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Announcement 05-06 ***August 24, 2005***

Amends these Guides: Servicing

Insurance Claim Settlements

The purpose of this Announcement is to describe the changes to our natural disaster relief procedures, primarily for disbursing insurance claim proceeds.

Servicing Guide Part III: Section 1101, Evaluating the Damage and Section 1103, Insurance Claim Settlements.

After a disaster, most large servicers mobilize into the affected areas to assist borrowers with the task of rebuilding or repairing their properties and assess the needs of borrowers. As a result, we are streamlining our procedures for handling insurance proceeds to provide servicers with more discretion in managing their process for the disposition of hazard (and, if applicable, flood or earthquake) insurance proceeds. These streamlined procedures are based primarily upon the status of the mortgage at the time of the disaster and the extent of the damage. The procedures have four categories that:

1. provide servicers with more discretion to disburse funds when properties securing current mortgages have not suffered a total or near-total loss (servicers, therefore, may choose to disburse all proceeds for the repairs and restoration in a single payment, regardless of the amount, or in a series of progress payments as work is completed);
2. increase the maximum amounts that servicers can disburse when properties securing delinquent mortgages have not suffered a total or near-total loss;
3. provide an electronic process for servicers to make recommendations for the disposition of the insurance proceeds for mortgages 90 days or more delinquent and for mortgages in foreclosure; and
4. address options for the disposition of insurance proceeds for mortgages that are current or 30 to 90 days delinquent based upon borrowers' willingness to repair their properties.

Additionally, we will now require servicers to temporarily discontinue reporting delinquencies to credit bureaus if they are aware that the borrower's delinquency is attributable to hardships as the result of a natural disaster. Also, servicers may now use the

reports provided by property inspectors to document the property inspections. These requirements also pertain to mortgages in bankruptcy.

Our former procedures governing insurance claim settlements were based upon mortgages that were current or less than 90 days delinquent, mortgages that were 90 days or more delinquent, and mortgages that were in foreclosure. A servicer's authority to disburse insurance proceeds with respect to a mortgage that was current or less than 90 days delinquent depended upon the dollar amount of the proceeds and the length of time to complete the repairs. Servicers only had authority to release the funds to the borrower for repairing the property when the insurance proceeds were less than $10,000 and the borrower provided a copy of the contractor's estimate for the repairs. Amounts in excess of $10,000 had to be escrowed if the repairs could be completed quickly. If the repairs could not be completed for some time, the servicer could issue a check to the borrower for the difference between the amount of the insurance loss draft and the current unpaid principal balance of the mortgage provided that the mortgage was current and the borrower had never been more than 30 days delinquent in the preceding 12 months.

We anticipate that the new procedures will enable servicers to work more effectively and efficiently to address the needs of those borrowers that may require more assistance. Accordingly, the following procedures are effective immediately and are applicable to any federal or state declared natural disaster.

For a current mortgage when the property securing the mortgage has not suffered a total or near-total loss (a loss not greater than 80 percent of the coverage amount of the insurance policy):

The servicer must use its discretion to determine the amount of insurance proceeds to disburse and the timing of the disbursements in a manner that is consistent with these procedures. Any funds not disbursed to the borrower should be escrowed in an interest-bearing account for the borrower's benefit. There are no limitations on the amount of funds that the servicer can disburse. Thus, a servicer may choose to disburse proceeds for the repairs and restoration in a single payment regardless of the amount, or in a series of progress payments as work is completed. We expect that the servicer will make its decision after taking appropriate steps to assess the extent and impact of the damage and after consulting with the borrower to ensure that the damage will be appropriately repaired. The servicer must document its actions and the basis for its decisions, including, at a minimum, its consideration of the following:

- the amount of the insurance loss proceeds,
- a contractor's estimate,
- the prevailing down payment amount being requested by contractors in the affected disaster area,
- the length of time for repairs to be completed,
- the preservation of mortgage insurance coverage, and
- requiring the borrower to utilize licensed and insured contractors to perform all repairs.

We suggest that as part of the evaluation the servicer also should consider based upon the cost and time to complete the repairs whether it is necessary to monitor the progress of the repair work through periodic property inspections and whether it is necessary to conduct a final inspection to ensure all repairs are completed. When performing property inspections, servicers may use the reports provided by property inspectors to document property inspections. A servicer must, however, ensure that, at a minimum, each property inspection report includes an accurate assessment of the current condition of the property, is dated, and clearly identifies the mortgagor and the property address.

For a mortgage that is 30 to 90 days delinquent when the property securing the mortgage has not suffered a total or near-total loss (a loss not greater than 80 percent of the coverage amount of the insurance policy), and for a mortgage that is current under the terms of a bankruptcy plan when the property securing the mortgage has not suffered a total or near-total loss:

Generally, the servicer should:

- release up to 20 percent of the total claim proceeds, but not more than $15,000, to the borrower;
- require the borrower to utilize a licensed and insured contractor to perform all repairs;
- review the contractor's estimate and determine the method of disbursement for the remaining funds;
- escrow funds not disbursed to the borrower in an interest-bearing account for the borrower's benefit;
- monitor the progress and completion of the repair work through periodic property inspections, ensuring that, at a minimum, the property inspection report includes an accurate assessment of the current condition of the property, is dated, and clearly identifies the mortgagor and the property address;
- conduct a final inspection to ensure all repairs are completed;
- issue final payment payable to both the borrower and the contractor; and
- document its actions in the mortgage file.

