

**National Consumer Law Center**  
**Analysis and Legislative Text Recommendations for**  
**Servicing Provisions in Johnson-Crapo Discussion Draft**

**April 2014**

Effective servicing provisions in housing finance reform will help maintain the integrity of the Mortgage Insurance Fund by aligning the incentives of servicers of loans in covered securities with other market stakeholders. Currently, servicers often stand to gain by delaying assistance to struggling homeowners or overcharging on fees, resulting in increased losses to investors. Such conduct in the new FMIC system would result in losses that would trigger the government guarantee. Until servicers' incentives are brought in line with investors', any government guarantee will continue to be jeopardized by servicer conduct. Fair servicing also is an important part of access and affordability in the new FMIC system, particularly for special populations including successors in interest, borrowers with disabilities, and borrowers with limited English proficiency.

The draft bill includes provisions to:

- create a substantial system of servicer accountability,
- address the inefficiencies and costs caused by the dual tracking of foreclosures and loss mitigation reviews,
- ensure that affordable loan modifications are provided to qualified homeowners with loans in covered securities,
- promote efficient and fair transfers of servicing,
- establish the groundwork for improving transparency and accountability for loan documentation, and
- initiate reform of servicer compensation.

While these provisions strengthen FMIC's ability to secure efficient mortgage servicing, changes are needed to avoid loopholes and better minimize losses to the Mortgage Insurance Fund. Moreover, a loan modification mandate for the entire mortgage system, not just for loans in covered securities, would level the playing field and prevent excessive migration from FMIC to the PLS market. While the CFPB's servicing regulations are an important step forward, they are procedural in nature and do not address the sustainability of loss mitigation outcomes, nor do they create needed incentives for sustainable servicing for loans in covered securities.. The FMIC system will require specialized servicing rules that protect the Mortgage Insurance Fund and that meet the specific needs of that market.

**Enhancing incentives for compliance.**

- **Penalties for noncompliance.** While the draft includes measures such as a process for certifying compliance with servicing requirements and associated penalties for false certification, as well as a system for revocation of servicing rights, it also must clearly empower the Corporation to assess penalties for material non-compliance. This would provide the Corporation with recourse for identified problems before they rise to the level of a revocation of servicing. Only through a comprehensive system for addressing non-

compliance in servicing will FMIC be able to protect the integrity of the Mortgage Insurance Fund.

- **A path for escalations.** An Office of the Homeowner Ombudsman or similar department inside the Office of Consumer and Market Access or elsewhere in the Corporation would provide a needed pipeline for homeowners and their representatives seeking oversight in real time for a particular case of non-compliance. Such office must have the ability to stop or seek reversal of wrongful foreclosures caused by material non-compliance with Corporation standards. This work could be coordinated with the CFPB complaints function, just as the draft contemplates coordination of supervisory duties, and would be particularly useful at FMIC where the non-compliance with FMIC requirements could be directly addressed. Identification of individual borrower complaints is often the first and sometimes the only warning signal of larger systemic problems and thus an escalations program would assist the Corporation in addressing problems early.

### **Revising the dual tracking limitations to better align servicer incentives with homeowner and investor/insurance fund interests.**

- **Consider borrower costs.** The factors considered in connection with issuance of a rule on dual tracking must address the costs and benefits to all stakeholders. Accordingly, the list of factors must include consideration of the costs to borrowers caused by the initiation or continuation of foreclosure. Dual tracking often leads to wrongful foreclosure, given the difficulty of coordinating loss mitigation and foreclosure sales. Not infrequently, even highly placed loss mitigation managers find themselves powerless to stop a foreclosure once entrained. Conducting a foreclosure during a loss mitigation review increases a servicer's opportunity to charge fees, whether or not earned, that the servicer can retain. These fees can add to a borrower's loan balance, thus making it harder for the homeowner to qualify for an affordable loan modification or bring the mortgage current. In the event of foreclosure, these added fees reduce any recovery to investors and increase any deficiency judgment against borrowers, further hamstringing borrowers from rebuilding their credit. Incorporation of a borrower-related factor would result in more, and faster, loan modifications that also benefit the insurance fund. While the CFPB's regulations include some dual tracking protections, in many cases they still leave investors vulnerable to unnecessary losses where the homeowner seeks assistance after the foreclosure has begun.
- **Trigger protections with submission of an initial package.** Additionally, any dual tracking requirement must be keyed to a borrower's submission of an initial package, as it is under HAMP. Submission of such a package demonstrates good faith by the borrower without creating an incentive for the servicer to elongate the paperwork submission phase. Existing standards that rely on a "complete" package promote loss mitigation delay by allowing servicers to drag out the application process.

