

COMMENTS

to the

**U.S. Department of Housing and Urban Development,
Office of Lender Activities and Program Compliance,
Quality Assurance Division**

on

**Single Family Housing Loan Quality Assessment Methodology
Defect Taxonomy, Version 2**

by the

**National Consumer Law Center,
on behalf of its low-income clients**

and

Americans for Financial Reform Education Fund

June 28, 2019

Thank you for the opportunity to comment on the defect taxonomy for FHA servicing. We understand that HUD will use this defect taxonomy as a tool to evaluate lender and servicer compliance with their regulations, and our comments focus on the mortgage servicing components of the taxonomy. The National Consumer Law Center and Americans for Financial Reform Education Fund have significant experience and expertise in FHA-insured mortgage servicing and borrower experience with servicers.

Servicer compliance with loss mitigation regulations avoids unnecessary foreclosure and unjustified claims. Developing clear and appropriate standards for the servicing taxonomy will help ensure that servicers are properly held accountable for non-compliance with FHA's requirements. It promises to improve the quality of FHA servicing, which in turn will benefit homeowners and the Mutual Mortgage Insurance (MMI) fund. HUD must ensure that its taxonomy tool encompasses these loss mitigation regulations and allows for borrower input into servicer performance in order to truly gauge whether loss mitigation is working for neighborhoods and for the MMI fund.

In its current form, the servicing taxonomy is less developed than HUD's rules for origination. We urge HUD to enhance the proposed guidelines and bring them more into line with the origination rules by giving them greater specificity.

We have provided a detailed list of suggestions for HUD's taxonomy below. The following is a summary of our key recommendations:

- Sources should be expanded to more fully reflect FHA servicing requirements.
- In considering sources, HUD must reach out to borrowers. HUD must verify servicer claims of borrower disengagement—and verify servicer outreach steps—through independent borrower contact.
- HUD must provide notice of identified problems to borrowers and specifically remedy them.
- HUD must specifically define the tolerances provided in the taxonomy and reconsider the use of “large/small” degrees of non-compliance as small issues can have a large cumulative impact over time.
- Even if HUD retains the large/small degrees of non-compliance, HUD must more specifically define the threshold for problems covered, as it does for

- origination. Categories should include: causing acceleration or foreclosure; increased costs; systemic problems; and misrepresentation to the borrower.
- As part of the defect analysis, HUD must analyze servicer performance on borrower protective rules such as the RESPA Notice of Error rule and other common non-compliance challenges such as servicing transfers. HUD's analysis should go beyond FHA loss mitigation protocols to include these crucial RESPA requirements that apply to FHA loans.
 - When HUD finds that a defect affects additional homeowners, HUD should notify such homeowners and make remedies available to all affected homeowners.

We note that that the Defect Taxonomy's introduction states that the proposed guidelines do not “[l]imit FHA’s actions with regard to fraud or misrepresentations.” p. 3. We understand this reference to mean that the proposal does not address issues concerning certifications in the servicing or origination context, and particularly the consequences of servicers’ or originators' false certifications of compliance with FHA guidelines. We also note that recent court decisions have addressed concerns raised by certain industry groups regarding exposure to “strict liability” under the False Claims Act (“FCA”) for minor and insubstantial misrepresentations. In *Universal Health Services, Inc. v. United States*, 136 S. Ct. 1989 (2016) the Supreme Court expressly ruled that minor or insubstantial false statements cannot trigger FCA liability. With the Seventh Circuit’s recent ruling in *United States v. Luce*, 873 F. 3d 999 (7th Cir 2017) all circuits have now adopted a common standard for determining causation of damages for FCA claims. All courts now apply the familiar concept of proximate cause in determining FCA liability. To the extent that HUD does address the consequences of false certifications, we emphasize that it would be inappropriate to make policy decisions regarding these consequences based on legal doctrines that are now obsolete.

