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Client Alert

CFPB Adopts Mortgage Servicing Rules

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On January 17, 2013, the Consumer Financial Protection Bureau ("CFPB") issued final Rules establishing national mortgage servicing standards. The Rules cover nine major topics and implement the mortgage servicing provisions set forth in Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). These changes will go into effect on January 10, 2014.

The Rules amend Regulation Z, which implements the Truth in Lending Act, and Regulation X, which implements the Real Estate Settlement Procedures Act. The Rules apply to all mortgage servicers (except "small servicers" as indicated below) and all segments of the mortgage market.

The implementation of these new servicing standards will be expensive requiring servicers to, among other things, add additional personnel, which costs will be passed through to borrowers directly or indirectly. Industry participants (servicers, lenders, mortgage brokers) should immediately review the Rules to determine how they will comply with them. As part of this review, servicers should examine, among other things, their operations, technology and controls to determine how the changes relate to and interact with other applicable requirements, including for many servicers, the servicing standards required by the national mortgage loan servicing and foreclosure settlement, which placed servicing requirements on five of the largest U.S. banks (the "National Mortgage Settlement"), as well as other guidance from banking regulators such as the Independent Foreclosure Review and the SAI (see "Conclusion"). Provisions of the National Mortgage Settlement have been incorporated into the Rules. Industry participants will also need to review the recently adopted CFPB Ability to Repay and Qualified Mortgage Rules. A memo discussing these rules is set forth at http://www.hinshawlaw.com/ files/upload/CorporateFinancial_12413.pdf.

Summary of the Rules

Regulation Z Rule

The Rule amending Regulation Z implements Dodd-Frank Act sections addressing: (i) initial rate adjustment notices for adjustable-rate mortgages; (ii) periodic statements for residential mortgage loans; (iii) prompt crediting of mortgage payments; and (iv) responses to requests for payoff amounts. Existing rules which govern the scope, timing, content, and format of disclosures to consumers regarding the interest rate adjustments of their variable-rate transactions have also been revised.

Regulation X Rule

The Rule revising Regulation X implements Dodd-Frank Act sections by: (i) addressing servicers' obligations to correct errors asserted by mortgage loan borrowers; and (ii) directing servicers to provide (a) certain information requested by borrowers; and (b) protections to borrowers in connection with force-placed insurance. Servicers must also establish reasonable policies and procedures in managing and maintaining their systems in order to achieve certain delineated objectives. The Rule directs servicers to: (i) provide information about mortgage loss mitigation options, if any, available to delinquent borrowers; (ii) establish policies and procedures for providing delinquent borrowers with continuity of contact with servicer personnel capable of assisting such borrowers with loss mitigation efforts and other functions; and (iii) evaluate (in a timely manner) a borrower's application for available loss mitigation options.

The Rule contains loss mitigation provisions that are quite favorable to borrowers, basically requiring servicers to provide borrowers with all available options to avoid foreclosure. For example, a servicer may not start the foreclosure process until the borrower is delinquent at least 120 days and if a delinquent borrower submits a complete loss mitigation application at least 37 days before the foreclosure sale, the loss mitigation process must be completed before the foreclosure may proceed (see "Final Rules -- Provisions under Regulation Z – Loss Mitigation Procedures"). The Rules do not require that a borrower be awarded a loan modification; however, they do set forth procedures that have to be followed, such as a loss mitigation review, before a foreclosure action can be brought.

"Small Servicer" Exemption

The Rules include a number of exemptions and other adjustments for small servicers. A small servicer is defined as a servicer: (i) that services 5,000 mortgage loans or less; and (ii) that only services mortgage loans that it, or an affiliate, owns or originated. Thus, a small servicer may not service mortgages for other entities unless the small servicer originated the mortgages. The CFPB anticipates that the new small servicer definition will cover substantially all of the community banks and credit unions that are involved in servicing mortgages, thereby reducing burdens for those entities.