### **Elaborating on the loss mitigation requirement to better ensure sustainable modifications.**

- **Ensure clarity and transparency.** The loss mitigation requirement for covered loans, including affordable loan modifications, is an essential element of a final bill. The language would be more likely to yield a well-functioning loss mitigation system if it mandated that the Corporation define "affordable" and that the basis for loss mitigation decisionmaking,

such as a net present value test, be transparent to the borrower. Clarity and transparency yield a more efficient system; borrowers who know their options can assess which options should be pursued and which abandoned.

- **Level the playing field by requiring modifications in the entire market.** If loan modifications are required only for loans in covered securities, servicers will face a patchwork of standards to implement and originators will be incentivized to originate more loans outside of the FMIC system. Only a broad loan modification requirement, where servicers apply standards to PLS loans as well, will level the playing field and preserve competition.
- **Promote loss mitigation through treatment of advances.** The language addressing the treatment of advances should be clarified to more clearly promote modifications. Advances should no longer be required where a repayment plan or modification has been established (not only when full repayment has occurred). Servicers also should be able to recover advances upon permanent modification, to address the lopsided effect now of a faster recovery in case of foreclosure. These changes would encourage all parties to move quickly towards the most economically rational solution and would thus improve outcomes for all stakeholders and for the insurance fund. Existing servicing regulations do not address treatment of advances; thus getting this incentive for efficient loss mitigation right is a priority.

#### **Ensuring fair and efficient transfers of servicing.**

- **Provide for continuity of loss mitigation.** The discussion draft contemplates significant authority for FMIC to transfer servicing rights and the development of servicer succession plans. These powers will enable FMIC to secure more efficient conduct from mortgage servicers. In order to ensure that FMIC requirements are met through such a transfer, the succession plans should include a plan to achieve not only continuity of contact for borrowers but also continuity of the loss mitigation process that may already have begun, including submission of paperwork and review of requests. Currently, transfers of servicing generally are accompanied by a need for any loss mitigation process to be restarted from scratch. For the benefit of the insurance fund, FMIC should ensure that transfers of loans in covered securities do not disrupt the servicer's duty to provide value to investors.
- **Promote efficient and accurate transfers.** Routine servicing also is affected by transfers. The draft ensures transparency and accountability in that process by addressing acceptance of payments and imposition of fees in connection with transfers. Transfers done with such safeguards promote efficiency and accuracy in accounting, decrease disputes and litigation risk, and increase loan performance, thus benefitting homeowners and the insurance fund.

#### **Balancing the registry provisions to better reflect borrower and community stakeholder concerns.**

- **Include homeowner representatives in the working group.** The draft rightly defers to states with existing recordation systems while encouraging states to go online. The working group can be an effective mechanism for exploring a federal registry. However, any working group should equally include homeowner advocates and industry representatives. The

current draft includes industry but not borrower representatives. This imbalance must be corrected to ensure that the work of the group is balanced and effective.

- **Ensure free and transparent access.** Moreover, any eventual registry must provide free access for homeowners to information about the ownership and the servicing rights for their loans. Non-confidential information about loan ownership and servicing should also be available without cost to the public. Problems with the current, private electronic registration system include inaccurate recordkeeping and lack of transparency.

#### **Ensuring that compensation promotes an efficient mortgage servicing system.**

- **Promote maximizing of investor returns, not liquidity.** Servicing non-performing loans is more resource intensive than routine mortgage servicing. Compensation for such work must promote sustainable outcomes for the insurance fund, borrowers, and communities. The servicing compensation study required by the discussion draft should include recommendations that promote such conduct. In addition to structuring compensation to reduce risk to servicers while providing flexibility for guarantors, the system must promote the health of the insurance fund by incentivizing behavior that maximizes investor returns, rather than promoting liquidity, which generally results in unwarranted emphasis on expediting foreclosures at the expense of maximizing value.