Below we provide comments linked to specific text in the servicing defect taxonomy proposal, including recommendations and analysis. We look forward to working with you to more fully develop the servicing defect taxonomy. For further discussion on this matter, please contact Geoff Walsh, staff attorney at NCLC, at gwalsh@nclc.org or 617-542-8010.

I. General Servicing

Sources/Causes (Servicer Obligations)

- Pg. 28: Add to Sources - “Documentation of Fees”

Explanation of Recommendation: The file should document all fees charged to the borrower. The Handbook lists specific allowable and prohibited fees. Handbook 4000.1 Section 3.A.1. f. According to the Handbook, all fees must be reasonable, customary, and based on actual work performed. The HUD review should verify that the file contains this documentation for any fee charged to the borrower, including documentation supporting actual cost of any work performed.

- Pg. 28: Add to Sources – “Accuracy of Notice of Error and Request for Information Responses”

Explanation of Recommendation: Under RESPA, borrowers have the right to ask their servicers to correct errors and provide information about their accounts 12 C.F.R. §1024.35 & §1024.36. The requests may seek, *inter alia*, correction of account errors, information about charges and fees, and raise concerns about loss mitigation. All of these topics implicate FHA servicing guidelines, including the servicer’s compliance with Handbook 4000.1 Providing incorrect information and failure to correct errors can seriously impair compliance with FHA guidelines and cause unnecessary claims. When inaccurate or incorrect information appears in a servicer’s response to a Notice of Error or Request for Information, HUD should note this as a significant servicing defect.

- Pg. 28: Add to Sources – “Transfer of Servicing”

Explanation of Recommendation: HUD should add a specific oversight item concerning servicing transfers. The failure to transfer complete and accurate account records impairs compliance with FHA guidelines in many ways. Deficient transfers distort accurate account histories. They also impair loss mitigation applications, reviews for loss mitigation options, and the implementation of options approved by a prior servicer. HUD’s reviews must assess the accuracy and completeness of records received from prior servicers and note deficiencies as significant defects.

Severity

- Pg. 29: Comment on Severity Tiers – HUD should specifically define the tolerances provided in the taxonomy and reconsider the use of “large/small” degrees of non-compliance as small issues can have a large cumulative impact over time. A more bright-line threshold for distinguishing unacceptable vs. deficient servicing conduct also is needed.

Explanation of Recommendation: The proposed severity tier definitions include a distinction between failures to comply with guidelines that are noncompliant “by a small degree” and those that are noncompliant “by a large degree.” The relevant “degree” for each type of defect is to be based on a tolerance determination by FHA. Because FHA has not disclosed any aspect of the tolerance determination, the utility of any comments on this Defect Taxonomy is extremely limited. HUD should seek further public comments before it implements a Defect Taxonomy with actual tolerance thresholds.

We urge HUD to reconsider the use of a “large/small” degree of non-compliance as a standard to assess non-compliance with FHA servicing guidelines. Such a system may work better in the origination context. For example, it is possible to set concrete thresholds for severity of errors in an originator’s DTI and LTV calculations. Servicing, however, involves a long-term, continuing relationship and not a one-time transaction. Errors can have cumulative impacts over time, potentially leading to inappropriate accelerations and foreclosures. As will be discussed later in the loss mitigation context, when loans are in default servicers act under incentives to complete foreclosures and avoid time-consuming and labor-intensive engagement with borrowers. These incentives to non-compliance do not appear in the origination context and need to be taken into account through use of evaluation standards designed to recognize particular servicing defects.

- Pg. 29: Comment on Severity Tiers: HUD’s general servicing assessments should consider the following defects as severe and requiring remedial action (this applies to all servicing severity tiers):
 - Errors resulting in costs improperly added to the borrower’s account.
 - Errors that inappropriately lead to actual acceleration or foreclosure.
 - Errors that indicate a systemic problem.