The exemptions for small servicers include: (i) those relating to general servicing policies, procedures, and requirements; (ii) early intervention with delinquent borrowers; and (iii) continuity of contact. The Rules do not prohibit small servicers from purchasing force-placed insurance for borrowers with escrow accounts for the payment of hazard insurance. However, the cost to the borrower of the force-placed insurance must be less than the amount the small servicer would be required to disburse from the borrower's escrow account to ensure that the borrower's hazard insurance premium charges were paid in a timely manner (see “Final Rules – Provisions under Regulation Z – Force-placed Insurance”).

Small servicers are required to comply with limited loss mitigation requirements which provide that they:

- may not make the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, and

- may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing in accordance with the terms of a loss mitigation agreement (see “Final Rules – Provisions under Regulation Z – Loss Mitigation Procedures”).

The exemptions applicable to small servicers in the final Rules are also available to Housing Finance Agencies, without regard to the number of mortgage loans serviced by such an agency.

Final Rules

The provisions of the final Rules are summarized below. When reviewing the summary, please keep in mind that in the Rules and related materials are over 1,100 pages long.

Provisions under Regulation Z

Periodic billing statements. Creditors, assignees, and servicers must provide a periodic statement for each billing cycle. The statement must contain, among other things, information on payments currently due and recently made, fees imposed, transaction activity, application of past payments, contact information for the servicer and housing counselors, and, if applicable, information regarding delinquencies. These statements must meet the timing, form, and content requirements provided in the Rule. The information must be in writing and mailed within a reasonable time after the payment due date or the end of the grace period for the most recent billing cycle. If the borrower consents, the statement may be delivered electronically.

The Rule contains sample forms that may be used.

The periodic statement requirement generally does not apply to fixed-rate loans if the servicer provides a coupon book. The coupon book must contain certain information specified in the Rule and the servicer must make certain other information specified in the Rule available to the consumer. Reverse mortgages and timeshares are also exempt.

Small servicers are exempt from this Rule.

Interest-rate adjustment notices for ARMs. Creditors, assignees, and servicers must provide a consumer with an adjustable rate mortgage notice between

210 and 240 days prior to the first payment due after the rate first adjusts. This notice may contain an estimate of the new rate and new payment. A notice must be provided between 60 and 120 days before the adjusted payment is due when the rate adjustment causes the payment to change. The current annual notice that must be provided for ARMs for which the interest rate, but not the payment, has changed over the course of the year is no longer required.

The Rule contains model and sample forms that may be used. The Rule grandfathers all ARMs originated prior to January 15, 2015 having look-back periods of less than 45 days.

Crediting payments and issuing payoff statements. A full periodic payment from a borrower must be credited as of the day of receipt. A full periodic payment consists of the entire principal, interest, and escrow amount (if applicable) that is due.

Partial periodic payments may be held in a suspense account. The servicer must apply these funds when the amount in the suspense account will allow a full periodic payment to be made.

Creditors, assignees, and servicers must provide an accurate payoff balance to a consumer no later than seven business days after receipt of a written request from the borrower.

Provisions under RESPA

Force-placed insurance. A servicer may not charge a borrower for force-placed insurance coverage unless (i) it has a reasonable basis to believe the borrower has failed to maintain hazard insurance; (ii) it has notified the borrower; and (iii) it has not received evidence indicating that the borrower has such insurance.

An initial notice containing the required information must be sent to the borrower at least 45 days before the servicer may charge the borrower for force-placed insurance coverage. A second notice containing the required information must be sent no earlier than 30 days after the first notice. A servicer may not charge a borrower for insurance coverage for at least 15 days following the second notice. The second notice must include a good faith estimate of the cost of the insurance. If the borrower's evidence of insurance is inadequate, the servicer must notify the borrower.

The Rule contains model forms that servicers may use.