### **LINE EDIT RECOMMENDATIONS**

#### Section 309

Page 129, line 12: insert after “market participants” the following: “to promote market competition that will reduce costs”

#### Section 314

Page 175, line 18: remove “seek to”

Page 175, line 23: insert after “borrowers” the following: “who have submitted an initial loan modification request package”

Page 176, line 2: insert after “modification”: “as defined by the Corporation, and offered such modification for each documented hardship”

Page 176, line 5: insert new (iii): “(iii) establishing by rule a requirement to make available to the public at no cost any net present value test that is applicable to a loss mitigation review.”

Page 176, line 5: insert new (iv): “(iv) establishing standards to ensure that affordable loan modifications provided by a servicer in connection with loans in covered securities also are made available to other borrowers with loans serviced by the servicer.”

Page 176, line 8: insert after “arrear” the following: “, the borrower has entered into a repayment plan or modification”

Page 176, line 11: insert after “liquidated” the following: “, including standards that the servicer shall recover advances upon permanent modification of a borrower’s mortgage loan”

Page 176, line 13: replace “may initiate or continue a foreclosure” with “must refrain from initiation or continuation of a foreclosure until completion of a loss mitigation review”

Page 176, line 21: add new (II): “costs to borrowers caused by the initiation or continuation of foreclosure;”

Page 177, line 8: replace “may restrict” with “address”

Page 177, line 13: insert new subsections (J) and (K):

“(J) communication with and the provision of loss mitigation, including loan modifications, to successors in interest protected from enforcement of a due-on-sale clause under 12 U.S.C. §1701j-3(d);

(K) the provision of free, contemporaneous oral interpretation services for borrowers with limited English proficiency, the provision of documents translated into certain foreign languages as determined by the Corporation, and the acceptance of certain documents in such foreign languages.”

Page 179, line 8: insert new subsection (5):

“(5) Borrower Ombudsman

The Corporation shall establish an Office of the Homeowner Ombudsman to receive complaints from homeowners, homeowners’ representatives, and other designated third parties representing homeowner interests. The ombudsman shall have the authority to investigate, including the right to obtain information, documents, and records, in whatever form kept, from the servicer, and to resolve disputes between any homeowner and the servicer of a covered mortgage, including but not limited to resolving disputes regarding any of the servicing obligations under the Real Estate Settlement Procedures Act, 12 U.S.C. 2605, and any foreclosure. The ombudsman shall have the authority to direct a servicer to take action to remedy any material violation, including by directing the servicer to halt or reverse a foreclosure where there has been no transfer of the property to a bona fide purchaser. The ombudsman shall coordinate with the Consumer Financial Protection Bureau in the exercise of this subsection.”

Page 180, line 9: replace “of this Act” with “of initial servicer approval”

Page 183, line 12: insert new (D) (and redesignate current (D) as (E)): “If the Corporation finds that an approved servicer has engaged in material non-compliance of this Act or the rules promulgated pursuant to this Act, the Corporation shall have the authority to impose enforcement penalties in the same manner and to the same extent as the Federal Deposit Insurance Corporation has with respect to insured depository institutions under the provisions of subsection(i) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818).”

Page 189, line 22: insert after “borrowers” the following: “and continuation of any loss mitigation process”

Page 192, line 23: remove “promoting continued liquidity” and replace with “maximizing investor returns”

Page 193, line 6: insert new (j) [note this is drafted as an amendment to 12 USC 1701j-3 but could also be drafted as applying to loans in covered securities (although this approach below is preferable)]:

“(j) Access to Loan Modifications

12 U.S.C. § 1701j-3 shall be amended by adding subsection (h) as follows:

(h) Access to Loan Modifications

(h)(1) In case of a transfer protected from enforcement of a due-on-sale clause under 12 U.S.C. §1701j-3(d), owners of the mortgage debt obligation and their agents must evaluate the homeowner for a loan modification on the same terms as if the homeowner had been the original borrower and mortgagor. Consistent with this obligation, owners of the mortgage debt obligation and their agents, including servicers, must provide transferee homeowners with information about available loan modification options and conduct all loan modification evaluations promptly.