- For example, a software defect that produces a relatively small improper charge found in one loan file may easily cause the same error across the servicer’s entire portfolio of FHA loans. Misinformation displayed in a response to a Notice of Error or Request for Information may reveal a lack of staff training and oversight that impacts thousands of FHA loans. For these reasons, the assessment of each instance of non-compliance must involve an inquiry into *why* the non-compliance occurred. The proposed assessment tool fails to require any inquiry into this important factor, yet purports to make a judgment about severity.
- Errors that involve a misrepresentation to the borrower of the servicer’s obligations under FHA guidelines.
 - A misrepresentation communicated from a servicer to the borrower regarding what FHA guidelines require should not be treated the same as a math mistake.

Remedies

- Pg. 29: Add to Remedies – “Notify Borrower of Error”

Explanation of Recommendation: Requiring recalculation to remedy account errors and the refund of erroneously assessed fees are appropriate responses to many defects. However, the remedies proposed in the Defect Taxonomy do not include a requirement to notify the borrower directly about the error and give the borrower an accurate explanation of the corrective action. Because the severity index omits consideration of the cause of a defect, other borrowers affected in the same way receive no information about the defect.

In addition to requiring investigation into causation, HUD must require notice and correction for all affected borrowers whenever the defect affects other borrowers.

II. Default Servicing

Sources/Causes (Servicer Obligations)

- Pg. 30: Add to Sources – “Non-compliance with RESPA Notice Requirements for Incomplete Applications”

Explanation of Recommendation: The completion of an application is essential for the effective implementation of FHA's loss mitigation program. In its reviews HUD should include an examination of the servicer's compliance with the RESPA rules regarding incomplete loss mitigation applications. The RESPA rules define an "application" for loss mitigation as a borrower request, verbal or written, for assistance in avoiding foreclosure when accompanied by any information that the servicer uses to consider a borrower for loss mitigation (such as a reference to loss of income). Official Bureau Interpretation of Reg. X ¶ 41(b)(1)-2.

Any communication from a borrower that meets this very broad standard triggers the servicer's affirmative duty to assist the borrower to complete the loss mitigation application process. Upon receipt of this general inquiry regarding foreclosure avoidance, the servicer must promptly give the borrower a written notice describing the documentation needed to complete a loss mitigation application. The servicer must continue to provide these notices upon receipt of additional information, until the application is complete. The only exception to this requirement applies when the initial communication from the borrower comes less than 45 days before a scheduled foreclosure sale. Evidence in a file review that a servicer is not complying with the incomplete application rules is good indication that loss mitigation is not getting off the ground with the servicer. This defect is severe.

- Pg. 30: Add to Sources – “Duplicative or Irrelevant Document Requests”

Explanation of Recommendation: Servicers frequently demand that a borrower provide multiple copies of the same documents, such as pay stubs. This practice delays loss mitigation and discourages borrower participation. Similarly, servicers ask for documents that are not necessary for evaluation under FHA's loss mitigation waterfall. This can include particularized documentation of borrower expenses instead of relying on IRS expense standards. These defects impede loss mitigation and are severe.

- Pg. 30: Add to Sources – “Transmission of Loss Mitigation Upon Transfer”

Explanation of Recommendation: Servicing transfers take place with increasing frequency. Successor servicers' mishandling of pending and completed applications for loss mitigation seriously impairs the loss mitigation program.

RESPA rules, including recent amendments, obligate servicers to implement systems to ensure seamless handling of loss mitigation when a transfer of servicing rights occurs. 12 C.F.R. §1024.41(k); § 1024.38(b)(4) and Official Bureau Interpretation to Reg. X ¶ 41(i)-2. File reviews should verify that successor servicers obtained complete and accurate records from predecessor servicers.

- Pg. 30: Add to Sources: “Accuracy of Notice of Error and Request for Information Responses”

Explanation of Recommendation: As discussed in the previous section regarding general servicing, HUD should carefully review servicers’ responses to a borrower’s Request for Correction of Error or Request for Information. Review of responses pertaining to default servicing will give HUD valuable insight into the efficacy of the servicer’s staff training in the area of FHA guidelines. The responses will reveal systemic misunderstandings that can be subject to corrective actions directed by HUD.

