# Connecticut Avenue Securities™ Investor Call

## Mortgage Insurance Primer

Co-hosted by Citi

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# Agenda

- Overview of Borrower Insurance Requirements
- MI Requirements and Example Payment Calculation
  - MI Insurance Trends
- How MI works
  - Typical Loan
  - Typical Loan Possible Claim Outcomes
  - MI Cancellation Provisions
  - Disaster Events
  - Considerations for Disaster Events
- Overview of property and flood insurance requirements for Sellers and Servicers

# Overview of Borrower Insurance Requirements

- Fannie Mae generally requires **mortgage insurance (MI)** for all mortgage loans with original loan-to-value ratios greater than 80%
  - MI compensates the policy holder for losses due to a default of a mortgage loan and is designed to protect against borrower credit default
- Fannie Mae requires **property insurance** for properties securing loans delivered to us
  - Property insurance must protect against loss or damage from fire and other hazards covered by the standard extended coverage endorsement
- Fannie Mae requires **flood insurance** for any property that has a residential building, dwelling, structure, or improvement situated in a Special Flood Hazard Area (SFHA) that
  - has federally mandated flood insurance purchase requirements, or
  - is located in the Coastal Barrier Resources System or Otherwise Protected Area

Fannie Mae's public *Selling Guide* and *Servicing Guide* detail Fannie Mae's policies related to mortgage, property, and flood insurance.

# MI Requirements and Example Payment Calculation

- All loans in CAS deals with original loan-to-value ratios greater than 80% are required to have mortgage insurance (MI) in place provided by one of 7 approved and active mortgage insurance companies
  - Borrower-paid MI: the borrower makes a monthly payment as part of his/her mortgage payment
    - Approximately 85% of MI is borrower-paid. Monthly MI payment is typically 7% - 7.5%[1] of the borrower's total mortgage payment at loan inception. MI coverage automatically terminates when the loan reaches a certain 78% LTV (and can be canceled by the borrower in other circumstances).
  - Lender-paid MI: the lender pays for the MI and charges the borrower a higher interest rate
    - Approximately 15% of MI is lender-paid. In accordance with GSE guidelines, Lender-paid MI cannot be cancelled and must be maintained for the life of the loan.
- If a loan goes to foreclosure (or deed-in-lieu or short sale), the mortgage insurance company is obligated to pay Fannie Mae a benefit. This payment is passed through to the CAS investor as additional disposition proceeds and reduces the loss.

| LTV Range | Standard MI Coverage % (30-year Mortgages) |
|---|---|
| 95.01 – 97.00 | 35.0% |
| 90.01 – 95.00 | 30.0% |
| 85.01 – 90.00 | 25.0% |
| 80.01 – 85.00 | 12.0% |

*Note: most loans have "standard" coverage; however, levels may differ on some loans – this is disclosed on the loan-level deal file*

**Example CAS Loss Calculation**

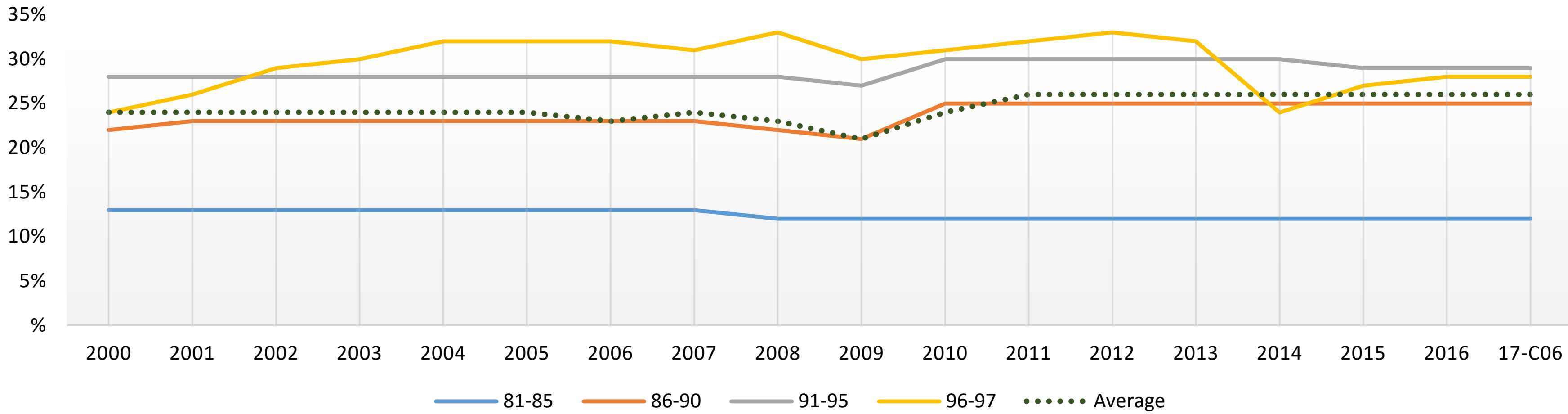
| | | | |
|---|---|---|---|
| Defaulted UPB: | $ | (100,000) | |
| Lost Interest: | $ | (5,000) | |
| Expenses: | $ | (5,000) | |
| Total Indebtedness: | $ | (110,000) | |
| Net Sales Proceeds: | $ | 80,000 | |
| Gross Loss: | $ | (30,000) | |
| MI Benefit: | $ | 27,500 | (MI Coverage: 25%) |
| **CAS Investor Net Loss** | **$** | **(2,500)** | |