If the servicer places the insurance and the borrower provides proof of coverage, the servicer must cancel the insurance and refund any premiums and related fees paid for overlapping periods in which the borrower's coverage was in place within 15 days of being notified by the borrower.

A servicer may impose charges related to force-placed insurance (other than those subject to State regulation as the business of insurance or authorized by Federal law for flood insurance). These charges must be for actual services and bear a reasonable relationship to the servicer's cost of providing the services.

If the borrower has an escrow account for the payment of hazard insurance premiums, the servicer is prohibited from obtaining force-placed insurance if the servicer can continue the borrower's insurance, even if the servicer must advance funds to the borrower's escrow account to do so. The servicer may seek repayment of such advances except to the extent prohibited by law.

Hazard insurance required by the Flood Disaster Protection Act of 1973 is not hazard insurance for purposes of this Rule.

The Rules do not prohibit small servicers from purchasing force-placed insurance for borrowers with escrow accounts for the payment of hazard insurance. However, the cost to the borrower of the force-placed insurance must be less than the amount the small servicer would be required to disburse from the borrower's escrow account to ensure that the borrower's hazard insurance premium charges were paid in a timely manner.

Error resolution requests. Servicers are required to meet certain procedural requirements for responding to written complaints of errors. Servicers may designate a specific address for borrowers to use for error notices.

Servicers must comply with the error resolution procedures for eleven different errors. These errors include:

- incorrect calculations of credits or payments;
- incorrect payments (or non-payments) of taxes and insurance from escrow accounts;
- failure to provide information regarding loss mitigation options and foreclosure; and
- (a catch-all provision) any other error relating to the servicing of the borrower's mortgage loan.

A servicer is deemed to be on notice of an error when it receives written notice from the borrower that asserts an error and includes the borrower's name and contains information which enables the servicer to identify the borrower's loan.

Servicers generally are required to acknowledge the receipt of a notice of error within five business days. Servicers also generally are required to: (i) correct the error asserted by the borrower and provide the borrower written notification of the correction; or (ii) conduct an investigation and provide the borrower written notification that no error occurred. Notification of either decision should be made within 30 business days.

A servicer may not (i) charge a fee or require the borrower to make a payment on the loan as a condition to responding to the error notice; and (ii) for 60 days furnish adverse information to a credit reporting agency with respect to the payment that is described in the error notice. While addressing an error notice, a servicer may pursue remedies it has under applicable law, including foreclosure. However, the servicer may not proceed on a foreclosure if the alleged error relates to either: (i) the giving of the first notice or filing for foreclosure in violation of the loss mitigation requirements; or (ii) moving for a foreclosure judgment or conducting a foreclosure sale in violation of the loss mitigation requirements (see “Final Rules – Provisions under Regulation Z – Loss Mitigation Procedures”).

Information requests. Servicers generally are required to respond to written requests for information within ten business days if it concerns the owner of the loan and 30 business days for all other requests. The servicer must either provide the information or explain why the information is not available. The servicer may establish an address to be used to submit such requests. The Rule prohibits a servicer from charging a fee or requiring a payment to be made on the loan before responding to an information request.

Servicing policies, procedures and requirements. Servicers must establish policies and procedures reasonably designed to maintain and manage accounts so as to achieve the objectives specified in the Rules. The reasonableness of a servicer’s policies and procedures will depend on the size, scope, and nature of the servicer’s operations. Examples of the specified objectives include: (i) providing accurate and timely information to borrowers, investors, and courts; (ii) properly evaluating loss mitigation applications in accordance with the eligibility rules established by the owners of the loans; (iii) facilitating oversight of, and compliance by, service providers; (iv) facilitating transfer of information during servicing transfers; (v) informing borrowers of written error resolution and information request procedures; and (vi) investigating and correcting complaints made by borrowers.