- Pg. 30: Comment on Sources - HUD must verify servicer claims of borrower disengagement through independent borrower contact.

Explanation of Recommendation: Many files indicate no loss mitigation review occurred because the borrower did not cooperate in completing a loss mitigation application. Servicers have a financial incentive to minimize staff time devoted to loss mitigation. This can lead servicers to disregard communications from borrowers that indicate an interest in pursuing loss mitigation. HUD’s reviews must routinely include verification of servicer claims of borrower disengagement. This can be accomplished only by direct communication with the affected borrowers. Misrepresenting facts regarding borrower disinterest has serious implications affecting many aspects of the servicer’s loss mitigation documentation and is a serious defect.

- Pg. 30: Comment on Sources – Servicer file reviews should examine communications between borrowers and servicer staff.

Explanation of Recommendation: Servicers routinely record calls between front-line staff and borrowers. The file reviews should include an examination of the

content of these calls as well as written communications. These calls will provide examiners with direct evidence of what servicers are telling borrowers.

- Pg. 30: Comment on Sources – Assistance to LEP borrowers must be assessed.

Explanation of Recommendation: Review of recorded calls and other file information can reveal deficiencies in the servicer’s ability to interact with borrowers who have LEP needs. Servicers that outsource their call centers may also be using staff who have their own LEP needs. These problems need to be detected and made subject to corrective actions.

- Pg. 30: Add to Causes – “Evidence of Servicer Misrepresentation on Loss Mitigation”

Explanation of Recommendation: In listing “causes” for defects, HUD includes an item for “Evidence of Fraud or Misrepresentation.” This appears to refer to fraud or misrepresentation about borrower income and assets that create problems in loan origination. HUD’s taxonomy does not clearly address the forms of fraud or misrepresentation that are common in the servicing context. Servicer misrepresentations to borrowers about loss mitigation can undermine the entire loss mitigation program. These can include verbal and written statements that discourage applications, misrepresentations about application requirements and eligibility, and failure to disclose a continuing right to be considered for loss mitigation. HUD’s evaluation needs to root out false and misleading communications that appear in written communication and phone recordings. Servicer misrepresentations to borrowers regarding loss mitigation should be documented as a distinct category in a file review

Severity

- Pg. 31: Comment on Severity: If a servicer obstructs the borrower’s initial engagement in loss mitigation, particularly by deterring submission of an application, this undercuts the entire FHA loss mitigation program. HUD should attribute a high level of severity to defects that impair or deter the initial steps in the loss mitigation process, including:
 - Non-compliance with RESPA requirements for written notices regarding incomplete applications;

- Communications (verbal or written) that discourage applications, or misrepresent application status or eligibility;
- False statements to HUD of borrower disengagement; and
- Failure to conduct a face-to-face meeting unless a verified exception applies.

Remedies

- Pg. 31: Add to Remedies – “Correction of Accounts”

Explanation of Recommendation: When a servicer impairs access to FHA loss mitigation, this can have far-reaching consequences. These can include assessment of improperly high interest charges, imposition of improper default fees and charges, and even unwarranted acceleration and foreclosure. These actions may trigger unnecessary claim payments. They also have a significant impact on borrowers. HUD must follow up findings of defects in loss mitigation with reviews to ensure that borrower accounts have been adjusted properly to correct for the errors.

- Pg. 31: Add to Remedies – “Suspension of Foreclosure”

Explanation of Recommendation: As HUD’s proposed taxonomy guidelines provide, all foreclosure activities must be suspended when HUD finds errors in the servicer’s default servicing. If a third party has not acquired title to the property after a sale, the foreclosure sale should be set aside. Any default-related fees and costs assessed to the account must be removed from the account.

- Pg. 31: Add to Remedies – “Curtailment of interest, fees, and costs”

Explanation of Recommendation: HUD should require curtailment of charges for interest, costs, and fees accrued to the account from the time the default servicing error occurred until the time the servicer corrected the error. The curtailment should include adjustment of the borrower’s account as well as to the insurance claim

- Pg. 31: Add to Remedies – “Notice to affected borrower of findings.”

