FEDERAL HOUSING FINANCE AGENCY

ADVISORY BULLETIN

AB 2013 – 05

MANAGEMENT OF DEFICIENCY BALANCES

Introduction

This advisory bulletin establishes supervisory expectations for deficiency balance management at Fannie Mae and Freddie Mac (the Enterprises). The bulletin describes factors that should be considered when deciding whether to pursue recovery of deficiency balances as part of a deficiency balance management program. The guidance in this bulletin is not intended to require actions to recover deficiency balances from borrowers who have made efforts to cure their default or to participate in a refinance, modification, or other foreclosure avoidance program.

Background

There is a deficiency balance when the proceeds from a foreclosure sale are insufficient to satisfy the outstanding unpaid principal balance, accrued but unpaid interest, and other expenses associated with a defaulted loan. When permitted under federal law and the laws of the jurisdiction governing the foreclosure, Fannie Mae and Freddie Mac may take action to recover the deficiency balance from the defaulting borrower. Such actions may include obtaining a deficiency judgment and other collection efforts. Pursuing recovery of a deficiency balance when economically beneficial to the Enterprise will reduce credit losses, and may act as a deterrent to so-called "strategic defaulters," that is, borrowers who possess the financial ability to meet their mortgage loan contractual obligations but choose to stop making payments.

Guidance

The Enterprises should maintain formal policies and procedures for managing and monitoring their deficiency balance collection decisions and processes consistent with prudent practices utilized in the financial services industry. An effective deficiency balance management program requires coordination among all parties involved in recovery activities, including third-party service providers. The Enterprises should establish controls to monitor the activities of these counterparties to ensure that deficiency balance management processes are timely, effective, and efficient, and consider possible remedial actions if they are not.

The Enterprises' deficiency balance management programs should identify relevant factors to consider when determining whether to take action to recover a deficiency balance and the appropriate form of action. Those factors should include, but are not limited to, the following:

1. <u>Jurisdiction of Foreclosure</u>: The laws governing foreclosure processes and collection of deficiency balances vary by state. Some states prohibit the practice and others place restrictions and timeframes on a lender's ability to obtain and collect deficiency judgments. It is important that each Enterprise and its vendors comply with the applicable statute of limitations in order to preserve the ability to pursue collection.

2. <u>Federal and other Law</u>: The Enterprise should consider whether a borrower has filed for bankruptcy or there is other litigation involving the property.

3. <u>Mortgage Insurance:</u> For federally insured loans, the Department of Housing and Urban Development or the Department of Veterans Affairs may require the lender to pursue a deficiency judgment. For loans with private mortgage insurance, the terms of the policy that may affect the Enterprise's ability to pursue a deficiency judgment must be considered.

4. <u>Loss Mitigation Efforts</u>: A borrower's efforts to cure the default or pursue an alternative to foreclosure, such as loan refinance or modification program offered by the Enterprise. An additional factor is the borrower's participation in the Enterprise's short sale or deed-in-lieu programs, which provide for a waiver of the Enterprise's right to pursue deficiency judgments.

5. <u>Loan/Borrower-related Factors</u>: An Enterprise should take into account particular characteristics of the loan and borrower that may indicate the likelihood of success of deficiency judgment in a particular case. These factors would include, for example, whether the foreclosed property was owner-occupied or purchased for investment purposes; whether the borrower defaulted on more than one mortgage held by the Enterprise; and available information (e.g., in a credit report) about whether the borrower has kept other financial obligations current.

6. <u>Elements of Bad Faith</u>: Characteristics of strategic default behavior or possible fraudulent acts, such as loan documents that appear inaccurate or falsified, should be considered.

7. <u>Business Judgment</u>: The decision to pursue collection should make economic sense to the Enterprise and reflect that the associated costs are in line with the Enterprise's loss mitigation strategies. The amount of the deficiency, the reason for the default, the financial condition of the borrower, legal fees, and the availability and cost of qualified collection vendor(s) might all influence the decision to pursue a deficiency balance.

The Enterprise's determinations regarding deficiency balances should indicate relative weights of the different factors considered by the Enterprise. The Enterprise's documented process in place for deficiency balance determinations should include a risk-based process for internal review of decisions as appropriate.

Examiners will review policies, procedures, and practices when examining Fannie Mae and Freddie Mac's deficiency balance management programs. Each Enterprise should maintain documented analysis to support decisions regarding actions to recover deficiency balances.

Advisory Bulletins communicate guidance to FHFA supervision staff and the regulated entities on specific supervisory matters pertaining to the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. This bulletin is effective immediately upon issuance. Contact Kari Walter, Senior Associate Director, Office of Supervision Policy or Kyle Roberts, Associate Director, Examination Standards Branch with comments or questions pertaining to this bulletin.