Certain Balloon Mortgages

The Homeowners Protection Act of 1998 required that mortgage insurance be terminated on the first day of the month after the date that is the mid-point of the amortization period for the mortgage (even if the 78% loan-to-value ratio required for automatic termination had not been reached.) However, the Act was unclear about how the mid-point should be determined for a balloon mortgage that has a conditional refinancing option. We took the position that a 7-year balloon mortgage would not be eligible for automatic termination since the balloon maturity date would occur before the mid-point of the amortization period, but that, if a conditional refinancing option were exercised (thus refinancing the mortgage for an additional 23 years), the mortgage insurance would be eligible for automatic termination at the mid-point for the new refinance mortgage – which would be 11 ½ years after the refinancing.

The technical changes made by the American Homeownership and Economic Opportunity Act of 2000 clarified that a balloon mortgage with a conditional right to refinance should be treated like an adjustable-rate mortgage with respect to the provisions of the Homeowners Protection Act. This means that our 7-year balloon mortgage, which has a conditional right to refinance for another 23 years, must be treated as one continuous mortgage financing (rather than as two independent

mortgages). The result of this amendment is that the "then-current amortization schedule" must be used to determine when a balloon mortgage with a conditional right to refinance will reach the mid-point, at which automatic termination is required. This means that the mortgage insurance must be terminated as of the mid-point of the original amortization term for the mortgage -- which would be at the beginning of the 16th year (and eight years into the term of the refinance mortgage) -- unless the mortgage insurance has already been cancelled or terminated by then.

Termination/Cancellation of Mortgage Insurance for Modified Mortgages

We did not previously address how to handle automatic terminations or borrower-initiated cancellations of mortgage insurance for mortgages that have been modified to change their repayment terms, primarily because the provisions of the Homeowners Protection Act of 1998 were unclear. The technical changes made by the American Homeownership and Economic Opportunity Act of 2000 clarify the treatment of modified mortgages by requiring that the dates for automatic termination or borrower-initiated cancellation be reset based on the new terms of the modified mortgage. For our purposes, a modified mortgage is any mortgage for which the interest rate, payment rate, or mortgage term has been changed in a way that affects the original amortization schedule of the mortgage. (We do not consider an adjustable-rate mortgage that has undergone a scheduled interest rate or payment change to be a modified mortgage.)

When assessing the borrower's 24-month payment history in connection with the cancellation of mortgage insurance for a modified mortgage, a lender does not need to consider the borrower's payment history before the modification took place unless the modification occurred within the 24 months preceding the cancellation request. Depending on the timing of the request for cancellation, the 24-month payment history period may include payments made only before the modification, payments made both before and after the modification, or payments made only after the modification. (If the borrower has had the mortgage for fewer than 24 months, the lender must review the borrower's payment history for the length of time the borrower has had the mortgage.) To illustrate the effect of this treatment of the borrower's payment history, assume that a borrower who obtained a modification under our loss mitigation policy subsequently requests the cancellation of mortgage insurance because the unpaid principal balance of the mortgage has been reduced to 80% or less of the original value of the property. The borrower must have had no payment 30 days or more past due in the 12 months preceding the cancellation date and must have had no payment 60 days or more past due in the 24 months preceding the cancellation date. This means that the previously delinquent borrower must re-establish an acceptable payment history before the mortgage insurance can be terminated or cancelled.

Payment Status for Borrower-Initiated Cancellation Requests

The technical changes made by the American Homeownership and Economic Opportunity Act of 2000 address some ambiguities related to the payment history status of a borrower who requests a borrower-initiated cancellation based on the original value of the property. One of the changes relates to the status of the borrower's payments on the mortgage as to which the cancellation is being requested and the other relates to giving a borrower who has had some past delinquencies an opportunity to cancel mortgage insurance after he or she has re-established a good payment history.

- A borrower must be current at the time the cancellation is requested – that is, he or she must have made the mortgage payment due for the month preceding the date of the cancellation request.

- The borrower must satisfy the payment history requirements -- no payment 30 days or more past due in the past 12 months and no payment 60 days or more past due in the past 24 months -- as of the date that is the later of (1) the date that the balance is first scheduled to reach (or actually reaches) 80% of the original property value or (2) the date the borrower actually requests the cancellation.

Definition of "Value" for Refinances

Under the Homeowners Protection Act, eligibility for automatic termination or borrower-initiated cancellation is tied to the date that the mortgage balance is first scheduled to reach a specified percentage of the original value of the property. The "original value" in the Homeowners Protection Act is defined as "the lesser of the sales price of the property securing the mortgage, as reflected in the contract, or the appraised value at the time at which the subject residential mortgage transaction was consummated." The technical changes made by the American Homeownership and Economic Opportunity Act of 2000 clarify that the "original value" for refinanced mortgages is whatever "appraised value" the lender relied on in the specific transaction, thus eliminating the confusion over the fact that, in a refinance, no "sales price" exists to make the calculation that the Homeowners Protection Act originally contemplated.

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Lenders should contact their Servicing Specialist in their lead Fannie Mae regional office if they have any questions about the changes discussed in this Announcement or any other aspect of our policy related to the termination or cancellation of conventional mortgage insurance.

(Signed)

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