- If the mortgage insurance company fails to pay a claim per their contractual obligation, Fannie Mae will step in and cover the MI contractual benefit amount on that loan. Investors are not exposed to mortgage insurance company counterparty risk.

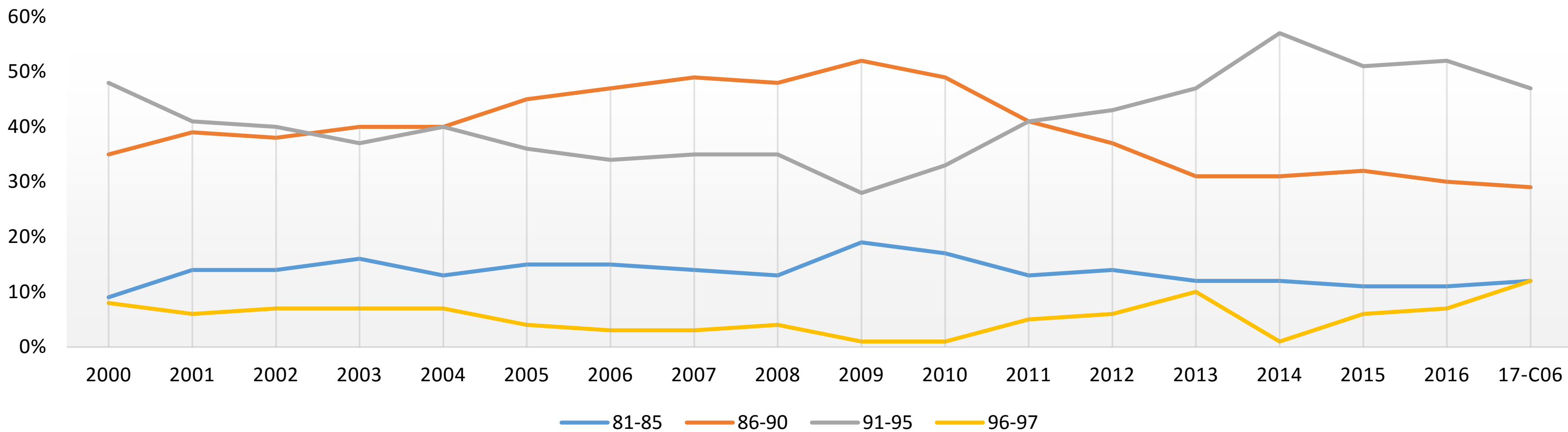
*(1) Given the following key assumptions: 90% LTV, 740 FICO, MGIC Mortgage Insurance rates (44 bps for a 740 FICO loan)*

# Mortgage Insurance (MI) trends

MI coverage percent by original loan-to-value (LTV) ratio*




% UPB for loans that have mortgage insurance*




*Source: Fannie Mae Single-Family Loan Performance Dataset; 2017-C06 G2 At issuance loan tape*

# How MI Works: Typical Loan

**MI Benefit**
**Settled with the "Percentage Option"**

= (Default UPB + DQ Interest + Allowable Expenses) x MI Coverage %

Servicer Informs MI of 60-day DQ

Servicer files claim within 60 days of Foreclosure

Loan Origination

Last Paid Installment

Foreclosure Date

Claim Paid

Property Disposition Date

Potential MI Cancellation due to:

- Loan amortizes to 78% of original home value (automatic)
- Property balance reduced to 80% of original value (borrower-initiated)
- Current property valuation (borrower-initiated)

Loan must be current and meet other requirements

**Disposition Expenses Accrued**

- Property Preservation
- Associated Taxes
- Misc.

