

U.S. Structured Finance Newsletter

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LOAN MODIFICATIONS AND YOUR CREDIT SCORE

Over the last few years as residential mortgage credit quality continued to weaken, with both delinquencies and charge-offs on the rise, loan modifications have become the most common approach to loss mitigation for servicers. Modifications can take several forms, including the following:

- Resetting the monthly payment over the remaining loan term to recoup all due and unpaid mortgage payments, late charges and attorney and other fees.
- Capitalizing all unpaid amounts and other costs into a balloon payment due at maturity.
- Reducing a borrower's note rate, extending the term of the mortgage or reducing the loan's unpaid principal balance by forgiving the debt or requiring a balloon payment at the end of the mortgage.

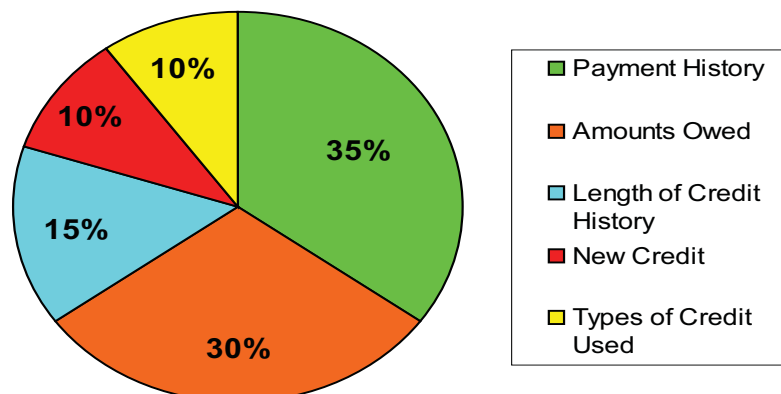
Since servicers reclassify a delinquent mortgage as current once a modification is obtained by a borrower (often after a successful trial period), borrowers usually believe the modification will have no impact on their credit score even though the U.S. Government's Making Home Affordable website says:

"Each month, servicers must describe to the credit reporting agencies the exact status of each mortgage. If you are current with your mortgage payments prior to the trial period and you make each trial period payment on time, your servicer must report you as current and also identify the loan as *modified under federal government plan*. If you are delinquent (at least 30 days past the due date) prior to the trial period and the reduced payments do not bring the account current, your servicer must report the level of delinquency and also identify the loan as *modified under federal government plan*."

Therefore, if a borrower is 90 days past due when beginning a 3-month "trial modification", the servicer will report them as 90 days delinquent on their mortgage to all of the Major Credit Repositories until the borrower has proven that they can sustain the new payments under the modification (in this case 3 months). Once the trial period has ended and the loan is fully modified, the servicer will report them as current but under a *modified payment plan* which indicates that the consumer has only made a partial payment on their mortgage. Based on the reporting code that is used by the servicer, this could cause a consumers credit score to fall anywhere from 30 to 100 points, depending on the other information in their credit file.

In an effort to shield homeowner credit ratings after a modification, a new bill has been referred to the House Committee on Financial Services entitled "H.R.5743: Protecting Homeowners' Credit History Act". The bill seeks to bar banks and servicers from reporting on-time modified loan payments as delinquent and would prevent credit reporting bureaus from including this information in credit reports.

What Affects Your Credit Score



Source: www.myFICO.com

While the Treasury Department feels that homeowners who faced foreclosure and participated in a modification program should not have their credit scores harmed, others in the lending industry feel that modified payments are partial payments and should be reported as such because the borrower is not fully meeting the debt obligation. DBRS will continue to monitor the industry for its use of modifications and their

impact on consumer credit scores as well as the outcome of this proposed bill.

For comments or questions please contact Kathleen Tillwitz at ktillwitz@dbrs.com.

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