In addition, servicers are required to maintain certain documents and information for each mortgage loan in a manner that enables the servicer to compile it into a servicing file within five days. This information includes a schedule of all transactions on the loan and escrow account, any notes reflecting communications with the borrower and loan documents. The servicer must retain records documenting the servicing of a loan until one year after the loan has been paid off or transferred to another servicer.

Small servicers are exempt from this Rule.

Consumers will not have a private right of action to enforce these provisions.

Early intervention with delinquent borrowers. Servicers must establish (or make good faith efforts to establish) live contact with a borrower by the 36th day of the borrower’s delinquency. Once live contact has been established, a servicer must promptly inform a borrower that loss mitigation options may be available if appropriate.

In addition, a servicer must provide a borrower a written notice by the 45th day of a borrower's delinquency. The notice must include, among other things, the servicer's telephone number and address and, if applicable, a description of loss mitigation options offered by the owner of the loan and how to pursue them.

The second written notice must contain examples of loss mitigation options, which may be available to avoid foreclosure. These options could include changing the interest rate, extending the terms of the loan, deferring or forgiving principal, or coming up with some other alternative payment plan. Servicers must include information about housing counseling in the written notice. The Rule contains model language servicers may use for the written notice.

Small servicers are exempt from this provision.

Delinquent borrower contact. Servicers must maintain reasonable policies and procedures with respect to providing delinquent borrowers with access to personnel to: (i) respond to a borrower's inquiries; and (ii) assist a borrower with available loss mitigation options. This service must be provided until the borrower has made two consecutive mortgage payments (without incurring any late charges) in accordance with the terms of a permanent loss mitigation agreement.

Personnel must be assigned to a delinquent borrower by the time a servicer provides such borrower with the written notice required by the early intervention requirements discussed above, but in any event, by the 45th day of a borrower's delinquency.

These personnel should be accessible to the borrower by phone. Such personal must be able to: (i) assist the borrower in pursuing loss mitigation options available from the owner of the loan, including how to pursue such options; and (ii) advise the borrower on the status of any loss mitigation application and applicable timelines and the circumstances under which the servicer may make a foreclosure referral. The personnel should be able to access all of the information (i) about the borrower's payment history; and (ii) provided by the borrower to the servicer. They must provide that information, when appropriate, to those responsible for evaluating the borrower for loss mitigation options.

Small servicers are exempt from this provision.

Consumers will not have a private right of action to enforce these provisions.

Loss Mitigation Procedures. Servicers are required to follow specified loss mitigation procedures for a mortgage loan secured by a borrower's principal residence if such procedures are offered by the owner or assignee of the loan.

It should be noted that nothing in the Rules requires an owner or assignee to provide loss mitigation options.

If a borrower submits an application for a loss mitigation option, the servicer is generally required to acknowledge the receipt of the application in writing within five days and inform the borrower whether the application is complete. If the application is not complete, the servicer must advise the borrower of the information needed to complete the application.

A complete loss mitigation application is one in which the servicer has received all the information it needs from the borrower to evaluate the loss mitigation options available to the borrower. The servicer is required to exercise reasonable diligence in obtaining documents and information to complete the application.

A loss mitigation application means an oral or written request for a loss mitigation option that is accompanied by any information required by the servicer to evaluate a loss mitigation option. A loss mitigation option is an alternative to foreclosure offered by the owner or assignee of the mortgage that is made available to the borrower through the servicer.

Servicers must:

- adopt policies and procedures to ensure that they know which options the owner of the loan (like Fannie Mae, Freddie Mac, the Federal Housing Authority, or the private owner of the mortgage) will allow;
- evaluate a borrower for all loss mitigation options permitted by the owner of the loan for which the borrower may be eligible (so long as a complete application has been received by the required deadlines); and
- ensure that a borrower is not directed to apply for particular options that are most favorable to the servicer or the owner of the loan.

Servicers must inform the borrower, within five business days of the receipt of a loss mitigation application, whether the application is complete (as long as the application is received 45 days or more before a foreclosure sale). If the application is not complete, the servicer must notify the borrower of the missing information.