(h)(2) Nothing in this section shall be construed to limit or interfere with the independent rights of a homeowner to assume a mortgage under state law. Owners of the mortgage debt obligation or their agents, including servicers, are not empowered by this section to place any restrictions on the right of homeowners protected by 12 U.S.C. §1701j-3(d) to assume the mortgage.

(h)(3) If an owner of the mortgage debt obligation or its agent, including a servicer, fails to evaluate a homeowner protected by 12 U.S.C. §1701j-3(d) such action may be asserted as a defense to a judicial or nonjudicial foreclosure.

(h)(4) In any successful action brought by a homeowner under this subsection, the homeowner shall be entitled to recover actual damages, costs, and attorneys fees.”

### Section 326

Page 259, line 12: Replace caption with “Consultation Required”

### Section 334

Page 265, line 23: Insert new subsection (C): “(C) Community stakeholders and representatives of homeowners.”

Page 266, line 1: before “national” insert “free and publically accessible”

Page 267, line 3: insert “free” before “access”

Page 267, line 5: insert new (5): “(5) the need to ensure registry information is reliable and accurate, including that such compliance would be a prerequisite to judicial or non-judicial foreclosure.”

Page 268, line 2: insert after “government agencies” the following: “, including requirements to ensure accurate reporting to such systems”

Page 270, line 7, insert at end of sentence, “other than as a defense to a judicial or non-judicial foreclosure.”

Page 270, line 20: insert “or foreclosure law” after “real property recording”

### Section 803

Page 440, omit lines 5-19 to remove section 803(a) so that it remains clear that new owners themselves are obligated to notify the homeowner of the new owner.

Page 441, line 11: change “before the due date applicable to such payment” to “on or before the applicable due date, including any grace period allowed under the loan documents” [this matches the Regulation X language]

Page 441 line 13 insert new subsection (h):

“(h) Disclosure of fees requirement.

(1) A creditor, including a servicer, shall provide to the borrower, not more than 15 days after the effective date of transfer of servicing of a mortgage, a statement regarding the loan which shows the following:

(A) the application of all payments and charges, including the date received, as allocated to principal, interest, escrow, and other charges;

(B) the status of the loan as of the date of the transfer including whether the loan is in default and whether any loss mitigation application submitted by the borrower is pending;

C) an itemization and explanation for all arrearages claimed to be due as of the date of the transfer.”

Page 441 line 13: Subsection (h) becomes subsection (i) [note that currently the discussion draft on page 440 line 24 redesignates 1641(g) as 1641(i); this would need to be adjusted to keep the language we propose here next to the fee waiver language]. Also, note that moving section 1641(g) to (i), as the draft does, moves it away from 1641(f), which is a similar provision for servicers. Perhaps the Safe Harbor for Mistaken Payments can be (j).

Page 442, delete lines 4-7. Note that “servicer” and “residential mortgage loan” are already defined in section 1602(cc) of TILA.

Pages 441-442: all references to “securitized residential mortgage loan” should be changed to “residential mortgage loan”

Page 442, line 4: Insert “Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by inserting at the end of subsection (g) the following: ‘For purposes of Section 1640, the term ‘creditor’ also includes any person with obligations under this Act.’”

Page 442, line 4 following above insertion: “Section 131(g)(1) of the Truth in Lending Act (15 U.S.C. 1641) is amended to change ‘creditor’ to ‘person’ and Sections 131(g)(A), (C) and (E) are amended to change ‘new creditor’ to ‘new owner.’”

Page 442, line 4 following above insertions: Add “Section 130(e) of the Truth in Lending Act (15 U.S.C. 1640) is amended by replacing ‘subsequent sentence’ with ‘elsewhere in this subparagraph’ and by adding after the end of the first sentence, ‘The date of occurrence for violations of section 1641(g) shall be the earlier of the date the homeowner receives the transfer notice or has actual notice of the transfer of the debt obligation, not including a recording of an assignment of interest in the land in a public records office.’”

Page 442, line 4 following the above insertions: “Section 128 of the Truth in Lending Act (15 U.S.C. 1638) is amended by inserting at the end of subsection (f)(2) the following: “The Board shall develop and prescribe appropriate alterations to the standard form for when the form is transmitted to a borrower who has filed for relief under a chapter of Title 11 of the United States Code.””