Explanation of Recommendation: HUD must notify the affected borrower when it finds that the servicer erred in implementing FHA default servicing guidelines.

This is not only a matter of fairness, but will also increase the likelihood that corrective action will be taken.

- Pg. 31: Add to Remedies – “Notice to all affected borrowers where the defect indicates a systemic problem.”

Explanation of Recommendation: As mentioned in the previous section, HUD’s review must investigate the cause of a defect. If the investigation indicates a problem with software or staff training, this is a systemic problem that likely affects many more borrowers. All affected borrowers should be notified of the finding. This will promote broad compliance and deter future errors.

III. Loss Mitigation

Sources/Causes (Servicer Obligations)

In addition to the sources and causes of defects listed in HUD’s proposal, reviewers should examine the following:

- Pg. 32: Add to Sources – “Periodic Loss Mitigation Reviews”

Explanation of Recommendation: Servicers often ignore FHA’s requirement for continuing monthly reviews for loss mitigation after the initial review at 90-days delinquency. The absence of documentation of continuing efforts to complete a review is a significant defect, particularly where the foreclosure procedures are lengthy and borrowers’ financial condition changes.

- Pg. 32: Add to Sources – “FHA-HAMP Waterfall Review”

Explanation of Recommendation: The servicing file should include a completed waterfall analysis, including documentation, for all instances when the borrower sought loss mitigation help. The analysis should follow the steps in FHA’s waterfall chart contained in Handbook 4000.1 section III.A.2. j and include numerical inputs for the gross income and surplus income components the servicer used.

- Pg. 32: Add to Sources – “Claims for Attorneys Fees”

Explanation of Recommendation: For loss mitigation options such as repayment and forbearance plans, as well as modifications and partial claims, servicers may include certain default-related fees and costs, including attorney's fees, in the amount to be repaid. FHA guidelines limit the charges for these items. Handbook 4000.1 Sections III.A.1.f and III.A.2. k. Overcharges for default fees and costs can lead to improper accelerations and foreclosures. These are severe defects and HUD must require adjustments to the accounts whenever appropriate.

- Pg. 32: Add to Sources – “Loss Mitigation Evaluation Timeframes”

Explanation of Recommendation: As proposed, HUD calls for evaluation of whether the servicer completed the required review for loss mitigation, but not whether the servicer performed the review in compliance with RESPA and HUD time frames. Servicers often delay decisions on reviews for many months, making reinstatement much more difficult. The applicable guidelines require that the servicer inform the borrower of a decision within thirty days of receipt of the complete application. Delays are a significant defect and often symptomatic of a system-wide bad practice.

- Pg. 32: Comment on Sources – HUD should evaluate borrower feedback in determining lender compliance.

Explanation of Recommendation: As mentioned above with respect to other assessment areas, borrower disengagement cannot be assessed solely from a review of the documents the servicer chose to include in files. The documents need to be supplemented with feedback from the borrowers who communicated directly with the servicer's staff.

- Pg. 32: Comment on Sources/Causes – HUD must review files for servicer misrepresentation of loss mitigation.

Explanation of Recommendation: Under FHA and RESPA guidelines, servicers have an obligation to provide complete and accurate information to borrowers about FHA loss mitigation options. Inaccurate statements, whether verbal or in writing, about the availability of loss mitigation can cause borrowers to disengage from the process. Reviewers must examine servicer statements in this context and determine whether they had the effect of discouraging, rather than encouraging,

borrower involvement. Servicer communications that discourage borrower involvement are a significant defect.