If a complete loss mitigation application is received more than 37 days before a foreclosure sale, the servicer is required to evaluate the borrower, within 30 days, for all loss mitigation options for which the borrower may be eligible in accordance with the owner's eligibility rules, including options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale). Servicers are free to follow "waterfalls" established by the owner of the loan to determine eligibility for particular loss mitigation options.

The servicer must provide the borrower with a written decision, including an explanation of the reasons for denying the borrower for any loan modification option offered by the owner of the loan. A borrower may appeal a denial of a loan modification program so long as the borrower's complete loss mitigation application is received 90 days or more before a scheduled foreclosure sale. The appeal must be handled by different personnel and the servicer must provide notice to the borrower of its decision within 30 days of the appeal request.

The Rule prohibits a servicer from making the first notice or filing required for a foreclosure process until a mortgage loan is more than 120 days delinquent.

The Rule restricts “dual tracking,” where a servicer is simultaneously evaluating a consumer for loan modifications or other alternatives at the same time that it is preparing to foreclose on the property.

Even if a borrower is more than 120 days delinquent, if a borrower submits a complete loss mitigation application before a servicer has made the first notice or filing required for a foreclosure process, a servicer may not start the foreclosure process unless:

- the servicer informs the borrower that the borrower is not eligible for any loss mitigation option (and any appeal has been exhausted);
- a borrower rejects all loss mitigation offers; or
- a borrower fails to comply with the terms of a loss mitigation option such as a trial modification (as defined in the Rules).

If a borrower submits a complete loss mitigation application after the foreclosure process has commenced but more than 37 days before a foreclosure sale, a servicer may not move for a foreclosure judgment or order of sale, or conduct a foreclosure sale, until one of the three conditions listed above has been satisfied. The servicer must promptly instruct the servicer’s foreclosure counsel not to proceed with filing for foreclosure judgment or order of sale, or to conduct a foreclosure sale, as applicable.

Small servicers are exempt from this Rule but they:

- may not make the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, and
- may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing in accordance with the terms of a loss mitigation agreement.

Consumers have been granted a private right of action to enforce all of the provisions relating to loss mitigation.

The CFPB has indicated that it and other regulators can supervise servicers within their jurisdiction to assure compliance with these requirements.

Conclusion

The prohibition of "dual tracking" (when coupled with (i) the requirement that the foreclosure process cannot start until the borrower is 120 days delinquent; and (ii) the complexities and inherent time delays contained in the loss mitigation rules) could bring the foreclosure process to a standstill. These requirements will make it far more difficult and time-consuming to foreclose on a delinquent borrower. This will further complicate a trend at the state level, where, in many cases, the foreclosure process has been delayed. This may cause additional expenses and losses to be incurred. For example, even if the borrower has vacated the property, a foreclosure would be delayed if the borrower is communicating with the servicer regarding loss mitigation opportunities. Furthermore, extending an already cumbersome foreclosure process could unjustly reward delinquent borrowers; recent reports indicate that 42% of delinquent borrowers have not made a mortgage payment in two years.

Further complicating matters is the fact that a private right of action exists for violations of several provisions of the Rules, including dual tracking, early intervention and loss mitigation procedures. In addition, enforcement of the new servicing standards will be undertaken in most cases by the CFPB and other enforcement agencies.

In addition to having to comply with the Rules, servicers will have to ensure they comply with other regulations such as the recent settlement provisions respecting foreclosure processes entered into in January of 2013 by the Federal Reserve and the Office of the Comptroller of the Currency and ten mortgage servicing companies (the “Independent Foreclosure Review”) and the new Servicing Alignment Initiative adopted on January 8, 2013 by the Federal Housing Finance Agency, Fannie Mae and Freddie Mac (the “SAI”).

For further information about these Rules, please contact Tim Sullivan, Michael D. Morehead or your regular Hinshaw attorney.

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