For a mortgage that is 90 days or more delinquent regardless of the extent of the property damage, or for a mortgage that is delinquent under the terms of a bankruptcy plan regardless of the extent of the property damage, or for a mortgage in foreclosure regardless of the extent of the property damage:

The servicer:

- may release up to 10 percent of the insurance proceeds, but not more than $10,000, jointly to the borrower and the contractor to cover the cost of materials needed to repair property damages, and must escrow funds not disbursed in an interest-bearing account for the borrower's benefit;
- must require the borrower to utilize a licensed and insured contractor to perform all repairs; and

- must submit a *Report of Hazard Insurance Loss* (Form 176) to Fannie Mae to recommend an appropriate disposition of the remaining proceeds. The servicer must recommend either that the proceeds be used to repair the property or that the proceeds be applied to reduce the outstanding mortgage debt. The Form 176 must be submitted electronically to Fannie Mae using our dedicated mailbox, hazard_loss@fanniemae.com.

For a mortgage that is current when the property has suffered a total or near-total loss (a loss greater than 80 percent of the coverage amount of the insurance policy), or for a mortgage that is 30 to 90 days delinquent when the property has suffered a total or near-total loss:

The servicer must discuss with the borrower any plans that the borrower has for repairing the property. If the borrower is unwilling to repair the property or if the property is vacant or abandoned, the servicer must submit a *Report of Hazard Insurance Loss* (Form 176) to Fannie Mae to recommend an appropriate disposition of the remaining proceeds. The servicer must recommend either that the proceeds be used to repair the property or that the proceeds be applied to reduce the outstanding mortgage debt. If the borrower is willing to repair the property and the restoration or repair is economically feasible, the servicer must follow either option (I) or (II) below:

I. If the insurance proceeds exceed the sum of the unpaid principal balance (UPB), accrued interest, and any advances, the servicer should issue a check to the borrower for the amount by which the insurance proceeds exceed the sum of the UPB, accrued interest, and any advances.

II. If the insurance proceeds do not exceed the sum of the UPB, accrued interest, and any advances, the servicer should:
   - release up to 20 percent of the total claim proceeds, but not more than $15,000, to the borrower and contractor;
   - review the contractor's estimate; and
   - make a determination on how to disburse the remaining funds.

In both options, the servicer must:

- require the borrower to utilize a licensed and insured contractor to perform all repairs;
- escrow the funds not disbursed to the borrower in an interest-bearing account for the borrower's benefit;
- closely monitor the progress and completion of the repair work through periodic property inspections, ensuring that, at a minimum, the property inspection report includes an accurate assessment of the current condition of the property, is dated, and clearly identifies the mortgagor and the property address;
- conduct a final inspection to ensure all repairs are completed;
- issue final payment payable to both the borrower and the contractor or to the borrower if the servicer can obtain lien waivers from the contractor(s); and
- document its actions in the mortgage file.

The application of these procedures for mortgages in bankruptcy is to be implemented only to the extent permitted by applicable bankruptcy law.

In all instances in which the servicer deposits insurance loss proceeds in an interest-bearing account, the account must be for the borrower's benefit, must yield an amount of interest that is equivalent to the interest that the borrower could expect to obtain from a passbook savings account or a money market account, and must be in a depository institution that meets our eligibility criteria for custodial depositories. The depository account also must provide for all interest earned on the funds to be credited to the account at least quarterly. The servicer must pay the accumulated interest to the borrower at the end of the reconstruction period for the property, unless the borrower requests an earlier disbursement. Additionally, there may be circumstances in which the servicer receives an insurance claim check that includes payments for contents (e.g., personal property) or living expenses. The amount of the claim proceeds attributable to these items should be immediately released to the borrower.

We expect that servicers will make every effort to work with borrowers who are victims of natural disasters to prevent (or minimize) delinquencies and to avoid foreclosures for the mortgages they service on our behalf. Accordingly, we wish to emphasize that servicers **will now be required to** temporarily discontinue reporting delinquencies to credit bureaus if they are aware that the borrower's delinquency is attributable to hardships the borrower has incurred as the result of a natural disaster. Servicers are encouraged to consider waiving any late payment charges if the borrower's payment is late because the borrower has incurred added expenses or loss of income due to the natural disaster, or if the borrower needs additional time to receive a pending insurance settlement.

Servicers are reminded that they must ensure that hazard (and, if applicable, flood or earthquake) insurance claims are filed. If the servicer becomes aware of a loss and the borrower has not filed a proof of loss, the servicer must take appropriate action to ensure that the proof of loss is filed within the time period specified in the insurance policy.

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Because some decisions about the proper action to be taken may need to be handled on a case-by-case basis, the servicer should contact its Portfolio Manager, Servicing Consultant, or Fannie Mae's National Servicing Organization's Customer Care Center at 1-888-326-6438 for assistance in determining how a policy should be applied.

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