Severity/Remedies

- Pg. 33: Add to Severity - The following defects should be considered severe and require remedial action:
 - Any defect involving servicer misrepresentation of the borrower's ability to apply for loss mitigation or the borrower's eligibility for an option, including concealment of information material to the borrower's decision to pursue loss mitigation.
 - Any defect involving delays in processing applications so that options became unavailable or bear an incremental cost for the borrower.
 - Any defect in the loss mitigation evaluation that resulted in excess or inappropriate charges to the borrower's account.
 - Any defect that indicates a systemic problem with the servicer's operations, including software design or inadequate staff training in FHA guidelines

- Pg. 33: Add to Remedies - The following remedies are appropriate for loss mitigation defects of the severity indicated above:
 - Borrowers must receive notice of servicer errors that affected their accounts. For defects that were systemic, the notices must go to all affected borrowers
 - Interest, costs, and fees improperly assessed to accounts must be removed
 - Foreclosure must be suspended until the noted defects have been corrected
 - HUD should curtail charges for interest, costs, and fees accrued to the account from the time the servicer made the loss mitigation error until the time the servicer corrected it.

IV. Foreclosure Processing

Sources/Causes (Servicer Obligations)

- Pg. 34: Add to Sources – “Detailed Management Review Checklist”

Explanation of Recommendation: Handbook 4000.1 Section III.A. 2. r. requires that the servicing file include a Management Review form in the nature of a checklist on which the servicer indicates compliance with default servicing and loss mitigation guidelines before it initiates foreclosure. HUD should not leave it to servicers to develop this form. Instead, HUD should prepare a form that includes the obligations and the documentation requirements that we have recommended in these comments. The form should require details including the dates and documentation of actions to comply with FHA's loss mitigation and default servicing obligations.

- Pg. 34: Add to Sources – “Loss Mitigation During Foreclosure”

Explanation of Recommendation: HUD should review both for the existence of communications that completely and accurately inform borrowers of this right, as well as for their absence, and for misrepresentations about this significant right. This is particularly pertinent when the borrower has offered information about changed financial circumstances.

- Pg. 34: Add to Sources – “RESPA Dual Tracking Restrictions”

Explanation of Recommendation: Non-compliance with dual tracking limitations under HUD guidelines and RESPA rules is a severe defect. The defect occurs, *inter alia*, when the servicer by misrepresentation or omission causes borrower disengagement from the loss mitigation process. This can occur when the servicer fails to comply with requirements to timely inform borrowers about the status of an incomplete application.

- Pg. 34: Add to Sources – “Servicer Transfer Through Foreclosure”

Explanation of Recommendation: As discussed in parts I and II, above, transfers of servicing rights are frequently the cause of non-compliance with loss mitigation and default servicing obligations. File reviews must include a verification that servicing transfers proceeded seamlessly and that borrowers were not harmed by lack of access to documents from predecessor servicers.

- Pg. 34: Add to Sources – “State Mediation Law”

Explanation of Recommendation: Servicer files must contain documentation of compliance with foreclosure conference and mediation requirements before a foreclosure sale may go ahead.

Severity/Remedies

- Pg. 35: Add to Severity - The following defects should be considered severe and require remedial action:
 - Any defect involving initiation or continuation of foreclosure contrary to the servicer's obligation to complete a review for loss mitigation.
 - Any defect involving servicer misrepresentation of the borrower's right to be considered for loss mitigation, including the concealment of facts that were material to the borrower's decision to disengage from loss mitigation.
 - Any defect in the foreclosure process that resulted in excess or inappropriate charges to the borrower's account
 - Any defect that indicates a systemic problem with the servicer's operations, including software design, inadequate staff training in FHA guidelines, and deficient supervision of foreclosure attorneys
- Pg. 35: Add to Remedies - The following remedies are appropriate for foreclosure processing defects of the severity indicated above:
 - Borrowers must receive notice of servicer errors that affected their accounts in foreclosure. For defects that were systemic, the notices must go to all affected borrowers
 - Interest, costs, and fees assessed to accounts affected by the defects must be corrected
 - Foreclosure underway must be suspended until the defect has been corrected
 - HUD should curtail charges for interest, costs, and fees accrued to the account from the time the loss mitigation error occurred until the time the servicer corrected the error.