Residual loss (net of MI Benefit) applied to CAS structure 90 days after property disposition

- MI Coverage acquired by Lender
- Fannie Mae's requirement for MI Coverage Percent determined by Original LTV

**Foreclosure Expenses Accrued**

- DQ Interest
- Foreclosure Costs
- Asset Recovery Costs
- Associated Taxes
- Misc.

The claim must be "perfected" within 120 days of claim filing, and settled within 180 days of the "perfect date".

# How MI Works: Typical Loan Possible Claim Outcomes

| | |
|---|---|
| **MI Coverage "Percentage Option" Settlement** | ▪ MI elects to pay amount equal to Total indebtedness * MI coverage %<br>▪ Indebtedness=Defaulted UPB + DQ Interest + Allowable Expenses<br>▪ CAS Investor sustains net loss after MI benefit is recognized |
| **Property Sale** | ▪ Fannie Mae disposes of property prior to MI's settlement of the claim<br>▪ MI responsible for payment equal to the lesser of the loss sustained by Fannie Mae or the amount calculated under the Percentage Option<br>▪ CAS deal could sustain a loss if amount recovered from MI is less than loss amount because MI caps expenses and accrued interest |
| **Conveyance** | ▪ MI opts to acquire the property from Fannie Mae by paying amount equal to Total Indebtedness (subject to MI limits on expenses)<br>▪ Fannie Mae transfers property deed to MI company<br>▪ CAS deal sustains no loss (unless MI limits on expenses apply) |
| **Rescission** | ▪ MI QC review uncovers R&W breach and rescinds coverage<br>▪ Fannie Mae will seek make-whole recoveries from the seller/servicer for amount equivalent to MI proceeds that are otherwise contractually due. If Fannie Mae also identifies a R&W breach, seller/servicer may be responsible for the entire loss.<br>▪ CAS investor will receive benefit equal to the amount of make-whole recoveries collected by Fannie Mae |

Post-crisis, MI benefits were reduced in some cases due to a Deferred Payment Obligation (DPO) imposed by MI regulators

In this event, Fannie Mae will step in and make the CAS investor whole for the full MI claim amount due

# How MI Works: MI Cancellation Provisions

Borrower Paid Mortgage Insurance may be cancelled under the following circumstances:

1. Automatic Termination (based on scheduled amortization):
   - the principal balance of the mortgage loan reaches 78% of the original value of the property AND
   - the borrower's payment is current
2. Borrower-Initiated Termination Based on Original Property Value (i.e, loan balance decrease):
   - Outstanding balance of the loan is reduced such that the LTV ratio reaches <=80% of the original value of the property (typically due to a curtailment) AND
   - Borrower must have an acceptable payment history:
     - ❑ payment is current;
     - ❑ has no payment 30 or more days past due in the last 12 months; and
     - ❑ has no payment 60 or more days past due in the last 24 months.
   - The servicer must warrant that the current property value is at least equal to the original property value. The servicer may choose to order a BPO, a certification of value, or a new appraisal to verify the current property value
3. Borrower-Initiated Termination Based on Current Property Value (i.e., property value increase):
   - Servicer must establish current property value as evidenced by a new appraisal based on an interior and exterior inspection of the property and prepared in accordance with Fannie Mae's appraisal standards.
   - LTV ratio must be:
     - ❑ 75% or less, if the seasoning of the mortgage loan is between two and five years.
     - ❑ 80% or less, if the seasoning of the mortgage loan is greater than five years.
   - Borrower must have an acceptable payment history (see requirements above for borrower-initiated termination)

*Applicable to mortgages secured by one-unit principal residence or second home; lower LTV ratios required for other loan types.*
*To note, #1 and #2, above, are provisions of the Homeowner's Protection Act of 1998. #3 is allowed under current Fannie Mae Servicing Guidelines.*

# How MI Works: Disaster events

- Because mortgage insurers are licensed as monoline insurance companies, MI is designed to compensate the policy holder for losses due to a default of a mortgage loan, not for physical damage to the property

- Under the MI master policies, an MI claim can be denied in full if the principal cause of default is determined to be physical damage

- Physical damage may be caused by accident or otherwise, such as flood, earthquake, and any event declared a disaster by the Federal Emergency Management Agency (FEMA) or other governmental agency; the determination as to whether it is the principal cause of default is made by:
  - Direct evidence
  - OR if certain additional criteria are met in totality, some of which may include, but is not limited to
    - the property has not been restored to its condition on the commitment date, reasonable (wear and tear excepted), the property is uninhabitable, the default occurred on or after the date that the physical damage occurred*

** For a complete list of criteria, please refer to Mortgage Insurance Master Policies*

# How MI Works: Considerations for Disaster Events

Even if property damage was ***not*** the primary cause of the loan default, the MI claim amount can still be reduced because of unrepaired physical damage to the property.

If the mortgage insurance company settles the claim by Conveyance or Property Sale option, then it can reduce the benefit by the estimated property repair cost if:

1. As of the claim submission date, the property has not been restored to its condition that existed on the commitment date, reasonable wear and tear excepted.

2. The mortgage insurance company reasonably determines that the estimated cost to restore the property to its condition on the commitment date exceeds $5000.

If the MI company reasonably determines that no claim would be payable if repairs were made (i.e., if there were no loss), the mortgage insurance company can deny the claim in full regardless of the settlement option selected.

# Overview of Property and Flood Insurance Requirements for Sellers

## Property Insurance

**Borrowers have the right** to select his or her own property insurance carrier, provided that the carrier meets our rating requirements. The insurance policy coverages must meet Fannie Mae's requirements.

**The lenders must ensure** that the insurance carrier, policy, and coverage meet Fannie Mae's requirements. In some cases, **Fannie Mae may require additional coverage** or consider coverage that differs from these requirements.

Property Insurance for properties securing loans delivered to Fannie Mae must protect against loss or damage from **fire and other hazards covered by the standard extended coverage endorsement,** which must include, at minimum, wind, civil commotion (including riots), smoke, hail, and damages caused by aircraft, vehicle, or explosion. The coverage must provide for claims to be paid on a **replacement cost basis.** Fannie Mae does NOT accept property insurance policies that limit or exclude from coverage (in whole or in part) windstorm, hurricane, hail damages, or any other perils that normally are included under an extended coverage endorsement.

## Flood Insurance

The **lender must ensure** that any flood insurance required for the security property is in place. Fannie Mae requires flood insurance for any property that has a residential building, dwelling, structure, or improvement situated in a **Special Flood Hazard Area** (SFHA) that

- has federally mandated flood insurance purchase requirements, or
- is located in the Coastal Barrier Resources System or Otherwise Protected Area.

Flood insurance should be in the form of the standard policy issued under the NFIP or by a private insurer. The terms and conditions of the flood insurance coverage must be at least equivalent to the terms and conditions of coverage provided under the standard policy of the NFIP for the appropriate property type.

# Overview of Property and Flood Insurance Requirements for Servicers

**Property Insurance**

The **servicer must:**

- Verify **annually** that the selected insurance carrier, policy amount and type of coverage meet Fannie Mae's requirements.
- Ensure requirements contained in any negotiated contract are met.
- Ensure property insurance **premiums are paid.**
- Immediately **obtain new coverage** to meet Fannie Mae's requirements if the borrower allows the insurance coverage to lapse.
- Contact its Fannie Mae Servicing Representative to determine if additional coverage is needed if the insurable improvements of the property securing a mortgage loan are exposed to hazards that a fire and extended coverage policy does not protect against.
- **Change the insurance coverage** for a mortgage loan when it is inadequate to protect Fannie Mae's interests or, in the instance of lender-placed insurance, causes Fannie Mae to be overinsured.
- Ask the property insurance carrier to cancel the policy, in the event of a loan liquidation.

**Flood Insurance**

The **servicer must:**

- Ensure the property securing the mortgage loan is **adequately protected** by flood insurance when required, with no lapses of coverage.
- Ensure the flood insurance **premiums are paid**.
- Actively monitor all flood maps and community status changes and take appropriate action as changes occur.
- Provide evidence of flood insurance coverage to Fannie Mae within **10 business days** of the date of Fannie Mae's request.
- Increase the coverage for home renovation or construction mortgage loans, if necessary, when the renovation or construction work is completed or the borrower occupies the property.

# Additional Resources

## Approved Mortgage Insurers and Related Identifiers

https://www.fanniemae.com/content/tool/approved-mortgage-insurers-related-identifiers.pdf

## Approved Mortgage Insurance Forms

https://www.fanniemae.com/content/tool/approved-mortgage-insurance-forms.pdf

## Access our Servicing Guide

https://www.fanniemae.com/content/guide/servicing/index.html

## Access our Selling Guide

https://www.fanniemae.com/content/guide/selling/

## Hurricane Relief FAQ

http://www.fanniemae.com/resources/file/mbs/pdf/hurricane-relief-investors-faqs.pdf